

Estate Planning after The Tax Cuts and Jobs Acts of 2017

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The Tax Cuts and Jobs Act of 2017 (the "Act") doubled the amount of property that an individual can transfer without incurring federal estate, gift or generation-skipping transfer tax ("Exemption Amount") from \$5,490,000 in 2017 to **\$11,180,000** (indexed for inflation) in 2018. The Exemption Amount is "portable" for estate and gift tax purposes (but not generation-skipping transfer tax purposes), meaning any unused Exemption Amount on the first spouse's death may be transferred to a surviving spouse if an estate tax return is filed within the deadline for filing estate tax returns. Under the Act, a married couple can now exclude up to **\$22,360,000** in assets from estate, gift, and generation-skipping transfer tax. The increased Exemption Amount sunsets at the end of 2025 and will revert back to the \$5,490,000 applicable for 2017 (indexed for inflation). This change in the law creates both a significant opportunity and a limited window during which estate plans can be modified to maximize the tax savings created by the Act.

In the past, when the Exemption Amount was lower, estate plans were often designed to exclude assets from a taxpayer's estate so that the assets would not be subject to estate tax. However, most assets that are included in a taxpayer's estate receive a basis adjustment for income tax purposes at the taxpayer's death to date of death value (resulting in a basis "step-up" if the date of death value exceeds the income tax basis). Thus, a taxpayer with assets valued at less than the Exemption Amount may benefit from an estate plan that includes all of those assets in the taxpayer's estate at death in order to achieve a step-up in income tax basis. Doing so reduces the capital gains tax on appreciated assets that might otherwise be payable by the taxpayer's heirs and without incurring any estate tax. For example, irrevocable trusts were often set up for children and/or grandchildren to hold assets that were not subject to estate taxes at the death of the beneficiary; therefore, the assets did not receive a step-up in basis for income tax purposes on the beneficiary's death. It may be beneficial to review these irrevocable trusts to determine if a modification could result in income tax savings if estate taxes are no longer a concern due to the increased Exemption Amount.

In addition, prior to portability, estate plans between husband and wife were often designed under the traditional "A/B" plan to set aside assets equal to the Exemption Amount remaining on the first spouse's death in a separate trust for the benefit of the surviving spouse and/or for the benefit of descendants (sometimes excluding a surviving spouse). Under this plan, the assets in the separate trust were not



subject to estate taxes on the surviving spouse's death and, thus, did not receive a step-up in basis for income tax purposes. With the increase in the Exemption Amount, these plans should be reviewed to evaluate if the assets should continue to be set aside in a separate trust for the surviving spouse that will not be subject to estate taxes on the surviving spouse's death or if clients should rely on portability in order to receive a second step-up in basis on the surviving spouse's death. In addition, if a plan sets aside assets equal to the Exemption Amount for the benefit of descendants and not for the surviving spouse, this amount may now be overfunded as to descendants due to the significant increase in the Exemption Amount, with the result of fewer assets passing to or for the benefit of the surviving spouse.

Under current law, years 2018 to 2025 provide a limited window under which married taxpayers can gift up to \$22,360,000 in assets thereby removing such assets (and any appreciation) from the transfer tax system. The benefit of shielding those assets from estate, gift and generation-skipping transfer tax should be weighed against the savings in capital gains tax if those assets were instead retained in the taxpayer's estate to achieve a step-up in income tax basis.

The increase in the Exemption Amount is relevant to all taxpayers, not just those with assets exceeding the Exemption Amount. Some taxpayers may benefit from making gifts to utilize the increased Exemption Amount before it expires. Other taxpayers may benefit from designing their estate plans to include assets in their estates in order to obtain a step-up in income tax basis. Anyone who is unsure if his or her estate plan has the necessary provisions to maximize the tax savings created by the Act should have it reviewed. If you have questions about this alert, or would like to have your estate plan reviewed, please contact your Lathrop Gage LLP attorney or any of the attorneys listed herein.