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Estate Planning Update Winter 2023/2024 - Inflation Adjustments and Gifting Strategies for 2024

2024 Inflation Adjustments

Each year, certain federal gift, estate and generation-skipping transfer (GST) tax figures are subject to inflation adjustments:

- For 2024, the annual exclusion amount for gifts increases to $18,000 (from $17,000). The annual exclusion amount for gifts made to a noncitizen spouse in 2024 increases to $185,000 (from $175,000).
- The federal gift, estate and GST tax exemption amount for gifts made in 2024 and decedents dying in 2024 increases to $13.61 million (from $12.92 million). These exemption amounts apply to U.S. citizens and those domiciled in the United States.

There are changes to exemptions in four of the states in which Day Pitney has offices:

- The Connecticut gift and estate tax exemption for gifts made in 2024 and decedents dying in 2024 matches the federal exemption, so it also increases to $13.61 million (from $12.92 million).
- The New York estate tax exemption for decedents dying in 2024 will increase to $6,940,000 (from $6,580,000).
- The Rhode Island estate tax credit amount for decedents dying in 2024 will increase to $83,370, making the estate tax threshold $1,774,583. The 2023 estate tax threshold was $1,733,264.
- Massachusetts passed a new law in October 2023 that provides for an estate tax credit amount of $99,600, making the estate tax threshold $2 million. The law is retroactive, applying to estates of decedents dying on or after January 1, 2023. The Massachusetts credit amount is not indexed for inflation and will remain fixed unless modified by future legislation. For additional information on this legislation, please see our alert here.

Note also some changes to retirement plan contribution limits:

- The contribution limit for 401(k) plans will increase in 2024 to $23,000 (from $22,500). The limit for catch-up contributions to such plans for people over age 50 will remain at $7,500.
- The limit on annual contributions to an IRA will increase to $7,000 (from $6,500), with the IRA catch-up contribution limit remaining at $1,000.
- For further information on retirement plan contribution limits, see our alert here.

An individual who relinquishes U.S. citizenship or long-term resident status may be subject to a mark-to-market tax on the deemed sale of all assets and other adverse tax consequences if the individual's net worth is more than $2 million or average annual income tax liability is above certain thresholds. A certain amount of gain is excluded from the mark-to-market tax. Note these changes:

- The income tax threshold for triggering covered expatriate status increases to $201,000 in 2024 (from $190,000).
- The excluded gain under the mark-to-market tax increases to $866,000 in 2024 (from $821,000).

Gifting Opportunities and Strategies for 2024

The inflation-adjusted gift, estate and GST exemptions (collectively, the "lifetime exemptions") provide clients who had previously exhausted their lifetime exemptions with the opportunity to make additional gifts. An individual will be able to give away an additional $690,000 in 2024. Married couples will be able to give away twice that amount ($1.38 million). For clients who have not yet engaged in gifting, the current lifetime exemption is historically high and presents an opportunity to transfer wealth and reduce their taxable estates before the current federal law expires on December 31, 2025, and the lifetime exemptions are reduced by about half. Absent law changes, beginning January 1, 2026, the lifetime exemptions will drop to a base amount of $5 million per person adjusted for inflation, which currently projects to be an exclusion of $6.5 million to $7 million per person. Gifting strategies can be as simple as writing checks to family members but often involve the use of irrevocable trusts. This article highlights several strategies clients could implement in 2024.

Annual Exclusion Gifts

One of the fundamental strategies for all clients is leveraging annual exclusion gifts. The annual exclusion allows individuals to gift a specified amount per recipient per year without affecting their lifetime exemption. In 2024, the annual exclusion will be $18,000 per person. By taking advantage of this strategy, individuals and couples can gradually transfer significant assets while minimizing tax implications. For example, in 2024 a married couple with three children and six grandchildren can combine their annual exclusions and gift $36,000 to each of their children and grandchildren, for a total of $324,000 in gifts for that year. Since all gifts are within the annual exclusion amount, the $324,000 does not reduce the couple's lifetime exemption.

Gifting Strategies Using Trusts

The simplest way to make a gift is to transfer assets outright to a beneficiary, such as cash in hand. This method has the advantage of being simple but has drawbacks. Assets gifted outright become part of the recipient's taxable estate and will generally be accessible to the recipient's creditors, including a potential divorcing spouse. These drawbacks can be mitigated by making gifts to an irrevocable trust. There are many types of irrevocable trusts clients can utilize as part of a gifting plan, including the following.

