Tax Cuts and Jobs Act ("TCJA")

Estate Planning Update

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Overview

- The Tax Cuts and Jobs Act ("TCJA") passed the House on December 19, 2017 by a vote of 227-203. The short title "Tax Cuts and Jobs Act" was removed, but the Act may continue informally to be referred to by that former and commonly used name (hereinafter "TCJA").
- Most of the provisions regarding individual tax reform (including the transfer tax provisions) sunset on December 31, 2025.
- Planning must account for the significant possibility that sunsetting will occur.

Equivalent Exemption Doubled

- The Act increases the equivalent exemption amount provided in § 2010(c)(3) from $5 million to $10 million (indexed for inflation occurring after 2011) for estates of decedents dying, generation-skipping transfers, and gifts made **after 2017** and **before 2026**.
- The relevant 2018 figures under the new "chained CPI" approach:
  - **Equivalent Exemption: $11,180,000**
  - **Annual Exclusion: $15,000**
- Note that the equivalent exemption remains at $60,000 for Non U.S. Persons.

Income Tax

For trusts and estates there was a reduction from five brackets to four brackets:

~~15%~~	10%
~~25%~~	24%
~~28%~~	35%
~~33%~~	37%
~~39.6%~~	

- The top bracket still kicks in at $12,500. However, prior to the Act this was scheduled to be $12,700.
- Please note that the 3.8% Net Investment Income Tax ("NIIT") still applies.

Miscellaneous Itemized Deductions

- Miscellaneous itemized deductions are no longer allowed.
- § 67(g) - Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.
- Because § 641(b) provides that trusts and estates must compute taxable income in the same manner as individuals, miscellaneous itemized deductions should also be disallowed for trusts and estates.

Miscellaneous Itemized Deductions (Cont'd)

- But see § 67(e) which allows costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred otherwise. While there is some uncertainty on this issue the general consensus is that trustee fees, personal representative fees, attorney fees, and other costs unique to trust and estate administration will continue to be deductible under § 67(e) despite § 67(g).
- The Joint Explanatory Statement provides that § 67(g) is intended to suspend "all miscellaneous itemized deductions that are subject to the two-percent floor under present law." As unique administration expenses under § 67(e) were never subject to the 2% floor it would seem that such deductions would escape the reach of § 67(g).
- Given the lower income tax brackets and the potential uncertainty surrounding § 67(g) the scales would certainly tip in favor of taking the maximum amount of deductions on the Form 706 Estate Tax Return for taxable estates.

Clawback

- To lock in the benefits of the increased equivalent exemption a donor must make a gift in excess of the $5 million indexed amount, under current law.
- For example:
  - Client has not previously made a taxable gift.
  - Client makes a gift of $5 million in 2018.
  - Client passes away on January 1, 2026.
- Assuming no further congressional action, the client will be treated as having used up $5 million of the total $5 million equivalent exemption amount indexed for inflation as of 2026. The extra $5 million under the TCJA will have been lost.

Clawback (Cont'd)

- It is possible that the Treasury will exercise its authority under new
- § 2001(g)(2) to issue regulations to provide that gifts come "off the top" of the $10 million (indexed) equivalent exemption.
- By way of example, the DSUE portability regulations provide this type of clarification.
  - Treas. Reg. § 25.2505-2(b) - If a donor who is a surviving spouse makes a taxable gift and a DSUE amount is included in determining the surviving spouse's equivalent exemption amount under section 2010(c)(2), such surviving spouse will be considered to apply such DSUE amount to the taxable gift before the surviving spouse's own equivalent exemption is used.

Formula Clauses

- It is important to review formula clauses in existing documents. Under a standard A/B Plan with a Marital Trust and Credit Shelter Trust, the Credit Shelter Trust is funded with the maximum amount possible without incurring estate taxes. For many that results with all assets pouring into the Credit Shelter Trust. This was already a problem for persons who had documents prepared in the 1990s and early 2000s.
- With the new equivalent exemption of $11.18 million the problem is exacerbated.
- While the surviving spouse may be the primary beneficiary under both the Marital Trust and Credit Shelter Trust, the terms of the Credit Shelter Trust do not typically mandate income distributions and may include other beneficiaries (e.g., children). This can increase tension in split-family scenarios. It is also not unusual for the children to also be permissible beneficiaries of a Credits Shelter Trust during the surviving spouse's lifetime, which can lead to greater conflict.

