

Trust Us December 2024 – Federal Estate Tax Exemption

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Danielle Friedman: Hi, Max. Hi, Herb. Today, we are talking about a topic that is top of mind for a lot of estate planners and a lot of clients, which is the sunset of the federal estate tax exemption. And what is the federal estate tax exemption? I think is a good place to start for listeners who are unfamiliar with this concept.

Danielle Friedman: So I'll start there, which is that the Federal Estate Tax Exemption is the IRS taxes your estate based on the value of your estate. And if the value of your estate exceeds a certain threshold, it is subject to Federal Estate Tax and the tax rate is 40%.

Danielle Friedman: But everyone is afforded an exemption. So if your taxable estate is below the exemption, no taxes do. Currently, the exemption is historically high. It is 13. 61 million per person. We're recording this in 2024 and in 2025, it is scheduled to increase to 13. 99 million per person. However, Under the current law, which is the Tax Cuts and Jobs Act, which is expiring at the end of 2025, the exemption is going to be cut in half, approximately, and will be 7 million per person, rather than 13.

Danielle Friedman: 99 per person. So when everybody wakes up on January 1st, 2026, the exemption will be around 7 million per person. However, If Congress extends the current law or makes the current law permanent, then the exemption could continue to be as high as it currently is, or they could change the law and change the exemption amount.

Danielle Friedman: But generally speaking, the exemption is like a credit against the value of your estate. And if the value of your estate exceeds the exemption in the year of your death, Federal estate taxes do.

Herb Fineburg: So if I had a client who has a taxable, an estate 20 million, and let's assume it's a husband and wife, if they were to pass away this year, both of them were to pass away this year, how much of that estate would be taxable?

Danielle Friedman: So because the exemption can essentially be coupled between married couples they would not owe federal estate tax because they each get. 13. 61 million of exemption or almost 28 million per couple. So if their taxable estate between the two of them is 20 million, no taxes due.

Danielle Friedman: But if that same couple dies in 2026 and the law doesn't change and it, the exemption is 7 million per person, then they have \$14 million of exemption between the two of them. So the \$6

million difference. is going to be subject to a tax of 40 percent at the federal level.

Max McCauley: Isn't it true that the new administration might make further changes to the state tax?

Danielle Friedman: Yeah. So now that we have the election behind us and we know who is in control in Washington, there is an appetite to extend the current law, which was enacted in 2017. And it's, a temporary law at the moment but there is an appetite to extend the exemption so that this historically high exemption of 14 million per person.

Danielle Friedman: Let's call it will remain in place, and usually the exemption increases with inflation. So you see, between 2024 and 2025, it's going from 13. 61 million per person to 13. 99 million per person. If this law is made permanent or is extended, the exemption will likely continue to go up with inflation.

Max McCauley: And I understand there's a lot of uncertainty there, as well as uncertainty with maybe a change to the state tax rate from 40 percent down to 20%.

Danielle Friedman: There's some discussion of changing the tax rate, but as with any law, Congress has to pass it first. The president has to sign it. So I think 2025 is going to be a busy year, and I think we're all going to be watching what's going on in Congress very closely to see how this law is impacted.

Max McCauley: So with all this uncertainty in place, is there anything that we can do now to assist?

Herb Fineburg: Yeah, so one of the things that we suggest to people is that they do some planning now. One of the items that is commonly used is to sell your assets to a trust for the benefit of either a spouse or for children.

Herb Fineburg: And in that matter, when you sell your assets to the trust, you would take back a promissory note to pay you back for the assets that have been sold. In a sale situation, it's actually not a gift. So technically it's not something you have to report because it's a sale, but we reported anyway to make sure that if the IRS thinks that the sales price was too low, And there was, in essence, a gift.

Herb Fineburg: We put it on a gift tax return. What does that do putting it on a gift tax return, Max? What's the purpose of it?

Max McCauley: Well, the purpose of reporting the sale or a gift on the return is to start the running of the statute of limitations, the

period of time the IRS could audit the tax return.

Max McCauley: And so once three years has passed from the date the return is filed, the IRS is stuck with the evaluation and the information disclosed in the gift tax return. They cannot later challenge it once the statute of limitations has expired.

Danielle Friedman: I just want to add that statute only starts running if there is an adequate disclosure on the gift tax return.

Danielle Friedman: So you have to have a qualified appraisal or enough financial information and enough information. To justify the value being reported on the return in order for the statute of limitations to start running. But I really liked that plan, Herb, because we put the infrastructure in place in anticipation of this uncertainty.