Spousal Lifetime Access Trusts (SLATs) and Gifting Trusts for Children

SLATs continue to be a valuable tool for married couples in estate planning. With the enhanced exemption, couples can establish separate trusts for each other, allowing flexible access to the gifted assets. This strategy provides a balance between gifting and retaining control over family wealth. Clients may also establish "gifting trusts" that do not include the spouse as a beneficiary and benefit their children, grandchildren and more remote descendants. Contributions to SLATs and gifting trusts can qualify for the annual exclusion by allowing the trust beneficiaries to withdraw a portion of the contribution for a period of time. Assets contributed to SLATs or gifting trusts in excess of the available annual exclusion are taxable gifts and will reduce the lifetime exemption of the settlor (the person creating and funding the trust) available for future gifts or at death. Any post-gift appreciation in the assets contributed to a SLAT or a gifting trust avoid taxation in the estate of either spouse (assuming proper trust administration).

Strategies to Leverage Lifetime Exemption When Gifting to Trusts

While SLATs and gifting trusts work well for many clients given the currently high lifetime exemption, there are also strategies where clients can leverage their exemptions by structuring a gift in such a way that the value of the taxable gift for gift tax purposes is less than the fair market value of the gifted asset. Two common strategies for leveraging a client's exemption are qualified personal residence trusts (QPRTs) and grantor retained annuity trusts (GRATs).

1. **Qualified Personal Residence Trusts**

QPRTs have become more attractive planning options with the current high interest rate environment. A QPRT is a specialized trust designed to facilitate the transfer of a primary residence or vacation home to beneficiaries while allowing the original owner to retain the right to live in the property for a specified term. The key features of the QPRT are:

- Retained Interest: The settlor retains the right to reside in the personal residence for a predetermined period, often referred to as the retained interest term. This ensures that the settlor can continue to enjoy the property during this period.
- Transfer of Residual Interest: At the end of the retained interest term, the ownership of the property is transferred to the designated beneficiaries, typically a trust established for the settlor's family members. This transfer occurs without additional gift tax implications, as the value of the gift is determined at the inception of the trust based on actuarial calculations.
- Reduced Gift Tax Impact: The gift of the residence is calculated based on the present value of the property, taking into account the length of the retained interest term and the applicable 7520 rate. This valuation method often results in a lower gift tax value compared to the property's full fair market value.

For example, based on the 7520 rate for November 2023 (5.6 percent), an individual who is 65 years old could transfer a property worth $5 million to a QPRT and the value of the taxable gift would only be about $1,985,000. For comparison, the same gift made in November 2020, when the 7520 rate was only 0.4 percent, would have resulted in a taxable gift of about $4,635,000.

2. **Grantor Retained Annuity Trusts**

GRATs can be an effective way to transfer assets to beneficiaries with minimal, potentially no, estate and gift tax consequences. By placing assets in a GRAT, the settlor retains the right to receive annual annuity payments for a specified number of years (usually two to 10 years). The full amount of the initial contribution, plus interest at the 7520 rate, will be repaid to the settlor in annual payments. Any appreciation in excess of the amount needed to make the annuity payments goes to the remainder beneficiary (usually a trust established for the benefit of the settlor's family) free of estate and gift taxes without using any of the settlor's lifetime exemption. For a GRAT to work to its full potential, the appreciation in the gifted assets must exceed the annuity payments due to the settlor. Ideally, the settlor should gift assets projected to appreciate significantly to maximize the amount of assets that can pass to the beneficiaries free of estate and gift taxes. Unlike QPRTs, which have become more attractive in the current high-interest-rate environment, higher interest rates make GRATs less attractive, since assets gifted to a GRAT may not appreciate at a rate that outpaces the annuity payments due to the settlor.

Leveraging Valuation Discounts

Clients who own businesses can leverage their lifetime exemption by making gifts of fractional interests in the business over a series of years. Valuation discounts are available when the gift is of less than an entire interest. Each gift would be valued as a fraction of the total at the time of the transfer, discounted to reflect its lack of marketability and the recipient's lack of control. Depending on a number of factors, discounts can be justified through qualified appraisals at rates reaching 30 percent to 35 percent or more.