

Now is Not the Time to Watch the Sunset

Planning Considerations for Potential Changes
to the Estate and Gift Tax Exemptions

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Brief History of Estate Tax

- Stamp Act of 1797
- Revenue Act of 1862
- War Revenue Act of 1898
- Revenue Act of 1916
- Tax Reform Act of 1976
- Economic Recovery Act of 1981
- Omnibus Reconciliation Act of 1993
- Taxpayer Relief Act of 1997
- Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)
- 2010 Tax Relief Act
- American Taxpayer Relief Act of 2012
- Tax Cuts and Jobs Act of 2017 (TCJA)

Estate Tax Exemption

Year	Exemption Amount	Max Tax Rate
2001	\$675,000	55%
2002	\$1 million	50%
2003	\$1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$ 2 million	46%
2007	\$ 2 million	45%
2008	\$ 2 million	45%
2009	\$3.5 million	45%
2010	Estate Tax Repealed!!	---%
2011 through 2017	\$5 million, indexed for inflation	40%
2018 through 2025	\$10 million, indexed for inflation	40%
2026	\$5 million, indexed for inflation (~\$7m)	40%

Federal Estate and Gift Tax

■ 2012:

- The American Taxpayer Relief Act of 2012 was passed on January 1, 2013, avoiding sunset exemption
- Federal Gift and Estate Tax Exemption:
 - \$5.12 million
- Implemented spousal portability

■ 2018:

- Tax Cuts and Jobs Act became law on December 22, 2017
- Doubled Federal Gift and Estate Tax Exemption:
 - \$11.18 million
- Continued spousal portability

Federal Estate and Gift Tax

- **2024:**
 - Annual Exclusion: \$18,000
 - Federal Gift and Estate Tax Exemption:
 - **\$13.61 million**
 - Spousal portability
- **2025:**
 - Annual Exclusion: \$19,000
 - Federal Gift and Estate Tax Exemption:
 - **\$13.99 million**
 - Spousal portability
- **2026:**
 - The 2017 Tax Cuts & Jobs Act expires on December 31, 2025
 - Federal Gift & Estate Tax exemptions will drop back down to **\$5 million**, indexed for inflation, so approximately \$7 million
 - (unless Congress takes action before then)

Window of Opportunity for Substantial Gifting Between Now and 2026

- More time to make “use it or lose it” gifting decisions
- Making large gifts now won’t harm estates after 2025 84 Fed. Reg. 64,995, (Nov. 26, 2019)
- Risks to further delaying gifts:
 - Asset appreciation between now and the date of the gift (future gift of appreciated asset uses more exemption than a gift now)
 - Congress could act sooner to reduce exemptions or prohibit common gifting strategies (Grantor Trusts, discount rules)

Gifts Must Be Substantial

- Ms. Doe makes a gift of \$2 million in 2024 (when the exemption amount is \$13.61 million) but later passes away in 2026 when the exemption is \$7 million. So, Ms. Doe's applicable exclusion amount is \$5 million (the prior gift reduces exemption).
 - \$21 million estate
 - Less: \$ 5 million rem. exemption
 - \$16 million
 - x 40% tax rate
 - \$6.4 million of estate tax
- Important: To take full advantage of tax savings, gifts must exceed what the exemption will be reduced to!

Implications of 2024 Election?

- Democratic party proposals:
 - Reduced Estate Tax exemption (\$3.5 million)
 - Increased Estate Tax rate
 - (60% \$13 million, 65% on \$93 million and above)
 - 10% surtax on billion dollar estates
 - Cut Annual Exclusion amount to \$10,000 per done
 - Limit transfers to trusts benefiting 3+ generations below
- Republican party proposals:
 - Make the 2017 TCJA Estate Tax changes permanent
- 2024 election results:
 - Republican control of House, Senate, and the White House suggest that the TCJA Estate Tax changes could be made permanent (maybe no sunset in 2026?)

Case Study – Estate Under \$14 million

- Chris and Dana
 - Married with 2 adult kids and 3 grandkids
 - Both in their late 70's
 - Net worth = \$10 million
 - \$8 million in liquid investments
 - \$2 million in real property
 - No debt, but travel a lot and live a lavish lifestyle. Rely heavily on investments to generate necessary income to achieve their lifestyle.

