



NAEPC

Journal of Estate & Tax Planning

[Click here to view the Second Quarter 2014 Issue](#)



Estate Planning in 2014 and Beyond*

***Originally published in the WealthCounsel Quarterly, April 2014**

By Jonathan A. Mintz, Partner Matsen Voorhees Mintz LLP

Times have changed. In fact, passage of the American Taxpayer Relief Act of 2012, signed into law January 2, 2013 (the 2013 Tax Act) turned the world of estate planning upside down. If you think that's an exaggeration, consider the significant changes brought about by the 2013 Tax Act. After examining those changes, this article will explore the resulting changes we should consider as a result of this act.

The 2013 Tax Act: Emphasis on income tax planning

First, as we all know, the 2013 Tax Act established a "permanent" federal estate tax exemption of \$5 million per person, indexed for inflation (in 2014, \$5.34 million or \$10.68 million for a married couple). This higher exemption amount means approx. 99.8% of all Americans will not be subject to the federal estate tax. One critical component is the index for inflation; estimates are that the exemption will increase to nearly \$7 million per person in 10 years, and over \$9 million per person in 20 years. (Of course, this law is permanent only as long as Congress does not change it.)

At the same time, the maximum rate for the federal estate tax fell from 55% a few years ago to only 40%. Contrast this with the increase in income tax rates, which for high income earners increased by double-digit percentages as a result of the 2013 Tax Act. First, the maximum federal rate increased from 35% to 39.6%, a 13% increase. However, once we factor in the ObamaCare surtax of 3.8%, the maximum federal rate increased from 35% to 43.4%, a whopping 24% increase! When we also factor in personal exemption and itemized deduction phase outs, plus state income tax rates, the differential between income tax and estate tax rates is even more striking. Here in California, the top marginal combined federal and state income tax rate exceeds 57%!

Second, recall that 99.8% of all Americans are no longer subject to the federal estate tax. However, all Americans are subject to income tax, whether at their individual rates (e.g., for trust distributions and LLC or partnership earnings), or worse, the maximum federal rate at only \$12,120 of undistributed net income for trusts.

Capital gain rates, while not as high as ordinary income tax rates, increased by a whopping 59% on the federal side alone and are now also more important than the estate tax for most Americans. Thus, it is critically important that we consider income taxes when we plan for our clients, including drafting basic wills and trusts.

Drafting Considerations

For decades, estate planners drafted to eliminate the estate tax by funding the credit shelter trust with the maximum amount that could pass free of estate tax. This made sense with the significantly lower exemption amount and relatively high estate tax rates. In the new world, however, this no longer makes sense for most Americans.

Marital Share Funding Options

What should we do? First, we should consider options that provide the greatest degree of flexibility to address income tax **and** estate tax to the extent necessary. For some, this means marital disclaimer funding provisions that fund the credit shelter trust only to the extent of disclaimed assets. However, in our office we're reluctant to rely on disclaimers to effectuate planning. Moreover, our non-taxable estate clients generally have at least several million dollars of assets, and thus they are also concerned with asset protection. Therefore, we frequently use the Clayton QTIP option, electing QTIP treatment via the filing of a 706 at the death of the first spouse to die. If the client is otherwise subject to estate tax, we can choose to not elect QTIP to fund a credit shelter trust, always mindful that the credit shelter trust assets will not get a step up in basis at the second death (note, however, the WealthDocx option discussed below can solve this problem **if** the provision is included in the trust). The downside, of course, is the need to file a 706 to elect QTIP treatment, but given that we must timely file a 706 to elect portability we believe that we are getting additional flexibility at little additional cost to the client.

What if we need the step up in basis or don't opt out of QTIP treatment? The temporary regulations tell us that we can use portability to apply the deceased spouse's unused exclusion amount (DSUEA) to transfers (ideally to an irrevocable trust) made shortly after the death of the first spouse to die, ensuring that it's not subsequently lost due to remarriage. But recall that the federal generation-skipping transfer tax (GSTT) exemption is not portable; thus those who wish to pass wealth to future generations should not rely on portability.

While we practice in a state that does not have a state estate tax, those with a state estate tax could use this strategy to fund a credit shelter trust in the amount of the state's estate tax exemption, thereby eliminating state estate tax at the death of the first to die. (To my understanding only DE and HI offer portability for their state estate tax.)

For many of our clients, we frequently incorporate the safety net of either a testamentary Charitable Lead Trust (TCLAT) or other charitable strategies into their base planning. For those who are well above the exemption amount and who likely will be subject to estate tax, we're continuing to make lifetime transfers to avoid the estate tax. However, we're leveraging those transfers to the extent possible, and doing so mindful of the above income tax issues, often

using assets the client does not want sold in the future (e.g., family cabins, etc.) or those that can be substituted for cash or other high-basis assets after the death of the surviving spouse.

Elect to Treat Capital Gains as Income

Finally, we should also strongly consider the option in WealthDocx to treat capital gains as income for purposes of distributable net income (DNI), so that capital gains are not trapped and taxed at the compressed rates for trusts. There remains the conflict between keeping assets in trust for asset protection reasons and minimizing the tax on trust income, but at least we can include capital gains in DNI if we are making distributions, ideally to a beneficiary in a lower tax bracket.

Existing Estate Plans

The above leads us to conclude that ***all*** estate plans drafted before 2013 should, at a minimum, be reviewed and in many instances should be restated or amended to incorporate additional flexibility for income tax planning. Fortunately, several years ago WealthCounsel added a provision that gives either an independent trustee or a trust protector the power to grant a general power of appointment to a credit shelter trust beneficiary, thereby effectuating a step-up in basis for credit shelter trust assets. But particularly for trusts created before this provision was added, or those not created by WealthDocx, they should potentially be revised to reflect this new paradigm.

Non-Tax Reasons for Planning Continue

The non-tax reasons for estate planning continue after the 2013 Tax Act. These include:

- Planning for the orderly disposition of one's financial and non-financial wealth
- Disability planning
- Bloodline/divorce protection
- Creditor protection
- Spendthrift protection
- Special needs planning
- Probate avoidance
- Charitable planning
- Retirement planning
- Business succession planning

Conclusion

Estate planning remains a critical need for many Americans, particularly since approx. 70% of Americans have no estate plan (other than their state's "default" plan). However, with higher income tax rates, income tax planning has replaced estate tax planning as a motivator for many clients. Thus, in our firm we've honed our skills to help clients defer, reduce, and in some cases eliminate capital gain and ordinary income tax in multiple contexts. While a discussion of these strategies is beyond the scope of this article, my partner Tim Voorhees and I will discuss several of these strategies at our breakout session at the Planning for the Generations Symposium this July in Denver. We hope to see you there. Questions about this article should be directed to the author at JMintz@MVMLawyers.com.