Estate Planning SMARTS

The Bottom Line At the Dawn of 2020

An update to *Estate Planning Smarts,* 4th Edition

By Deborah L. Jacobs

As we turn the page to 2020, *Estate Planning Smarts* marks a milestone. It's been a decade since I published the first edition of this consumer-oriented book. At the time, I promised to keep readers current with future editions and free updates that could be downloaded ***from the book's website.*** During the past 10 years Congress has enacted changes that have transformed the field. I've chronicled them in four editions, numerous updates and many dozens of articles.

This update, which replaces earlier ones, starts with the two most noteworthy developments of 2019, and synthesizes other key changes since the fourth edition was published.

Retirement Accounts

Just before its holiday recess, Congress passed a new law, the Setting Every Community Up for Retirement Enhancement, or SECURE, Act. It raises the age at which account owners must begin taking distributions from taxable retirement accounts such as traditional IRAs and 401(k)s. Starting this year, it's 72 instead of 70 1/2; if you turned 70 1/2 before 2020, the old timetable applies.

Other provisions of the SECURE Act, which affect IRA inheritors, will radically alter estate planning with retirement assets (see Chapter 7). Most notably, the new law does away with what was colloquially known as the "stretch-out" – the ability of IRA beneficiaries to extend withdrawals (and any associated tax) over their life expectancies. In most cases the stretch-out is no longer available if an account owner dies after December 31, 2019.

Instead, starting for deaths in 2020, IRA inheritors will generally be required to withdraw everything in the account by the end of the tenth calendar year following the year of the account owner's death. (This is true for both traditional IRAs and Roths.) Certain exceptions apply, most notably for spouses, who can continue to take distributions over their life expectancy; and for minor children of the account owner, who can do so until they reach the age of majority. After that, the clock starts running for the 10-year-rule to apply.

Three other exceptions apply regardless of the beneficiary's relationship to the account owner: for those who are disabled; chronically ill; or not more than 10 years younger than the account owner. These beneficiaries can also continue to take payouts according to their life expectancy.

In light of the new law, account owners will want to rethink various elements of their estate planning. Leaving IRAs to grandchildren, for example, which was a popular way to take advantage of the stretch-out, could now stick them with a big tax bite if the 10-year withdrawal period coincides with their peak earning years. And if you have made a trust the beneficiary of your IRA, you should consult advisers promptly about whether the new law could wreak havoc with your arrangement.

Since there is no tax on withdrawals from Roth IRAs, converting a traditional IRA to a Roth, discussed in Chapter 7, has become even more appealing. The new time frame for withdrawals will still apply, but unlike with a traditional IRA, there will be no tax on the funds as they come out of the IRA wrapper.

To help you weigh the pros and cons of a Roth conversion, there's a decision tree, on page 127 of *Estate Planning Smarts,* and a sidebar mapping out the mechanics, on the following page. Note that the 2017 tax law made it impossible to reverse your decision. Previously you could undo, or "recharacterize," a Roth conversion for a limited time – say, if your investments declined in value after you did the conversion. Now this is no longer permitted.

Federal Estate Tax

The federal estate tax exclusion – the amount that can be passed to heirs tax-free – was $3.5 million per person ($7 million for married couples) when the first edition of this book was published, in December 2009. Now, in 2020, the limit on tax-free lifetime gifts or transfers through an estate plan is $11.58 million ($23.16 million for spouses).

A wild card is what will happen after 2025. Unless Congress acts before then, we might go back to the future: Under current law, on January 1, 2026, the rates are scheduled to automatically revert to the 2017 level of $5 million per person ($10 million for married couples), adjusted for inflation.

For the past two years, the prospect of lower limits raised a quandary for the super-rich (and their tax advisers): Would those who took advantage of the high exclusion between 2018 and 2025, to engage in various tax-saving strategies such as those described in Chapters 14 and 15 of *Estate Planning Smarts,* be penalized when the rates went down to pre-2018 levels?

The Internal Revenue Service put that possibility to rest on November 26, 2019 in ***Treasury Decision 9884.*** In it, the service indicated that if the exclusion amount drops to less than the total value of the lifetime gifts an individual or couple has made, there won't be a tax "clawback."

Instead, for people who made gifts during this period and die after 2025, the estate has a choice about how to compute the tax credit. (What was once called the "unified credit" is now called the "basic exclusion amount.") They can use the credit that applied to gifts made during life, or on the date of death, whichever is higher.

For a person's own exclusion amount, the current high rate is a "use or lose" benefit, which is available only through 2025, the IRS said. As in the past, whatever you've already used (for example, by making lifetime gifts) gets subtracted from the credit available when you die.

But here's the rub: Once the credit drops, it's conceivable that someone who has made substantial lifetime gifts will die with a tax-credit deficit. In other words, she won't have enough exclusion to cover assets that weren't already transferred. In that case, her heirs could wind up owing estate tax on what she leaves behind.

Married couples, take note. What's not lost, under the Treasury decision, is the unused credit of a spouse who died before the sunset. As discussed in Chapter 3, widows and widowers can carry over any unused exclusion of the spouse who died most recently and add it to their own. Tax geeks call this "portability." And now, under the Treasury decision, there's a potential anomaly: Those widowed after 2017 and before 2026 who "elect portability" (in legal lingo) could wind up with millions of dollars more in tax credit than if their spouse had survived until 2026!

