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Case Study: How Concerned Should You Be about Estate Tax Issues?

If you have significant wealth, you may be exposed to future estate tax burdens that must be acted on before the Tax Cuts and Jobs Act reduces the estate tax exemption in 2026. Developing and implementing the right estate planning and tax strategies takes time. You may need to prepare regardless of whether the estate tax continues at its current level or if it is cut in half. This means strategizing to minimize your estate tax liability now.

Does This Sound Like You?

Meet the Andersons, a well-off family living in a state with a high cost of living. Robert Anderson, the father, is a successful entrepreneur who built a thriving business over the years. His wife, Sarah, is an accomplished artist, and together they have accumulated a substantial estate of $8 million each, for a total of $16 million. Their estate is primarily composed of their business assets, valuable artwork, life insurance, a family residence, a vacation home, and other lucrative investments. They have two adult children, James and Emily, both actively involved in the family business.

Their Unique Estate Tax Situation

With the generous federal estate tax exemption set at $10 million adjusted for inflation per individual in 2017, steadily increasing to $13.61 million in 2024, the Andersons have felt relatively secure about avoiding estate taxes. Their primary concern has been preserving the family legacy and ensuring a smooth transition of their assets (business, accounts, and property) to the next generation. They had taken some initial estate planning steps, such as creating a will, discussing the use of a family limited partnership, and exploring gifting strategies to transfer the assets to their children gradually.

If the estate tax exemption drops to $5 million adjusted for inflation, the Andersons may face several estate tax issues that require professional advice and assistance before the end of 2025. The Andersons need to find other ways to protect their money and property.

Business Succession Planning

The family business represents a significant portion of the Andersons' estate, and the sunsetting of the higher exemption amount could have profound implications for its continued viability. Robert and Sarah need to develop a comprehensive business valuation and succession plan now to minimize the total estate tax burden and ensure a smooth ownership transition to James and Emily later.

Property and Investments

Given the potential changes in the estate tax landscape, the Andersons need to revisit the valuation of their financial accounts, retirement and life insurance investments, personal property, real estate, and artwork to ensure accurate assessments. Then they need to determine which items will affect the estate tax calculation and any remaining exemption they have left from prior legacy planning. Depending on their assets' values, these items can easily put them over the potentially soon-to-be lower estate tax exemption, exposing them to a 40 percent tax rate.

Lifetime Gifting

With the uncertainty surrounding the estate tax exemption, the Andersons may want to consider accelerated lifetime gifting strategies to reduce their taxable estate while the higher exemption is in place. The Internal Revenue Service declared in 2019 that individuals who take advantage of the increased gift tax exclusion from 2018 to 2025 will not be negatively impacted after 2025 if the exclusion amount drops.[1] Gifting up to $13.61 million in 2024 has a zero tax liability. But gifting over $6.4 million in 2026 may have major consequences.

Life Insurance

The Andersons may want to use life insurance to ensure that their loved ones are provided for at their passing. They may want to consider creating an irrevocable life insurance trust to own the life insurance policy and be the recipient of the death benefit. This removes the value of the policy from the Andersons' estate and protects the death benefit for their chosen beneficiaries.

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1 Estate and Gift Tax Facts, IRS.gov, https://www.irs.gov/newsroom/estate-and-gift-tax-faqs# (last updated Dec. 5, 2023).

Marital Deduction Planning

The significant portfolios of high-net-worth and ultra-high-net-worth families may require advanced tax planning techniques, including an AB trust, to optimize each spouse's estate tax exemption and potentially minimize their estate tax liability. At the client's death, an amount equal to the current estate tax exemption amount is placed in one trust, which uses the exemption, and the remainder is placed in a second trust for the surviving spouse's benefit, which qualifies for the unlimited marital deduction. This results in no estate tax being owed at the death of the first spouse.

Portability and the Deceased Spouse Unused Exemption Amount

Spouses are able to give an unlimited amount of money and property to each other without having to worry about estate or gift tax. Because of this, some clients may not have an estate tax issue at the first spouse's death because everything (or a substantial portion) went to the surviving spouse. Because they are utilizing the unlimited marital deduction, the deceased spouse's exemption is not needed. However, even if this is the case, it may be advisable to file an estate tax return at the first spouse's death to document how much of that deceased spouse's exemption is being used, if any, and that the remainder is going to the surviving spouse. This will allow the surviving spouse to add the deceased spouse's unused exclusion (DSUE) to the surviving spouse's own exemption amount and apply that combined amount against their own estate at the time of death.

Charitable Giving

If the Andersons are philanthropically inclined, another great option would be to engage in charitable giving through the use of a charitable remainder trust. Setting up this type of trust can be time-consuming —sometimes the process is fairly straightforward but often highly complex, requiring advanced planning and consideration.

Contacting a Trusted Advisor

If your situation is similar to the Andersons, expert guidance is necessary to address estate tax issues and help you evaluate the impact of the potential sunsetting of the higher estate tax exemption amount on your estate. Contact us to learn more about strategies to protect, preserve, and pass down valuable property.