

Lindstrom Estate & Trust

UNDERSTANDING ESTATE / GIFT TAX AND DISCLAIMERS

In the area of Estate-Tax law, the past few years have been relatively stable. At the end of 2010, the Federal Estate-Tax laws were revised. Estate and Gift tax laws have been further amended in the years following 2010 – most recently in 2018. Though possible, it may be difficult for Congress to “take back” or largely reduce exemption levels once put into motion. Under the Biden Administration, there is some discussion towards reducing the exemption amounts to 2009 levels (\$3.5 million) and increasing tax rates to 45%.

Current Federal Estate-Tax Exemption

For 2024, the Federal Exemption amount is set at \$6.8 million per individual and is indexed to inflation. Thus, in general, that means an effective Federal Estate-Tax exemption of approximately \$13.6 million for a husband and wife with proper planning. (These amounts are temporarily doubled through the year 2025 pending further action by Congress.)

Current Minnesota Estate-Tax Exemption

Despite a Federal Exemption amount of \$6.8 million, Minnesota’s exemption amount is \$3 million for 2024. The \$3 million includes transfers that occurred within 3 years of death. Minnesota’s Estate-Tax exemption (credit) amount previously was “coupled” with the Federal Exemption and they were equivalent. The amounts have been decoupled for several years. Minnesota is one of numerous states that have exemption amounts that are decoupled from the Federal Exemption. Several states have varying exemption amounts while others have no estate tax. For married couples, only with proper planning can the Minnesota exemption be effectively doubled. NOTE: Some family-owned businesses and farms may qualify for a \$5 million exemption.

Gift Tax

Presently, there is an annual Gift Tax exclusion of \$18,000 (starting in 2024) which is indexed to inflation in increments of \$1,000. Each individual may give to another individual up to \$18,000 in any given year without tax consequences and without the need for a gift tax return. This amount can be given to an unlimited number of individuals. Thus, by electing what is called “gift splitting” spouses can effectively pass \$36,000 to any individual each year. Gifts exceeding the “annual exclusion” will result in a reduction of your estate-tax exemption; a gift tax return (Form 709) will also be required. Additionally, payments made for tuition and for medical care of another can be excluded provided the payments are properly structured. Moreover, certain contributions to 529 educational plans can be excluded.

Marital Deduction and Portability of Federal Exemption

There is an unlimited amount that spouses can pass to each other free of estate tax (The Marital Deduction). As a result, there was rarely an estate tax incurred on the death of the first spouse (provided everything passed to the surviving spouse). However, if a spouse passed everything to his or her surviving spouse then his/her exemption went unused and was “lost”. The only way to make use of the first spouse’s exemption was to have assets pass in some other fashion other than outright to the surviving spouse. For example, the first spouse could pass a portion of his/her assets directly to his/her kids or could use one of the various Trusts to have assets pass into. Such Trusts, among others, were commonly referred to as A-B Trusts, Credit-Shelter Trusts, or Disclaimer Trusts. Thus, the first spouse would use part, or all, of his/her exemption by having a portion of his/her assets pass to such Trust with the remainder to his/her surviving spouse. Another way for the first spouse to use his/her exemption was by directly passing assets to someone other than his/her spouse (i.e. children) but this situation reduced the amount of assets passing to the surviving spouse which was often not a desired result. By using a Trust for the first spouse’s exemption, the surviving spouse was able to maintain certain rights to the Trust assets (such as a right to income and portions of the principal for support) without loss of the first spouse’s exemption. **Maximizing amounts that couples can pass tax free requires some specific planning.**

"Portability" of exemption amounts. A newly enacted "Portability" provision allows a spouse to pass his/her assets to the surviving spouse and the surviving spouse essentially inherits the unused exemption amount of the deceased spouse and it is no longer "lost" by way of the Marital Deduction and the passing of all assets to the surviving spouse. (for example, if a couple has a net worth of \$8 million and one spouse passes away leaving all assets to the surviving spouse, the surviving spouse would now have a \$13.6 million (temporarily \$27.2 million) exemption and if he/she were to pass away shortly thereafter there would be no Federal Estate Tax. A Federal Estate Tax Return (Form 706) is required on the first spouse's passing to receive portability. **HOWEVER, DUE TO THE MINNESOTA ESTATE TAX, THE USE OF TRUSTS (SUCH AS A DISCLAIMER TRUST) IS STILL A CRUCIAL TOOL TO PROVIDE A SURVIVING SPOUSE THE FLEXIBILITY TO REDUCE OR ELIMINATE ESTATE TAXES. MINNESOTA DOES NOT HAVE PORTABILITY OF EXEMPTIONS; THUS, PROPER PLANNING IS CRUCIAL TO MAXIMIZING THE MINNESOTA EXEMPTION FOR A HUSBAND AND WIFE. HUNDREDS OF THOUSANDS, IF NOT MILLIONS, OF INCREASED TAXES MAY BE OWED WITHOUT PROPER PLANNING.**

Disclaimers

A disclaimer, where a beneficiary disclaims an asset, is essentially a beneficiary asserting that he/she does not desire to have the asset(s). This seems unusual but it is an important and flexible estate-tax planning tool for spouses. The surviving spouse can disclaim certain assets to make sure that the State Estate-Tax exemption is not "lost" but the surviving spouse can disclaim certain assets and have them pass into a Disclaimer Trust and still have certain rights to use such assets (such as right to income and right to use assets for health, education, support, and maintenance) without having the disclaimed assets being treated as part of the surviving spouse's estate.

NOTE: There are strict laws which must be adhered to in order to make sure that the Disclaimer is treated as a Qualified Disclaimer for estate-tax purposes in order to accomplish the desired objectives and thus it is important for the surviving spouse to meet with legal or tax counsel shortly after the first spouse's death. The Disclaimer must be done within 9 months of the date of death of the first spouse but, due to unique requirements to make the Disclaimer "Qualified", the Disclaimer process must be commenced much sooner than that. This is of the utmost importance in that the tax dollars involved can be in the tens of thousands if not more.

NOTE - THE ABOVE IS FOR INFORMATIONAL PURPOSES AND IS A LIMITED OUTLINE OF ESTATE TAX ISSUES AND IS NOT EXHAUSTIVE OF ALL OF THE POSSIBLE ESTATE AND GIFT TAX LAWS AND REGULATIONS