This article originally appeared in the March 2018 edition of the Allegheny County Medical Society Bulletin www.acms.org

Schedule a check-up for your estate plan

Maximizing estate planning opportunities under the 2017 Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act (TCJA), enacted in December 2017, made major changes in the tax laws and will affect nearly every taxpayer in some way. For high net worth individuals, the estate and gift tax changes present planning opportunities as well as challenges.

While periodic reviews of an estate plan are always a good idea, a review now is essential.

The TCJA increases the federal estate and gift tax exclusion amount from $5.49 million in 2017 to approximately $11.2 million in 2018. The exclusion will be adjusted for inflation through 2025, but in 2026 the exclusion drops back down to 2017 levels – $5 million adjusted for inflation starting in 2012. This "moving target" presents some estate planning challenges but also some short-term opportunities.

Perils of the A/B structure: When the estate tax exclusion amount was lower, many estate plans employed an A/B structure in which two shares or trusts were created at death: The "B" share included the estate tax exclusion amount, and the "A" share included the balance of the estate. The "A" share was reserved for the surviving spouse, whether outright to the spouse or held in trust and would be designed to qualify for the so-called "unlimited marital deduction." The "B" share was often also held in trust for the benefit of the surviving spouse but on a more restricted basis, with less ability of the spouse to withdraw property from the trust.

This A/B trust structure allowed for the use of both spouse's estate tax exclusion amounts which allowed for a reduction or a decrease in a couple's overall estate tax. Since 2011, however, a "portability election" has been available to the surviving spouse, which would allow the surviving spouse to use both his/her own estate tax exclusion amount *plus* any unused exclusion amount of the predeceased spouse. For many estates, the portability election could eliminate the need for the A/B trust structure and allow for a more direct (less complicated) estate plan between the spouses.

Additionally, in some situations, especially in blended families, the "B" share would be distributed to the decedent's children, and the "A" share would be held for the benefit of

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the surviving spouse. When the estate tax exclusion was lower, this A/B trust arrangement would allow for the appropriate funding between the A/B shares. With a much higher estate tax exclusion amount, however, the "B" share might be "overfunded" to the detriment of the surviving spouse.

A review of your current plan can determine whether you have an A/B structure and, if so, whether there is a better way to achieve your goals. With portability between spouses and the $11+ million exclusion, there are many options with and without using trusts.

The power of powers of appointment: For most, the term "power of appointment" has little meaning, but in tax law, the term carries great weight, as well as opportunity. Basically, a power of appointment is the power of a trust beneficiary (or someone else) to direct to whom the balance of the trust estate is distributed at the beneficiary's death.

The power of appointment can be "general," by allowing the beneficiary to appoint the property to any group that includes his/her own estate, creditors, and/or the creditors of his/her estate. Alternatively, a power of appointment can be "limited," namely to any person(s) or classes of persons other than a beneficiary's estate, creditors or creditors of the estate. General powers of appointment generally cause the trust estate to be included in the beneficiary's estate for federal estate tax purposes, whereas limited powers do not. Whether the trust estate is included in the beneficiary's estate is important for two reasons: the obvious one – that the property is then taxed for federal estate tax purposes, and the less obvious one – that the property receives a "step-up" in basis at the beneficiary's death for purposes of the capital gains income tax.

The step-up in basis: Assets that are included in a decedent's estate get a "step-up in basis" to the value of the assets as of the decedent's death. When the beneficiary later sells those assets, that stepped-up basis is used, and the capital gains are typically reduced. For high net worth individuals who have assets with low basis, gaining that step-up for their beneficiaries can be very important.

With the much higher estate tax exclusion amount and the resulting lesser impact of the estate and gift taxes, the focus of tax planning shifts to minimizing income taxes – mainly capital gains taxes. When the federal estate tax exemption amount was lower and there was a greater likelihood that the 40 percent federal estate tax would apply, the goal was typically to remove assets from the decedent's estate. With federal estate tax a lesser concern for most, causing assets to be included in someone's estate to gain the benefit of the stepped-up basis becomes a more beneficial goal. This often can be accomplished with the grant of a power of appointment or with other planning techniques.

Striking while the iron is hot: During the 8-year period while the exclusions are $11 million and higher, gifting up to the limit may allow a person to lock in gift and estate tax savings. Although lifetime gifting to use the exclusion amount can be beneficial, please keep in mind that gifted assets do not get the step-up in basis. Combining lifetime gifting, however, with a method that can cause an early step-up in basis can provide even greater benefits. A review of your plan by an attorney well versed in this type of planning could possibly provide significant benefits to your beneficiaries.

Overview of the new estate and gift tax environment

Federal estate and gift tax. A simple but powerful change was made to the federal estate and gift tax: Starting in 2018, the amount that an individual can transfer free from estate tax (the "exclusion amount") increased from a base of $5 million to a base of $10 million, each increased for inflation starting in 2012. Although the exact figure for 2018 has not been set yet, the estimate is $11.18 million. The tax rate for assets above the exclusion amount is 40 percent. In addition to the greatly increased exclusion amount, the "step-up in basis" applied to assets of a decedent continues.

Gift tax annual exclusion. Although not effected by the TCJA, the annual exclusion from gift tax amount increased for 2018 to $15,000 per donor, per donee, per year.

Portability. "Portability" is still available for married couples to allow them effectively to "share" their exclusion amounts and transfer a total of approximately $22.36 million before their estates will pay federal estate or gift tax. This doubling of the base exclusion, however, expires after 2025, and the 2026 exclusion is scheduled to return to the $5 million base, again indexed from 2012.

Generation-skipping transfer tax. The generation-skipping transfer tax, a tax intended to prevent the avoidance of estate and gift taxes by transferring assets directly to grandchildren or even younger generations, is tied to the same exclusion amounts, and generation-skipping transfers will enjoy the same larger exclusions until 2026.

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