

Congress Doubles Estate and Gift Tax Exemption

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PRACTICES Tax-Exempt Organizations and Private Foundations, Trust and Estate Administration, Family Office, Family Wealth and Estate Planning, Private Clients and Estate Planning, Tax

The tax reform bill passed by Congress at the end of 2017 significantly reduces the number of taxpayers whose families will pay gift tax or estate tax, but it comes with an “expiration date” of December 31, 2025.

Prior to the Tax Cuts and Jobs Act (the Act), an individual could transfer up to \$5,490,000 (\$10,980,000 for a married couple) without paying estate, gift, or generation-skipping transfer (GST) taxes. The Act doubles these exemptions to \$11,200,000 and \$22,400,000, respectively. These exemption amounts will continue to grow, based on inflation, until 2025. However, absent further changes by Congress, the exemptions are scheduled to revert to \$5,600,000, as adjusted for inflation on January 1, 2026.

Annual Gift Tax Exclusion

The Act also increased the federal gift tax annual exclusion amount from \$14,000 in 2017 to \$15,000 for 2018.

Other Important Transfer Tax Provisions Unchanged

Although the Act includes dozens of provisions that impact individual and business income taxes, it leaves untouched beneficial provisions relating to payments for medical expenses and tuition. Payments for medical expenses and/or tuition made directly to a provider will continue to be exempt from federal gift tax and GST tax. Further, under the Act, the recipient of property transferred at death will continue to receive a “step-up” in the cost basis of such property to its fair market value on the donor’s date of death, whether or not estate tax is payable.

Income Tax Changes

A number of income tax changes will impact trusts and younger children who have significant amounts of passive income, including the “Kiddie” tax on children under age 14, deductibility of state and local taxes by trusts, and deductibility of fees and administrative expenses by trusts. For clients with an interest in a subchapter S corporation, the Act now allows a nonresident alien individual to be a beneficiary of a trust that is a shareholder, if it is an Electing Small Business Trust (ESBT). The Act also includes additional changes regarding charitable deductions by ESBTs.

With the substantial reduction in the corporate tax rate and tax deductions applicable to pass-through business entities, clients will want to review the structures of their business entities. Our firm sent a separate [alert](#) regarding income tax changes.

Unintended Consequences, Planning Opportunities, and Consulting with Your Attorney

Formula Gifts. Many of our clients have formula clauses in their estate planning documents that call for the maximum tax-exempt amount to pass into a trust for the benefit of the surviving spouse and

children, or in some cases directly to children. In 2001 and 2010 we suggested that our clients review their estate plan as the estate tax exemption increased (from \$3.5 million to \$5 million in 2010), and we again encourage clients to consider whether they wish to pass the full amount of the exemption into such a trust.

Simplify Estate Plan. With the larger federal estate tax exemption, a client whose estate is unlikely to ever be subject to estate tax should review an older will or revocable trust to determine whether to retain a formula gift to a credit shelter trust or to simplify the estate plan with an outright gift to the surviving spouse.

Retain Benefits of Basis Step-Up on Second Death. In particular, the continuation of the “step-up” in basis of property at death (which can eliminate capital gains tax on assets that appreciate after the first death) may be more valuable to many clients than the increased estate tax exemption if the family is unlikely to ever be subject to estate tax, even with the 2017 exemptions that may apply after 2025. Some clients may want to revise their estate plans to incorporate additional flexibility to take advantage of the basis increase without risking an increase in estate taxes on the second spouse’s death.

State Death Taxes. While residents of Texas are not subject to state inheritance or estate taxes, there are states that have such taxes, and clients will need to consider the application of those taxes as part of their estate planning.

Use Additional Exemption for Gifts or Sales. With a much larger gift tax and GST tax exemption under the Act, a client whose estate is likely to be subject to estate tax should consider the long-term benefits of making additional lifetime gifts now, rather than at the time of death. Married couples that have already used their entire lifetime exemption prior to 2018, would have the ability to make additional tax-free gifts of approximately \$11,000,000. These gifts could be made to existing trusts or a new trust, or to forgive intra-family debt. Additional considerations should include non-taxable sales of discounted assets, partnership interests, limited liability interests, or interests in real estate to a trust for a spouse, children, or grandchildren. The increased gift tax and GST tax exemptions are certain (for now); therefore, clients may want to take advantage of these exemptions before they expire or are reduced by Congress.

Planning to Minimize Capital Gains. It is important to note that there is a trade-off to utilization of the exemption amount during your lifetime; any assets transferred during your lifetime will not receive a “stepped-up” basis on your death. Therefore, you should consider retaining assets with a low cost basis and transferring assets with a high cost basis or that have a high likelihood to appreciate.

Consult With Your Tax Advisors. Although the Act may seem cumbersome, complicated and confusing, it does present a number of new planning opportunities. All individuals should consult with their tax advisors regarding the impact of the individual and business income tax changes.