Private Bank

Gifting when the US transfer tax exemption amounts are at an all-time high

Overview

Exemption amounts

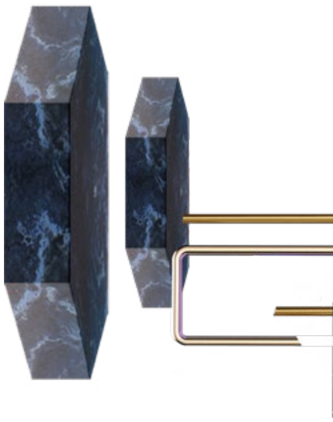
The exemption amount (for both US gift tax and US estate tax purposes) is at a record high in 2024, but current law will reduce this exemption amount by 50% on the first day of 2026

Scenarios

Scenarios that compare the effect of not making any gifts, waiting to gift the reduced exemption amount in early 2026, and currently transferring the all-time high exemption amount in 2024

Gifting now

Gifting now may significantly increase the amount of wealth that you could pass on to the next generation and beyond



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TRANSFER TAX LANDSCAPE

Is it better to gift assets now to family members and others or make bequests to them after your death? There are many tax and non-tax aspects to consider in determining the best approach.

One major factor to explore is whether to take advantage of the gift tax exemption amount and the generation-skipping transfer (GST) tax exemption amount, both of which currently stand at all-time highs. Unfortunately, this opportunity to transfer significant wealth free of gift taxes and GST taxes to children, grandchildren, and future generations will not last. Both exemption amounts are set to be dramatically reduced on the first day of 2026 (or possibly sooner through legislative action).

One or more transfer taxes may apply when making a gift or bequest – the gift tax, the estate tax, and the GST tax.

US tax law sets a limit on the total amount of gifts and bequests (outright or in trust) that a US citizen and US domiciliary – collectively "US person" – can transfer without paying gift taxes or estate taxes. This limitation is in the form of an "exemption amount" when making lifetime gifts, death-time bequests, or a combination of the two.

A US person, however, can make any of the following types of gifts and bequests without paying any transfer taxes and without using up any part of his/her exemption amount:

- Annual exclusion gifts – an individual may transfer up to $18,000 per recipient during the 2024 calendar year or up to $36,000 per recipient if a married donor elects to split gifts with his/her spouse
- Direct payments to an educational organization for anyone's tuition expense
- Direct payments to the provider of medical care for anyone's medical expenses
- Annual exclusion gifts to a non-US citizen spouse – up to $185,000 during the 2024 calendar year
- Gifts and bequests to – or for the benefit of – a US citizen spouse, with no dollar limitation on transfers made free of trust and/or to a qualified marital trust
- Bequests to a Qualified Domestic Trust for the benefit of a non-US citizen spouse, with no dollar limitation
- Charitable gifts and bequests (if made in certain ways), with no dollar limitation

EXEMPTION AMOUNTS - GIFT TAX, ESTATE TAX AND GST TAX

Every US person has a single exemption amount for making gifts and bequests. This exemption amount is frequently referred to as the "gift tax exemption amount" when talking about lifetime gifts and often called the "estate tax exemption amount" when discussing death-time bequests.

To the extent a US person uses his/her gift tax exemption amount by making lifetime gifts, it results in a dollar-for-dollar reduction of that person's estate tax exemption amount for death-time bequests. Current US law imposes a 40% tax on the value of lifetime gifts that exceeds a person's gift tax exemption amount. Likewise, it imposes a 40% tax on the value of death-time bequests that exceeds a person's remaining estate tax exemption amount.

In 2024, the gift tax exemption amount is $13.61 million for each US person or $27.22 million if a married person elects to split gifts with his/her spouse. One advantage of making gifts prior to death is that any income and appreciation on the gifted property will not be subject to estate taxation at the time of the donor's death.

US law also provides a separate exemption amount for GST tax purposes when making gifts and bequests to persons who are two or more generations below the transferor (e.g., grandchildren, grandnephews and grandnieces; and nonfamily members who are more than 37.5 years younger than the transferor) or to multigenerational irrevocable trusts.

