Estate Planning for the Middle Income

Kansas Society of CPAs
November 21, 2024

Today's Presentation

- Not all planning focuses on reducing the estate as much as possible…
  - Smaller estates have specific challenges that must be addressed
  - Cash needs and asset types must be carefully considered
  - The balance between income tax and estate tax can take on an even greater importance
  - Transactions that are inefficient in larger estates may have value in smaller estates

Not All Smaller Estates are the Same

- For clients closer to the end of their life expectancy, these amount may not grow significantly or at all after taking into account expenses

- For younger clients, a smaller estate today could be a very large estate tomorrow
  - A 40yo with $15-30M today at a 4% after-tax growth rate would have assets totaling around $88-175M in 45 years
  - At 5% those amounts grow to around $135-270M in 45 years

For Our Discussion Today

- Being real, not reactionary
- What "will" change
- Gift and estate planning strategies
- Where we go from here

Being Real,
Not Reactionary

Countdown to Midnight December 31, 2025

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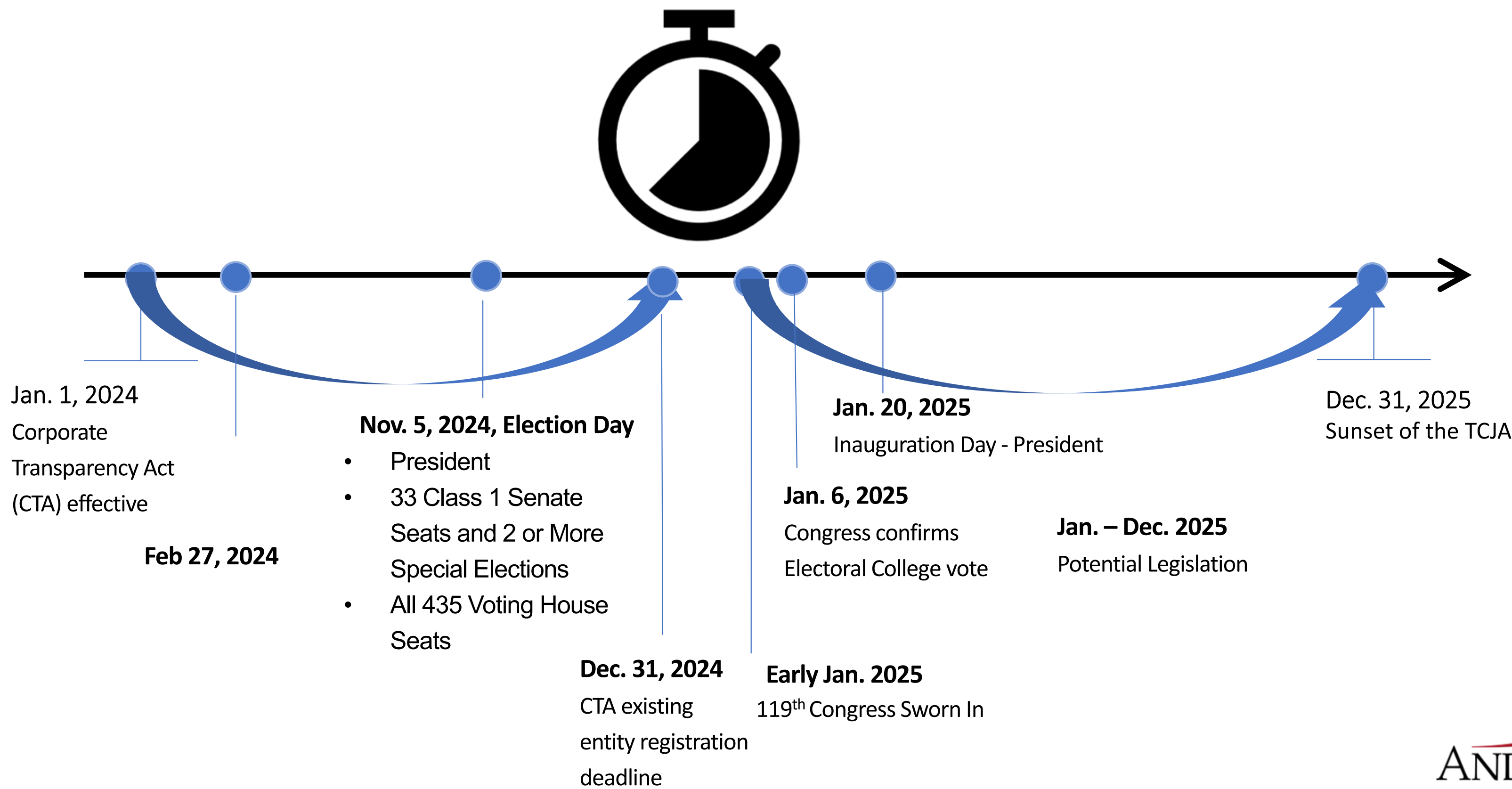
Timeline to Sunset – Tick Tock



