



Planning for the Prospect That TCJA Provisions Sunset

The temporary nature of an increase in the estate and gift tax exemption, coupled with IRS assurances of no clawbacks, provide an incentive for gift giving.

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The fact that fewer families are subject to estate taxes today might lead financial advisors to think they need to spend less time talking with their clients about wealth transfer. Nothing could be further from the truth.

The Tax Cuts and Jobs Act of 2017 (TCJA) surprised many by increasing the lifetime gift exemption to \$11.18 million per individual and \$22.36 million per couple in 2018, which effectively doubled the amounts from 2017. Due to annual inflation adjustments, the thresholds rose to \$11.4 million per individual and \$22.8 million per couple in 2019.¹ While the TCJA altered the transfer taxation threshold of estates dramatically, the fundamental questions of wealth transfer have not changed. Advisors should not assume that clients do not need to address significant estate planning issues simply because their wealth falls well below the estate tax exemption amount.

Uncertainty remains, as a 2026 sunset provision could mean a potential reversion to the prior lower exemption amounts. Further, a change in political power could shift policy yet again, in any number of ways.

Today's historically high exemption creates a unique opportunity and several challenges for advisors and their clients. Now that tax efficiency does not have to drive planning for many clients, personal preferences and goals, as well as practical considerations, can take a front seat in the planning process.

Answering the key estate planning questions

For most clients, planning is about much more than taxes. For many, tax planning no longer has to drive the planning structure. Therefore,

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estate planners must continue to have substantive conversations on key foundational estate planning decisions. These discussions generally revolve around three important questions:

1. What testamentary vehicle should guide the plan?
2. Who does the client want to inherit his or her property after death or the death of his or her spouse?
3. How should the assets be received, outright or in trust?

Is a simple will sufficient or should a trust be created? There are generally two types of testamentary instruments, a “last will and testament” or “a revocable trust” (with pour-over will). Determining the appropriate vehicle to govern the distribution of assets is generally the first step for all estate plans. Revocable trusts, for many, have become the primary vehicle. Beyond the avoidance of probate, trusts also provide privacy for the

family and ensure that assets are transferred to the beneficiaries more efficiently. There may be a slight increase in attorney's fees for establishing a revocable trust, but trusts are becoming the baseline document of choice for many estate planning attorneys, so the gap in fees seems to be narrowing. This is an important starting point for any estate planning discussion.

How and when will assets be transferred to beneficiaries? Regardless of the vehicle selected, it is important to determine how the client's selected heirs or beneficiaries will receive the inherited assets. Many tend to think in terms of the extremes: Should I give all of my assets outright, or should I pass my assets to beneficiaries in a trust with restrictions? In fact, there are hybrid approaches. Families can share a portion of their wealth outright while holding a share of the assets in a trust.

Outright distributions or bequests give the beneficiary complete control of the assets immediately upon receipt. The disadvantage is the potential loss of assets due to a divorce, creditor claims, or spendthrift issues. Retaining assets in a well-drafted trust provides greater comfort that the assets will stay in the family and be used the way the decedent intended.

Aside from concerns about creditor protection, many families select an estate plan based on the lowest common denominator, whereby restrictions are tailored for the least responsible or most concerning beneficiary, and the inheritance of all of the other beneficiaries is governed under the same rules. This is often done in an effort to be fair or avoid conflict. However, a trust is an infinitely customizable document and can be drafted in any way desired by the family. This includes providing different provisions and

restrictions for different beneficiaries, or building in flexibility or allowing for a "wait-and-see" approach. For example, the trust can include powers of appointment to allow a surviving spouse to adjust provisions applicable to the

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children's inheritance, or to allow children to adjust provisions governing trusts for the grandchildren.

