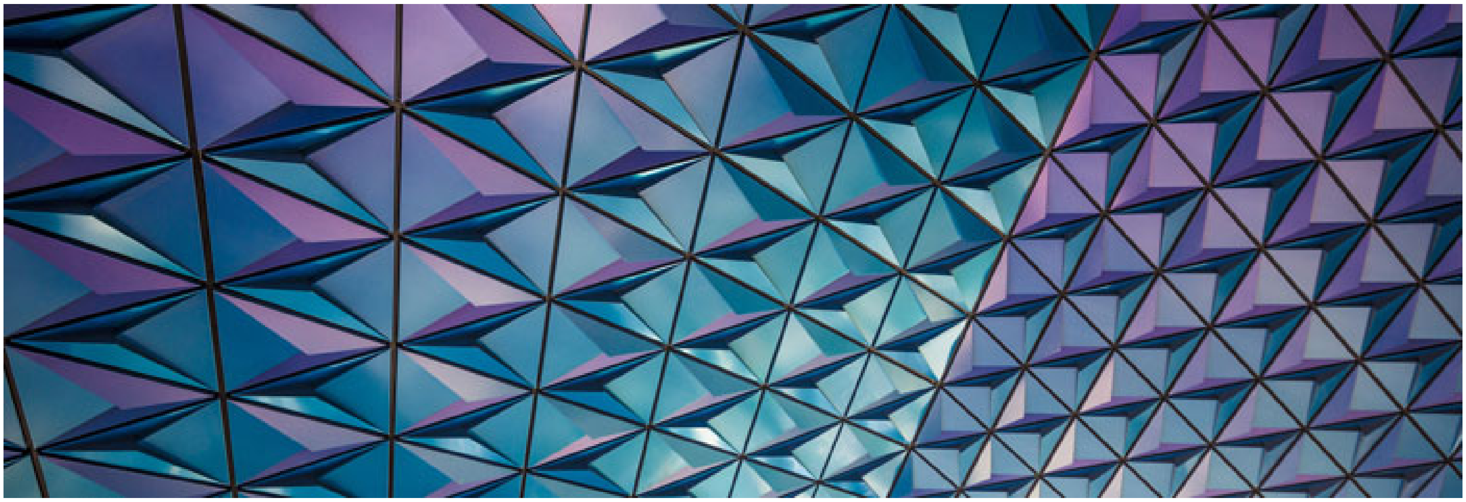

Gift opportunities before year-end

Trusts and Estates Alert

9 September 2020

Many have speculated that the 2020 elections could result in taxpayer-unfriendly changes to gift and estate tax laws. Although no one can predict the outcome this November, it is important to consider some planning opportunities before year-end. Current laws (which are historically very favorable) are scheduled to change in 2026; the results of the election could accelerate these changes and bring others.

Current gift and estate tax regime, and possible changes

The 2017 Tax Act doubled the gift/estate tax exemption for each person from $5 million to $10 million – each adjusted for inflation – through 2025. This means that, for assets passing by lifetime gifts or at death from now until 2026, $11.58 million ($23.16 million for married couples) can be transferred without triggering gift/estate tax. Assets transferred over these amounts would be taxed at 40 percent unless passing to a spouse, "marital trust" for a spouse or charity. In 2026, the exemption is scheduled to revert to $5 million, as adjusted for inflation. (Gifts qualifying for the annual exclusion – $15,000 in 2020, per donor, per donee – and those paid directly to medical providers and educational institutions do not consume the larger exemption amount.)

Among the numerous potential changes to gift/estate tax laws about which political commentators have speculated (and which could occur as early as next year) are:

i. a reduction in the gift/estate tax exemption from existing levels to as low as $3.5 million (lower than the 2026 scheduled amount)

ii. an increase in the gift/estate tax rate from 40 percent to as high as 55 percent
iii. an acceleration of the 2026 sunset of the current laws and
iv. the elimination of the cost basis step-up for assets inherited upon a person's death.

Locking in the high exemption

The current (all-time high) gift tax exemption presents a "use it or lose it" opportunity. Once scaled back in 2026, each individual's remaining exemption will equal the then -applicable maximum amount *reduced* (but not below zero) by lifetime taxable gifts to date. If, for example, an individual gave $7 million to a trust for her descendants before 2026, and the maximum exemption, after the law changes, was then $6 million, she would have no exemption left – $6 million minus $7 million, but not less than $0. The additional $4.58 million of today's exemption would have been lost. (Treasury Regulations have clarified that, if an individual has made more gifts than a future (lower) maximum threshold, there will be no clawback of gift tax on any overage.)

To take full advantage of the current law, after factoring in previous gifts, an individual must give $11.58 million of assets, and married couples must give $23.16 million. For couples, an intermediate option would be for one spouse to give assets equal to his/her entire exemption, and the other spouse to give away no assets. Once the law changes, the spouse who had used his/her exemption would have none remaining, but the spouse who had made no gifts would at least have his/her entire amount under the future new law. (This would be preferable to each spouse using about half of his/her current exemptions, which could result in neither spouse having any left after the law changes.)

Benefits of lifetime gifting

Even in a normal environment, making gifts during one's lifetime is attractive because all future appreciation in the transferred assets occurs outside of the gift-giver's taxable estate. However, given this window of opportunity – historically high (albeit temporary) exemption and low rates, with the added possibility of changes sooner than anticipated – most individuals should strongly consider making lifetime gifts to utilize his/her gift tax exemption while one still can. Furthermore, all-time low interest rates also present many estate planning opportunities – eg, loans to family members and certain types of trusts on very favorable terms.

There are a multitude of options available. If taking advantage of the current favorable laws appeals to you, please contact us to discuss which assets and flexible structures might be most appropriate, given your and your family's situation.

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