

# Use It or Lose It? Plan Now for a Potential Reduction in Estate, Gift and GST Tax Exemptions

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The federal government taxes the transfer of assets via three separate but interrelated taxes: the estate tax, which taxes the transfer of assets at death, the gift tax, which taxes gratuitous transfers during your lifetime, and the generation-skipping transfer (GST) tax, which is an additional tax assessed when assets are transferred to grandchildren or more remote generations. All three taxes are linked via the federal estate, gift and GST tax exemptions.

## The Current Exemptions

The federal gift and estate tax exemption is the cumulative amount you can give during life and at your death without incurring a tax at the federal level. The amount has varied significantly over the past 25 years, from as low as \$600,000 to the current amount of \$11.58 million. The GST tax has a similar exemption, the amount of which is currently linked to the gift and estate tax exemption. Therefore, at present, \$11.58 million can also be sheltered from GST tax.

As part of the Tax Cuts and Jobs Act of 2017, the gift and estate tax exemption amount was doubled in 2018 from \$5 million to \$10 million, adjusted for inflation. With the inflation-adjusted amount in 2020 being \$11.58 million, today, a married couple can transfer, without considering the availability of any deductions or exclusions, approximately \$23 million before having to pay a federal gift or estate tax. Unless Congress takes further action, the exemption amount is scheduled to revert to pre-2018 exemption levels (indexed for inflation) on January 1, 2026.

## Locking in the Current Exemptions

Of course, Congress could take action to change the gift and estate tax exemption prior to 2026. Although it seems highly improbable that any such action will be taken in 2020, many commentators believe that after the election, a new Congress may enact changes as early as next year. Therefore, it may be advisable to act before the end of this year if you wish to take advantage of the law as it exists today.

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The Treasury Department has issued regulations stating that there will not be a “clawback” if you make a lifetime transfer now and the gift and estate tax exemption is subsequently reduced to pre-2018 levels in 2026, as currently scheduled. Although not addressed in the regulations, many commentators believe that the result will be the same if the exemption is reduced prior to 2026. This means that it may be beneficial to use the higher exemption amount available today by making lifetime taxable gifts before any reduction becomes effective.

However, in order to benefit from the higher exemption amount, you will need to transfer an amount that is greater than the exemption amount that ultimately will be available at the time of your death. If, for example, the exemption is reduced to \$5 million, adjusted for inflation, you would need to have transferred an amount in excess of \$5 million, adjusted for inflation, prior to the reduction.

## **Ways to Use the Current Exemptions**

The current exemption amount can be used by making lifetime gifts, either outright or in trust. Often individuals choose to benefit both their children and more remote generations. If a large gift benefits grandchildren or even younger generations, the GST exemption can also be used.

An outright gift is the simplest method of using your lifetime exemption amount, provided you are comfortable giving unfettered control of the assets to the recipient. If you have made any intrafamily loans, another way to make an outright gift is to forgive the outstanding debt.

While gifting in trust is more complex, it offers more control over how the assets will be used and also may provide some asset protection for your beneficiaries. If it is determined that a trust is the appropriate vehicle, first consideration should be given to whether there is an existing trust already in place that would be suitable. Some individuals might be reluctant to make sizeable gifts now due to the potential need for the assets in the future to maintain their desired standard of living. Through proper planning, however, you can take advantage of some or all of the current exemption amount while maintaining access to these gifted assets, if needed. Among the techniques that may be considered are Spousal Lifetime Access Trusts (SLATs). A SLAT is an irrevocable trust established by you, of which your spouse is a beneficiary. Although the intent would not be to make distributions to your spouse (as doing so would only put the distributed assets back into your spouse’s taxable estate), creating such a trust may give couples some comfort that the assets transferred to the trust will at least be available to the beneficiary spouse in the event of unforeseen circumstances. Your advisors can discuss this and other techniques with you to help find the option best suited to your circumstances.

## **Funding the Gift**

As important as choosing which planning techniques best meet your goals is choosing which assets to transfer. To maximize the benefit of the transfer, you should choose assets with the greatest potential for appreciation. All of the growth after the transfer should not be in your estate (and therefore, not subject to subsequent gift or estate tax).

Traditional wisdom is to lean toward gifting assets with a high basis. Under the current transfer tax system, the cost basis of property transferred at death receives a “step-up” in basis to its fair market value. This eliminates the capital gains tax liability on the appreciation in the property’s value that occurred during the decedent’s lifetime. Use of the lifetime transfers discussed here will forego the step-up at your death since assets received by lifetime gift do not benefit from a basis step-up. However, holding on to assets simply to receive the basis step-up may not be in your best interests,

particularly if the step-up at death is eliminated by future legislation (as has been proposed from time to time). Thus, while choosing high basis assets may be preferable, it is important to consider the pros and cons of all of your assets before deciding what you will transfer.

## Conclusion

While future tax policy remains uncertain, there are a variety of tools at your disposal to take advantage of the current federal gift and estate tax exemption amount. However, how to structure and fund lifetime gifts requires careful consideration as discussed above. There are other factors, including state gift and estate tax laws and income tax implications, that need to be considered as well. Therefore, we recommend that you act soon to consult with your advisors and review your current estate plan in order to determine whether making significant lifetime transfers is an appropriate strategy for you.

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