TAX CUTS AND JOBS ACT USHERS IN BIG CHANGES TO THE ESTATE AND GIFT TAX

Estates and Trusts Alert
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On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act ("TCJA") into law. The new law will have a substantial impact on current estate plans and planning moving forward. Significantly, however, there will be no estate tax repeal.

- **Increased Exemption Amount.** Under pre-TCJA law, all individuals have a credit against gift and estate tax which shields the first $5 million of gifts made during life or at death from tax. This amount is indexed annually for inflation, and it is $5.49 million in 2017. There is also a concurrent exemption from generation-skipping transfer tax equal to the same amount. Starting on January 1, 2018, the TCJA doubles these exemption amounts, up to $10 million, as indexed for inflation ($11.2 million for 2018).
  - *Practical Impact*. With the new exemption amounts, individuals will now be able to make more significant transfers of wealth tax-free. In 2018, a married couple essentially can transfer up to $22.4 million of wealth without incurring estate and gift tax (but only after taking into account any exemption already used by prior year gifts). This change, however, may bring unintended consequences to many current estate plans. For example, a person who thought that he only had $1 million of estate tax exemption remaining may have an existing Will with a formula that directs that property equal to the unused exemption amount be distributed to his children at death, with the remainder going to a surviving spouse. With the increased exemption amount, the children will now get $6.5 million at the first death ($1 million of remaining exemption, plus the 2018 increase), drastically reducing the distribution to the surviving spouse.
- **Sunset of Increased Exemption.** The increased exemption amounts may be short-lived. The law provides that the increased exemption amounts will apply only from January 1, 2018 through December 31, 2025. Starting in 2026, the exemption amounts will automatically revert to their current $5 million level, as indexed for inflation. As such, there is effectively an eight year window of increased exemption.
  - *Practical Impact*. An automatic sunset on the increased exemption amounts introduces significant uncertainty for those attempting to plan for the transfer of wealth. Plans must be carefully crafted to take into account both the increased exemption and the scheduled sunset. On the other hand, the eight

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year window also presents savvy planners an opportunity to take advantage of increased exemption amounts and to pass more wealth tax-free than would have otherwise been possible.

- **Continued Step-Up in Basis at Death.** Under pre-TCJA law, an individual's income tax basis in property that he or she inherits from a decedent is the fair market value of the property as of the decedent's date of death. This includes property passing in the "gross estate," meaning anything that is subject to estate tax (whether or not actual tax is owing). The step-up basis rules will continue under the TCJA.
- **Changes to the Charitable Income Tax Deduction**. The charitable income tax deduction is preserved, but with an increase on the deductibility limit for cash contributions to public charities. Under the new law, the deductibility limit increases to 60% of the taxpayer's adjusted gross income, up from 50%.
- **20% Deduction for Pass-Through Business Income**. The TCJA allows an owner to deduct 20% of the "domestic qualified business income" from pass-through business entities. The TCJA in its final form allows trusts and estates to take advantage of this deduction (the prior Senate bill did not). The 20% deduction is discussed further in our Federal Tax Alert.
- **Modifications to Section 529 Education Savings Plans**. The TCJA expands the permitted uses of 529 plans. Now, distributions can be used tax-free for elementary and secondary private and religious schools, up to $10,000 per student per year.
- **Annual Exclusion Gifting**. The TCJA does not make any changes to the rules permitting annual exclusion gifting. In 2018, the annual exclusion gift limit will increase to $15,000 per donee, as was already scheduled to occur.

New York State Estate Tax Planning in 2018 and Beyond

For New York State residents, the state estate tax exemption remains unchanged. The current New York estate tax exemption is $5,250,000. As of January 1, 2019, the exemption will be $5 million with an index for inflation, meaning that the actual amount will likely be in the range of $5,500,000. The significant discrepancy between the federal and New York estate tax exemptions means that even taxpayers who are no longer subject to the federal estate tax still need to plan for the New York estate tax.

As a result of these changes, all of which will be effective on January 1, 2018, taxation of transfers of wealth in the United States will be, at least for next eight years, much more generous. Taxpayers should review their current estate plans to ensure that the changes will not have unintended consequences. Further, the new law presents opportunities to use more immediate planning to take full advantage of the increased lifetime exemption amounts.

For more information on the changes, their potential impact on your current estate plan, or new planning opportunities moving forward, please contact one of the members of Hodgson Russ's Estates and Trusts Practice Group.