Federal Tax Client Alert

Significant Changes to Federal Estate, Gift, and Related Tax Laws

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The 2017 tax law made significant changes to the estate, gift, and related tax laws. Many of you have tax reasons to consider changes to your estate plans. If you do not have a tax reason to change your estate plan, you may want to review your estate plan to make sure that it is up to date.

Estate and Gift Taxes

Your "exemption" from gift and estate taxes has doubled. When you die, your estate pays a 40% tax on your net taxable estate in excess of your exemption. (The law uses technical terms to define your exemption.)

You also pay a 40% tax on taxable gifts in excess of your exemption. If you use part of your exemption to avoid gift taxes, your estate tax exemption is reduced.

In 2017, your exemption was approximately $5.5 million. The new law doubled your exemption to approximately $11 million. Your exemption will increase over time, based on a measure of inflation.

The amount that you can give grandchildren or other young people, without paying a very high gift or estate tax, also has increased from approximately $5.5 million to approximately $11 million. This amount is called the "Generation Skipping Transfer Tax" exemption.

If you are married, you and your spouse have separate exemptions. If one spouse dies, the other spouse may file an estate tax return and claim the deceased spouse's unused exemption. As a result, if the deceased spouse dies between 2018 and 2025 and does not use his/her exemption, the surviving spouse might have more than a $22 million exemption.

Unless Congress extends the exemptions, the lower 2017 exemptions will reappear in 2026.

Who should consider making changes? Here is a short list of those who should consider changing their estate plans:

1. If your will or trust gives the exempt amount to a trust or family members, too much money might go to that trust or family member–and other loved ones might be disinherited. You should review your estate plan.

2. If your estate plan gives money to a charity, the law changes might result in reduced gifts or might eliminate the gifts. You should review your estate plan.

3. If your net worth permits you to do so and your family is stable, you could consider using your increased gift tax exemption to give minority interests in family businesses, or other appreciating assets, to family members directly, in trust, or through family partnerships. Since the increased exemptions are scheduled to disappear in 2026, you should consult your tax advisor before you make large gifts.

4. If you have life insurance to pay anticipated estate taxes, you should consider whether you need the policies. Keep in mind that if you live past 2025, you might need the policies. If you keep the policies, consider placing them in Life Insurance Trusts.

5. If you have sophisticated estate planning trusts such as insurance trusts, GRATS, Unitrusts, Lead Trusts, or Personal Residence Trusts, you should review the trusts and consider whether it is advisable–and possible–to make changes. You might, for example, be able to give up your remainder interest in a Lead Trust, or let life insurance lapse and buy new life insurance policies.

6. If you hold a "low basis" asset until you die, your basis increases to the asset's fair market value at your death. The law has not changed, but if you hold these assets until you die, you and your heirs might avoid any tax on the increase in value of these assets.

"Kiddie" Income Taxes

In the past, parents tried to move income to their children, and file the child's income tax return to pay lower tax rates. Many of the loopholes were eliminated over the years.

2017's tax law taxed part of your child's wages and other earned income at the parent's tax rate. The new law taxes this income at the child's separate income tax rate.

The child's unearned income–interest, dividends, etc.–is taxed at the rates for estates and trusts; these rates are much higher than individual rates.

What should you do?

1. Consider investments that are in custodial accounts or similar investments, on which your child is subject to income taxes. You may want to reinvest and use investments that defer taxes until your child is not your tax dependent.

2. Can your business hire your child for legitimate work, and pay that child wages? If so, the child may pay no (or low) taxes on the wages, and your business could deduct the wages.

(a) Even if you personally hire your child, the child may pay no (or low) taxes on the wages.

(b) In addition, you can give an additional amount, equal to part or all of the child's wages, to a Roth IRA for the child.

3. If your child has income in 2018, check with your tax advisor. Your child may need to file a personal income tax return.

Charitable Deductions

In 2017, some types of charitable deductions were limited to 50% of your adjusted gross income. For the tax years 2018 through 2025, the 50% limit is increased to 60%. The additional deduction is available only for cash contributions to "public charities" and some private foundations. If you contribute more than 60% of your adjusted gross income to such charities, you usually are permitted to carry the deductions forward for 5 years.

What should you do? If you want to make large cash contributions to public charities or private foundations, consult with your tax advisor.

529 Accounts

A 529 Account is an investment program for a child. Adults set aside money for the child. The Account has some tax advantages if it is used for qualified higher education expenses.

The new law adds new types of expenses that can be paid from a 529 Account. Now, the Account can pay for some elementary or secondary tuition at public or private schools. It also can transfer some money to an ABLE Account (see below).

What should you do? Consider whether a 529 Account is right for your loved one.

1. Do you really want the Account to pay for elementary school tuition? While the child is young, the Account invests in long-term investments. These investments might be inappropriate to fund expenses that are paid in a year or two.

2. A college may consider 529 money as fully-available to pay tuition, and may offer a lower scholarship. If you hold money in your name instead of a 529 Account, the college might consider less or none of the money to be available – and might offer a higher scholarship.

3. If a child is not suited for college, a 529 Account may be inappropriate.

Disabled Individuals

If a loved one has severe disabilities, you could establish an "ABLE Account." This is a tax-preferred savings account that pays for the loved one's supplemental needs.

The new law allows you to contribute more money to an ABLE Account.

The new law also allows your loved one to take an income tax credit for part of the money that your loved one contributes to an ABLE Account. He/she must be at least 18 and cannot be a student.

What should you do? The new law is complex. If you want to consider an ABLE Account, you should contact your tax professional.

Inflation Adjustments

You probably know that many tax deductions and exemptions increase with inflation. The new tax law uses a different measure of inflation. In most years, the new measure will reduce the rate at which the tax deductions and exemptions increase.

Additional information regarding the new tax law is available at www.gablelaw.com. If you have questions or would like to discuss the new federal tax law generally or how this law may affect you, please contact a GableGotwals attorney, including an attorney in the Firm's Tax Law Practice Group.

David McKinney
dmckinney@gablelaw.com
918-595-4860

James Scears
jscears@gablelaw.com
918-595-4879

Sheppard Miers, Jr.
smiers@gablelaw.com
918-595-4834

John Russell
jrussell@gablelaw.com
918-595-4806

GableGotwals, 100 West Fifth Street, Suite 1100, Tulsa, Oklahoma 74103-4217