

**CHANGES TO ESTATE PLANNING BECAUSE OF
TAX CUT AND JOBS ACT
Effective January 1, 2018**

- I. Estate, gift and generation-skipping transfer (GST) tax
 - A. Changes sunset (end) December 31, 2025
 - B. Estate and gift tax exclusion amounts increased. For 2019, amount is \$11,400,000 for each citizen and permanent resident - a married couple has \$22,800,000
 - C. GST tax exemption amount is also \$11,400,000 for each citizen and permanent resident
 - D. Expected taxable estates with increase will be approximately 1,000 - 2,000 per year
 - E. Portability of first-to-die spouse's exclusion amount - deceased spouse unused exclusion amount continued
 - F. Stepped-up basis rule retained for determining the income tax basis of assets acquired from a decedent
 - G. Changes to estate plans because of the Act
 - 1. Use portability planning to insure full use of both spouses' exclusion amounts and achieve income tax step-up in basis on both deaths
 - 2. Consider gifts to use increased exclusion amount before end of 2025
 - 3. Replace formula estate plans with more flexible planning options

- II. Portability of spouses exclusion amounts
 - A. Failure to plan for use and to preserve may be malpractice
 - B. Estate tax exclusion amount for surviving spouse includes
 - 1. Basic exclusion amount \$11,400,000 for 2019, plus
 - 2. The deceased spouse unused exclusion amount
 - C. Making portability election to claim deceased spouse unused exclusion amount
 - 1. Personal representative or trustee of deceased spouse must file a timely estate tax return.
 - 2. Filing estate tax form 706 makes the election. **Must file even if estate is not taxable. Not filing will prohibit use of deceased spouse unused exclusion amount**
 - 3. Personal representative/trustee does not have to include appraisals
 - a. Identify assets passing to surviving spouse with evidence showing of title and/or beneficiary designations; and
 - b. Provide certification of best estimate of the fair market value of the gross estate
 - 4. **Filing is required for all marital deduction transfers**
 - a. **Property passing outright to surviving spouse**
 - b. **Property passes in trust for surviving spouse, including QTIP, power of appointment, and charitable remainder trusts**

5. QTIP trust
 - a. Filing when surviving spouse is beneficiary of QTIP trust makes the QTIP election
 - b. Not filing QTIP means deceased spouse's exclusion amount is used for the trust property and there will be no step-up on surviving spouse's death
 6. **QTIP and other marital deduction property must be listed on 706 Schedule M**
 7. Portability election allows income tax basis step up at both first and second death. First-to-die's property is stepped up, passes by marital deduction and is included in estate of surviving spouse – receives another step up along with surviving spouse's property
- D. Problems with Portability
1. Portability does not apply to GST tax
 - a. Leaving everything to surviving spouse wastes first-to-die's GST tax exemption
 - b. Solution: Use QTIP marital trust and reverse QTIP election to allocated first-to-die's GST exemption to part or all of marital trust.
 2. Second marriage situations - outright distributions to surviving spouse does not provide any assurance first-to-die's descendants will receive anything
 3. Creditor protection - Outright to surviving spouse provides no asset protection - use QTIP marital shelter trust with spendthrift clauses to provide asset protection

III. Replace Marital Deduction Formula Estate Plans

- A. Traditional marital deduction formula clauses either provided
 1. The maximum amount permitted to pass tax free goes to the credit shelter/family trust, or
 2. The marital trust receives the minimum amount needed for a marital deduction to avoid estate tax on the first death
 3. Result in both cases is that the estate tax exclusion amount, now \$11,400,000, goes to the credit shelter/family trust
- B. Retaining formula credit shelter - marital trusts may cause problems
 1. Increased estate exclusion amount means no marital share or marital trust
 2. If credit shelter/family trust restricts surviving spouse's access to income and principal, standard of living may be affected
 3. If credit shelter/family trust includes deceased spouse's children who are not children of surviving spouse, friction may occur
 4. If credit shelter/family trust is only for children, surviving spouse may have nothing
 5. Property placed in credit shelter/family trust on first death will have no

- step-up in basis at survivor's death
- 6. Credit shelter trust requires a separate EIN and tax return - marital trust may be structured as grantor trust with no EIN or return
- C. Advantages of retaining credit shelter/marital trust (A B Trusts) formula plans
 - 1. Certainty of use of exclusion amount of first-to-die
 - a. No disclaimer or partial QTIP election is required
 - b. Appreciation in estate between deaths will only apply to marital trust or marital share
 - c. Estate tax exclusion amount may be reduced
 - 2. Without credit shelter trust, distributions to children may have to be gifts from surviving spouse
 - a. Will be limited to annual exclusion gifts to avoid reducing surviving spouse's estate tax exclusion
 - b. Distributions from credit shelter trust are permitted trust distributions and will not be gifts by surviving spouse
 - 3. Protection for descendants of first spouse to die
 - a. Outright bequest or distribution to surviving spouse puts surviving spouse in control of ultimate disposition of all the couple's property
 - b. Credit shelter trust limits surviving spouse to specified rights and preserves some of property for descendants
 - c. Credit shelter trust with spendthrift clause will provide creditor protection for surviving spouse and children

IV. Children's GST trust formula provisions - may need revision to avoid all of children's share being directed to long-term trusts.

