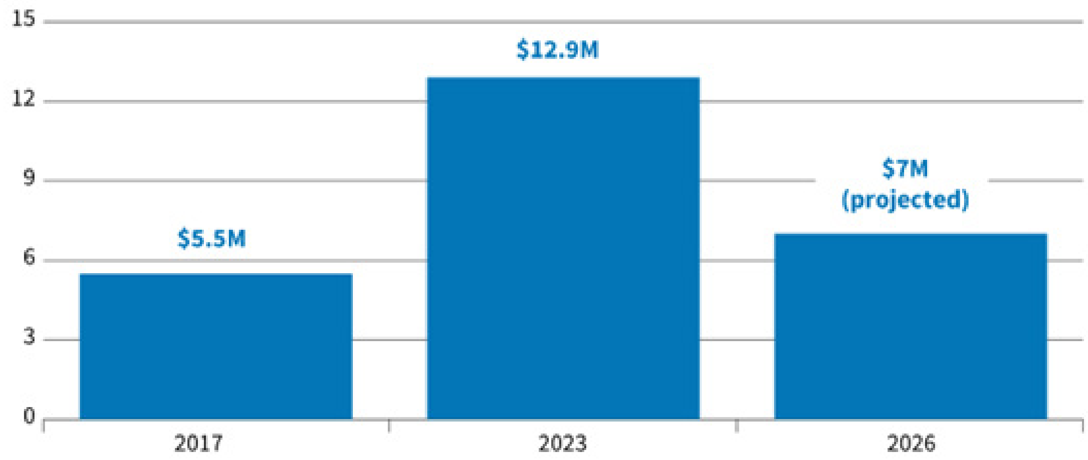
Estate Tax Planning - Intelligent Gifting for High-Net-Worth Couples

In the realm of tax laws, high-net-worth couples have found themselves with a unique opportunity. Since 2018, they've had a chance to safeguard their wealth from the clutches of federal estate taxes, all thanks to a helpful provision known as the Basic Exclusion Amount (BEA).

Let's rewind to 2017, when the BEA was a modest $5.5 million. Then, along came the Tax Cuts and Jobs Act (TCJA) in 2018, doubling it to a generous $11 million. Fast forward to today, and it's grown to an impressive $12.92 million for 2023, thanks to annual adjustments for inflation.

But here's the catch: much of this federal estate tax relief is set to expire in 2025, when the BEA is scheduled to revert back to its 2017 level, adjusted for inflation (around $7 million). This presents a dilemma for high-net-worth households.



The big question is whether it's wise to make significant lifetime gifts before the BEA potentially shrinks. With the top estate tax rate at 40%, moving assets out of your estate now could lead to substantial savings.

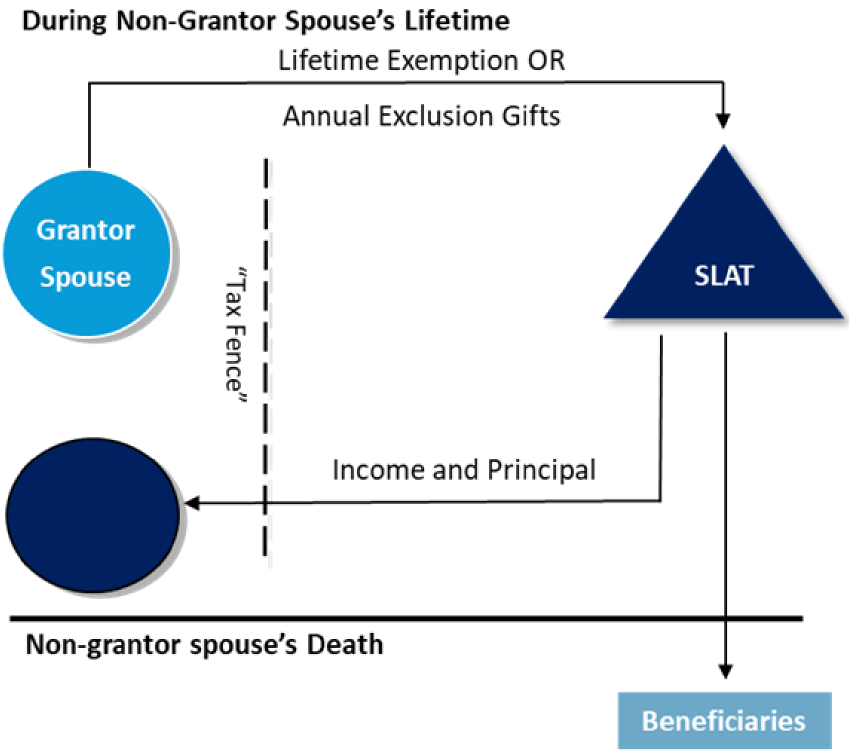
However, it's crucial to tread carefully when making large gifts, as they're typically irrevocable decisions. What if Congress extends the high level of the BEA beyond 2025? Recall that in 2013 the American Taxpayer Relief Act (ATRA) was signed, which avoided a reduction in the BEA. And what about the looming possibility of a claw back – could those gifts be reclaimed into your estate once the tax law sunsets in 2025?