If a family wishes to leave assets to their children in trust, there are infinite ways in which the trust can be drafted to fit the family and beneficiary's desires and circumstances. Many estate planners promote flexibility over specificity to allow the trust to adjust to the unknown. As part of the drafting process, the question as to how long the assets should remain in trust often arises. Clients often allow assets to be withdrawn at a certain age or in stages (e.g., $\frac{1}{3}$ at age 30, $\frac{1}{2}$ at age 35). This mechanism works well for families whose primary concern is the financial maturity of the beneficiaries. If, however, there are creditor concerns (including concerns about a divorce, etc.), some families might prefer to have the assets remain in trust perpetually.

In such event, the trustee may make distributions to the beneficiary based on the parameters set forth in the trust (e.g., for health, education, maintenance, and support), but the assets that are not distributed remain protected in the trust if and until the beneficiary

needs them. There are, of course, administrative costs and practicalities (including the anticipated value of the trust) to consider and balance when drafting a trust vehicle for beneficiaries.

Trustee selection. Another important conversation, and often troubling for the client, is trustee selection:

- Should one of the children be named and essentially become his or her own trustee?
- Will an individual outside of the family or a corporate entity be named?

For typical trusts, there seems to have been a shift to the selection of individuals or family members to minimize fees and administrative complexity. Individuals tend to better understand family dynamics and often are more flexible in making distributions from a trust. Those more concerned about the prudent use of assets or proper administration (i.e., filing proper tax returns, prudent investing, making mandatory distributions, etc.), or those establishing a specialized trust where careful administration is required (e.g., a supplemental needs trust) might prefer to name a corporate trustee. Others may name an individual as the initial trustee and a corporate trustee as the successor to ensure there is never a gap in trusteeship.

Order of inheritance. Determining who will inherit from the estate can require significant thought. Will the estate provide for siblings and their families in a vertical silo? In this case, if one of the siblings dies, his or her share of assets transfers to his or her descendants. However, some may choose to think horizon-

¹ Section 2010(c)(3).

² Prop. Reg. 20.2010-1(c); REG-106706-18, 11/23/2018.

tally or generationally in terms of all the grandchildren first by providing a certain percentage or dollar amount to each living grandchild with the residual balance passing to the children. In this case, if one sibling has three children and another has just one, each grandchild gets the same amount.

While almost all estate plans address the sequential order of death, it is not uncommon for a parent to work through the scenario of a child predeceasing the surviving parent or both parents. While painful to contemplate, this level of planning can prevent grandchildren from receiving assets outright at ages that are not appropriate for the grandchild.

Remarriage. Thoughtful estate plans will engage spouses early in a broad conversation about remarriage should one spouse predecease the other. Under prior tax laws, the first deceased spouse's federal estate tax exemption was "use or lose," but now with "portability" of the first deceased spouse's exemption, the division of assets at the first spouse's death is less tax driven. Under prior tax laws, the first deceased spouse's assets would be placed into an "exemption" or "credit shelter" trust with the assets in excess of the first deceased spouse's exemption either going outright or in trust to the surviving spouse.

Portability and the much larger exemption amounts, however, have reduced the need for this type of planning. Now, the conversation is much more focused on whether the first deceased spouse wants flexibility for the surviving spouse. Does the predeceasing spouse want the survivor to have complete control over all of the assets, or does he or she want a portion or all of his or her share of the assets to go into an irrevocable trust for the benefit of

the surviving spouse. The trust structure guarantees that the residual balance of the trust will go where and how the predeceasing spouse wanted at the surviving spouse's death.

Typically, it is prudent for only one spouse to make a gift to a trust for the other spouse, without an offsetting gift to a trust for the other to avoid the violation of the reciprocal trust doctrine.

Determining how flexible versus controlled the plan should be, whether it is for the surviving spouse or the children and even future generations, is generally a qualitative discussion focused less on taxes and more on family values and wealth transfer goals.

A limited gifting opportunity?

