

## **2024 Estate Planning Outlook: Transfer Tax Changes are on the Horizon**

Article By:

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The Tax Cuts and Jobs Act of 2017 (TCJA) significantly increased the lifetime estate and gift tax exemption from \$5.6 million to \$11.18 million for individuals, with adjustments for inflation starting in 2018. For 2023, the lifetime estate and gift tax exemption is \$12.92 million (or \$25.84 million for married couples). For 2024, the lifetime estate and gift tax exemption will be \$13.61

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million (or \$27.22 million for married couples). This relatively high exemption level has offered substantial relief to many taxpayers in recent years.

However, absent Congressional action, the lifetime estate and gift tax exemption is scheduled to sunset after 2025 to its pre-2018 amount (adjusted for inflation). If this sunset does in fact occur, we anticipate that the lifetime estate and gift tax exemption will revert to around \$7 million (\$14 million for couples) for 2026, effectively reducing the exemption by about one-half. This substantial reduction in the lifetime estate and gift tax exemption will cause many more people to be potentially subject to federal estate tax at death.

The potential substantial reduction in the lifetime estate and gift tax exemption could have several significant impacts on estate planning:

1. **Increased Number of Estates Subject to Estate Tax.** A much higher number of individuals could be subject to estate tax at death due to the new lower estate tax exemption threshold. Proper planning is crucial to minimize this impact.
2. **Increased Estate Tax Liability.** Individuals with estates valued in excess of the new lower estate tax exemption threshold could be subject to higher estate taxes at death.

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3. **Gifting Strategies.** If the lifetime gift tax exemption is reduced, then individuals will have a diminished ability to make significant gifts during their lifetime and greater care will need to be given to maximizing the tax benefits of the lower exemption.
4. **Reviewing Existing Plans.** Individuals who designed their estate plans based on the current lifetime estate and gift tax exemption should consider revisiting their plans to ensure those plans remain aligned with their goals and objectives.

The big question in the estate planning world today is whether, when, and to what extent Congress will enact changes to gift, estate, and income tax laws. With many challenges facing the current Biden Administration and a heavily divided Congress, it is not certain that major tax legislation even will be considered in 2024. Nevertheless, the tax proposals endorsed by the Biden Administration provide signals for actions clients should consider during the current year.

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## Executive Summary

- The time to gift is 2024 — change is potentially on the horizon.
- The timing and extent of potential changes to gift and estate tax
- Some potential changes could include reducing the exemption, increasing the capital gains tax rate, and eliminating the basis a
- Consider “locking in” the 2024 exemption amount by gifting to ir continuing to take advantage of planning opportunities to shift a with techniques such as GRATs and intra-family loans.

## Potential Legislative Tax Changes[1]

### Potential Transfer Tax Changes - Lowered Transfer Tax Exemptions & Increased Transfer Tax Rate

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The Biden Administration has proposed lowering the current lifetime estate and gift tax exemption amount to around \$3.5 million per individual and increasing the estate tax rate from 40% to 45% on amounts exceeding the exemption. Instead, we may see Congress simply let the exemption sunset back to around \$7 million (adjusted for inflation), which was the exemption amount before the substantial increase enacted under the TCJA.

For what it's worth, the exemption has never been lowered. Despite this, the doubling of the exemption under the TCJA was a dramatic departure from past policies. Thus, reducing the exemption to \$7 million (adjusted for inflation) may seem like an easier path, particularly since Congress is so heavily divided. In other words, Congress may opt to treat the last seven years as a fluke and return to "normal."

### **Potential Income Tax Changes - Repeal Basis Adjustment & Capital Gains Taxed as Ordinary Income**

The Biden Administration also signaled that it might seek repeal of the basis step-up at death and tax capital gains as ordinary income. Although the basis step-up is an income tax planning concept, it is also an important consideration in transfer tax planning. Under current law, gifts of low basis assets can be detrimental because the donee receives the donor's basis. Taxpayers often decide to retain certain low basis assets, rather than sell them or gift them, to obtain the basis step-up at death. The family members or trusts receiving those assets then can sell those assets with little or no capital gains tax.

The Biden Administration has proposed to eliminate this basis adjustment. An alternative proposal involves treating the transfer of appreciated property at death or by gift as a taxable event causing

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the gain to be recognized, but many commentators think this is unlikely.

