

# Flexibility is Key in Estate Planning

The Tax Cuts and Jobs Act (TCJA) made only one change to the federal gift and estate tax regime, but it was significant. The act more than doubled the combined gift and estate tax exemption, as well as the generation-skipping transfer (GST) tax exemption, to a current \$11.4 million.

If your estate is smaller than 2019's amount, the higher exemption isn't likely to affect your estate planning strategies. However, if your estate is in the \$6 million to \$11 million range (\$12 million to \$22 million for married couples), you'll want to consider building some flexibility into your plan to address potential tax liabilities when the exemption expires in 2026.

## Hazy Outlook

Of course, 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 inflation-adjusted 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. Just watch out for a potential IRS "clawback" — estate taxes on the amount by which pre-2026 gifts exceed the post-2025 exemption of those gifts into your estate.

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 little 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substantial lifetime gifts and the exemption amount remains at its current level in the future (or the estate tax is repealed), you'll have triggered capital gains taxes needlessly.

## Trusts and Other Strategies

There are several strategies you can use to build flexibility into your plan, enabling you or your representatives to switch gears once the future of the estate tax becomes clearer. For example, consider establishing an irrevocable trust. You transfer assets to the 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.

Or, you could retain the right to exchange cash or high-basis assets for low-basis trust assets. This would allow you to bring appreciated assets back into your estate if Congress repeals the estate tax or extends the current exemption beyond 2025.

Other strategies include:

**QPRTs.** A qualified personal residence trust (QPRT) is a great tool for removing the value of your home, including future appreciation, while you continue to live in it for a term of years. At the end of the term, the home is transferred to your children or other beneficiaries, but you can arrange to continue living there in exchange for fair market rent. If you establish a QPRT but discover later that you won't be subject to estate tax, you can bring the home back into your estate by neglecting to pay rent, allowing your beneficiaries to enjoy a stepped-up basis.

**Disclaimers.** A carefully designed qualified disclaimer gives your beneficiaries the power to reject inherited assets, allowing them to pass to another beneficiary in a more tax-efficient manner. Let's say you leave your \$8 million estate outright to your daughter with a disclaimer provision that allows her to redirect some or all the assets into a trust for the benefit of her children. At the time of your death in late 2025, Congress has passed legislation reducing the exemption to \$3.5 million in 2026. Your daughter disclaims \$4.5 million of her inheritance, causing those assets to pass into a trust for her children and avoiding taxes as part of her estate.

### **If Congress Doesn't Act ...**

Don't assume that today's higher exemption amounts will be available forever. Unless Congress takes further action, the exemptions will return to their inflation-adjusted 2017 levels starting in 2026.

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