Estate planning:

Act now before the sun sets on these estate planning tax breaks.

"Those who fail to plan, plan to fail," Benjamin Franklin once said. When it comes to passing on your money, planning is essential. With the right steps, you'll be able to minimize transfer taxes and have greater control over your legacy.

Something you have less control over is the wider political and economic environment. This can also have a major impact on how you pass on your assets and how much you're able to shield from taxation.

Today's environment is well-suited for affluent individuals and families to maximize flexibility, minimize tax, and pass on wealth in the way they want to. However, things can change quickly. The benefits available in the current climate may not be around tomorrow, so it's critical to act now and think about your estate plan.

Understanding estate tax: Use it or lose it

Estate planning is the process of organizing your finances so you can pass on those things you own that you've worked hard for, such as your home, your savings or your IRA. An important part of estate planning is managing the tax you have to pay, so your loved ones can inherit more of your estate once you're gone.

The government will collect estate tax on the value of someone's assets above a certain level when that person passes away. The current level, called the "exemption amount," is a generous $13.61 million per taxpayer, or $27.2 million per couple—established in the Tax Cuts and Jobs Act of 2017. Unfortunately, at the end of 2025, this increased exemption is scheduled to sunset. At that time, the exemption will fall back to an inflation-adjusted $5 million (currently estimated to be around $7 million).

The good news is that the estate planning you do now may hold up over time. The Internal Revenue Service (IRS) has been reluctant to "claw back" money from people's estates where they took planning steps before tax laws changed. That said, you won't get a chance to take advantage of these higher exemptions again once the threshold drops—once they're gone, they're gone. Consider speaking to a wealth planner to understand how to make the most of this allowance in your estate planning before the rules change.

Gifting vs. selling strategies: Why to consider trusts

We can achieve estate planning objectives through a variety of sometimes complex, but very well-established trust strategies. A trust is a legal framework which can be used to "ring-fence" assets; a trustee then holds and manages the assets until it's time to distribute them to the right person. In order to move assets into a trust, there are two options: gifting and selling.

Gifting is a sound strategy for estates worth less than the exemption amount. As we mentioned above, there are large gifting allowances currently available which are due to end next year—and wealth planners may be able to help you use trusts to lock in these higher allowances before they expire. But for larger estates, or for those looking for flexibility in their plan, selling offers a number of great opportunities.

Current estate tax laws allow you to implement transfer strategies that could minimize estate taxes depending on what's happening in the wider economic environment.

Low interest rate environments, for example, tend to favor strategies such as grantor retained annuity trusts (GRATs). In a higher interest rate environment, qualified personal residence trusts and charitable remainder trusts become more attractive. The appropriate strategy depends on your goals and the assets available for gifting. A qualified financial planner will be able to advise you on the best option for your situation.

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Valuation discounts: Reducing asset value to reduce taxes

Another tax-minimizing strategy available today is valuation discounts. This works by reducing the value of the assets you own so that less taxes are payable when you transfer them.

How does it work? Let's look at an example.

Imagine a husband and wife own real estate worth $100 million. Gifting it outright would mean the vast majority would be subject to gift tax.

Instead, under current law, the couple may choose to use a family limited partnership (FLP) to recapitalize their real estate assets into 10 general partner voting shares and 90 limited partner non-voting shares. The underlying assets are worth the same, but the non-voting shares don't have the same value as voting shares (due to their lack of marketability and control).

A valuation expert must determine how much of a discount the non-voting shares should have—but for illustration purposes, let's assume a 30% discount. This would mean 90% of the real estate could be transferred for a value of $63 million, not $90 million. At the current 40% federal estate tax rate, that $27 million reduction in valuation would save the couple $10.8 million in federal transfer taxes.[1]

In this case, the couple would keep control of the family limited partnership and the real estate assets, while also transferring the future value of those assets to the next generation.

Valuation discounts are one area we continue to watch for legislative action, as we worry it may not survive future tax reform. If you'd like to make the most of this strategy, time is of the essence.

Opportunities for fast movers

Estate tax has historically been somewhat of a political football, and a constant subject of policy discussions. Reforms here can have a big impact on people's finances. The estate tax rate itself can and does change, along with other related factors, and each state takes a different approach to taxing individuals' wealth upon death.

None of us can influence what policymakers do, but we can take action on our own financial situation. The economic and tax backdrop today is unique and most likely temporary, but it offers a lot of opportunities for planners to meet your needs, if you act quickly. A well-crafted estate plan could help bring you confidence that you'll pass on your assets in the way you'd like and support future generations.

The time is now to start learning how you, your heirs, and your legacy can benefit from a well-crafted estate plan.

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[1] For illustration purposes only.

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