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We Have Seen This All Before

- **2001**- Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) "once in a decade tax-cut package"
- **2010** – One year repeal of estate tax and original December 31, 2010, sunset of EGTRRA
- **2012** - Deferred December 31, 2012, sunset of EGTRRA
- **2017** - Most recently, the enactment of the Tax Cuts and Jobs Act (TCJA) December 22, 2017, effective January 1, 2018, with the December 31, 2025, sunset

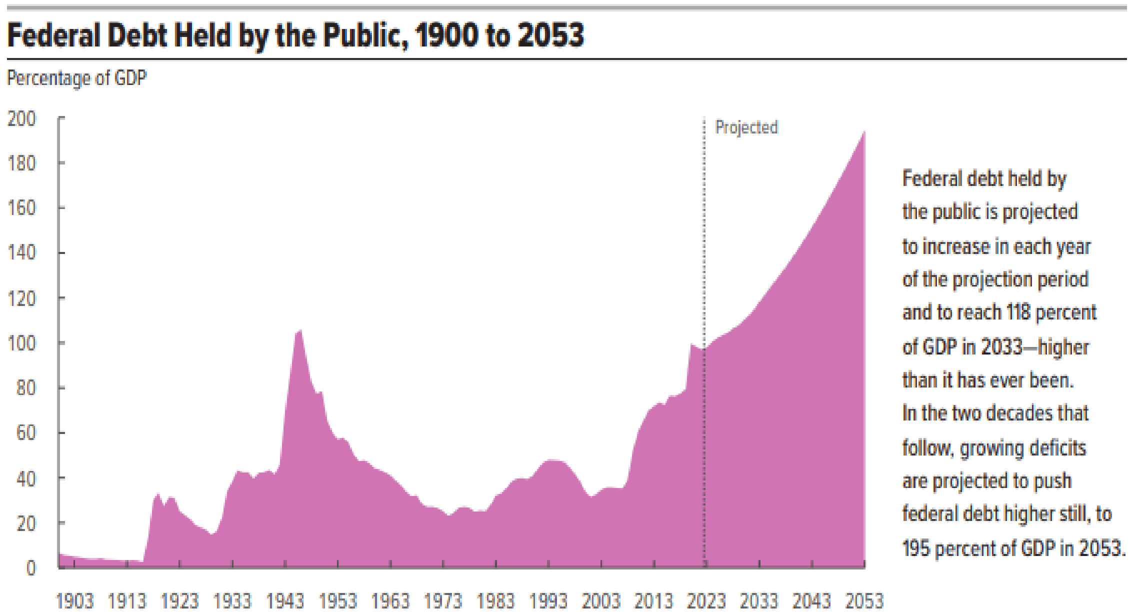
Why the Recurring Sunsets?

- Management of the 10-year revenue impact
- The projected 10-year revenue impact of the TCJA was a revenue reduction of **$1.456 trillion**
- The projected 10-year revenue reduction of the individual tax reform was **$1.043 trillion** (excluding doubling of the gift, estate, and generation-skipping transfer tax exclusion)
- The projected 10-year revenue impact of the doubling of the gift, estate and generation-skipping transfer taxes was a revenue reduction of *only* **$83 billion**
- The projected 10-year revenue reduction of the business tax reform was **$653.8 trillion**

What to Expect This Time?

The Fiscal Pressure of Long-Term Debt

Federal Debt as a % of GDP



Source: Congressional Budget Office – The Budget and Economic Outlook: 2023 to 2033 (Feb. 2023)

