Estate Planning SMARTS

How the New Tax Law Affects Your Estate Plan

An update to *Estate Planning Smarts,* 4th Edition

By Deborah L. Jacobs

As last year drew to a close, the December tax overhaul got a lot of attention. The first priority for many of us was to take advantage of income tax breaks that we will never be able to use again. At the dawn of 2018, there's time to reflect on the more far-reaching impact that the new law will have on our own finances, and those of our heirs.

This is a law that was written and passed in a hurry, without the benefit of hearings or careful deliberation. Already loopholes and inconsistencies are apparent. More are certain to emerge as we apply the law to specific situations. I'll be covering some of the angles ***on my blog***, and as I work on my next book. Meantime, I want to alert you to some of the key changes that may affect your planning.

In a broad sense, the Tax Cuts and Jobs Act, as it is called, gives even greater force to a couple of key themes that thread through the fourth (and most recent) edition of *Estate Planning Smarts*. Fewer folks need to worry about the federal estate tax: The Joint Committee on Taxation estimates that in 2018 it will affect only 1,800 estates. And income tax strategies play an increasingly important role in estate planning (see Chapter 3).

The Basics

Here's what you need to know about the new law. Changes are highlighted in yellow.

- The amount that you can transfer tax-free, during life or at death, has doubled, from $5 million to $10 million per person, indexed for inflation after 2011. Depending on how inflation is calculated, the exemption for 2018 could be as much as $11.2 million ($22.4 million for married couples). If you exceed the limit, you (or your heirs) will owe tax of 40 percent (see Chapter 3).
- As in the past, there is an unlimited deduction from estate and gift tax that postpones the tax on assets spouses inherit from each other until the second spouse dies. This marital deduction, as it is called, applies only if the inheriting spouse is a U.S. citizen.
- Widows and widowers can carry over any unused exemption of the spouse who died most recently and add it to their own. Portability (as tax geeks call it), which started for deaths in 2011, currently allows married couples (whether the spouses are same-sex or heterosexual) to transfer as much as $22.4 million together tax-free.

  To take advantage of this option, or "elect portability" (in legal lingo), the executor handling the estate of the spouse who died must file an estate tax return (IRS Form 706), even if no tax is due. This return is due nine months after death, with an automatic six-month extension allowed. Though you can ***request additional time*** after that, it's much better to mark your calendar and make sure the executor meets the deadline.
- If you live in a state that has a separate estate or inheritance tax (17 states, plus Washington, D.C.) – or own real estate in one of these states – you may need to consider the effect of this tax, and keep an eye out for changes. In Hawaii, Maine and Washington, D.C., for example, the amount is tied to the federal exemption, so theoretically it should go up this year. (Similar provisions in Maryland and Connecticut are scheduled to take effect in 2019 and 2020, respectively.) But lawmakers concerned about lost revenues could change these generous rules retroactively.
- Anyone can give another person $15,000 per year without it counting against the lifetime exemption discussed above. (The amount, which is adjusted for inflation, went up in 2018, from $14,000, where it had been for the previous five years.) Spouses can combine this *annual exclusion* to double the size of the gift. Don't

confuse this with the gift-tax exemption – that $11.2 million discussed above (see Chapter 10). But do note that if your annual exclusion gift to anyone exceeds $15,000, you must report that gift on Form 709 – the gift-tax return that's due in April of the year after you make your gift.

- Generation-skipping transfer tax applies, on top of estate or gift tax, to assets given to grandchildren (or to trusts for their benefit). But here, too, the law offers an exemption of as much as $11.2 million (indexed for inflation), whether the transfer is made during life or at death, before a 40 percent levy applies. There is no portability for this tax, but for transfers during life married couples can combine each of their exemptions to give away a total of $22.4 million (see Chapter 14).
- For income tax purposes, the cost basis of inherited assets gets adjusted to the fair market value on the date of the owner's death. This limits the capital gains tax inheritors must pay if they sell the property. Unlike the estate tax exemption, which now concerns only very wealthy people, capital gains tax affects all of us (see Chapter 3).
- Sunset provisions: In 2026 all the numbers highlighted above, except for the annual exclusion, revert to the rates in effect in 2017, adjusted for inflation.

Miscellaneous Changes

The new tax law makes the following additional changes that affect material covered in *Estate Planning Smarts*, 4th edition.

