Lowenstein Sandler's Trusts & Estates Podcast: Splitting Heirs

Episode 17:
Can't Kick the Can Any More—How the Expiring Tax Cuts Could Affect You

By [Warren K. Racusin](), [Beth Shapiro Kaufman]()

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Warren Racusin: Welcome to the Lowenstein Sandler podcast series. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts. Or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, Soundcloud or YouTube. Now let's take a listen.

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Warren Racusin: From the law firm Lowenstein Sandler, this is Splitting Heirs. I'm Warren Racusin. You may have heard that there's an election about to happen—it may have already occurred by the time you listen to this—and maybe we'll even know who won. Some people think this election will decide the future of democracy in the United States, and the whole great American experiment. But way more importantly than that, the election may affect how much tax you have to pay.

Take one client of ours, she knows that currently she can give away almost $14 million without having to pay any gift tax, and that'll also help reduce her estate taxes. She also knows that in 2026, that exemption from the estate and gift tax is going to be cut roughly in half. So under current law, the $14 million carriage turns into a $7 million pumpkin on January 1st, 2026. So she wants to make gifts and use that bigger exemption now.

Problem is, her husband died recently. The dying part isn't really the problem, not for us tax geeks. But why is that a problem? Why? Because the law allows him to give her not only his whole estate, which he did in his will, he also gave her his own $14 million exemption, which he never used during his lifetime. It's called portability. Sounds great. What's the problem with that? Problem is, the law says that when she makes gifts, she has to use his exemption first. By the time she blows through that, it'll be 2026 and she'll have lost half of her own exemption. What to do?

Lots to cover. We have two folks who are going to give you a real sense of what's going on here. My partner Beth Kaufman, is the national chair of Lowenstein's Private Client Service Group. She advises high net worth individuals and family offices on estate, gift, and generation skipping transfer taxes. In a former life, she was an attorney advisor and then was associate

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tax legislative counsel in the Treasury Department where she had principal responsibility for all tax policy matters affecting trusts and estates.

She was the primary treasury representative involved in legislative and regulatory developments affecting estate, gift, and generation skipping transfer tax. Sandra Swirski is the founder of Integer, a bipartisan advocacy firm. Among the advocacy issues they've worked on are comprehensive tax reform, charitable tax incentives, capital gains, the estate tax, corporate taxation, education tax issues, energy tax incentives, and more.

Thank you both for being here today. Really looking forward to this. So let's dive in. Beth and Sandra, let's start with talking a little bit about how we got here in the first place. How is it that these exemptions, and deductions, and tax rates seem to come and go? As The New York Times once said about a prior tax law, "These exemptions, and deductions, and tax rates seem to come and go like a spring afternoon." How did we get here in the first place? Why is everything expiring? Or, at least what we've talked about, why is this is expiring on January 1st, 2026?

Beth Kaufman: Well, Warren, we had a tax act at the end of 2017, the Tax Cuts and Jobs Act, which had a lot of provisions that took effect January 1st, 2018, but expire on December 31st, 2025. Now, why do we get provisions and tax bills expiring? It's because of the costs of them. When we have tax cuts, Congress generally wants to pay for them with some other revenue raisers. In this case, they could only find the revenue to pay for these tax cuts for eight years. So we have an expiration coming up at the end of next year strictly for fiscal reasons.

Warren Racusin: So in effect, you're saying Congress can only let these tax cuts, that's called the Tax Cuts and Jobs Act, go on for a certain period of time. Otherwise, the cost of reducing taxes by that much get too great and so they got to start all over again before 2026, right?

Beth Kaufman: Yes. And interestingly, on the Hill, one chamber looks at only 5-year revenues and the other looks at 10-year revenues. Beyond that, it's if these things don't cost anything, but apparently, they couldn't get to 10 years in 2017.

Warren Racusin: So what some people would say is, this is a little bit of a gimmick to give people tax cuts for a certain period of time, kick the can down the road, and then look at it again several presidents, several congresses out into the future, right?

Beth Kaufman: Absolutely.

Warren Racusin: So they thought that looked great. But now it's the end of 2024, and we've come back to where the can is right now, and we are going to talk about whether that's going to get kicked down the road or whether something else is going to happen to it. Let's talk about our client. The problem that she faces... And we should all have such problems, giving away $14 million or more. But the problem that she has is that she inherited a lot of exemption

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from her pre-deceased spouse, and she's got to figure out how to deal with all that.

You described this to me, Beth, as thinking about this problem as a stack of pancakes. And I love pancakes, particularly the ones with the walnuts on top. Those are really great. You described it as thinking about it as a stack of pancakes. Explain that to us so everybody can understand it in terms that really makes sense to folks.

Beth Kaufman: Sure, Warren, it's all about the food.

Warren Racusin: Exactly.