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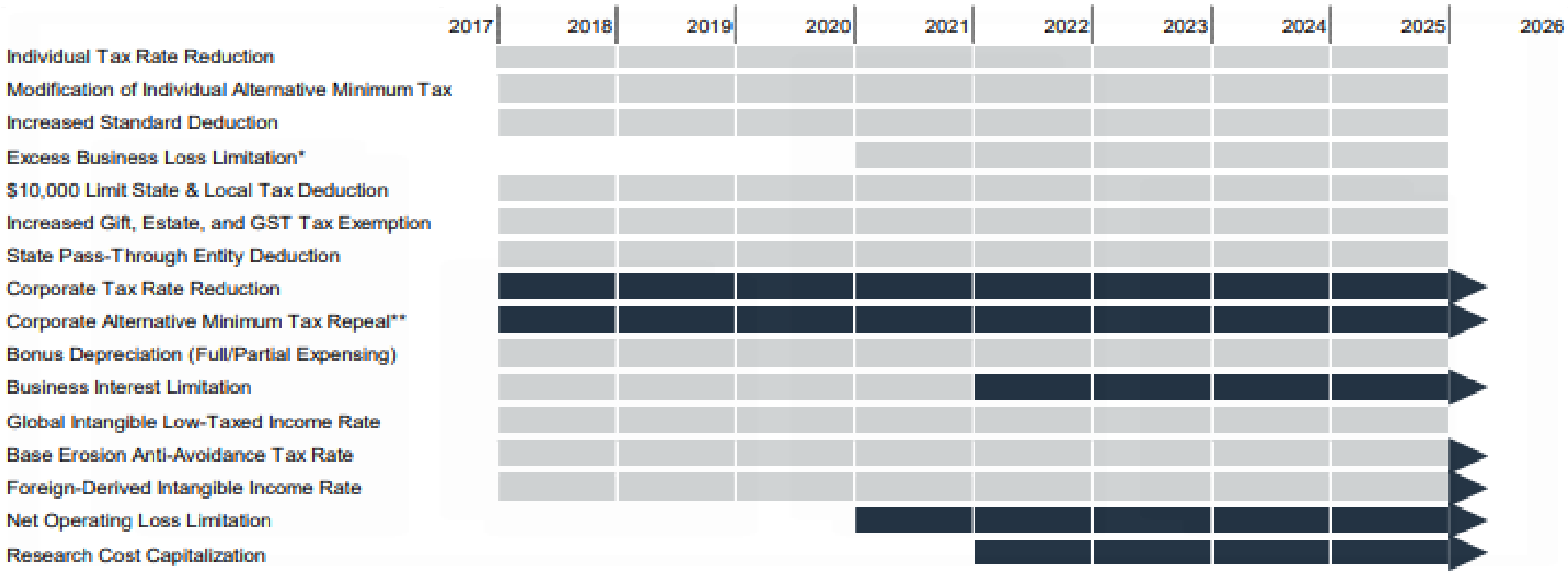
What "Will" Change

The Temporary Nature of the TCJA



Inflation Reduction Act of 2022:

*Excess Business Loss Limitation extended to **2028**.

New Corporate Alternative Minimum Tax effective in **2023.

Gift and Estate Planning Strategies

The Pending Plunge in the Basic Exclusion Amount

Federal Estate, Generation Skipping Transfer (GST) & Gift Tax Rates and Exemptions			
Year	Highest Estate, GST & Gift Tax Rate	Estate, GST & Gift Tax Exemption	Gift Tax Exclusion
2026	40%	$7,000,000 (estimated)	$19,000 - $20,000 (estimated)
2025	40%	$13,990,000	$19,000
2024	40%	$13,610,000	$18,000

The Rise and Fall of the Basic Exclusion Amount

Year	Highest Estate, GST & Gift Tax Rate	Estate, GST & Gift Tax Exemption	Gift Tax Exclusion
2026	40%	$7,000,000 (estimated)	$19,000 - $20,000 (estimated)
2025	40%	$13,990,000	$19,000
2024	40%	$13,610,000	$18,000
2023	40%	$12,920,000	$17,000
2022	40%	$12,060,000	$16,000
2021	40%	$11,700,000	$15,000
2020	40%	$11,580,000	$15,000
2019	40%	$11,400,000	$15,000
2018	40%	$11,180,000	$15,000
2017	40%	$5,490,000	$14,000
2016	40%	$5,450,000	$14,000
2015	40%	$5,430,000	$14,000

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Who will be impacted?

The anticipated 50% decrease in the gift, estate, and generation-skipping transfer tax exclusions will elevate the relevance of tax planning for clients at lower wealth levels.

Anticipated Wealth Level	Single Federal and State	
	2025	2026
Up to $7 million	No federal estate tax	No change
Over $7 million – $13.99 million	**No federal estate tax**	**Federal estate tax**
Over $13.99 million	Federal estate tax	"No change"

Who will be impacted?

The anticipated 50% decrease in the gift, estate, and generation-skipping transfer tax exclusions will elevate the relevance of tax planning for clients at lower wealth levels.

Anticipated Wealth Level	Married Federal	
	2025	2026
Up to $14 million	No federal estate tax	No change
Over $14 million - $27.98 million	**No federal estate tax**	**Federal estate tax**
Over $27.98 million	Federal estate tax	"No change"

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The Clawback Threat

- Will clients who make gifts to use the increased exclusion amount before the sunset but die after the sunset risk "clawback"?
- Generally, no. Treas. Reg. §20.2010-1 eliminates potential clawback, except for transfers that were not completed gifts.
- For decedents who made gifts prior to the sunset who die after the sunset, in calculating the estate tax, the estate may use the greater of the gift tax exclusion at the time of the gift or the estate tax exclusion at the time of death.