- A. Some estate plans have provisions that create lifetime trusts for children to the extent of the parent or parents' generation-skipping transfer (GST) tax exemption
- B. Amount over GST tax exemption may go outright to children or to trusts that terminate when each child reaches a specified age
- C. GST tax exemption is now \$11,400,000
- D. Increase in GST tax exemption may result in all of children's shares being placed in lifetime trusts
- E. Change trust division to provide a percentage of trust property will be allocated to the GST exempt trusts

V. Charitable formula planning for single individuals may need revision

- A. Typical formula provides for exclusion amount to children or other family members and amount subject to tax to charity
- B. Increase in exclusion amount may eliminate any distributions to charity
- C. Formula may need to be replaced with percentage provision for charity

VI. Replace Formula Trusts with Flexible Planning

A. Disclaimer trusts

1. All trust property or residuary estate after payment of expenses goes outright to surviving spouse or to marital trust for sole benefit of surviving spouse. If surviving spouse disclaims, disclaimed amount goes to credit shelter trust
2. **Advantages:** Provides flexibility in determining the amounts allocated to marital and non marital shares
 - a. Easy to draft and easy to explain to clients
 - b. Survivor has complete control of decision to fund trust for children
 - c. Spouse disclaimer and will not be treated as gift under IRC 2518
 - d. If spouse does not disclaim, no estate tax consequence – marital deduction eliminates estate tax at first death
3. **Disadvantages:**
 - a. Surviving spouse may not have power of appointment over property disclaimed to credit shelter trust. May cause problems if family circumstances change.
 - b. Only have nine months to disclaim
 - c. Acceptance of benefits of property may prevent disclaimer.
 - d. Surviving spouse may forget to disclaim or refuse to disclaim
 - e. May not be appropriate for second marriages. Spouse's refusal to disclaim may mean nothing goes to children and spouse uses all assets before death

B. One Trust QTIP trust

1. All trust property or residuary estate remaining after payment of expenses goes to QTIP marital trust for benefit of surviving spouse
 - a. Surviving spouse has right to all income from trust property – paid all income annually or right to demand payment of all income annually
 - b. No one has the power to appoint trust property to anyone other than the surviving spouse during spouse's lifetime
 - (1) Surviving spouse may have power to appoint at his or her death
 - (2) Surviving spouse's power to appoint cannot be a general power
 - c. If surviving spouse is trustee, power to distribute principal to herself /himself must be limited to ascertainable standard (HEMS)
2. **Advantages**
 - a. No formula required - amount used of first-to-die's estate tax exclusion is flexible
 - b. Surviving spouse does not have to agree – election can be made by trustee or personal representative who is not surviving spouse
 - c. Does not have to be done within 9 months of death. Division

- election can be deferred until estate tax return is due, including extensions – up to 15 months after death.
- d. Acceptance of benefits of property prior to election will not disqualify election
 - e. Surviving spouse only required to have right to all income – principal can be preserved for children
 - f. Preserves first-to-die's ability to apply his or her GST exemption
 - g. QTIP elected trust will qualify for deceased spouse unused exclusion amount under portability, if 706 is filed on first death
3. Use QTIP elections to divide QTIP trust
 - a. Can elect entire trust for marital deduction
 - b. Can use partial QTIP election to create two trusts
 - (1) Elected trust that qualifies for the estate tax marital deduction – included in estate of surviving spouse
 - (2) Non-elected trust that does not qualify for the marital deduction and instead uses the estate tax exclusion amount of the first-to-die – not included in estate of surviving spouse
 - c. Reverse QTIP election dividing the elected trust into two trusts to make the first-to-die the transferor of a reverse elected trust for generation-skipping transfer tax exemption purposes.
 4. All trusts created from QTIP elections may have same marital deduction terms – all income to spouse, distributions of principal only to spouse, or
 5. Trusts may have different terms
 - a. Non-QTIP elected trust may be for benefit of persons other than surviving spouse – may have same terms as a credit shelter trust and provide for distributions to children and spouse
 - b. QTIP elected trust, including reverse QTIP elected trust, must meet marital deduction requirements and only benefit surviving spouse
 6. To increase flexibility:
 - a. Provide surviving spouse has power of appointment to change disposition of both elected and non-elected trust at his or her death
 - b. Permit trustee or personal representative to divide QTIP trust in non pro rata manner to avoid fractionalizing trust properties

VII. Gifting Opportunities

- A. If taxable gifts were made previous to 2018 that used all of the \$5,490,000 exclusion amount, an additional \$5,910,000 of gifts can be made in 2019 without payment of gift tax
 1. Even when previous taxable gifts used entire exclusion amount and gift tax was paid on the amount of gift over the exclusion amount
 2. Result is the same even though gift tax rate at the time of the previous gift was higher or lower than the 40% rate now applicable

- B. If increased exclusion amount is used for gifts before end of 2025, will there be a recapture or clawback when the increased exclusion amount expires?
 - 1. When it appeared the estate and gift tax exclusion amount would be reduced after 2012, IRS form 706 was modified to eliminate possibility of recapture/clawback
 - 2. IRS recently issued regulations providing for no recapture or clawback
- C. Advantages of using the \$11,400,000 gift tax exclusion now:
 - 1. Gifts will remove appreciation and income from the gifted property from the estate
 - 2. Except for gifts, there is no way to lock in the use of the larger exclusion amount, if the exclusion amount is later reduced
- D. Gifts of the increased exclusion amount
 - 1. Gifts of business interests to children or grandchildren discounted in value or not discounted
 - 2. Gifts to defective grantor trusts
 - a. Income remains taxable to grantor/donor
 - b. Grantor/donor retains power to substitute or replace assets – bring low basis assets back to estate for step-up
 - 3. Gifts to dynasty trusts for children and grandchildren using increased GST exemption and use Wyoming 1,000 year rule against perpetuities
 - 4. Disadvantage of gifts: No income tax basis step-up

VIII. Conclusion

- A. Portability is now permanent and must be considered in planning
- B. Old trusts and wills with formula clauses should be reviewed for negative impact
- C. Planning with disclaimer and QTIP trusts provides the flexibility needed for changes in tax laws
- D. Income tax impact of the estate plan and planning for basis step-up is now more important for most couples and individuals than the estate tax impact