Beth Kaufman: So imagine a stack of three pancakes, and the top pancake is the exclusion that this client inherited from her spouse. We call that the deceased spousal unused exclusion or DSUE. So our top pancake is the DSUE. The next pancake down in the stack is what I call the basic exclusion. That's the amount of exclusion that our client would have left after the sunset. And then the bottom pancake in the stack is what I call the bonus exclusion. That's the part that's temporarily doubled from the year 2018 to the year 2025.

So when our client starts to use her exclusion by making gifts, she has to go through those pancakes in order. She has to eat the top pancake first before she gets to the second pancake in the stack, before she gets to the bottom pancake in the stack. So if she makes a $14 million gift, she would use up the DSUE, the top pancake, and not have touched the basic exclusion or the bonus exclusion. Even if she were to make a $15 million... Well, let's go higher than that. Even if she were to make a $20 million gift, she would use up $14 million of DSUE and $6 million of basic exemption, and she would not have touched her bonus exemption, with the effect that, if we really do have a sunset when January 1st, 2026 rolls around, she would have $1 million of her basic exemption left and nothing else.

Warren Racusin: Though she's got to dig into the bonus exemption at the bottom of the stack before the busboy takes it away on January 1st, 2026. Right?

Beth Kaufman: Exactly.

Warren Racusin: You and I have talked a little bit about what kind of recommendations we can make for this client, and one of them that we talked about, that probably doesn't work but it's amusing enough to chat about a little bit, she inherited DSUE from her deceased spouse. What if she got married again? Is there a better DSUE candidate out there that might help with this?

Beth Kaufman: The rules for DSUE are rather interesting and designed to make sure that people can't marry and kill off the subsequent spouses and collect lots of DSUE. So the rule says, you only get the DSUE from your last deceased spouse. So if she were to marry again, and her second spouse is living, she still has the DSUE from the first spouse. I know how you people from New

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Jersey think, Warren, "Let's get out the cement," he says, "Kill off the second spouse. How about that?"

Warren Racusin: We are the state that gave the world The Sopranos, so we do think in those terms, but it sounds like there's a fly in that ointment or in that concrete.

Beth Kaufman: Indeed. So did you want to assume that the second spouse has remaining exemption or has none?

Warren Racusin: Let's assume that she put an ad on Tinder saying, "Looking for spouse. Here's how great I am. By the way, bonus points if you already blew through your own exemption."

Beth Kaufman: Okay. So Mr. Second Husband, let's call him, he has no DSUE, and one way or another he meets his demise. Then she no longer would have the $14 million of DSUE from the first spouse because now she's got a more recent deceased spouse. So then when we look at her picture, she would have approximately $7 million of basic exclusion and approximately $7 million of bonus exclusion. She's got her second and third pancakes. Then if she made gifts of $14 million, she would indeed get to her bonus exclusion and use it up.

I know that sounds good, but it's actually not so good. Compare that to if she didn't mess around with Mr. Second Husband and she just left things as they were, if she made a $14 million gift then, she would've used up all her DSUE, but she still would've had her own basic exemption even though the bonus exclusion had gone away. She still would've had her own basic exclusion even though the bonus exclusion had gone away. So in total, she would end up with $21 million of exclusion to use in the first scenario where she doesn't remarry, versus if she did remarry the guy with no remaining exclusion, she would only get to use $14.

Warren Racusin: So a better result on an overall basis, even though not nearly as exciting from the perspective of a podcast episode. But it is dollars and cents, she can give away $7 million more if she just sticks with deceased hubby number one.

Beth Kaufman: Right. But let's say that she's very wealthy, and she's got 100 million dollars in assets, and the $14 of DSUE, and the $7 of basic, and the $7 of bonus, she could give away $28 before the end of next year and have locked in the benefit of all of it.

Warren Racusin: That brings us to an important question that goes a little bit beyond today's topic, but I think it's important to discuss. Who should make gift, when should they make gift? You and I talked a little bit about your scenario, thinking about January 1st, 2026, when the sky's falling, who's it falling for and who's it not falling for?

Beth Kaufman: Yeah, it's important to keep that in mind, Warren, because for the vast, vast majority of Americans, this makes no difference whatsoever. Think about it. If we have a sunset, every person will still have an exemption of somewhere around $7 million. If we look at wealth in this country, a family unit that's got

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wealth of about $13 million is in the top 1%. So 99% of the people don't need to worry about this sunset at all.

Then if we go to the other extreme, we've got clients who have $100 million, or a billion, or whatever in wealth. They, by and large, have already used this bonus exclusion, so they don't need to worry about the sunset at all. What we're left with is this narrow band of people who are wealthy by anyone's definition but fall between the merely wealthy and the extremely wealthy and have to really think about whether they're going to use this bonus exclusion before it goes away, if it is going to go away.

