

CONSIDER THE IMPORTANCE

Watching the Sunrise?

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In 2023, I authored an article titled *Watching the Sunset*, and it was a call to action for advisors and their clients to recognize the impending 2026 sunset of the estate and gift tax exemption and to plan accordingly. Too many people, I argued, were attempting to “wait and see” what would happen to exemption limits when we already knew they had a built-in expiration date (*i.e.*, the sunset).

Now that the results of the 2024 Election will mean a Republican-controlled House, Senate, and Presidency, many reflexive reactions claim that intervention for the sunset is mere months away. As is often the case, however, things may not be as simple as they seem.

THE BACKGROUND

To understand where we might be headed with the estate and gift tax exemption, we need to look at how we got to where we are – namely, why we are facing a “sunset” of the exemption in the first place. Usually if Congress passes legislation, it doesn’t have an expiration date, does it? Well, it can if the legislation comes about through a somewhat enigmatic process known as budget reconciliation.

Reconciliation was created in 1974 as a means of assisting Congress in meeting proposed levels of taxes and spending. Essentially, it is a “fast-track” legislative process designed to ensure that necessary fiscal decisions aren’t waylaid by partisan bickering or other potential delays. Bills in the Senate that are put forth through reconciliation receive exalted treatment, most notably that they cannot be filibustered and consequently the Senate can pass a bill with a simple majority.

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This privileged status is balanced by requirements that the contents of a reconciliation bill meet the test of what is now known as the Byrd Rule (after a former West Virginian senator). Under this rule, reconciliation legislation cannot include any items that have no fiscal bearing, cannot affect Social Security spending, and cannot increase long-term deficits, and it is that last requirement that set the stage for the sunset of the estate and gift tax exemption.

You may have heard that the sunset will equate to cutting the current exemption level in half, and that is effectively true because the exemption was *doubled* in the first place by the 2017 Tax Cuts and Jobs Act (TCJA). Simple mathematics dictates that increasing the exemptions (thereby decreasing the number of estates that would pay taxes) would lead to an increase in the federal budget deficit. But, if said deficit increase were only in the short-term, it would not run afoul of that particular prong of the Byrd Rule. Thus, the estate and gift tax exemption provisions of the TCJA had a built-in expiration date: December 31, 2025, otherwise known as the sunset.

WHY DOES THIS MATTER?

The most direct consequence of all this background is that the incoming Senate – even with a 3-seat majority – would need to pass its major partisan legislative goals via reconciliation. With a host of “Day 1” campaign promises (taxes, tariffs, immigration, etc.), it is unclear whether Senate Republicans might choose to prioritize some issues over others, as trying to accomplish all or most of its goals in one mega-bill may be too administratively complex and risk unnecessary delay.

Furthermore, when reconciliation has been used in the past, it has been to the tune of one bill per fiscal year¹. If other issues take precedence over extending the exemption limits of the TCJA, then the earliest Senate would feasibly attempt another reconciliation bill would be after October 1, 2025 (the beginning of a new fiscal year). Could they manage to pass intervention prior to the sunset occurring just 3 months later?

Finally, and most importantly, presuming the Senate does enact some form of intervention for the higher exemption limits (or, conceivably, a re-creation of them after the sunset has occurred), this too would likely have to come about through a reconciliation bill. If so, for the reasons expressed above such a bill would likely *also* have to have a built-in expiration date to comply with the Byrd Rule, meaning that end result would be the proverbial kicking of the can down the road, and we will be preparing for yet another sunset in the future.

¹ Technically, reconciliation allows for three bills – one each regarding revenue, spending, and the debt limit – but historically these three topics have been addressed in one comprehensive bill within a fiscal year.

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WHERE DO WE GO FROM HERE?

In terms of the sunset and trying to predict what will happen in Washington in the coming weeks and over the next few years, one's guess is as good as any. The lesson to be learned is that matters such as the estate and gift tax exemption seem destined to have an air of uncertainty in the short term and an impermanence in the longer term. The guidance for planning should, however, remain the same: if clients are capable of making large legacy gifts, then that is a strategy that should be explored. For clients who can't readily do so, their estate and legacy plans should be monitored for optimal efficiency, and their advisors should invest time in strategies that deliver sound planning results regardless of whether the sun is rising or setting.

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