

Looking Ahead: Tax Rates, Gift & Estate Exemptions and Tax Legislation

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Yearend tax planning should not be done in a vacuum. Thinking about tomorrow is as important as thinking about today. Taxpayers are often advised to make gifts before the end of a calendar year. Before engaging in such a gifting program, taxpayers should consider the consequences and implications of making year-end gifts. Specifically, what can we all expect in 2023? Here are some thoughts:

Federal Tax Legislation: 2023 is an “off year” for elections. Tax legislation usually is enacted in off years. For example, the 2017 Tax Act was passed and signed in December of 2017, mostly affecting tax years beginning in 2018. Surprisingly, The Inflation Reduction Act of 2022 was signed by President Biden on August 16, 2022. Are we likely to see new tax legislation in 2023? Assuming the Republicans take at least one house of Congress, any legislation will require the two parties to work together, which is very unlikely.

Regulatory Changes: While Federal Tax Legislation is unlikely, the Treasury certainly will issue new, detailed tax regulations. Generally, tax regulations have the force of law. Among the items that the IRS is likely to address is a perceived “loophole” regarding grantor trusts that permit a taxpayer who receives a bequest to increase the basis of the bequest to the fair market value as of the taxpayer's date of death, even if the property is not included in the Federal Estate Tax Return of the decedent. While a date of death adjustment to basis is the rule when the property is included in the Federal Estate Tax Return of the decedent, critics have stated that no adjustment to basis should be allowed if the bequest was not included in the estate of the decedent's Federal Estate Tax Return. Ironically, because of a large increase in the Federal Gift and Estate Tax Exemption since 2010, taxpayers are generally better off if the property is included in their Federal Estate Tax Return when they die because the *Federal Income Tax*, and not the *Federal Estate Tax*, is of greater concern. Some commentators have referred to the *Federal Income Tax* as the “new” *Federal Estate Tax*. This is discussed next.

Reviewing Your Wills: Now is a good time to review your will (or revocable trust if that is your primary vehicle for transferring your wealth at death), especially if your last will was executed before 2010. While reviewing your will is generally not a preferred activity for a Saturday night, it is important to ensure your will continues to represent your wishes at your death. Further, the current Federal Gift and Estate Tax Exemption for 2022 of \$12.06 Million will increase to \$12.92 Million in 2023. This means that a married couple who have never made reportable lifetime gifts, and therefore have never used any of their Federal joint gift tax/estate tax exclusion, can die with nearly \$26 million of net property before the 40% Federal Gift and Estate Tax rate applies. Some thoughts on why reviewing your will, and other documents such as your living will and health care proxy, and your Power of Attorney are below:

1. Are the trusted persons, Executors, Trustees, and Guardians, still the persons that you want in those positions? For example, perhaps a substitute Executor has died, or your sister's husband and your sister, who are named as guardians in your will, have since divorced.

2. Especially for wills executed before 2010, but for all wills, planning may have been done to avoid the inclusion of property in your estate. For example, the lifetime Federal Gift and Estate Exclusion in 2009 was \$3.5 million, which meant that a married couple who had never made reportable gifts could transfer an aggregate of \$7 million before the Federal Estate Tax applied. Thus, a married couple in 2009 who had a net worth of \$10 million might plan to exclude \$3 million from their estates. The exclusion of the property from a decedent's estate meant that there would not be an income tax basis increase to fair market value on the death of the person. In 2022, the Exclusion is \$24.12 million, and in 2023, the Exclusion increases to nearly \$26 million. A single person has an exemption of \$12.92 Million in 2023. The increase in the lifetime Federal Gift and Estate Exemption has dramatically changed Gift and Estate Planning.

For Example: A married couple who have never made reportable gifts have a net worth of \$20 million. Included in their net worth is a building with a tax basis of \$1 million and a fair market value of \$3 million. In 2009, the estate planning might have focused on avoiding the inclusion of the building in their respective estates. In 2009, the Federal *income tax* on the \$2 million gain on the sale of the building after the death of the married couple would be approximately \$500,000. However, if the building is included in the respective estates of the married couple in 2009, and the building was sold soon thereafter the last of the married couple to die, there would be no Federal Income Tax, but the Federal Estate Tax would total \$1,350,000. Thus, planning to exclude the property from the respective estates of the married couple made sense. In 2022, there is no Federal Estate Tax if the married couple's net worth is less than \$24.12 million. Thus, if the property is included in the respective estates, the property is not subject to the Federal Estate Tax. Further, the tax basis of the property will be increased to \$3 million, and a sale of the property will not result in Federal Income Tax. In short, it is important that the married taxpayer's respective will reflect this change, and, by doing so, the couple's respective beneficiaries will save \$500,000 in Federal Income Tax. Unfortunately, many wills have not been changed or drafted to reflect this thinking.

Making Gifts Before Year End: Year-end gifting can effectively reduce or eliminate Federal Income, Gift, Estate, and Generation-Skipping taxes.

3. Most taxpayers limit their gifts to the yearly excludable amount of \$16,000 in 2022 (\$17,000 in 2023). A married couple with two married children and two grandchildren can make gifts in 2022 of \$32,000 per each child, each child's spouse, and each grandchild without affecting their Federal Lifetime Exclusion. This means that in the right situation, the couple can make \$192,000 of gifts in 2022 without filing a gift tax return. This can be especially helpful if the married couple is near the maximum Federal Lifetime Exclusion or has little or no Federal Lifetime Exclusion remaining.
4. If a taxpayer is near a net worth of \$20 million or more and has Federal Gift and Estate Tax Exclusion remaining, it may be advisable to gift investments with a current low value but with a substantial upside potential to remove the potential increase in value from his estate.
5. It is worth noting, that a married couple who have used up their Federal Lifetime Exclusion in 2022, will be "recharged" with \$1.72 million of Federal Lifetime Exclusion in 2023 (\$860,000 per taxpayer).
6. The selection of assets requires thought and planning. Consulting with your professional advisors is a "must" for effective gifting.