Warren Racusin: Because, for the most part, the good part of giving the money away is that you're taking advantage of that larger exemption. If you give it away in a manner that's effective, you don't have the use of the money anymore, at least not the unfettered use of the money. That's something that clients have to think about. We've been talking about tax land here the whole time, but in the real world, what we tell people, and I'm sure you too, Beth, is that when you're thinking about this kind of gifting, or people in this narrow band, any band, but certainly in this narrow band, what I always say to them is, "Listen, you think about how much money you need in your own pocket so that, for the rest of your natural born days, you will never have to worry about money again."

You figure out what that is and you'll only think about gifting the excess over that. If the excess over that dives you into that bottom pancake, great. If not, so be it. That's how we always advise clients. I'm sure that's how you advise clients as well because, again, any tax planning idea that works has real world consequences to it. Anybody tells you that they have a tax planning idea that doesn't have real world consequences, you should run as quickly as possible in the other direction.

Sandra, I'm sure you are familiar with the saying that goes, "Legislation is like sausage, you're better off not seeing either of them being made," but our listeners want to hear about the sausage, and how the sausage gets made, particularly in this environment with an election coming up. We're certainly not taking sides, but it's a meaningful set of issues. One of your colleagues wrote a piece recently that was called “Missing From the Debate,” and he was talking about presidential debate, Missing From the Debate - A Plan to Address the Looming Tax Cliff, and he was talking about the cliff that happens as we've been discussing on January 1st, 2026.

He could have just as easily been talking about the larger cliff that's out there somewhere where the United States has borrowed trillions and trillions of dollars, and that potentially could be problematic at some point down the road. So tell us a little bit, Sandra, about how the sausage gets made. And, to the extent you can, share some stories that you're not going to want to attach any names to, but that would be enlightening and maybe even a little amusing for folks.

Sandra Swirski: Well, I always aim for amusing. Let's start with the politics, that's the most interesting here. Beth is absolutely right that when 2017 rolled around, and we had all of these wonderful tax breaks, there was only so much money that

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Congress was willing to spend. So as a result, a lot of these extenders, these expiring provisions are done at the end of '25.

So what's different about the legislative process that has already begun but will really ramp up next year? What's different from that process vis-à-vis the process that went in 2017 is that, in the intervening years, our deficit has exploded, number one. Number two, we have a whole lot more members of Congress that care about that deficit, that agree that we can't keep offering tax candy without paying for some of it, most of it.

So there's this fervor on Capitol Hill right now among Democrats and Republicans at the polls, the left and the right, that next year we're going to have to pay for most, if not all, of extending some of these tax benefits. Well, why is that important? Well, because we're unlikely going to be able to extend all the 2017 tax cuts permanently or at 100%. They're going to have to make some decisions, and tough decisions.

Warren Racusin: Again, it's not just the estate tax, there are lower income tax rates, there's the limitation on the salt exemption. There are other things, some of which have been helpful to taxpayers, some of which not so much, but that all goes into the hopper, right?

Sandra Swirski: That all goes into the hopper. One example is capital gains. Right now, we're enjoying a much lower rate. The end of '25, it's going to snap back to the highest marginal rate. You're right, it is the income tax rates, it's investment tax rates, it's the estate tax rate. As for the SALT deduction, for those of you who live in high property tax jurisdictions, that cap on that tax deduction is also expiring at the end of 2025.

When that snaps back, there's a lot of happy news. You'll be able to take a full deduction for your state and local property taxes. But I think that is going to continue to be a pay for, I don't see that snapping back, and folks being able to deduct 100% other state and local income taxes. I think that despite what some of the presidential candidates are saying, it's a very attractive revenue raiser because it only impacts higher earners in coastal cities.

So the politics suggests that we are going to continue to have some type of cap on state and local property taxes. You've got income taxes, investment taxes, estate taxes, you've got SALT, but it's not going to stop there. Once you open up the tax code, as many of you know, there is a whole lot more that can be done. Corporations are already lining up to get a lower corporate tax rate. Small businesses are also lining up to get greater benefits for their investments, and their plant and equipment, and the like. So while we are focused on those expiring provisions from 2017, the entire lobbying community, from corporations, to individuals, to small businesses, to partnerships are queuing up to try to persuade Congress to give them a better tax outcome in 2025.

Warren Racusin: Because, as former Senator Everett Dirksen once said, to praise him, "We're running trillion-dollar budget deficits, a trillion here and a trillion there, and pretty soon you're talking about real money," right?

