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The Sunset is Not Worth Waiting For

Estate Tax Planning Strategies in 2024

The federal estate tax exemption amount is currently $13.61 million per individual ($27.22 million for a married couple) and is scheduled to increase each year through December 31, 2025. On January 1, 2026, the exemption increases are scheduled to sunset. The sunset will result in the estate tax exemption amount reverting to the prior $5 million exemption level adjusted for inflation (approximately $7 million per individual, $14 million for a married couple). Because the sunset reduction is scheduled to occur automatically, congressional action would be needed to prevent the sunset from happening. If Congress remains divided, it is unlikely there will be enough votes to prevent the scheduled sunset at the end of 2025. Given that scenario and the ability to transfer assets up to $13.61 million now, with no clawback after 2025, it would be prudent for individuals who could have an estate tax problem starting in 2026, to consider available estate tax planning options now.

There are a variety of estate tax reduction strategies being employed in the current environment. Here is an overview of some common estate planning strategies to consider:

Strategies to Lock in Current Estate Tax Exemption Amount Before 2026 Sunset:

- **Spousal Lifetime Access Trust (SLAT).** A SLAT allows an individual to set up a lifetime trust that benefits their spouse, locks in the current estate tax exemption amount of $13.61 million, and then passes the assets, including all appreciation, estate tax-free to beneficiaries of the donor spouse's choosing. Both spouses can set up a SLAT for the other but proper drafting needs to be done to make sure the trusts are not too similar. Many SLATs are drafted as dynasty trusts (see below) for multigenerational planning purposes.
- **Dynasty Trust.** A dynasty trust is constructed to benefit multiple family generations without its assets being subject to estate tax. Dynasty trust assets also generally provide beneficiaries protection from creditor and divorce claims.

Strategies That Can Work in Any Environment:

- **Annual Gifting.** In 2024, an individual can gift $18,000 per year ($36,000 for a married couple) to an unlimited number of people. If a married couple has two children and five grandchildren, that means they can gift $252,000 per year to their family members. Annual gifting can also be accomplished by gifting to properly drafted irrevocable trusts rather than being limited to outright distributions.
- **Grantor Retained Annuity Trust (GRAT).** GRATs are considered an estate freeze technique because they remove the appreciation, rather than the value of the asset itself, from a donor's estate. The value removed from the donor's estate is roughly the growth of the asset in excess of a mandated federal rate. Although the mandated federal rate rises with inflation, estate tax reduction opportunities still exist. For example, if a donor has a closely held business interest that is expected to grow at 20% and the mandated federal rate is 4%, that removes 16% of the growth from the donor's estate every year. If the asset has a value of $10 million and the donor creates a two-year GRAT, over $3 million would be removed from the donor's estate (plus all future appreciation thereon) over the two-year period.
- **Sale to an Intentionally Defective Grantor Trust (IDGT).** IDGTs work similar to GRATs, except they involve the sale of assets to a trust in exchange for a promissory note. The transaction is structured to make the sale from the grantor to the trust tax-free. IDGTs are generally entitled to use a slightly lower federal rate than GRATs, which makes it possible to remove more assets from a donor's estate. IDGTs are also better vehicles than GRATs for multigenerational wealth-transfer planning. Unlike GRATs, which can be structured to avoid any gift tax consequence, it is recommended that a donor make a 10% "seed" gift of liquid assets to an IDGT to support the validity of the trust loan.

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Strategies That Become More Effective in Higher Interest Rate Environments:

- **Charitable Remainder Trust (CRT).** A CRT provides a stream of income and an immediate income tax deduction to the donor. Funding with highly appreciated assets is optimal because the CRT can sell them and reinvest all the proceeds without paying income taxes. After the end of the trust term, the trust property passes to charities selected by the donor. The stream of income paid to the donor from the CRT is sometimes used to fund other irrevocable trusts that pass assets to beneficiaries free of income and estate tax.
- **Qualified Personal Residence Trust (QPRT).** A QPRT involves a donor gifting a primary or secondary residence to an irrevocable trust. The donor is entitled to live in the residence for a term of years, after which, the residence passes to the donor's heirs. The donor can stay in the residence after the QPRT term but must pay rent. The rent is not considered a gift and removes more assets from the donor's estate.

Even though the strategies discussed above are common, each person's situation is different, and the strategies discussed above may not best achieve your specific needs. For questions about your current estate plan or help with your estate tax planning needs, please contact our Estate Planning Services specialists at EPS@ceritypartners.com.

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