Top 10 Estate Planning Tax Facts for 2019 You Need to Know

(Expanded version)

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Although every client should review his or her estate planning strategy on a fairly regular basis, after a major tax overhaul, it's important for clients to take an even more detailed look at the various elements of their estate plans.

For some clients, this will require evaluating changing circumstances and future goals to determine whether existing trusts and other planning strategies continue to make sense in light of tax reform. Here are the top issues that clients may need to consider in 2019.

1. Enlarged Estate Tax Exemption

The 2017 tax reform legislation roughly doubled the transfer tax exemption to $11.4 million per individual, or $22.8 million per married couple, as adjusted for inflation in 2019 (the 2018 exemption was $11.18 million per person). Because the transfer tax exemption exempts both transfers at death and transfers made during life from estate, gift and GST taxes, the expansion has created an opportunity for wealthy clients to shield an even greater portion of their wealth from eventual taxation.

2. IRS Confirms: No Clawback for Post-Reform Transfer Tax Exemption

For transfer tax purposes, the IRS has released guidance confirming that clients will be allowed to make large gifts from 2018-2025 (when the expanded $11.4 million-per person transfer tax exemption is in place) without fear of any kind of "clawback" if the client dies in a later year, when the exemption is lower. This means that clients can take steps to use up the entire $22.8 million per-married-couple transfer tax exemption between 2019 and 2025 without any fear that they will be subject to transfer tax liability for those gifts in later years.

3. Inheriting an IRA

If a client inherits an IRA, the distribution requirements depend upon whether the client-beneficiary is a spouse or non-spouse beneficiary. A spousal beneficiary has the option of rolling the funds into an inherited IRA or his or her own IRA, and can wait to begin taking RMDs until reaching age 70 1/2. A non-spousal beneficiary cannot wait until age 70½ to begin taking RMDs—he or she must either withdraw all funds within five years or based upon his or her life expectancy. RMDs will depend on whether the original owner died before or after his or her required beginning date.

4. Inheriting Qualified Plan Funds

While inherited IRAs often may be distributed over time, qualified plans (such as 401(k)s and profit-sharing plans) do not allow the funds to be distributed over the beneficiary's life expectancy. When a client inherits a 401(k), the funds typically must be distributed immediately in a single lump sum payment, resulting in an immediate tax liability for the beneficiary. Most plans will specifically require lump sum distribution treatment because of the administrative burdens associated with allowing stretched out distributions. Fortunately, designated beneficiaries of qualified plans have the ability to roll those funds into an inherited IRA. Because of this, clients should regularly review their beneficiary designations on qualified plans.

5. Formula Trusts Should Be Reevaluated Post-Reform

Many clients have used so-called "formula trusts" in their estate planning to take advantage of the full transfer tax exemption, which changes each year. Like many other estate planning techniques, these trusts will need to be reevaluated in light of the increased estate tax exemption amount. A particularly problematic issue may arise when the formula in the plan directs that assets up to the exemption amount will be placed into a credit shelter trust, with the remainder placed into a marital trust designed to take advantage of the marital deduction. With the enlarged estate tax exemption, some clients may find that no assets will remain to be transferred to the marital trust. This can present a problem if the surviving spouse is not also the beneficiary of the credit shelter trust (for example, if the decedent's children are beneficiaries of that trust).

6. Portability Remains Possible Post-Reform

Portability simply allows a surviving spouse to make use of both his or her individual federal estate tax exemption and the exemption granted to a first-to-die spouse. The portability rules were not changed by tax reform. This generous estate tax exemption, however, can often cause a problem for surviving spouses when the entire estate of the first-to-die spouse is sheltered from estate tax. Clients and advisors alike commonly overlook a key requirement for obtaining the benefits of portability: you have to ask for it. Even if no estate tax is due upon the death of a first-to-die spouse, the executor of the estate must elect portability by filing an estate tax return on Form 706 within nine months of death, although an extension (requested by filing Form 4768) may be available if the executor can show good cause.

7. Reevaluating SLAT Trusts

A spousal lifetime access trust (SLAT) can potentially be useful in allowing clients to take advantage of the full transfer tax exemption before it expires after 2025. A SLAT is an irrevocable trust that can potentially allow a client to remove assets from his or her estate while also maintaining access to those assets during life. To fund a SLAT, a married client transfers assets into the irrevocable trust for the benefit of his or her spouse. An independent trustee is appointed to oversee the trust (adult children may serve as trustee so long as a concrete, ascertainable standard exists for trust distributions). The gift to the irrevocable trust removes the assets from the client’s estate, but allows the spouse to access the trust assets if necessary. The strategy allows the client to retain a degree of control over the assets, and also puts the assets out of the reach of creditors. However, the risk of divorce must also be considered—once the client creates the SLAT, if he or she divorces the spouse, the client could lose control of SLAT assets.

8. ING Trusts: Complete vs. Incomplete Gift Strategy

An ING trust is an intentionally non-grantor trust (or an irrevocable non-grantor trust) that is primarily designed to generate income tax savings, but can add value from an estate planning perspective in light of the temporary nature of the enlarged estate tax exemption. Central to the ING trust strategy is the presence of an "adverse party"—or a group of adverse parties—who control trust distributions to beneficiaries. Gifts to the trust can be either incomplete, allowing the trust creator to retain a degree of control over the assets and avoid gift taxes, or complete—meaning that the transfer would create a deduction from the client's lifetime transfer tax exemption amount. For transfer tax purposes, the calculus on whether a complete or incomplete gift to the ING trust is most beneficial has changed post-reform—primarily because the IRS has confirmed that there will be no clawback of the currently high transfer tax exemption.

9. State-Level Estate Taxes Remain an Issue Post-Reform

Despite the generous federal-level transfer tax exemption, states that continue to impose their own estate taxes have largely decided against matching the federal exemption. Washington, D.C., determined that its exemption would remain at the $5.6 million level, while Hawaii kept its exemption at $5.49 million (the same as the federal exemption amount in 2017). In Maryland, the legislature decided to fix its exemption at $5 million for 2019 and beyond, although the state also adopted a portability regime that matches the federal portability rules to allow a surviving spouse to take advantage of his or her deceased spouse's exemption. These changes are important, because they highlight the continued need for estate planning guidance for higher income clients who reside in states that continue to impose estate or inheritance taxes.

10. $11.4 Million Exemption Is Only Temporary: Flexibility Is Key

Finally, in all of their planning, clients should consistently be reminded that the $11.4 million per individual transfer tax exemption (as adjusted for inflation in 2019) is only temporary. After 2025, it is set to revert back to the pre-reform levels of around $6 million per individual, factoring in anticipated inflation adjustments. Clients should also be reminded that in reality, everything in the tax code is temporary—as political winds shift, so can tax rules that have been labeled as permanent. Because of this, flexibility is always key to the success of any estate planning strategy.

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