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Estate Planning in the New Tax and Societal Environment

A holistic, yet practical, view of recent changes

Much has already been written about the tax changes made by the Tax Cuts and Jobs Act of 2017 (the Act). Articles have explained how the Act dramatically changed the way practitioners should handle tax and estate planning for many clients. But, the changes to the estate-planning environment are much broader and deeper than merely higher exemptions and the use of non-grantor trusts. Let's take a holistic, yet practical, view of the recent changes.

Estate planning is evolving in significant ways, and if your clients haven't updated their planning and documents for the new world of estate planning, the planning likely won't be as effective as they wish. More than ever before, estate planning is intertwined with income tax planning. While estate planners have been quite conscious of the income tax basis implications of estate plans, the new paradigm implicates a wide range of income tax planning decisions into the estate-planning process. Many, perhaps most, old wills and revocable trust dispositive schemes, especially if based on formula clauses, might not be optimal. They may even pose the danger of causing adverse tax results versus having no planning in place at all.

With the estate tax exemption increased to $10 million inflation adjusted ($11.18 million in 2018), many clients believe they don't need to address their estate planning as they don't see themselves as having a tax problem. Practitioners may need to educate clients and show why documents that don't contemplate the dramatic new environment caused by the Act will almost assuredly leave less than an optimal result for the intended heirs. Of importance is educating clients that failing to address robust trust planning now may result in the client incurring greater income taxes each year, even if the client's estate will never face an estate tax.

Human Considerations

People are complicated, and families often don't get along. Emotional dynamics often influence or control the estate-planning process, including whether the client will even meet with the practitioner to address planning. Family tensions can be exacerbated by the division of estate assets. If practitioners don't deal with the human elements when crafting an estate plan, it's likely that the plan will be ineffective, and the client's goals won't be accomplished. In the past, many estate disputes could use tax benefits to resolve financial issues. For most clients, there will be no estate tax savings "carrot" to hold in front of warring heirs. So, whether the tax laws are new or old, practitioners can help a client reduce the potential for estate disputes with intelligent planning. This can be a challenge as it requires helping a client address family dynamics and deal with potential tensions proactively.

In their landmark study,[1] Roy Williams and Vic Preisser found that only 30 percent of the 3,250 people interviewed successfully transitioned wealth to the next generation. Only 3 percent of the failures were due to poorly crafted estate plans. The number one issue that led to failure was lack of communication and trust (60 percent), followed by lack of preparation of heirs (25 percent). In examining the 30 percent who were successful, the commonalities included total family involvement in the estate plan, managing the family

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wealth as an enterprise, family mission statements that reflected the values of the individual family members and opportunities to practice skills important to building financial acumen. Many of these were and remain characterized as "soft" issues, but practitioners know they can be incredibly hard to address. With the demise of the estate tax for most clients and the aging population, addressing soft issues is critical not only for clients and their intended heirs but also for the financial success of many estate-planning practices. Soft issues remain a matter with which practitioners can assist clients, especially as the estate tax has become irrelevant for many.

As a society, we hardly seem able to talk about depression and mental health issues, the debilitating consequences of aging and chronic disease, family dysfunction and real diversity. Practitioners should integrate these considerations into most clients' plans. Addressing these tough issues is what can personalize an estate plan for your clients. Clients and their children might choose different religions and lifestyles, be subject to difficult divorces, spend with abandon, have cognitive issues or develop major health issues. All of these client challenges present an opportunity for practitioners to provide guidance beyond saving clients' estate or income taxes. The experienced advisor can be an advocate for addressing the human elements of estate planning with both compassion and realism. The future of estate planning will require taking this holistic view of assisting clients. With time and education, clients may come to see the value practitioners can offer in helping to steer through the many human considerations of estate planning.

