Trusts

The Goldilocks Effect

Planning Considerations for Mid-Size Estates

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Many of us began our careers when the estate tax exemption was $1 million (or less) per person and portability did not exist. As such, planning for many clients revolved around ensuring use of the full exemption amount upon the death of the first spouse. In short, the tax tail wagged the planning dog. As the individual exemption has grown significantly to its current $13.61 million and with the introduction of portability, fewer and fewer clients have had the need for estate tax planning. Even if the exemption sunsets at the end of 2025 as per the current legislation and resets between $6 and $7 million per person, the overwhelming majority of Americans will not have estates subject to estate taxation. As a result, advisors are able to place a higher priority on other tax planning concerns and can focus on making certain that a client's assets pass in a manner with which they are comfortable and with flexibility to adapt to changes in future circumstances.

Current State of the Estate Tax Exemption

The 2017 Tax Cuts and Jobs Act ("TCJA") increased individual exemptions from $5.6 million to their current $13.61 million over the course of the last seven years. Under that current legislation, as of January 1, 2026, the exemption changes sunset, returning to their pre-TCJA amount of $5 million indexed for inflation. After indexing, estimates are that the 2026 exemption will be approximately $7 million per individual and $14 million per married couple. For individuals with estates that are not currently taxable but may become so after the sunset, planning requires a multifaceted approach, taking into account income tax implications, beneficiary designations, traditional tax planning and non-tax factors.

Tax Planning Considerations

As the exemption amounts have climbed, fewer clients have a need to prioritize estate tax planning. For those clients whose estates are on the borderline, especially after a decrease in exemptions, traditional estate tax planning may still be unnecessary. Many Americans find the majority of their wealth derives from two main asset classes: real estate and retirement accounts.

Retirement accounts are not conducive to irrevocable tax planning due to their income tax inefficiencies, but for clients with charitable intent they present an important planning opportunity. Where retirement accounts will be the difference between an estate being taxable or not, leaving those accounts to charity allows the estate to take a charitable deduction, thereby offsetting the inclusion of the assets in a client's estate. And since the charity does not pay income taxes on the gift, both estate and income tax savings are maximized.

For clients whose real estate puts them over the exemption amount, a Qualified Personal Residence Trust ("QPRT") may be advisable. This allows the client to transfer their residence or a vacation property into the QPRT, thereby removing the full value of the residence from their estate, including any appreciation over the term of the trust, at a highly discounted value for gift tax purposes. The grantor retains the right to use the home during the term of the trust and may pay rent thereafter to remain in the property, reducing their taxable estate even further. The trade-off is a loss of the step-up in basis that the beneficiaries would receive if the home remained a part of the client's taxable estate.

Of course, a client's estate may be near the taxable amount without the help of retirement accounts or real estate. For these clients, and many others, the use of a Spousal Lifetime Access Trust ("SLAT") may be advisable. These are particularly attractive to many clients in this range who fear large gifts to irrevocable trusts will leave them short on assets needed to live out their lives comfortably in the lifestyle to which they are accustomed. For married couples interested in locking in exemption amounts today, the SLAT allows clients to remove assets from their taxable estate but still allows access if the assets were to become needed later in life. Most often both spouses establish SLATs for the benefit of each other with slightly differing provisions in order to avoid the Reciprocal Trust Doctrine (e.g. giving one spouse a power of appointment but not the other, having a 5x5 power in one trust but full discretion in the other, etc.). However, upon the death of the first spouse, the survivor does lose their indirect access to the first-to-die spouse's SLAT funds, so the determination of proper funding amounts must be adjusted accordingly.

For some clients on the cusp of a taxable estate, income tax planning may be more advantageous than estate tax planning. For example, clients who hold highly appreciated, low-cost basis assets may realize a more significant overall tax savings by keeping those assets in their estates versus gifting them during lifetime. This allows them to take advantage of a step-up in cost basis upon their death rather than removing the asset from their estate and losing the basis step-up. This allows the client to retain the benefit of the asset during life while also giving the ultimate beneficiaries greater flexibility in determining if or when to sell the assets without having to factor significant capital gains into the equation.

