Summer 2018

Estate Planning Update July 2018 - Estate Planning in 2018

We continue to digest and act on the changes to federal tax law that were passed late last year. In a sense, the changes to the federal gift and estate tax just continue a trend of increasing exemptions that started 20 years ago. In 1997, an individual had a federal gift and estate tax exemption of $600,000 and a married couple, with proper planning, had a combined exemption of $1.2 million. Today, those amounts are $11.18 million and $22.36 million, respectively, increasing with inflation through 2025, and then, under current law, cut in half in 2026. In addition, many states (though certainly not all) have reduced or eliminated their state estate tax.

State estate tax considerations can impact the amount and timing of gifts. The current status of state estate taxes in our footprint states was summarized in our March 2018 *Update*. See also the accompanying article, "Connecticut Estate Tax Interim Update."

While every situation is different, some general observations may help illustrate the impact of these changes on many of our clients. We can start with three general groups of people:

1. People who expect they will not be impacted by the federal estate tax, even if it is reduced as scheduled in 2026. This group generally includes individuals who expect to have taxable estates under $5.5 million and married couples who expect to have combined taxable estates under $11 million.
2. People who would not be subject to the federal estate tax currently but might after 2026. This group generally includes individuals who expect to have taxable estates between $5.5 million and $11 million and married couples who expect to have combined taxable estates between $11 million and $22 million.
3. People who expect they will be subject to the federal estate tax even under the current exemptions. This group generally includes individuals who expect to have taxable estates in excess of $11 million and married couples who expect to have combined taxable estates in excess of $22 million.

People in the first group may find that they are no longer concerned with the federal estate tax and that their primary concern is saving income taxes. If they live in states like Florida or New Jersey with no state estate tax or in states like New York and Connecticut that are in the process of increasing their exemptions, they may no longer have to worry about state estate tax either. Further, those who have been diligent in their estate planning over the years may find they have estate planning vehicles that are no longer necessary in light of the increased federal gift and estate tax exemptions. People in this group may want to explore the following opportunities:

- Review estate planning documents and beneficiary designations in light of current federal and state tax rules as well as nontax goals. Formulas in older documents may not work properly under current law.
- Consider whether existing irrevocable trusts can be combined or eliminated, keeping in mind, however, the nontax benefits of trusts, including creditor protection (including protection for children in the event of divorce), investment management and protection from overspending.
- Review whether life insurance policies earmarked for payment of estate tax are still needed, or whether they could be modified to better suit current circumstances.
- Revisit provisions for charities, whether in estate planning documents or retirement plan beneficiary designations.

- Review opportunities to save income taxes on assets held in trust.

People in the second group may be dealing with the most estate tax uncertainty. Under current law, they would face a federal estate tax again when the exemption is cut in half in 2026. If the current exemption is made permanent (or if death occurs before 2026), there may be no need for further planning for federal estate tax. While the temptation may be to wait, the increased exemption will be lost if not used before it disappears. Decisions regarding making gifts and funding trusts may be difficult, and there may be no perfect plan in light of the uncertainty. People in this group may wish to consider:

- Making gifts to take advantage of the temporarily increased exemption before it goes away. Doing so almost certainly requires making cumulative lifetime gifts of a full $11.18 million ($22.36 million for a married couple) in order to use the full exemption amount.
- For married couples, one spouse could make gifts using up to the full $11.18 million exemption amount. Gifts could be made to a trust with the other spouse as one of the beneficiaries, in addition to beneficiaries in younger generations (this type of trust is sometimes called a SLAT, or spousal lifetime access trust). The gifted funds should still be available to the spouse if needed, making the decision to make the gift a little easier.
- Existing planning for federal estate tax, such as life insurance and irrevocable trusts, should probably be kept in place in anticipation of the exemption being reduced in 2026 and in light of the nontax benefits of trusts described above.

People in the third group (individuals with assets in excess of $11 million and couples with more than $22 million) may be more comfortable making large gifts and should certainly consider using the full gift and estate tax exemption. They may wish to consider:

- Making large gifts to new or existing irrevocable trusts. Gifts may be used as "seed money" for an installment sale—a sale of investment assets to a trust in exchange for a promissory note.
- Forgiving loans to family members or trusts, including loans that were part of an installment sale to a trust.
- Continuing to use the full array of techniques that we have available for reducing one's taxable estate.

Of course, the above suggestions are just a starting point. Please contact your Day Pitney estate planning attorney to discuss the opportunities that would make sense for you.