

Key Wealth Institute

Here Comes the Sunset; Are You Ready?

Or will your estate planning strategies end up in the dark when the 2017 tax cuts end?

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There is still an open window to take advantage of the tax savings available to high-wealth individuals under the 2017 Tax Cut and Jobs Act (TCJA). But don't blink. That window will close sooner than you think.

We do not recommend that you allow taxes to drive your financial strategies. However, the changes that are coming on January 1, 2026, should at least prompt many of you to review your goals and strategies. The lifetime unified credit included in the TCJA's provisions could get cut in half in less than three years, so now may be the best time to determine if you are optimizing the outcomes you want for yourself and your loved ones.

Some history

The TCJA was passed in 2017 but will end on the last day of 2025 if Congress does not act before then. The TCJA has dozens of provisions that affect taxpayers, but none more so than the boon for estate planning among high-net-worth individuals and couples. The law more than doubled the lifetime estate tax exemption, which, through incremental increases, is almost \$13 million per individual in 2023 and \$26 million for married couples.

However, the increase in the estate and generation-skipping transfer tax exemption is scheduled to sunset

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back to its pre-2018 amount, which should be around \$6 million per individual and \$12 million for a couple. Moreover, the 40% maximum gift and estate tax rate is set to increase to 45% in 2026.

Given that estate and tax planning at that level can take time to develop and implement, the clock is ticking for high-net-worth individuals to take advantage of the current amount of increased exemptions.

Now is the time to consult with your KeyBank advisor on your sunset strategy.

Where to start

Begin with an evaluation of your net worth and expected future income compared with your anticipated lifestyle and projected spending needs. If the assets making up your net worth comfortably exceed what is needed to support your lifestyle, then those assets are available for redeployment.

Where your wealth lands on the spectrum is important in determining the most critical steps to take, as shown in the table below.

Married couples with a net worth of:

More than \$25M (more than \$12 million for individuals)

Individuals and couples should take a deep dive into their planning since their estate-tax exemptions will drop drastically in 2026. Actions taken now could dramatically reduce future estate-tax liabilities.

\$12M – \$25M (\$6 million to \$12 million for individuals)

Individuals and couples could take substantive steps to eliminate future estate tax exposure.

Less than \$12M (less than \$6 million for individuals)

Individuals and couples should keep an eye on the congressional proposal to reduce the lifetime tax-free wealth transfer to less than \$5 million, like a recently proposed federal exemption amount of \$3.5 million. Also, consider the possibility that net worth may be in this bucket now, but with appreciation, net worth could grow to be larger than the future lifetime exemption amount.

The foregoing net worth thresholds may need to be adjusted in situations where state estate, gift, generation-skipping tax, and/or other death taxes apply. If you are in one of the first two categories, there are several strategies to consider in preparing for the sunset.

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Living gifts that keep on giving

Giving gifts during your lifetime can have multiple benefits. They provide a chance to observe how loved ones and their families manage their increased wealth. Giving early also adds growth potential and can reduce tax burdens in the future.

Gifts come in various forms:

Outright gifts	Are the simplest but can create potential problems. An outright gift to a loved one would be subject to the recipient's creditors (a spouse looks like a creditor in the event of divorce) and could be squandered away due to mismanagement. Also, these amounts could be subject to potential estate tax again when the recipient dies.
Gifts in trust	Come with guardrails that can protect the recipient from how they might spend the funds and from creditors and alienated spouses.
A gift of a minority interest in your business	Can provide spending and control guardrails as well as leverage the value because of liquidity and control limitations that come with a minority interest.
Gifts that provide an income to you and future value to loved ones	Allow you to leverage assets and reduce the taxable value of the future gift.
Gifts that provide income for a loved one but ultimately pass to another party	Can be a nice way to enhance lifestyle support for a loved one and others or charities, reducing the value of the gift as a consequence.

Other potential strategies

Frontload 529 educational plans for children or grandchildren	Families can frontload contributions to the 529 plans for the education of their children or grandchildren, transferring funds out of their taxable estates. Current rules allow contributions up to \$170,000 by married couples (\$85,000 for individuals), but the contributions must be treated as though they were spread over five years. This strategy does not require the use of any lifetime gift exemption.
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Other potential strategies (continued)

Make Roth IRA conversions	<p>The expansion of the tax brackets under the TCJA creates a good opportunity for clients to consider a three-year Roth IRA conversion plan. Roth conversions take advantage of paying tax now at current lower rates rather than later when rates are projected to be higher. Roth conversions will be more expensive, tax-wise, after 2025. Ideally, conversions should be considered before reaching age 73, when required minimum distributions (RMDs) are scheduled to begin for most individual taxpayers. Once you reach age 73, taxes can dramatically increase because of having to take RMDs. Converting to a Roth means less of an IRA balance to calculate future RMDs, resulting in lower taxes.</p>
Place additional cash in an irrevocable life insurance trust (ILIT)	<p>These ILITs, once funded, can provide many benefits, including:</p> <ul style="list-style-type: none">• Minimizing estate taxes• Avoiding gift taxes• Protecting assets from creditors (how much depends on the state)• Providing liquidity• Giving trustees control over the distribution to beneficiaries <p>The issue with using irrevocable trusts is that the donor can never have access to any of those assets again. Clients with a net worth of more than \$25 million can utilize their lifetime exemption without having any interest in irrevocable trusts since they have enough assets outside to support their lifestyle. Moderately wealthy clients (\$12 million to \$25 million) may want to still have access to these assets if circumstances change, though there are strategies to gain indirect access.</p>
Add funds to family-limited partnerships or family-limited companies	<p>Although your interest level will have to be adjusted to reflect your increased ownership, you can then gift additional partnership interests to utilize the available lifetime exemption.</p>

