ESTATE TAX PLANNING *OPPORTUNITIES* Guide

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2025 Estate Tax Planning Opportunities

Estate tax planning: now more than ever is critical. The current federal gift and estate tax laws are favorable. The gift and estate tax exemption amount is $13,990,000 in 2025 and the maximum tax rate is 40%. There is a sunset provision in the law that mandates a reduction of the exemption on December 31, 2025 unless Congress decides to act.

Federal Gift and Estate Tax Exemption

Under current law (the Tax Cuts and Jobs Act of 2017), the federal estate and gift tax exemption amount is $13,990,000 for 2025 (subject to an annual inflation adjustment). This exemption is slated to sunset on December 31, 2025, with the federal gift and estate tax exemption being reduced to approximately $7,000,000.

Spousal Portability

Current law provides for portability of the Federal spousal estate tax exemption (called the Deceased Spouse Unused Exemption Amount or "DSUEA"). If a predeceased spouse does not fully utilize their gift and estate tax exemption of $13,990,000 (in 2025), the surviving spouse could utilize the unused exemption of their predeceased spouse, subject to certain requirements being met.

The New York State Estate Tax Traps

Exemption Amount. New York State's estate tax exemption amount does not mirror the higher Federal estate tax exemption amount. The NYS estate tax exemption is $7,160,000 for individuals dying in 2025. Estate tax planning may be required even if an individual does not have a federal taxable estate.

Spousal Portability. New York State does not provide for Spousal Portability. Steps may need to be taken to allocate assets between spouses in order to minimize or eliminate New York State estate taxation.

The Estate Tax Cliff. New York has an estate tax "cliff" which precludes the decedent's estate from taking advantage of the NYS estate tax exemption amount if the taxable estate is more than 105% of the applicable exclusion amount. Hence, estates of $7,518,000 or greater in 2025 will be fully taxed by New York State.

Gifting. Individuals with taxable estates need to be aware of the differences between the Federal and New York estate tax laws and take advantage of the planning opportunities that result from these differences. Significant New York State estate taxes may be saved by implementing a gifting program. Please note that New York State does not have a gift tax law, but gifts made within three years prior to death will be included for NYS estate tax purposes.

For example, assume that an unmarried client has an estate with a value of $13,990,000. If the client does no estate planning and dies on or after January 2025, there would be no Federal estate tax due. The New York State estate tax would be $1,705,200.

If an individual had an estate of $13,990,000 and made gifts of $6,670,000 (more than three years prior to their demise in 2025) to their children or to a trust for them, there would be no Federal gift or estate tax and no New York estate tax. By engaging in gift and estate tax planning, the individual saved $1,705,200 in New York State estate taxes for their family.

Leveraging the Gifts

Estate planning is not limited to outright gifts which reduce the estate and gift tax exemption dollar for dollar. High net worth individuals would be wise to take advantage of leveraged gifting. Under current law, this can be done using a number of gift tax strategies, such as Grantor Retained Annuity Trusts (GRATs), Qualified Personal Residence Trusts (QPRTs) and Charitable Trusts. The use of Spousal Lifetime Access Trusts (SLATs) can avoid estate tax on the future appreciation of assets. For estates of significant value, the use of Intentionally Defective Grantor Trusts can be helpful.

Grantor Retained Annuity Trusts (GRATs) Funded with LLC Units or S Corp Shares

A Grantor Retained Annuity Trust (GRAT) is an irrevocable Trust which requires that a percentage of the value of the trust property be paid to the Grantor each year (referred to as an annuity payment) for a term of years. When the term of years expires, the trust assets are no longer included in the estate of the Grantor. The value of a gift to a GRAT is reduced by the value of the annuity payment to the Grantor because the annuity is considered funds that the Grantor did not give away. The value of the gift to the trust can be further reduced if the GRAT is funded by assets which are themselves discounted, such as nonvoting units of limited liability companies (LLCs) or non-voting shares of Subchapter S Corporations (S Corps). Therefore, combining the GRAT with discounted nonvoting units or shares in LLCs or S Corps can maximize gift and estate tax savings.

For example, a client with a taxable estate could take a $5,000,000 portfolio of real properties, establish an LLC, and transfer the properties to this LLC in exchange for 4 voting and 96 nonvoting units of the LLC, called "membership units." This could also be accomplished with business interests and/or liquid assets, such as a brokerage account.

