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As the Sun Sets: Prepare Now for Anticipated Tax Law Changes

Considerations for gifting ahead of 2026

Alvina H. Lo
Chief Wealth Strategist

Dolly Donnelly
Director, Wealth Strategies

Key points

- Barring any intervening legislation, the current federal estate and gift tax exemption amount is slated to sunset on December 31, 2025
- With the potential for a considerably reduced federal gift tax exemption, now may be a good time to consider making significant gifts
- As with all planning strategies, it's important to consult with your advisors to determine the best steps for your situation, while keeping a close eye on the calendar

In the absence of any legislative action, the current historically high federal gift and estate tax exemption is scheduled to decrease by nearly half as of January 1, 2026. Therefore, it may be more important than ever to revisit your planning before the opportunity to shield $13.61 million of assets from federal gift and estate tax passes.

Consider making significant gifts to take advantage of the disappearing gift tax exemption

For those whose assets are substantial enough to have a taxable estate, planning may be even more important now. One result of the comprehensive tax reform enacted in 2017, the Tax Cuts and Jobs Act (TCJA), was a considerable increase in the gift, estate, and generation-skipping transfer (GST) tax exemption. Indexed for inflation, the amount exempt from federal gift and estate tax in 2024 is $13.61 million per person ($27.22 million for a married couple),[1] which means that you may give up to this amount during your lifetime, free of gift tax, with any unused amount applied against federal estate taxes at your death.

Barring any intervening legislation, the current exemption amount is slated to sunset on December 31, 2025, and effective January 1, 2026, the exemption will revert to $5 million per individual ($10 million for a married couple), indexed for inflation (meaning that the exemption as of January 1, 2026, is expected to be around $7 million per person, or $14 million for a married couple).[1] Therefore, if the sunset occurs as anticipated, high-net-worth individuals could be substantially limited in their ability to efficiently transfer wealth as of January 1, 2026. That said, the Internal Revenue Service (IRS) has confirmed that individuals who use their full exemptions prior to the sunset will not be penalized if the applicable estate tax exemption is lower at the time of their deaths, meaning that those with taxable estates have an opportunity to shield the current exemption amounts from federal gift and estate tax by gifting prior to January 1, 2026, even if the exemption decreases in the future.

Consider creating a trust and gifting assets to it sooner rather than later

If structured and administered properly, the trust may serve multiple generations with potentially significant tax benefits. Using the dynasty trust as an example (see Figure 1), and based on the assumptions depicted, if you gift $1 million to this type of long-term trust, that gift could grow to almost three times its value in just two generations as compared to an outright gift, due to its protection from future estate taxes.

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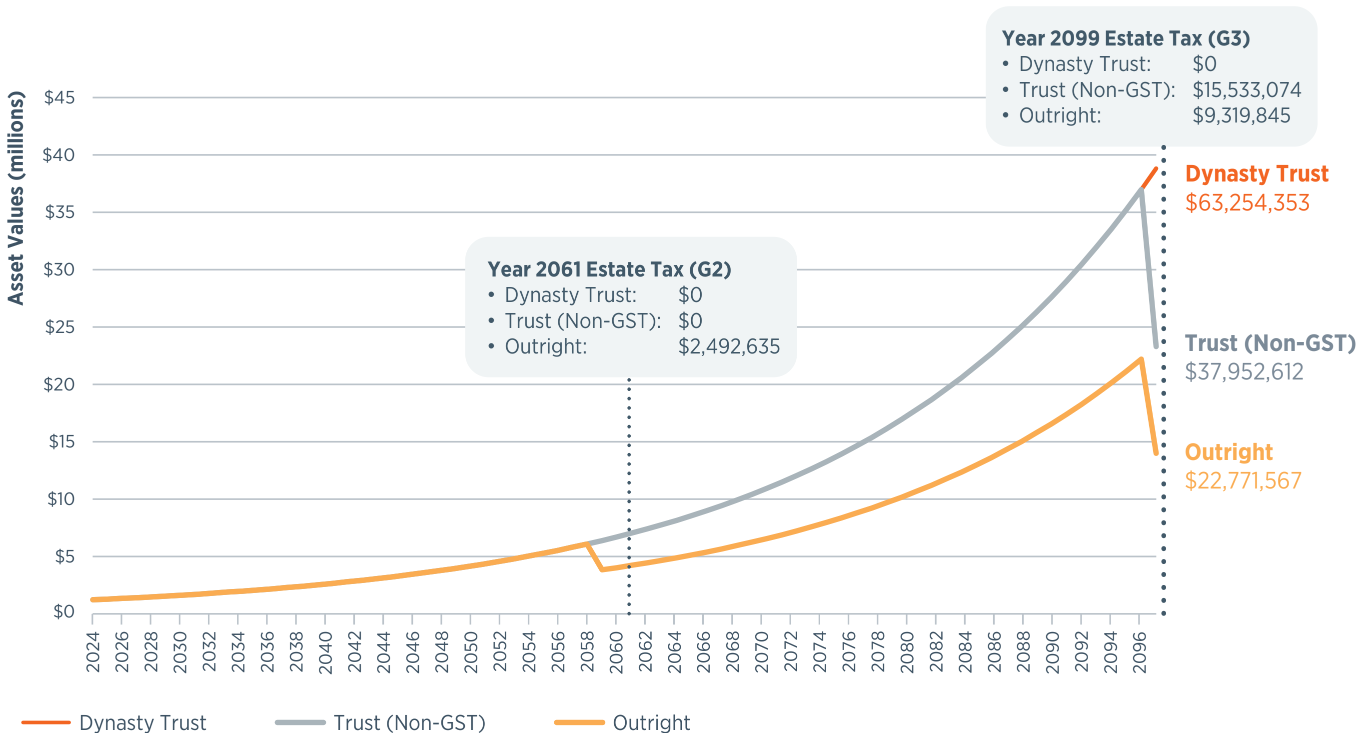
Figure 1
Example of benefits of gifting to a dynasty trust

