Uncertainty in tax law is nothing new for estate planners, who in recent years have seen significant changes to the rules affecting their practice, including temporary repeal of the estate tax in 2010. Both major current reform proposals — by President Donald Trump and by House Republicans — would place the estate tax back on the chopping block. Both would also likely eliminate the generation-skipping transfer (GST) tax, although only the House Republican plan specifically calls for GST tax repeal.

Estate tax repeal could mean changes in the income tax to replace the lost revenue. On the campaign trail, Trump floated the idea of imposing a tax on capital gains on appreciated assets held until death, though the details were not clear (a document on Trump’s website at the time stated that “capital gains held until death and valued over $10 million will be subject to tax to exempt small businesses and family farms”). However, that provision was not included in his April 26 tax reform outline, which referred to only repeal of the “death tax.” A related possibility often associated with estate tax reform — and that was included in the Republican-led legislation that repealed the estate tax in 2010 — is ending the policy of “stepping up” the basis of appreciated assets in an estate at death to fair market value, which reduces future income taxes for heirs when they sell or dispose of those assets. In other words, an alternative to the current basis step-up would be to carry over the decedent’s basis, generally resulting in capital gains tax when the heirs eventually dispose of the assets. It was not clear if the plan floated by Trump during the campaign would have imposed the capital gains tax at death or at the heir’s later disposition. Some assumed that the Trump proposal would have continued the stepped-up basis for assets exempted from the new capital gains tax.

Little has been said so far about the gift tax, but given the sweeping nature of the current reform proposals, it could also undergo revisions. If it is repealed, lawmakers would likely have to come up with an alternative method of limiting the use of tax-free gifts to shift income, particularly with regard to capital assets. It is worth noting that the legislation that led to the temporary repeal of the estate tax in 2010 did not include gift tax repeal.

Even as we await the final decisions of lawmakers on tax reform, the need for estate, wealth and succession planning continues. Although the law has not yet changed, the task for planners and clients has grown more complicated, as they must consider all possible outcomes of the law when drafting new documents or amending old ones.
Bloomberg BNA Analysis

Republican proposals once again are targeting the transfer tax system for big changes, but beyond the general agreement that the estate tax should be repealed, there are few details about what will happen next. Not even the esteemed presenters at the 2017 Heckerling Institute on Estate Planning could agree on whether repeal would ultimately be included in tax overhaul legislation or on the likelihood of passage if it were. If the estate tax is repealed, will the Trump rumination on a capital gains tax at death be implemented? Will we return to a “modified carryover basis” regime, or will the repeal plan just go whole hog and continue to allow basis step-up at death? How will the gift tax change if it is going to serve not as a backstop to the estate tax but as a backstop to income tax collections?

And if reconciliation is used as the vehicle to drive any changes, we could be in for another 10-year saga of changes, tweaks, and sunsets that only serves to keep the tax bar at full employment as clients try to stay one step ahead of the lawmakers. Of course, it seems probable that any Democratic presidential nominee in 2020 would include restoration of the estate tax (potentially with a higher rate and lower exemption than in current law) in his or her platform.

It is also possible that the whole repeal concept could go off the rails entirely as members of Congress begin looking for sources of revenue to pay for the higher-profile business and individual reforms that are on the table in an effort to keep tax reform “revenue-neutral.” With the border adjustment tax declared dead by some and with the elimination of the interest deduction on life support, much of the added revenue in the House reform proposal has drained away. Could lawmakers decide that, although the revenue raised by the estate tax is small, keeping the tax (perhaps with some changes relating to easing any burden on family farms or small businesses) allows them to come through on some of the most popular proposals that are likely to turn into votes on Election Day? (Polling still shows that tax cuts are popular with the voters.) We still have to wait and see.

Life After the Estate Tax

With the gradual increase in the estate tax exemption since 2001, only about 0.2 percent of all estates currently pay any estate tax, according to the Tax Policy Center. In recent years, many wealth planners have shifted their focus in planning for clients to income tax issues and other non-tax factors, such as how to protect assets from divorce, creditors and litigation. Those issues will remain relevant even if the estate tax is repealed.

Focus on retirement accounts. Discussing the typical matters he reviews with his clients, Richard Behrendt, director of estate planning services for Annex Wealth Management, said, “With very few exceptions, you look at their balance sheet and their biggest assets are retirement accounts – IRAs, 401ks.” The complexities of “trying to preserve the tax-deferred growth as you pass that to a spouse or children is really an important part of that typical family’s planning.”
Income tax savings. “Such repeal could result in a greater emphasis on obtaining income tax savings for charitable planned gifts instead of estate tax savings. One type of inherited property that will most likely remain subject to income tax is income in respect of a decedent. The primary assets in this category are qualified retirement benefits and individual retirement accounts. Neither type of asset is subject to income tax on the death of the participant; rather each type is subject to income tax when withdrawn by the beneficiary. While there has always been a special tax advantage associated with leaving retirement accounts to charities (and thus avoiding income tax on withdrawal), with the repeal of the estate tax, there would be an added incentive to consider the use of such assets for charitable bequests if the donor is interested in obtaining tax savings resulting from the donor’s charitable bequests.” – Kirk A. Hoopingarner

Drafting for All Possibilities
While lawmakers work to agree on how to reform the tax code, practitioners and clients must continue planning for the future. Existing plans may need to be amended and future documents drafted with provisions that take into account the potential for changes in the law.