The GST tax exemption amount is currently the same dollar amount as the gift tax exemption amount. This GST tax exemption amount is allocated to certain gifts and bequests to shield such transfers from current and future GST taxation. US law will impose a separate 40% GST tax on the value of any transfers that exceeds the GST tax exemption amount. The GST tax is in addition to any gift tax or estate tax.

All exemption amounts are adjusted annually to account for inflation. Current US law, however, will reduce all exemption amounts by 50% on January 1, 2026. Assuming an annual 2.5% inflation rate for the next couple of years, the gift tax exemption amount could decrease to approximately $7.15 million at the beginning of the 2026 year.

It's less than two years before the start of the 2026 year, which is a short window of time to take advantage of this historic gifting opportunity. It's possible that new tax legislation might occur before 2026 that could reduce the dollar amount of the gift tax exemption and/or impact wealth-transfer strategies that use the gift tax exemption. So, you should begin discussions now on how to maximize and leverage the all-time high gift tax exemption amount, as thoughtful wealth-transfer planning will take time to properly structure and implement.

Establishing an irrevocable Dynasty Trust can be an effective way to take advantage of your gift tax exemption amount and your GST tax exemption amount. A Dynasty Trust can potentially help you attain your long-term wealth planning goals, preserve more family wealth for future generations by mitigating/reducing future transfer taxes, and protect the trust's assets from the claims of the beneficiaries' creditors.

TRANSFERRING EXEMPTION AMOUNTS NOW OR LATER

Deciding how, when and whether to use your exemption amounts can have a big impact on how much wealth you can transfer to others.

To demonstrate this, let's compare the effects of:

1. Not transferring your gift tax exemption amount during your lifetime
2. Waiting until 2026 before transferring your gift tax exemption amount to a Dynasty Trust
3. Transferring your gift tax exemption amount to a Dynasty Trust in 2024

To estimate the legacy that you would leave to your family, we will make these assumptions:

- Your assets are worth $50 million at the start of 2024
- Assets grow at an annualized rate of 5%
- Income is taxed at a flat 40.8% rate, combining a 37% US income tax rate and a 3.8% "net investment income tax" rate
- You and your child live in a state that has neither a state-level income tax nor a state-level transfer tax
- You have not used any part of your gift tax exemption amount or any part of your GST tax exemption amount
- All exemption amounts are (i) annually adjusted for inflation by 2.5%, and (ii) reduced by 50% on January 1, 2026
- A flat 40% rate for the US estate tax
- You die at the end of year 2053 (30 years from now) and your child dies at the end of year 2083 (60 years from now)

Scenario 1 | You do not make any lifetime gifts

Over the next 30 years, your assets ($50 million) grow as part of your taxable estate. Your remaining taxable estate will be subject to estate taxation when you die in 2053, with the then-prevailing estate tax exemption amount reducing the estate taxes due.

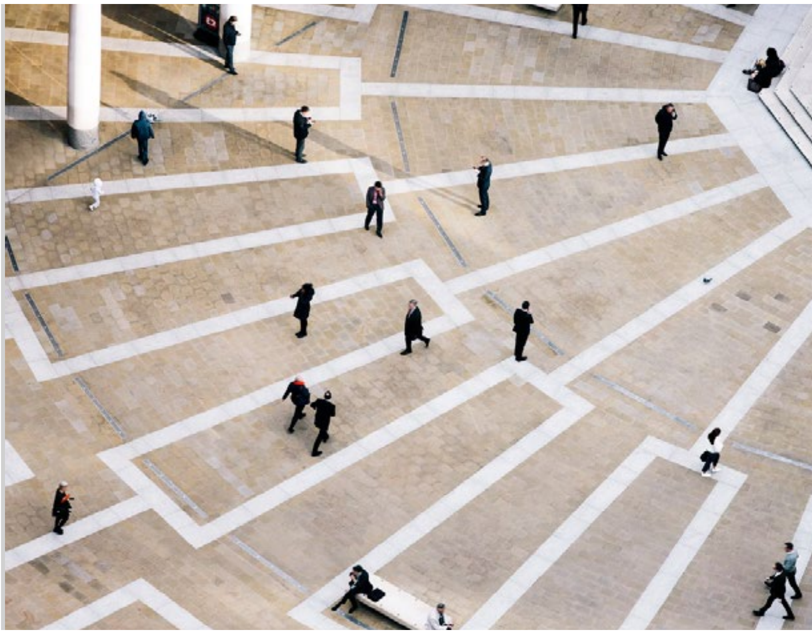
The after-tax remaining assets pass free of trust to your child and then grow as part of your child's taxable estate. Your child does not make any gifts during his/her lifetime. Upon your child's death in 2083, your child's remaining taxable estate will be subject to estate taxation, with the then-prevailing estate tax exemption amount reducing the estate taxes due.

