

# *34th Annual Tax Symposium*

## **YOU CAN'T TAKE IT WITH YOU, BUT UNCLE SAM CAN TAKE HIS CUT** **OVERVIEW OF FEDERAL TRANSFER TAXES**

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### **I. INTRODUCTION**

#### **A. Three components.**

##### **1. Gift tax.**

- a. Gratuitous transfers during life.
- b. Tax is generally imposed on the donor.
- c. “Unified” with the estate tax.

##### **2. Estate tax.**

- a. Gratuitous transfers on death.
- b. Tax is imposed on the estate.
- c. “Unified” with the gift tax.

##### **3. Generation skipping transfer or “GST” tax.**

- a. Gratuitous transfers during life or upon death to “skip” persons.
- b. Tax is imposed on donor, assets transferred, or donee.
- c. Coordinated with gift and estate tax.

#### **B. These three taxes are wealth transfer taxes and are imposed in addition to income taxes.**

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1. Often, the transferred assets have already been subject to income taxes.
  2. Income in respect of a decedent is subject to both income and estate (and possibly GST) tax on the decedent's death.
- C. The GST tax is imposed in addition to gift and estate taxes.
1. A gift to a grandchild during life or at death is subject to both gift/estate tax and GST tax.
- D. There are exemptions from each tax. Cumulative, gratuitous transfers below and up to the exemption amount reduce the amount of available exemption, but do not result in out-of-pocket tax payments.
1. Gift tax - \$13,990,000 during 2025.
  2. Estate tax - \$13,990,000 during 2025.
  3. GST tax - \$13,990,000 during 2025.
  4. Each exemption will be \$15,000,000 beginning in 2026.
    - a. Adjusted for inflation after 2026.
    - b. Unlike prior years, there is no "sunset" of these amounts.
    - c. Therefore, the exemptions stay at these amounts unless/until Congress changes them.
- E. There are exclusions from gift and GST tax.
1. Annual exclusion.
  2. Direct payments of tuition.
  3. Direct payments of medical expenses.

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## F. Valuation.

1. The valuation standard is “fair market value.”
2. Fair market value is the “price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts.”
3. Cash and marketable securities are easily valued.
4. How do you value real property, artwork, or interests in closely-held businesses?

## G. Tax rates.

1. Gift and estate tax rates are graduated. The tax rate increases as the value of the transferred property increases.

|    |                       |     |
|----|-----------------------|-----|
| a. | \$0 - \$10,000        | 18% |
| b. | \$10,000 - \$20,000   | 20% |
| c. | \$20,000 - \$40,000   | 22% |
| d. | \$40,000 - \$60,000   | 24% |
| e. | \$60,000 - \$80,000   | 26% |
| f. | \$80,000 - \$100,000  | 28% |
| g. | \$100,000 - \$150,000 | 30% |
| h. | \$150,000 - \$250,000 | 32% |
| i. | \$250,000 - \$500,000 | 34% |

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- j. \$500,000 - \$750,000 37%
  - k. \$750,000 - \$1,000,000 39%
  - l. Over \$1,000,000 40%
- 2. Applied on a cumulative basis, not a year-to-year basis.
  - a. In determining which bracket/rate applies, prior taxable gifts are taken into account.
  - b. E.g., if a donor's taxable gifts in prior years total \$1,000,000 and the donor makes a current gift of \$500,000, the tax rate applicable to the \$500,000 gift is the tax rate applicable to gifts over \$1,000,000.
- 3. The GST tax rate is fixed.
  - a. Equal to the highest gift/estate tax rate applicable at the time of transfer or other event triggering GST.
  - b. Currently 40%.

## II. GIFT TAX

- A. "The gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible."
  - 1. Does not apply to the extent consideration is received.
    - a. Bargain sales. Sale of property below FMV is treated as a part gift/part sale.
    - b. Retained interests. Where the donor retains a qualifying interest, the actuarial value of the interest retained reduces the value of the gift.

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E.g., grantor retained annuity trusts and qualified personal residence trusts.

