Tax reform not only ushered in some major changes for individual taxpayers but crucially put many of the new provisions on a deadline. The opportunity to exclude more property, such as cash, stock or real estate from federal gift and estate taxes, is one of those benefits scheduled to sunset after 2025.

What’s at stake
Most US taxpayers will not be affected, as most estates are not large enough to trigger federal estate taxes, but some will be. For the 2019 tax year, taxpayers can offset up to $11.4 million per individual or $22.8 million per couple. This will include gifts they have made over a lifetime with any remaining exemption going toward reducing or eliminating the estate tax. After 2025, the exclusion is set to drop back to the pre-2018 level of $5 million, adjusted for inflation. The difference is dramatic. An estate that exceeds the exemption amount is subject to a 40% estate tax.

Now what
The decision to transfer property before 2026, typically to a trust, likely became a lot easier for many to make after the IRS confirmed in November 2019 that the US cannot claw back and tax property from those who’ve already acted to take advantage of the increased exclusion. Those gifts are essentially grandfathered in. Yet there’s more complexity to accelerating estate and gift planning than it may seem.

Considerations
Timing the wealth transfer: Given the prospect a future Congress could decide to change the law and reset the exclusion limit, some taxpayers are deciding to act now in order to ‘use it or lose it’. They are typically transferring assets into trust and will allow any appreciation to build in a trust. In this hypothetical case, given compound annual returns of 8%, $10 million added to a trust today allows $2.60 million more to escape the estate over the next three years, without creating additional gift tax exposure. Others are hesitant to lock-in. In their minds, foregoing greater control over their property outweighs putting as much toward the exemption amount as they can. Taxpayers with this view should be aware that when the limit drops back to pre-2017 $5 million (before inflation), the window to reach the higher exemption amount will be truly closed. If the taxpayer has used only part of their total $11+ million of exemption (i.e. only transferred $5 million), they will not have any gift or estate exemption remaining if/when the limit drops.
Paying (other) taxes: There’s more to consider than the federal gift/estate exclusion amount. A handful of states also levy an estate tax, usually with a lower exemption amount than federal (12 states have this +DC) and there could also be state inheritance taxes (more rare). Because only one state (Connecticut) imposes a gift tax, transferring assets now to take advantage of the increased federal exemption would also reduce state estate tax in those states that impose one. Besides transfer taxes like these, income taxes should also be considered. One of the more consequential provisions of 2017 tax reform – the $10,000 cap on state and local tax (SALT) deductions – is extending its reach into estate planning. Before tax reform, it was beneficial to set up a trust as a defective grantor trust, allowing the grantor to pay the income tax (federal and state) on the trust assets thereby allowing the trust to grow tax free. Although this is still a benefit, for some high tax states, the SALT cap has increased the cost of this planning idea. One consideration would be to set up a trust as a nongrantor trust in a state that does not tax nongrantor trusts. Although the gift tax transfer benefit would be lost, it would save state income taxes on trust assets where there is no longer a deduction. Note that this may not always work—for example, a DC resident setting up a nongrantor trust in Delaware may still be taxed in DC. In addition, if the beneficiaries live in a state with tax, any distributions would still be taxable to them.

Revisiting the estate planning as the family grows: Due to portability, couples no longer have to each have enough property in their separate names to take full advantage of the estate and gift tax exemptions that are in effect. However, portability does not apply to the generation skipping transfer (GST) tax exemption, so putting property in separate names may still be beneficial for those wanting to engage in GST planning. In addition, portability may also not be available in every state that imposes a separate state level estate tax. A review of asset ownership can help you determine whether lifetime gifts or transfers between spouses or partners can occur.

How PwC can help

PwC’s Estate and gift tax planning is updated annually. Find information on family and business taxes, investment and insurance planning, and options and tax-savvy alternatives for giving to charity. A thorough discussion of choices and tax implications relating to estate and gift planning is also included, as well as insights on the myriad tax issues stemming from cross border activities, including residency nuances. The Guide also covers topics relating to setting up and maintaining a family office.

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