Portability is not automatic. To carry over the so-called "deceased spousal unused exclusion" (or DSUE), the executor handling the estate of the spouse who died needs to file an estate tax return (IRS Form 706), even if no tax is due (see Chapter 3). Regardless of net worth, it's something all surviving spouses should see to, because who knows what the future holds? With a sunset on the horizon, portability is especially beneficial to people who need to worry about federal estate tax – either currently, or once the exclusion amount drops in 2026.

Same-Sex Spouses

An important – and historic – development during the life of *Estate Planning Smarts* has involved the rights of same-sex married couples. By the time the fourth edition went to press, it was clear that same-sex spouses were entitled to the same federal tax breaks and other rights that heterosexual spouses rely on in estate planning. In a subsequent, June 2015, decision in ***Obergefell v. Hodges,*** the U.S. Supreme Court ruled that same-sex marriage is a constitutional right. Among other things, this gave these couples all the same estate planning protections when state laws are concerned (see Chapters 4 and 5).

Miscellaneous Updates

Depending on your situation, these other changes since the fourth edition was published may affect your planning.

Use of Section 529 plans. The permitted uses of education savings plans, covered at length in Chapter 9, have been gradually but greatly expanded. Qualified state tuition programs can now be applied to purchases of computer equipment and to pay for Internet access used primarily by the student who is the beneficiary of the plan. And the use of these plans is no longer limited to higher education: It's now possible to withdraw up to $10,000 per year, per beneficiary, to pay for elementary or secondary education at a private or parochial school, and for certain homeschooling expenses. The SECURE Act went even further, allowing 529 plans to be applied to the expenses of an apprenticeship program, and to reduce student debt. Subject to a lifetime limit of $10,000 per person, they can be used to pay down the student loans of both the beneficiary and his or her siblings.

Contributions to ABLE accounts. These state-operated, tax-advantaged entities, discussed in Chapter 10, can lessen the financial burden on families of paying disability-related expenses. (The acronym "ABLE" stands for Achieving a Better Life Experience.) A change in the law eliminated the residency requirement; it is no longer necessary for the beneficiary to be a resident of the state to participate in its program.

State estate or inheritance taxes. The number of states with these taxes swells and shrinks with budgets and political currents. Those that still have an estate tax include: Connecticut, Illinois, Maine, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, Washington and the District of Columbia. Some states have an inheritance tax. In contrast with the estate tax, which applies before individual inheritors get their share, an inheritance tax is levied against the amount left to certain individuals. Maryland has both. Other states have only an inheritance tax: Iowa, Kentucky, Nebraska, New Jersey and Pennsylvania.

Reporting foreign financial assets. Links to foreign countries can affect your estate plan. As Chapter 13 notes, U.S. taxpayers are required to report offshore accounts and pay taxes on them, or face substantial penalties. It also summarizes the Offshore Voluntary Disclosure Program (OVDP), which enabled taxpayers or their estates to avoid criminal penalties, and prescribed a mechanism for resolving their civil tax and penalty obligations. This program closed to new entrants on September 28, 2018. Other procedures for compliance explained in Chapter 13 remain in effect.

Inflation Adjustments

The following numbers, mentioned in *Estate Planning Smarts* and indexed for inflation, have gone up to the amounts listed below:

- Annual exclusion (the amount that can be given annually to each of as many people as you want without counting as a taxable gift): $15,000 (see Chapter 10)
- Annual tax-free gift to a spouse who is not a U.S. citizen: $157,000 (see Chapter 4)

- Maximum total tax-free gifts received each year from foreign partnerships, foreign trusts or foreign corporations: $16,649 (see Chapter 13)
- Average annual net income tax, based on which expatriate status is measured: $171,000 (see Chapter 13)
- Amount of gain on expatriate's property exempt from exit tax: $737,000 (see Chapter 13)

Is Your Estate Plan Obsolete?

Make a New Year's resolution to give your estate plan a checkup, and keep it! Be sure you have all the basic documents to provide for your own care if you can no longer handle your affairs (Chapter 1) and to leave your assets to the people (Chapter 2) or charities (Chapter 16) that you wish to benefit. Beneficiary designation forms for your retirement accounts should also be filled out and coordinated with the rest of your estate plan (Chapter 7), especially in light of the SECURE Act.

If you have a spouse or partner, make sure your mate is well provided for financially (Chapter 4). Name a guardian for children who are minors or have special needs, and leave funds for them in good hands in case something happens to you (Chapter 5). Don't delay saving for the enormous education expenses that your children or grandchildren will face (Chapter 9).

If you previously set up trusts or family entities (such as family limited partnerships or liability companies) primarily for the purpose of minimizing estate taxes, discuss with advisers whether to modify or dismantle those arrangements. As discussed in Chapters 1, 3, 6 and 17, there are also non-tax reasons for setting up trusts: to provide for children from a previous marriage; protect assets from creditors and former spouses; and safeguard money if you become unable to handle your finances. But for people who no longer want or need trusts, recent state-law changes make it easier to revise plans that once seemed irrevocable.

Revisit your plan about every five years, or more often if there have been changes in your finances, your personal life (including your health) or the law (see Chapter 18). Life doesn't stand still, and neither should your estate plan.

Deborah L. Jacobs, a lawyer and award-winning journalist, is the author of ***Estate Planning Smarts: A Practical, User-Friendly, Action-Oriented Guide, 4th Edition.***
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