Regardless of the extremely high exemption amounts, many advisors have clients who may still be subject to estate tax. For these clients, advisors should continue to discuss estate tax planning techniques and opportunities. Despite the inherent obscurity surrounding the longevity of new exemption levels, the IRS has clarified with certainty that there will not be a clawback of the

gift tax for those who move ahead now.

Many advisors were pleased to gain more clarity when the IRS released proposed regulations in November 2018 that provides assurance to those who take advantage of the increased gift and estate tax exemption before 2025 that they *will not be penalized for having used the higher exemption amount for lifetime gifts* if the exemption should drop to pre-2018 levels.² Before the Treasury Department released this guidance, some planners had real concerns that transfers effected before 2026 could face transfer tax liability if no action was taken and the sunset provision returned the transfer tax exemptions to prior levels. Families can now feel a bit more confident moving ahead with lifetime wealth transfers.

Who should take advantage of the historically high exemption? To better understand who might want to accelerate gifts before the sunset given this historically high exemption, consider three broad groups:

- *Those with assets under \$5.6 million per individual/\$11.18 million per couple.* No one can predict with certainty the level at which the exemption will end up in 2026. Yet, because this group's wealth is lower than the 2017 exemption levels, there is less urgency to transfer wealth as this demo-

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EXHIBIT 1
Gift Tax
Exemption Amount
(2000 through 2019)

| Year | Exemption Amount |
|------|------------------|
| 2000 | \$ 675,000 |
| 2001 | \$ 675,000 |
| 2002 | \$1,000,000 |
| 2003 | \$1,000,000 |
| 2004 | \$1,000,000 |
| 2005 | \$1,000,000 |
| 2006 | \$1,000,000 |
| 2007 | \$1,000,000 |
| 2008 | \$1,000,000 |
| 2009 | \$1,000,000 |
| 2010 | \$1,000,000 |
| 2011 | \$5,000,000 |
| 2012 | \$5,120,000 |
| 2013 | \$5,250,000 |
| 2014 | \$5,340,000 |
| 2015 | \$5,430,000 |
| 2016 | \$5,450,000 |
| 2017 | \$5,490,000 |
| 2018 | \$11,180,000 |
| 2019 | \$11,400,000 |

graphic group is unlikely to be affected by the approaching sunset.

- *Those with assets between \$5.6 million to \$11.18 million per individual/\$11.18 million to \$22.36 million per couple.* Here, a decision must be made whether to gift before the 2026 sunset. In order to maximize the exemption with the sunset provision approaching, these individuals would need to make gifts of more than \$5.6 million per individual/\$11.18 million per couple to take advantage of the higher exemption now. Because gifts of this size would be a significant portion of their net worth, couples in this category

may opt to wait to gain more clarity as to the ultimate direction of the exemption before making large lifetime gifts.

- *Those with assets more than \$11.18 million/\$22.36 million per couple.* All else being equal, this group should probably use the exemption now before the sunset provision reverts back to 2017 levels.

Keep in mind that if a client dies before using his or her full lifetime exemption, assets in the amount of the remaining exemption pass to loved ones estate tax-free.

Strategies for wealth transfer. Every family should review their estate planning documents annually to determine if revisions are necessary as a result of changes to federal or state tax laws, net worth, or family dynamics. In light of the new law, it may be important to update plans.

One truth in estate planning is that nothing is certain or permanent. Since 2000, the gift tax exemption has changed multiple times (in addition to cost-of-living adjustments). The exemption amounts are shown in Exhibit 1. In some of those years, estate planners were inundated with requests to revise plans before new laws went into effect. In 2012, many families rushed into gifting strategies only to have the lifetime gifting exemption extended and expanded. Some later regretted having lost control of their assets after transferring their wealth.

