Estate and gift tax changes under the Tax Cuts and Jobs Act

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The Tax Cuts and Jobs Act of 2017 (“TCJA”) increases the federal estate, gift and generation-skipping transfer (GST) tax exemptions to $10,000,000 (indexed for inflation) per person beginning January 1, 2018. The exemptions are scheduled to sunset effective January 1, 2026, with reversion to current federal law.

Estate, Gift and GST tax exemption

While the federal estate, gift and generation-skipping tax rate remains 40% under the TCJA, the amount exempt from these taxes would change:

<table>
<thead>
<tr>
<th>Estate, Gift and Generation-Skipping Transfer tax</th>
<th>Exemption in 2017</th>
<th>Exemption from 01/01/2018 to 12/31/2025</th>
<th>Exemption on 01/01/2026</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic exclusion amount</td>
<td>$5,000,000</td>
<td>$10,000,000</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Inflation adjustment</td>
<td>$490,000</td>
<td>To be determined</td>
<td>To be determined</td>
</tr>
<tr>
<td>Total exemption</td>
<td>$5,490,000</td>
<td>$10,000,000+</td>
<td>$5,000,000+</td>
</tr>
</tbody>
</table>

Moving forward

— **Estate planning:** Under the TCJA’s provisions, most taxpayers will never pay a federal estate tax. Even with the enlarged exemption, however, there are many reasons to engage in estate planning. Trusts can provide protection from creditors and divorcing spouses and provide control over how beneficiaries inherit wealth (particularly important for families with spendthrift, mental illness and addiction considerations) and help preserve wealth for generations. Many states have separate estate tax regimes; people who reside or own property in those states should continue to plan around those taxes.

— **Portability election:** The Portability Election, which allows a surviving spouse to use his/her deceased spouse’s unused federal estate and gift tax exemption, is unchanged. This means a married couple can use the full $20,000,000 exemption (indexed for inflation).
— **Estate tax exposure:** For very high net worth clients who will still have federal estate tax exposure and clients who live or own property in states with their own estate tax, the traditional wealth transfer strategies will still be useful. Clients will want to review their federal estate tax exposure under the new rules.

— **Basis step-up at death:** The step-up in tax cost, by which a decedent’s assets obtain a step-up in their tax cost to their fair market value at the date of death, is not changed. With the step-up in tax cost retained and a much higher federal estate tax exemption, income tax planning becomes a much more important element in estate planning and estate administration.

— **Annual exclusion gifts:** Individuals will want to consider whether making intervivos gifts is the right tax planning for them. The gift tax annual exclusion amount will be $15,000 effective January 1, 2018. The gift tax annual exclusion amount remains subject to an inflation adjustment.

— **Basis carryover for gifts:** Intervivos gifts will continue to pass to the donee with the donor’s tax cost. It may make sense for a donor to hold off making inter vivos gifts of assets that have significant unrealized gain until the donor’s death in order to give the beneficiary the asset and the step-up in tax cost. Of course, there are many other considerations in gift tax planning, and individuals should consult with their estate planning attorney before embarking on or changing a gift program.

— **GRATs:** Short term grantor-retained annuity trusts (GRATs) or qualified personal residence trusts (QPRTs) whose terms end before the Act’s sunset provisions will still be an effective planning technique for very high net worth clients. If the trust's settlor dies within the term (before January 1, 2026), a basis step-up should be available for the assets in the trust. If the settlor outlives the GRAT's term, the growth within the GRAT could be shifted to the next generation.

— **Irrevocable trusts:** Existing irrevocable trusts that hold low-basis assets should be reviewed to determine whether there is benefit to (and the possibility of) rendering them subject to estate tax in the estate of a beneficiary who might die before the increased exemptions sunset. The planning opportunity is to obtain the step-up in tax cost (thus reducing capital gains tax for the next set of beneficiaries) without payment of estate tax.

— **Closely-held businesses:** With the exemption amounts scheduled to revert back to $5 million (indexed for inflation) in 2026, planning is still critical for families with large closely-held businesses and a net worth significantly greater than the exemption amounts. If, as 2026 approaches, reversion to current law appears likely, clients should consult with their advisors to determine whether an aggressive gifting plan makes sense.

— **Repeal:** There is always a possibility of repeal of the TCJA in a subsequent Congress. Taxpayers should stay informed.

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