Estate Planning Under the Tax Cuts and Jobs Act

If enacted, the Tax Cuts and Jobs Act could open up significant estate planning opportunities.

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TAKEAWAYS

😊 The House bill doubles the exemptions from estate, gift and generation-skipping transfer taxes, creating new opportunities for transferring wealth. In the short term, the increase in the gift exemption will offer important opportunities.

😊 The House bill does not impose new limits on the duration of the generation-skipping transfer tax (GSTT), allowing taxpayers to leverage the increased exemption over generations. In the short term, the increase in the GSTT exemption, combined with its continued unlimited longevity, offers very important tax saving opportunities.

😊 The Senate will revise the House bill, but both the House and Senate agree on doubling these exemptions.

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Pillsbury’s Estates, Trusts, and Tax Planning team has been closely monitoring developments with the Tax Cuts and Jobs Act passed by the House on November 16 and currently pending in the Senate, and assessing the legislation’s impact on—and the opportunities it provides for—our estate planning clients.

The 450-page act will almost certainly be amended and revised as it is debated in the Senate over the next weeks. If enacted, the legislation will be a significant change in the estate and gift tax regime, and will open up equally significant planning opportunities.
Below, we’ve outlined the provisions we believe will have the most impact on our clients’ estate planning choices. Where applicable, we have noted areas in which the Senate Finance Committee’s working version of the act departs from the House bill. Unless otherwise specified, references to the act are to the House bill. If enacted, most provisions of the act will go into effect as of January 1, 2018.

**Increase in Exemption from Estate and Gift Taxes**

The biggest opportunity for our clients is the proposed reduction of the gift and estate tax and possible elimination of the estate tax.

The act immediately doubles each taxpayer’s lifetime exemptions from estate and gift tax through 2024. If enacted, in 2018 a taxpayer may give, or a taxpayer who dies will be able to transfer, up to $11.2 million\(^1\) (or $22.4 million per couple) to future generations without incurring federal estate or gift tax.

After 2024, the act eliminates the estate tax entirely. As under current law, families of decedents passing away after 2024 will still benefit from a “step-up” in basis on inherited assets.

While the existing Senate version of the act does not eliminate the estate tax, it does propose doubling the exemption amount. As both versions of the bill agree on this, it is likely we will see a significant increase in the value of assets that may be transferred free of gift and estate tax.

**Increase in Exemption from the Generation-Skipping Transfer Tax**

The generation-skipping transfer tax (currently imposed at a rate of 40 percent on assets over $5.6 million in 2018) would also be reduced and eliminated under the House bill. As with the estate tax exemption, the act immediately doubles each taxpayer’s exemption from the generation-skipping transfer tax to $11.2 million in 2018, and eliminates the GSTT entirely after 2024.

While the Senate proposal does not contemplate elimination of the GSTT, it does follow the House bill’s lead in doubling the exemption amount.

Crucially, the act does not change current law that allows GSTT-exempt assets in trust to remain exempt for an unlimited duration. Limiting the duration of the GSTT exemption could result in a 40 percent levy at every successive generation—quickly depleting a family’s wealth. The act, however, appears to retain the unlimited GSTT exemption, so that a properly structured transaction may still benefit from multi-generational exemption, and may substantially leverage the value of assets exempt from tax.

**Portability Eliminated**

The act eliminates the portability election beginning in 2024, which currently provides a simple way for a taxpayer to preserve the unused gift and estate tax exemption of a deceased spouse. If this provision is
enacted, couples with taxable estates will need to make sure that their revocable trusts are properly structured to preserve both spouses’ exclusion amounts, without reliance on a portability election.

**New Rules for Charitable Contributions and Nonprofit Organizations**

The act benefits taxpayers who make charitable gifts by raising the deduction limits. Donors will be able to deduct cash contributions up to 60 percent of their adjusted gross income—an increase of 10 percent as compared to current law.

Families who operate private foundations will need to be aware that the act proposes a 1.4 percent uniform excise tax on such foundations’ net income. Clients with donor-advised funds (DAFs) should be aware that DAF-sponsoring organizations may be subject to enhanced reporting requirements.

**Tax Brackets and AMT**

As has been widely reported, the House bill proposes four, rather than the current seven, tax brackets, with a top rate of 39.6 percent on single filers over $500,000 and married couples over $1 million. The Senate proposal maintains seven brackets, but reduces the top rate to 38.5 percent.

The Alternative Minimum Tax (AMT) will be repealed, if the legislation is enacted.

**Deductions Limited**

The act eliminates a number of existing deductions, including those for student loan interest, medical expenses, moving expenses, alimony, and most casualty losses.

Our clients, particularly in states with high income tax rates, such as California and New York, may be affected by the House bill’s elimination of deductions for state and local income and sales taxes. Moreover, the House bill limits deductions for property taxes to $10,000, and the Senate proposal eliminates this deduction entirely.

Another consideration for our clients is a lower limit on mortgage interest deductions. The House bill caps the mortgage interest deduction to interest on $500,000 of new-loan principal, and eliminates the deduction for home equity loans or mortgages on second homes. The Senate proposal retains the current $1 million cap.

**International Tax**

The act has significant implications for the international tax regime. In particular, the act provides for a transition to a modified territorial international tax system, which exempts from taxation certain foreign source dividends.

**Pass-Through Businesses**
The proposed legislation may benefit the owners of pass-through businesses, such as real estate development businesses. Qualified business income from a passive pass-through business may be taxed at a 25 percent rate—lowering the tax burden of an owner who may fall into the highest individual income tax rate.

**Private Equity**

Although the “carried interest” of hedge funds and private equity firms was a frequent target during the 2016 election, the act’s treatment of carried interest is of limited application. Generally, investments held for at least three years (instead of the existing one year) will still qualify for favorable rates.

**Opportunities for Estate and Tax Planning:**

- Many families will want to pursue additional gifting transactions in 2018, to fully utilize the additional $5.6 million exemption that will become available if tax reform is enacted. Even if the Senate follows the House bill to repeal the estate tax after 2024, current gifting makes sense for many clients. There is no guarantee that the estate tax will not be reinstated—on much less favorable terms—by a future administration.

- Consider gifting transactions that pass assets to long-term trusts for grandchildren and future generations. This takes advantage both of the increase in GSTT exemption, and current law that allows the exemption to be leveraged and retained for an unlimited number of generations. Even if the GSTT is eliminated after 2024 per the House bill, it may be revived under a new administration. Accordingly, it seems advisable to take advantage of the current opportunity to exempt assets for a potentially unlimited term while that opportunity is available.

- With the possible elimination of state and local tax deductions in 2018, clients should consider prepaying any state income and property taxes that can properly be paid before the year-end (subject to consultation with clients’ accountants, as there may be limitations on the amounts that are owed and deductible).

- Clients with real estate holdings should consult with their advisors to ensure they qualify for the act’s favorable treatment of pass-through income and other benefits.

Please contact our team to discuss ways in which you and your family may benefit from the opportunities afforded by these recent developments.

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1 Base exemption amount of $10 million, adjusted for inflation.