Building a House on Shifting Sand?

Estate Planning in a Changing Environment

By Robert Prior

The Greek philosopher Heraclitus is attributed with saying, "The only thing that stays the same is change." Nowhere is this more true than in politics. Every four to eight years, Americans experience a different political environment with radically different philosophies. These different philosophies have far-reaching impacts on estate planning issues. In the next several months, for example, we should see radical changes in laws affecting estate and gift tax, individual income tax, capital gains tax, corporate tax, and the stretch IRAs. How does a good citizen plan in the midst of this ever-changing political landscape?

A Trump presidency promises several changes which should be taken into account in an estate plan. Two of the most prominent include estate tax repeal and change in capital gains tax reform.

Estate taxes are levied on wealthy taxpayers based on the value of their estate at death. Under current law, any taxpayer can leave an estate worth up to $5,490,000 (in 2017) without paying any estate tax. Any amounts over that figure are taxed at a flat rate of 40%. The President-elect and many in Congress are pushing to repeal the tax altogether.

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While the repeal of the estate tax is a very popular Republican platform, only a fraction of a percent of the U.S. population pays any estate tax. According to the IRS, less than 12,000 estate tax returns were filed in 2015 (down from more than 49,000 in 2006). That's out of more than 2,600,000 America deaths. And those returns generated $17.1 billion in taxes.

Many current plans contain sophisticated estate tax saving techniques and strategies designed to eliminate or reduce estate taxes. If the estate tax is repealed, those plans will need to be revisited to ensure the taxpayer's objectives are still being met.

Proposed changes in the way capital gains are treated at death will impact many more Americans than estate tax repeal. Capital gains tax is assessed when capital assets (like stock or real estate) are sold. The tax is calculated as a percentage of the difference in the sales price less the seller's tax basis. Tax basis, in its simplest form, refers to what the taxpayer paid for the asset. For example, if a taxpayer buys a share of stock for $1,000, the tax basis in that share of stock is $1,000. If that share of stock is later sold, capital gains tax is paid on the difference in the sales price and the tax basis. So if the stock is sold for $1,500, capital gains tax is paid on $500.

Under current law, at a taxpayer's death, the tax basis in capital assets "steps up" to the value of the asset on the date of death. So the taxpayer's heirs could sell the same share of stock the next day and pay no capital gains tax.

The Trump administration is considering an alternative—to do away with the "step-up" in basis at death altogether. Instead, on the death of a taxpayer owning capital assets, tax would immediately be owed by the estate on the value of the asset at death less the deceased taxpayer's tax basis, even if the property is not sold. This could create challenges for maintaining family farms, real property, and even family wealth because the funds needed to pay the tax would not be available. Estate plans will need to be reevaluated to ensure this need for liquidity at death is planned for.

Many are tempted to wait and see what happens next year before implementing changes to their estate plan. But an estate plan is based on the laws in effect when a taxpayer dies, not when the plan was drafted. A better approach is to design a plan that provides distribution and administration alternatives that address both how the plan should be administered under current tax laws and tax laws that may exist upon death.

Don't build your estate planning home on shifting sand. Consult with your estate planning attorney about drafting an estate plan flexible enough to change with a changing political landscape.

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