Reviewing Estate Plans as a Result of New Tax Act

By Robert D. Kaplow

Our estate planning attorneys have received numerous questions regarding the effect of the recent Tax Cuts and Jobs Act ("TCJA") on existing estate plans. This article will answer some typical questions.

1. What is the major change in the gift and estate tax law as a result of the TCJA?

The major change is that the combined gift and estate tax exemption jumped from $5,000,000 as adjusted for inflation to $10,000,000 as adjusted for inflation. The amount for 2018 with the inflation adjustment is $11,180,000 per person. Thus, a husband and wife have a combined estate tax exemption of $22,360,000.

2. Wow, with such a high exemption, it seems like I really don't need to worry about my estate plan.

Well, yes and no. The primary purpose of your estate plan is to provide for your family. The tax law does not change that purpose. On the estate tax side, most of us (unfortunately) will be below the $11,180,000 exemption amount. However, this increased exemption amount (which will continue to increase with inflation) is scheduled to end as of 1/1/2026, at which time the exemption will revert to the $5,000,000 amount (plus inflation). Of course, Congress may make further changes (perhaps good or bad) to the estate and gift tax laws in the coming years.

In addition, the new exemption amount may result in some unintended consequences in the operation of the estate plan.

3. Wait. Won't my estate plan still provide for my spouse and children?

Yes, the estate plan continues to be effective to provide for your spouse and children. Most estate plans for a married couple divide into a Marital Trust and a Family Trust (also known as a credit shelter trust) when the creator of the Trust dies. In order to reduce estate taxes under the old law, assets are allocated first to

the Family Trust in an amount equal to the deceased spouse's remaining estate tax exemption. The balance of the assets are then allocated to the Marital Trust for the benefit of the surviving spouse. The allocation to the Marital Trust qualifies for a marital deduction from the estate. This allocation to the two subtrusts results in no estate tax upon the death of the first spouse, no matter how large the estate.

4. What is the issue regarding full allocation to the Family Trust?

In order to avoid the assets in the Family Trust from being included in the estate of the second spouse, the Family Trust has some restrictions on distributions that may be made to the beneficiaries. For example, where the spouse is the sole successor trustee of the Trust, distributions to the surviving spouse may only be made for the health, education, maintenance and support of the surviving spouse. This limitation on distributions is needed in order to prevent the Family Trust assets from being included in the estate of the surviving spouse when the surviving spouse dies. While the spouse in most cases will receive all of the income of the Family Trust and principal as needed for support and maintenance, the surviving spouse does not have unfettered control of the Family Trust assets. When the estate tax exemption was lower, this was not much of an issue. However, the surviving spouse may not be happy with all of the trust assets being allocated to the Family Trust and no assets allocated to the Marital Trust. This allocation to the Family Trust may also be an issue if the surviving spouse is not the sole beneficiary of the Family Trust.

Allocations to the Family Trust also limit the ability of the Family Trust to receive a "step-up" in basis upon the death of the surviving spouse. The Internal Revenue Code provides that assets receive a new basis (or cost) equal to the fair market value of the assets upon death of the owner. While we refer to this as a "step-up", it is actually a new basis at the time of death, which could also be a reduction in basis if the value of the asset has declined since it was purchased. Assets in the Family Trust will not receive a new basis upon the death of the surviving spouse since the assets in the Family Trust are not included in the estate of the surviving spouse. However, assets in the Marital Trust WILL receive a new basis. If there is an increased basis, this may reduce or eliminate any capital gains tax on the later sale of the assets.

5. How would the allocation to the Family Trust work?

For example, under the old law, if the deceased spouse had an estate of

$7,000,000, approximately $5,000,000 would be allocated to the Family Trust and $2,000,000 allocated to the Marital Trust. Under the new law with the increased exemption, the full $7,000,000 is allocated to the Family Trust and nothing to the Marital Trust.

6. Can my trust be changed if I want to provide more flexibility to my spouse?

Yes, if you have a revocable trust, it can be amended during your lifetime. For example, you could amend the trust to provide that the assets are allocated entirely to the Marital Trust if your spouse survives you.

7. Does transferring assets to my revocable trust protect the assets from creditors?

Assets in your own revocable trust are subject to claims of your creditors. However, after your death, assets in the trust may be free of claims of creditors of your beneficiaries, depending upon the beneficiary's rights to withdraw trust assets.

Although not part of the tax law changes, it is worth noting that if creditor protection is a concern, Michigan recently enacted a Domestic Asset Protection Trust statute which allows you to create an irrevocable trust which can be used for your benefit, and the assets in the trust are not subject to the claims of your creditors. The trust needs to be carefully prepared to be in compliance with the statute. We would be happy to discuss the Asset Protection Trust with you.

8. With such a high exemption amount, do my wife and I still need a separate trust for each of us?

While there are merits for some families maintaining separate trusts for husband and wife, some clients are switching to a joint trust. Among other advantages, the joint trust simplifies trust administration after the death of both husband and wife.

9. What else should I be doing?

In light of the high estate tax exemption which may disappear in 2026, it can be very worthwhile to make large gifts over the next few years. The gifting will take the appreciation in the gifted assets out of your estate, with no current gift tax out

of pocket costs. The amount of any taxable gifts will be applied against the current high gift and estate tax exemption. It is believed, but not certain, that gifts made under the current high exemption amounts will not result in taxation later if the exemptions are reduced.

10. You've given me a lot to think about. What should I do now?

There is a lot to think about, so we recommend that you contact one of our estate planning attorneys to set up a convenient time to meet to discuss how the new tax act affects you and your family.