

July 2020

With the 2020 Presidential and Congressional elections on the horizon, many clients have asked us about the impact that a possible shift in the political order may have on their personal, estate and tax planning. Specifically, many of our clients have heard predictions that a significant electoral victory by the Democratic Party may lead to the curtailment of the temporarily increased estate, gift and generation-skipping transfer (GST) tax exemption amounts. Although it is impossible for us to handicap either the outcome of the elections or the likelihood that, if there were a change in the White House and Senate, there would be changes to the law and, if so, the effective date of those changes, we will nevertheless tell you our general thoughts about some potential results and planning opportunities.

Potential Reduction of Exemption Amounts

After the 2017 Tax Act, the gift, estate and GST tax exemption amounts are \$11,580,000 each in 2020 and are indexed for inflation annually going forward, so they will likely increase with inflation over time. However, the current amounts are slated to automatically "revert back" in 2026 to the lower, pre-2018 exemption amounts (\$5,000,000 each, but indexed for inflation from 2011). However, a new Congress and President could accelerate the reduction of the increased exemption amounts (or possibly reduce them even further). Some commentators believe that such reductions in the exemption amounts, even if passed in the middle or later part of 2021, *could be implemented "retroactively" to be effective as of January 1, 2021*. Therefore, clients who due to the size of their estates are confident that their estates will pay estate tax if the exemption amounts are reduced, may wish to consider gifting options designed to "lock in" the benefit of the temporarily increased and potentially expiring exemption amounts.

How to Take Advantage of Currently Higher Exemption Amounts

At the beginning of 2018, the gift, estate and GST tax exemption amounts were essentially "doubled" from pre-2017 levels. For simplicity's sake, assume the current exemption amounts are \$11.5 million per person (or \$23 million for a married couple), but are scheduled to be reduced to \$6 million per person (or \$12 million for a married couple) - whether in 2026 under current law, or earlier if the laws change. It is important to note that an individual cannot simply give away \$5.5 million to "lock in" the increased exemption amount, because if/when the exemption amounts are reduced to \$6 million, the donor is deemed to have utilized *only the first \$5.5 million* of his or her exemption (and not the excess \$5.5 million of exemption). In other words, a donor who makes a \$5.5 million gift when the exemption amount is \$11.5 million will be left with \$500,000 remaining exemption when the exemption is reduced to \$6 million, and will therefore have derived no benefit from the increases in the exemption amounts.

As a result, for an individual who has not already used any part of his or her gift tax exemption amount, he or she must give up to \$11.5 million to fully use the benefit of the \$5.5 million excess exemption amount, and couples must give up to \$23 million to fully lock in the benefit of the combined \$11 million excess exemption amounts. With a 40% estate tax rate, every \$1 million of excess exemption used on lifetime gifts (that otherwise would expire or be reduced) would result in \$400,000 of estate tax savings when the donor passes away.

One intermediate approach is to lock in the benefit of at least one spouse's excess \$5.5 million exemption by having just one spouse make an \$11.5 million gift (and not split gifts with the non-gifting spouse on the gift tax return). This should lock in the benefit of the excess \$5.5 million exemption of one spouse, who, if/when the exemption reverts to \$6 million will have \$500,000 exemption left and the spouse who did not make gifts with \$6 million left - thus "losing" only one spouse's excess \$5.5 million exemption.

Gifts to utilize exemption can take a variety of forms - outright gifts to descendants, gifts in trusts for descendants, or gifts into trusts that can benefit both the spouse and descendants - just to name a few. One option for gifting to take advantage of the currently higher exemption amounts, applicable to married couples, would be to create a so-called spousal limited access trust ("SLAT"). A SLAT is a trust that one spouse creates, making the other spouse a permissible beneficiary during the beneficiary-spouse's lifetime, which creates planning flexibility.

Generally, any assets that are given away during life will maintain the donor's income tax basis and, absent additional planning, will not receive a step-up in basis upon the donor's death. By comparison, assets that pass at death will receive a step-up in basis at the owner's death. Given this, it is usually better to use cash or assets with high income tax cost basis for lifetime gifts. It is also beneficial to make lifetime gifts with assets that are expected to appreciate significantly, in order to shift the appreciation out of the donor's taxable estate.

Why Planning Sooner is Better than at Year-End

We are communicating with you in July 2020 because if there is a substantial political change as a result of the November elections, that may lead many clients to rush to engage in gift planning at the end of 2020 to use the currently higher exemption amounts. Although we at HTT&S will be ready and able to assist with any such year-end planning, there are two important reasons to begin the planning process sooner, rather than at the end of the year after the elections. With the benefit of more lead time, clients and their advisors will be able to give more careful thought and consideration to the gift plan to ensure that the gift not only makes use of the increased exemption amounts, but also, and more importantly, actually creates a structure that achieves the clients' long-term wealth transfer goals. Second, to ensure that the favorable 2020 laws apply, such gifts must be completed before the end of the year. From a practical perspective, many banks and financial institutions can take several days or weeks to open bank or brokerage accounts for irrevocable trusts in the best of circumstances. Further delays and difficulties should be anticipated in light of COVID-19 related closures and upheaval. If a gift plan is implemented too late in the year, then the bank or brokerage accounts may not be open

before the end of the year to receive the gift transfers from the donors. Certain assets may take longer to transfer. For example, the transfer of real estate necessitates the preparation and recording of a new deed.

Many clients have found a "wait-and-see" approach to be attractive. A donor may create a trust "now" and open a trust account with a nominal amount so that the gifting structure is established and available at such time that the client is ready to make gifts. Later on, but before the end of the year, the donor can decide whether to make significant gifts to the trust. If the donor chooses to do so, the gifting vehicle is already in place. If the donor chooses not to make a gift, then the trust that was previously established can simply be terminated.

One additional note is pertinent. Whether or not the gift and estate tax laws change in the short term (whether in 2021 or 2026, or sometime in between), taking advantage of gift tax exemption is and has been an attractive plan for a variety of reasons, not the least of which is removing post-gift income from and appreciation on the gifted assets from the donor's taxable estate. When coupled with other planning techniques, including, for example, valuation discounts, the use of generation-skipping transfer tax exemption, low-interest rate loans and the use of so-called "grantor trusts" and "GRATs," the potential benefits of a gift program have been and should continue to be considered as part of your estate planning agenda when the circumstances warrant.

If you are considering a plan to take advantage of the currently higher exemption amounts before the end of 2020, or if you would like to discuss the potential impact of a change in the estate, gift and GST tax laws on your personal estate planning, we encourage you to reach out to your HTT&S attorney. Sooner is better than later. Get ahead of the year-end rush!