TOP ESTATE PLANNING TIPS

for Those Nearing Tax Exemption Limits

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1. Use The Annual Exclusion
2. Donate To Charity
3. Use A Grantor-Retained Annuity Trust

It's often said that death and taxes are the only certainties in life. But the specifics—when, how much—are not certain. The estate tax exemption, currently set at $11.7 million for singles and $23.4 million for married couples, is set to expire in 2026. While it's anyone's guess what the exemption will be after then, few advisors expect tax rates to go down. With a new administration in place and billions in recent pandemic stimulus payments, it's widely expected that tax rates will increase as the government looks for additional tax revenue.

"It's all up in the air at this point; we really don't know what's going to happen … but at some point, if you don't use it, you're going to lose it", Derek Hamblet, Vice President and Client Advisor at Whittier Trust, says of estate tax exemptions.

The uncertainty around estate tax exemption means anyone with more than $5 million in assets will likely be interested in ways to maximize giving while minimizing taxes. Here are some of the most common estate planning techniques for those nearing estate tax exemption limits.

Use The Annual Exclusion

One of the easiest ways to reduce your taxable estate is to maximize the annual exclusion limit, currently set at $15,000 a year per giftee, says Hamblet. The gift could be to an individual or trust. So, for instance, if someone has three children and six grandchildren and wants to give them each the maximum amount per year, that adds up to $135,000 a year in gifts without having to pay gift taxes.

Donate To Charity

Those who are philanthropic (or who have philanthropic endeavors) can consider giving to charity during their lifetime. Donors don't often think to donate appreciated assets—such as stock—by transferring the assets directly from the estate to charity. Donating in this way also avoids capital gains tax because the donor is not selling the assets.

Donating straight cash or assets to charity is just one method. Other strategies include:

- **Donate Required Minimum Distributions To Charity (Qualified Charitable Distributions)**
  The IRS requires those 72 years and older to start drawing annually from their IRAs. (The qualified charitable distribution doesn't apply to 401(k) plans.) Those who don't need this income can donate their required minimum distribution directly to charity. Current regulations allow taxpayers to donate up to $100,000 of the distributions to charity. One added bonus: Because required minimum distributions are usually taxed as ordinary income, the donation also reduces income tax liability.
  "It's the trifecta there. It's an excellent way to reduce your tax bill and reduce your estate while also helping out a charitable cause," says Hamblet.

- **Use A Donor-Advised Fund**
  Donations to qualified charities are excluded from taxable estates, but sometimes donors want more flexibility in their charitable giving. Maybe they want the option of donating to different charities in the future or want to stretch out the giving over years, rather than in one lump sum. Donor-advised funds, flexible accounts designed exclusively for charitable giving, provide those options. Donors make a tax-deductible contribution into the fund, which then grows tax-free. The donor can then make distributions from the DAF to any qualified charity in any amount at any time.

- **Use A Charitable Split-Interest Trust**
  Another way to reduce a taxable estate by giving to charity is to use a charitable remainder trust or charitable lead trust. For someone who wants to give to charities during their lifetime while also providing for heirs, a charitable lead trust is a great option. These vehicles provide income to a charity for the term of the trust, then the remainder goes to a noncharitable beneficiary, usually a family member. A charitable remainder trust works the other way around. It initially benefits a noncharitable beneficiary, which could be the donor or a family member, then, at the end of the trust term, gives the remainder to charity.

Use A Grantor-Retained Annuity Trust
A wealthy person with a taxable estate and near the lifetime exemption limit can effectively reduce their estate by transferring assets to a grantor-retained annuity trust—another type of irrevocable split-interest trust. Once transferred to the GRAT, the assets are not counted as part of the estate. In return, they receive an annuity payment from the trust for a specified number of years. The annuity is tied to the applicable federal rate, or AFR, which is currently at historically low levels. Any return above AFR can transfer to a beneficiary tax-free.

The grantor, or person who sets up the trust and receives the annuity, is still liable for income tax incurred by the trust. But income tax is marginal, and even at the highest rate of 37%, it's less than the current flat estate tax rate of 40%. Also, "you're getting more money out of your estate by paying income taxes rather than reducing the value of the trust," says Hamblet.

GRATs are popular among startup founders who use the vehicle to pass on shares in startup companies. GRATs last for a set number of years. Once expired, the assets can transfer to the beneficiary or fund another GRAT. However, if the grantor dies before the trust expires, those assets revert back to the estate for estate tax purposes. For that reason, advisors often recommend shorter terms for older clients.

It's unclear what the estate tax exemption will be beyond 2026, but few expect it to stay as high as it currently is. Wealthy individuals nearing the exemption limits may want to look at ways of reducing the size of their taxable estate by maximizing their giving in a tax-efficient way.

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