

## The Gift and Estate Tax Exclusion: Lock It In or Let it Ride?

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The Gift and Estate Tax Exclusion is currently scheduled to be reduced by approximately 50% in about 13 months. Without action from Congress, on January 1, 2026, the Exclusion will go from almost \$14 million to about \$7 million. But with Republicans taking over the presidency, House and Senate in 2025, the increased Exclusion could be extended. For families with more than \$14 million, this legal uncertainty creates gift planning uncertainty.

As explained below, the temporary increase to the Exclusion is a use-it-or-lose-it benefit, but its expiration date is in flux. High net worth families should keep an eye on changes in the tax law and be ready to pull the trigger on big gifts if necessary.

### How does the Gift and Estate Tax Exclusion Work?

Gift taxes are imposed on the donor, not the recipient. Estate taxes are imposed on the estate and not the recipient.

However, gifts are not taxed until they reach a certain threshold. And estates are not taxed until they reach a certain threshold. The two thresholds are combined into the Unified Credit or the Gift and Estate Exclusion Amount (the "Exclusion"). This is meant to be a single lifetime exclusion amount which applies to gifts given during the donor's life and estate at death. So, basically, you use up your exclusion amount as you give gifts during your life. Then, if you have any leftover exclusion amount at death, you can use that amount to exclude your estate from tax.

In addition, there is another threshold for annual gift *reporting*. In 2024, the gift reporting threshold is \$18,000. If you give a gift less than \$18,000 to one person in 2024, you do not have to report it and it does not reduce your remaining Exclusion. Unlike the Exclusion threshold, the gift reporting threshold applies separately to each gift that you give. Also, you and your spouse each have separate gift reporting thresholds. Therefore, you and your spouse can give up to \$36,000 per year to your son without reporting it and without reducing your Exclusion. You can also give an additional amount up to \$36,000 per year to your daughter without reporting it and without reducing your Exclusion.

If you give a gift that exceeds the gift reporting amount, you must report it to the IRS and reduce your Exclusion going forward. For example, if you give away \$10 million in 2024, that is less than the Exclusion available in 2024 (\$13.61 million), and no gift tax would be due. But you would still have to report the gift and reduce your Exclusion going forward by \$10 million.

At death, your estate will not owe estate taxes unless your estate exceeds the Exclusion amount you have remaining. So, in simple terms, if you are single and gave away \$10 million in 2024 and then pass away in 2025 with an estate still valued \$5 million, then your remaining United Credit is \$3.99 million (\$13.99 million minus \$10 million). And your taxable estate would be \$1.01 million (\$5 million minus \$3.99 million).

### Can the IRS claw back your Exclusion if you give a gift during a higher Exclusion time period and the Exclusion amount is later reduced?

No. If you give gifts before the reduction and die after the reduction, you can still take advantage of the higher Exclusion. For example, if you give away \$10 million in 2024 and the Exclusion is reduced to \$7 million in 2026, your exemption amount is not clawed back for the year 2024. You still get to exempt the entire \$10 million gift amount, but

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your Exclusion remaining after that would be reduced to zero. But if you do not make a gift during the high Exclusion time period, the higher exclusion is lost.

Therefore, assuming the higher Exclusion is allowed to expire, if you are planning on gifting over \$7 million, it is a good idea to do it in 2024 or 2025, to take advantage of the higher Exclusion.

### **Can the IRS claw back your Exclusion if your spouse dies during a high Exclusion time period and the Exclusion amount is later reduced?**

No. Generally, the surviving spouse of a married couple can use the other spouse's Exclusion amount on top of their own, if an election is made on the deceased spouse's estate tax return. That is called the Deceased Spousal Unused Exclusion.

If a spouse dies when the Exclusion was higher, there was a DSUE election, and the Exclusion is later reduced, then the surviving spouse still gets to use (1) the amount of the Exclusion that was available in the year of the deceased spouse's death, plus (2) the amount of the Exclusion in the year the surviving spouse dies.

### **Will the Exclusion still be reduced under the new administration?**

The temporary increase of the Exclusion was part of the Tax Cuts and Jobs Act (TCJA), the Republican tax law adopted in 2017. Now that Republicans will control the White House and Congress again, they seem likely to extend the TCJA past 2025.

It is impossible, however, to know now whether there will actually be an extension, when the extension could happen and for how many years it could be extended. Political compromise, budget reconciliation, and the need to offset at least some of the other planned tax cuts may scuttle the extension of the increased Exclusion. And if the Exclusion is extended, it may be only for three to five years and not another eight years, because of budget concerns.

Furthermore, the transfer of hard-to-value assets may be a long, drawn-out process, especially if the assets include closely held businesses, real estate or art. It may not be possible to wait until the 11<sup>th</sup> hour to decide what to do.

### **How should you plan for gifts when the extension of the Exclusion is uncertain?**

High net worth families who have not already used up their Exclusions should keep an eye out for the possible extension of the higher extension. It could happen rather quickly in the new year (in the springtime), or it could possibly be drawn out to the end of the year. Or it could not happen at all.

If using the current higher Gift and Estate Tax Exclusion is part of your estate plan, but you don't want to make any premature transfers, you can at least be prepared. Make your plans, get appraisals, have assets ready to transfer and decide on the recipients. Contact a Miller Canfield estate planning attorney to discuss your estate plan and family wealth transfer goals.