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TEN TOOLS EVERY ESTATE PLANNER SHOULD KNOW HOW TO USE

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I. INTRODUCTION

With the passage of the American Taxpayer Relief Act of 2012, P.L. 112-240, 126 Stat. 2313 (2013) ("ATRA"), the estate planning landscape changed. ATRA gave us "permanent," unified estate, gift, and generation-skipping transfer ("GST") tax laws with some little twists, like portability. High transfer tax exclusions and a tick up in the transfer tax rate, which closed much of the gap between income and transfer tax rates, caused estate planners to step back and refocus how they help clients plan their estates. Now, with the enactment of the Tax Cut and Jobs Act of 2017, P.L. 115-97, 131 Stat. 2054 (2018) ("TCJA 2017") on December 22, 2017,[1] additional significant changes have been made to the income and transfer tax laws. All of this doesn't mean that we have had to throw out the estate planning toolbox and start over; it just means we have had to look at our tools with fresh eyes. In doing so, we find that, with a little polish, our existing tools can help our clients in new ways.

II. FEDERAL ESTATE, GIFT, AND GST TAX LAWS

A. Permanent, Unified Transfer Tax System

1. Historical Perspective

Prior to 2002, each person had a "unified" transfer tax credit which could be used to offset estate and gift taxes. IRC §§ 2010, 2505. This credit effectively sheltered a set amount of transfers (by gift or at death) without incurring any transfer tax. The Economic Growth and Taxpayer Relief Reconciliation Act of 2001, P.L. 107-16, 115 Stat. 38 (2001) ("EGTRRA") "de-unified" the estate and gift tax credit, with the estate tax exemption exceeding the $1 million lifetime gift tax exemption from 2004 through 2009. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111-312, 124 Stat. 3296 (2010) ("TRA 2010") re-unified the estate, gift, and GST tax exemptions, increasing them to $5 million for 2011, with an inflation adjustment in 2012. In 2013, the law was scheduled to revert to the law in effect in 2001, immediately prior to the enactment of EGTRRA.

2. American Taxpayer Relief Act of 2012, P.L. 112-240

ATRA was passed by Congress on January 2, 2013 and signed into law on January 4, 2013. ATRA adjusted tax rates and made the changes to the estate and gift tax exclusions and the GST tax exemption first enacted in 2010 "permanent," while increasing the effective federal estate tax rate on the excess from 35% to 40%. As a result, ATRA reunified the estate, gift, and GST tax laws with an exclusion of $5,000,000, adjusted annually for inflation after 2011, and a top estate, gift, and GST tax bracket of 40%.[2] For 2017, after applying the inflation adjustment, this exclusion was $5,490,000. For reference, a chart outlining the estate, gift, and GST tax exemptions since 1916 is attached as **Exhibit A**.

3. Permanency

As we all know, tax laws are never truly permanent. However, for the first time since 2001, ATRA meant there was no set expiration date for the estate, gift, and GST tax laws. From 2001 to 2013, the estate rules had built-in expiration dates, with a possibility that Congress would make them "permanent." There was continued uncertainty about "will they or won't they," but with ATRA's unexpiring exclusions, it literally meant that it would take an act of Congress to make a change. And then came December 2017.

4. Tax Cut and Jobs Act of 2017, P.L. 115-97

With the passage of TCJA 2017, we lost permanency. TCJA 2017 essentially doubled the estate and gift exclusions and GST tax exemption for persons dying and transfers made between 2018 and 2025. As a

[1] The technical name of the Act is "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018", but "AAPRPTIIVCRBFY 2018" seems to be a remarkably unhelpful acronym. Some have suggested "the Act Formerly known as TCJA 2018," or perhaps its abbreviation, "AFKATCJA."