Estate Planning for Real People

The first question so many clients ask of an estate planner is, "What will it cost?" Estimating the cost for a simple plan might be easy. However, practitioners can go beyond offering their clients those simple plans. Consider discussing with clients the need to: tackle a budget and adjust their lifestyles accordingly with the financial resources they have on hand (especially to remain secure considering the potential for longevity); face the financial, physical, cognitive or other limitations they and their heirs have (which aren't only limited to aging); and create a trust structure tailored to address concerns created by bipolar disorder, gambling or alcohol addiction or whatever else the clients' circumstances might suggest is an important focus. Clients should be coached so that their first question becomes, "Can you help me and my family?"

Team Approach

Modern estate planning seeks to address a wide array of personal, financial, income tax, estate tax and asset protection goals in a flexible and robust manner. If a client's planning documents are even a few years old, they may not incorporate many of these new concepts that estate planning has evolved to include. Modern estate planning recognizes the evolution of the American family. Modern estate planning tends to focus on long-term or perpetual trusts, directed trust structures, use of trust-friendly jurisdictions and more. So, regardless of the tax law changes, your clients' planning may need an upgrade. Most trusts were created before many of the modern trust drafting techniques were feasible or known. Due to the multifaceted approach to modern estate planning, we highly recommend engagement by the client's entire advisory team. This is important for estate planners in every discipline to understand. For example, while use of a non-grantor trust might provide income tax advantages, grantor trusts might remain vital to hold life insurance that's part of the plan. So, involvement of the insurance consultant is important. The new types of non-grantor trusts, and there are several variants worthy of consideration, impact asset location decisions, so the client's investment advisor must be involved. Many clients should take advantage of the current high temporary exemptions. But, those high exemptions require clients to shift larger portions of wealth than ever done before in history. Having a property insurance plan (for example, long-term care,

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personal excess liability) in place and financial forecasts to corroborate the reasonableness of the transfer require the client's CPA and wealth advisor to provide input. Overall, collaboration has never been more critical to optimal planning.

Planning by Wealth Level

While planning generalizations can be potentially misleading, it might help to consider how the approach for planning might differ based on clients' wealth levels.

Ultra-high-net-worth (UHNW) clients. Most individuals with wealth that will last well beyond their lifetimes are planning aggressively. The last great chance to repeal the estate tax, in the view of many, failed with President Trump's efforts that culminated in the Act. The current environment (no restrictions on valuation discounts, high exemptions) may just be the most advantageous the transfer tax environment will ever be. Some UHNW clients worry that a change in the administration in a future election could bring back many of the proposals President Obama put forth in his *Greenbook*. This provides opportunities for practitioners to discuss more robust planning with their UHNW clients. Practitioners should also caution their clients to fear the unknown. What might the 2020 election bring? Might the tax and other winds in Washington shift? It may not be worth the risk for clients to adopt a wait-and-see strategy, as many have done. Practitioners may need to discuss and implement planning now to help their clients shift wealth before that process becomes more costly and difficult. Considering the only constant in the estate, gift and transfer tax space lately has been change, be certain that the plans you craft and help clients implement incorporate as much flexibility as the clients and plans permit to be able to address future tax changes in Washington or your client's domiciled state.

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Planning for clients at this level is always complex and risky (for example, balancing estate tax savings with the income tax savings of the loss of a potential basis adjustment on death all need to be considered in any planning implemented at this level). Educating clients so they understand both the benefits and the risks of the planning proposed will be essential before beginning implementation. But, most UHNW clients seem to believe that these negatives pale by comparison to the risk of doing nothing and waiting for Washington to change the tax rules. For example, the *Estate of Powell v. Commissioner*[2] partnership case in 2017 and the *Estate of Cahill v. Comm'r*[3] split-dollar case in 2018 both were bad fact cases in which the Tax Court provided negative decisions for taxpayers. UHNW clients and practitioners should be concerned that additional negative decisions may erode the effectiveness of available estate-planning techniques, if not acted on with alacrity. But, how far the Internal Revenue Service or courts will interpret or apply the holdings in cases with fewer bad facts is uncertain.

