The Estate Tax Exemption Could Be Halved at the End of 2025. How to Lock It In.

There are trusts and other tactics to take advantage of the generous exemption now while giving yourself flexibility.

Many wealthy are on the fence about whether they should give away much of their wealth under the current more-lenient law.
DREAMSTIME

The $13.61 million estate- and gift-tax exemption is due to expire at the end of 2025, but many wealthy folks are on the fence about whether they should lock in the massive tax break before the deadline.

Under current law, the exemption—the amount a person can transfer to beneficiaries free of gift and estate taxes—will be roughly halved at the end of next year to around $7 million. But Congress, particularly if the Republicans take control in elections later this year, could opt to extend the exemption.

The uncertainty poses a dilemma for Americans with large estates. If they do nothing, and the exemption shrinks, a large portion of their estates could be exposed to estate taxes when they die. The top estate tax rate is currently 40%. However, if they take steps now to irrevocably move money out of their estate, and Congress extends the exemption, they will have needlessly ceded control of millions of dollars in assets.

Advisors say they are nudging clients to take advantage of the high exemption now, because strategies can take months to establish and specialists will be swamped as the expiration date nears.

"But there are a lot of people worried that they'll have giver's remorse if they transfer a large portion of their wealth," says Jere Doyle, senior estate planning strategist at BNY Mellon Wealth Management.

The good news: There are creative ways to lock in the lofty exemption while leaving yourself some flexibility.

Consider a SLAT if you're married

The spousal lifetime access trust (SLAT) allows you to transfer assets out of your estate with the potential to access them later. These irrevocable trusts, available to married couples, are set up by one spouse with the other as beneficiary. Children are typically secondary beneficiaries.

By funding a SLAT, you not only get assets and future growth out of your estate, but your spouse can get distributions from the trust and merge them back into the family finances if needed. As the trust creator, or granter, you pay tax on trust income.

Assets you transfer to the trust must be in your name only. In community property states, a partition agreement must define individual ownership of assets transferred to a SLAT.

But there are risks: If you get divorced or your spouse dies, you could lose control over assets while still obligated to pay taxes on trust income.

A carefully constructed SLAT can address risk of divorce, says Robert Dietz, national director of tax research at Bernstein Private Wealth Management.

For example, instead of identifying a spouse as beneficiary by name, the beneficiary can simply be noted generically as spouse, Dietz says.

If there is a second marriage, assets go to the second spouse; if there is no subsequent marriage the assets go to secondary beneficiaries.

Keep in mind that the Internal Revenue Service could potentially disallow a SLAT if it appears to be purely a tax-avoidance scheme. “The concern is people are rushing to create these without fully understanding them,” Dietz says.

It’s best to think of your asset transfer as an irrevocable gift with an emergency access provision, he says.

Each spouse can set up a SLAT for the other to use a combined $27.24 million exemption, but the trusts cannot be identical or the IRS may disallow them, says Pamela Dennett, a partner at EisnerAmper.

To make the trusts different, “you might create the trusts in different years, or create one with children as beneficiaries and the other with grandchildren as beneficiaries,” Dennett says. “Or you might contribute real estate to one and marketable securities to the other.”

Plan now, decide later

There’s a risk in waiting any longer to lock in the current exemption.

“Your options may become constrained because it takes time to draft documents and value assets,” Dietz says. You’ll have a lot of people trying to do this quickly—you may have a hard time finding valuation experts if you need one.”

To avoid the mad rush, consider getting your structure in place
now and flipping the wealth transfer switch later.

One approach is to loan assets to a grantor trust in exchange for
a promissory note.

Once the structure is in place, you can make an 11th hour decision to either cancel the promissory note to maintain the transfer to the trust and take advantage of the high exemption, or call the note and take the assets back into your estate.

Use one spouse's exemption

For couples who want to take advantage of the high exemption, but not their entire combined $27.22 million, consider using one spouse's exemption rather than just part of each spouse's, says Steven Lockshin, a principal at AdvicePeriod.

"Say you have $25 million and are comfortable moving half out of
your estate," Lockshin says.

If you use your exemption to move $12.5 million and the per-person exemption drops to $7 million, you will have exhausted your exemption but your spouse will still have $7 million to use.

In contrast, Lockshin says, "if you each use $6.25 million of your exemptions and the threshold goes down to $7 million, you will each have less than $1 million left of the exemption."