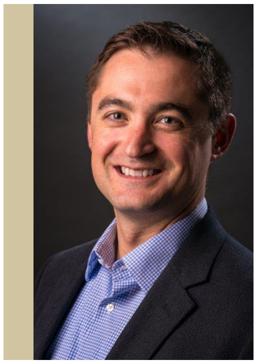
Call us:
866-CREATIVE

Email us:
cpi@creativeplanning.com

Visit us online:
www.creativeplanning.com

AUGUST 2020

USE IT OR (LIKELY) LOSE IT – FEDERAL ESTATE TAX EXEMPTION UNCERTAINTY



Seamus Smith
JD, LLM
Attorney

Mötely Crüe was probably not referring to the federal estate tax exemption in their song "Use It or Lose It," but it could serve as an anthem right now for estate tax planning.

The federal estate tax exemption, the amount of assets that you can pass free of federal estate tax at death, has risen significantly over the past decade. As a result, most people are not currently affected by the tax and it has become viewed as a problem for only the ultra-affluent. Unfortunately, the federal estate tax exemption is set for a big drop . . . and that drop may happen much sooner than was previously expected because of the current political climate.

The current inflation-adjusted federal estate tax exemption is $11,580,000 per person, or a combined $23,160,000 for a married couple. If you die with assets below the exemption, there is no federal estate tax due. If you die with assets in excess of the exemption, the value of the assets above the exemption is taxed at a rate of 40%. At least today, a federal estate tax bill is rare. This is because the vast majority of the population have assets below the exemption amount and any assets passing to spouses or charities are not subject to the tax anyway.

The current exemption of $11,580,000 per person is a consequence of legislation adopted in 2017 that temporarily doubled the exemption otherwise in place. The doubled exemption will continue to increase annually for inflation until the end of 2025. Assuming no interim change in law, the exemption will be reduced by half as of January 1, 2026.

The economic consequences of the 2026 reduction to the exemption will be catastrophic for higher net worth individuals. For example, assume that you die in 2020 and leave assets worth $11,580,000 to your children, there would be zero estate tax due because the value of your assets did not exceed the exemption. If we ignore subsequent inflation adjustments and assume your 2026 exemption is $5,790,000, or one-half of your 2020 exemption amount, your death in 2026 would trigger a federal estate tax of over $2,300,000. Your children are getting over two million less just because you happened to die after 2025!

Luckily, you can capture the benefit of your increased federal estate tax exemption before it drops without actually dying. If you make taxable gifts during life, it will utilize your exemption. While the exemption is not scheduled to drop until 2026, there is some added urgency to use your increased exemption sooner rather than later. A change in administration this fall may very well result in a decrease to the estate tax exemption ahead of 2026.

Some commentators originally suggested that the use of your increased exemption during life would later trigger some kind of clawback or penalty from the IRS. This is no longer a concern. The IRS has issued regulations indicating that there will be no clawback or penalty.

In addition to hedging a drop in the exemption, gifting during life provides significant leverage of your exemption over time. For example, assume you gift assets worth $11,580,000 to a trust for the benefit of your children and that the value of those gifted assets grows to $30,000,000 by the time of your death. You will have leveraged your exemption into an ultimate estate tax savings of over seven million dollars or 40% of the post-gift growth of the assets.

Some states still impose a state level estate tax as well. State level estate taxes generally have a tax rate well below the federal estate tax rate, but the state estate tax exemption levels are usually significantly less than the federal exemption. Utilizing your federal exemption during life to remove assets from your estate has an added benefit of minimizing state estate taxes due at your death as well.

If you are facing an estate tax liability and have not exhausted your federal estate tax exemption, you need to consider doing so before the end of 2025. If there is a change in administration this fall, you may lose the luxury of waiting until then and may need to make a decision to utilize your exemption much sooner. You may have to use it or lose it.

Call us:
866-CREATIVE

Email us:
cpi@creativeplanning.com

Visit us online:
www.creativeplanning.com

5454 W. 110th Street, Overland Park, KS 66211
direct: 866-CREATIVE | fax: 888-243-9402