Flex Plan:
Building Flexibility into Estate Planning

The Tax Cuts and Jobs Act (TCJA) made one substantial change to the federal gift and estate tax regime. It more than doubled the combined gift and estate tax exemption, as well as the generation-skipping transfer (GST) tax exemption. This change is only temporary, however. Unless Congress takes further action, the exemptions will return to their inflation-adjusted 2017 levels starting in 2026.

What does this mean for your estate plan?

If an estate is well within the 2020 exemption amount of $11.58 million, the higher exemption won't have a big impact on estate planning strategies. But if an estate is in the $6 million to $11 million range, it's important to build some flexibility into the estate plan to address potential tax liability after 2025.

An uncertain future

While the IRS has confirmed that there will not be an estate tax clawback, anything can happen between now and 2026. Lawmakers may allow the exemption amount to revert to its pre-TCJA level, reduce it even further (some have suggested $3.5 million) or make the current amount permanent. Or they may repeal the gift, estate and GST taxes altogether.

This uncertainty makes planning a challenge. Let's say a person's estate is worth $8 million. If this person dies between now and 2025, they will avoid estate taxes. But suppose this person lives beyond 2025 and the exemption drops to an inflation-adjusted $5.75 million. The estate will be hit with a $900,000 tax liability. A $3.5 million exemption would double the tax to $1.8 million.

One option is to take advantage of the higher exemption by giving away assets (either outright or in trust) during your lifetime. These gifts would be shielded from gift and GST taxes by the current exemption. And the assets (together with any future appreciation in value) would be removed from your estate, avoiding estate taxes even if the exemption decreases in the future.

The problem with this approach is that gifts of appreciated assets retain the donor's tax basis, subjecting the beneficiaries to capital gains taxes if they're sold. Assets transferred at death, on the other hand, enjoy a "stepped-up basis" and can be sold with lower or no capital gains. If substantial lifetime gifts are made and the exemption amount remains at its current level in the future (or the estate tax is repealed), it will have triggered capital gains taxes needlessly.

Staying flexible

One strategy to use to build flexibility into an estate plan is to use an irrevocable trust. This can enable a person or his/her representatives to switch gears once the future of the estate tax becomes clearer. With this strategy, assets are transferred to an irrevocable trust, taking advantage of the current exemption amount. But the trustee is given the authority to take certain actions that would cause the assets to be included in your estate — such as granting you a power of appointment or naming you as successor trustee. The trustee would exercise this authority if it turns out that estate inclusion would produce a better tax outcome.

For more information or to learn about this or other strategies to build flexibility into your estate plan, contact your Anchin Relationship Partner or a member of Anchin Private Client at 212.840.3456 or info@anchin.com.

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