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THE YEAR IN REVIEW
AN ANNUAL PUBLICATION OF THE ABA/SECTION OF INTERNATIONAL LAW

International Private Client Committee

FREDERICK K. SCHOENBRODT, II*

2018 saw important and substantial changes in the law governing the taxation of wealth transfer in the United States. Most notably, under the Tax Cuts and Jobs Act of 2017 (TCJA),[1] the federal estate and gift tax exemption increased in 2018 to $11,180,000 per person, indexed for inflation.[2] This is the amount that an individual can pass to beneficiaries other than a spouse (for whom the unlimited estate tax marital deduction will ordinarily apply) or charity (for which the estate tax charitable deduction may apply) without generating a federal estate or gift tax equal to forty percent of the amount over the exemption.[3] This increase effectively doubled the prior federal exemption of $5,490,000 in 2017.[4] Through a feature of the federal estate tax law known as "portability" of the estate tax exemption, a married couple effectively has a combined exemption in 2018 of more than $22,000,000.[5] For clients interested in multi-generational wealth transfer planning, the TCJA also increased the generation-skipping transfer tax exemption, or GST exemption, to $11,180,000.[6] All three of these federal exemptions—estate, gift, and GST—match and are set to increase through inflation indexing over time. Note, however, that the GST exemption is not portable between spouses, so a couple that wishes to maximize the use of their GST exemptions will need to engage in planning at the first spouse's death to ensure that both exemptions are fully utilized, or at least utilized to the maximum extent possible. The individual reforms of the TCJA, including the increases in the estate, gift, and GST exemptions, are currently set to sunset on January 1, 2026.[7] If that occurs, those exemptions will revert to pre-TCJA levels. Very wealthy clients may consider using their increased exemptions through the funding of lifetime

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1. Tax Cut and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054.
2. I.R.C. § 2010(c) (West 2018); Rev. Proc. 2018-18, 2018-10 I.R.B. 392 (2018).
3. I.R.C. § 2001 (West 2018).
4. *Compare* I.R.C. § 2010(c) (West 2017) *with* I.R.C. § 2010(c) (West 2018); Rev. Proc. 2016-55, 2016-45 I.R.B. 707 (2016).
5. I.R.C. § 2010(c) (2018). Portability allows a surviving spouse to succeed to a deceased spouse's unused estate tax exemption, called the deceased spousal unused exclusion (DSUE) amount, so long as a so-called "portability election" is made on a timely-filed federal estate tax return for the deceased spouse's estate. *Id.*
6. I.R.C. § 2631(c) (West 2018); I.R.C. § 2010(c) (West 2018); Rev. Proc. 2018-18, 2018-10 I.R.B. 392 (2018).
7. I.R.C. § 2010(c)(3)(C) (West 2018).

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trusts to avoid the loss of this unprecedented planning opportunity if sunset occurs.

The TCJA made other substantial changes to the tax law, including reducing both individual[8] and corporate[9] tax rates and limiting certain long-standing income tax deductions, including limiting the deduction for state and local taxes (the so-called "SALT deduction") to $10,000[10] and capping new deductible mortgage interest (so-called "qualified residence interest") on home loans of up to $750,000.[11] On the other hand, the TCJA increased the standard deduction to $12,000 for an individual and $24,000 for a couple.[12] This higher standard deduction, coupled with the limitations on the SALT and mortgage deductions, may make the standard deduction more beneficial than itemized deductions. The resulting shift away from the use of itemized deductions may eliminate the benefit of the charitable deduction for many.[13] For clients who wish to use their charitable deductions, bunching future contributions into one larger current year contribution to a family donor-advised fund at a public charity that will (when taken in conjunction with other itemized deductions) exceed the standard deduction will allow them to wring out a tax benefit from their charitable contributions.

Further, under the TCJA, clients may consider restructuring certain business and investment structures to take advantage of new provisions in the tax code. Notably, for qualifying small business owners who operate using certain pass-through entities like partnerships, LLCs, and S corporations, a new deduction under Section 199A of the Internal Revenue Code for up to twenty percent of the owner's qualified business income may be available.[14] Also, the corporate tax rate applicable to C corporations was "permanently" reduced to twenty-one percent, which may lead to certain businesses to evaluate possible reorganization as a C corporation.[15] Finally, the tax law established the Qualified Opportunity Zone program, which provides a potential vehicle for owners to defer, or potentially eliminate, the recognition of capital gain on qualifying investments in certain distressed

8. I.R.C. § 1(j) (West 2018); Rev. Proc. 2018-18, 2018-10 I.R.B. 392 (2018). These reduced rates will apply for taxable years 2018 through 2025. I.R.C. § 1(j).

9. I.R.C. § 11(b) (West 2018).

10. I.R.C. § 164(b)(6)(B) (West).

11. I.R.C. § 163(h)(3) (2018); I.R.C. § 163(h)(3)(F) (2018). This limit is $375,000 for a taxpayer with a "married filing separately" status, and these deduction limits will apply for taxable years 2018 through 2025. *Id.*

12. I.R.C. § 63(c) (West 2018). The increased standard deduction will apply for taxable years 2018 through 2025 and, during that time, are subject to adjustment for inflation. *Id.*

13. The deduction for charitable contributions is an itemized deduction. I.R.C. § 170(c) (West 2018).

14. I.R.C. § 199A (West 2018).

15. I.R.C. § 11(b) (West 2018).

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areas.[16] This development is being widely discussed among US private client advisors.

In summary, the year brought substantial and important changes to the law applicable to the estate, tax, and financial planning of many of private clients. The dominant theme in trusts and estates over the past decade or so has been uncertainty in the rules that will govern an individual's estate at the time of his death. Given the increased exemptions and sunset provisions under the new law, it seems likely that this theme will continue into 2019 and beyond.

16. I.R.C. §§ 1400Z-1, 1400Z-2 (West 2018). If an eligible taxpayer reinvests gain on the sale of property to an unrelated party in a Qualified Opportunity Fund (QOF) within 180 days, that gain may be deferred until the earlier of the taxpayer's disposition of the QOF investment or December 31, 2026. I.R.C. § 1400Z-2(a). The election to defer gain must be made on an IRS Form 8949 and attached to the taxpayer's tax return for the year in which the gain would have been recognized. The gain on appreciation of the new investment within the QOF may be reduced, and even eliminated, depending on the length of time that the taxpayer holds its investment in the QOF. *Id.*

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