YEAR-END ESTATE PLANNING UPDATE

Date: 21 November 2022

U.S. Estate Planning and Trusts and Estates Alert

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As the end of the calendar year approaches, we would like to remind our clients of some year-end estate planning ideas to consider.

A person can currently make annual gifts of up to US$16,000 per recipient to an unlimited number of individuals free from any gift tax. For a married couple splitting gifts, this allows for annual tax-free gifts of up to US$32,000 per recipient. Because these gifts are within this so-called annual exclusion amount, the gifts do not reduce the taxpayer's lifetime federal estate and gift tax exemption. These annual exclusion gifts are an effective way to pass wealth to family members or others free from estate or gift taxes as well as reduce one's asset base that will be subject to estate tax at one's passing. All gifts made outright can qualify for this annual exclusion, and certain gifts made to a beneficiary in trust can also qualify for the annual exclusion if properly structured.

The annual exclusion is renewed each year, but one cannot apply last year's annual exclusion amount to this year's gifts. For persons planning to make annual exclusion gifts this year, the gifts must be completed by December 31.

In 2023, the annual gift tax exclusion amount will increase to US$17,000 per recipient (or up to US$34,000 for a married couple).

FEDERAL ESTATE TAX, GIFT TAX, AND GENERATION-SKIPPING TAX EXEMPTIONS

The lifetime federal estate and gift tax exemption is the combined amount one can transfer either during life without triggering a current gift tax or upon death free from estate tax. (In all events, transfers to U.S. citizen spouses and qualified charitable organizations are not generally subject to tax.) Lifetime gifts other than those that qualify for the annual exclusion described above will reduce the amount of estate tax exemption available at death for one's estate on a dollar-for-dollar basis. Currently, the lifetime exemption stands at US$12,060,000 per taxpayer estate. In 2023, the federal exemption for estate and gift taxes will increase by US$860,000 to US$12,920,000 per taxpayer. Gifts and estates in excess of the exemption amount are subject to a 40% federal gift or estate tax.

The federal generation-skipping transfer tax exemption will also increase to US$12,920,000 per taxpayer in 2023. Generation-skipping transfer tax, or GST tax, is a separate transfer tax that applies to transfers to individuals two or more generations below the original transferor.

Because lifetime transfers are often more effective at reducing estate taxes than transfers that occur upon one's passing, the large increase in the lifetime exemption in 2023 should offer opportunities for further and effective estate planning, particularly for families that have already made significant lifetime taxable gifts. In addition,

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because the State of Washington imposes no gift tax whatsoever, those lifetime gifts will also remove the assets from the Washington estate tax altogether.

Under the 2017 Tax Cuts and Jobs Act, the lifetime federal gift, estate, and generation-skipping transfer tax exemptions were temporarily doubled from their prior limits. This doubling of the exemptions will expire after 2025, at which point the exemptions will be one-half of their then current limits subject to applicable inflation adjustments. While Congress could vote to extend or make permanent the current exemption amounts, this would require an affirmative act of Congress. As a result, taxpayers may wish to consider strategies through lifetime gifts outright or in trust to lock in the current higher exemptions (including the annual inflation adjustments) before the end of 2025 when the exemptions may be reduced by one-half.

WASHINGTON STATE ESTATE TAX EXEMPTION

In 2023, the Washington State estate tax exemption is currently set to remain at US$2,193,000 per taxpayer—the same rate as 2022. This is the amount that a Washington resident can leave at death to beneficiaries without incurring a Washington estate tax. (There is no estate tax on transfers to U.S. citizen spouses or qualified charitable organizations.) The assets of one's estate in excess of this exempt amount are taxed at graduated rates from 10% to 20%. Generally, real estate and tangible personal property located outside of Washington are not subject to tax. Conversely, for estates of nonresidents of Washington, the tax generally applies only to real estate and tangible personal property located within Washington. The Washington estate tax is calculated separately from the federal estate tax.

Washington does not impose a gift tax on lifetime gifts, and those gifts do not reduce the amount of the Washington estate tax exemption available at death. Consequently, making lifetime gifts is often an effective strategy to reduce the value of one's taxable estate for purposes of the Washington estate tax.

The Washington law that allows for the state estate tax exemption to increase based on inflation is tied to a consumer price index that no longer exists. As a result, the Washington State estate tax exemption has not risen since 2018. There have been multiple attempts to update the law to tie the inflation adjustments to the new consumer price index, but none has passed to date.

Washington does not impose a generation-skipping transfer tax.

PLANNING OPPORTUNITIES

Please contact one of the attorneys in the K&L Gates Estate Planning & Trust and Estates practice group if you would like to discuss how these changes to the various transfer tax exemptions may impact your own estate plan and other planning opportunities that may exist. Please note that the exemption amounts referenced in this alert in general apply to U.S. citizens and resident aliens and will vary if you are a non-resident alien.

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