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Proposed Tax Changes Shorten the Window for Using the Current Gift and Estate Tax Exemption Before it Drops

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In 2018 the gift and estate tax exemption was doubled from \$5 million to \$10 million (per person). The exemption is adjusted for inflation every year. In 2021 the exemption as adjusted for inflation is \$11.7 million. The exemption applies to both gift tax and estate tax. It is first used against gifts made during life that exceed the annual exclusion (currently \$15,000), and any remaining exemption not used against gift tax is applied against estate tax at death. In the case of a couple, each has an exemption of \$11.7 million, so with the right planning a couple's combined estate would not be subject to estate tax if it does not exceed \$23.4 million, or two exemptions, under current law.

What you need to know:

- Under changes to the tax law being considered by Congress, the federal gift and estate tax exemption will be reduced by one-half, or from the current \$11.7 million to \$5.85 million.
- The effective date of the proposed reduction will be the beginning of 2022, but one popular technique for using the exemption before it is lost will be eliminated as of the effective date of the enactment of the new law, which could be as soon as a few weeks from now.
- Anyone with an estate in excess of the LOWER exemption, or any couple whose combined marital estate is in excess of DOUBLE THE COMBINED LOWER exemption, should consult their advisor immediately to discuss the possibility of using his or her exemption before it is lost.

The law provides that the exemption will revert to the pre-2018 law at the beginning of 2026, or \$5 million adjusted for inflation which in 2026 may be in the range of \$6 million. This would result in a couple each having a \$6 million exemption at that time, which would mean that after the reversion to the former law a couple's combined estate would have to be no more than \$12 million to avoid estate tax. The general consensus has been that taxpayers whose estates are large enough to be subject to estate tax should use their exemption now by making gifts before the exemption drops. However, using the entire exemption now by making gifts is not as easy as one might think. If an individual who has an estate that exceeds \$12.7 million made a gift of \$6 million today, and the exemption drops to \$6 million at the time of the individual's death, then the \$6 million estate tax exemption would be deemed to have already been utilized by virtue of the \$6 million gift the individual previously made, and that individual would have no exemption left to be utilized at death. In other words, the only way to use the current \$11.7 million exemption is to make a taxable gift of the entire \$11.7 million before the exemption drops.

Recent proposals in Congress would cause the drop in the gift and estate tax exemption currently scheduled to take place at the beginning of 2026 to be accelerated to the beginning of 2022. If the proposals become law, that would not give much time for planning gifts to use the exemption before it drops. In certain cases the remaining time to use the unreduced exemption could be even less than that. One popular technique to use the exemption now is a trust referred to as a Spousal Lifetime Access Trust ("SLAT"). In the case of a SLAT, an individual transfers assets to a trust for the individual's spouse, using his current gift tax exemption before it is reduced. The individual's spouse is the beneficiary of the SLAT, and as such the spouse has access to income and principal from the SLAT. Even though the assets are removed from the individual's estate, the spouse still has access

to them, so the assets are not out of reach. Upon the spouse's death the SLAT passes to the couple's children or other heirs without being subject to estate tax.

The SLAT technique may no longer work if the recent proposed bill in Congress becomes law because a SLAT is a Grantor Trust, a type of trust where the trust's income is taxed to the person who established the trust. A Grantor Trust is a very favorable estate planning technique because it allows the person establishing the Grantor Trust to make indirect non-taxable gifts to the Grantor Trust by paying the Grantor Trust's income tax, and it also has other significant estate planning advantages. The proposed law provides that Grantor Trusts established after the date of enactment (as well as transfers to Grantor Trusts that exist prior to the date of enactment) will be included in the estate of the person establishing the Grantor Trust. Therefore Grantor Trusts will no longer be effective planning tools. Since a SLAT is a Grantor Trust, it will no longer be a viable technique under the proposal.

Therefore, spouses whose combined estates exceed \$10 million (including any taxable gifts that were previously made) and who have an interest in using the current gift and estate tax exemption before it drops and are considering a SLAT, should contact their estate planning attorney as soon as possible.

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