Lifetime Gifting

- Annual exclusion gifting
 - 2025: \$19,000 per spouse
- Direct Payment of Tuition and Medical Expenses
 - Education expenses must be tuition only (any grade level)
 - Medical expenses including medical insurance, prescription drugs, or payments directly to medical care provider.
- Qualified Charitable Distributions from IRAs
 - \$100,000 to charity tax-free each year
- 529 College Savings Plan
 - Superfund with 5 years worth of contributions all at once

Spousal Lifetime Access Trust

- Irrevocable trust
- Spouse is the primary beneficiary
- “Grantor trust” for income tax purposes
- Benefits:
 - Gets future growth of asset out of Grantor’s estate
 - Preserves income stream for spouse
- Risks:
 - Premature death of spouse
 - Divorce
 - Uncooperative trustee
 - Reciprocal trust doctrine

Case Study – Estate between \$14 MM and \$28 MM

- Aaron and Cydney
 - Married with 3 minor children
 - Both in their early 50's
 - Net worth = \$20 million
 - \$5 million in liquid investments
 - \$5 million in real property
 - \$8 million in stock in family business
 - \$2 million in permanent life insurance
 - Live a frugal lifestyle and have concerns about long term care cost. Rely heavily on income/distributions from the family business. Would like to leave a large inheritance to their children

Gift to an Intentionally Defective Grantor Trust

- Irrevocable trust
- Children or other family/friends are the primary beneficiaries
- “Grantor trust” for income tax purposes
- Best assets to fund trust?
 - Assets likely to appreciate
- Benefits:
 - Future growth removed from gross estate
 - Grantor pays the income taxes on trust income

Wait and See Disclaimer Trust

- Transfer to irrevocable marital trust for spouse's benefit
- Spouse decides whether to disclaim (9 months to decide)
 - No disclaimer? Spouse receives the trust property outright and free of trust
 - Qualified disclaimer? Confirms the gift. The trust continues on like a SLAT or IDGT.
- Benefit?
 - Permits a “way out of the gift” if future information suggests the gift isn't necessary.

Sale to an IDGT

- Structured as an installment sale
- Grantor creates and funds trust as a “grantor trust”
- Grantor sells assets to the trustee of the trust
 - Sale may be equal payments of principal & interest, interest only with balloon payment, etc.
- Benefits:
 - Not a taxable sale for income tax purposes
 - Freezes value
 - Promissory note interest tied to Applicable Federal Rate
 - Grantor pays the income taxes on trust income

