porterwright

ESTATE PLANNING ALERT

JANUARY 27, 2021

MICHELLE WONG-HALABI
614.227.2075
mwong-halabi@porterwright.com

ELIZABETH ARENTZ
614.227.1984
earentz@porterwright.com

Saying goodbye to large estate and gift tax exemptions: The potential impact of new legislation and strategies to use your current exemption before it expires

On Dec. 22, 2017, the Tax Cuts and Jobs Act of 2017 (TCJA) was signed into law. Among the various changes to the tax code, one change that impacted individuals of high net worth and ultra-high net worth were the significant increases to the estate, gift and generation-skipping transfer (GST) tax exemptions.

The TCJA raised the lifetime exemption from $5 million (indexed for inflation) per person to $11.7 million for the 2021 tax year, allowing a married couple to transfer a combined $23.4 million without paying any gift or estate taxes on such transfers. The recent Democratic sweep of both the White House and U.S. Congress, however, is likely to result in a significant reduction to the current federal estate/gift/GST tax exemption levels. While it is impossible to predict the exact impact of future legislation, the TCJA is scheduled to sunset on Dec. 31, 2025, which will bring the exemption back down to its pre-2018 level of $5 million indexed for inflation. Congress could enact legislation to reduce the exemption even sooner, and possibly even lower.

The reduction of estate/gift/GST tax exemptions potentially leaves more assets exposed to an estate tax at death. The current estate tax rate is a staggering 40 percent (and there is some indication it may increase to 50 percent). That's at least 40 percent less assets going to children and loved ones. Fortunately, with some careful planning and forethought, the impact of estate taxes can be minimized, if not eliminated altogether. This is done by making lifetime gifts to use the current estate/gift tax exemption before they expire.

A few strategies to consider:

- **Spousal Lifetime Access Trust (SLAT):** A donor spouse can establish an irrevocable trust for the benefit of his or her spouse, as well as children and lineal descendants. The donor spouse makes a taxable gift to fund the SLAT, using a portion of his or her lifetime exemption. During the beneficiary spouse's lifetime, he or she can access the income and principal of the trust which will indirectly be enjoyed by the donor spouse. Upon the death of the donor spouse, the value of the assets in the SLAT will not be subject to estate tax. Any appreciation and growth of the trust assets will also pass estate tax-free. Even if the estate tax exemption is reduced after the trust is established, the SLAT assets should not be subject to estate tax.
- **Direct and Indirect Gifting:** The annual gift tax exclusion allows individuals to gift up to $15,000 per person, per year tax free. Married couples can give a total of $30,000 per person, per year. If individuals or married couples give more than these amounts, they do not necessarily have to pay taxes on those gifts. Instead, those gifts will reduce the lifetime exemption limit. For example, if an individual gifts someone $515,000, the donor's lifetime exemption amount will be reduced by $500,000, the amount by which their gift exceeds the annual exclusion. Individuals who are able to make significant gifts, either directly or in trust, will be better able to utilize the currently high exemption before the limits are reduced.
- **Business Succession Gifts:** Gifting strategies should not be limited to just cash. In fact, an effective gift strategy for some closely-held business owners is to gift a portion of their business interests to children who may be involved in the business. This could be done, for example, through a family limited partnership or limited liability company where the donor maintains control. A present gift will lock in the value for gift tax purposes, allowing all post-gift appreciation to pass free of estate or gift tax to the donor. And with some careful trust planning, the gift could also be shielded from further estate tax for the recipient, allowing for wealth to build for future generations.
- **Gifts of Depressed Stocks:** A similar approach can be taken with stocks whose values have been depressed due to the pandemic. If the stocks return to their pre-pandemic values after the date of the gift, all the appreciation and growth will pass free of gift or estate tax.
- **Grantor Retained Annuity Trust (GRAT):** GRATs allow a donor to transfer the future appreciation in an asset without using any gift or estate tax exemption amount. GRATs, however, may also be a target in upcoming legislation.
- **Low Interest Loans:** Another technique to consider in today's extremely low interest environment is to make a loan to a child or

porterwright

ESTATE PLANNING ALERT

family member. The borrower can reinvest the funds, potentially generating a return greater than the interest rate on the loan.

Of course, the above strategies are only a few of the available options to preserve current estate and gift tax exemptions before expiration. Additionally, it is possible that other traditionally effective estate tax reduction strategies might also be significantly impacted with the new administration.

For more information on structuring your estate plan to fit your individualized goals, contact Michelle Wong-Halabi, Elizabeth Arentz or any member of Porter Wright's Tax, Estate Planning and Personal Wealth practice group.