Predicting and Preparing for The Estate and Gift Tax

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The automatic sunset of the lifetime exemption in 2026, the pending presidential election, and the daily Congressional dysfunction produces considerable uncertainty and anxious estate planning clients. However, the current unique circumstances provide many opportunities to employ flexible planning techniques that reduce taxes and provide flexibility to address unexpected future estate and gift tax changes.

Current State of The Estate and Gift Tax

Current estate and gift tax rules provide a lifetime exemption of $11.58 million per person ($23.16 million for married couples) while the estate and gift tax rate remains at 40 percent. Under the Tax Cuts and Jobs Act of 2017 (TCJA), the current increase in the lifetime exemption automatically sunsets on December 31, 2025.

The automatic sunset initially spurred concern about a possible "clawback" of gifts made during higher exemption periods, but Prop. Reg. § 20.2010-1(c) negates this concern. The preamble to these Proposed Regulations describes the estate and gift tax calculation process and presents a special rule allowing estates to compute the estate tax credit using the higher of the Basic Exclusion Amount (BEA) applicable to gifts made during lifetime or the BEA applicable on the date of death. This approach also avoids any "reverse clawback" from using the date-of-death BEA, where rising exemption amounts always covered the gifts.

Comparison of Proposed Changes to The Estate and Gift Tax

The upcoming presidential election adds uncertainty for clients and practitioners contemplating estate planning. Under the current administration, we can reasonably assume a small likelihood of the lifetime exemption dropping or the tax rate increasing.

Only some of the presidential candidates have outlined their thoughts on the estate and gift tax. The chart below compares the current laws, current legislative proposals and proposals advanced by the current presidential candidates. Of course, these proposals require congressional action to become law.

Current Laws				
	Estate & Gift Tax Rate	Lifetime Exemption	Gift Exemption	Basis Step-up?
Current Rules	40%	$11.58/$23.16 million	Unified	Yes
After Sunset	40%	Pre-TCJA levels plus inflation (est. $6.5 million)	Unified	Yes
Current Proposals				
	Estate & Gift Tax Rate	Lifetime Exemption	Gift Exemption	Basis Step-up?
Jimmy Gomez (D)	45%-77%	$3.5 million		No
John Thune (R)	Repeal			
Candidate Proposals				
	Estate & Gift Tax Rate	Lifetime Exemption	Gift Exemption	Basis Step-up?
Joe Biden	Unknown			No
Bernie Sanders	45%-77%	$3.5 million		No
Elizabeth Warren	45% plus 10% surtax on billion dollar estates	$3.5 million	Unified	No
Pete Buttigieg	Unknown - but wants "more equitable use of the estate tax."			
Andrew Yang	Unknown - but wants to "increase it at a progressive rate."			
Amy Klobuchar	Unknown			
Corey Booker	2009 rate (45%) plus increase for higher levels	$3.5 million	Unified	Unlikely
Michael Bloomberg	Unknown			
Tulsi Gabbard	Unknown			
Tom Steyer	Unknown - but wants to raise the estate tax.			
Michael Bennett	2009 rate (45%) plus increase for higher levels	$3.5 million	Unified	Unknown
Deval Patrick	Unknown - but wants to raise the estate tax.			
John Delaney	Unknown			

Addressing Uncertainty Use It or Lose It

Without the clawback, most clients should plan to take advantage of the increased lifetime exemption before it decreases, whether by the sunset or by legislative action. Particularly apprehensive clients may require significant preparation before the election to ensure prompt execution thereafter.

Some situations may indicate the use of upstream gifting, a wealth transfer planning technique involving older generations, and their unused lifetime exemption. For example, upstream gifting opportunities may exist where a married couple owns highly appreciated assets, and their parents or grandparents do not expect to owe estate taxes. A trust that addresses your tax and non-tax goals offers a gift receptacle that preserves the significant tax-saving opportunity and avoids potential pitfalls.

Build in Flexibility

Many readers may recall 2012, where similar uncertainty caused a rush on estate planning based on the expectation of a return of the estate and gift exemption to 2009 levels. Instead, Congress increased the exemption, causing many clients to ask about revising or even undoing work done at the last minute in 2012. More flexible planning techniques, including basis harvesting and state trust modification statutes, help eliminate some of the risks of "over-planning" by building in flexibility.

Basis Harvesting

Basis harvesting uses a testamentary general power of appointment over all or selected trust assets to include such assets in the estate of the power holder (a surviving spouse or another trust beneficiary) under Section 2014 of the Code, which in turn results in a basis step-up under Section 1015 of the Code.

While the mere existence of a lifetime testamentary appointment power causes the needed inclusion, a "testamentary only" general power of appointment ensures the maximum available creditor protection. Also, consider allowing the exercise of such general power only with the permission of an adverse third party, which allows the drafter to cause estate inclusion without allowing the redirection of trust assets beyond the desires of the settlor. Requiring third-party consent to the exercise of the power of appointment curtails the power holder's ability to redirect the assets to someone other than the intended beneficiaries designated by the settlor. Typically, the general power of appointment applies solely to appreciated assets and only where the exercise will not result in additional federal estate taxes.

Trust Modification Under State Law

Modern state trust statutes typically allow modification of irrevocable trusts, such as adding a basis harvesting provision to an existing trust. Deciding to modify an irrevocable trust requires consideration of existing trust provisions enabling the desired changes, and which state laws produce. To provide clients with the greatest flexibility, practitioners must consider the terms of the trust agreement. Including specific language allowing for trust modification under the applicable state law may eliminate the need for judicial approval of changes to an irrevocable trust.

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