Scenario 2 | Transferring your gift tax exemption amount to a Dynasty Trust in 2026

In early 2026, you transfer your entire gift tax exemption amount to an irrevocable Dynasty Trust for the benefit of your descendants. Scenario 2 assumes that the 2026 gift tax exemption amount has been reduced to around $7.15 million from its 2024 level of $13.61 million.

You established the Dynasty Trust in a state that allows perpetual trusts and has neither a state-level income tax nor a state-level transfer tax. Every subsequent year, you transfer an amount equal to the annual 2.5% increase in the gift tax exemption amount to the Dynasty Trust. Your GST tax exemption amount will be allocated to each gift you make to the Dynasty Trust.

The Dynasty Trust contains special "grantor trust" provisions that require you to report the income generated by the Dynasty Trust on your income tax returns. You pay any income taxes attributable to such income out of your own assets – such tax payments will not be treated as additional gifts to the Dynasty Trust. These "grantor trust" provisions come to end upon your death.



When you die in 2053, your remaining taxable estate – the assets that were not gifted to the Dynasty Trust – will be subject to estate taxation. The after-tax assets pass free of trust to your child and then grow as part of your child's taxable estate. Your child does not make any gifts during his/her lifetime. Between the time of your death and the time of your child's death, the Dynasty Trust will pay income taxes on any income it generates.

Upon your child's death in 2083, your child's remaining taxable estate will be subject to estate taxation, with the then-prevailing estate tax exemption amount reducing the estate taxes due.

The value of the Dynasty Trust's assets will not be subject to estate taxation or GST taxation upon either your death or your child's death.

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Scenario 3 | Transferring your gift tax exemption amount to a Dynasty Trust in 2024

This scenario involves making three changes to scenario 2.

First, you transfer the current gift tax exemption amount of $13.61 million in early 2024 to the Dynasty Trust (again structured as a grantor trust).

Second, in 2025, you transfer an amount equal to the 2.5% increase in the gift tax exemption amount to the Dynasty Trust.

Third, you stop making gifts in 2026 because your pre-2026 gifts to the Dynasty Trust exceed the reduced gift tax exemption amount and the 2.5% annual adjustments.

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How the scenarios compare

For the three scenarios, figures 1 and 2 show the ending value of the Dynasty Trust's assets, the ending value of non-gifted assets (after subtracting any estate taxes due), and the total amount of estate taxes paid to date. Figure 1 shows the outcome after 30 years and figure 2 illustrates the outcome after 60 years. The total amount of estate taxes paid in figure 2 is the sum of the estate taxes paid at the end of 30 years and the estate taxes paid at the end of 60 years.

