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Advanced Sales - Four Ways to Pay for Estate Taxes

Provide Options For Your Clients On How to Pay Estate Taxes

How Will Your Clients Pass Wealth on to the Next Generation

Your clients have worked hard to build their wealth and they likely want to keep their wealth in the family by passing it on to the next generation. Unfortunately, the assets your clients own may be subject to federal estate tax and state estate tax (if applicable). How can your clients pass their wealth to the next generation without depleting their net worth from estate taxes? The following four ways to pay for estate tax will provide clients with options on how to pay for estate tax.

Candidates

- Individual clients who have a net worth of $5,000,000 or more; married couples who have a net worth of $10,000,000 or more.

Non-Candidates

- Clients who do not have enough net-worth to be subject to estate tax.

Purpose: Executive Benefit

- Provides options for clients on how to pay their estate tax.

Opportunity Under the New Tax Law

- The Tax Cuts and Jobs Act of 2017 doubled the estate and gift tax exemption amount. Under current law, the estate and gift tax exemption for 2022 is $12,060,000 per person. For a married couple, they have an exemption up to $24,120,000 without incurring gift taxation. The doubled exemption amount is temporary, and it is set to expire on December 31, 2025, reverting back to $5,000,000 indexed for inflation. We can estimate after indexing for inflation that the lifetime exemption will be approximately $6,000,000 per person and $12,000,000 for a married couple in year 2026.

- The current increased lifetime gift exemption has a no claw-back rule. If your married clients were to use a lifetime exemption and gift $24,120,000 in assets today, then in 2026 when the exemption amount reverts back to the lower amount(approximately $6,000,000 per person and $12,000,000 for a married couple) the clients get to keep the $24,120,000 exemption. However, if your clients would not use all of the $24,120,000 exemption before 2026, they may miss an opportunity to gift $12,120,000 without incurring gift taxation ($24,120,000 -$12,000,000 = $12,120,000).

- This creates an opportunity for you to talk with your high-net-worth clients about estate planning and being able to seize the opportunity of the extra gifting powers currently available.

- Another important aspect to consider is the state estate tax or the state inheritance tax. Twelve states have a state estate tax and five states have an inheritance tax. Maryland has both state estate tax and inheritance tax. The grid below shows the states that have state estate and/or inheritance taxes, the exemption amount for that state, and the state's top tax rate for 2020.

State Estate Tax:

State	Top Estate Tax Rate	State Exemption
MA	16%	$1,000,000
OR	16%	$1,000,000
RI	16%	$1,561,719
MN	16%	$2,700,000
VT	16%	$2,750,000
CT	12%	$3,600,000
IL	16%	$4,000,000
MD*	16%	$5,000,000
HI	16%	$5,490,000
ME	18%	$5,600,000
DC	16%	$5,600,000
NY	16%	$5,749,000

Inheritance Tax:

State	Top Inheritance Tax Rate	State Exemption
MD*	10%	None
PA	15%	None
NJ	16%	None
IA	15%	None
KY	16%	$500

What Are the Four Ways to Pay for Estate Tax?

The Four Ways to Pay for Estate Tax concept provides options for your clients on how they are going to pay for the estate taxes. If your client's estate owes federal estate taxes or state estate taxes, the tax bill will be due and payable within nine months after the client's date of death. Your client's representative or successor trustee will be faced with the challenge of determining where the cash will come from to pay the tax bill. The four options to pay estate tax are:

1. **Cash**: The estate will need cash or liquid assets on hand to pay the estate tax due.
2. **Forced Sale**: If the estate is made up of illiquid assets or assets that lack marketability, it may be challenging to find a buyer. The estate may have to sell these assets at a discount to provide the cash to pay for the estate tax due.
3. **Loan**: If there isn't enough cash or the ability to sell assets, the estate may need to take a loan.
4. **Life Insurance**: Clients can purchase a life insurance policy inside an Irrevocable Trust. The life insurance policy will provide the cash the estate needs to pay for the estate tax bill.

Now that we know the choices available to pay for the estate tax due, let's take a look at a case study. This will help you provide your clients with choices on how their heirs can pay for their estate tax bill that will be due within the nine months of their death.

Case Study:

Today's Net Worth

John Smith:	Age 55, Preferred Nonsmoker
Mary Smith:	Age 55, Preferred Nonsmoker
Residence:	Massachusetts
Current Net Worth:	$15,000,000
Estimated Joint Life Expectancy:	32 years (both age 87)
Lifetime Exclusion:	Current Law, Sunsets in 2026
Inflation Rate for Estate Tax Exclusion:	2%
Federal Estate Tax Rate:	40%

Estate Tax Protection:

Current Year:		2022
Current Tentative Tax Base:		$15,000,000
Growth Rate:		3%
Client's Age:		55
Spouse's Age:		55
Number of Years of Growth:		32
Life Expectancy Used:		Joint Life
Sunset in 2026:		Yes
Inflation Rate for Estate Tax Exclusion:		2%
State:		MA
Projected Value of Taxable Estate in 2051:		$38,172,232
Federal Estate Tax in 2051:	$4,223,150	
Massachusetts Estate Tax in 2051:	$5,574,357	
Total Federal and Estate Tax Due:	$9,797,507	
Estate Remaining in 2051 After Taxes Paid:		$28,374,725

Four Choices to Pay for Estate Tax	Total Cost	Cost Per Dollar of Estate Tax
Cash (the cash that needs to be available)	$9,797,507	$1.00
Forced Sale of Assets (75% of Market Value, $9,957,507/.75)	$13,063,343	$1.33
Loan ($9,957,507 plus 8% loan interest for 10 years)	$14,601,175	$1.49
Life Insurance Premium ($70,459 annual premium for a $9,957,507 death benefit paid until joint life expectancy)*	$2254,688	$0.23

Conclusion

There will be some uncertainties in the future, such as the uncertainty of what the lifetime exemption will be. The uncertainty of health and age can cause life insurance premiums to be more expensive as clients age or the uncertainty of the opportunity to buy life insurance if your clients become uninsurable. If the Smith family opted to purchase life insurance today in an irrevocable trust, they will mitigate some of these uncertainties. The life insurance will provide the liquidity they need to settle their estate with the potential of saving up to 77% (100%- 23%, see above case study) on their estate tax bill by purchasing life insurance today.

Which option may be best for your clients? Encourage your clients to talk with their financial planning team to discuss how they are going to plan for the uncertainties by preparing today. By planning today, it may save your clients dollars tomorrow.

For More Information Contact CBS Brokerage at 763.450.1870