Motivating Clients to Act

- The real challenge before us is not
  a technical tax or gift planning challenge.
- It is motivating our clients to
  take action – sooner rather than later.
- Query?
  How to demonstrate the
  opportunity cost of inaction in order to
  get our clients to take action?

Power of Planning for Use of Basic Exclusion Amount

Assumptions:

Initial Gift: $13.61 million (2024 exclusion) or $6.8 million (2026 estimated exclusion)
After Tax Growth Rates: 3%, 5%, and 7%

	2024 Initial Gift $13.61 Million			2026 Initial Gift $6.8 Million			Difference		
	3%	5%	7%	3%	5%	7%	3%	5%	7%
10 Years	$18.3M	$22.2M	$26.8M	$9.1M	$11.1M	$13.4M	($9.2M)	($11.1M)	($13.4M)
20 Years	$24.6M	$36.1M	$52.7M	$12.3M	$18.0M	$26.3M	($12.3M)	($18.1M)	($26.4M)
30 Years	$33.0M	$58.8M	$103.6M	$16.5M	$29.4M	$51.8M	($16.5M)	($29.4M)	($51.8M)

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Power of Planning for Use of Basic Exclusion Amount *and* GST Tax Exemption

Assumptions: $6.8 million or $13.61 million Initial Gift with After Tax Growth Rate of 5% and Time between Generations: 30 Years

	$13.61 Million		$6.8 Million		Difference
	Do Not Allocate GST Exemption	**Allocate GST Exemption**	**Do Not Allocate GST Exemption**	**Allocate GST Exemption**	**Without GST / With GST Exemption Allocation**
Generation One Dies	$58,821,636	$58,821,636	$29,389,208	$29,389,208	
Taxes	($23,528,654)	$-	($11,755,683)	$-	
Value of Trust	**$35,292,982**	**$58,821,636**	**$17,633,525**	**$29,389,208**	**($17,659,457 / 29,432,428)**
Generation Two Dies	$152,534,234	$254,223,721	$76,211,079	$127,018,463	
Taxes	($61,013,694)	$-	($30,484,432)	$-	
Value of Trust	**$91,520,540**	**254,223,721**	**$45,726,647**	**127,018,463**	**($45,793,893 / $127,205,258)**
Generation Three Dies	$395,546,500	$1,098,740,273	$197,627,933	$548,966,478	
Taxes	($158,218,600)	$-	($79,051,173)	$-	
Value of Trust	**$237,327,900**	**$1,098,740,273**	**$118,576,760**	**$548,966,478**	**($118,751,140 / $439,092,451)**

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Planning for Use of Basic Exclusion Amount, GST Tax Exemption and Income Tax Mitigation

- Use of the increased basic exclusion amount has demonstrated single-generation gift and estate tax saving benefits.
- Use of the increased basic exclusion amount and the generation-skipping transfer tax exemption has demonstrated multi-generation gift, estate, and generation-skipping transfer tax benefits.
- Use of the increased exclusion amount, the generation-skipping transfer tax exemption and income tax strategies such as investment in private placement life insurance in a dynasty trust has even greater wealth transfer optimization and tax minimization benefits.

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Strategies

Strategy: Simple Gifts

- **WHAT:** Annual exclusion gifts and direct payment of tuition and medical expenses, including medical insurance premiums and ability to front-load five years of annual exclusion gifts to section 529 plans by making a section 529(c)(2)(B) election.
- **WHY:** Easy way to reduce estate.
- **HOW:** Outright gifts up to the annual exclusion amount $18,000 in 2024, $36,000 for a married couple, using 529 plans for education funding; unlimited amount of direct payment of tuition and medical expenses.
- **BEWARE:** Substantial amount in UTMA available to child at age 21 (or 18)

Strategy: Annual Exclusion Gifts

Assumptions:

- Married Couple Age 50
- After Tax Return on Gifts: 5%
- Initial Year Annual Exclusion: $18,000 each
- Annual Exclusion Inflation Adjustment: 2.5%
- Effective Combined Federal and State Estate Tax Bracket: 40%
- Time Period: 30 Years

Donees	2	3	4
Total Amount of Gifts	$3,161,000	$4,741,500	$6,322,000
Cumulative Gifts with Growth	$6,726,539	$10,089,811	$13,453,081
Estate Tax Savings	$2,690,616	$4,035,924	$5,381,232

Strategy: Annual Exclusion Gifts in Trust

- **WHAT:** Make annual exclusion gifts in trust.
- **WHY:** Annual exclusion gifts in trust have the added benefit of control by the trust, spousal and asset protection, and, as desired, leveraging of grantor trust status.
- **HOW:** Irrevocable grantor or non-grantor gift trust with annual *Crummey* withdrawal rights (hanging of excess over $5,000 and 5% trust estate).
- **BEWARE:** *Crummey* right of withdrawal made to qualify gifts in trust as present interests covered by the annual **gift** tax exclusion amount **do not** qualify the trust for a zero-inclusion ratio for **GST tax** purposes; apply GST exemption or include GST direct skip trust vesting provisions in any trust for a grandchild. Otherwise, a trust may have an inclusion ratio between zero and one.