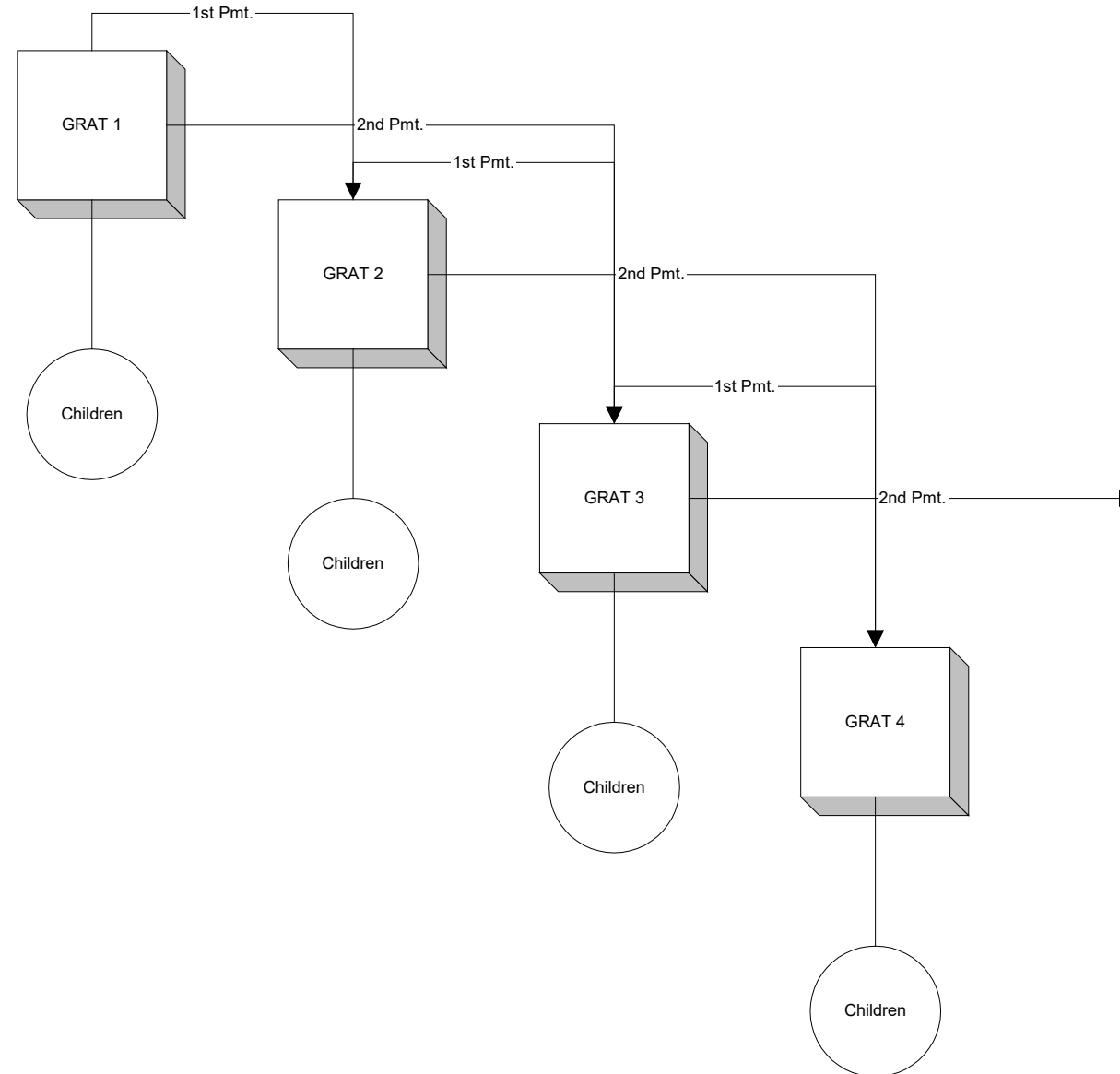
Case Study – Estate Over \$28 million

- Walt and Sydney
 - Married 2 kids and 6 grandchildren
 - Both in their mid 80's
 - Net Worth = \$45 million
 - \$35 million in liquid investments (from sale of business)
 - \$5 million in stock in buyer's company
 - \$1 million in life insurance
 - \$4 million in real property
 - Walt and Sydney each made gifts of \$12.06 MM in 2022 to trusts for their kids. Concerned about estate taxes, but feel have sufficiently provided for their kids. Charitably inclined.

Grantor Retained Annuity Trusts (GRATs)

- Transfer of high-yielding and rapidly appreciating asset
- Grantor retains a fixed annuity interest
- Future growth removed from gross estate
- Consider short-term rolling GRATs, particularly when markets are down

Rolling GRATs



Irrevocable Life Insurance Trusts (“ILITs”)

- The trust (“ILIT”) is the owner and beneficiary of a life insurance policy
- The policy death benefit is not subject to the estate tax in the grantor’s estate
- Grantor is not a beneficiary or trustee of the ILIT

Charitable Trust

- Living Charitable Remainder Trust
 - Grantor retains the right to an annual trust distribution
 - Remainder of the trust passes to charity at the grantor's death
 - Grantor receives an income tax deduction for the charitable remainder value
 - Sale of trust assets are not currently subject to income tax
 - Distributions to the grantor are often subject to income tax

Primary Approaches in Earlier Planning – Estate Tax Focused

- Maximize use of Estate and Gift Tax Exemptions
- Maximize Marital Deduction Planning
- Aggressive Lower Valuations
- Use of Lifetime Planning/Charitable Giving/Second to Die Life Insurance

New Planning Approaches – Increased Flexibility and More Income Tax Focused

- Estate and Gift Tax is not relevant in decision making for most people
- Income Taxes can be substantially more costly (particularly for estates and trusts)
- Shift in focus?
 - Focus is on income tax, particularly tax basis planning
 - Carryover basis vs. step-up basis

Income Tax Basis

- Lifetime transfers:
 - Generally, carry-over basis
 - Basis of gifted property is lower of carryover basis or FMV of asset
- Testamentary transfers:
 - Inherited assets generally receive assets with a “step up” in cost basis equal to the FMV as of date of death
 - Basis step up can provide significant income tax benefits to heirs and beneficiaries

Strategies for Obtaining Basis Step Up

- Hold Asset Until Death
- Gift assets “up” a generation
- Argue that IRS Arguments for inclusion apply
- Distribute assets to trust beneficiary before beneficiary’s death
- Use of General Powers of Appointment (“GPOA”)
 - GPOA causes estate inclusion
 - Full GPOA v. Formula GPOA
- Trust modification to cause inclusion in beneficiary’s estate
 - Trust “decanting” to add a testamentary GPOA

Strategies for Adding Flexibility

- Add “Trust Protector” who has the power to make certain changes to the trust:
 - Authority to create or modify powers of appointment
 - Remove and appoint trustees
 - Make tweaks to the trust if the tax laws change
 - Change administrative provisions or change trust situs
- Draft trust with flexibility to allow for trust modification and trust decanting

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