

Are Changes Coming For The Gift And Estate Tax Exemption?

Under current estate tax law, taxpayers benefit from the most generous gift and estate tax regime in history. Indeed, in 2023, an individual can shield assets worth up to \$12.92 million from federal gift and estate tax.

But the good times won't last forever, or at least they're not designed to. The increase in the exemption amount brought by the Tax Cuts and Jobs Act (TCJA) is scheduled to "sunset" after 2025, so changes could be coming soon. Even though the fate of the exemption amount is yet to be determined, it's best to be prepared for all possibilities.

Evolution Of Estate Tax Law

Generally, you can shelter your estate from federal estate tax through a combination of the unlimited marital deduction and the unified gift and estate tax exemption. As the name implies, the unlimited marital deduction covers transfers between spouses. The exemption applies to transfers to nonspousal beneficiaries.

With the enactment of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), the estate tax exemption amount gradually increased from \$1 million in 2001 to \$3.5 million in 2009, while reducing the top estate tax rate from 55% to 45%. It also severed the unified gift and estate tax systems, creating a lifetime gift tax exemption of \$1 million. EGTRRA repealed the estate tax outright in 2010, but just for one year. The estate tax returned in full force in 2011.

Subsequently, under the Tax Relief Act of 2010, the exemption was boosted to \$5 million (indexed for inflation), the top estate tax rate was lowered to 35%, and the gift and estate tax exemption was reunified. Furthermore, this law allowed "portability" of exemptions between spouses and restored favorable rules enabling beneficiaries to benefit from a "step-up in basis" on the value of inherited assets.

Next, the American Taxpayer Relief Act (ATRA) preserved the gift and estate tax exemption of \$5 million with inflation indexing. It also made exemption portability permanent. At the same time, ATRA bumped up the top federal estate tax rate from 35% to 40%, where it currently remains.

At long last, the TCJA doubled the estate tax exemption to \$10 million with inflation indexing. But is the other shoe about to drop?

Planning For After The Sunset

Barring further legislation, the \$10 million exemption is scheduled to revert to \$5 million, with inflation indexing, after 2025. Of course, a lot can happen between now and the beginning of 2026.

From a political perspective, it may be difficult for either of the two political parties to support such a significant reduction. Indeed, the conventional wisdom is that the existing exemption is likely to be extended or modified to provide a more generous exemption than \$5 million.

In the meantime, the worst-case scenario can be factored into your current estate plan. Primarily, your estate planning documents, including your will, should include language that maximizes the applicable gift and estate tax exemption amount at the time of death.

Also, consider making lifetime gifts. For example, you can begin a series of gifts that qualify for the annual gift tax exclusion. For 2023, you can give each recipient up to \$17,000 without paying gift tax or eroding your gift and estate tax exemption.

Similarly, you can contribute to a Section 529 plan that can be used to pay for higher education expenses of your children or grandchildren. Further, for 529 plans you have the opportunity to “front-load” five years (\$85,000 at the current amount, or \$170,000 for a married couple) of annual exclusions.

Planning For The Future

The sunset date of the gift and estate exemption amount is still a few years away. The hope is that Congress will act sooner rather than later to quell uncertainty regarding the exemption's future. Your estate planning advisor will continue to keep you updated on any new developments that should be factored into your estate plan.

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