Strategy: Annual Exclusion Gifts in Trust

- **EXAMPLE:** Nana and Papa establish a gift trust for their new grandchild Noah in 2024 and make annual exclusion gifts to the trust of $36,000 in 2024 and continue for 20 years. The annual gift exclusion grows by 2.5% per year, the trust estate grows at 5% and all income taxes are paid by Nana and Papa.

	Size and Savings
Trust estate in year 20	$3,068,421
Federal estate tax savings at 40% federal and state rate	$1,227,368

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Strategy: Top Off Existing Gift Trusts

- **WHAT:** Make additions to existing gift trusts and apply available exclusion.
- **WHY:** A simple way to utilize remaining elevated exclusion amount.
- **HOW:** Transfer cash or assets with high appreciation potential; leverage the exclusion with transfers of minority interests in entities valued at a discount.
- **BEWARE:** Assets transferred to a gift trust carry their basis with them and no future basis adjustment at death is available. Consider asset swaps for basis planning.

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Strategy: Top Off Existing Gift Trusts

- **EXAMPLE:** Sam, a widower, established an irrevocable gift trust for his descendants in 2011 using $5 million exclusion and tops off the trust with an additional gift of $8.61 million in 2024. The trust increases in value at 5% per year. Sam pays the income taxes on the trust. Sam dies in 2026 when the estate tax exclusion is $6.8 million. The combined federal and state estate tax rate is 40%.

	By the Numbers
Assets excluded with original gift alone	$10,394,641
Assets excluded with the augmented gift	$20,361,792
Difference with the augmented gift	$ 9,967,151
Estate tax savings at 40%:	$ 3,986,860

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Strategy: Gifts to Pay Off Intra-Family Loans

- **WHAT:** When interest rates were at rock bottom levels, as recently as 2021, senior generation family members often made low-rate loans to irrevocable dynasty trusts and the trusts then invested the borrowed funds and retained the growth in value above the interest rate/note payments; some loans were structured to require only periodic payment of interest with principal due at a later date, allowing the trust to retain use of the principal for a longer period of time; consider use of the current increased exclusion level to make gifts to trusts to settle outstanding loans.
- **WHY:** Additional gifts to trust can provide the liquidity to pay the loans without selling assets and triggering gains.
- **HOW:** Simple addition to existing trust with outstanding loan amounts.
- **BEWARE:** Existing low-rate loans won't be easily replaced in the current economic environment if there is a future need for financing.

Strategy: Cancel Notes in Intra-Family Sales to Intentionally Defective Grantor Trusts

- **WHAT:** Sale transactions to intentionally defective grantor trusts have been used as alternatives to Grantor Retained Annuity Trusts (IDGT) for gift and estate tax planning– effectively freezing the value of assets in the seller's estate; purchases were typically for a note.
- **WHY:** Ideally, the note taken back by the seller is paid in full prior to the seller's death, as sales to IDGTs have been subject to IRS scrutiny and potential income tax if debt remains outstanding at the seller's death.
- **HOW:** Consider cancelling the debt – a gift but no cancellation of debt income if the trust is a grantor trust.

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Strategy: Establish New Gift Trusts – Spousal Lifetime Access Trust

- **WHAT:** The time to establish and fund an irrevocable gift trust is before January 1, 2026, but large ($27.98 million) gifts entirely outside the marital unit may be difficult for clients to embrace – what a client can "afford" and what they are comfortable with are often two different questions.

- **WHY:** The increased exclusion amount is a use it or lose it tax benefit.

- **HOW:** Spousal lifetime access trusts ("SLAT"s) remain a vehicle for gifting with a safety net for married couples – each spouse creates a gift trust for the benefit of the other spouse and/or children.

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Strategy: Establish New Gift Trusts – Spousal Lifetime Access Trusts

- **BEWARE:** The reciprocal trust doctrine and IRC Sec. 2036 estate tax inclusion – if the spouses are in substantially the same economic position before and after creation of the trusts, the trust of which the deceased spouse is a beneficiary will be included in their estate.

- **BEWARE:** IRC Sec. 2036 estate tax inclusion if the trust estate may be used to discharge a legal obligation of support of the Settlor.