Converting a traditional IRA to a Roth account. The law repeals a special rule that allows the conversion to be reversed, or "recharacterized." (Roth conversions are discussed at length in Chapter 7.)

Charitable giving. An indirect effect of the tax overhaul is that there will be fewer deductions for charitable donations – either during life or through an estate plan. Though charitable bequests reduce the size of the estate you leave behind, with the exemption amount now at $11.2 million, that will be an issue for very few people.

With lifetime gifts, you can take an income tax deduction for the year in which you make the gift, but to do that you will need to itemize. By capping or eliminating certain itemized deductions, and raising the standard deduction, the law is expected to reduce the number of people who itemize. The Joint Committee on Taxation estimates that 94 percent of taxpayers will claim the standard deduction starting in 2018, compared with about 70 percent previously. Those who no longer itemize will lose their ability to take a current income tax deduction for contributions to charity.

People who continue to itemize will be able to benefit from the increased deduction for *cash gifts* – from 50 percent of adjusted gross income to 60 percent.

None of this has changed the ability of people 70½ and older to transfer as much as $100,000 per year from their traditional IRAs to charity. The donation can count against the minimum required distribution the IRA owner would otherwise be required to take. In that case, the donor doesn't get a charitable deduction, but there's no tax on the distribution, either. This may become the preferred method of donating for people in this age group; younger people may prefer to "bunch" donations, including donations to charity, into years in which they plan to itemize, rather than taking the standard deduction. (Charitable giving is discussed extensively in Chapter 16.)

Use of Section 529 plans. As noted in the 2016 update to this book, qualified state tuition programs can now be used to buy computer equipment and to pay for Internet access used primarily by the student who is the beneficiary of the plan.

Under the recent tax overhaul, the use of these plans is no longer limited to higher education: It's now possible to withdraw up to $10,000 per year, per beneficiary, to pay for elementary or secondary education at a private or parochial school, and for certain homeschooling expenses. (Education savings plans are covered at length in Chapter 9.)

Other Inflation Indexing

Independent of the tax overhaul, the following numbers, mentioned in *Estate Planning Smarts* and indexed for inflation, in 2018 have gone up to the amounts listed below:

- Annual tax-free gift to a spouse who is not a U.S. citizen: $152,000 (see Chapter 4)
- Maximum total tax-free gifts received each year from foreign partnerships, foreign trusts or foreign corporations: $16,111 (see Chapter 13)
- Average annual net income tax, based on which expatriate status is measured: $165,000 (see Chapter 13)
- Amount of gain on expatriate's property exempt from exit tax: $713,000 (see Chapter 13)

Is Your Estate Plan Obsolete?

Nearly 2.5 million Americans die each year, and many haven't signed the basic documents needed to protect loved ones (see Chapters 1 and 2). If you haven't yet tackled that subject, there's no time like the present. Otherwise, you should revisit your plan about every five years, or more often if there have been changes in your finances, your personal life (including your health) or the law. Here are some issues to consider in light of the tax overhaul:

- Make sure your estate planning documents do not result in any unintended consequences. For example, some people who had their estate plans prepared many years ago may have left the full exemption amount directly to their children, or the full GST exemption amount directly to trusts for their grandchildren. With the current $11.2 million exemption, that may result in their entire estate being transferred that way.
- If you previously set up trusts or family entities (such as family limited partnerships or liability companies) primarily for the purpose of minimizing estate taxes, discuss with advisers whether to modify or dismantle those arrangements. As discussed in Chapters 3, 6 and 17, there are also non-tax reasons for setting up trusts: to provide for children from a previous marriage; protect assets from creditors and former spouses; and safeguard money if you become unable to handle your finances.
- If you are super-wealthy – meaning that your net worth is more than the new estate and gift tax exemption – consider making lifetime gifts that leverage the increased amount that can pass tax-free before 2026 (see Chapter 15). It's not clear whether these gifts would be subject to a tax "clawback" if the exemption amount subsequently drops to less than the total value of the lifetime gifts you have made.

Deborah L. Jacobs, a lawyer and award-winning journalist, is the author of ***Estate Planning Smarts: A Practical, User-Friendly, Action-Oriented Guide,* 4th Edition**. This update assumes that you have the book, either in print or as a Kindle e-book. You can ***register*** to receive e-mail notifications of future updates and editions.