A Summary of Tax Reform Changes Affecting Estate and Gift Taxes August 2018

On December 22, 2017, the Tax Reform and Jobs Act of 2017 ("Act") was signed into law. The Act, as illustrated below, modified the estate, gift, and generation-skipping transfer tax exemptions.

Annual Gift Tax Exclusion Amount. The annual gift tax exclusion amount is that amount taxpayers can gift annually without being taxed. The Act did not impact the annual gift tax exclusion amount. However, the IRS announced that the annual gift tax exclusion amount increased in 2018 from $14,000 to $15,000 per recipient due to inflation.

Lifetime Exclusion Against Estate & Gift Tax and Generation-Skipping Transfer Tax. The lifetime exclusions against estate, gift, and generation-skipping tax is the amount taxpayers can give during their lifetime, or at death, without being subject to gift, estate, or generation-skipping taxes. Generation-skipping taxes are taxes imposed to gifts made to recipients who are two or more generations younger than the donor, such as grandchildren and great-grandchildren. Generation-skipping taxes are imposed in addition to gift and estate taxes. The Act doubled the amount of estate and gift tax life time exclusion amount and the generation¬skipping tax exemption from $5 million to $10 million, adjusted for inflation (from a base year of 2010), effective for decedents dying and transfers made after 2017 and before 2026. After inflation, the adjusted exclusions are $11.2 million per donor or $22.4 million per married couple.

Increase in Charitable Contribution Limit for Cash Donations. The Act increased the amount of cash contributions to charities that a taxpayer may deduct from 50% to 60% of the taxpayer’s contribution base (generally equivalent to adjusted gross income), for contributions made after 2017 and before 2026.

New 20% deduction for Pass-Through Entities. The Act introduces a 20% deduction to pass-through entities, including partnerships, LLCs, S corporations, and trusts and estates for certain business income. Pass-through entities that have Qualified Business Income ("QBI") can take advantage of the deduction. QBI includes income from conducting qualified trade or business within the United States, however certain service businesses (such as law, accounting, investment management, etc.) are excluded. QBI does not include capital gains; interest income or annuities received not in connection with a qualified trade or business; reasonable compensation paid to the taxpayer or a guaranteed payment paid to a partner by a qualified trade or business for services rendered with respect to the trade or business; or a payment to a partner as a result of a transaction between the partner and partnership with respect to the trade or business. Other certain income limits and conditions are placed on the receipt of the deduction which should be considered in each particular case. The deduction expires after December 31, 2025.

Repeal of Miscellaneous Itemized Deductions Subject to 2% Floor. Miscellaneous Itemized Deductions are items that taxpayers could deduct against their taxable income in determining their taxes due, subject to a 2% floor, which were not specifically enumerated in Internal Revenue Code Section 67. For example, if a taxpayer has $100 of taxable income and $20 of miscellaneous deductible items, the taxpayer's taxable income becomes $80. The Act added Section 67(g) to the Code, which suspends these previously deductible miscellaneous items during any taxable year between 2017 and 2026. Examples of previously deductible miscellaneous items include expenses paid to accountants, trustees, and tax preparers. The IRS has clarified that expenses, deductible by estates and non-grantor trusts as permitted under IRC Section 67(e) in arriving at adjusted gross income, such as administration costs, remain intact and are considered above-the-line deductions not subject to the 2% floor. Net federal estate tax paid on income in respect of a decedent (IRD), which is not subject to the 2% floor, also remains deductible whether for an estate, trust, or an individual who includes the IRD in gross income.

Repeal of Ability of Taxpayers to recharacterize Roth IRA Contribution. Contributions to traditional IRAs are deductible. Earnings and withdrawals from traditional IRAs are taxable. Oppositely, taxpayers cannot deduct contributions to Roth IRAs, but earnings and withdrawals from Roth IRAs are tax free. Some taxpayers convert their IRA contributions between traditional and Roth IRAs to reduce their taxes due. For example, if a taxpayer anticipates increases in income, leading to higher tax bracket or tax rates in the future, the taxpayer may want to convert to a Roth IRA in the current year to pay less taxes on the conversion and to avoid the higher taxes that would result from withdrawing funds from the non-Roth IRA in the future. Taxpayers pay conversion tax when they convert from traditional to Roth IRA. Unwinding or "recharacterizing" an IRA conversion can be desirable when it will reduce the taxes due as a result of a change of the taxpayer's financial situation or tax rates. Prior to the Act, taxpayers were able to recharacterize IRA conversions from traditional to Roth IRA or vice versa. The Act, however, has eliminated the ability for taxpayers to recharacterize Roth conversions for taxable years after 2017. Therefore, if a contribution was converted from a traditional IRA to a Roth IRA, that conversion will be permanent. Recharacterization is still permitted with respect to other contributions.

Limitations on Federal Deduction for State and Local Taxes. Taxpayers are able to deduct state and local sales, income or property taxes against their federal taxable income. The Act limited the amount of this deduction to $10,000 ($5,000 for a married taxpayer filing a separate return) for tax years after 2017 and before 2026.

In light of the above you may wish to review your estate plan to ensure that the effects of the new legislation remain consistent with your tax and family planning goals.