CALLAN CAPITAL

# WHY YOU (STILL) NEED AN ESTATE PLAN

## What families need to know about estate planning changes

## + ESTATE PLANNING CHANGES

In 2018, the current administration signed a new tax legislation into law, which includes a higher estate, gift and generation-skipping transfer tax exemption of $11.18 million per individual. These new lifetime exclusion amounts might make some married couples, who have a taxable estate lower than $22.36 million, question whether they still need an estate plan.

First, let's discuss what has changed for 2018. In 2017, the Federal Estate Tax Exemption amount was $5.49 million for an individual or $10.98 million for a married couple. This means a married couple could leave their children a $10.98 million-dollar estate without paying a federal estate tax on that amount. However, if the second spouse to die passes away with an estate in excess of $10.98 million, that estate would be subject to a 40% estate tax on every dollar over $10.98 million dollars (CA & TX do not have state level estate or inheritance taxes but some states have one or both). The new Tax Cuts and Jobs Act that came into effect this year increased the Federal Estate Tax Exemption to $11.18 million for an individual and $22.36 million for a married couple. With this massive increase in the federal exemption amount, very few married couples would need to pay a federal estate tax upon the death of the second spouse. All of that said, there are significant non-tax reasons for married couples to have an estate plan.

## + NOT ONLY ABOUT TAXES

Aside from helping minimize the 40% estate tax on estates over $22.36 million dollars, an estate plan can accomplish many other goals, such as avoiding a public (estate appraisal and inventory), lengthy (six months to two years) and expensive (probate fees averaging 5% of the total estate value) probate process in states like California. Even in Texas where the probate process is private (affidavit may be filed in lieu of an inventory), efficient (six months to one year) and inexpensive (attorney fees and nominal court costs), there simply remains no better form of asset protection than an irrevocable trust. Most estate plans are written so that upon the death of the second spouse, the family's assets will be held in an irrevocable (i.e. can no longer be modified or terminated) trust for the benefit of children (and/or other beneficiaries), thereby insulating the trust assets from the reach of creditors and possible future divorcing spouses. Tax savings, control over asset destination and the opportunity for charitable giving all result in peace of mind.

Depending on a family's net worth, certain estate planning techniques may be more or less relevant than they were before the new tax law changes. Many affluent families implemented a Credit Shelter Trust (also known as an A/B Trust) to take advantage of the then current estate tax laws. In 2011, portability was enacted which allows the surviving spouse to use any remaining portion of the deceased spouse's Federal Estate Tax Exemption for their own estate. For many couples, this negated the need for the traditional A/B Trust, but for affluent families, the A/B Trust remained a good planning tool to freeze future asset appreciation out of the surviving spouse's estate. With the recent tax law changes, it is critical that you and your family evaluate your current estate plan to ensure it is still meeting your needs. Traditional Credit Shelter Trusts were very valuable when the estate tax exemption was much lower. The original intention of this trust was to allow couples to reduce their estate tax burden by creating and funding an irrevocable trust upon the first spouse's passing. Generally, this irrevocable trust was funded with the estate tax limit for the year in which the first spouse passes. This allowed for the deceased spouse's estate to take advantage of the full exclusion amount and for that amount to grow outside of the surviving spouse's estate.

Credit Shelter trusts, however, are not without disadvantages. Primarily, the amount placed into the irrevocable credit shelter trust do not receive a second step up in basis when the surviving spouse passes away. Also, in a Credit Shelter Trust, the surviving spouse might receive income from trust but not have direct access to the principal (which is why the trust was not included in his/her estate). Since this trust is not included in his/her estate, the value of that trust is not eligible for a step-up when that surviving spouse passes away (this is the trade-off). Furthermore, these types of trusts can contain provisions that make funding mandatory. Therefore, under the new tax laws, this irrevocable trust could end up being funded unnecessarily since the exclusion amount is now double what it was when the estate plan was originally written. This could limit the surviving spouse's access to funds needlessly while creating the extra burden of managing an irrevocable trust.

A Disclaimer Trust may be an alternative worth considering in this new estate tax environment. This trust allows the surviving spouse to elect to create and fund a credit shelter trust upon the first spouse's passing, but does not make it mandatory. The major downside associated with a Disclaimer Trust is that the surviving spouse must affirmatively elect to create the Credit Shelter Trust within a 9-month window. If they fail to do so, a potential tax planning opportunity may be missed. Furthermore, a Disclaimer Trust puts the control in the surviving spouse's hands, which means this might not be a good alternative for guaranteeing that assets pass to children from a prior marriage. This underlines the point that estate planning is often driven by a myriad of non-estate tax reasons such as probate avoidance, incapacity protection, providing for the next generation in an asset protection structure and keeping the surviving spouse from giving the decedent's share to a new spouse or someone besides who the decedent intended.

Estate planning is influenced by constantly changing legislation, which means it is important for individuals and families to review their estate plans on a regular basis. Even the most recent tax law changes are already scheduled to change, with the new tax law sunsetting at the end of 2025. In 2026, the estate tax will revert to its previous exemption base amount of $5 million, indexed for inflation annually. Therefore, even if you do not require complex estate planning today due to the unlimited marital deduction, portability (the which allows the surviving spouse to transfer the unused exemption of a deceased spouse to themselves) and the $22.36 million in total exemptions for a married couple, it does not mean you will not require it in the future. For families with significant assets, you should consider the opportunity to utilize the current exemption in order to remove assets from your estate today as well as the $15,000 annual gift tax exclusion and various income tax planning opportunities under the new tax laws.

Again, proper and regular estate planning is not only about estate taxes. It can accomplish many other goals such as avoiding probate, giving you control of where your assets go after you pass, creating privacy for you and your family, divorce protection and increasing your peace of mind. Even if your taxable estate is not over the new threshold, it's an important time to revisit your estate plan with your trusted advisors and make sure that it still accomplishes your family's unique goals.

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