

In Focus

Investment Insights into Current Events

Use It or (Potentially) Lose It

The Elevated Estate Exemption & Planning Opportunities for High Net Worth Individuals

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With estate and gifting limits currently at favorable levels, high net worth individuals have ample estate planning opportunities. However, with the presidential and congressional elections only a few weeks away, the window to act may be closing should tax reform become a reality as early as 2021.

What is the current estate exemption?

For 2020, the federal estate and gift tax exemption stands at \$11.58 million per person, which means a married couple collectively has \$23.16 million of estate exemption. This exemption amount covers the combination of gifts made during an individual's lifetime and at death. Estates with assets in excess of the exemption amount are subject to a 40 percent federal estate tax.

In addition to the federal estate tax, high net worth individuals may also be subject to state estate taxes, as 12 states and the District of Columbia currently impose estate taxes.

Is the current exemption amount historically significant?

Yes. The Tax Cuts and Jobs Act (TCJA), passed in late 2017, temporarily doubled the 'basic exclusion amount' (BEA) from a base of \$5 million per person to \$10 million per person. As a result, the estate exemption jumped from \$5.49 million per person in 2017 to \$11.18 million in 2018. For historical perspective, the estate exemption was only \$3.5 million as recently as 2009.

Is the estate exemption scheduled to decrease in the future?

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The estate exemption is scheduled to remain at an elevated level through 2025, at which point the exemption would revert to \$5 million per person (adjusted for inflation) in 2026. However, a future administration could push to lower the exemption amount prior to 2026.

Will individuals who take advantage of today's elevated exemption be penalized should the amount decrease in the future?

The Treasury Department and the IRS issued final regulations in November 2019 which clarified that individuals taking advantage of the increased exemption amounts from 2018 to 2025 would not be adversely impacted after 2025, should the exemption amount drop to pre-2018 levels.

Prior to the November 2019 final regulations, high net worth individuals were concerned that a 'clawback' (tax) might apply should lifetime gifts exceed a future estate exemption. Per the IRS¹, "the final regulations provide a special rule that allows the estate to compute its estate tax credit using *the higher of* the BEA [basic exclusion amount] applicable to gifts made during life *or* the BEA applicable on the date of death."

What is the advantage of moving assets out of one's estate?

For individuals who are likely to one day have a taxable estate (i.e. assets in excess of the estate exclusion), the key advantage is reducing the portion of assets that would otherwise be subject to federal estate tax. The potential federal estate tax savings could be significant should the exclusion amount decrease sharply from the current limit of \$11.58 million per person.

To illustrate the potential benefit, let's consider a hypothetical example:

John Smith makes no lifetime gifts and dies in 2028 at which point the estate exclusion is hypothetically \$6.5 million. At death, John's estate is valued at \$15 million. John's final estate exceeds the exclusion by \$8.5 million and is subject to an assumed 40 percent federal estate tax. Had John instead decided to gift \$10 million in 2020 while the lifetime gifting exemption was much higher, he would have only had \$5 million of assets exposed to federal estate tax – a significant tax difference of \$1.4 million (calculated as $((\$8.5 \text{ million} - \$5.0 \text{ million}) \times 40 \text{ percent})$).

¹ IRS. IR-2019-189, November 22, 2019. <https://www.irs.gov/newsroom/final-regulations-confirm-making-large-gifts-now-wont-harm-estates-after-2025>.

In this simplified example, the hypothetical federal estate tax savings are a byproduct of an estate being able to use “*the higher of* the BEA [basic exclusion amount] applicable to gifts made during life *or* the BEA applicable on the date of death,” per the IRS clarification detailed above.

Who might consider gifting additional assets?

The ideal candidates are high net worth individuals who have assets in excess of the current \$11.58 million lifetime gifting exemption and who have sufficient assets for the remainder of their expected lifetime. Individuals with assets in excess of \$5 million (the previous BEA (basic exclusion amount)) but below \$11.58 million might weigh how much might be needed for their remaining lifetime against the potential benefit of additional gifting. Individuals with assets below \$5 million may be less concerned over future tax reform and the impact on the federal estate exemption.

Aside from outright gifts to individuals, are there other strategies which might take advantage of the current estate and gift tax exemption?

The short answer is yes. Married couples could consider establishing Spousal Lifetime Access Trusts (SLATs), while single individuals could consider a self-settled trust. The basics of these trusts are beyond the scope of this article, though an experienced estate planning attorney should be able to help determine the viability of either trust strategy, in addition to other planning strategies such as installment sales, etc.

Is December 31, 2020 an important deadline to complete additional gifting?

The answer to this question is largely dependent on the outcome of the November 3 elections. A Democratic administration would likely look to reduce the current federal estate and gift tax exemption, while a Republican administration would likely maintain the status quo. It is unclear whether tax reform, if enacted, might be made retroactive to January 1, 2021 or if it would instead be made effective as of a future date, which would provide additional time for planning.

High net worth individuals who have not recently reviewed their estate plans should consider having a conversation with their estate planning attorney as soon as possible to evaluate the potential benefit of gifting assets prior to year-end. The ultimate decision on whether to pursue additional gifting in 2020 might be made following the November 3 elections, at which point we may have a better sense of the potential for future tax reform.

For more information, please contact any of the professionals at Fiducient Advisors.

About the Author



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Nick provides investment consulting services to high net worth investors, corporate executives, family trusts, and nonprofit organizations. He services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process and overall investment management. Prior to joining the firm in 2007, Nick was a Senior Financial Planner with The Ayco Company where he provided comprehensive advice to affluent clientele. Nick earned a B.A. in Finance and Economics from the University of Illinois at Urbana-Champaign. He obtained the designation of Certified Financial Planner (CFP®) from the College of Financial Planning and is a CFA® charterholder and member of the CFA Society of Chicago. Nick enjoys spending time with his family, golfing, volleyball, and long-distance running, having completed four marathons and multiple half-marathons.