The Treasury Department has provided some reassurance by confirming that no claw back rule would apply to gifts made prior to the sunset on December 31, 2025. (However, in April 2022, the Treasury Department issued proposed regulations that could alter the anti-claw back rule for gifts made prior to the 2025 BEA sunset, potentially including certain transfers in a taxable estate. It's a twist in the plot that's worth noting.)

Also, since Congress knows that the reduction of the BEA is already scheduled (along with the tax revenue that will follow), it's prudent to assume that a complete federal estate tax repeal is highly unlikely. This gives high-net-worth families an enticing option: take advantage of the current BEA increase to make significant lifetime gifts now, before the law changes or expires.

Making large gifts often means surrendering control over those assets down the road, which isn't always ideal. That's where the **Spousal Lifetime Access Trust (SLAT)** comes into play.

When structured correctly, a SLAT allows one spouse to transfer assets into a trust for the benefit of the other spouse, reducing the taxable estate. The donor spouse can still indirectly benefit from the irrevocable trust's assets, and upon the passing of either spouse, the assets within the SLAT remain untouched by estate taxes.



However, there are nuances to consider. What if the recipient spouse passes away before the donor? In that case, the donor might lose access to those assets indirectly. And in the event of a divorce, things can get complicated. This underscores the importance of consulting with an experienced estate planning attorney to determine if a SLAT strategy suits your specific circumstances.

So, for high-net-worth couples, the takeaway is clear: consider making substantial lifetime gifts and explore the SLAT option while these opportunities are available. The estate tax landscape is evolving, but with prudent planning, you can shape your financial future to your advantage.

RETIREMENT PLAN UPDATE

The IRS has granted a two-year reprieve to individuals aged 50 and above with higher earnings, allowing them to continue using pre-tax dollars for catch-up contributions into 401(k) plans and similar accounts. This delay was prompted by a change in the law that would have required high earners to make “catch-up contributions” into Roth-style accounts funded with post-tax dollars. The requirement applied to those who earned more than $145,000 in the previous year and contributed more than the standard maximum limit for 401(k) plans, set at $22,500 for 2023.

The IRS decided to postpone this requirement until 2026 to ensure a smooth transition to the new system, considering the challenges faced by employers in updating their systems. Currently, contributions to 401(k) plans are capped at $22,500 in 2023, but individuals aged 50 and older can make catch-up contributions beyond this limit, with a maximum additional contribution of $7,500 this year, using either pre-tax or post-tax dollars.

The change in the law was aimed at generating revenue within a 10-year budgetary window used by Congress and also contributed to financing other recent tax law changes, including a delay in the starting age for required minimum distributions from tax-deferred accounts. While this shift to Roth-style accounts may seem disadvantageous for savers in their peak earning years, it offers flexibility for those who consistently maximize their contributions to traditional accounts.

Roth-style accounts involve contributing post-tax dollars, but future appreciation and withdrawals can be tax-free, which can be advantageous for individuals expecting higher tax rates during retirement compared to their working years. Conversely, those anticipating lower tax rates in retirement tend to favor traditional accounts.

Additionally, the IRS clarified that last year’s legislation did not inadvertently ban all catch-up contributions, alleviating worries and discussions in Congress about the need to amend the legislation for further clarity.