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The Tax Cuts and Jobs Act: Estate and GST Taxes Repealed; Retirement Accounts Remain Unaltered

WEALTHCOUNSEL INSIGHT BRIEF | NOVEMBER 2, 2017

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On November 2, 2017, Republicans in the House of Representatives released their version of a tax reform bill: The Tax Cuts and Jobs Act (the "GOP Act"). It is the first draft of what could be the most comprehensive tax code revision in decades. It is also the first detailed iteration of the broad-stroke proposals contained in the Unified Framework for Fixing Our Broken Tax Code ("Unified Framework"), released by the Trump Administration on September 27, 2017.

The GOP Act in its current form is still subject to revision, even before it goes to a vote, and is only the beginning of what is sure to become a legislative battle involving not only Republicans and Democrats, but also special interest groups.

As anticipated, the GOP Act is extensive and requires scrutiny to fully understand its provisions and their impact, as well as their correlation with the other provisions of the Internal Revenue Code ("Code"). This Insight Brief discusses the feature most likely to interest estate planning attorneys: The repeal of the estate and generation-skipping transfer ("GST") taxes. It also discusses the omission of the feared changes to retirement accounts from the GOP Act.

Repeal of Estate and Generation-Skipping Transfer Taxes

Every major Republican tax reform proposal for the past eighteen months has included estate tax repeal. Estate and GST tax repeal were included in some form in Tax Reform Task Force Blueprint created by House Republicans in June 2016, in President Trump's campaign tax plan, in the Trump Administration's April 2017 tax reform plan, and in the Unified Framework. The GOP Act is the first piece of major legislation resulting from those proposals.

The GOP Act repeals both the estate and GST taxes for decedents dying and generation-skipping transfers occurring after December 31, 2023. In the interim—between January 1, 2018, and full repeal—the GOP Act doubles the basic exclusion amount from $5 million to $10 million (adjusted for inflation after 2010 in both cases). If the GOP Act becomes law, an individual could transfer $11.2 million (up from the $5.6 million scheduled for 2018 under current law) of assets free from estate and GST tax in 2018, and even more thereafter until full repeal because of the annual inflation adjustment.

The drastic increase in exemption amounts would mean that very few people would have estate tax concerns after 2017. Currently, only 0.2% of estates are taxable. With the exclusion amount doubled, the number of taxable estates will be drastically reduced even further, effectively repealing the estate and GST taxes for practically all Americans as of January 1, 2018.

One function of the gift tax is as a backstop to the income tax system. It serves this purpose by discouraging taxpayers in higher income tax brackets from transferring income-producing or low-basis property to other taxpayers in lower income tax brackets as an income tax reduction strategy. The GOP Act leaves this protection in place. The gift tax remains in effect for taxable lifetime gifts even after the repeal of the estate and GST taxes under the GOP Act, but with two important changes. First, it lowers the maximum gift tax rate to 35 percent for gifts made after December 31, 2023. Second, the increase in the basic exclusion amount described above will continue to apply to taxable gifts after 2024. Taken together, these changes effectively eviscerate the gift tax for most people.

The GOP Act is also notable for two things that it did not do. First, the GOP Act did not replace the repealed estate and GST taxes with a capital gains tax. President Trump's campaign tax proposal would have replaced the estate and GST taxes with a capital gains tax on any unrealized appreciation in assets in excess of $10 million that are acquired from a decedent. No mention of this is made in the GOP Act. Second, unlike the Economic Growth Tax Relief Reconciliation Act of 2001 (EGTRRA), the GOP Act does not disturb the current basis adjustment for property acquired from a decedent under Code § 1014. If enacted, many estate tax driven plans, particularly those including trusts utilizing AB or marital/credit-shelter formulas and discount-driven planning tools like family partnerships or family LLCs, will need to be revisited.

No Changes to Treatment of Retirement Accounts

There has been much contention surrounding proposals to change the current retirement plan structure, which were intended to increase federal income tax revenue on an immediate short-term basis. Fear and debate stemmed from the 2016 Retirement Enhancement and Savings Act ("RESA") that passed with a unanimous 26 to 0 vote out of the Senate Finance Committee.

Among other controversial provisions, RESA included a proposal to severely limit the "stretch" retirement account rules for non-spouse beneficiaries. Currently, non-spouse beneficiaries are entitled to stretch out the distributions from a 401(k)/IRA over their life expectancy. This is generally preferred to a lump sum distribution because of the tax-deferral benefits. Under RESA, the deferral would have been limited to a five-year payout for accounts exceeding $450,000, potentially rapidly accelerating an income tax burden that could have been deferred under current law.

In addition, Republican members of Congress were considering a proposal to cap contributions made to retirement accounts to $2,400 annually, which is a significant drop from the current $18,000. This substantial reduction would greatly impact the amount of pre-tax dollars Americans could save. The anticipated result of such a cap would have been a massive shift to Roth accounts, which are funded on a post-tax basis.

Although the Unified Framework failed to address any specific changes to the treatment of retirement accounts, some changes were, nonetheless, generally contemplated. However, even though the GOP Act broadly tracks the proposals laid out in the Unified Framework, there is no mention whatsoever of plans to change anything in the retirement arena. This undoubtedly comes as a major relief to many Americans and is in line with the President's assertions throughout this tax reform discussion that no changes will be made in this regard.

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Conclusion

In the media and from political opponents, the GOP Act is already being met with much of the same criticism as the Unified Framework: That it disproportionately favors wealthy Americans, in spite of its being touted as middle-class tax relief. That said, it is fairly certain that the GOP Act will morph several times prior to reaching its final form.

While we wait and see its progression down the legislative pipeline, we must also keep in mind the question of its permanency as a result of the Byrd Rule. Named after Democratic West Virginia Senator Robert Byrd, the Byrd Rule allows Senators during the Reconciliation process to block legislation if it possibly would increase significantly the federal deficit beyond a ten-year term. This would mean a potential sunset of the ultimate tax reform legislation ten years after it becomes effective—ostensibly, next year. The 2010 sunset of EGTRRA is an example of the Byrd Rule at play. It is still too soon to ascertain how the Byrd Rule will impact the GOP Act.

WealthCounsel will continue to track the GOP Act and provide attorneys with the latest information about its progress. Future publications will discuss other features of the GOP Act, including business reforms and the reduced rates that would apply to pass-through entities like partnerships, limited liability companies, and S corporations.

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