Strategy: Establish New Gift Trusts – Spousal Lifetime Access Trusts

- **BEWARE:** We are experiencing post-Covid and graying of divorce trends which increase the likelihood that clients married today may not be married tomorrow – the U.S. divorce rate is estimated at between 44.2% and 50% of all marriages and the divorce rate of adults aged 55 to 64 is 46%.
- **BEWARE:** The impact of divorce on the family balance sheet, family dynamics and trust administration – Will each spouse continue as a beneficiary or a fiduciary following divorce?
- **BEWARE:** State statutes that revoke trust provisions for a former spouse upon divorce commonly only pertain to provisions that are revocable by the settlor pertaining to the settlor's former spouse.
- Sources: Center for Disease Control and Prevention provisional number of marriages and marriage rate; U.S. Census Bureau – Number, Timing, and Duration of Marriages and Divorces

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Strategy: Establish New Gift Trusts – Spousal Lifetime Access Trusts

- **BEWARE:** Grantor Trust Spousal Unity Rule: The grantor is treated as the owner (for income tax) of a trust whose income, without the approval or consent of an adverse party is, or in the discretion of the grantor or non-adverse party or both may be, payable to or accumulated for future distribution of the grantor's spouse (IRC Sec. 677(a)).
- The identity of the grantor's spouse is determined *at the time of the creation* of the power or interest; thus, the grantor will be treated as the income tax owner of a trust for the person who was the grantor's spouse at the time the trust was created.
- Prior to the 2017 Tax Cuts and Jobs Act, this was not as important, because IRC Sec. 682 shifted income taxation to the beneficiary-spouse following divorce.
- The Tax Cuts and Jobs Act repealed IRC Sec. 682, so this issue is now much more important! The grantor will continue to pay income tax on a grantor trust for their former spouse after the divorce.

Strategy: Establish New Gift Trusts – Spousal Lifetime Access Trusts

- **PLANNING AHEAD:**
- Consider a “SMAT” rather than a SLAT – Spousal Marital Access Trust.
- Address the issue of an ex-spouse continuing as a beneficiary and/or as a trustee explicitly in the trust agreement and a written explanation of the operation of the trust provided to the client.
- Consider adding the requirement that distributions be made only with the approval or consent of an adverse party in the event of divorce but be mindful of the associated family strain.
- Consider whether to authorize but not require tax reimbursement in the trust agreement upon divorce.
- Consider whether to address tax aspects of future gift trusts in pre-marital agreement.
- Address the tax aspects of all trusts in any divorce negotiations.

Strategy: Fund Existing Irrevocable Life Insurance Trusts

- **WHAT:** Owning life insurance in an irrevocable life insurance trust (ILIT) removes the insurance proceeds from the insured's taxable estate, but the policy must be maintained in the trust, with recurring premium payments. Typically, annual contributions within the annual gift tax exclusion amount are made to the trust, and the trustee then provides notices of the contributions to beneficiaries and subsequently pays the annual policy premium. Consider funding the trust to cover future premiums.
- **WHY:** The contribution, notice, and payment cycle repeats, and repeats, and repeats. Sometimes there are time crunches and record of ILIT contributions and beneficiary notices are not always maintained.
- **HOW:** If a larger contribution is made to the trust in an amount to cover projected premium payments and available exclusion is applied to the contribution, the gift is tax-free and annual contributions and notices are no longer required. The trustee can simply pay the annual premium each year from the liquid assets in the trust.

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Strategy: Create (and Fund) New Irrevocable Life Insurance Trusts

- **WHAT:** Create irrevocable life insurance trust to own individual and joint and survivor life insurance to remove insurance proceeds for the gross estate.
- **WHY:** Lower exclusions mean more estates will be pushed over the exclusion amount by insurance death benefits and more estates will require life insurance death benefits to provide liquidity for estate tax payment.
- **HOW:** Establish ILIT and purchase life insurance in the trust or transfer existing life insurance to the trust – and survive 3 years.
- **CONSIDER:** Private placement life insurance for income tax minimization.
- **BEWARE:** Policies transferred to an ILIT within 3 years of death will be brought back into the estate.

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Strategy: Charitable Planning (Live to Give!)

- **WHAT:** Living into a mindset of gratitude and generosity with charitable gift planning.
- **WHY:** Giving is good for the well-being of the giver and benefits the recipient.
- **WHY:** As transfer tax exclusions decrease and income tax rates increase, the power of charitable planning accelerates. The gift and estate tax charitable deduction, unlike the income tax deduction, is unlimited.
- **WHY:** In a single generation, we have shifted from a cultural norm of charitable giving (over 2/3 in 2000) to a cultural norm of not-giving, at least in traditional ways (under 50% is 2018).
- **HOW:** Effective strategies for giving (live to give!) include simple transfers of appreciated securities, donor advised funds, $100,000 qualified retirement plan required minimum distributions to public charities, to the more complex use of split-interest trusts, foundations, and hybrid entities.