FIGURE 1. ASSETS' VALUES IN 30 YEARS AFTER US TAXES

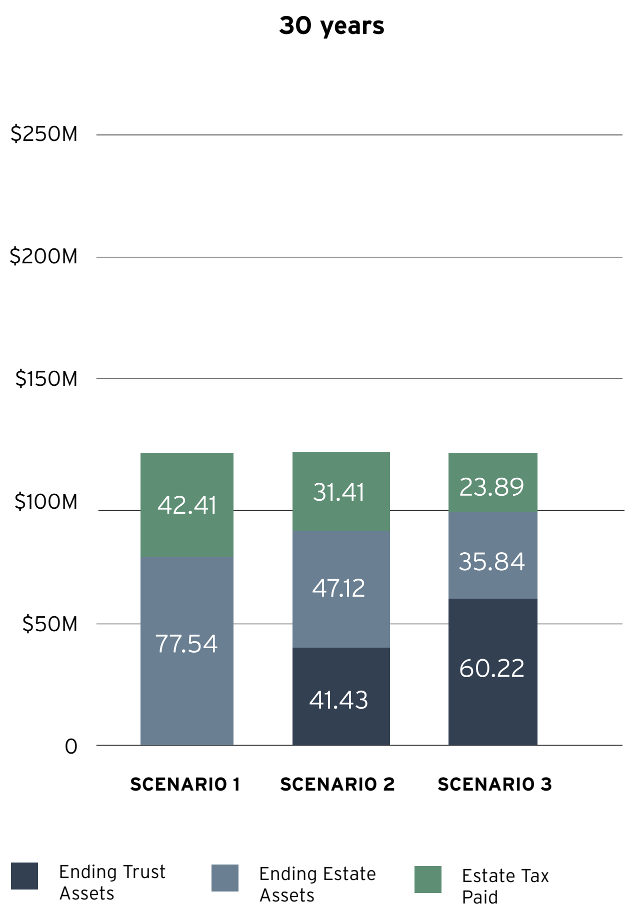
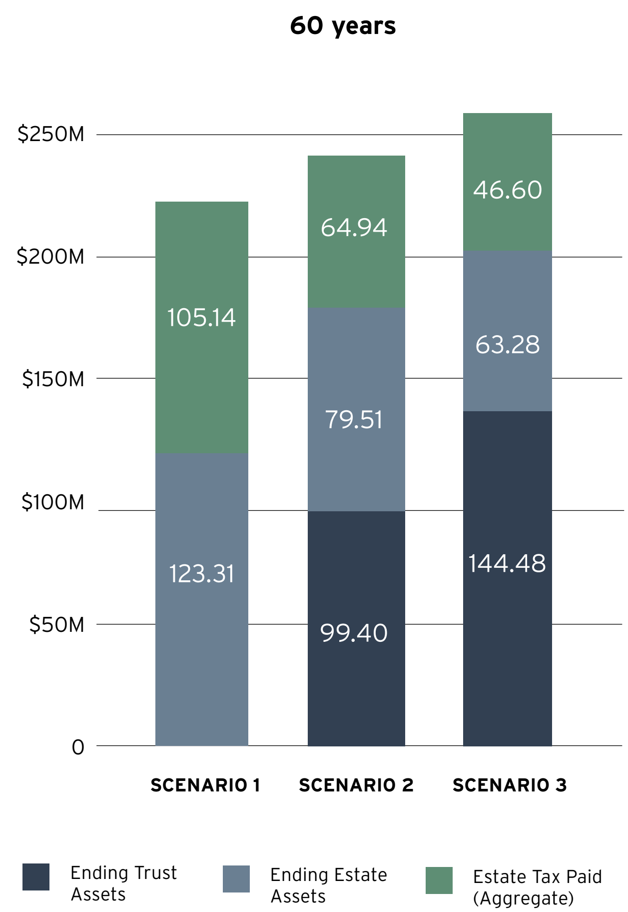


FIGURE 2. ASSETS' VALUES IN 60 YEARS AFTER US TAXES



Source: Trust & Wealth Planning, Citi Private Bank. Chart assumes a starting asset value of $50 million.

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ACTION BEATS INACTION, AND THE SOONER THE BETTER

Scenario 1 illustrates the potential cost of not making lifetime gifts. The original $50 million in assets grows to about $77.5 million after the payment of estate taxes in year 30. This after-tax amount passes to your child, growing to about $123.3 million after the payment of estate taxes in year 60 for the benefit of your child's heirs.

