Recent Developments Affecting Estate Planning

Stanley M. Johanson

University Distinguished Teaching Professor and
James A. Elkins Centennial Chair in Law
The University of Texas School of Law
Austin, Texas

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I. The Federal Estate Tax—*What* Federal Estate Tax?

A. **The one constant with respect to transfer taxes has been constant change**. It all began with the Tax Reform Act of 1976, which "unified" the federal estate tax and gift taxes, increased the estate tax exemption from $60,000 to $175,625, introduced the first (mercifully short-lived) version of the generation-skipping transfer tax, repealed (for a few years) the "new basis at death" rule, and made other significant changes (and some insignificant changes—remember the orphan's deduction?). Then came ERTA 1981, which increased the estate tax exemption to $600,000, introduced the unlimited marital deduction, and gave us QTIP trusts. The Tax Reform Act of 1986 increased the exemption, reduced the maximum estate & gift tax rate, and gave us the current version of the generation-skipping transfer tax. In 1990, we were introduced to the Special Valuation Rules of Chapter 14. EGTRRA 2001 repealed the estate tax under the Budget Reconciliation procedure's "sunset" rule—a slow-burning fuse. After an estate-tax-free year in 2010, in 2012 Congress made the exemption "permanent" at $5,000,000 (with annual CPI adjustments).

1. And those are just the highlights! These same Acts, and sundry statutes and Technical Corrections Acts in between, made more-than-tinkering changes to our transfer tax laws on an almost annual basis.

2. And here we are again—maybe!

B. **The House—Tax Cuts and Jobs Act of 2017.** On November 16, 2017, in the House of Representatives—actually, the Republicans in the House of Representatives—passed the Tax Cuts and Jobs Act. While the bulk of the 400-page bill addresses a bevy of proposed income tax changes, the bill would increase the estate and gift tax basic exclusion amount to $10 million (with annual inflation adjustments) effective January 1, 2018, and would totally repeal the estate tax effective January 1, 2024, while maintaining the "new basis at death" rule (a.k.a. the stepped-up basis rule) for inherited property. The Wall Street Journal (11/3/2017) quoted an economist with the Tax Policy Center who estimated that the exemption increase would lower the number of taxable estates filed annually from around 5,500 to fewer than 2,000. The gift tax would remain intact, but effective January 1, 2023 the gift tax rate would be reduced from 40% to 35%. The annual exclusion amount ($15,000 for 2018) would remain in place.

1. **The Senate Tax Act**. On the same day (November 16), the Senate Finance Committee reported out (along party lines) the Senate version of the Tax Act, and on November 28 the bill was approved by the Senate Budget Committee. The Senate bill, which has its own bevy of proposed income tax changes, would not repeal the estate tax—but as with the House bill, the exemption would be increased $10 million (with annual inflation adjustments) and would maintain the "new basis at death" rule.

2. And on December 15, 2017, I can tell you that …

C. **What do we (and our clients) do in the meantime?** Daily Tax Reports (12-28-16) had a choice quote from Cynda Ottaway, president of ACTEC: "You've got to say, 'keep your plan in place and stay healthy,' because you don't know what's going to happen." Digging further into history, also helpful is a quotation attributable to Oliver Cromwell, the 17th Century British revolutionary: "put your trust in God; but keep your powder dry." Bottom line: wait and see. If planning decisions must be made in the interim, it will be important to build as much flexibility into the plan as possible.

1. **Did Benjamin Franklin have it wrong?** It was Benjamin Franklin, in a 1789 letter, who wrote that "Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes." Death, yes; income taxes, yes; but death taxes can hardly be said to be certain.

   a. The annual Short Course on Estate Planning given by the Center for American and International Law (formerly the Southwestern Legal Foundation) in Dallas, at which I have lectured for 50 years, was scheduled this year for the first week in February. We decided to postpone the course because none of the speakers had a clue as to whether anything we might say would have any relevance six months later.

2. For the short run (and possibly for the long run—we just don't know), clients assuredly should shelve plans for that proposed installment sale to a defective grantor trust or any other sophisticated planning transaction. (And this is yet another reason to not text while driving.)

3. **Should you consider changing your practice to another area? Not to worry!** There is a good likelihood that, whatever Congress does, you will be busier than you are now! Think back on all of the changes that I mentioned at the beginning of this outline, and how they affected your practice. Virtually every time Congress has made changes in the transfer tax area—especially when the rules are "simplified," things tend to get more complicated, meaning more work for estate planners in revising existing wills and trusts (and doing it again a couple of years later).

D. One thing that won't change: Trusts will remain the linchpin in estate planning.

1. **Trusts for spouses remain important**. A "bypass" trust that gives the spouse a life income interest and limited invasion powers over trust principal will continue to be important even if there are not going to be any estate taxes to bypass. It must be conceded that clients really like two page "I love you" wills: "to my [spouse] if he survives me, otherwise to my children in equal shares"—or perhaps "to my descendants per stirpes."

   a. One concern is that if the spouse later becomes incapacitated, the result will be a costly and cumbersome guardianship administration. If instead the estate was left in trust—with the spouse serving as trustee for as long as he or she is able and so inclined—a guardianship administration will be avoided.

   b. Another concern is the risk of financial abuse. In <u>Financial Abuse: the Silent Epidemic</u>, Barron's (Nov. 12, 2016), it was estimated that one out of five older citizens has been financially exploited, and that in 70 percent of the cases a child was the suspected perpetrator. Settling assets in a trust shields the assets from being exploited—unless, of course, that bad-apple child is the trustee!

   c. A trust settlement assures that the remainder interest on the spouse's death will pass to the children, rather than to that dreaded second husband, that trophy second wife, or that too-solicitous caretaker.

      (1) As for caretakers, *c.f.* Texas Family Code §123.102 (triggered by alleged instances in which Caretaker whisked Patient to a justice of the peace, married him, disappeared, and then reappeared after his death wearing black—she's a widow, after all), authorizing a suit to challenge a marriage on the ground that the decedent lacked sufficient mental capacity to enter into the marriage if (1) the marriage

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