Assumptions: Initial investment of $1,000,000 | Net rate of return of 5% | Each generation holds assets for 37.5 years | Estate tax of 40%



This chart is for illustration purposes only and does not reflect the actual performance of any specific investment. The illustration is hypothetical and is intended solely to depict the benefits of a dynasty trust.

Source: Wilmington Trust Wealth Planning team.

Overcome common "roadblocks"

Although the inherent value of gifting is understood by many, the mental roadblock of parting with such sizable assets can be daunting, and there are some strategies that can help you get past them. Like many, you may feel that you are being rushed into this decision and it may paralyze your ability to move forward. No one likes the feeling of being rushed. Here are three common roadblocks and strategies that may help you to get past them.

1. How can I maintain flexibility in a trust?

Consider a spousal lifetime access trust (SLAT). These trusts are designed to take advantage of the gift tax exemption while allowing a way for your spouse (as a beneficiary of the trust) to continue to enjoy the benefits of the trust now and in the future, if needed. For example, if a husband were to create a trust for the benefit of his wife and children, because his wife is a beneficiary of the trust, she may request a distribution of the funds from the trustee. The trustee may exercise its fiduciary responsibility and make the distribution to the wife, as beneficiary, assuming it is appropriate and in accordance with the terms of the trust. If the wife wishes to then later share that distribution from the trust with her husband or use the distribution for their joint benefit (e.g., making improvements to the family home), she may do so, thereby preserving some flexibility to use the gifted assets. In some cases, it may make sense for the family to have two trusts: one where the husband creates a trust for the benefit of his wife and children, and one where the wife creates a trust for the benefit of her husband and children. This way, both spouses could potentially benefit from the trust assets should the need arise in the future. One thing to note is that these trusts must not be identical and need to contain enough variations so as not to run afoul of the "reciprocal trust doctrine."

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Perhaps the biggest roadblock for many is having to give up control over the trust assets. While an irrevocable trust, by its nature, necessitates some limits and restrictions over control, the directed trust structure allows for greater flexibility.

Include a testamentary power of appointment. In the SLAT strategy described above, an additional feature that can offer further flexibility is a special power known as a "testamentary power of appointment." This would allow you to give your spouse a "second bite of the apple" because your spouse may, using this power in his/her will, redirect the trust assets to a predetermined group of people or charity. For those who are concerned about deciding now how their assets are to be distributed down the road, this is a good way to effectively delay that decision and allow your spouse to make that decision at a later time when your wishes have become clearer.

Implement a directed trust. Perhaps the biggest roadblock for many is having to give up control over the trust assets. While an irrevocable trust, by its nature, necessitates some limits and restrictions over control, the directed trust structure allows for greater flexibility. A properly drafted directed trust under the right jurisdiction can allow traditional trustee responsibilities over distribution and investment decisions to remain with trusted family members, friends, or advisors.

Essentially, the directed trust splits fiduciary responsibilities, allowing you as the grantor of the trust to name your own investment advisor to manage the assets, while the trustee is responsible for other aspects of administering the trust. The trustee can't be held liable for the investment advisor's actions unless the trustee engages in willful misconduct related to the investment process. This structure is particularly beneficial for business owners who do not wish to divest the business interests held in a trust.