Compared to doing nothing in scenario 1, scenario 2 shows that gifting around $7.15 million gift tax exemption amount to a Dynasty Trust in 2026 – as well as making subsequent gifts of the annual inflation adjustments to the gift tax exemption amount – will increase the after-tax legacy to your family by about $11 million in year 30. It also increases the after-tax legacy to your family by approximately $55.6 million in year 60. These after-tax increases in the total legacy include the assets in the Dynasty Trust.

What about acting now rather than in 2026? In scenario 3, gifting the $13.61 million gift tax exemption amount in 2024 – as well as making a gift of the 2025 inflation adjustment to the gift tax exemption amount – to a Dynasty Trust further increases the after-tax legacy to your family by about another approximate $7.5 million in year 30. It further increases the after-tax legacy to your family by about another approximate $28.9 million after estate taxes in year 60. These after-tax increases in the total legacy include the assets in the Dynasty Trust.

Figure 2's comparison of scenario 1 (no gift during your lifetime) and scenario 3 (first gift to Dynasty Trust in 2024) shows that there are significant potential advantages in using your gift tax exemption amount and GST tax exemption amount now to establish and fund an irrevocable Dynasty Trust. After 60 years, acting now (scenario 3) results in about $58.5 million less in aggregate estate taxes compared to doing nothing (scenario 1). Also, acting now could increase the legacy to your family at the end of the 60-year period by about $84.4 million when compared to doing nothing.

50% REDUCTION IN 2026 – IT WILL TAKE YEARS TO RETURN TO 2024 EXEMPTION AMOUNT

The gift tax exemption amount could decrease to approximately $7.15 million at the beginning of the 2026, assuming an annual increase to the gift tax exemption amount of 2.5%. Applying this 2.5% increase each year thereafter, it would take about 26 years for the gift tax exemption amount in 2026 to return to the current gift tax exemption amount of $13.61 million.

Let's assume you first fund the Dynasty Trust in 2026 with a gift of around $7.15 million rather than making a large gift of $13.61 million in 2024. Further assume that, starting in 2027, you subsequently make a gift each year to the Dynasty Trust that has a value equal to the 2.5% increase in the gift tax exemption amount. You would need to make these post-2026 gifts for the next 26 years before the aggregate value of your gifts to the Dynasty Trust would equal $13.61 million. Trying to fund the Dynasty Trust any faster with gifts that have a value greater than the annual 2.5% increases in the gift tax exemption amount will result in the payment of gift taxes.

By not taking advantage of the all-time high gift tax exemption amount now, you may lose the opportunity to fully capture both the income and appreciation on this large gift in a tax-efficient Dynasty Trust over a long period of time.

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CONSIDER STATE-LEVEL TAXES TOO

Without proper planning, residency in a state with a state-level income tax and/or a state-level transfer tax can have a tremendous impact on the size of the legacy passing to family after 30 years and after 60 years.

One potential solution is to consider gifting the gift tax exemption amount to a long-term or perpetual Dynasty Trust – and allocating the GST tax exemption amount to such a gift – in a state with no such state-level taxes or in a state that will not impose any such state-level taxes on the Dynasty Trust's assets. This may help mitigate the impact of state-level taxation when passing wealth to future generations.

DYNASTY TRUST PLANNING

Some US states may restrict the duration of trusts and may require the termination of a trust between 80 and 100 years after inception. Upon termination, the trustee would distribute the remaining trust assets to the beneficiaries free of trust. Subsequent gifts of such assets by a beneficiary would be subject to gift taxation. Assets retained by a beneficiary would be subject to estate taxation upon that beneficiary's death.

However, under the current laws of states such as South Dakota and Delaware, certain qualifying trusts can theoretically continue forever without terminating. As a result, a Dynasty Trust established in South Dakota or Delaware can offer you a significant opportunity to preserve more family wealth for future generations in a highly tax-advantaged manner.

