Gift Tax Exclusion Opens Opportunity

By Mark McBride and Joey Kaempf

Prior to 2018, the federal estate and gift tax exclusion amount (i.e. the amount that an individual can give during life or at death without incurring federal transfer taxes) was $5 million, adjusted annually for inflation. The Tax Cuts and Jobs Act of 2017 *temporarily* increased the exclusion amount. Including the inflation adjustments, the exclusion amount in 2020 is $11,580,000. Unless further legislation is passed, the exclusion amount will revert to $5 million (plus inflation) on Jan. 1, 2026.

Fortunately, the U.S. Treasury has signaled through proposed regulations that there will no "clawback" of any portion of the increased exclusion amount that is used between 2018 and 2025. This means that an individual who makes an $11,580,000 taxable gift prior to Jan. 1, 2026, will not incur gift tax (assuming no prior taxable gifts have been made) and will not incur gift or estate tax if the exclusion amount reverts to the lower level.

Therefore, those taxpayers whose gift and estate tax liability would be reduced by making lifetime gifts have a potentially limited period to take advantage of this increased exclusion.

For married couples, gifts of this nature may be most effective if they are made to a lifetime trust commonly referred to as a Spousal Lifetime Access Trust (SLAT). For a typical SLAT, which is established while both spouses are living, one spouse (the "donor spouse") establishes the trust for the benefit of the other spouse (the "beneficiary spouse") and transfers assets to the SLAT, utilizing some or all of the donor spouse's $11,580,000 exclusion amount. If the SLAT is structured properly, the assets transferred to the SLAT should not be included in either spouse's estate for estate tax purposes. The terms of the SLAT should permit, but not require, the trustee to make distributions to the beneficiary spouse as well as to the donor spouse's children and other descendants. Ideally (for estate tax purposes), the trustee would not make any distributions to the beneficiary spouse, instead preserving the trust assets for the donor spouse's children and other descendants. However, if circumstances warrant, the trustee may distribute cash or other assets of the SLAT to the beneficiary spouse for health, education, support, or maintenance. In this manner, gifts to a SLAT allow the donor spouse to utilize the exclusion amount and benefit his or her spouse, children, and other descendants.

Each spouse may create a SLAT for the benefit of the other. However, there is a risk in doing so under the "reciprocal trust doctrine," which treats gifts by two people to trusts for the benefit of each other as gifts to themselves. If the reciprocal trust doctrine applies to gifts to SLATs, the SLAT assets may be subject to estate tax on the death of the spouses. Because the interpretation and enforcement of this doctrine has been inconsistent it is critical that taxpayers considering gifts of this nature seek competent advice of legal counsel before making gifts to a SLAT.

Many high net-worth married couples have developed estate plans limiting the value of assets passing to their children and other descendants to a specific dollar amount and giving the balance of their estates to charitable organizations. Those couples may take advantage of their exclusion amount without departing from the limits set in their estate plan through the use of SLATs. To do so, the SLAT would grant to the beneficiary spouse the power to redirect the trust assets to other

individuals and charitable organizations during the beneficiary spouse's lifetime or at his or her death. Under this plan, the donor spouse may utilize his or her gift tax exclusion amount and allow the beneficiary spouse to make the final decision regarding the value of assets that will pass to their children and other descendants. If structured properly, this power to redirect assets to charities will not expose the SLAT assets to estate taxes.

For residents of states that impose state estate taxes, such as Washington, gift planning is particularly beneficial. For residents who die in 2020, Washington imposes a state estate tax on assets in excess of $2,193,000. Because Washington does not impose a gift tax or reduce the $2,193,000 exclusion as a result of gifts, those who make gifts to utilize the federal gift tax exclusion amount will also save significant state estate taxes. As with all transfer tax planning, other taxes, such as capital gains taxes, must be considered before making such gifts. Therefore, it is important that taxpayers work closely with competent tax and legal advisors before making large gifts, including gifts to a SLAT.

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