Tax Planning Opportunities Following the Enactment of the Tax Cuts And Jobs Act

Patrick R. McCabe, Richard S. Kinyon, April Hopkins Rox, Danielle T. Zaragoza, Florence M. Jao, Dan M. Porter

On December 22, 2017 H.R.1, commonly referred to as the Tax Cuts and Jobs Act ("the Act"), was signed into law. The Act is the first major overhaul of the Internal Revenue Code in three decades. This alert is meant to highlight the major changes in the law that provide current family wealth planning opportunities.

Increase of Estate, Gift, and GST Exclusions

- The Act increases the unified federal estate and gift tax basic exclusion amount from $5,000,000 per individual (adjusted for inflation from 2010) to $10,000,000 per individual (adjusted for inflation from 2010) effective for decedents dying and gifts made after 2017 and before 2026. The 2017 federal gift and estate tax exclusion amount adjusted for inflation was $5,490,000. The federal gift and estate tax exclusion amount per individual for 2018 is expected to be about $11,200,000. Thus, for a married couple, the combined exclusion is approximately $22,400,000. It is important to note that this change in the exclusion amount is temporary and is set to expire after 2025, bringing the exclusion amount back down to $5,000,000 in 2026 (adjusted for inflation from the base year of 2010). Individuals with large estates have significant planning opportunities in the coming years to capitalize on the increase in the exclusion amount, but we also suggest to keep in mind that as of now this is only a temporary increase. It is unclear how the IRS will treat gifts and estates in excess of the increased exclusion amount if the exclusion drops back to the inflation-adjusted $5,000,000 in 2026. Depending on how the law is addressed following 2025, there is the risk that the benefit of the increased exclusion is "recaptured" at death. However, we would expect that any appreciation of the gifted assets from the date of the gift would not be subject to recapture.

- The Act also increases the generation-skipping transfer tax exemption by the same amount, $10,000,000 per individual (adjusted for inflation from the same 2010 base year), effective for generation-skipping transfers made after 2017 but before 2026. The 2018 GST exemption amount adjusted for inflation is expected to be about $11,200,000 per individual, or approximately $22,400,000 for a married couple. Similar to the estate and gift tax exclusion, this is a temporary provision set to expire after 2025.

- Please note, if your existing estate plan is one in which your remaining estate and/or generation-skipping transfer tax exemption determines how your estate will be distributed for different beneficiaries upon your death (for example, if your remaining estate tax exemption amount will pass directly to or in trust for the benefit of your children, and the balance of your estate will pass to a marital trust for the benefit of your surviving spouse), then we recommend contacting your estate planning attorney to review how your existing plan operates under the unprecedented higher exemption amounts and whether updates should be made at this time.

Increased Annual Exclusion

- The annual gift exclusion for 2018 has been adjusted for inflation and increased from $14,000 to $15,000 per donee. Thus, a married couple together can give up to $30,000 to each donee in 2018 without even having to report it on a gift tax return.

Increased Limitation for Charitable Contributions

- The Act increases the AGI (adjusted gross income) limitation for cash contributions to public charities and private operating foundations from 50% to 60%. This provision goes into effect in 2018 and expires after 2025.

Expansion of IRC § 529 Plans

- The Act expands the use of Internal Revenue Code Section 529 plans to allow up to $10,000 a year to be used for elementary and secondary school expenses. This provision applies to distributions from 529 plans starting in 2018 and has no expiration date.

Reduction in the Top Individual Income Tax Rate

- The top federal income tax rate applicable to individuals, estates, and trusts is reduced from 39.6% to 37%, and the individual alternative minimum tax exemption amount is substantially increased.

Significant Changes to Itemized Deductions

- The Act significantly increases the standard deduction and eliminates many of the itemized deductions, which can substantially affect a taxpayer's federal income tax liability, especially taxpayers in high income tax states such as California. Deductions for all state and local taxes paid, including property taxes, will be subject to an aggregate limit of $10,000. All miscellaneous 2% itemized deductions (e.g., unreimbursed employee expenses, tax preparation fees, and other expenses paid to produce or collect income) will be disallowed. The mortgage interest deduction will be reduced to interest on $750,000 of acquisition indebtedness (previously at $1,000,000). All of these changes are temporary under the Act and expire after 2025.

- The Act also temporarily suspends the overall limitation on itemized deductions, known as the "Pease" limitation, for tax years beginning in 2018 and ending after 2025. The Pease limitation required high-income taxpayers to reduce the total amount of most itemized deductions, including charitable deductions, by the lesser of (a) 3% of AGI above a specific income threshold or (b) 80% of the taxpayer's itemized deductions. This suspension of the Pease limitation should improve the deductibility of charitable contributions for high-income taxpayers.

Each individual's estate plan is unique to his/her circumstances and as a result each plan must be evaluated independently. It is important to keep in mind that many of these changes in the tax law are temporary and are scheduled to last only through 2025. However, these changes in the law provide significant opportunities for tax planning (especially around lifetime gifts). If you have any questions or concerns about your estate plan and whether you should make any changes, please contact us.