Are You Ready For the 2026 Estate Tax Sunset?

Most Americans have not paid much attention to estate taxes, or "death taxes", as the mass media likes to call them. But moderately or very wealthy people need to . . . now! Here's why:

The federal estate tax exemption amount for 2024 is $13.61 million per person. That means that each person can usually give away during life, or at death, up to the exemption amount without any federal estate or gift tax consequences. For a married couple, with proper planning, that's twice the exemption amount. Typically, only ultra-wealthy people need to worry about estate taxes. To put those high numbers into perspective, according to the IRS, in a recent analysis, only 0.08% of people who died in 2019 were subject to federal estate taxes.[1] In 2019, the exemption amount was "only" $11.4 million so there's a good chance that even less people are subject to the estate tax today.

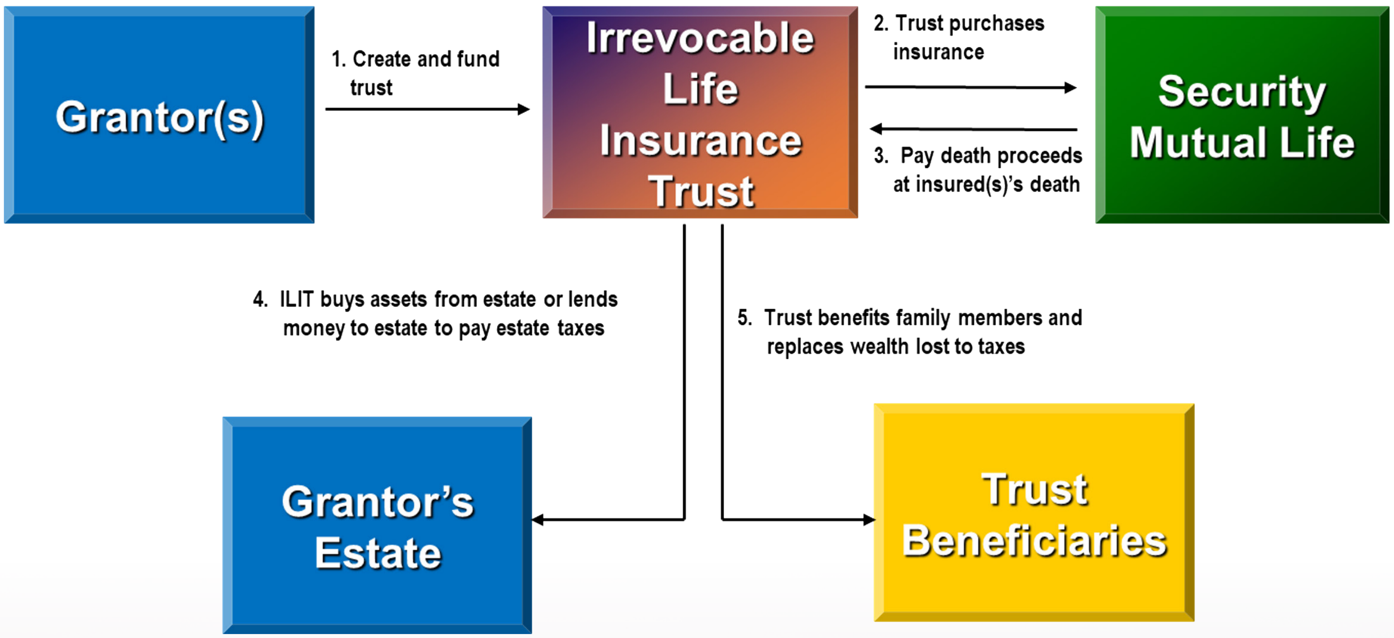
So, why do we need to talk about it? Well, it's because of the Tax Cuts and Jobs Act of 2017 ("TCJA"). The TCJA doubled the exemption amount at that time of $5 million to $10 million, adjusted annually for inflation. However, the TCJA also includes a provision that this doubling will expire at the end of 2025, causing the exemption to revert back to $5 million plus inflation adjustments in 2026. There seems to be little likelihood that this law will be extended. Indeed, if the Presidency and both Houses of Congress become controlled by Democrats, then it is quite possible for the exemption to be reduced even further.