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Sandra Swirski: Absolutely. Absolutely. So I get asked a lot, "Well, is the election really going to impact how tax reform is done?" I think, at the margins, sure. Whoever is in control of Congress gets to actually craft the bill. But since 2017, what we've seen is, there's a lot more agreement on the far left and the far right around tax reform than there ever has been. So while it is important, whether Democrats or Republicans are writing the bill, because they're going to have to pay for a big chunk of tax reform because of deficit hawks, the Republicans are not going to be able to be as magnanimous with the tax revenue as they typically are. So I think that we're looking at a modest size tax reform bill.

Beth Kaufman: Listening to Sandra, it sounds like we should be pretty pessimistic about the bonus exemption living beyond January 1st, 2026. I just want to articulate a couple of reasons why, despite all odds, it could survive. One is that, in the grand scheme of things, it doesn't really cost that much money. That provision alone doesn't add that much to the deficit. The reason for that is because so few people pay estate tax that it's a fairly finite amount of money. Cynically, second, there are a lot of people who pay estate taxes on both sides of the aisle who are important to elected officials, and it's possible that elected officials might feel that that's a constituency that they want to keep happy.

Sandra Swirski: Beth, I agree with you on both of those, and I'd add a third. Which is that, to date, the estate tax has largely been pointed to as a benefit for family farms, and ranchers, and all of those good middle-of-the-road folks. I think that we've gotten as far as we've gotten because of the family farmers, and the ranchers, and those small businesses that want to pass down their businesses from generation to generation.

However, we are in a very different economic situation than we were back in 2017 because of the deficit, and because we have a lot of populist Republicans that care far less about the political donors and far more about middle America. So I think we will have a bonus. It's hard for me to see how we're going to have a bonus as rich as we currently have, given that the politics have changed, and our economic situation has changed.

Warren Racusin: We've talked about a lot of high policy here. Give us a couple of real-world, nitty-gritty tidbits. What happens in those back rooms at 3:00 in the morning in the Capitol when the sausage is being made?

Sandra Swirski: I think you'd be surprised to learn that those that are really deferred to are the staff. Members of Congress, for the most part, work at very high levels. They work with talking points, they work with index cards that they keep in their pocket. So when an issue that is on their index card in their pocket comes up, they whip it out and say, "I care." Then they turn to their staff and say, "Remind me why I care, and remind me of the talking points that I need to influence my peers." That's what happens, and that's what happens at 2:00AM in the morning.

The other thing that folks probably understand, and I know Beth knows this for sure, is that Congress has this internal tax department called the Joint Committee on Taxation, and those are the folks that are up at 2:00AM that

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are also very important to the details around tax reform, and the details around how it's crafted. So members of Congress like to puff up their chests and say, "I've done it again for my constituents. Yet, the power is really behind the throne."

It is with the Joint Committee on Taxation. It is with the staff of these members, and the committee staff, and those that are the tax lawyers who support these members of Congress. So that is why, while members of Congress are critically important because they vote, so much time influencing Capitol Hill is done with staff that are behind the scenes, hard to get know, and are more invisible than members of Congress.

Warren Racusin: Though a lot of the lobbying happens at the staff level.

Sandra Swirski: Yeah.

Warren Racusin: Is that right?

Sandra Swirski: That's the dirty little secret. We love to go to fundraisers. We love to eat steak dinners. We love to hobnob. But if you're really going to win, you have to do it at the staff level because the devil's in the details, and if you're expecting a member of Congress to get those details right, you're going to be sorely disappointed.

Warren Racusin: You probably do know why lobbying is called lobbying, by the way?

Sandra Swirski: I believe it has a lot to do with the Willard Hotel down the street.

Warren Racusin: Lots to do with the Willard Hotel, yep.

Sandra Swirski: Tell us the story.

Warren Racusin: The Willard Hotel, some of you may know, is a very famous hotel across the street from The White House. Abraham Lincoln stayed there the night before he was inaugurated, and it's been a place where lots of people, famous and infamous, have spent the night. It has a beautiful lobby that's been restored, and if you go to Washington, you see it. It's really a beautiful lobby. Because it's so beautiful, back in the old days, maybe even now, congressmen and senators spent time having a drink and rubbing shoulders in the lobby, so people who wanted to influence them came to the Willard Hotel lobby to talk to them. Right?

Sandra Swirski: That's exactly right.

Warren Racusin: Right. On that, I don't know if it's a high note or low note or somewhere in between, we could talk a lot more, there's so much more to cover, but this has been so helpful. I think people are going to have a much better sense of what the stakes are, and how it really works. Stakes, S-T-A-K-E-S. Maybe the steaks also. But what the stakes are, and how this is going to go down.

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Sandra Swirski, Beth Kaufman, thank you both so much for a really good chat. Thanks to everybody at Lowenstein and at Good2BSocial who makes this possible. Thanks mostly to all of you who listen. We'll have another episode coming up real soon as we keep trying to make trusts and estates great again, and it'll be on a whole new topic because we're not going back. See you next time. Till then, as we say in these parts, have a good one.

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