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Strategy: Split Interest Charitable Trusts

- **WHAT:** Charitable trusts with charitable and non-charitable beneficiaries – lead or remainder and annuity trust or unitrust.
- **WHY:** To at once minimize taxes and provide benefits to charitable and non-charitable beneficiaries.
- **BEWARE:** Split interest charitable annuity trusts are interest rate sensitive.
- Like grantor retained annuity trusts, charitable lead annuity trusts are most powerful when interest rates are "low" but can still be useful when rates are higher.
- Charitable remainder annuity trusts are most powerful when interest rates are higher.

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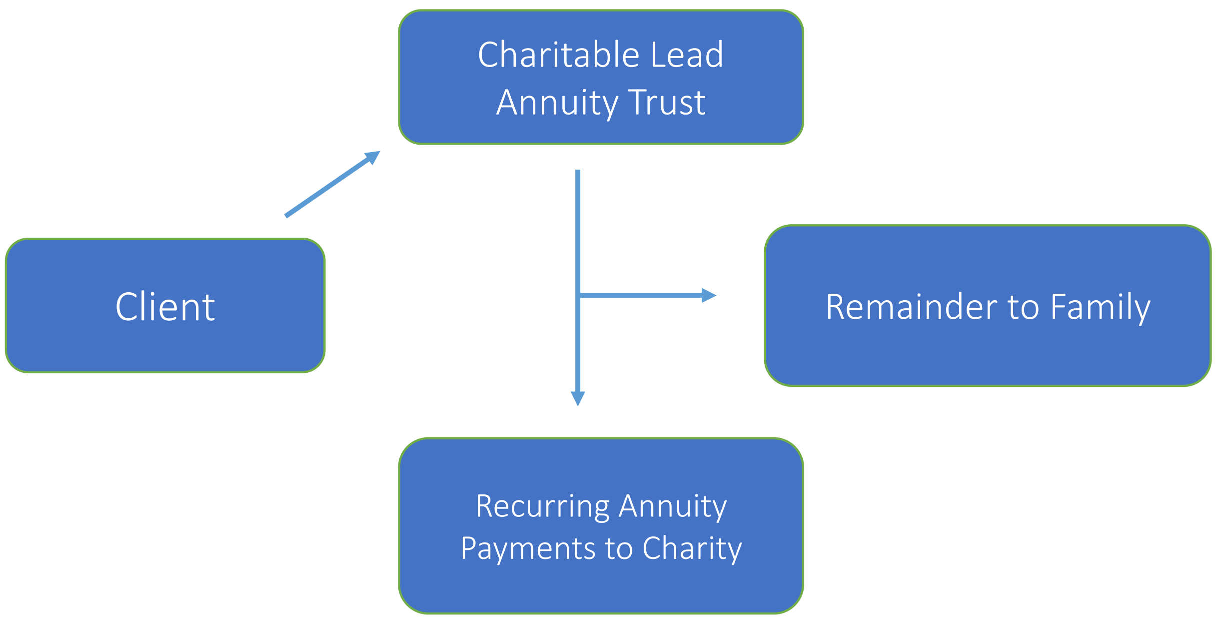
Strategy: Charitable Lead Annuity Trusts



Strategy: Charitable Lead Annuity Trust

- Examples: Charitable lead annuity trust, $5,000,000, 5% annuity, 10 years, assumed annual growth 5%

	November 2021	November 2024
IRC 7520/AFR	1.4%	4.4%
Charitable Lead (deductible)	$2,317,800	$1,987,950
Family Remainder (non-deductible)	$2,682,200	$3,012,050

