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Counseling Your Estate Planning Clients about Tax Law

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Most estate planning attorneys aren't versed in the nuances of the tax code and don't necessarily need to be. The average client walks into an initial estate planning meeting with two main goals: (1) avoid probate and (2) control where their assets go and how fast they get there. Very rarely do I meet with a client who asks me about the tax implications of their estate plan, other than maybe the general question, "Will my kids pay taxes on all of this?" And for that reason, not every client I see needs a primer on the tax implications of their estate plan because there aren't many, if any. Our run-of-the-mill revocable trust package is going to pay out immediately to the kids at their parents' death and is nowhere near the estate tax threshold; boring the client with a bunch of "what if" tax facts isn't always prudent. So, how do we know when clients need tax advice sprinkled in with their estate planning?

I know that two types of estate plans will necessitate tax discussions in the planning meeting, if not in the estate plan itself. When clients have a net worth of $5 million dollars or more, we must discuss the estate tax exemption and the future for planning. These high-net-worth clients need to be taking steps to include estate tax planning in the overall estate plan. Clients with retirement accounts and income-producing property also require discussions of how those assets will impact the beneficiaries' income tax liability and how we can structure the plan with that in mind. I like to make sure my clients, whether estate planning or probate and trust administration, have a general knowledge of how taxes will be impacted at each step. Estate planning and tax law are intertwined more than we realize, and below, we will discuss when we need to bring more attention to the tax aspect of an estate plan.

Estate Planning and Estate Tax Planning

When working with a client whose net worth is nearing $5 million, I always try to have a conversation about the estate tax and the coming sunset of the estate tax exemption in 2026. As of January 1, 2026, the current estate tax exemption, $11 million adjusted annually for inflation, is set to roll back to pre-2017 exemption amounts. Without congressional action, we know the exemption is going to revert to $5 million (adjusted with inflation, it will probably end up around $7 million), and I like to make sure those clients have at least a basic understanding, especially if they are younger clients. While it might not need to be the main focus of their current estate plan, they definitely need to be aware of and understand that the estate tax is something we can easily plan for when they are on the cusp of a taxable estate.

Another concept that I like to mention to clients with a net worth hovering around $5 million to $10 million is portability. Portability allows the surviving spouse to inherit the unused estate tax exemption amount from the deceased spouse. If one spouse dies and does not use their entire exemption amount, the surviving spouse is allowed to "port" the remaining exemption into their estate, adding it to their own personal exemption amount. Portability has the potential to benefit your clients, and it is important to consider how this could be utilized and how planning might look different for someone with a taxable gross estate than it would for someone under the exemption amount.

It might be necessary to use a qualified terminable interest property (QTIP) election if we have limitations on what we want the surviving spouse to have access to. QTIP election is a tax strategy that allows a person to leave assets to their surviving spouse in a trust, whereby the surviving spouse receives income from the trust during their lifetime; when the spouse passes away, the remaining assets then pass to other beneficiaries, such as children from a prior marriage. The assets in the trust qualify for the marital deduction, deferring estate taxes until the surviving spouse's death. This ensures that the spouse is financially supported while preserving assets for the ultimate beneficiaries.

Funding a marital trust and a credit shelter trust might even be advisable under such circumstances; this hasn't been as necessary with the current exemption amounts so high. As planners, we must also ensure that the trustee or executor has the authority to make the portability election on IRS Form 706, Estate Tax Return. For estate planners who do not handle much estate tax planning, cultivating an understanding of the 706 isn't the easiest chore, but for portability purposes, it is an invaluable concept. We must file a Form 706 to elect portability (and make a QTIP election, for that matter), and failure to file the form will result in losing portability. However, the IRS does allow for an abbreviated 706 when you are filing solely for portability purposes. The IRS has even extended the time to file the "portability 706" to five years after the date of death. Let this be your reminder: If you have any clients who have passed in the last five years while the exemption has been high, you might want to contact their surviving spouses to see if it would be in their best interests to file a 706 to elect portability (Rev. Proc. 2022-34). Locking in $11 million to $13 million worth of exemption isn't a bad idea if you know they are likely to have, at minimum, a $7 million to $10 million estate. While the exemption is so high, I like to make sure my older clients understand the importance of portability and making that election when the first spouse passes. While they may not have a taxable estate in 2024, they could easily have one in 2026, and we want to make sure they understand that we can lock in the first-to-die spouse's exemption amount, whatever it may be.

While estate tax planning isn't the first goal on my mind for a lot of my estate planning clients, it is one that you cannot miss if you see a net worth creeping into the range of $5 million or higher. When you are gathering information from your client in the planning phase, it is so important to understand all their assets, not just the few they remember to mention. Just because it is not an asset that is going to flow through the trust we are creating doesn't mean it shouldn't be discussed. I like to ask for a personal financial statement or even last year's tax return to make sure they aren't forgetting to mention assets. I know we all have had cases where individuals forgot they were a silent partner in a company or didn't think their rental property needed to be included. You do not have to be a CPA to be able to read a tax return and determine where their income is sourced from and if they are taking business deductions.

