

Higher Estate and Gift Exemption Can Reduce Estate Taxes

By Dani N. Ruran, Esq.

*This article is the fourth in a five-part series regarding
the Tax Cuts and Jobs Act signed into law December 22, 2017*

The new *Tax Cuts and Jobs Act* (“The Act”) signed into law last December makes significant changes to the federal income tax laws for individuals and corporations. In addition, the changes it makes to the estate and gift tax exemptions provide important opportunities to reduce estate taxes.

EXEMPTION DOUBLES FOR ESTATES AND GIFTS

The Act increases the federal combined gift and estate tax exemption, and the federal generation-skipping transfer “GST” tax exemption, from the 2017 limit of \$5.49 million to approximately \$11.2 million in 2018. For married couples, the new exemption increases from \$10.98 million to approximately \$22.4 million. These exemption amounts will be subject to annual inflation adjustments until 2025. At that time, the exemption is scheduled to revert to the 2017 levels--with an inflation adjustment. On amounts above the exemptions, the gift, estate, and GST tax rates will remain at 40%.

The gift tax annual exclusion is the amount that a person may gift in each year during his or her lifetime to any individual, or to a qualifying trust for the benefit of one or more individuals, without using up any of his or her combined federal gift and estate tax exemption. Under an inflation adjustment permitted by previous law, the federal gift tax “annual exclusion” amount increases from \$14,000 in 2017 to \$15,000 in 2018. For example, this means a married couple may gift up to \$30,000 each year to each child, or to a qualifying trust for each child, as annual exclusion gifts. Annual exclusion gifting helps reduce both federal and state estate taxes.

LIFETIME GIFTING CAN REDUCE ESTATE TAXES

The very large increases in the federal combined gift/estate exemption and the federal GST exemption present an important estate planning opportunity for individuals whose estates are likely to be above \$11.2 million, or \$22.4 million for married couples. For these individuals or couples, lifetime gifting to children and/or grandchildren even in excess of “annual exclusion” amounts will probably reduce federal estate taxes and possibly GST taxes. This is because appreciation in the gifted assets between the date of the gift and one’s date of death is not included in the calculation of federal estate tax. There is no federal gift tax on gifted amounts as long as the aggregate amount of the gifts does not exceed the combined

gift/estate tax exemption of \$11.2 million or \$22.4 million for married couples.

Moreover, even individuals whose estates are under the new \$11.2 million/\$22.4 million exemptions but over \$5.49 million—or \$10.98 million for married couples--may wish to engage in lifetime gifting to reduce the federal estate tax, in case the exemption does revert back to the 2017 level, as scheduled in the year 2025.

In addition, Massachusetts residents whose estates may exceed \$1 million—or \$2 million for married couples who have established “credit shelter trusts” as part of their estate plans--may be able to reduce or eliminate the Massachusetts estate tax by engaging in lifetime gifting. There is no Massachusetts gift tax, so any amounts may be gifted during one’s lifetime without incurring a Massachusetts gift tax. At death, the Massachusetts estate tax is calculated based on the value of the “adjusted taxable estate,” which does not include the amount of lifetime gifts. Estates are taxed in Massachusetts only if they exceed the \$1 million “filing threshold.” Lifetime gifts that exceed “annual exclusion” amounts (currently \$15,000) are included in the calculation of this \$1 million threshold. So, if the sum of such lifetime gifts and the estate assets together exceed \$1 million, there will be estate tax. The estate tax will, however, be calculated on the value of the estate assets only.

Even if individuals or couples want to limit lifetime gifts to the annual exclusion amounts--up to \$15,000 per year per donee, or up to \$30,000 per year per donee for gifts made jointly by married couples--such gifts should be considered as a way of reducing both Massachusetts and federal estate taxes.

REVIEW WILL AND TRUST FUNDING FORMULAS

People should review their existing wills and trusts to determine whether any gifts to be made after death under those documents are still appropriate, given the increased federal estate tax exemption. This review should include formulas used to create one or more subtrusts. For example, a will or trust may provide for the creation of a trust after death for the benefit of the deceased’s children. These trusts are often set up to be funded with “the federal estate tax exemption” in effect at the time of death, with the balance of the assets passing to the

deceased's spouse, or to a trust for the spouse's benefit. Now that the federal estate tax exemption is so large, such a formula may result in nothing being left for the surviving spouse.

We suggest contacting a qualified trust & estate attorney to discuss the new combined federal gift and estate tax exemption, including the new GST exemption. Taxpayers may wish to explore whether it makes sense in their own situation to make lifetime gifts to children, grandchildren, and/or other beneficiaries – either directly or to a qualifying trust for their benefit. Given these changes to the tax law, it also makes sense to have an attorney review current will or trust documents to ascertain whether the existing gift or trust funding formula needs revision in light of the increased gift/estate and GST exemptions.

On the face of it, the new higher exemptions are good news for people with sizeable estates. But it is important to review existing documents to make sure the new laws do not create unintended consequences.

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Dani N. Ruran

P: 508.459.8048

F: 508.459.8348

E: druran@fletchertilton.com

Fletcher Tilton PC
Attorneys at law

FletcherTilton.com

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