The Biden Administration proposal to tax long-term capital gains and qualified dividends as ordinary income on all income over \$1 million would further exacerbate the impact of a repeal of the basis step-up.

### **Planning Ahead**

2024 is an opportune time to make the most of your estate and gift tax exemption.

### **“Locking In” the Estate and Gift Tax Exemption**

Many ultra-high net worth individuals have used most, if not all, of their exemption. Under current tax laws, in 2024, individuals may gift up to \$13.61 million during their lives (\$27.22 million for married couples). If the exemption decreases from \$13.61 million to \$3.5 million and the estate tax rate is raised from 40% to 45% percent, the cost of inaction is more than \$4.5 million (if an individual makes a gift of \$13.61 million while the exemption is \$3.5 million and gifts beyond the exemption are taxed at a rate of 45%, the resulting gift tax amounts to roughly \$4.5 million; \$9 million for married couples). If individuals and married couples have not used their exemption(s) and can afford to, they should give serious consideration to completing gifts equal to their remaining exemption(s) in 2024, ideally to a generation-skipping trust for the benefit of their descendants, particularly since these exemptions are scheduled to sunset in 2025.

Depending on your and your family's goals, circumstances, remaining exemption, and cash flow needs, gifting up to \$27.22

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million, or even \$13.61 million, to a trust for your beneficiaries may not be feasible. A long-accepted way to address this concern is to create a trust that benefits both the Grantor's spouse and descendants. This type of trust is commonly referred to as a Spousal Lifetime Access Trust (SLAT). A SLAT is a simple and effective way to address the possible need of the senior generation to access the property transferred. It provides direct access for the beneficiary spouse and indirect access for a Grantor spouse. Grantor Trust provisions, such as ones allowing the Grantor of the trust to swap assets or take loans from the trust without full and adequate consideration, offer tax flexibility, and access to funds by loan.

SLATs have become so popular that couples have created trusts for each other. This is not without risk and should only be done with different trust provisions and with creation of the trusts separated in time. Finally, it is important to remember that potential estate tax savings should never be the sole determinate of your financial planning decisions. Individuals who have stretched themselves thin to make significant gifts sometimes have profound "gifter's remorse." Thus, make gifts if you can, but, more importantly, make them if you're comfortable doing so.

## **Freezing the Size of the Estate**

Perhaps you and your spouse have already utilized your exemptions and are seeking ways to further reduce the tax burden on your estate, or you are not ready to commit large transfers of your property. In either situation, an excellent alternative is to freeze the growth of your estate with strategies like Grantor Retained Annuity Trusts (GRATs) and installment sales with trusts or family loans. GRATs and installment sales have thrived in the past low interest rate environment because assets have often

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grown in value at a rate above the rate of the annuity, in the case of GRATs, or the interest rate on a promissory note. However, in today's current higher rate environment, the tax benefits of these planning opportunities may be more restrictive as the appreciation hurdle for a GRAT is now substantially higher than before, and the interest rate on an installment sale is also substantially higher. However, these strategies will still essentially "freeze" the size of one's estate and transfer potentially significant appreciation, which would have otherwise remained in the client's estate, out of his or her estate.

### **Uncertainty Doesn't Preclude Planning**

It is absolutely within the power of Congress to enact retroactive tax legislation if it is rationally related to a legislative purpose, but on a practical level, Congress usually avoids that option. It is almost always unpopular and adds only nominal additional revenue for budgeting purposes. Biden Administration officials already have stated they are not interested in seeking retroactive tax changes. Given the low probability, the threat of retroactive tax law changes should not prevent clients from implementing new estate planning strategies. For those who remain worried, a number of strategies can be structured in a manner that limits potential gift tax liability in the unlikely event legislative changes are enacted retroactively. In 2024, clients should consider reviewing their existing plan to determine whether they can employ certain strategies to maximize use of their exemption and achieve their planning objectives. If the lifetime estate and gift tax exemption is reduced, clients will lose the ability to give away that excess amount (and all subsequent appreciation on that amount).

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**[1]** The following list of potential legislative changes is not all-inclusive. Instead, it focuses on the transfer tax and income tax

proposals that would have the most significant impact on the practice of wealth transfer.

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