



Potential Estate Tax Threat?

Over the past few decades, federal taxes have generally trended lower. That era may be coming to an end, especially for well-off individuals. The major factor to consider is that our country might finally be forced to confront the issue of ongoing huge federal budget deficits—which have been made that much bigger by costly federal COVID-19 relief measures. Here is the question you need to address:

Can You Protect What You Currently Possess From a Possible Oncoming Federal Estate and Gift Tax Threat/Reform?

Today's Federal Estate and Gift Tax Picture

The Tax Cuts and Jobs Act (TCJA) drastically increased the unified federal estate and gift tax exemption from \$5.49 million for 2017 to \$11.58 million for 2020—with inflation adjustments scheduled for 2021-2025. If you are married, your spouse is entitled to a separate exemption in the same amount.

If you make cumulative lifetime *taxable gifts* in excess of the exemption amount, the excess is taxed at a flat 40 percent rate. If you pass away with an estate valued at more than the exemption amount, the excess is taxed at the same flat 40 percent rate.

Taxable gifts mean gifts made in one year to one individual that exceed the annual federal gift tax exclusion. The exclusion for 2020 is \$15,000, and it will probably stay at that number for the next few years. If you make taxable gifts during your lifetime, you won't actually owe any federal gift tax until the cumulative amount of such gifts exceeds the unified federal estate and gift tax exemption. Excess gifts reduce your unified exemption dollar-for-dollar, but only a few very generous individuals ever actually owe federal gift tax.

Snapshots of Earlier Federal Estate and Gift Tax Regimes

Today's federal estate and gift tax regime is far more taxpayer friendly than the regimes that existed earlier in this century:

- For 2000, the federal estate tax exemption was \$675,000, and the maximum tax rate was 55 percent.
- For 2005, the exemption was \$1.5 million, and the maximum tax rate was 47 percent.
- For 2009, the exemption was \$3.5 million, and the maximum tax rate was 45 percent.



- For 2010, but just for that one year, estate executors could opt for a zero federal estate tax bill in exchange for giving up tax-basis step-ups for certain assets inherited by beneficiaries of the deceased individual.
- For 2015, the unified federal estate and gift tax exemption was \$5.43 million. The tax rate on cumulative lifetime gifts in excess of the exemption and estates valued in excess of the exemption was a flat 40 percent.
- For 2020, the unified federal estate and gift tax exemption is \$11.58 million. The tax rate on cumulative lifetime gifts in excess of the exemption is a flat 40 percent. The tax rate on the estate of an individual who passes away this year with an estate valued in excess of the exemption is a flat 40 percent.

The Portable Exemption Privilege

Since 2011, we have also enjoyed a federal estate and gift tax *exemption portability* option for married couples. If one spouse dies without using his or her exemption, the surviving spouse is allowed to inherit the deceased spouse's unused exemption.

Example. Bob passes away this year without using any of his \$11.58 million exemption (he made no taxable gifts during his lifetime).

Surviving spouse, Carol, inherits Bob's unused exemption and adds it to her own exemption. So far, Carol has made no taxable gifts during her lifetime.

For 2020, Carol has a whopping \$23.16 million unified federal estate and gift tax exemption to work with (\$11.58 million x 2).

Between now and year-end, Carol could give away \$23.16 million with no federal gift tax liability. If Carol passes away before year-end, her heirs could inherit \$23.16 million with no federal estate tax liability.

Scheduled Federal Estate and Gift Tax Regime for 2021-2025 and Sunset Provision Scheduled for 2026

For 2021-2025, today's version of the Internal Revenue Code stipulates that the unified federal estate and gift tax exemption (currently \$11.58 million) will be adjusted annually for inflation. The flat tax rate on excess lifetime gifts and excess estate values will remain at 40 percent.

So far, so good. However, a sunset provision stipulates that the exemption for 2026 will revert back to the 2017 amount of \$5.49 million, with a cumulative inflation adjustment for 2018-2025. About \$6.5 million is a good guess for the 2026 exemption amount if the sunset provision takes effect for that year.



The flat tax rate on cumulative lifetime gifts in excess of that number and estate values in excess of that number would remain at 40 percent.

The Looming Federal Estate and Gift Tax Threat

There's no guarantee that today's super-favorable federal estate and gift tax regime will survive beyond this year.

What actually happens to the federal estate and gift tax regime (if anything) will depend on events. The current regime might survive, or it might be trashed and replaced with something not nearly so taxpayer friendly. Possible outcomes could include:

- The existing taxpayer-friendly regime stays in place through at least 2024 (the next general election year).
- The portable exemption privilege is repealed, and the effective date of the aforementioned sunset provision is accelerated to January 1, 2021. The 2021 exemption would be about \$6 million.
- Starting next year, we go back to the 2009 regime with its much-smaller \$3.5 million exemption, 45 percent maximum tax rate, and no portable exemption.
- Starting next year, we get something much worse. For instance, we could go all the way back to the 2000 regime with its skimpy \$675,000 exemption, confiscatory 55 percent maximum tax rate, and no portable exemption. Ugh!

What to Do?

Very good question. Here's one idea. If you have an estate in the large-to-very-large category, put yourself in position to make large-to-very-large gifts before year-end to reduce the value of your taxable estate.

You can shelter the gifts from the federal gift tax with this year's unified federal estate and gift tax exemption. Remember, it's that hefty \$11.58 million.

Example. Alicia is an 85-year-old widow with a \$12 million estate (not counting her nice home). She has financially responsible adult children who are in her good graces. She has never made any taxable gifts, and her husband died before the portable exemption deal became law.

As of today, she has an \$11.58 million unified federal estate and gift tax exemption in hand. So far, so good.

Alicia might want to be prepared to give away \$8 million to the kids with the verbal understanding that the kids will help her out in the future, if necessary.



If Alicia feels forced to implement the plan, she will still have her home and \$4 million. That should be enough to comfortably get by.

If the federal estate and gift tax regime is changed much for the worse starting *next year*, Alicia's post-2020 exposure to estate and gift taxes may be changed for the worse. But she dodged at least part of the problem by giving away \$8 million this year.

You get the idea. There are no guarantees here because we can't predict the future.

Considerations

1. Depending on the assets on your personal balance sheet, it could be easy or hard to position yourself to make large-to-very-large gifts before year-end. You may need to make some moves to get into position.
2. Depending on who would receive your large-to-very-large gifts, you may need to take some extra steps, such as setting up trusts for some or all of your intended gift recipients.
3. If you're married, remember that both you and your spouse are entitled to separate unified federal estate and gift tax exemptions.
4. If your spouse passed away after 2010, we hope the executor of your spouse's estate filed Form 706 (the federal estate tax return) to elect to take advantage of the portable exemption privilege. If so, your exemption is that much bigger. If not, consult a good estate planning pro to see if the election can still be made. If so, it could make a big difference in your favor.
5. If you make gifts to someone who is more than one generation beneath you (like a grandchild or great-grandchild), the federal generation-skipping transfer tax (GSTT) can become a factor. The GSTT is sneaky. It can come into play with gifts to a trust that will *eventually* benefit someone who is more than one generation beneath you. Talk to your estate planning pro about the GSTT, especially if you're considering making a gift to a trust.

If you or a loved one is giving this a good look and would like my input, please call me at (800) 810-1736.

It's a good life!