Danielle Friedman: So if there is a reduction in the federal estate tax exemption towards the end of 2025, the client can decide to make a gift. Either, make additional gifts to the trust or forgive a portion of this note, which would be a gift, and therefore they can use up some of their exemption. Because the thing about the federal estate tax exemption, it's currently use it or lose it.

Danielle Friedman: So, you have, Each of us has up to 13. 61 million in 2024 to give away. If we don't use that 13. 61 million and the exemption is reduced to 7 million in the future, you can't give away 13. 61 or you'll have Federal estate and gift tax do but if you give away 13. 61 now, then the I. R. S. If the law is reduced, cannot claw back any excess that you've given away.

Danielle Friedman: So if you give away 10, 000, 000 today, And then the exemption is reduced to 7 million in 2026. You don't have any more exemption left, but the IRS cannot say that you owe gift tax on the difference between what you gave away and what the exemption is at that time. The 3 million difference. Another strategy that we're telling clients to do is, This use it or lose it technique where if you know that you can give away over 7 million worth of assets to make a gift or take this wait and see approach and at least sell the assets to a trust and then forgive the note in the future.

Danielle Friedman: Maybe when the law is going to be a little bit clearer as to what will happen.

Max McCauley: So it sounds like we can plan for the uncertainty, but it's important to get started with that planning as early as possible in 2025 because given the current political environment in the transition. You might not know whether or not it's extended or if the rate changes until very late in 2025, which would then cause a lot of uncertainty and a lot of people that wait to all want to make a change at the same time at the end of 2025.

Max McCauley: Correct?

Danielle Friedman: Absolutely. So you want to have the infrastructure in place. We were in a very similar situation. In 2012, where the tax laws were going to change and it was not clear what was going to happen until late December. So we don't want clients calling us at that time because we may not be able to help them.

Danielle Friedman: There's going to be a line out the door if that's the case. So it's very advantageous to set up the infrastructure now and then it will be a lot easier to make completed gifts in the future. And this type of planning takes some time. As Max explained, you have to report a valuation on a gift tax return.

Danielle Friedman: It takes time to prepare valuations. It takes time to set up trusts and get all of the proper documentation in place to have this work the way it's supposed to.

Herb Fineburg: Is there an advantage to doing this anyway, even if the exemption doesn't shrink from 14 million, approximately back down to 7 million and you sell 14 million worth of assets to the trust.

Herb Fineburg: Are you achieving any other benefits by taking back a 14 million note and placing all those assets, hopefully substantially appreciating assets into the trust for it? Either a spouse or the next generation.

Danielle Friedman: Absolutely. So even if you haven't reduced the value of your estate at the time that you sell the assets, because you're That's replacing 14 million worth of assets with a 14 million note.

Danielle Friedman: You have now frozen the value of your estate. So while the assets in the trust are going to increase in value, hopefully they're going to appreciate your estate value is not going to increase with respect to that 14 million because you've just taken back a promissory note. The promissory note is not going to increase in value.

Danielle Friedman: So you've accomplished an estate freeze. If you have assets that you expect to appreciate significantly in the future, you've now gotten all of the appreciation on those assets out of your taxable estate. So even if the exemption stays high, you've at least gotten a lot of value out of your estate and are able to pass it to, a spouse or to the next generation with no estate tax.

Herb Fineburg: So it's a solid estate planning technique to use regardless of what the exemption is later.

Danielle Friedman: Of course. And as we've said in prior episodes, the type of trust that you would use to implement this type of planning is an irrevocable trust that would be a trust for the benefit of whomever your beneficiary is for their lifetime.

Danielle Friedman: You wouldn't want. The assets passing out to the beneficiary at certain benchmarks because then you bring those assets back into the estate tax system and we don't want that to happen. We want the assets to remain outside the estate tax system once they're given away.

Herb Fineburg: Sounds like a good idea then to do that regardless of what Congress decides next year or sometime before.

Herb Fineburg: Presumably. Possibly. Possibly. December 31st 2025.

Danielle Friedman: Absolutely. And I'm sure we will be revisiting this topic and checking in with listeners as it becomes clear what's going to happen with the current tax law.

Max McCauley: And my suggestion again is to do it in the first quarter of 2025 before the stampede begins.

Danielle Friedman: Absolutely. I've heard it called the trust tsunami of 2025. So get in line now because it's going to be very busy. As the year progresses.

Herb Fineburg: It sounds like we have some good recommendations that will work regardless of what happens to the Tax Cuts and Jobs Act. And any extension to it or changes to it.

Danielle Friedman: Absolutely.

Herb Fineburg: Well, I'm glad we got to get together and share this with everybody.

Danielle Friedman: Always a pleasure.

Herb Fineburg: Thank you. Thank you.