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Worth It Episode 2: Should You Use Your Gift Tax Exemption in 2020?

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In this episode of Worth It, associate Daniel W. Hatten, and partner, Lindsay A. Rehns, will discuss whether clients should use their federal lifetime gift tax exemption before the end of 2020. As part of this podcast discussion, Dan and Lindsay will explain some details about the lifetime gift tax exemption, highlight some of the potential tax consequences of the upcoming election and ultimately explain why now is in fact a great time to use the remainder of one's lifetime gift tax exemption.

Dan Hatten: Hello and welcome to Worth It, a podcast brought to you by Proskauer's Private Client Services Group, covering a wide range of topics concerning estate planning, wealth transfers and important legal developments and other issues our clients frequently face when organizing their estates. My name is Dan Hatten, associate in Proskauer's New York office. In this episode we'll be discussing whether clients should use their federal lifetime gift tax exemption for the end of 2020. As part of this discussion we will explain a little bit about the lifetime gift tax exemption, highlight some of the potential tax consequences of the upcoming election, and ultimately explain why now is in fact a great time for clients to use the remainder of their lifetime gift tax exemption. Joining me for this episode is Lindsay Rehns, partner in Proskauer's Boca Raton office.

Lindsay Rehns: Hi Dan. I'm glad to be here, I'm excited to speak with you about this timely topic.

Dan Hatten: By way of background, Lindsay, could you please give a brief explanation about the Federal Lifetime gift tax exemption as of today in 2020?

Lindsay Rehns: Sure but first I think it makes sense to give a little background on the federal gift and estate taxes. So generally, gratuitous transfers by United States persons whether by gift or transfers taking affect at death are taxed at a 40% rate. It's the lifetime gift and estate tax exemption that essentially shields a certain amount from this 40% tax imposed by the federal government on lifetime gifts or transfers at death.

Dan Hatten: And you refer to this as a shield. How much is a particular individual allowed to shield in 2020?

Lindsay Rehns: Well in 2020, the lifetime gift and estate tax exemption is $11,580,000 for each individual and this means that a single individual can transfer by gift or at death $11,580,000 and spouses together can transfer by gift or at death $23,160,000 without being subject to the 40% gift and estate tax.

Dan Hatten: That’s a lot of exemptions. Is that always going to be available for U.S. people?

Lindsay Rehns: The short answer Dan is no. The lifetime gift and estate tax exemption is provided by statute and the statute used to provide that the amount of exemption was around $5 million increased for inflation each year from 2011 through 2017 but then in 2018 the lifetime gift tax exemption was effectively doubled to over $11 million. Currently the statute provides the exemption will continue to increase off of a base of $11 million annually until December 31st, 2025. This increased base however is scheduled to sunset on December 31st 2025 and return to its pre-2018 base.

Dan Hatten: And is it possible that the upcoming election will have any effect on the lifetime federal gift tax exemption?

Lindsay Rehns: Obviously there's a lot of uncertainties as we head into the November election. It is clear however that Vice President Biden could and very well may seek to change the lifetime exemption back to its pre-2018 base. If that happens, we believe the lifetime gift tax exemption would be reduced back to about $5,900,000. The Trump administration has clarified however that individuals who use the current exemption at the increased amount will not be subject to a claw back. This means that we're potentially in a use it or lose it situation with the increased lifetime gift tax exemption. Of course there's some risk that a change of law in a Biden Administration could either reduce the exemption further or be retroactive to some point in 2020. Both of these possibilities increase the urgency for clients to use their available lifetime gift tax exemptions as soon as possible.

Dan Hatten: Wow that potential change under a Biden Administration sounds like a big shift. With that in mind, what are you advising clients to do before the end of the year?

Lindsay Rehns: Well, we're advising clients to consider using their lifetime gift tax exemptions by the end of the year by making gifts to long-term trusts for client's descendants and in some cases for the client's spouse and client's descendants.

Dan Hatten: Does this same advice apply if President Trump wins re-election on November 3rd?

Lindsay Rehns: Yes this advice would apply regardless of what happens on November 3rd as we know that the increased exemption is currently scheduled to sunset at the end of 2025. In addition, it is almost always beneficial for clients to use their exemption on lifetime gifts as compared to transfers at death for a few reasons. First, a lifetime gift removes the appreciation on the gifted asset from the client's taxable estate; second, a lifetime gift often minimizes applicable state transfer taxes as few states impose a separate gift tax; and third, a trust that a client creates during his or her life can be what we call a "grantor trust," which allows the client to pay the income tax on the trust's assets each year without that income tax payment being an additional gift. Effectively, by the client paying the trust's income taxes each year the client is making an additional tax-free gift to the trust which allows the trust to grow faster while simultaneously reducing the client's estate even further.

Dan Hatten: Thanks for that. It sounds like it’s definitely important for clients to consider using their remaining lifetime gift tax exemption by the end of 2020 no matter what happens in the election. Before we wrap up I wanted to check if there are any particular techniques you are often recommending to clients this year in order to use the remaining exception.

Lindsay Rehns: Absolutely. In addition to the usual advice we give, which is for clients to gift assets that the client thinks will appreciate, we’re frequently suggesting that married couples create two separate SLATs, which stands for spousal lifetime access trusts.

Dan Hatten: And we're going to talk about SLATs in greater detail in a separate podcast but can you briefly explain how SLATs work?

Lindsay Rehns: Sure. As a preview in a SLAT plan, Spouse A would create a trust for the benefit of Spouse B and their descendants. While Spouse B would create a separate trust for the benefit of Spouse A and their descendants. There always has to be some differences between these two trusts to avoid what is called the “reciprocal trust doctrine,” but generally the beneficiaries would be similar. This kind of plan provides increased flexibility for clients going forward in case they ever need to quote “access” the assets. While ideally the gifted assets would stay in trust and grow to benefit the couple’s descendants by using SLATs it's possible for each Spouse to access the assets of the trust for which he or she is a beneficiary.

Dan Hatten: Thanks for that helpful explanation and thanks for joining me today, Lindsay. Sounds important for clients to use their remaining lifetime exemption before the end of the year and clients may be able to even do so while preserving some access to the assets of the gift by using the SLAT plan.

Lindsay Rehns: That's right and it was a pleasure being here today. I hope that our listeners found the topic helpful, insightful, inspiring and if they have any further questions they should feel free to reach out to us to discuss.

Dan Hatten: With that we'll wrap up this episode of Worth It. We hope you enjoyed this podcast and please join us for future episodes. If you would like to receive notifications when new episodes are available please visit our website Proskauer.com and click the subscribe button to our publications link at the bottom of any page. Thank you for listening!