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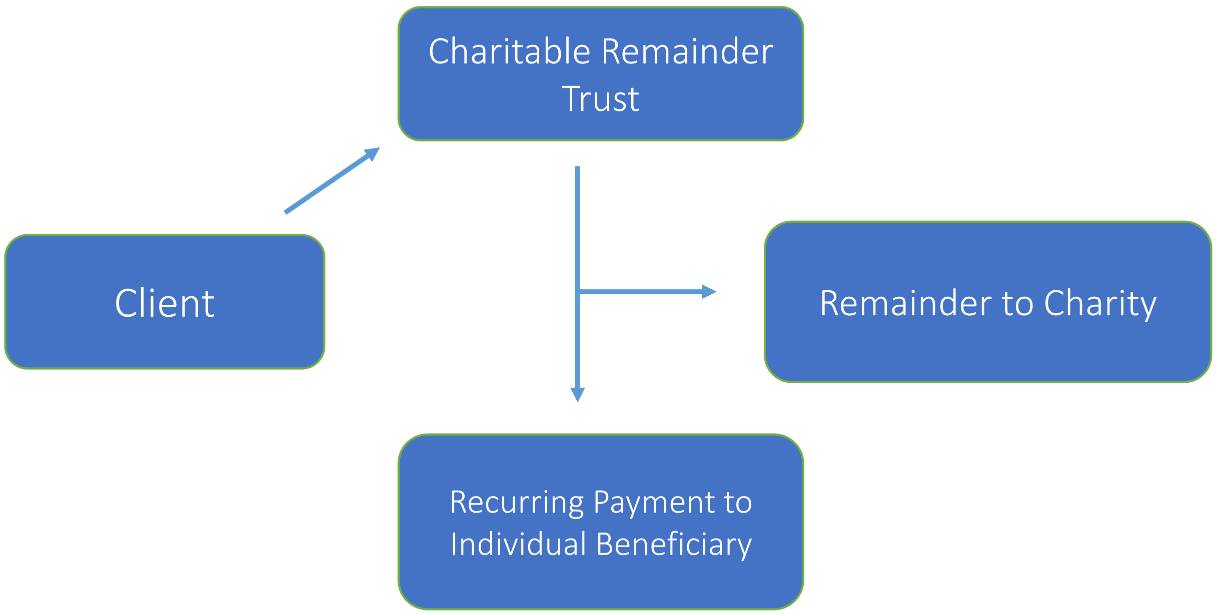
Strategy: Charitable Remainder Trust



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Strategy: Charitable Remainder Annuity Trust

- Examples: Charitable remainder annuity trust, $5,000,000, 5%, 10 years, assumed growth 5%

AFR	November 2021	November 2024
IRC 7520/AFR	1.4%	4.4%
Lead for Family (non-deductible)	$2,317,800	$1,987,950
Remainder for Charity (deductible)	$2,682,200	$3,012,050

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Strategy: Split Interest Charitable Trusts

- **WHAT**: Pairing successful lifetime grantor retained annuity trusts (GRATs) with testamentary charitable lead annuity trusts (CLATs) can achieve both wealth transfer to family and charity with minimal gift and estate tax.
- **WHY**: Children receive the lifetime benefit of the GRAT transfers and transfers to children at death are delayed by the lead charitable term of a testamentary CLAT to reduce estate tax.
- **CONSIDER**: For increased flexibility and ability to assess the impact of interest rates at death, provide for testamentary transfers to children with disclaimer to testamentary CLAT.

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Where We Go From Here

Where We Go From Here

Key Considerations:

- Will the TCJA temporary provisions expire in 2026, be extended, or modified?
- Tax increases may surface especially with the growing federal deficit.
- Tax changes are less likely if the election results in divided government.
- Growing fiscal deficits may pressure requests for tax rate increases.

Where We Go From Here

Prepare ourselves and our clients to take action:

- Evaluate overall posture in light of the expiring provisions and potential tax changes – gift, estate, GST, individual income, corporate income.
- Use remaining estate tax exemptions.

Where We Go From Here

After the exclusion amount reverts (if it does), traditional gifting strategies that use little or no exclusion amount will be advantageous

- Annual exclusion gifts, at the continually increasing annual gift exclusion level
- Bunching of annual exclusion gifts to fund 529 plans
- GRATs, if interest rates taper
- Sales to defective grantor trusts
- Qualified personal residence trusts
- Irrevocable life insurance trusts
- Charitable split interest trusts

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Paige Goepfert

- *Managing Director – Chicago*

Paige Goepfert is a managing director within Andersen's Private Client Services practice and works with ultra-high-net worth families, family offices, business owners, and executives on tax planning and income tax compliance. She also leads the Family Office strategy team.

Paige has over 20 years of experience in public accounting specializing in pass-through, individual, fiduciary, and estate taxation. For family office clients, Paige provides expertise on a variety of tax matters with a focus on structuring of family offices, development and implementation of multi-generational wealth transfer plans, and preparation of related tax returns.

She also consults with clients regarding other planning matters including use of partnerships, gifting, private foundations and other charitable vehicles. Paige also works with executors and estate administrators in managing a decedent's estate.

Paige frequently lectures on estate planning, taxation of trusts, and wealth strategies for the AICPA Advanced Estate Planning Conference and a variety of other professional venues. She has also published an article in *The Tax Adviser: Important Lessons Regarding Valuation Issues.*

EMAIL: paige.goepfert@Andersen.com

PHONE: 312.283.5547

EDUCATION
- Brigham Young University, BS (Accounting)
- Brigham Young University, MAcc (Taxation)

AFFILIATIONS
- American Institute of Certified Public Accountants
- Illinois CPA Society – Taxation Estate, Gift and Trust Committee (Past Chair); Content Advisory Group Member
- Chicago Estate Planning Council – Executive Committee (Vice President)
- Certified Specialist in Estate Planning