The directed trust feature can provide significant flexibility since it can be added to virtually any type of trust structure in Delaware, where the directed trust law provides:

- Freedom to engage in estate planning or asset protection planning using illiquid assets, such as stock in the family business, real estate, or hedge fund/private equity investments, when a trustee may otherwise be reluctant to hold these types of assets
- Flexibility for a trusted advisor or family member to retain control over a trustee's investment or distribution decisions so that they can do what is best for the family/beneficiaries[2]

Generally, gone are the days where trusts were created and operated in a black box. Modern trust law and drafting have evolved to allow for the family to remain involved and provide flexibility for generations to come.

2. How do I know how much and what assets to gift to the trust?

It's one thing to talk about gifting in the abstract; it's quite another to make that a reality. One of the most common questions is: How much do I gift and what asset do I gift?

An experienced financial planner can help you answer this question by running detailed analyses and projections to quantify the impact of the gift against your future needs. A sustainability analysis is recommended to help determine how a gift that's removed from your balance sheet may impact your future cash flow and lifestyle needs. The sustainability analysis should also be stress tested to account for any future contingencies. Depending on your balance sheet and needs, gifting the maximum amount allowed under the current law might be too large a gift and could begin to erode your future cash flow or lifestyle needs. In that case, it may be wise to reverse engineer back to a more comfortable gifting amount.

Additionally, in situations where a married couple is not comfortable gifting the full $27.22 million of exemption they have between both spouses, but still want to make some gifts, care should be taken as to which spouse is deemed to make such gifts. In such situations, it may make sense for one spouse to use as much of his or her gift tax exemption as

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possible, while preserving for use the other spouse's full gift tax exemption at whatever reduced amount it may be after December 31, 2025.

3. I am still not sure and may need more time, but what strategies may give me more flexibility as the sunset approaches?

As the sunset approaches, it is anticipated that a large number of individuals with estate tax exposure may look to lock in the benefits of the currently higher gift tax exemption. Waiting too close to the sunset to enact your gifting plans may make it more likely that the professionals, such as valuation experts and attorneys, may be at capacity or leave you feeling like you are rushing into making gifting decisions. While connecting with your team of advisors and preparing your gifting plan as soon as possible is advisable to help ensure successful implementation of a well-crafted plan, here are some strategies that may help you buy a little more time as the sunset draws near.

Gift cash or marketable securities now to lock in the exemption and include a "swap" power

Like many, your most valuable asset with the highest appreciation potential (and typically the ideal asset to gift) is often also a complex asset that is hard to value. Many of these assets also are leveraged where a transfer of ownership implicates credit that can be challenging to restructure. In these cases, there may not be enough time to properly value the asset and work through the mechanics involved for a quick gift. A potential strategy is to utilize a "swap" power in the trust. This type of power allows you to substitute assets of equal value in and out of the trust at a later time. For example, let's say you wish to make a gift of $13.61 million consisting of your business interests and you are concerned that you cannot do so in time for the December 31, 2025 sunset. In this case, you may instead make a gift of cash or marketable securities (that are readily valued) of $13.61 million into a trust as soon as possible to lock in the use of the gifting exemption. Then, at a later date, including after the sunset, as grantor of the trust, you could exercise your swap power and exchange the business interests for the cash/marketable securities. The result: The business interest is held in the trust, and you have the cash/marketable securities back. If cash flow is an issue, many banking institutions may be able to provide a short-term lending facility to accommodate and bridge the timing gap. If structured and implemented correctly, this kind of swap will not have any negative tax consequences.

Issue a promissory note now and cancel the note later if gifting is desired

If you are still uncomfortable with making a sizable gift and want a little more time to consider your options before making a final decision, one strategy is to lend the asset that potentially may be gifted to your beneficiary (or a trust for his/her benefit) and receive a promissory note in return. Under existing law, you can forgive all or a portion of the note at a later date, hence making the effective date of any resulting taxable gift prior to the sunset.

What if this kind of gifting is just not for me; what else should I consider for my estate planning before the large gift tax exemption disappears?

Do not forget the existing trusts you've created. You may already have an existing estate plan that includes trusts. Many of these older existing trusts may not have been created properly with the right allocation of GST exemption. In some cases, you may be able to apply the current GST exemption and "protect" these old trusts, making them effectively GST trusts. This would not require additional asset outlay from you. You're simply using up your exemption in a smart way. Before implementing this strategy, you will want to work with your wealth advisor and attorney to be sure that the existing trusts are in the proper form, and if not, determine whether a modification is possible.