2. Donative intent is not required.
  - a. A donor does not have to intend to make a gift in order to make a gift.
3. Applies to direct and indirect gifts.
  - a. Donor gives her daughter \$100,000. Donor has made a direct gift to her daughter.
  - b. Donor gives \$100,000 to a noncharitable corporation. Donor has made an indirect gift to the corporation's shareholders in proportion to the shareholders' ownership interests.
  - c. Corporation gives \$100,000 to A, who is not a shareholder. The corporation's shareholders have made an indirect gift to A in proportion to the shareholders' ownership interests.
4. Does not apply to "incomplete gifts."
  - a. There is no taxable gift if the donor has not relinquished complete dominion and control.
  - b. Donor makes a gift to an irrevocable trust, but the donor retains (i) the right to receive all trust income, (ii) the right to change beneficiaries, or (iii) the right to change the nature or extent of their beneficial interests.
  - c. In this case, the gift and all post-gift appreciation are brought back into the donor's taxable estate upon death.

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5. Donee takes the same basis as the donor in the assets given (so-called “carryover basis”).
  - a. This means there is no “step up” in basis on assets given away during life.
  - b. Unless the donor retained one or more “strings” that bring those assets back into the donor’s taxable estate upon death (e.g., beneficial interest or control), in which case there is a step up.
- B. The gift tax is “unified” with the estate tax.
  1. Gift tax exemption and estate tax exemption are tied to each other.
  2. Lifetime taxable gifts reduce the estate tax exemption available at death.
  3. If A dies in 2026 having made a taxable gift of \$1,000,000 in 2001 and a taxable gift of \$9,000,000 in 2022, A’s estate will have only \$5,000,000 of available exemption (\$15M less \$1M less \$9M).
- C. Exemption.
  1. \$13,990,000 for 2025.
  2. \$15,000,000 for 2026.
  3. Exemption is often used in connection with gifts to irrevocable trusts.
- D. Exclusions.
  1. These amounts are not treated as taxable gifts and do not use gift tax exemption.
  2. Annual exclusion.

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- a. \$19,000 per donee, per year. Donor can give up to \$19,000 per year to everyone on the planet without using any gift tax exemption.
  - b. Adjusted for inflation.
  - c. Must be a gift of a “present interest.” The donee must have immediate right to possession, use, and enjoyment of the gift.
  - d. A gift to an irrevocable trust does not qualify as a present interest, since there is no guarantee the trust beneficiary will have immediate possession, use, and enjoyment of the property given (the exact opposite is normally the case). “Crummey” withdrawal powers, which give a beneficiary an immediate right to withdraw all or a portion of the amount given, enable gifts to irrevocable trusts to qualify for the annual exclusion.
  - e. Gifts can be “split” with a spouse, thereby doubling the amount of the annual exclusion. If Spouse A gives \$38,000 to donee, Spouse B can join in the gift and the Spouses can treat the gift as having been made one-half by each and no exemption of either Spouse will be used.
  - f. A gift to a 529 account can be front-loaded up to five years and treated as though the gift had been made equally over those five years. However, if the donor dies during the five-year period, a portion of the gift is brought back into the donor’s taxable estate.
3. Tuition.
- a. Unlimited in amount.

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- b. Must be paid directly to the educational institution. Donor cannot use the exclusion if a check is written to the donee as reimbursement for the donee's payment of tuition.
    - c. Exclusion does not apply to room and board, fees, books, supplies, etc.
    - d. Tuition is narrowly defined.
  - 4. Medical expenses.
    - a. Unlimited in amount.
    - b. Must be paid directly to the medical provider. Does not apply if the donor reimburses the donee for payment of medical expenses.
    - c. Allowable expenses are fairly broad and include insurance premiums, prescription drugs, doctor visits, and procedures.
- E. Deductions.
  - 1. These amounts reduce taxable gifts and do not use exemption.
  - 2. Marital.
    - a. Unlimited in amount.
    - b. Applies to outright transfers.
    - c. Applies to certain transfers in trust (e.g., qualified terminable interest trusts or "QTIPs").
    - d. Is the donee spouse a United States citizen?
  - 3. Charitable.