Planning Beyond Taxes

When estate tax minimization does not drive planning, the focus can shift to making sure the client's assets pass exactly how they would like, not necessarily in the most tax efficient manner. This means more attention can be paid to whether outright distributions or funding trusts is better for the beneficiaries, whether one beneficiary has needs that are better met in a different method than the others, whether age attainment distributions/terminations are appropriate, whether there is a beneficiary who does or may require special needs provisions, spendthrifts, etc. While these factors certainly play a part even when tax planning is necessary, they often become the primary drivers when tax planning takes a back seat.

This also allows drafters to build maximum flexibility into the estate plan. Trustees can have broad discretion to make determinations at the time key events occur. By way of example, a client may want their assets to distribute outright to their children upon their death, but at death one child may be involved in a lawsuit, a divorce, or another situation whereby an outright distribution would have negative consequences for the beneficiary. Similarly, trusts that include outright distributions at certain ages may occur where a child is struggling with chemical dependency or other issues impacting their ability to properly manage their finances. By drafting trusts that give trustees guidance as to the grantor's preferences (e.g. outright distributions preferred over continuing trusts, distributions contingent on a beneficiary reaching certain milestones, etc.) it gives the trustee discretion to make determinations at relevant times, estate plans can best accomplish a grantor's goals and serve the needs of the beneficiaries.

That said, drafting flexibility into a trust means the decision as to whom should serve as trustee becomes vitally important. This aspect of planning is often glossed over but can have a substantial impact on a client's overall estate plan. Oftentimes people default to naming a family member or close friend to serve as their fiduciary. One of the advantages of that arrangement (and why it is often done) is that this person will have personal knowledge of the client's family situation, important family dynamics, and will likely be familiar with their financial values and wishes. They may know if there is a beneficiary who is less financially responsible, who has special needs, or any other unique needs of the beneficiaries. This puts them in the best position to make decisions as the clients would have done themselves. However, the amount of work required of a fiduciary can become overwhelming for an individual, particularly if they are asked to serve without compensation.

As an alternative, some people choose to appoint a professional trustee, such as a trust company or lawyer. Estate and trust administration can be time-consuming, and professional trustees have the expertise, knowledge and technology to be able to administer them efficiently and effectively. Particularly in complex estate planning, where complicated trustee/executor decisions have important ramifications, professional fiduciaries are well suited to understanding how to make these

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determinations. Additionally, professional trustees may be better situated to act impartially, outside of the constraints of familial relationships and dynamics. Trust companies can provide continuity in the fiduciary role, maintaining relationships over multiple generations and seamlessly continuing administration over the life of the estate/trust. They also have controls in place to ensure the trust is properly administered throughout its existence and are appropriately insured if an issue is discovered.

One approach that works particularly well is pairing a family member or friend with a trust company as co-trustees. In these situations, the burden of day-to-day administration, record-keeping, tax preparation, etc. can be handled by the corporate trustee, while distribution and/or investment decisions can be made jointly by the co-trustees. This balances the advantages of an individual trustee who has close personal knowledge of the family, its dynamics and goals, with the strengths of a corporate trustee who can act impartially and help guide (and in some cases, serve as a buffer, for) the individual trustee during difficult decisions. In situations where the family member or friend is uncomfortable saying no, the corporate trustee can take that on, allowing the individual trustee to maintain a comfortable relationship with the beneficiary.

Looking at the Big Picture

When approaching clients' planning needs it is always important to take their entire financial and family story into account and to consider both the tax and non-tax drivers that influence their planning. For families well under the exemption amounts, income tax and non-tax related planning may be more important, while families near those amounts may look to focus on reducing their taxable estate.

We know from past experience that many times attorneys are unable to continue taking on new clients as we approach the tax change deadline, or they will not have the time to draft new trusts for everyone who wants to establish one. For that reason, having clients review and adjust their estate and gift tax plans in 2024 ensures their ability to take advantage of the decreasing exemption (assuming no legislative changes are made). Clients can hold off on funding those trusts, or at least fully funding them, until there is more certainty around the change in exemption amount. This is especially true for married clients with estates near the $14 million expected exemption amount in 2026. Putting estate planning vehicles into place now is recommended to allow clients to take full advantage of this "use it or lose it" exemption amount.

**This article is not tax or legal advice. Readers should consult with their professional advisors.*

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