Now is Not the Time to Watch the Sunset

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

Christopher W. Genheimer
Carruthers & Roth, P.A.
336-478-1156
cwg@crlaw.com

J. Aaron Bennett
Carruthers & Roth, P.A.
336-478-1105
jab@crlaw.com

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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)

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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2010	Estate Tax Repealed!!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 sunsetting 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

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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)

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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)**

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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
  - <u>Less: $ 5 million</u> rem. exemption
  - $16 million
  - <u>x 40% tax rate</u>
  - $6.4 million of estate tax
- <u>Important</u>: To take full advantage of tax savings, gifts must exceed what the exemption will be reduced to!

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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?)

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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

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Spousal Lifetime Access Trust

- Irrevocable trust
- Spouse is the primary beneficiary
- "Grantor trust" for income tax purposes
- <u>Benefits</u>:
  - Gets future growth of asset out of Grantor's estate
  - Preserves income stream for spouse
- <u>Risks</u>:
  - 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

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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

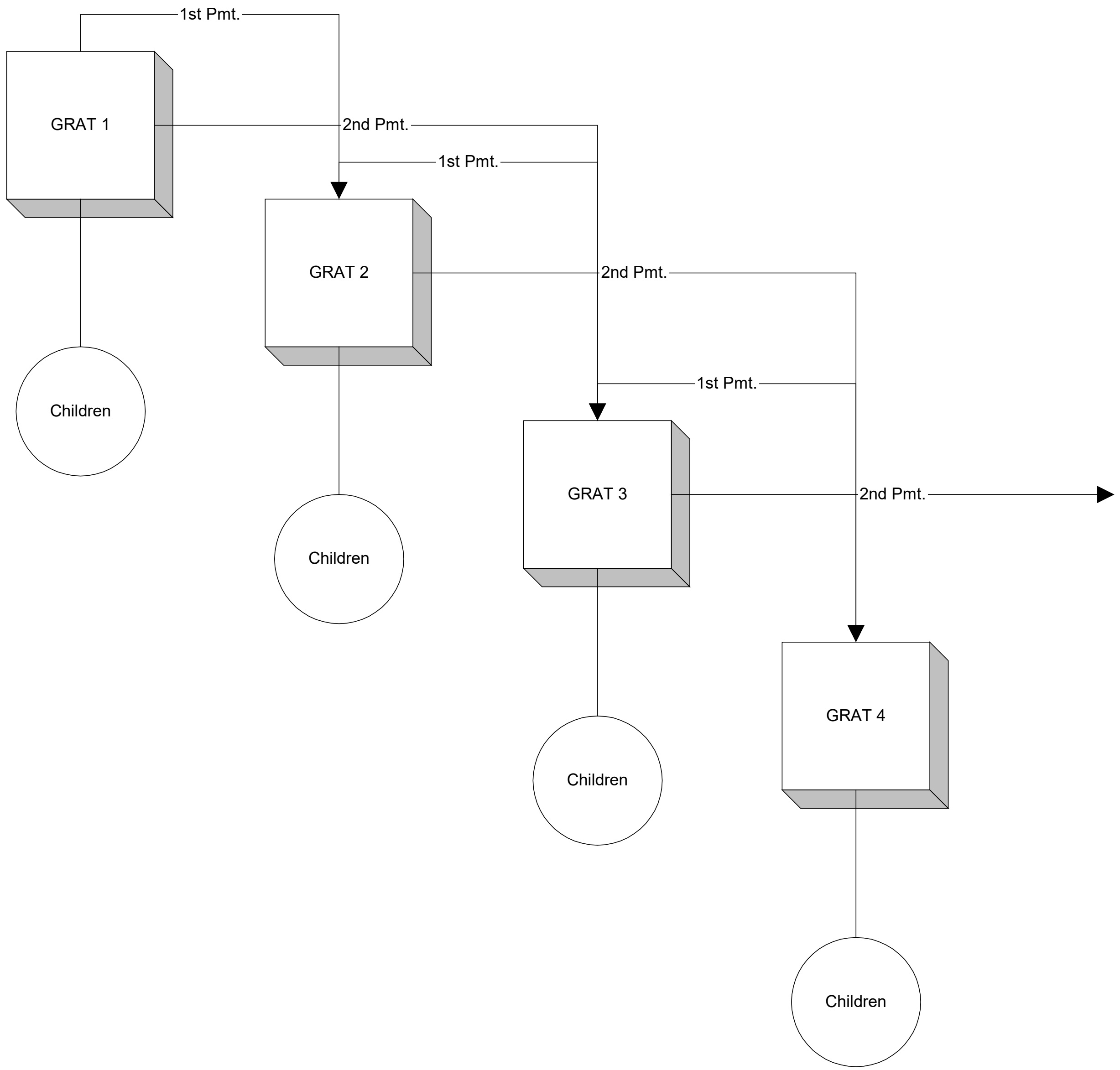
Case Study – Estate Over $28 million

- 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



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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

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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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