Loss of capacity. “A common issue when tax laws are in flux is what happens if a client, due to aging, health challenges or injury, loses the capacity to execute a new document? It is certainly the theoretically preferable approach to revise documents now to provide more flexibility to deal with various possible outcomes.... If repeal in fact occurs, how will the provisions of wills, revocable trusts, and irrevocable trusts be interpreted in an environment that may not have been contemplated at the time of drafting (and that still remains uncertain)? A better plan may be to have a funded revocable trust created and give the independent protector the power to modify disposition on account of tax law or other changes.” – Jonathan Blattmachr, principal Pioneer Wealth Partners and member, Bloomberg BNA Estates, Gifts and Trusts Advisory Board, and Martin M. Shenkman, founder, Shenkman Law

The Future of the Discount Valuation Regulations
Even if the estate tax remains on the books, recently proposed valuation regulations may be on their way out. The proposed regulations (REG-163113-02), issued toward the close of the Obama era, were intended to stem perceived abuses in valuing interests in closely held entities, particularly those that held marketable securities such as stocks and bonds that are publicly traded. A key focus was the use of restrictive provisions in organizing documents and other agreements between owners that would command valuation discounts.
when applied to an outside “hypothetical buyer” of an interest, but that could be lifted by the family members who actually inherit or receive the interests being passed on. However, the regulations have generated strong protests from family businesses and conservative lawmakers, who say the rules are too broad.

**A quick fix.** An exemption for closely held businesses “would make most of the objections to these proposed regs go away,” said Catherine V. Hughes, estate and gift tax attorney-adviser in the Treasury Department’s Office of Tax Policy, speaking January 20 at the American Bar Association Section of Taxation’s midyear meeting in Orlando, Florida. That was one of the “big points” that came out of the December hearing on the rules, “so we will take that into consideration.”

**Relief for Large Family Farms**
Trump signed an executive order on April 25 establishing an interagency task force on agriculture and rural prosperity to improve the U.S. rural economy by considering changes to current regulations and taxes. The order instructs the task force – which includes Treasury Department Secretary Steven Mnuchin – to identify legislative, regulatory and policy changes to “promote the preservation of family farms and other agribusiness operations as they are passed from one generation to the next, including changes to the estate tax and the tax valuation of family or cooperatively held businesses.”

**What the numbers say.** The issue of small businesses and family farms is a complete lie frankly,” said Eric Schoenberg of the pro-estate tax group the Patriotic Millionaires. “Nobody has been able to actually identify any farms — small family farms — that have had to be sold as a result of the estate tax.” For the 40 percent estate tax to apply, an estate in 2017 would have to be worth more than $5.49 million for an individual and almost $11 million for a couple.

**Advising on Donor Advised Funds**
Tax reform efforts could involve changes to donor advised funds, which some lawmakers have targeted as a possible area of abuse.

**Potential for change.** “Despite substantial evidence to the contrary, there is a concern that individuals are able to accumulate vast sums in these funds while obtaining substantial charitable tax deductions, instead of giving to charities. Thus, there is a strong likelihood of future legislation being enacted to force increased current distributions from such funds similar to required qualified distributions from private foundations. When advising clients on the formation and further funding of donor advised funds, one should acknowledge that various compliance rules (many of which are appealing to donors considering such donor advised funds) may likely change in the future.” – Kirk A. Hoopingarner, partner, Quarles & Brady LLP
The Cost of Charitable Giving

The tax reform plans of both Trump and the House Republicans would preserve the deduction for charitable giving, but they also contain provisions that would decrease the number of taxpayers who would benefit from itemizing – and thereby benefit from the charitable deduction. The House Republican plan would double the standard deduction, raising it to $12,000 for individuals and $24,000 for married couples filing jointly. That would mean only 5 percent of taxpayers would continue to itemize their returns, according to practitioner estimates.

Effect of estate tax repeal. A 2004 study by the Congressional Budget Office “concluded that eliminating the estate tax would result in a reduction of amounts bequeathed to charity, with donations decreasing by 6 percent to 12 percent. The net effect of losing estate tax savings would be to increase the effective cost to a donor’s family of leaving substantial sums to charity.” – Kirk A. Hoopingarner

Bloomberg BNA Analysis. It will be interesting to see what projections will say about the reform proposals that have been floated. Many people who do not itemize under the current regime still give to charity and do so for reasons unrelated to the deduction. As a result, the proposed increase in the standard deduction may have less impact on charitable giving than some believe. In addition, the large-dollar donors who are responsible for most charitable fundraising will probably be among the taxpayers who continue to itemize. Such donors are more likely to be impacted by the estate tax plans. To that end, one hopes the CBO will update its 2004 study on the impact of estate tax repeal on donations. We now have hard data from the past decade that can be employed to determine what the actual impact the increased exclusion amounts and spousal portability provisions have had on donations and the fundraising efforts of the charitable sector. Do the data support the CBO’s original projections, or might the impact of repeal in 2017 be smaller than earlier efforts were likely to be?