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The LLC would be appraised, and an appraiser may determine a discount in the range of 15 – 40% percent as to the nonvoting units due to lack of voting rights and lack of marketability.

The client would then create one or more Grantor Retained Annuity Trusts (GRATs) providing income to the client for a term of years. When each GRAT is created, the client will determine the term and the annual rate of return which would impact the amount of the discount.

As an example, the client, age 65, receives a 30% discount on the nonvoting units of the LLC ($4,800,000 x .30 or $3,360,000) and makes a gift of the units to a GRAT with a twelve-year term and a reversion provision. The client retains an income stream of 5% of the funded value of the LLC units during the GRAT period. Once the client outlives the GRAT term, the assets in the GRAT (the 96 nonvoting LLC units), would pass to children, grandchildren outright or continue in trust for their benefit without estate taxation. This example assumes that at the time of funding the GRAT the Section 7520 rate was five percent (5.00%), and annual growth of principal and income earned is projected to be six percent (6.00%).

By utilizing leveraged gifting and employing an LLC and a GRAT strategy, and assuming the client survives the GRAT term, the client will have gifted $4,800,000 in real estate using approximately $1,438,940 of gift and estate tax exemption.

The client would have reduced the gift of real estate in total by approximately 71%. Once the client outlives the term, the estate tax savings would be approximately $1,512,477 based on a 45% combined federal and state tax rate). In addition, any future appreciation in the real estate from the time the initial term expired would be outside the client's taxable estate, resulting in additional estate tax savings.

Depending on the value of the taxable estate & the federal estate tax rates in effect at the clients' date of death, leveraging the gift in this way can save the client's estate a significant amount of money in federal and state estate taxes.

The Qualified Personal Residence Trusts (QPRTs)

A client may leverage a gift of his or her home (and/or a second home) by using a Trust called a QPRT (Qualified Personal Residence Trust). A QPRT is a trust that provides for the client to have a right to use and occupy the residence for a term of years.

During the QPRT term, the client has the right to reside rent free in the residence and is treated as the owner for tax purposes. At the end of the term the residence can remain in the trust or pass to children, grandchildren outright or in trust for their benefit. If the residence remains in the trust, the client, as a rental tenant, can continue to use the residence under certain conditions. The primary benefit of the QPRT is that all future appreciation of the home will escape estate taxation once the client outlives the term, and the value of the gift will be discounted for gift tax purposes.

For example, a 70-year-old client with a taxable estate transfers a $1,500,000 residence to a QPRT with a term of ten years. Assuming at the time of funding the Section 7520 rate was five percent (5%) and the annual growth rate of principal at five percent (5.00%). The client has made a taxable gift of $674,265.

After the client outlives the term, the $1,500,000 residence (with any additional appreciation) is now outside of the client's estate. The estate tax savings would be $370,846 (based on a 45% combined federal and state tax rate). In addition, any future appreciation in the real estate would be outside the client's taxable estate, resulting in additional estate tax savings. There are additional techniques which can be employed to save additional estate taxes with the use of a QPRT funded by a client's residence.

Please note that if the home is sold by the QPRT during the term, there may be capital gains tax liability. This liability may be reduced (or in some cases eliminated) by use of the $250,000 capital gains tax exclusion for the sale of one's personal residence ($500,000 for a married couple). Additionally, if a replacement home is not purchased within two (2) years of the sale, the QPRT must be converted to a GRAT.

If the home is sold by the QPRT after the term, and the trust is structured as a grantor – type trust, then there may be capital gains tax liability. In that situation, the capital gains tax liability may be reduced if the creator of the trust qualifies for the $250,000 capital gains tax exclusion ($500,000 for married taxpayers filing jointly).

Wills and Trusts with Disclaimer Provisions

It is important for married couples to take advantage of their individual estate tax exemption.

Each Will or Living Trust can be structured to take advantage of each spouse's exemption utilizing Credit Shelter and Marital Trusts.

One approach is to provide in one's estate planning documents for the assets of the first spouse to be funded into a Marital Trust for the sole benefit of the surviving spouse. Assets passing into a Marital Trust that qualifies for the marital deduction are not subject to estate tax in the first's spouse's estate but will be included in the surviving spouse's estate for estate tax purposes.

