Estate and Tax Planning Techniques for Seven-Figure Estates

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The concept of estate planning is relatively simple—you should be able to pass on your wealth and success to those who mean the most to you. Estates valued over a certain amount are subject to a variety of taxes. Depending on your overarching objectives, though, you could use an array of trusts to help minimize taxes and allow your loved ones to enjoy more of your wealth.

Estate planners for high-net-worth individuals have a few types of taxes to address when making an estate plan. These tax liabilities include:

- **Federal Estate Tax** — According to the IRS, estates that are worth more than $11.7 million (2021 exemption amount) or $23.4 million for couples using a concept called "portability." The taxable amount for an estate is any

amount of assets above those numbers. Because this number is very high, only 0.1–0.2 percent of estates are subject to the federal estate tax each year. The federal tax rates for estates maxes out at 40 percent. The $11.7 million exemption is scheduled to “sunset” in December of 2025 and return to its previous level of $5.49 million (adjusted for inflation). This means that estates will be taxed on any wealth above $5.49 million in just a few years. However, Congress is actively trying to reduce the exemption before 2025, meaning that high net worth individuals should move quickly to complete their estate planning in order to minimize the Federal Estate Tax.

- **Washington Estate Tax —** Washington is one of about a dozen states that levies taxes on estates. The exemption amount, currently at $2.193 million, is also quite low relative to the federal amount. This means that any wealth

above $2.193 million is subject to taxes. Currently, the Washington tax rate for estates ranges from 10-20 percent. Once you add up the value of retirement accounts and property value, many Washingtonians are approaching the exemption amount. Also unfortunately, there is no "portability" at the state level and additional trust planning must be put in place order to increase the state estate exemption amount to $4.386 million for married couples.

- **Gift Tax** — You are allowed to "gift" just about anything to your loved ones during your lifetime, but sometimes the IRS wants to know about these gifts. Specifically, you will have to report a gift tax return if you gift any one person more than $15,000 in a year. That does not mean that you, as the donor, or the recipient will have to pay gift taxes. A gift donor has a lifetime exemption of $11.7 million

(equal to the federal estate tax exemption). This means a donor may gift up to $11.7 million during his or her lifetime without having to pay taxes. There is no Washington state gift tax. However, the federal gift and estate tax is “unified” - meaning you have $11.7 million for both the estate and gift tax at the federal level. Since Washington has no gift tax, there are planning opportunities at the state level to help ensure you are passing on the maximum wealth to your loved ones.

- **Capital Gains Tax** — One other tax commonly levied on U.S. persons is the capital gains tax, which is a tax on any funds generated by selling an asset like a stock or real estate. The capital gains tax rate depends on whether you held the asset for more or less than one year. In order to avoid the capital gains tax, estate planning should ensure a “step-up” in tax basis to the current fair market value. This means all the

gain that was built up over time is eliminated thereby saving tax once the asset is sold.

- **Generation-Skipping Transfer Tax** – This federal tax applies to people passing down wealth to somebody at least two generations removed from the grantor. It typically applies to grandparents giving money or assets to grandchildren. However, it can apply to anybody who receives a gift that is 37.5 years younger than the donor. Each gift is additive, meaning that gifts to each grandchild or younger person is subject to the tax after the exemption limit is reached. Currently, you may gift up to $11.7 million (2021) before taxes are applied. However, the tax rate is substantial: 40% of all wealth above that exemption amount. The generation-skipping tax is in addition to any estate taxes, meaning that it is very important to plan for it ahead of

time to ensure that maximum wealth is passed down.

Strategies to Avoid Estate, Gift, and Generation-Skipping Taxes

Before we dive into the wide array of trusts you can use to efficiently transfer assets and wealth to your heirs and beneficiaries, it's important to know that tax avoidance is not a crime. Many people conflate tax avoidance with tax evasion, which is a crime. Tax avoidance simply means that a taxpayer is using one or more provisions in the tax code to minimize tax obligations.