One strategy to reduce regret and retain some control of the assets is to make use of a spousal lifetime access trust (SLAT). SLATs can be designed as grantor trusts, with the grantor and trust considered one and the same³ for income tax purposes, but not for gift and estate tax purposes. To fund a SLAT, a married person can transfer assets into an

irrevocable trust that will benefit a spouse throughout his or her lifetime, and ultimately transfer to the designated heirs after the spouse's death. This strategy removes the assets from the gifting spouse's estate, while providing the beneficiary spouse with discretionary access to the trust assets during the beneficiary spouse's lifetime.⁴ In addition, the SLAT may also provide a level of asset protection.

SLAT strategies are not without risk. The gifting spouse is not a beneficiary of the trust and thus must rely on the beneficiary spouse to independently share any distributions received from the trust. In the case of divorce, the beneficiary spouse commonly remains the beneficiary, and the assets would no longer be accessible to the gifting spouse. Although the trust can be drafted to treat the spouse as having predeceased in the event of a divorce, cutting off his or her access to the funds as a beneficiary, the gifting spouse would still no longer have any indirect access to the funds. In some events, the grantor trust status of the trust may also be, intentionally or unintentionally, terminated in such event, leading to potentially unintended tax consequences. Additionally, if a beneficiary spouse should die prematurely, the remainder of the trust assets pass to the remainder beneficiaries, effectively eliminating the gifting spouse's indirect access to the assets (through the beneficiary spouse).

Typically, it is prudent for only one spouse to make a gift to a trust for the other spouse, without an offsetting gift to a trust for the other

³ Sections 671 through 679.

⁴ Blattmachr and Shenkman, "Wrap Up Lecture: Planning After the Tax Cut and Jobs Act of 2017; 52nd Heckerling Institute on Estate Planning," available at <https://media.law.miami.edu/heckerling/2018/SupMaterials/wrapup.pdf>.

⁵ Lehman, 109 F.2d 99, 24 AFTR 198 (CA-2, 1940).

⁶ Grace, 395 U.S. 316, 23 AFTR2d 69-1954 (1969).

⁷ Section 1015(a).

⁸ Section 1014(a)(1).

to avoid the violation of the reciprocal trust doctrine. This doctrine was established to protect against misuse of trusts such as SLATs, where couples might make reciprocal and identical trusts for the benefit of each other.⁵

For example, if Person A creates a SLAT for Person B, and Person B creates a reciprocal, nearly identical trust for Person A, then the arrangement can be viewed from a legal perspective as each creating a trust for his or her own benefit. In such a situation, the reciprocal trust doctrine may result in the IRS unwinding the trusts—causing the value of each SLAT to be included in each spouse's respective estate under Section 2036.⁶ Reciprocal trust guidelines are governed by court judgment; caution should be exercised when implementing SLATs.

Potential problems with large gifts before the sunset. Before making large wealth transfers through SLATs or other methods, consider the associated complexities and costs that might accompany these gifts. In addition to the associated administrative costs and attorney fees, annual tax returns for irrevocable trusts may need to be filed (except in the case of grantor trusts).

Before making large gifts, consider the income tax consequences. Gifting certain assets out of the estate can mean missing out on cost basis adjustments that occur at death; gains that are unrealized at the time of the asset transfer will ultimately be paid by the gift recipients because they will receive the assets without a step-up in basis (i.e., their basis in the assets will be the same as that of the donor).⁷ In contrast, the basis of property acquired by inheritance from a decedent generally is its fair market value at the date of the decedent's death.⁸

Conclusion

Many of the important questions for estate planners are the same for a family with assets of \$2 million or \$22 million. Just because a family is well below the federal exemption amount does not mean they will not have complex planning needs. Additionally, the new tax law creates a clear opportunity for couples with significant wealth to take advantage of the his-

torically high exemption without fear of a clawback. So, to fully take advantage of it, gift more than the pre-2017 \$5.6 million per individual or \$11.2 million per couple exemption amount before the scheduled sunset date of 2026. Using advanced planning tools like spousal lifetime access trusts can allow couples to do so while retaining some access to their assets during their lifetimes. ■

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