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Changes to the Federal Gift and Estate Tax May Be Trap for Unsuspecting Massachusetts Residents

The "Tax Cuts and Jobs Act" which President Trump signed on December 22, 2017 is the most significant tax overhaul in three decades. A number of the significant changes to the tax code for individuals and businesses took effect on January 1, 2018.

For individuals, one important change is that the Act doubles the amount of money that is exempt from the Federal Gift and Estate Tax. In 2017, the exemption was $5.49 million for an individual and $10.98 million for married couples. Beginning on January 1, 2018, the exemption has more than doubled to roughly $11.2 million for individuals and $22.4 million for married couples. Estates subject to the Federal Estate Tax pay a flat tax of 40% on every dollar which is over the exemption.

Only 0.2% of estates were large enough to pay Federal Estate Tax upon the 2017 exemption levels. Since the exemption has doubled for 2018, the number of estates subject to the Federal Estate Tax will shrink even further.

Based on these numbers, the national media is reporting that the Act has virtually eliminated the "estate tax" for all but a handful of people in the country. Massachusetts residents who hear this news may think that the estate tax only affects less than 1% of taxpayers and that they do not need to worry about estate taxes any longer.

While there is some truth to the story that the **Federal** Gift and Estate Tax will only affect a few estates based on the changes made in the Act, **Massachusetts** residents should be aware that:

- **The Massachusetts Estate Tax applies to estates which are over $1 million**
- **The doubled Federal Gift and Estate Tax exemption is temporary and will drop back to pre-2018 rates in 2026**

Let's take a closer look at each of these points:

Massachusetts Estate Tax Applies to Estates Over $1 Million

Massachusetts taxes all estates which are over $1 million. The Massachusetts Estate Tax ranges from 0.8% up to a maximum of 16%. When Massachusetts residents add up the value of their home, retirement accounts and life insurance policies, many discover they are over the $1 million threshold.

In addition, Massachusetts does not have a “true exemption” like the exemption for the Federal Estate Tax. This means that if your estate is over $1 million by *even a single dollar*, the *entire value of your estate* is subject to tax in Massachusetts.

Here’s an example of the difference:

- Jane Doe is a resident of Florida, which has no state estate tax. She dies leaving an estate of $11.3 million. Under the Federal Estate Tax, the first $11.2 million is exempt from taxes and passes to her heirs tax free. Assuming the estate claims no other deductions, her estate only has to pay a flat tax of 40% on the $100,000 that is over the current exemption, which works out to $40,000 in Federal Estate Tax.

- John Smith is a resident of Massachusetts. He dies leaving an estate of $1,200,000. Since his estate is over the $1 million threshold, his *entire estate* and *not* just the $200,000 that is over $1 million is subject to the Massachusetts Estate Tax. Assuming the estate claims no other deductions, his estate owes a Massachusetts Estate Tax of $45,200.

The result is that John Smith’s estate actually pays $5,200 more in Massachusetts Estate Tax than Jane Doe’s estate paid in Federal Estate Tax even though his estate was $10.1 million smaller!

With all of the news about the changes to the Federal Gift and Estate Tax, it is easy to forget or not realize that the threshold for the Massachusetts Estate Tax is *significantly lower* and that your entire estate will be taxed if you go over this threshold by even a *single* dollar. But the example above demonstrates why Massachusetts residents still should work with an estate planning attorney to develop an estate plan designed to minimize or even eliminate the Massachusetts Estate Tax.

In addition to minimizing estate taxes, a properly drafted estate plan can also allow you to avoid the time and expense of Probate, provide asset protection, and transfer your property to your loved ones quickly and efficiently.

Double Federal Gift and Estate Tax Exemption Temporary

Before we get into the specifics of the Federal Gift and Estate Tax Exemption, let’s quickly answer an important question first:

What exactly is the Federal Gift and Estate Tax?

The Federal Estate Tax is a ***transfer tax*** imposed when assets you owned or controlled during lifetime are transferred to or for the benefit of another person following your death. The Federal Estate Tax has been ***combined*** with the Federal Gift Tax and the Federal Generation Skipping Transfer Tax in a single system of taxation. It is commonly referred to as the “Unified System” or the “Unified Tax System.”

The Unified System imposes a tax ***on all gifts*** a person makes during lifetime and ***all transfers*** from the person’s estate after death. The tax is based upon the ***value*** of the assets transferred. The Unified System allows a person to transfer assets tax free until the value of the transferred assets reaches a certain ***threshold***.

Under the Act, the current ***threshold*** is $11.2 million per individual and $22.4 million per couple. The threshold amount is commonly referred to as the “exempt amount” or simply the “exemption” because it is the amount of assets that a person can transfer ***exempt*** of Federal Estate Tax.

Current Threshold Temporary

The Federal Gift and Estate Tax exemption will go back down to pre-2018 levels in 2026.

If you are a Massachusetts resident who has or may have enough assets to be subject to the Federal Estate Tax based upon the 2017 exemption of $5.49 million per individual and $10.98 million per couple, you should consult with your attorney and other professional advisors to explore the new opportunities you have to reduce your potential estate tax exposure and to transfer wealth to loved ones or younger generations at a reduced tax cost. These opportunities are temporary and will only exist for 8 years unless Congress extends this provision of the Act beyond 2026.

In fact, it is possible the doubled exemption may not last the full 8 years. The Federal Estate Tax has always been a political issue and has fluctuated dramatically over the years depending on whether Democrats or Republicans were in control of Congress. Although the Republicans currently hold majorities in the House and the Senate, the Democrats could take control of Congress in the 2018 or 2020 elections and pass a new bill to reduce the exemption to pre-2018 levels or below. For example, one of Hillary Clinton’s campaign proposals was to reduce the exemption to $3.5 million for individuals and $7 million for married couples and increase the tax rate to a minimum of 45% up to a maximum rate of 65% on the largest estates.

Thus, there may be only a few years to take advantage of the doubled exemption under the Act. You should act now to make the most of the current planning opportunities.