2021 Estate and Gift Tax Planning

Under the current estate tax law, all persons have a transfer tax credit equivalent of $11,700,000 (2021) of property which can be transferred to others prior to death without the payment of any gift taxes. Any lifetime transfer will reduce the estate tax exemption. The credit equivalent, for estate tax purposes, is $11,700,000 (2021). However, for the years 2026 and thereafter, the estate and gift tax credit equivalent will revert to $5,000,000 adjusted for inflation (approximately $6,000,000) with a 40% estate tax rate for assets in excess of the exemption.

The Biden administration and the new Congress is likely to act to effectuate what has been described as a "return to historical norms" for estate and gift tax laws. This would likely be a proposal whereby the estate tax exemption is reduced to $3,500,000, the gift tax exemption is reduced to $1,000,000, and the tax rate would increase to 45%. Another possibility would be the acceleration of the current sunset of the exemption.

Clients have inquired as to how they can utilize the current gift, estate, and generation-skipping transfer tax laws and $11.7 million exclusion amount in 2021 to their advantage, particularly given the increasing likelihood that there will be a reduction in the exclusion before the sunset date of December 31, 2025. There is no certainty as to when or whether Congress will even act in this area or if Congress does act what the estate tax laws for 2021 and thereafter will look like. However, the possibility that the current estate and gift tax exclusion amounts will fall within the “use it or lose it” category are increasing. It is possible that Congress acts to reduce the exclusion amount under the current law retroactive to January 1, 2021 or that Congress could implement a "claw back" if an individual makes gifts in 2021 utilizing the current exclusion amount, but then the individual dies in a year when the exclusion amount is less than the amount the individual already gave away. However, most of the commentators on the subject appear to believe that neither of those are very likely. The more likely consensus appears to be that if the exemption amounts are utilized before any modification to the estate tax laws that there would probably be no “claw back” on death.

Accordingly, if your assets exceed the anticipated reduced estate tax exemption amounts, then maximizing the use of the current $11,700,000 exemption, prior to a change in the law, is an attractive option. The most common strategy used to capture the current exemptions is to gift appreciating assets to an irrevocable trust for the benefit of a spouse, children and grandchildren. Some of the strategies include:

$ Outright gifts;
$ Decanting assets in existing trusts into new trusts;
$ Business Restructuring, including the formation of Family Limited Partnerships and "Estate Freezes," including gifts and sales to intentionally defective grantor trusts;
$ Forgiveness or refinancing of outstanding promissory notes or loans;
$ Gifts to Irrevocable Life Insurance Trusts to facilitate the purchase of additional life insurance policies or increased death benefit on existing policies;
$ Qualified Personal Residence Trusts;
$ Spousal Lifetime Access Trusts (“SLATS”); and
$ Charitable Lead Annuity Trusts.

The basic concept in each of these planning techniques mentioned above are to move assets that are currently owned in a manner that would subject them to estate tax to beneficiaries (or trusts for beneficiaries) utilizing all or some portion of the current exemption amounts. These assets would then be removed from your estate for estate tax purposes. There would be little or no gift tax resulting from the restructuring due to the current gift tax exemption amounts. Additionally, future appreciation of the assets would also be removed from your estate. This also has the benefit of “locking in” the current exemption amounts in the event Congress acts to reduce them or the sunset provisions kick in.

If you believe that your financial situation indicates that considering such planning is required or beneficial given the potential for estate tax on your death if a substantially lower estate tax exemption returns, please contact us to discuss your specific needs and planning opportunities.