



2019 Estate Planning Important Reminder

Tax Cuts and Jobs Act / Increased Federal Estate Tax Exemption

Review Your Will and Trust for Needed Changes / Avoid Unexpected Effects

The Tax Cuts and Jobs Act ("TCJA"), enacted December 22, 2017, *doubled* the federal estate and gift tax exemption amount so fewer estates are subject to the federal estate tax, and larger estates will owe less tax. The exemption amount is increased to \$11,400,000 for 2019 and will likely increase further each year through 2025.

Although this change is very favorable, the terms of estate planning documents signed before enactment of the TCJA that use and apply the "*federal estate tax exemption*" could now have unexpected effect. If a will or trust refers to or applies the "*federal estate tax exemption*" to determine the amount and form of a transfer of funds or property under it, the transfer could now far exceed and have different effects than what is wanted or is most advantageous. **Previously signed wills and trusts should be reviewed for the effect of this change and amended if needed.**

TCJA Doubled Federal Estate and Gift Tax Exemption - Now \$11,400,000 in 2019

Before enactment of TCJA, the federal estate and gift tax exemption was set at \$5,000,000, adjusted for inflation after 2011, and was adjusted in 2017 to \$5,490,000. TCJA *doubled* the amount of the exemption for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026, as adjusted for inflation. As a result, the TCJA increased the federal estate and gift tax exemption to \$11,180,000 in 2018 and to *\$11,400,000* in 2019.

Review and Amendment of Existing Wills and Trusts Recommended

This doubling of the *federal estate tax exemption* makes it unlikely many individuals' estates will be subject to federal estate tax if they die before 2026. However, the increased exemption could *still impact an individual's estate plan* even if the individual's estate would not be taxed. This could happen if an individual has an existing will or trust that refers to the "*federal estate tax exemption*," and provides that the dollar amount of it (\$11,400,000 in 2019) at the time of death will still control or affect how the estate is to be transferred and administered.

Individuals affected by this increase of the *federal estate tax exemption* may have signed their estate planning documents, such as a will or trust, several or even many years ago. The amount of the federal estate tax exemption at that time was likely substantially less than now. A future *doubling* of the exemption was probably not anticipated. For example, in 2003, the *federal estate tax exemption* was \$1,000,000, approximately 9% of the present \$11,400,000 *federal estate tax exemption* amount in 2019. In prior years, the exemption was even less. The language of a previously signed will or trust may refer to the *federal estate tax exemption* or its amount as part of a formula or other provisions to be applied to determine the method and process of transferring the estate or trust property. This may still control the amount of transfers in a trust or directly to a surviving spouse and other beneficiaries.

The new, much higher, exemption after 2017 will likely exceed the entire value of many individuals' estates. The *federal estate tax exemption* and its amount may now have literally *outgrown* any previously intended advantage of referring to and applying it in the terms and provisions of a will, trust, and estate plan signed prior to 2018. Having a will or trust that continues to do so could be counterproductive, costly, and disadvantageous. Reviewing any previously signed will and trust, and making any needed amendments, is therefore advisable and recommended.

Possible Prior Will or Trust Unfavorable Effect: A "Bypass Trust" Created to Hold "Federal Estate Tax Exemption" Amount Could Be "Overfunded," No Longer Needed or Wanted

In prior years, wills and trusts have often been written to provide that an amount not exceeding the amount of the *federal estate tax exemption* would be placed in a certain form of trust referred to as a "*bypass trust*." Under terms of a *bypass trust*, it typically holds the trust property for the surviving spouse for life, and then distributes it to children or other beneficiaries. The trust effectively results in a *bypass* of a surviving spouse's estate by the property held in the trust for federal estate tax purposes. This approach has been taken frequently in prior years to maximize use of the individual exemption allowed for each spouse. At that time, the amount of the exemption was smaller, and often only a fraction of an individual's entire estate.

