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Higher Gift and Lifetime Exemptions Offer Potential Opportunity While Available

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Key Points

1. The lifetime estate and gift exemption has more than doubled since 2017.
2. Expanded limits will expire at the end of 2025, assuming no additional law changes.
3. Donors with a sizable estate may make tax-free annual gifts to family and friends.
4. There is potential opportunity using higher gift and lifetime exemptions with a CRT/PIF.
5. Parents may gift annual exemptions to fund life insurance for wealth replacement.

The U.S. wealth landscape is changing dramatically, creating an immediate need to prepare for the near future. Baby Boomers and the Silent Generation are expected to pass down some $84.4 trillion[1] in assets through 2045, with $72.6 trillion going directly to their heirs. Charity-minded individuals have a unique and timely opportunity to take advantage of a new law that lessens the tax burden for generational wealth transfer.

Since the Tax Cuts and Jobs Act (TCJA) was implemented in 2017, the lifetime estate and gift exemption has more than doubled to $12.92 million from $5.6 million for individuals, and to $25.84 million from $11.18 million for married couples. If there are no significant tax law changes, this provision will sunset at the end of 2025, effectively halving the limits. This creates tremendous opportunity to start planning for these changes by considering three key strategies.

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“There are three wealth transfer ideas that should be considered before the expanded TCJA expires on December 31, 2025.”

Remove assets out of your estate through gifting

Make annual gifts to family and friends tax free. An individual may gift as much as $17,000 annually, while a married couple can elect to gift split and combine their giving up to $34,000 per year without being taxed.

This is potentially a great way for donors with sizable estates to start making tax-free annual gifts to individuals to lower their overall holdings.

Distribute gifts through a Charitable Remainder Trust/Pooled Income Fund

Distribute income from a Charitable Remainder Trust (CRT) or turnkey vehicles like a Pooled Income Fund (PIF) to family members through a life income charitable giving strategy. This strategy allows you to gift appreciated positions to a CRT/PIF without recognition of capital gains tax, thereby creating a higher net invested value to begin generating income.

In addition to the distribution, donors are eligible for a charitable deduction. Assets contributed to CRTs/PIFs are removed from the donor’s taxable estate and treated as completed gifts for tax purposes, while gifts of income interest — that is, distributions — may effectively be used before the exemption amount is reduced.

This strategy allows the donors to gift appreciated assets, remove assets out of their estate and receive a charitable deduction. Moreover, unlike CRTs, PIFs don’t require a 10% remainder test, so income can be distributed to more and younger income beneficiaries. In some cases, PIFs can offer higher deductions, reducing the income interest used in the gift and lifetime exemptions.

Fund wealth replacement with insurance

Parents can use the income distributed from the CRT/PIF and gift the annual exemption amounts to their children, who can purchase a life insurance policy on the parents. As long as the irrevocable trust owns the insurance policy, it won’t be included in the donor’s estate and can be paid out tax free to heirs.

This strategy allows donors to replace the gifted asset in a trust with a potentially higher tax-free gift to heirs with life insurance. Assets contributed are removed out of the estate. Donors who have exhausted all or most of their lifetime exemptions are able to transfer wealth with this method.

Bottom line:

There are three ways to seek potential wealth transfer opportunities from the lifetime estate and gift exemption expanded by the TCJA, which should be considered before it expires on December 31, 2025. To choose the best strategy for your family, consider the size of your estate, the ages and number of your heirs, and any wealth transfer goals or considerations.

[1] The Cerulli Report, U.S. High-Net-Worth and Ultra-High-Net-Worth Markets 2021.

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