Is Your Estate Plan on Track with Current Tax Laws?

Be sure your plan meets today’s goals and is flexible for future change

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Key Points
• As with any change in tax legislation, the 2017 Tax Cuts and Jobs (the Tax Act) gave rise to valuable planning opportunities
• Tax law changes serve as a good reminder to review your estate plan to be sure that it is consistent with your current goals and is flexible to promote tax efficiency under today’s tax laws
• Many of the provisions of the current tax law are scheduled to sunset after December 31, 2025
Current tax law environment

Under the current tax law, the top federal, estate, gift, and generation-skipping transfer (GST) tax rate is forty percent, with the federal exemption amount at $11.58 million per person, as indexed for inflation.

The increase in the federal exemption provides a golden opportunity for high-net-worth individuals to enhance their estate plans and preserve more wealth for their heirs. It’s important to work with your advisors now to determine how today’s tax laws impact your own situation, and to take advantage of estate tax planning opportunities now that could help mitigate the negative effects of federal estate, gift, and GST taxes on your estate. Many of the provisions of the current tax law are scheduled to sunset after December 31, 2025, at which time the prior provisions of the tax law would return if no further legislative action is taken. Further, given the nature of politics and fiscal realities, there always exists a very real possibility that the estate tax law will be modified prior to 2025.

Planning opportunities

Estate tax planning may not seem as appealing or necessary if your estate is not approaching the current federal exemption level. However, given your age and the nature of the assets you hold, it is possible that appreciating assets and a reduction in the federal exemption by future legislative action could result in an unexpected federal estate tax liability if you opt not to engage in estate tax planning in this favorable environment. It’s still important to review your plan, consider untangling previous strategies, and focus on providing flexibility in your future plans.

Taking a look at your documents to understand if formula clauses are being utilized to fund marital and credit shelter trusts is a good first step. It is important to make sure the assets are funneled appropriately and in a way that meets your objectives. You may find that your objectives are better met by providing for a beneficiary outright, but also including disclaimer language in the document to allow for post-death planning. Another option to help maximize flexibility inside an estate plan is to include a QTIP trust. A QTIP trust is used in connection with portability to allow a fiduciary to make an election after the first spouse’s death, depending on the circumstances at that time. Flexibility can also be created within a plan by providing the option for estate tax inclusion at the second spouse’s death for additional basis adjustment.

The current tax law retains the concept of portability, which allows the unused estate and gift tax exemptions of a deceased spouse to be transferred to a surviving spouse, increasing the surviving spouse’s available exemption. However, portability only applies to the federal estate and gift tax exemptions and does not apply to the GST tax. For married taxpayers under the current estate tax exemption, it will be important to remember that electing portability of the unused exemption is only possible on a timely filed federal estate tax return.

Other tax considerations

State estate and inheritance tax: It is important to note that, despite the current federal tax law, many states still have an inheritance and/or estate tax. And, with increasing state fiscal challenges, there is no guarantee that one or more states will not pass legislation imposing more drastic state death tax laws. If you choose to utilize disclaimer trust provisions in your estate documents, you may want to consider language that funds a bypass trust with the state tax exemption amount at the first spouse’s death. QTIP trust planning may also be available at a state level depending on the specific state’s legislation. As referenced earlier, a QTIP trust offers flexibility in the allocation of your estate property while maximizing your tax saving benefits.

Income tax basis: Although an analysis of federal income taxes is beyond the scope of this article, it is worth noting that, while assets transferred at death generally enjoy a basis stepped up to the date of death value, assets gifted during life generally keep the basis of the donor. As such, the estate tax impact of any transfer of assets should be balanced against the future income tax effects of the sale of such assets. Planning techniques such as GRATs, ILITs, and substitution of assets may help you avoid over-planning for the federal estate tax at the expense of losing stepped-up basis of highly appreciated assets. For example, gifting a highly appreciated asset during life out of an estate that would not have otherwise exceeded the federal estate tax exemption will cause the recipient to recognize greater income tax gain on sale (due to the lower basis transferred with the gift) than if the recipient received the asset after the original owner’s death with a stepped-up basis.
Nonresidents: It is also important to remember that the exclusion amount is not the same for individuals who are not United States persons. Proper estate planning for non-U.S. citizen spouses remains critical in order to prevent unanticipated estate taxes.

Charitable trusts: With the many changes in the federal income tax laws, you may find it advantageous to change your approach to philanthropy. Charitable trusts and Donor Advised Funds may provide the flexibility to allow you to gift in a more tax-efficient manner under the current tax laws.

Grantor trusts: You may find that in your state of residence, your individual income tax position (combined state and federal) has changed under the current tax laws. To the extent that your tax position is negatively affected, you may want to revisit the merits of maintaining grantor trusts (which allow trust income to be reported by the grantor on a federal income tax return), and if appropriate, find value in turning off grantor trust status and allowing the trustee to shift income in the most efficient manner.

Other important considerations
The importance of estate tax planning and the opportunities presented by today’s tax laws should not be ignored. However, in addition to estate tax planning, there are several other considerations that should always play a role in a strong estate plan.

Asset protection should always be a concern, regardless of your relative level of wealth or potential estate tax liability. Asset protection trusts with Delaware situs continue to afford the highest levels of protection and flexibility. The current federal tax law does not change this.

In addition, using life insurance to pay your estate tax liabilities might seem less relevant in light of the temporarily higher exemption levels. However, life insurance can provide another way to transfer wealth out of your estate in a tax-efficient manner. Life insurance can often be a source of liquidity for the estate, which is especially important for individuals with illiquid assets such as closely held business interests and real estate. Revisiting and reviewing insurance policies is a best practice within any estate plan review.

Further, it is easy to become so focused on estate tax planning that the appointment of fiduciaries and the manner and timing of intergenerational wealth distribution is often neglected. Of course, you likely want to transfer as much wealth (net of taxes) to your beneficiaries as possible. However, it is important to continually take a fresh look at appropriate selection of fiduciaries, as well as your wealth distribution plan (beneficiaries, amounts, timing, vehicle, etc.). Again, the current federal tax law does nothing to lessen the importance of these basic building blocks of a strong estate plan.

It’s important to regularly review your estate plan to be sure that it is consistent with your current goals and that the plan is flexible to promote tax efficiency under today’s tax laws—as well as the unknown tax laws of the future.
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