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Other potential strategies (continued)

Transfer assets to a spousal lifetime access trust (SLAT)	You can take advantage of the current gift-tax exemption and receive income distribution by transferring assets to a SLAT. One spouse usually names the other as beneficiary, which gives both spouses access to the funds while they remain married and are alive. This strategy makes sense for protecting the assets of most clients, even those worth less than \$10 million. Many provisions can be incorporated to enhance the effectiveness of a SLAT.
Create a domestic asset protection trust (DAPT)	A DAPT is a self-settled trust in which an independent trustee controls and/or distributes trust assets to the beneficiaries. You can use the trust for your benefit, but its assets are protected from your creditors. Approximately 20 states now permit self-settled trusts.
Try a hybrid DAPT	Because there are some concerns in courts about DAPTs, many advisors prefer a hybrid version. This third-party irrevocable trust is set up for the benefit of your spouse and descendants in which you aren't a beneficiary initially. The hybrid gives you the power to appoint a trust protector who could add you as a beneficiary later.
Consider a special power of appointment trust (SPAT)	<p>These may be better than a standard DAPT. It is not a self-settled trust so it isn't subject to the laws that allow creditors access to such a trust. Still, a SPAT should be done in a jurisdiction that allows self-settled trusts. A SPAT gives a nonfiduciary power of appointment to any descendant of your mother.</p> <p>You should discuss mixing and matching these techniques. One spouse could use one technique, while the other takes a different strategy. This increases the effectiveness of your planning techniques.</p>

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Beware of clawbacks

If a taxpayer makes a gift while the higher exemption is in place and then dies after the higher exemption sunsets and the exemption is lower, what happens? Will the exemption that the taxpayer used when the gift was made be clawed back at death, resulting in unanticipated tax? Proposed regulations issued in April 2022 confirm that in most, but not all, cases, such gifts won't be subject to tax by reason of a clawback of the exemption. However, there are exceptions to this rule, meaning that some transactions that may have been tax-free when made will trigger an estate tax if the taxpayer dies after 2025.

Common techniques that will not trigger an estate tax if the taxpayer dies after 2025 include gifts to SLATs or self-settled DAPTs structured as completed gifts. Also, if the total of the taxable portion of the transfer value was 5% or less, the transfer would not be included in the estate (de minimis rule).

Transfers in which the donor continues to have the title, possession, or other retained rights in the transferred property during life that still will be treated as owned by the donor upon death may fail to preserve the bonus exemption and may trigger an estate tax.

These gifts include: 1) gifts made within three years of death; 2) transfers with a retained life estate; 3) transfers taking effect at death; 4) revocable transfers; 5) certain life insurance proceeds; 6) unsatisfied enforceable promise gifts; 7) freeze partnerships; and 8) certain transfers to grantor retained annuity trusts (GRATs), grantor retained unitrusts (GRUTs), and qualified personal residence trusts (QPRTs).

Also not included in the estate is the relinquishment or elimination of an interest in any one of the targeted transactions previously listed within 18 months of the decedent's death.

Although there are transfers that are quashed by the proposed clawback regulations, it should be noted that the transfer will nevertheless be effective and strongly recommended to preserve the generation-skipping tax exemption and portability allowances.

Final considerations

Remember that the 2017 tax act changed the way parts of the tax are adjusted for inflation, using the chained consumer price index (CPI), which lowered the annual inflation adjustment. This mechanism also sunsets after 2025 and the standard CPI adjustment will be used again. That might result in a greater adjustment for inflation.

The key takeaway to consider is what the impact could be if the 2017 tax law reverts to what it was before its enactment. Your KeyBank advisor can review your financial plan with and without the sunset of the 2017 TCJA so that you can see the impact of the law change. Take advantage of opportunities now to benefit from the current higher exemptions before it's too late.

For more information, please contact your advisor.

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About the Author

As the Director of Financial Planning for Key Private Bank, Tina is responsible for managing the Central Planning Team, as well as overseeing the National Advisory Committee, Monthly National Advisory Call, the Key Wealth Institute, and any financial planning literature developed internally and externally. She works with our Regional Directors of Planning to help facilitate our best thinking and advice delivery to clients.

Tina earned a B.S. in Business Administration from the University of Richmond and an M.Tax from Virginia Commonwealth Univ. She is a CFP® certificant, CPA/PFS, and is an AEP®. She is Treasurer of the Put-in-Bay Community Swim & Sail Program. Tina received the 2016 Exceptional Service Award from the Cleveland Estate Planning Council and the Circle of Excellence Award by Key Private Bank in 2016 and 2018.



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