But with the *federal estate tax exemption* now *doubled* to \$11,400,000 in 2019, the creation and maintaining of a *bypass trust* to hold up to the *federal estate tax exemption* amount in a trust for the life of a surviving spouse may no longer be needed or advisable as a part of an individual's estate plan. Transfer of an entire substantial estate (*e.g.* \$5,000,000) directly to a surviving spouse, instead of using a *bypass trust*, may now be more practical and still involve less risk of federal estate tax on the surviving spouse's estate. A "*portability*" election also allows any unused exemption of a decedent to be transferred to a surviving spouse.

The increase of the exemption amount in the federal tax code by the TCJA does not necessarily amend or change the terms and provisions stated in a previously signed will or trust or their application. If a will or trust signed before enactment of the TCJA still provides for the creation and administration of a *bypass trust*, those provisions could apply, even if the result would now be unnecessary or illogical. An amount up to the increased *federal estate tax exemption* amount (\$11,400,000 in 2019), and possibly an individual's *entire* estate, could be *required* to be placed in a *bypass trust*, although not actually needed or wanted now. A previously signed will or trust providing for creation of a *bypass trust* could now unnecessarily add complexity, limit direct access to property, and not be the most advantageous estate plan. The example below illustrates this possible effect.

The TCJA “Temporary” Estate Tax Exemption Increase – Estate Planning Considerations

The TCJA doubled the federal gift and estate tax exemption only for tax-years 2018 through 2025. Because the exemption is adjusted annually for inflation, it is \$11,400,000 for 2019. Under the TCJA, the increase is only “temporary.” Thus, in 2026, the exemption is due to revert to its pre-2018 level of \$5,000,000, as adjusted for inflation. The Internal Revenue Service has published proposed regulations on effect of the increased exemption for gifts made during the period from 2018 through 2025. Individuals should carefully consider the “temporary” nature of the present higher exemption, then followed by a major decrease of the exemption in 2026. A will or trust applying the amount of the exemption should be reconsidered in this regard. It may need to be amended to recognize the prospect and uncertainty that either the present higher exemption or the future reduced lower exemption could possibly apply and impact an individual’s estate plan.

Conclusion

The TCJA increase of the federal gift and estate exemption, now at \$11,400,000 in 2019, is a very favorable change in law that will exempt many more estates of individuals from tax.

However, individuals who have previously signed a will or trust should review its terms to see if it uses the term “federal estate tax exemption” to measure an amount to be transferred in a certain way such as being placed and administered in a *bypass trust*, as described. It may now be advisable to amend the will or trust document to better fit the current amount of the individual’s estate to provide the most favorable estate plan. The amendments should include updating the will or trust to assure it gives the right and best effect to the *doubled federal estate tax exemption*, and portability of the exemption for married couples, in 2019 and later years, as enacted by TCJA.

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EXAMPLE: Tax Cuts and Jobs Act / *Increased* Federal Estate Tax Exemption

Assume that D, an individual, signed a will in 2003 that provides an amount not exceeding the *federal estate tax exemption* at the time of D's death shall be placed and held in a *bypass trust* for S, his surviving spouse, and the remaining amount of the estate would be distributed directly to S; and when the will was signed in 2003, D's estate was \$3,000,000. If D died in 2003, the result would be the amount of the *federal estate tax exemption* at that time, \$1,000,000, would have been placed in the *bypass trust* for the benefit of S during S's lifetime but not be taxed as part of S's estate. The remaining \$2,000,000 would have been transferred outright and directly to S, as surviving spouse, for which a federal estate tax marital deduction would be allowed. If, however, D did not die until 2019, the will still containing the same *bypass trust* provisions, and value of the D's estate had increased to \$5,000,000, the result would be different. The *entire estate* of \$5,000,000 would be placed and held in the *bypass trust* because it would not exceed the *federal estate tax exemption* amount of \$11,400,000. S, as surviving spouse, would not receive *any* property of the estate directly. Creation of the *bypass trust* in 2019 would occur even if it was not now needed for its originally intended purpose. Trustee fees and trust administration expenses could be incurred over an extended time period.