The case for gifting now (or at least planning for the possibility)

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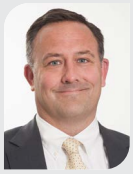

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Despite many attempts at repeal over the years, the modern U.S. Estate Tax has been in place since September 8, 1916. Each U.S. citizen and resident alien is entitled to a lifetime exemption from the federal Gift/Estate Tax called the Applicable Exclusion Amount. The Applicable Exclusion Amount for Gift/Estate Tax purposes is $11.58 million in 2020 and is subject to annual increases for inflation. If a donor's taxable gift—a gift that does not qualify for the annual, medical or education exclusion—is in excess of the Applicable Exclusion Amount, or if the value of a donor's aggregate taxable gifts exceeds the Applicable Exclusion Amount, the federal Gift Tax will be payable on such excess by April 15 of the following year. The current Gift Tax rate is 40 percent.

If the Applicable Exclusion Amount is used during a lifetime, it reduces the amount of the exemption available at death to shelter property from the Estate Tax. As a practical matter, this means that with proper planning, spouses can currently gift or die with assets of up to $23.16 million without incurring federal Estate or Gift Taxes.

The Applicable Exclusion Amount has undergone a dramatic increase in the last 20 years:

Year	Applicable Exclusion Amount
2000-2001	$675,000
2002-2003	$1,000,000
2004-2005	$1,500,000
2006-2008	$2,000,000
2009	$3,500,000
2010	$0 or $5,000,000
2011	$5,000,000
2012	$5,120,000
2013	$5,250,000
2014	$5,340,000
2015	$5,430,000
2016	$5,450,000
2017	$5,490,000
2018	$11,180,000
2019	$11,400,000
2020	$11,580,000

Under the Tax Cuts and Jobs Act signed in 2017, the Applicable Exclusion Amount will automatically decrease to approximately $6.5 million on January 1, 2026, after considering adjustments for inflation. Although many estate planning practitioners have already had discussions with their clients about

making gifts in advance of the scheduled decrease, there is a growing sense of uncertainty about whether the higher Applicable Exclusion Amounts will remain available until 2026. That uncertainty is driven by these factors:

- The dramatic increase in the Applicable Exclusion Amount over the last 20 years
- Trillions of dollars of federal stimulus spending spurred by the 2019 novel coronavirus (COVID-19) global pandemic and severe economic downturn in the U.S.
- A possible change in party control for the presidency and/or the Senate in the November 2020 election, or the use of the budget reconciliation process to pass tax increases with only 50 votes in the Senate and a democratic vice president to break the tie
- Democratic prioritization of tax reform as a top agenda item, including a proposal from former Vice President Joe Biden raising tax revenue by $3.8 trillion over 10 years
- Democratic discussions about a reduction in the Applicable Exclusion Amount to as low as $3.5 million, an increase in the Estate/Gift Tax rate of up to 55 percent and possible elimination of the step-up in basis
- Past precedent of passing tax legislation mid-year and applying it retroactively to January 1

Although in the 100 plus year history of the U.S. Estate Tax system the Applicable Exclusion Amount has never gone down, should democratic tax proposals become law there will undoubtedly be a surge of family business owners and other high net worth individuals looking to implement lifetime gifts before the legislation takes effect, assuming it is even possible. Attorneys, accountants, wealth advisors and valuation experts will be inundated, and the compressed timeframe will limit their clients' ability to consider their goals, objectives and long-term legacy in a strategic way. Those who experienced similar planning in anticipation of the 'fiscal cliff' leading up to December 31, 2012, already have some experience planning in that type of environment.

Those with a capacity to gift and a long-term planning view have an opportunity in this moment. In fact, 2020 has created the perfect storm for family-owned business owners and other high net worth individuals to advance and implement their lifetime gifting for the following reasons:

- The $11.58 million Applicable Exclusion Amount is at an all-time historical high
- The Internal Revenue Service has repeatedly signaled that a future reduction in the Applicable Exclusion Amount should not negatively impact clients who have fully utilized their lifetime exemptions (i.e. use of the Applicable Exclusion Amount should lock in the benefit)
- Applicable federal rates that drive many common gifting strategies are near all-time historic lows (the long-term rate for August 2020 is 1.12 percent)
- The business and economic disruptions resulting from the COVID-19 global pandemic have in many cases resulted in lower valuations for private business interests, allowing clients to gift or sell assets at a discount
- Market volatility creates opportunity to shift marketable assets at reduced values

When it comes to the transition of family and privately-held businesses and related estate planning, timing is critical. Although some business owners are likely to adopt a 'wait and see' approach, families and individuals who want to maximize the benefits of the current tax structure and related gifting opportunities are strongly encouraged to start (or re-start) the planning process and take action to use any remaining Applicable Exclusion Amount now.

For more information about the content of this article or other estate or succession planning matters, contact a member of our Estate Planning or Family and Privately-Held Business Practice Groups.