Estate Planning and Income Tax Considerations

Although not every client will need estate tax planning, most will have some kind of income tax consideration worth discussing. One of the more common factors to consider is the income tax implications of their retirement accounts. After the Secure Act and Secure Act 2.0, how we treat retirement accounts in estate planning is slightly different than it was before.

Retirement accounts are a common asset for even the simplest estate, so I usually like to remind clients that distributions from a retirement account (assuming it is not a Roth IRA), regardless of who inherits it, will be taxable income to the recipient. We, as planners, can do our best to understand their overall goals and make sure we are using strategies to limit the impact of those income taxes. We need to make our clients aware that leaving the retirement account to a surviving spouse, minor child, or disabled dependent (all known as eligible designated beneficiaries under the Secure Act) allows the recipient to have a more favorable distribution timeline, whereas leaving it to a trust or outright to anyone not in that category will require the recipient to take the total distribution in ten years (or potentially five years). Planning for this might be as simple as moving around which assets should go to which beneficiaries based on the client's overall goals. If you have a charitably inclined client, you might also discuss using the retirement account to fund that bequest because charities will not have to pay any income tax on the distributions.

Many clients do not consider the tax basis of the property they leave to the next generation. This is a simple income tax concept that, again, might not matter to a lot of clients, but for those with highly appreciated assets, it is worth noting. I like to explain that anything the client holds until death is going to receive a stepped-up basis to fair market value at the time of their death. This is a very important concept when you have a client who is inclined to gift assets other than cash during life. I want to make sure they understand that gifts during life hold onto the basis the grantor had at the time of the gift. While it might not necessarily be a tax issue for the grantor, it could potentially create tax considerations for the grantee.

If a father has held onto the farmland he bought in 1970 for $20,000 and wants to give it to his son, who has been working the farm for 33 years, that is an asset we would strongly suggest holding until death. Today's fair market value of that land might very well be $500,000 or more, and the son will receive a $20,000 tax basis in that land if the father gifts it during his life. If he holds onto it until death, his son is going to receive a stepped-up basis to $500,000, or whatever the fair market value is at the date of the father's death. Should the son decide he wants to pursue his dreams as a country music star in Nashville and sell out after Dad dies, he isn't going to have to pay capital gains on $480,000 upon that sale. This isn't always practical for every client but is worth bringing up in the estate plan.

In the administration phase, the income tax implications of an estate plan can get very complicated very quickly. While I do not recommend breaking down every nuance of trust and estate accounting and tax filings for the client, it is important to give them a general idea that their estate plan is not tax free.

Estate Planning and Taxes Generally

It has come to my attention recently that a lot of people just do not understand how taxes work in general once someone has passed and we are administering the estate plan. Whether everything is passing outside of probate or within the probate sphere, most people do not understand how income taxes and estate taxes work for the decedent or the beneficiaries. Lately, I have been seeing a lot of clients who were adults in 1985 when the estate tax was as low as $400,000; as recently as 2002, it was only $1 million. Because of this, I hear time and time again that "death taxes" will take most of their inheritance. The relief you can give someone when you tell them that estate taxes are not an issue in their estate is always great.

The issue isn't limited to estate taxes. I have seen numerous beneficiaries who are unaware that the assets they inherit aren't inherently (pun intended) tax free. I even received a call from my best friend last month, aghast that she needed to file a tax return for the trust she received from her grandfather. We had discussed the tax implications of all the assets she had inherited numerous times, but for someone outside of the field, it can be a difficult notion to comprehend. So, it is important as planners and administrators that we explain to our clients that beneficiaries might have income tax consequences for the assets they inherit, especially if they are income-producing assets. For example, clients need to be told that upon the first spouse's death, if their revocable trust becomes irrevocable, they will more than likely need to get an employer identification number (EIN) for the trust, and so forth. Our trustees, personal representatives, and executors need to be reminded that trusts and estates might require an income tax return and that someone needs to file the decedent's final tax return. I have even started including these items in a checklist I prepare for our administrators, just so it is on their radar.

Clients Don't Know What They Don't Know

Everyday estate planning goals can and should continue to be the first and foremost focus with clients as we have these tax conversations; that is why they come to us in the first place. But I find keeping a few key triggers in mind that might lead to a more detailed tax discussion to be very helpful. We must often remind ourselves that clients don't know what they don't know and that it is our job to educate them on all aspects of their estate plan, not just the documents we draft but their practicality as well.

Jessica Witherspoon is a partner at Davidson Law Firm in Little Rock, Arkansas. Her main focus is estate planning, business law, and tax planning. Witherspoon graduated from the University of Arkansas at Little Rock William H. Bowen School of Law in 2019 and went on to the University of Florida Levin School of Law for her LLM in taxation and graduated amid the pandemic. She enjoys working with clients to identify the needs that they might not even know they have and finding answers to those needs. Her husband likes to tell people that her main job is solving people's problems, and she couldn't agree more.