Tax Law Provisions (Part II): Don't Let the Sun Go Down

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A recent piece by my colleague Peter Deming presented the changes coming after December 31, 2025, when the Tax Cuts and Job Act (TCJA) "sunsets." In this Part Two, I detail several strategies clients should consider for taking advantage of the higher estate and gift tax (aka transfer tax) exemptions before they are halved at the end of 2025.

It is rare to know exactly what will happen years into the future, and for once, advisors do not need to make another stale "crystal ball" joke when asked about what will happen. In this matter on transfer tax exemptions, we know what the law is now, and what it is set to be in the future (barring legislative action). The better question is, "what should I do to prepare?"

Much like the chorus of Elton John's 1974 hit record, "Don't Let the Sun Go Down on Me," we do not want the sun to go down on your estate tax situations while there are still actions that can be taken to mitigate the potentially egregious tax ramifications. Peter indicated this in his piece, but it bears repeating emphatically: Do not wait for Congress to act prior to the expiration of estate and gift tax provisions of TCJA. No strategy is a bad strategy.

Annual Gifting

In 2024, an individual can give up to $18,000 to anyone they wish without incurring gift tax. This means that clients with taxable estates, over $13.61 million per individual or $27.22 million for married couples, could begin (or continue) gifting up to $18,000 per person to family members, friends, or anyone else to reduce their taxable estate. This number is indexed for inflation so gifting amounts could increase for 2025. Married couples can give $36,000 in 2024.

Directly pay medical and education expenses

Another way of reducing taxable estates is to directly pay medical expenses and education expenses to a healthcare provider or educational institution. This can be done for any person, family members or otherwise. These payments are not considered gifts and thus do not require a gift tax return to be filed nor count against the donor's annual gift exclusion amount (e.g., funding a 529 plan and directly paying tuition to the school for the 529 beneficiary).

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by Buck Patton, CFP®, CPWA®

Max-fund 529 accounts for children/grandchildren (and ALSO directly pay tuition)

To take education expenses a step further, you can max-fund a 529 education savings account for a beneficiary, which means contributing five years' worth of maximum annual gifts into the account in one year. For 2024, this would mean funding an account with $90,000 ($18,000 x 5). If married, you can contribute $180,000 into the account in one year. One important note – if you max-fund a 529 plan, you cannot make additional contributions to that same 529 plan or gift to that specific beneficiary during the next 5 years; however, other family members could if they wish.

I dive deep into 529s in another article here if you would like more details on these robust vehicles.

Use one spouse's full lifetime exemption

The estate and gift tax exemption amount for 2024 is $13,610,000 per individual, which is indexed for inflation so the 2025 amount should be higher. Keep in mind, however, it will be cut in half at the end of 2025. For example, if the 2025 exemption is raised to $14,000,000, the 2026 exemption amount will be reduced to $7,000,000 per individual. For married couples these amounts are doubled ($27,220,000 exemption today, hypothetical $14,000,000 exemption in 2026).

One action available to married couples who want to take advantage of the currently high but expiring exemption amount but keep some chips on the table for potential future changes is to utilize one spouse's entire exemption amount now. This could make sense for couples right on the edge of a taxable estate with somewhere between $12 million and $20 million. Use one maximum exemption now to lock in the benefit, and then even after the sunset reduces exemption amounts to pre-2018 levels, the remaining estate may also be covered by the other spouse's exemption. The IRS has previously ruled that taxpayers who use exemption amounts between 2018 and 2025 will not be adversely affected by the sunsetting.

Elect Portability of DSUE before 2026

Estate and gift tax exemptions are portable, meaning that those amounts can pass from one spouse to another after the first spouse passes. For couples who have not yet used all of their exemptions and one spouse passes away prior to 2026, completing the portability election allows the deceased spouse's unused exemption (DSUE, pronounced "dee-soo") to port over to the surviving spouse and be combined with their exemption at the time. Note: an estate tax return (Form 706) must be filed and the portability election made on the return. Portability does not automatically happen. The IRS has increased the amount of time for survivors to make this election and simplified the reporting of values on the 706. Another important note: Generation Skipping Transfer (GST) tax exemption amounts, which pertain to another type of transfer tax to beneficiaries two or more generations below the donor, are NOT portable.

Below are three trust vehicles that could be considered to reduce, eliminate, or assuage estate tax. It is important to seek counsel from an experienced attorney when considering these types of strategies.

SLATs

One mechanism for utilizing the exemption amount is to create a trust for the benefit of a family, including the spouse as primary beneficiary, called a Spousal Lifetime Access Trust (SLAT, pronounced

"slat"). A SLAT constitutes a completed gift in trust to one's spouse from which that spouse can request distributions of income and principal. Therefore, the donor spouse could also indirectly benefit. The gifted assets are out of the taxable estate of both the donor spouse and the beneficiary spouse. They have access to the funds and the assets can pass down to heirs at the beneficiary spouse's death. These can be complicated but powerful tools for efficiently transferring wealth.

IDGTs

Like a SLAT, an Intentionally Defective Grantor Trust (IDGT, pronounced "id-jit") is another mechanism by which a client can transfer assets into an irrevocable trust, thus removing the value from his/her taxable estate, but can continue to have responsibility for paying income taxes. Irrevocable trusts are separate tax entities from grantors and have separate tax rate schedules. However, an IDGT allows the grantor to be taxed on the income from the trust, meaning the grantor can further remove value from their taxable estate. Furthermore, any potential appreciation of the assets transferred to the trust are not subject to estate tax. Paying the tax may seem like a disadvantage rather than a benefit, but trusts hit the highest marginal rates significantly quicker than individuals (for 2024, 37% rate at $14,451 of income for trusts vs. $731,201 of income if married filing jointly). When the goal is to reduce the taxable estate, paying income taxes at individual rates as opposed to trust rates is an advantage. Again, this is all very complex – seek guidance from competent advisors!

QPRTs

With the growth of the middle Tennessee area over the last 15 years, one sneaky asset that may push clients into a taxable estate (exceeding the exemption amount) is their residence. A Qualified Personal Residence Trust (QPRT, pronounced "queue-pert") is a helpful vehicle when trying to get a home (and its potential future appreciation) out of your estate at a reduced gift tax amount, without having to pay transfer taxes on the value of the home at your death. The home is placed in trust for a set term, up to twenty years (the grantor(s) must live the entire term of the trust for this to work), and they retain the right to live in the house during the term (which provides a "present interest value" that reduces the taxable gift), and at the end of the term the house passes to the beneficiary of the trust. Caution: if the donor outlives the trust term and wishes to stay in the residence, they must then pay rent to the the trust or to the trust beneficiaries! This could also be an effective way to further reduce the taxable estate while moving assets to younger generations, if the beneficiaries of the trust were children of the donor.

These are just a few examples of structures and strategies to help reduce the potential estate tax burdens that could spring up after exemptions are reduced. At a current estate tax rate of 40%, not only is the confiscation significant, but there could be an unnecessary liquidity crisis when trying to pay the tax bill. Just because clients may not have an estate tax issue this year does not mean that they won't have one in the future. Don't get caught "frozen on the ladder of life" and make plans accordingly! Truxton specializes in helping clients navigate these complex issues and coordinate with other professionals such as attorneys and accountants to bring about positive outcomes for all. Give us a call or stop by our office and discuss your unique situation with one of our experienced professionals, before 2026, when the sun goes down! ▪