

Flex plan: In an unpredictable estate planning environment, flexibility is key

Published on November 14, 2019

The Tax Cuts and Jobs Act ("TCJA") made only one change to the federal gift and estate tax regime, but it was a big one. 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 your estate is well within the 2019 exemption amount of \$11.40 million (\$11.58 million for 2020), the higher exemption won't have a big impact on your estate planning strategies. But if your estate is in the \$6 million to \$11 million range, it's important to build some flexibility into your plan to address potential tax liability after 2025.

An uncertain future

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 your estate is worth \$8 million. If you die between now and 2025, you'll avoid estate taxes. But suppose you live beyond 2025 and the exemption drops to an inflation-adjusted \$5.75 million. Your 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 your tax basis, subjecting your 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 you make substantial lifetime gifts and the exemption amount remains at its current level in the future (or the estate tax is repealed), you'll have triggered capital gains taxes needlessly.

Staying flexible

One strategy to use to build flexibility into your plan is to use an irrevocable trust. This can enable you or your representatives to switch gears once the future of the estate tax becomes clearer. With this strategy, you transfer assets to an irrevocable trust, taking advantage of the current exemption amount. But you give the trustee 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.

Please contact us to learn about this or other strategies to build flexibility into your estate plan.

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