

Effect of the Tax Cuts and Jobs Act on Trust and Estate Planning

The Tax Cuts and Jobs Act, signed into law on December 22, 2017, includes significant changes to the U.S. federal gift, estate, and generation-skipping transfer (GST) tax laws, effective as of January 1, 2018. In addition, certain income tax changes may also affect trust and estate planning.

Federal gift, estate and GST tax exemption amounts are doubled. Federal gift and estate taxes apply at a rate of up to 40%. Each individual who is a citizen or resident of the U.S. is allowed a lifetime exclusion amount, which may be used to shelter transfers made during life or at death from gift and estate taxes. Under the new law, for estates of individuals dying and transfers made on or after January 1, 2018, the gift and estate tax exclusion is doubled to \$11.2 million per person (\$22.4 million for a couple), and will continue to be adjusted for inflation in future years. In certain cases, a surviving spouse may use a deceased spouse's unused exclusion amount.

The GST tax also applies to generation-skipping transfers at a rate of up to 40%, and a separate GST exemption amount may be applied to shelter transfers from that tax. Under the new law, the GST exemption amount is similarly doubled to \$11.2 million per person, and will continue to be adjusted for inflation in future years. GST exemption is not transferable between spouses.

These increases are scheduled to be in effect through December 31, 2025, after which the amounts will revert to current levels (\$5.6 million per person, as adjusted for inflation). Clients may therefore wish to consider gifts or other transfers to take advantage of the increased amounts while they are available.

Changes to exemption amounts may also have unintended consequences for existing estate planning documents. For example, dispositions defined by reference to these exemption amounts may become significantly larger than expected. We encourage clients to consult us to determine whether increases in exemption amounts may necessitate changes to existing estate planning documents.

Basis adjustment upon death is preserved. No changes have been made to tax provisions which permit appreciated property to pass to heirs at death with a "stepped-up" income tax basis (thereby allowing heirs to later sell property without recognizing capital gain on the appreciation that occurred during the prior owner's life). With increased estate tax exclusion amounts, there may be additional opportunities to obtain basis adjustments at an individual's death in a manner that will not result in additional estate tax. We encourage clients to consult us to review estate plans and existing trusts for this purpose.

State estate taxes will continue to apply. As you may know, many states, including New York, apply a separate estate tax at rates of up to 16%. State estate taxes may continue to be imposed at current exemption levels notwithstanding the changes to federal tax laws. For example, the New York estate tax exemption is currently \$5,250,000, and was scheduled to increase on January 1, 2019, to match the federal exclusion amount. However, the New York exemption amount will not match the newly-doubled federal amount absent further action by the New York State legislature. We will continue to recommend planning that is sensitive to state estate taxes.

Income tax changes may also affect trust and estate planning. The new law includes various income tax provisions affecting individuals and families, closely-held businesses, and family trusts. We have not summarized all of those provisions here, but a few provisions are notable. For example, trusts and estates—like individuals—may benefit from a

lower top marginal income tax rate of 37% (decreased from 39.6%), and may also be able to take advantage of a new 20% deduction for so-called qualified business income.

A new limitation on the deductibility of state and local income taxes will also apply to trusts and estates, and may increase the importance of strategies designed to reduce those taxes. These strategies include changing the income tax residence of existing trusts, converting existing grantor trusts to separate taxpayers, and making distributions to beneficiaries who may have lower tax burdens. We encourage clients with existing trusts to consult us regarding potential planning opportunities for minimizing trust income taxes.

Section 529 plans are expanded. Section 529 plans are designed to allow tax-free accumulation of education savings. Under current law, funds in these plans may be distributed income tax free for qualified higher education expenses. The new law allows distributions to be made on the same basis to elementary or secondary schools as well, subject to a limit of \$10,000 per plan beneficiary per year.

Annual exclusion amount has increased. As previously scheduled, and unrelated to the Tax Cuts and Jobs Act, the gift tax annual exclusion has increased to \$15,000 per donee (or \$30,000 per donee for a married couple) as of January 1, 2018. The annual exclusion amount for gifts to a spouse who is not a U.S. citizen has increased to \$152,000.

If you have any questions about how the new tax laws could impact your family or your estate plan, please contact us.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

<u>Michael S. Arlein</u>	212-336-2588	<u>msarlein@pbwt.com</u>
<u>Hugh J. Freund</u>	212-336-2370	<u>hjfrend@pbwt.com</u>
<u>John Sare</u>	212-336-2760	<u>jsare@pbwt.com</u>
<u>Jennifer W. Brown</u>	212-336-2341	<u>jbrown@pbwt.com</u>
<u>Carolyn B. Handler</u>	212-336-2480	<u>cbhandler@pbwt.com</u>
<u>Brian M. Sweet</u>	212-336-2349	<u>bsweet@pbwt.com</u>
<u>Megan Clair Frothingham</u>	212-336-2242	<u>mfrothingham@pbwt.com</u>
<u>Rachel Y. Meagher</u>	212-336-2708	<u>rmeagher@pbwt.com</u>
<u>Abbie Rose Pappas</u>	212-336-2473	<u>apappas@pbwt.com</u>

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