So, while you may not be subject to federal estate taxes currently, you might be in the near future, particularly if you are at least moderately wealthy. Also, don't forget about the various states that still have a state estate tax and/or inheritance tax with their own exemption amounts, which are typically significantly lower than the federal amount, and could be as low as $1 million (e.g., Oregon). A greater number of individuals fall into this wealth category.

Since we don't know what the laws will look like when we pass away, what should we do? The solution, of course, is to plan for what we know now and adjust if we need to later.

While there are many estate planning strategies that can help to minimize or avoid estate taxes, the most common, and perhaps one of the easier solutions, is to use life insurance. Life insurance proceeds can replace the wealth lost to taxes or provide liquidity to the estate to pay the estate taxes, which are generally due within nine months of death.

The life insurance can be a single-life insurance policy that pays out benefits when the insured passes, or a joint-lives policy, also known as a second-to-die, or survivorship life insurance policy, that insures two lives and only pays out when both insureds pass away. Survivorship policies are common tools used for the estate planning needs of married couples.



Typically, however, the life insurance is owned by an irrevocable life insurance trust or ILIT. The ILIT is created by you with the aid of an estate planning attorney who drafts the trust and may help to administer the trust. The trust is generally the initial owner, premium payor, and beneficiary of the life insurance policy. This structure is typical because the proceeds of personally owned life insurance policies are included in the gross estate for estate tax calculations. As a simplistic example, if your net worth is $10 million, but you personally own life insurance policies with a total death benefit of $2 million, then, for estate tax calculation purposes, it is as if you are really worth $12 million at the time of your death. However, if the life insurance policy is owned by an ILIT, then you are only worth $10 million for estate tax purposes.

Obviously, estate planning can be complex and should be done only with the assistance of knowledgeable financial services professionals, accountants, and attorneys, but conceptually, the use of life insurance is a fairly easy solution that can help address some, or all, of a person's estate tax liability.

To maintain some flexibility, an alternative could be to create a "dry" ILIT. This is the same as previously mentioned except that the ILIT does not purchase the policy initially. You can purchase the policy and own it personally. At some future point in time, perhaps as tax legislation becomes clearer, you can then gift the existing life insurance policy into the trust so that the ILIT now owns the policy. Note, however, that there are some additional gift and estate tax consequences to consider in this scenario, including the possibility that the insurance proceeds would be counted in your estate if you don't live more than three years from the date of the transfer of the policy to the ILIT.

For a survivorship policy, instead of having an ILIT own the policy initially, an alternative could be a strategy known as a "Standby Trust." That concept allows the policy to be owned, initially, by the spouse who has a shorter life expectancy. Upon that spouse's death, ownership of the policy is transferred to the ILIT. That too has some additional gift and estate tax consequences to consider, as well as the possibility that the spouse with the shorter life expectancy actually outlives the other spouse.

The ILIT, "dry" trust and "Standby Trust" alternatives involve various technical tax and legal issues including coordination with other aspects of your estate plan, funding the trusts, and details on keeping the insurance proceeds out of your taxable estate. Nevertheless, it remains one of the most common and easier solutions to potential estate tax liability. Accordingly, you should consult and work with your Security Mutual Life insurance advisor who can help to guide you.

For More Information Contact:

Contact your Security Mutual life insurance advisor today to get the process started. Your advisor will assemble your team and coordinate with your attorney and tax professional to review your situation and to determine the estate plan that will best suit your needs and objectives.

[1] IRS. "SOI Tax Stats – Historical Table 17." Irs.gov. https://www.irs.gov/statistics/soi-tax-stats-historical-table-17 (Accessed February 16, 2024)

The information presented is designed to provide general information regarding the subject matter covered. It is not intended to serve as legal, tax or other financial advice related to individual situations, because each person's legal, tax and financial situation is different. Specific advice needs to be tailored to your particular situation. Therefore, please consult with your own attorney, tax professional and/or other advisors regarding your specific situation.

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