Hughes Hubbard & Reed

Recent Changes to the Federal Estate and Gift Tax Law

Client Advisories

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January 2, 2018 - On December 22, 2017, President Trump signed into law H.R. 1, the latest tax bill, which will result in significant changes to the taxes imposed on our clients' estates and lifetime gifts, as well as personal income taxes. Below is a summary of some of those changes.

Estate and Gift Taxes

Under the new law, effective January 1, 2018, each person is granted an exemption from payment of United States gift tax and, to the extent not applied toward gift tax, United States estate tax. The exemption effectively shelters from gift or estate tax the total amount of transfers of property by a person to individuals and trusts (other than certain transfers to or in a qualifying trust for a spouse or to or in trust for one or more charitable entities) of up to an aggregate amount of $11,200,000. This exemption amount is twice the amount which would have been applicable in 2018 under the law in effect prior to passage of the new law. The exemption amount is indexed for inflation and will rise each year it is in effect.

Absent additional legislation, the new exemption amount will terminate on December 31, 2025 and revert thereafter to the unified credit amount in effect prior to enactment of the new law ($5,000,000 indexed for inflation after 2011).

For purposes of application of the exemption amount to gifts and estates, the market value of the property transferred as of the date of a gift or the date of death or other valuation date for an estate will apply.

The new law also doubles in size the exemption amount for generation skipping transfers ("GST") which may be made to persons (or trusts for the benefit of persons) who are of the same generation (or for tax purposes are deemed to be of the same generation) as a donor's grandchildren or more remote issue. The exemption amount for 2018 will be $11,200,000, the same amount as the exemption for gift and estate tax purposes, and, like the exemption amount for gift and estate tax purposes, will adjust annually for inflation. Absent additional legislation, on December 31, 2025, the generation skipping transfer tax exemption amount will revert to the level in effect prior to enactment of the new law ($5,000,000 indexed for inflation from 2011).

Taxable transfers which exceed the exemption amount then in effect will be subject to payment of tax at the rate of 40% under any of the gift tax, estate tax or generation skipping transfer tax provisions of the new law. This is the same rate as in effect for 2017.

The new law continues to provide for the "annual exclusion" for gift tax purposes. This is the amount a taxpayer can give to each individual or entity ("donee") each year without applying any of his or her federal gift tax exemption to the transfer or paying any federal gift tax on the transfer. Effective January 1, 2018, the annual gift tax exclusion amount will increase to $15,000.

It is recommended that each client review his or her current estate and lifetime gifting plan, as well as applicable current state estate tax laws, in light of the tax changes summarized above, and especially since the increased exemption amounts are temporary. Some possible adjustments that could save taxes include making additional gifts to individuals and trusts, decanting existing non-GST exempt trusts to make them partly or entirely GST exempt, selling appreciable assets to trusts, and establishing and funding spousal access trusts. These techniques, amongst others, move future appreciation of transferred assets outside of one's taxable estate thereby reducing the exposure to transfer taxes at death. The increased exemption amounts allow for greater assets (and therefore a greater amount of appreciation) to be shifted outside of the federal transfer tax system.

Personal Income Taxes

The new law changes a number of the Internal Revenue Code provisions governing income taxation of individuals. All of these changes are effective for 2018 and each future year thereafter until December 31, 2025, absent a further change in the law. After December 31, 2017, the percentage limit for allowable deductions for charitable contributions of cash to public charities has been increased to 60% of a taxpayer's adjusted gross income.

Under the former law, taxpayers could deduct certain miscellaneous itemized deductions to the extent they exceeded 2% of the taxpayer's adjusted gross income. The new law suspends all such deductions effective after Dec 31, 2017.

The deduction for home equity indebtedness is suspended effective after Dec 31, 2017. The new law also allows taxpayers with existing mortgages to continue to deduct interest on a total of $1 million of mortgage indebtedness for a first and second home, but for new buyers, the permitted deduction drops to interest on a total of $750,000 of mortgage indebtedness.

Certain business income that is taxed at the individual rates of the business owner rather than through the corporate tax structure, also known as "pass through" income, can now take advantage of a 20% deduction under the new law. Entities that produce pass through income include limited liability companies, sole proprietorships and partnerships. As a result, qualifying persons may wish to consider establishing such an entity to take advantage of this new deduction.

The new law limits the deductions allowable for state and local taxes (property and income taxes), providing an exception to this limitation that allows individuals to claim a deduction of up to $10,000 on state and local taxes which would otherwise not be allowed. This change is effective after December 31, 2017. Due to the varying nature of state and local taxes, individuals may wish to consider changing their domicile to another state with lower income taxes as well as establishing an incomplete non-grantor trust "("ING"). INGs are not permissible for New York residents. For an individual residing in a state which levies an income tax (other than New York), an ING is a trust for such individual's own benefit which avoids state income taxation on the assets held thereunder without incurring a gift tax or using any gift tax exemption on funding.

Finally, the new law will likely affect each individual's income tax rates; while it retains the existing seven tax brackets, the rates and income levels at which taxpayers will have to pay federal income taxes have changed. The law keeps the lowest bracket at a 10% rate, but reduces the highest bracket from 39.6% to 37%. This reduction applies in 2018 to single individuals and heads of household with an annual income of $500,000 or more, married couples filing jointly with a joint annual income of $600,000 or more, and married couples filing separately with individual annual incomes of $300,000 or more. The rate reduction is temporary and scheduled to return to the 2017 rates after December 31, 2025.

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