Elective Share

- If a surviving spouse does not receive at least 30 percent of the Elective Estate then they may seek an Elective Share.
- A QTIP Marital Trust is typically treated as an Elective Share Trust under the Florida Probate Code. If such trust includes a Qualifying Invasion Power (i.e. the trustee has the power to invade principal for the surviving spouse's health, maintenance, and support) then 80% of the value of the principal would ordinarily count towards satisfaction of the Elective Share.
- By contrast, with a standard Credit Shelter Trust only the transfer tax value of the spouse's interest on the applicable valuation date will count towards the Elective Share. This is very difficult to value and typically is far less than the fair market value of the trust principal.

Elective Share Problem

Example:

- Wife's estate consists of $9,000,000. Wife has made no taxable gifts during her lifetime and has a standard A/B format.
- If Wife died in 2017 the Credit Shelter Trust would receive $5,490,000 and the QTIP Marital Trust would receive $3,510,000. Assuming the QTIP has a Qualifying Invasion Power then 80% or $2,808,000 would count as having satisfied Husband's Elective Share. That amount is in excess of 30% of the Elective Estate ($2,700,000). Therefore, Husband would have no claim for an Elective Share.
- If Wife died in 2018 the QTIP Marital Trust would not be funded. The transfer tax value of Husband's interest in the Credit Shelter Trust would be difficult to value and almost certainly less than $2,700,000.

Same Old Story

- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 increased the Gift Tax exemption from $1 million to $5 million per donor (indexed for inflation to $5.12 million in 2012). However, the increased exemption was set to revert to $1 million on January 1, 2013. This mini-crisis set off a fury of estate planning to "lock in" the exemption.
- We could see a similar rush at the end of 2025 when the $11.18 million equivalent exemption amount is expected to sunset. A strong shift in the political climate, including a Democratic President and Congress could prompt earlier responses from clients. We can remain fairly confident that the majority will wait until the last possible moment to take advantage of planning opportunities.

GST Exemption

- The wealthiest individuals will likely find the easiest solution to be the best.
  - They should use their additional GST exemption and equivalent exemption amount to create and fund generation-skipping trusts, or to make additional contributions to existing generation-skipping trusts.
  - Donors who can afford to transfer another $5.69 million to such a trust can allocate (or be deemed to have allocated automatically) GST exemption to those transfers and create a fund that is permanently exempt from both estate and GST taxes.

Gift Tax Returns

- If a client is taking advantage of the increased equivalent exemption through GST transfers or otherwise it is critical for the Form 709 Gift Tax Return to be accurate in order to get the 3 year statute of limitations ticking.
- The IRS looks for opportunities to take a second look at returns, often years later in an estate tax audit. Err on the side of very complete and thorough disclosure on Form 709.

Spousal Lifetime Access Trusts ("SLAT")

- Husband funds an irrevocable discretionary Spousal Lifetime Access Trust ("SLAT") for Wife and perhaps descendants (works best in traditional family structure). Transfer to SLAT will use up Husband's exemption. Keep in mind the potential for a clawback. Assets held in a SLAT avoid estate inclusion in the Husband's estate.
- Wife can also set up a SLAT for Husband.
- But beware of the Reciprocal Trust Doctrine.

Spousal Lifetime Access Trusts ("SLAT")

- Both spouses may create "non-reciprocal" trusts that have sufficient differences to avoid the reciprocal trust doctrine.
- Mandatory versus discretionary income
- Add children as permissible beneficiaries of one SLAT
- Different funding amounts and dates
- Term GRAT into SLAT

Basis Adjustment

- The increase of the estate tax exclusion amount to $5 million (indexed) in 2010 followed by the recent jump to $10 million (indexed) under TCJA means that almost all of the population will have no estate tax concerns, but are still entitled to the benefit of basis adjustments to the date of death value under §1014.