Moderate wealth. The description of "moderate" wealth may now be a wide spectrum from $5 million to $40 million, given the new high exemptions. Those in these wealth ranges may benefit significantly from both the income and estate tax benefits of estate and non-grantor trust planning. The implementation of new types of trusts, and other opportunities created by the Act, might be able to save clients significant income taxes too. However, with these new options, planning has become more complicated than ever. Most moderate wealth clients seem to be under a misconception that with high exemptions, they don't need to address planning further, but that will be a significant mistake for many. Clients will need to understand that complicated means costly too. Planning should contemplate using some of the high exemption amounts before they sunset in 2026 (or a new administration in Washington changes them). Because the new exemptions are so high, a greater percentage of clients' wealth can potentially

be transferred through planning than ever before, and practitioners should consider crafting flexibility into planning, so that clients can still benefit from assets transferred to irrevocable trusts (even if only indirectly).

Practitioners should also consider whether clients would benefit from the income tax saving benefits of non-grantor trusts. Moderate wealth clients may need to achieve three conflicting planning objectives: (1) move assets out of their estates to lock in some of the high exemption before it's reduced; (2) retain access to those assets because they represent a great percentage of their overall wealth; and (3) maximize income tax savings using a non-grantor trust. Practitioners can thread that planning needle for their clients, but it will require a customized approach and coordination with the other members of a client's planning team (for example, his CPA or wealth advisor) to make these new breeds of trusts succeed.

While planning at this wealth level can be the most complex, including the use of grantor spousal lifetime access trusts (SLATs) and domestic asset protection trusts, techniques that have been used in planning for years, may benefit the client. In addition, consider twists on these structures, such as SALTy (that is, state and local taxes)-SLATs or spousal lifetime access non-grantor trusts, which are non-grantor variations of the SLAT, and completed gift non-grantor trusts (a completed gift variant of the traditional incomplete gift non-grantor trust), among other techniques. These new types of trusts will require practitioners to develop new drafting approaches and create new forms or templates for their practices. The benefits practitioners can offer clients of moderate wealth, including greater income tax savings than in the past, additional flexibility to access funds if needed and the ability to use the temporarily doubled estate tax exclusion, should provide an incentive for clients to meet with their estate-planning practitioners to discuss options. Unfortunately, the reality in many cases is that clients below the UHNW level are merely tuning out planning as something that's not necessary for them. This is why the CPA and wealth advisor's role is so much more important to the estate-planning process than ever before. If they don't educate clients as to the valuable new planning opportunities available, clients may never meet their estate-planning attorneys.

Lower wealth. Even lower wealth clients need to address the fact that their existing planning documents may cause unintended consequences under the Act. Reviewing and possibly updating a client's documents (for example, formula clauses, old trusts) to conform to the Act should be a priority. Lower wealth clients need education regarding the non-tax benefits of estate planning. Note that these two items—reviewing/updating documents and educating clients about the non-tax benefits of planning—are applicable at all wealth levels.

Too many clients with lower wealth are terminating old trusts without reviewing if there's a reason to maintain them under the new tax regime. Often, terminating these trusts may not be the right move. A client might have an old insurance trust holding insurance bought to pay an estate tax that might have been owed when the exemption was $1 million, not $11.18 million. However, terminating a well-crafted existing trust and cashing in a life insurance policy that's performing well may be the worst move for a client. For example, that policy might be a good ballast to the client's stock portfolio or closely held business investments. The policy might be exchanged into a product that serves the client's current needs better. It may be feasible to decant (merge) the old trust into a new and improved trust that can accomplish a range of goals. Discuss all of this with a client before decisions are made. Terminating an old trust might sound simple to clients, but practitioners will need to inform clients about the potential to transform old planning to meet current needs and goals before they take irreversible steps.

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Endnotes

1. Roy Williams and Vic Preisser, *Preparing Heirs* (San Francisco, Robert D. Reed Publishers, 2003).
2. *Estate of Powell v. Commissioner of Internal Revenue*, 148 T.C. No. 18 (2017).
3. *Estate of Cahill v. Comm'r*, T.C. Memo. 2018-84 (June 18, 2018).