

Planning Considerations for 2018 and Beyond

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Public Law No. 115-97, informally referred to as the “Tax Cuts and Jobs Act” (the “Act”), is a sweeping tax reform measure that included significant changes to gift and estate taxes.

The Act was all over the news at the beginning of the year, but now that the dust has settled a bit and there has been plenty of time to digest the details, it might be wise to take another look and consider any impact to your personal situation.

Important Changes

While there has been some discussion of repeal, the Act keeps the current estate tax rate of 40 percent in place. However, the exemption amounts were increased significantly from \$5 million to \$11 million, indexed annually for inflation. For 2018, an individual can transfer \$11.18 million, and married couples may transfer \$22.36 million, during lifetime or at death free of gift and estate tax.

Claw-back Tax

The increased exemptions can be a great opportunity for gifting for clients with estates over \$5 million, or \$10 million for married clients. The increased exemptions sunset at the end of 2025 and the exclusions are set to revert to \$5 million, indexed for inflation. Consider taking advantage of the exemption during this time. However, the reversion to the lower exemption raises the question of whether lifetime transfers in excess of the \$5 million exemption amount could be “clawed back” for gift and estate tax purposes after the Act provisions sunset in 2025.

When preparing the Form 706, Federal Estate Tax Return, prior taxable gifts are taken into account at the date-of-gift value for purposes of calculating the estate tax payable. As the Form 706 incorporates the tax-free amount in effect on the date of death, if that tax-free amount is less than the amount of the prior gifts, the donor’s estate may be liable for estate tax on the value of the previously tax-free gifts — those gifts may be “clawed back” into the estate.

Most estate planning professionals believe the claw-back is not likely to happen. Some point to the obvious public policy concerns raised by such a tax. It seems inequitable for taxpayers to make gifts in reliance on the current tax law and later be subject to tax because those tax laws change. Clarifications from the IRS are expected later this year.

Even if claw-back were to happen, the donor’s estate is still likely to benefit from the gifts

made in prior years. The claw-back would be the amount of the taxable gift, not the current value of the property given away. If the gift had not been made, the amount of the gift plus appreciation would be subject to tax.

Even in the worst-case scenario, all post-gift appreciation attributable to the excess gift amount would still be removed from the decedent's estate. Accordingly, earlier planning allows further appreciation to avoid transfer taxation. Increasing interest rates may favor current leveraged planning.

Effect on Existing Estate Plans

The increased exemption may have an unintended effect on your existing estate plan. For example, if your plan includes formulas, tied to the applicable exemption amount, to fund various bequests, certain bequests may become overfunded, underfunded or not funded at all. Engaging in income tax planning and protecting basis step-up is essential. Review existing plans to ensure that no changes need to be made.

Additional Opportunity for Gifting

The gift tax annual exclusion also increased for the first time since 2013. Each individual may now give up to \$15,000, or \$30,000 total from a married couple, per year to any individual(s) or trust(s) for an individual's benefit (limit applies in aggregate per person) without counting against the lifetime gift and estate tax exemption.

Annual exclusion gifts are a great way to fund 529 College Savings Plan accounts. For a transfer to a 529 plan, you may make a one-time contribution that's effectively treated as if it's made over five years for gift tax purposes.

In other words, you can gift the equivalent of five years' worth of contributions in a single year.

For instance, if your grandson plans to attend college next year, you and your spouse may be able to transfer up to \$150,000 to a 529 plan designating him as the beneficiary. The entire transfer in 2018 will be exempt from gift tax.

	\$15,000		\$30,000
x	2 spouses	x	5 years
<hr/>		<hr/>	
	\$30,000		\$150,000

As with any tax change, there are many details in the Act. If you have any questions or if you think it is time to take another look at your estate plan, please contact your Westwood advisor.



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