Upstream Gifts

- For clients who will have minimal estate tax concerns even if they pass after the 2025 sunset, it may be prudent to consider upstream gifts. This is where children or other individuals gift upstream to the parents in hopes of getting a basis increase upon the parent's death.
  - But beware of 1014(e) which results in a transferred basis instead of a stepped up basis if the decedent acquired the property by gift within 1 year of decedent's date of death and the property returns to the donor.
  - The upstream gift will also chip away at the donor's equivalent exemption. If the donor likely has a taxable estate then a GRAT may be used to make upstream transfers without requiring a significant taxable gift by the donor.

Substitution Powers

- Keep an eye out for substitution powers under various irrevocable trusts - GRATs, ILITs, IDGITs, etc…
- To the extent possible, the grantor may want to consider swapping high basis assets in return for low basis assets from the grantor trust (the low basis assets owned by the grantor at death would receive a basis adjustment under §1014). This is always good planning, even outside of the increased equivalent exemption under the TCJA.

Discounts Disadvantages

- In a world of very high exemptions valuation discounts can work to the disadvantage of clients. Consider here the client with a total net worth of around $10 million with a Family Limited Partnership ("FLP") or other closely held business set up in the 1990s when the equivalent exemption amount was low. In this scenario a 30% or 40% valuation discount for lack of marketability and lack of control will result in no estate tax benefits, but may substantially disadvantage the client's heirs as the step-up in basis will only be to the fair market value as of the client's date of death (after application of valuation discounts).
- One approach is to amend the limited partnership agreement (or other governing documents) to remove transfer restrictions as much as possible (i.e. – not limiting transfers to family members).
- A more aggressive approach to avoid valuation discounts for an FLP is to argue that the assets are included in the decedent's gross estate under § 2036(a)(2) under the reasoning pushed by the IRS in various cases the most recent being *Powell v. Commissioner*, 148 T.C. No. 18 (2017).

Electing Small Business Trusts (ESBT)

- **NRA as Permitted Potential Beneficiary**. Under the TCJA nonresident aliens (NRA) are now permitted as potential current beneficiaries of an electing small business trust (ESBT). This provision is permanent and will not sunset in 2025.

529 Accounts

- **Expanded Application of 529 Accounts**. For distributions after 2017, "qualified higher education expenses" will include tuition at public, private, or religious elementary or secondary schools, limited to $10,000 per student during any taxable year.

IRA's

- **Five Year Rule for IRAs**
- The Senate Finance Committee on September 21, 2016 approved the Retirement Enhancement and Savings Bill of 2016, which would have required that distributions from qualified plans and IRAs be made within five years of date of death.
- There were limited exceptions to the extent all of an individual's plans did not exceed $450,000.
- This provision is not included in the TCJA despite potential revenue savings.

Lien Release Procedure

- The estate tax lien arises at the time of the decedent's death and lasts for ten years unless sooner terminated. The estate tax lien is valid without recording. The lien is retroactive and attaches to every part of the decedent's gross estate whether or not the property comes into the possession of the personal representative or trustee.
- Prior to June 1, 2016, it was relatively painless to obtain a discharge on the automatic estate tax lien under § 6324(a). A Form 4422 was filed or hand delivered to the local office and a release of lien would take approximately 10 days.
- Under new procedures The IRS Collections Advisory Group is handling applications. All funds must be paid to the IRS or placed in escrow.

Lien Release Procedure

- There is some relaxation if sufficient documentation showing that full tax was paid is provided to the IRS. The critical issue here is timing. An escrow agreement can be arranged or the lien can be released but this can take months.
- Problems with liens can often arise when non U.S. persons owning real property pass away. Non U.S. persons only receive a $60,000 exemption and for property held jointly by spouses there is no marital deduction for property passing to a spouse who is a non U.S. person.

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