

Understanding The Estate Tax Exemption Sunset: How to Avoid the Rush

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A BRIEF HISTORY

The Tax Cuts and Jobs Act of 2017 (TCJA) included a provision that dramatically increased the amount of wealth that families could transfer tax-free to succeeding generations.

This provision is one of many in the TCJA that was temporary due to the Senate's rules against increasing the deficit beyond 10 years. Absent a literal Act of Congress (and a President's signature), the lifetime gift and estate tax exemption will be cut in half as of January 1, 2026 (the "sunset").

As we usher in 2024, it might seem like there's ample time to deliberate on the next steps. Considering the history of frequent changes in estate tax laws, one might speculate that Congress could pass new legislation to extend the higher exemptions before the sunset.

The reality is, however, that there is a practical deadline ahead of that statutory deadline. In short, an effective planning strategy is developed and implemented over time.

THE CURRENT FEDERAL GIFT AND ESTATE TAX EXEMPTION

The current regime of gift and estate tax laws was largely set by the Tax Relief Act of 2010. That law increased the lifetime exemption amount to \$5M and introduced "portability" which allows a surviving spouse to take over the unused exemption of a deceased spouse.

In 2012, Congress revised the law to index the exemption amount to inflation and increased the maximum estate tax rate to 40%. This represents the permanent gift and estate tax regime: an individual exemption of \$5M adjusted for inflation from 2011, a 40% tax rate, and spousal portability.

The Tax Cuts and Jobs Act of 2017 temporarily doubled the exemption amount, effectively making the limit \$10M adjusted for inflation from 2011.

As of January 2024, the individual exemption amount stands at \$13.61M. But, the TCJA provision will expire on December 31, 2025 and the exemption amount for 2026 will revert to \$5M indexed for inflation.

Imagine a couple with a net worth of \$28M celebrating New Year's Eve 2025 without any estate tax exposure, only to face a potential estate tax of over \$5.5M at the stroke of midnight!

THE IMPLICATIONS FOR ESTATE TAX PLANNING

Wealth transfer planning typically focuses on maximizing the value passed on to heirs and usually involves:

- Reducing the taxable estate
- Liquidity to pay estate taxes
- Shifting future growth in asset values out of the estate



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The cut in the federal exemption amount will increase many taxable estates creating a need for more liquidity at death. It will also decrease the opportunity to gift appreciating assets out of the estate. Wealthy families can mitigate those impacts by implementing a planning strategy before the sunset.

WAIT AND SEE?

Recent history underscores the impermanence of U.S. gift and estate tax law. Given this, some planners suggest that families should refrain from investing time and resources into wealth transfer planning now, as the landscape may change with future legislation.

Others argue that families should proactively engage in planning that addresses the current landscape while building in flexibility to adapt to future tax law changes. They warn that the “wait and see” approach may leave too little time to act once it becomes clear that action is necessary.

The pending sunset presents a significant “use it or lose it” scenario — at least \$7M of tax-free gifting per donor that is currently possible will no longer be available after Dec. 31, 2025.

HOW LATE IS TOO LATE?

Wealth transfer planning based on the current high exemption sunsetting in 2026 will incorporate two or three key elements – a large life insurance policy, a very large lifetime exemption gift (or private loan easily converted to a gift if desired), and an irrevocable trust established to hold the life insurance policy and/or the exemption gift.

Each of these elements has an inherent lead time that should be considered.

LIFE INSURANCE

Medical underwriting for life insurance for large face amounts with older insureds can require several weeks or even months

GIFTING

The process of making a substantial lifetime exemption gift may necessitate efforts to identify, value, and reposition illiquid assets.

IRREVOCABLE TRUST

The creation of a comprehensive trust instrument, capable of holding substantial amounts of wealth, and potentially enduring across multiple generations, will require the expertise and time of a proficient estate planning attorney.



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THE BOTTOM LINE: DON'T WAIT

As 2024 progresses, planning advisors — including insurance professionals, accountants, and attorneys — are going to be increasingly occupied. Top estate planning attorneys, in particular, are expected to have very full calendars in 2025.

Therefore, affluent families wanting to implement an effective wealth transfer plan should initiate the process now, ahead of the anticipated rush.