The surviving spouse, within the disclaimer period (nine [9] months from the spouse's date of death), may disclaim all or part of the assets of the Marital Trust. The disclaimed assets would be held in a Credit Shelter Trust for the benefit of the surviving spouse (and the children or grandchildren if desired). Assets funded into the Credit Shelter Trust would be subject to estate tax in the first spouse's estate (and offset by his or her exemption).

This strategy will minimize overall estate taxes on the married couple's estate. Additionally, the two-trust system will provide flexibility to the surviving spouse and allow the spouse to determine how much should be funded into the Marital and Credit Shelter Trusts to minimize estate taxes in both estates.

Further, the ability of the spouse to make a partial or total disclaimer of assets in the Marital Trust will facilitate the asset allocation between spouses if this division was not already accomplished during lifetime.

An Asset Allocation is especially important in New York State because New York State does not have a DSUEA provision which allows a surviving spouse to make use of the unused estate tax exemption of the first spouse to pass.

Spousal Lifetime Access Trusts (SLATs)

Clients who are interested in saving estate taxes but also want to maintain flexibility and control over the gifted assets, may want to consider Spousal Lifetime Access Trusts (SLATs). This approach allows for all future appreciation of the trust assets to avoid estate taxation while taking advantage of the current federal gift and estate tax exemption amount.

A SLAT addresses this concern because it enables one spouse (the donee-spouse) to gain access to funds transferred to the Trust by the donor-spouse while saving estate taxes. In this way, the donor-spouse uses his or her gift tax exemption and the assets are excluded from both spouses' estates. The donee-spouse can maintain some degree of control over the trust assets and be a beneficiary of the SLAT.

A client can create a SLAT lasting for the other spouse's lifetime. Also, a SLAT can be created for the benefit of each spouse (if the trusts are not reciprocal trusts under the tax laws).

The SLAT can be structured so that income and principal from the Trust could be distributed to the spouse, children or grandchildren in the sole discretion of the Trustee. The donee-spouse could serve as a Co-Trustee of this Trust provided assets from the Trust are not used by the spouse to discharge the client's obligation of supporting his or her spouse.

This Spousal Lifetime Access Trust is designed to work in a similar manner to the Credit Shelter Trust under a Will or Living Trust; except it is a way that the donee-spouse can obtain access to assets and income during lifetime that the donor spouse has gifted to the Trust.

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Any assets remaining in the Trust on the spouse's death can be used for the benefit of the surviving spouse, children, or grandchildren after the client's death. These assets will not be included in the surviving spouse's estate for estate tax purposes. On the surviving spouse's death, the trust assets can pass either to children and grandchildren outright or to a trust for the benefit of children and/or grandchildren.

All future appreciation would avoid estate taxation. Although the amount of the taxable gift would not be discounted as allowed under a GRAT/LLC approach, there is no requirement that the spouse survive a specific term of years to gain the estate tax benefit.

Estate Planning for Life Insurance

Generally, life insurance proceeds paid to a beneficiary are received *income* tax free. However, the value of the life insurance may still be included as part of your taxable estate for *estate* tax purposes. Under the current tax laws, if an individual dies owning life insurance on their life, the insurance proceeds are included in that person's Federal and New York taxable estate, subject to estate taxation.

Therefore, one approach is to remove the life insurance proceeds from estate taxation by utilizing an Irrevocable Life Insurance Trust (ILIT).

An ILIT can be established and funded by an insurance policy purchased by the trustee of the ILIT. The policy would pay out the face value of the policy to the ILIT upon the death of the insured, and the entire policy proceeds would escape Federal and New York State estate taxation. The entire amount of the proceeds could be used for the benefit of the insured's family and/or to indirectly pay any estate taxes owed at that time.

Generation Skipping Tax Opportunity (Dynasty Trusts)

Clients who have children with taxable estates (either from inheriting from the client or on their own) may wish to provide directly for their grandchildren without burdening their children with additional estate tax liability in their children's estates. This can be accomplished by a Generation Skipping Trust, sometimes referred to as a "Dynasty Trust".

