



November 10, 2017

## **DEATH TO THE ESTATE TAX?**

President Trump is preparing to bring the axe down on the federal estate tax. On November 2, the U.S. House of Representatives Ways and Means Committee unveiled what the President hopes will become his first major piece of legislation, the Tax Cut and Jobs Act, H.R. 1.<sup>i</sup> In addition to overhauling personal and corporate tax rates, the proposed bill is poised to phase out and eventually completely eliminate the federal estate tax and the generation-skipping transfer (GST) tax.<sup>ii</sup>

Under the current transfer tax regime, property transferred from an estate or gifts made during the life of a donor is subject to a tax, with a rate as high as 40%. Additionally, property that is transferred beyond one generation, whether from an estate or by lifetime gift, is subject to the generation-skipping transfer (GST) tax. The first \$5 million of transferred property (i.e., the “basic exclusion amount”) is exempt from estate, gift, and GST taxes. This amount is indexed for inflation and for 2017 is set at \$5.49 million (set to increase to \$5.6 million as of 2018) per person or \$10.98 million for a married couple.

The proposed bill is set to double the basic exclusion amount by January 1, 2018 and index it for inflation (i.e., \$11.2 million per person or \$22.4 million for a married couple). Additionally, as of January 1, 2024, the proposed bill is set to completely eliminate the estate tax and GST tax and also to reduce the maximum gift tax rate from 40% to 35%.<sup>iii</sup>

While it is important to consider the estate planning ramifications of the proposed bill, keep in mind that it is only a draft proposal and it still has a long way to go before becoming law.<sup>iv</sup> Even if some version of the proposed bill does become law, the elimination of the estate tax may never actually be implemented or its effect may be very limited. Given that the repeal is not set to take effect until 2024, it is entirely possible that a future administration with different priorities may be in place by then and the estate tax repeal may itself be repealed. In addition, under the Senate’s complicated budget reconciliation rules, if the bill passes the Senate with fewer than 60 votes, the bill likely will be required to “sunset” after 10 years. Thus, the lifespan of the estate tax repeal (even if it does go into effect) may be for no longer than four years (i.e., 2024-2028).

Due to the considerable uncertainty surrounding the current draft proposal and its implications for the future of the transfer tax system, it would still be prudent for individuals with potentially taxable estates to continue taking advantage of the annual gift tax exclusion of \$14,000 per person (set to increase to \$15,000 in 2018).<sup>v</sup> Furthermore, should the current draft proposal become law, serious thought should be given to taking advantage of the increased basic exclusion amount by gifting such amount to an irrevocable trust. Another strategy that may become popular if the proposal becomes law and full repeal is on track for 2024, is to hedge against the possibility of dying before 2024 by selling assets to an irrevocable grantor trust for a self-cancelling installment note (i.e., commonly referred to as a SCIN, the self-cancelling feature

relieves the buyer/borrower of payment on the outstanding principal if the seller dies before the note matures, thus causing the outstanding principal to be excluded from the seller's estate).

However, flexibility in this area will be key. A trust used for this purpose should be drafted so that trust assets do not become trapped within the trust when the original reason for the transfer to the trust is no longer relevant.<sup>vi</sup> Additionally, a spouse should be included as a permissible beneficiary of the trust, to provide an easy method for the transfer to be effectively undone if necessary.

Even if there is no estate tax, transfers to trusts can provide non-tax benefits such as creditor protection and allow for the reduction or complete avoidance of state income tax in certain instances.<sup>vii</sup>

Regardless of the future state of the transfer tax system, estate and trust planning remains important for a multitude of reasons. From a practical perspective, proper estate planning can be the difference of who benefits from your estate after death, who is appointed to manage your assets, and who will care for your minor children in extreme circumstances.

Please feel free to contact our firm to discuss the above and to discuss estate planning strategies based on your specific circumstances.

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*The information contained in this article is for general informational purposes only. It is not intended as professional counsel and should not be used as such.*

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<sup>i</sup> As we go to "print," the Senate Committee on Finance has scheduled to release their version of the proposed bill on November 13th and has already released a "description" of their proposed bill. See *Joint Committee on Taxation, Description of the Chairman's Mark of the "Tax Cuts and Jobs Act" (JCX-51-17)*, November 9, 2017, available at <https://www.jct.gov>. The description does not include the repeal of the estate and GST tax but does double the basic exclusion amount.

<sup>ii</sup> In support of these changes, the bill summary cited eliminating double taxation and easing the burden on small business owners as core considerations. According to an estimate by the Joint Committee on Taxation, the lost revenue from these changes would cost the federal government \$172.2 billion over the next ten years.

<sup>iii</sup> The current draft proposal makes no change to the §1014 basis "step-up" provision. Crafted as a counterbalance to the estate tax, this provision allows a beneficiary of an estate to receive a "step-up" in basis of estate property (i.e., the basis of the property in the hands of the beneficiary is the fair-market value of the property at the time of the decedent's death). Under the current draft of the bill, beneficiaries will still receive the income tax benefits of the basis step-up even after the estate tax is eliminated in 2024.

<sup>iv</sup> As an example of the many potential changes to the current draft, many experts believe Congress is likely to eliminate or limit the basis "step-up" provision discussed in the previous note.

<sup>v</sup> This amount can be given on an annual basis to any number of individuals gift tax free without reducing the donor's basic exclusion amount.

<sup>vi</sup> E.g., in the event there is no estate tax and preserving the income tax benefits of the basis step up is more important.

<sup>vii</sup> Additionally, even if there is no federal estate tax, it is unclear what would happen with the state estate tax (in states with an estate tax, such as New York).