THE SUNSET OF THE FEDERAL ESTATE TAX EXEMPTION: USE IT OR LOSE IT

This exemption is scheduled to expire on December 31, 2025, unless Congress acts to extend it or make it permanent. If no action is taken, the exemption amount will revert to its pre-TCJA level of $5.6 million per individual, adjusted for inflation from 2017.

The Tax Cuts and Jobs Act (TCJA) of 2017 significantly changed the federal estate and gift tax system. One of the most notable changes was the increase of the lifetime exemption amount from $5.6 million to $11.18 million per individual, indexed for inflation. For 2024, the exemption amount is $13.61 million per individual or $27.22 million per married couple. This means investors can transfer up to this amount of assets to their heirs, either during their lifetime or at death, without paying any federal gift or estate tax. Any assets passed above this exemption amount would be subject to a 40% transfer tax.

However, this historically high exemption amount is not permanent. It is scheduled to expire, or "sunset," on December 31, 2025, unless Congress acts to extend it or make it permanent. If no action is taken, the exemption amount will revert to its pre-TCJA level of $5.6 million per individual, adjusted for inflation from 2017. It is still possible that a new administration will take over in January 2025 and proactively change the estate tax exemption, but that would be pure speculation. This article is solely focused on the laws as they exist today.

No one know exactly what the new federal exemption will be in 2026 with the sunset, but most projections show that it will be somewhere in the $6-7 million range per person or $12-14 million per married couple. This will result in a significant increase in the number of estates subject to federal estate tax and a higher estate tax liability for estates already subject to the estate tax. Note that many states have their own estate or inheritance tax. However, this article will focus solely on the federal estate tax.

Who This Affects and Potential Tax Strategies to Employ

Married couples worth $10-14 million or individuals worth $5-7 million: Within this range, you are currently significantly below the estate tax exemption and likely have not been considering potential estate tax liabilities. If the exemption sunsets, however, you would immediately be within range of the estate tax as your estate value continues to grow. It is imperative to have a properly drafted revocable trust that accounts for an estate tax and an understanding of various advanced planning strategies.

Married couples worth $14-27 million or individuals worth $7-13 million: Within this range, you have enough estate tax exemption to avoid an estate tax as of 2024 but will immediately be over the exemption limit in 2026. A properly drafted revocable trust will still be necessary, and additional measures can be taken to avoid an estate tax. By gifting to irrevocable trusts, you can utilize your high exemption now and remove assets from your taxable estate. As a bonus, all future growth and appreciation tied to those assets will also be outside of your taxable estate.

Married couples worth more than $27 million or individuals worth more than $13.6 million: Within this range, you are already in estate tax territory, and all assets over the exemption amount will be subject to a 40% estate tax at your death. It is important to have a properly drafted revocable

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trust as well as irrevocable gifting trusts, as discussed above. Individuals in this category may also benefit from deploying discounting strategies to reduce the taxable value of their estate. These discounting strategies can shrink your assets' reported value, allowing you to transfer more assets into irrevocable trusts using the same exemption limitations. "Freezing" techniques to remove future growth and appreciation from your estate may also be necessary within this range.

Generational Wealth Considerations

If you do not wish to proactively plan for the estate tax or have too large of an estate to eliminate the tax, there are three options to consider for paying the tax:

- Let your estate pay the estate tax and pass on a smaller legacy to successive generations; or
- Choose to benefit charity at your death and receive a charitable deduction against the estate tax; or
- Purchase life insurance to pay for a potential estate tax. The life insurance option is particularly attractive if you wish to create liquidity to pay the tax and preserve assets for successive generations.

One of the key components of generational wealth is to choose a qualified trustee with specialized knowledge to make decisions for the trust and distributions to your beneficiaries. A corporate trustee is often employed in this role to ensure that descendants' inheritances are protected from creditors and predators. A corporate trustee can work with future generations to avoid poor purchase decisions, promote meaningful contributions to society, and advise on proper investments and planning strategies.

Where to Begin

The bottom line is that the current estate and gift tax exemption amount offers a unique window of opportunity for estate planning, but it may not last long. If you do not use your exemption while it is at a historical high, then a significant portion of it may be lost. The Internal Revenue Service has issued an "anti-claw-back" regulation that protects taxpayers from being punished for using their exemption during their lifetime. Under this regulation, any exemption used during life will be viewed as final. Thus, if the exemption were to decrease in subsequent years, the IRS would not impose a tax on the prior gifts, nor claw assets back into the taxpayer's estate.

The first step is to contact your LPL Financial advisor as soon as possible to discuss your existing estate plan and unique circumstances. Your advisor has access to:

- Planning services with qualified specialists to review your documents and provide you with a roadmap to prepare for the scheduled sunset.
- Corporate trustee services that can serve as trustee, co-trustee, or agent for trustee if desired.
- Insurance services to review existing policies and explore new life insurance needs.

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