The transfer of property passing from a grandparent to a grandchild is called a generation skipping transfer. However, Generation Skipping Tax (GST) is imposed on such transfers above a $13,990,000 GST exemption (for 2025). Clients can plan to avoid both estate tax in their children's estates and generation skipping tax on transfers to their grandchildren.

A Generation-Skipping Trust can be established for the benefit of a client's children and grandchildren which can save estate taxes in your children's estate and minimize if not eliminate any generation skipping tax. The generation skipping tax exemption is currently $13,990,000 for 2025.

This means that if the client gifts $13,990,000 to a generation skipping trust, the client can allocate the $13,990,000 generation skipping tax exemption (on a gift tax return) to the trust and, as a result, shelter the trust assets (including all appreciation) from estate taxation in the estates of the client's children and from generation skipping tax.

New York Estate Taxes

The top New York estate tax rate is 16%. The top rate only applies when the New York taxable estate is over $10,000,000. An estate below that amount is subject to estate tax at graduate rates, starting at 3.06% for the first $500,000.

Since April 1, 2014, the current law has provided for an annual increase in the estate tax exemption amount in New York. The current estate tax exemption amount for individuals dying on or after January 1, 2025, and before January 1, 2026, is $7,160,000.

These increases will help reduce or eliminate the New York State estate tax liability for those under the exemption level at the time of death. However, for clients over the exemption amount, planning should be implemented to reduce or eliminate the tax.

Also, clients should be aware that NYS has an Estate Tax Cliff. If a New York decedent has assets more than 105% of the estate tax exemption, then the exemption is eliminated, and the entire estate is subject to NYS estate taxation. Planning can be implemented to reduce or eliminate this harsh estate tax rule through gifting and for married couples, the use of a Credit Shelter Trust.

Income Tax Advantages

Keep in mind that the opportunity to make larger gifts of income producing property free of gift, estate and generation skipping taxes includes the opportunity to shift income, which is generated by the assets the client gives away, to lower-income tax bracket taxpayers.

For dual residents, planning needs to be carefully implemented if the client desires to avoid New York State income taxation on income derived outside of New York.

Protecting Your Inheritance

The use of trusts also provides an opportunity to protect assets from the claims of creditors and the marital problems of the client's children and grandchildren. A Family Protection Trust is a type of Living Trust. It can be revocable or irrevocable depending upon your objectives. Assets can be placed into the trust while you are alive or from your Will upon your demise. The assets in the Trust will be managed by your trustee(s) for the benefit of your loved one. This will protect the assets in the event of a bad marriage, creditor claims, undue influences, and bad judgement.

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Hedging on the Future Tax Laws

The motivation to implement estate tax planning strategies now provides advance planning in the event the federal and/or New York State tax exemptions should be reduced, the tax rates increased, or the existing tax strategies being prohibited in the future.

Further, if you have an estate that is appreciating in value with the possibility of exceeding the estate exemption amount in the future, gifts now can avoid estate tax later on the appreciation of those assets.

Estate Tax Planning Considerations

It is very important that the client is comfortable with any estate tax planning strategies being considered. The estate plan should meet the client's desires and provide for maximum flexibility.

Trusts are the most protective way to ensure that gifted assets are not wasted or subject to claims against your family.

Further, a gift of an appreciated asset may be subject to capital gains tax when later sold which could have been avoided by the asset passing upon the demise of the client with a step up in basis. One would need to consider the potential estate tax savings against the potential capital gains tax when considering gifts of appreciated assets.

Additionally, please remember that when gifted assets appreciate in value, the appreciation escapes estate taxation.

Take steps now to protect your assets and minimize estate taxes. Contact us for a planning meeting today!

Russo Law Group, P.C. can take steps to create an estate tax plan to minimize or eliminate estate taxes while protecting you and your family. Please call us at (516) 683-1717 or visit us at www.VJRussoLaw.com for an appointment.

NOTE: The above is merely informational and not legal advice. This guide was published in January 2025 and based on New York law. You should contact us for any changes or updates in the law or long-term care planning. Future changes in law may render the above information inaccurate.

If you have any questions regarding this guide, please do not hesitate to call RUSSO LAW GROUP, P.C. at (516) 683-1717 or contact us at www.VJRussoLaw.com.

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