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Consider a GRAT if you don't want to use your gift exemption. If you do not wish or are not ready to use your gift tax exemption, there are other strategies to consider. While more attractive in a lower interest rate environment, a grantor retained annuity trust (GRAT) still may be a valuable consideration for assets that are expected to appreciate significantly. A GRAT is a popular strategy of transferring property that is expected to appreciate in value to a trust in exchange for an annual payment (or annuity) for a term of years. The amount of the annuity is determined by the length of the trust, the value of the property transferred, and current interest rates. As of May 2024, this interest rate, also known as the 7520 rate, is 5.4% (up from the historically low interest rates over the past few years, but still relatively low).[1]

Provided that the grantor survives the term of the GRAT, the primary tax benefit of a GRAT is that any income or appreciation earned during the term, in excess of the stated interest rate, passes to the remainder beneficiaries (who are often children or family trusts) free of gift or estate tax. GRATs are a popular strategy because there is limited economic downside and you can effectively retain control of the property transferred. Moreover, under current tax laws, GRATs may be designed to pay back to you the entire value of the property plus the stated interest amount without any gift tax consequences. (This technique is often referred to as a zeroed-out GRAT.)

Do not forget about your life insurance. There is often a mistaken notion that the death benefit from life insurance is tax free. While life insurance proceeds are income tax free, they are not always estate tax free. In other words, life insurance owned outright by you is includable in your estate and subject to the estate tax. Many individuals have substantial life insurance policies, but they may be structured incorrectly, as they are not held in a trust. This may be a good time to gift those policies into an irrevocable life insurance trust (ILIT) for the benefit of your family. If structured and administered properly, the death benefit received by the ILIT could be free of both income and estate taxes. Although the gift of certain policies can be a taxable gift, this could be a good way to use your gift tax exemption without any additional cash outlay. Before implementing this strategy, it is important to work with your advisor to conduct a careful analysis of the nature of the insurance policies to see if this strategy is appropriate.

I already made large gifts since 2017—should I do more?

Even those who previously have made large gifts following the enactment of the TCJA to take advantage of the increased exemptions should keep in mind that the exemption has increased annually since 2018. For example, even if you already made full use of your gift tax exemption through 2023, the allowable exemption amount has increased by $690,000 per person (or $1,380,000 for a married couple) for 2024. You may wish to gift this additional amount into a previously created trust in order to maximize the use of your remaining gift tax exemption in 2024.

If prior gifting strategies included creating and funding one SLAT, you may want to consider creating a second SLAT where the beneficiary includes the other spouse and gift assets equal to any remaining gift tax exemption amount into the second SLAT. As previously discussed, care should be taken to ensure that the second SLAT does not contain the same terms as the first SLAT so that it runs afoul of the "reciprocal trust doctrine." The fact that the SLATs are created in different calendar years could be helpful in that regard. When thinking of utilizing a second SLAT, it also is important to be mindful of which spouse has gift tax exemption remaining and available for use, as the beneficiary-spouse's exemption should not be applied to a trust created for his/her benefit.

As with all planning strategies, it's important to consult with your advisors to determine the best steps for your situation, while keeping a close eye on the calendar.

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Alvina H. Lo

Chief Wealth Strategist

212.415.0567
alo@wilmingtontrust.com

As part of the Wilmington Trust Emerald Family Office & Advisory team, Alvina is responsible for wealth planning, family office services, and thought leadership development for Wilmington Trust's Wealth Management division. She oversees a national team of wealth strategists, family office services professionals, and thought leaders, who together, serve as advisors to high-net-worth individuals and families, business owners, entrepreneurs, and foundations.

Alvina holds a bachelor's degree in civil engineering from the University of Virginia where she was a Thomas Jefferson Scholar. She received her JD from the University of Pennsylvania, where she was a member of the Law Review and Order of the Coif. She also holds a Professional Tax Certificate in Estate Planning from New York University School of Law.

Dolly Donnelly

Director, Wealth Strategies

585.258.8301
ddonnelly@wilmingtontrust.com

As part of the Wilmington Trust Emerald Family Office & Advisory® team, Dolly is responsible for providing strategic and holistic wealth planning advice to high-net-worth individuals, entrepreneurs, executives, and their families by reviewing and illustrating their current plans, highlighting potential deficiencies, and modeling effective tax and estate planning strategies.

She holds a JD from the University of Miami School of Law, where she was a member of the Law Review and the International Moot Court team, and a bachelor's degree in international affairs from The George Washington University. She is admitted to the practice of law in New York and Florida and is a member of the New York State, Monroe County, and Florida Bar Associations.

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[1] Source: www.irs.gov

[2] Source: https://delcode.delaware.gov/title12/c033/index.html

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