Legislative Update | Tax Cuts and Jobs Act

Estate and gift tax provision highlights

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (P.L. 115-97). Highlights of the key provisions are outlined below. We'll continue to provide additional information and analysis as we move forward in 2018.

When will these provisions go into effect? Unless noted, **January 1, 2018**. However, most changes will **sunset after 2025** (as noted by footnote 1) and revert to their 2017 numbers, adjusted for inflation.

2018 Federal estate and trust income tax brackets and rates

Under the new law, the top federal marginal rate is 37%.

Income tax rates[1, 2]	Estates and trusts	
10%	$0 to $2,550	10% of the taxable income
24%	$2,551 to $9,150	$255 plus 24% of the excess over $2,550
35%	$9,151 to $12,500	$1,839 plus 35% of the excess over $9,150
37%	Over $12,500	$3,011.50 plus 37% of the excess over $12,500

Estate and gift tax:

Provision	2017 Law	New Law	Analysis
Estate and Gift Tax Exemption[1] IRC Section 2010(c)(3)	Exemption for both estate and gift taxes $5.49 million per person, indexed to the traditional consumer price index (CPI) measure of inflation	Exemption for both estate and gift taxes $11.2 million per person, indexed to the Chained CPI (C-CPI) measure of inflation	With higher exemption, fewer will be impacted by the estate and gift tax. Opportunity to make additional gifts.
Generation-Skipping Transfer Tax Exemption[1] IRC Section 2631(c)	Exemption for both estate and gift taxes $5.49 million per person, indexed to the traditional CPI measure of inflation	Exemption for both estate and gift taxes $11.2 million per person, indexed to the Chained CPI (C-CPI) measure of inflation	Opportunity to fund dynasty trusts for future generations.

Provision	2017 Law	New Law	Analysis
Annual Exclusion IRC Section 2503	$14,000 per donee, indexed to the traditional CPI measure of inflation	$15,000 per donee, indexed to the Chained CPI (C-CPI) measure of inflation	Opportunity for increased annual gifting.
Portability IRC Section 2010(c)	Allows surviving spouse to use deceased spouse's unused federal estate tax exemption (DSUE)	Retained	Consider filing for DSUE in anticipation of sunset of current estate tax exemption amounts at the end of 2025.
Basis adjustment at death IRC Section 1014	Original basis in property adjusted to fair market value at death of owner	Retained	Consider holding appreciated basis assets until death to receive step up.

[1] Change will sunset after 2025 and revert to its 2017 numbers, adjusted for inflation.
[2] These rates are imposed on *taxable income*, meaning income remaining after applicable exclusions, deductions and exemptions are claimed. Note that each rate applies only to income falling within that bracket.

Planning opportunities

Life insurance

Estate planning involves more than just planning for federal estate taxes. Even though the exemption is set at a relatively high level, many needs often addressed by estate planning remain. Life insurance, owned inside or outside of the estate (depending on your situation), may help solve these needs:

- Creating liquidity for the payment of state estate and inheritance taxes
- Providing for spouses, children and other loved ones
- Addressing special needs planning
- Protecting multi-generational planning
- Providing liquidity planning for income taxes
- Equalizing inheritances
- Protecting assets in an estate
- Navigating second marriages
- Planning for same-sex couples
- Protecting non-citizen spouses
- Augmenting supplemental retirement income
- Increasing charitable giving
- Planning for education
- Supporting healthcare planning (e.g., chronic illness)
- Funding business protection and business succession planning

Outright gifts

A current gift removes both the asset and any future appreciation from the taxable estate and may "lock in" the current $11.2 million exemption against future changes in the law. The higher gift exemption presents a substantial opportunity to transfer wealth and reduce long-term estate tax exposure for individuals willing and able to make lifetime gifts.

Of course, lifetime gifts carry over the basis of the asset gifted, instead of adjusting the basis to the fair market value, as happens when an asset is inherited. Individuals should consider the potential advantages and disadvantages of making lifetime gifts.

Irrevocable life insurance trusts (ILITs)

ILITs are trusts designed to hold life insurance policies and to make policy proceeds available for estate liquidity needs, while excluding policy death benefits from the insured's estate. The higher gift exemption provides clients the opportunity for increased funding of current policies, as well as the ability to potentially unwind existing private split dollar arrangements.