Credit Shelter Trust

This type of trust is often used by married couples in Washington to take advantage of the state tax exemption for *both* spouses. With a credit shelter trust (sometimes called a bypass trust), one spouse will arrange for his or her assets to

be funded into the trust upon death. This uses the $2.193 exemption amount for the first spouse to die so it is not wasted. An effective credit shelter trust allows married couples to utilize the full exemption amount for each spouse - effectively doubling the Washington estate tax exemption to $4.368 million. Any wealth above this amount would be taxed by the state unless additional planning is done.

Generation-Skipping Trusts

Historically, taxpayers could avoid paying the estate tax twice by making gifts directly to grandchildren and "skipping" the children's generation. In an attempt to block this strategy, Congress enacted the generation-skipping transfer tax (GSTT). However, a taxpayer can use their GSTT exemption to avoid tax on the initial transfer to a generation-skipping trust, also known as a Dynasty trust. This type of

trust allows the gift to pass down through generations without paying any more estate tax because the amount held in trust is not includable in the estates of the grandchildren, or their children, or any further generation for the term of the trust. The trust is permitted to pass down through successive generations for 150 years in the state of Washington. This type of trust can also protect the assets held in trust from creditors or future spouses.

Irrevocable Life Insurance Trust

Another effective tool for minimizing estate tax is an irrevocable life insurance trust (ILIT). An ILIT is an irrevocable trust that holds ownership of a life insurance policy and receives the proceeds of the policy after death. By using this technique, the life insurance proceeds are not included in the estate of the insured. If an ILIT is not used, the amount paid out on the insurance policy will be included in the

beneficiary's estate when they pass away. By using this technique, the life insurance proceeds are not included in the estate of either spouse. This can be a very effective technique at the state level where the estate tax exemption is much lower than the federal exemption. Although the trust is irrevocable and cannot be changed, if the trust stops paying the premiums on the policy it merely becomes an empty vessel.

Grantor Retained Annuity Trust

A Grantor Retained Annuity Trust (GRAT) can be an effective tool for estates that are above the federal estate tax exemption, which is currently $11.7 million. This technique removes value from your estate so that amount is not taxed. An individual can transfer an asset, such as stock, into a trust and be paid an annuity back. If the stock gains more value than the rate pre-set by the IRS (known as the IRC 7520 rate), this difference in value remains in the

GRAT and passes tax free to the beneficiaries. For instance the IRC 7520 rate is currently 1%. If the stock gains 8% during its time in the GRAT, 7% minus the annuity payout will passed tax free to the beneficiaries.

Charitable Trusts

Charitable trusts can provide current income tax deductions and also reduce estate tax obligations. The two most common types are a Charitable Remainder Trust (CRT) and a Charitable Lead Trust (CLT).

In a CRT, a gift is made to a trust and a payment is made out to a non-charitable beneficiary, such as a child, for a term of years or for life. Then afterwards, the remaining amount goes to the charity. The donor can claim a tax deduction. A CRT may be appropriate for individuals that want to sell highly appreciated assets

without triggering capital gains tax. A CLT is similar, except that the charity gets the payments for a term of years then the non-charitable beneficiary gets the remaining amount. The assets are distributed to the non-charitable beneficiary free of estate tax, however, capital gains tax may be due. A CLT may be useful for donors with heirs who are not yet ready to assume control of the assets.

An Attorney's Help is Crucial

Believe it or not, there are countless trusts we were not able to cover in this report that may help you avoid taxes associated with estates. Both federal and state governments are quite motivated to collect these tax obligations, but there are many provisions that allow estate planners to either avoid or defer a large portion of these liabilities. As you may have gleaned from this report, though, the rules surrounding trusts and tax-saving vehicles

are incredibly complex. You will need one or, possibly, multiple professionals to help you maximize estate planning for you and your loved ones.

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