TRUST COMPANY
OF THE SOUTH

# Watching the Sunset

One component of a well-advised estate plan is considering whether estate taxes may be due upon death. The estate tax is an onerous 40%, and it is charged on a person's assets in excess of the gift and estate tax exemption that pass to persons other than spouses and charities. The current gift and estate tax exemption is $13.61MM per person and $27.22MM per couple, so for many, estate tax has not been a concern. However, on January 1, 2026, the current law will sunset, and the estate and gift tax exemption will drop to $5MM indexed for inflation, which experts expect to be between $6.5-7MM. Essentially, then, in a little over 16 months from now, the exemption will be cut in half absent new legislation.

For those whose taxable estates will exceed the projected 2026 exemption level ($7MM for individuals and $14MM for married couples), there is a short planning window to consider techniques to mitigate potential estate taxes that take advantage of this bonus exemption. To appreciate the different tax results before and after sunset, consider that a married couple with $25MM in combined assets today would have no estate tax due when their estates passed to their children at the death of the survivor. After 2025, however, that same couple would have $4.4MM of estate tax assuming a $7MM exemption after sunset.

## ARE YOU A GOOD CANDIDATE FOR USING THE BONUS EXEMPTION?

Is there planning to be done to mitigate this estate tax problem for those who will have taxable estates after 2025? Yes! But first and foremost, you never want the tax tail to wag the dog. You should not enter into any transaction that afterward leaves you uncomfortable with your cash flow and available capital, your level of control or what/how/to whom you have passed your assets. You should work with your advisory team to assess your financial situation and establish your goals for the disposition of your estate prior to worrying about taxes. Second, making lifetime transfers to try and use a "bonus" exemption amount that is scheduled to drop off in 2026 will be difficult for most. When you make lifetime gifts, you use your base exemption first. For example, if you make a $3MM gift this year, in 2026 you will only have $4MM of exemption left. So, to use any of this bonus exemption, you need to have given away more than $7MM prior to January 1, 2026. Third, if you are able and advised to make large lifetime gifts, there is likely significant planning involved in doing so. Large gifts typically involve designing and establishing irrevocable trusts to which the gifts can be made. If assets other than cash equivalents are being given, an appraisal will be required to establish the value of the gift. There may be an opportunity to depress the value of the gift to leverage the exemption by creating entities and giving away fractional, noncontrolling interests at discounted values. Attorneys, accountants, appraisers and wealth advisors are going to be very busy helping their clients effect gifts prior to January 1, 2026, so you should get on their calendar.

## WHAT TYPES OF LARGE GIFTS COULD BE CONSIDERED?

A gift to a "SLAT" or a spousal lifetime access trust: A SLAT is an irrevocable trust that is set up to benefit the grantor's spouse for his/her lifetime and at the spouse's death can pass to descendants. It is designed to allow for the spouse (and grantor while married to the spouse) to retain access to the trust funds if needed via distributions that can be made to the spouse. The income of the trust is taxed to the grantor, which allows the trust to appreciate income tax-free and reduces the grantor's taxable estate by income taxes paid on behalf of the trust. Issues to consider prior to utilizing a SLAT include the grantor not having access to the trust upon the spouse's death, and what happens in the event the grantor and spouse divorce.

A gift to a GST (generation-skipping transfer) exempt trust for descendants: If neither spouse needs access to the gifted assets, an irrevocable trust could be established for descendants. This trust could last for multiple generations and never be subject to estate tax by using the clients' generation-skipping transfer, or "GST", tax exemption. This trust could also be designed so that the grantor continues to pay the trust's income taxes, allowing the trust to appreciate tax-free.

Charitable gifts: Donors can give assets during their lifetime or at death directly to a charity, to a donor-advised fund or to a private foundation, and those transfers are 100% deductible against gift and estate tax. (Transfers made during a lifetime can also provide an income tax deduction subject to AGI limitations.) Taxable retirement accounts left to charity at death will pass 100% to charity rather than potentially being subject to both estate and income tax at death. Charitable gifts can also be made in "split interest" trusts, namely charitable lead trusts and charitable remainder trusts. In these arrangements, a charity receives an interest for a term and an individual receives an interest for a term. The charitable portion is deductible, so the only portion of the transfer that is subject to gift or estate tax is the portion retained for the individual(s). For example, a charitable lead trust can be established in an estate plan, and at death, $10MM can be added to a trust that benefits charity for a term of 20 years, and at the end of the term, the remainder passes to children. The annuity payments to charity can be designed to result in the remainder value calculated as $0 based on the IRS assumed rate. If the actual growth rate on the trust assets is 7%, at the end of 20 years, $5.25MM will pass to the children but no estate tax will have been due on the transfer. As another example, a charitable remainder trust could be established as the beneficiary of a client's $5MM IRA. The client's child could be the beneficiary of the trust and receive a 5% annuity payment for 20 years. At the client's death, there will be a $2MM charitable deduction available to the estate; the child would receive $5MM in payments and at a 7% growth rate, the remainder passing to charity would be $9MM. (NOTE: These illustrations are not tax effected.)

## BASIC STRATEGIES CAN STILL MAKE AN IMPACT

What if you are not in a position to make large gifts but are still concerned with mitigating potential estate taxes if the current exemption law does sunset? There are many strategies that can be implemented that slowly reduce, or at least "freeze," your taxable estate. You can make low-interest loans to adult children to allow them to invest in an appreciating home or business or sell appreciating assets at the current value to a trust for family members, perhaps at a discounted value. More aggressively using simple strategies like annual exclusion gifts to family members, paying tuition and medical expenses for others, frontloading 529 plans, and making charitable gifts can really add up, and all the appreciation on those gifted assets will occur outside of your taxable estate. If a 60-year-old couple makes annual exclusion gifts to their 2 children, their spouses and their 4 grandchildren for 25 years, the total amount of gifts they have made without using any exemption would be over $7MM, saving them over $3MM in estate tax. If you assume a 7% return, over $12MM would have been passed to the family and almost $5MM in estate tax would have been saved, and the couple still has their estate exemptions. Imagine if this couple also paid 100% of tuition for all grandchildren.

If you are projected to have estate taxes after sunset, you should at least assess the liquidity of your estate to pay the tax bill. If the majority of your estate is in illiquid assets such as residences, alternative investments, commercial properties and business investments, you may explore obtaining some life insurance to cover your tax bill.

At Trust Company, we work with our clients to develop a comprehensive estate plan to meet our clients' dispositive goals. In doing so, we can help you assess your estate tax situation and identify opportunities to reduce your taxes.

## FOR MORE INFORMATION, PLEASE REACH OUT TO:

**Westray Veasey, J.D.**
Chief Fiduciary Counsel, Principal
wveasey@trustcompanyofthesouth.com

DISCLOSURES

*This communication is for informational purposes only and should not be used for any other purpose, as it does not constitute a recommendation or solicitation of the purchase or sale of any security or of any investment services. Some information referenced in this memo is generated by independent, third parties that are believed but not guaranteed to be reliable. Opinions expressed herein are subject to change without notice. These materials are not intended to be tax or legal advice, and readers are encouraged to consult with their own legal, tax, and investment advisors before implementing any financial strategy.*