[2] Of course, a client may make lifetime use of his or her GST tax exemption without making a corresponding taxable gift, or may make a taxable gift without allocating GST tax exemption. As a result, at death, the remaining amount of these exemptions may be unequal or out of sync.

result, we have unified estate, gift, and GST tax laws with an exclusion (and GST tax exemption) temporarily set at $10,000,000, adjusted annually for inflation after 2011[3] (scheduled to return to $5,000,000 after 2025, adjusted for inflation after 2011), and a top transfer tax bracket of 40%. For 2018, after applying the inflation adjustment, the exclusion and exemption are $11,180,000, anticipated to be $11,400,000 in 2019. As noted below, these tax acts have also adjusted income taxes. The changes to the income tax rates has maintained a spread between the top tax rates that is virtually nil. With the fluctuating amount of the exclusion and exemption and the scheduled reversion to ATRA in 2026, it continues to be important to review existing testamentary plans to ensure the amount that clients want to pass to their beneficiaries is the "right" amount. As the exclusion and exemption amounts continue to be adjusted for inflation, specific bequests tied to the exclusion amount or the GST exemption may become even trickier.

5. The Net Investment Income Tax

Coincidentally, although not a part of ATRA, January 1, 2013 also ushered in a new 3.8% income tax. The Health Care and Education Reconciliation Act of 2010, P.L. 111-152, 124 Stat. 1029 (2010) ("HCA 2010") imposes an additional 3.8% income tax on individuals, trusts, and estates, and that tax began being imposed in 2013. For individuals, the tax applies to the lesser of net investment income or the excess of a taxpayer's modified adjusted gross income over certain defined thresholds. For individuals who are married filing jointly, the threshold is $250,000; for married filing separately, $125,000 each; and for single individuals, $200,000. For estates and trusts, the 3.8% tax applies to the lesser of *undistributed* net investment income or the excess of adjusted gross income over a threshold determined based on the highest income tax bracket for estates and trusts, which was $12,300 for 2015, $12,400 for 2016, and is $12,500 for 2017 and 2018. When combined with the increase in income tax rates noted above, the additional 3.8% tax on net investment income yields a top tax rate of 40.8% on ordinary income and a top tax rate of 23.8% on capital gains and qualified dividends.

III. TEN TOOLS THAT EVERY ESTATE PLANNER SHOULD KNOW HOW TO USE

Traditionally, estate planners have recommended that their clients incorporate a variety of techniques into their estate plans which were designed to avoid, defer, or minimize the estate tax payable when property passed from one taxpayer to another. These strategies have often involved the use of one or more trusts which were aimed at minimizing transfer taxes. A corollary effect of many of these techniques was that income taxes payable might be increased in some cases, but when estate and gift tax rates exceeded 50%, and capital gain rates were only 15%, the income tax "cost" associated with many common estate planning tools seemed worthwhile. Under the current tax regime, higher estate tax exclusions and the availability of portability mean that many clients are no longer subject to estate or gift taxes, regardless of whether the estate planning strategies recommended in the past are employed. At the same time, the income tax cost of these strategies has increased, due to the enactment of higher federal income tax rates and the adoption of the 3.8% tax on net investment income. In short, common strategies previously employed to save estate tax may now fail to reduce estate taxes owed, and may instead increase income tax exposure.

Given the substantial, although perhaps only temporary changes in estate and gift tax exclusions and the GST exemption, the availability of portability, and the increase in income tax rates, estate planners are wrestling with the traditional tools in their tool box to try to decide which are still well suited to address clients' goals. At the same time, they are evaluating new ideas (or re-evaluating old ideas) in view of this new paradigm. So what works now?

[3] Prior to TCJA 2017, inflation was measured by changes to the Consumer Price Index ("CPI"), published by the U.S. Bureau of Labor Statistics. TCJA 2017 modified the index to the "Chained Consumer Price Index," ("C-CPI-U" or "Chained CPI"), which generally grows more slowly than CPI. Using CPI, the 2018 figure would have been $11.20 million instead of the $11.18 million that results from using C-CPI-U. Although many of the provisions related to individuals in TCJA 2017 are only effective for years 2018-2025, Chained CPI as the method of inflation adjustment is "permanent."

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