Even if federal estate taxes are not a concern, properly drafted ILITs may provide:

- Income tax-free death benefits upon the death of the insured(s)
- Potential protection from the claims of the grantor's future creditors, including ex-spouse or spendthrifts
- Distribution flexibility to provide for blended families or protection for beneficiaries who may need help handling money
- Protection from state estate and inheritance taxes
- Spousal support
- Inheritance equalization
- Generation-skipping transfer tax planning
- Management of insurance and assets
- Financial support for loved ones with special needs

Given that the current estate tax rules are scheduled to sunset after 2025, and the uncertainty of estate taxes in the future, you may wish to retain existing ILITs.

Reposition existing insurance

The increased gift tax exemption can be used to correct existing estate planning concerns. For example, if an existing life insurance policy is owned by the insured, the policy death benefit will generally be included in the taxable estate of the insured. The increased gift tax exemption may be used to transfer the policy from the insured or to fund an underfunded policy without incurring gift taxes.

It's important to consider the estate inclusion rule when policies are transferred within three years of death. Also remember that transfers of a policy, even if not subject to gift taxes, can trigger income tax recognition or a transfer for value, particularly when an outstanding loan exists or the policy is currently owned by a business.

In light of the higher federal tax exemption, some may desire to modify or unwind ILITs. ILITs are irrevocable and generally can't be amended. However, court actions, trust mergers, decanting, powers of appointment and sales of insurance policies may provide methods of modifying current arrangements.

Dynasty trusts

Dynasty trusts permit wealth to be excluded from transfer taxes over multiple generations by making use of the generation-skipping transfer tax (GSTT) exclusion. With the larger exemption, dynasty trusts can be funded with lifetime gifts equal to the full $11.2 million GSTT exemption without incurring gift taxes. These trusts can own life insurance, as well as other assets.

With proper allocation of the GSTT exemption, assets in the dynasty trust and appreciation of these assets may be exempt from future estate, gift and GSTT taxes.

Valuation discounts

Some may consider taking advantage of valuation discounts (e.g., minority interest discounts) in transferring interests in a business or closely held entity. Using this strategy, you gift minority interests of closely held entities subject to transfer restrictions. “Lack of control” and “lack of marketability” discounts may be applied to decrease the fair market value of the gift. Along with the increased lifetime gift and exemption amounts, valuation discounts may allow you to transfer more of the interest while reducing gift taxes.

Sale of assets to an intentionally defective grantor trust (IDGT)

Another strategy is a sale of assets to an IDGT. With an IDGT, property is sold to the trust by the grantor. Based on a special provision in the trust, the trust grantor continues to be treated as the “owner” of the trust property for income tax purposes. Yet, the trust property is kept outside of the grantor’s estate for federal estate tax purposes.

With the current low Applicable Federal Rates, the income generated by the asset sold to the IDGT may exceed that needed to service the note, leaving cash flow to pay life insurance premiums. The higher gift exemption can be used to help fund the initial down payment of the note. If the IDGT is designed as a dynasty trust and the GSTT exclusion is allocated, the trust assets can potentially be shielded from future transfer taxes.

Inheritance equalization

Business, farm or ranch assets may comprise the majority of your estate. When some children participate in the business or operations and others do not, life insurance may offer an opportunity to provide a fair division of assets, while making sure that control and ownership remain with the children working in the business. The increased exemption may simplify premium funding and minimize estate tax considerations.

Grantor retained annuity trusts (GRATs)

GRATs are popular wealth-transfer tools that are often used to provide funding for exit strategies from premium financing and split dollar life insurance programs. You may want to consider GRATs with durations of 2-8 years. Terminating the GRAT before the current estate tax changes sunset at the end of 2025, may allow you to take advantage of the potential higher estate tax exemption if you should die during the GRAT term.

Summary

The changing tax environment is a great opportunity to review your estate plans. While many of the benefits of the Tax Cuts and Jobs Act are scheduled to sunset after 2025, the basics and benefits of planning never expire. As with all estate planning strategies, it’s vital that you consult local counsel about your individual situations.

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