Furthermore, Dynasty Trusts created in South Dakota and Delaware may avoid probate, thus protecting your family's confidentiality regarding the terms of the trust and its assets.

Finally, with proper provisions and structure, such Dynasty Trusts may mitigate claims to the assets of the trust from certain creditors of the beneficiaries.

Citi Private Bank provides clients and their beneficiaries with the experience and personalized service that are essential to the long-term success of a Dynasty Trust, such as:

- Customized investment management
- Trust and wealth planning expertise
- Specialized dynasty trust administration
- Delaware or South Dakota situs
- Neutrality and objectivity

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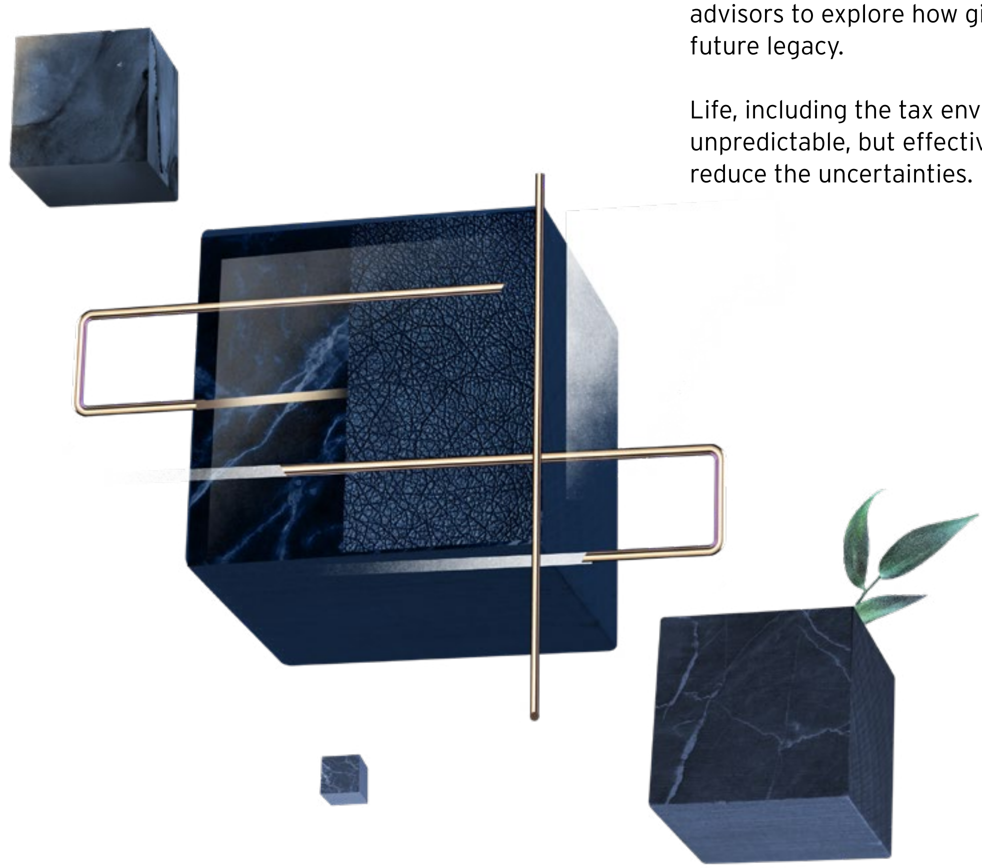
NOW IS THE TIME TO PLAN

As you review your wealth planning goals, we encourage you to consider utilizing the all-time high gift tax exemption amount and GST tax exemption amount. Acting now gives you more planning options and opportunities that can be done in a manner that's thoughtful and not rushed.

It can take time in determining which assets are best suited for gifting purposes, in valuing such assets for gift-tax purposes, and in creating structures that can hold those assets for the long term. Early planning typically results in successful wealth transfer planning.

Please engage with your Wealth Planner and other advisors to explore how gifting now can optimize your future legacy.

Life, including the tax environment, is often unpredictable, but effective wealth planning can reduce the uncertainties.



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