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- a. Unlimited in amount.
- b. Applies to outright transfers.
- c. Applies to a portion of certain transfers in trust (e.g., charitable remainder unitrusts or “CRUTs”).
- d. Unlike income tax charitable deductions, eligible recipients include certain foreign charities.

## F. Reporting.

- 1. Donors report taxable gifts on IRS Form 709.
- 2. “Adequate disclosure” is required to start the statute of limitations period. Be sure to attach those trust agreements and appraisals.

## III. ESTATE TAX

- A. “A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.”
  - 1. Gross estate plus lifetime taxable gifts less exemptions, exclusions, and deductions.
  - 2. Assets valued at fair market value.
  - 3. Beneficiaries get a “step up” in basis in assets received from a decedent.
    - a. This can be a misnomer, because a beneficiary receives basis equal to fair market value as of date of death, which may be higher or lower than the decedent’s basis immediately prior to death (i.e., there can be a step down in basis).

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- b. Income in respect of a decedent (“IRD”), such as a traditional IRA, does not get a step up since the decedent would have been required to pay income tax.
- B. The estate tax is “unified” with the gift tax.
  - 1. Estate tax exemption is reduced by lifetime taxable gifts.
- C. Exemption.
  - 1. \$13,990,000 for 2025.
  - 2. \$15,000,000 for 2026.
  - 3. If a portability election was made on a deceased spouse’s estate tax return, the surviving spouse may be able to use the deceased spouse’s unused exemption (“DSUE”).
- D. Exclusions.
  - 1. Assets that were given away during life, including assets contributed to an irrevocable trust, are normally excluded from a decedent’s gross estate (unless the decedent retained one or more “strings”).
- E. Deductions.
  - 1. These amounts reduce the gross estate and do not use estate tax exemption.
  - 2. Marital.
    - a. Unlimited in amount.
    - b. Applies to outright transfers.

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- c. Applies to certain transfers in trust (e.g., qualified terminable interest trusts or “QTIPs”).
  - d. Is the surviving spouse a United States citizen?
- 3. Charitable.
  - a. Unlimited in amount.
  - b. Applies to outright transfers.
  - c. Applies to a portion of certain transfers in trust (e.g., charitable remainder unitrusts or “CRUTs”).
  - d. Unlike income tax charitable deductions, eligible recipients include certain foreign charities.
- 4. Debts.
  - a. Unlimited in amount.
  - b. Mortgages.
  - c. Credit cards.
- 5. Claims against the estate.
  - a. Lawsuits against the decedent.
  - b. Personal guarantees by the decedent.
  - c. Are they deductible?
  - d. In what amount?
- 6. Funeral expenses.

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- a. Services.
  - b. Markers.
  - c. Flowers.
  - d. Obituary.
- 7. Administrative expenses.
  - a. Executor, attorney, and accounting fees.
  - b. Costs of appraisals.
  - c. Expenses for the maintenance and protection of estate property.
  - d. Cannot deduct for both estate tax purposes and income tax purposes.
- F. Reporting.
  - 1. Executors of decedent's estates report on IRS Form 706.
  - 2. Executors also file IRS Form 8971 and provide a copy to beneficiaries to inform the beneficiaries of the income tax basis of the assets they receive.

## IV. GENERATION SKIPPING TRANSFER TAX

- A. "A tax is hereby imposed on every generation-skipping transfer."
  - 1. GST tax prevents gift and estate tax avoidance on gifts to certain (young) donees. The government wants its cut at each generational level.
  - 2. Wealthy families cannot avoid estate taxes by skipping a (wealthy) generation.

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3. Applies to lifetime gifts, transfers at death, and certain trust events.
- B. GST tax is a separate tax and is in addition to gift/estate tax.
- C. Skip persons. For GST purposes, we are only concerned with certain types of donees.
  1. Descendants who are two or more generations below the donor (e.g., a grandchild).
    - a. Predeceased parent exception.
    - b. A grandchild whose parent is deceased is not a skip person with respect to the mother and father of the deceased parent.
  2. Unrelated donees who are more than 37.5 years younger than the donor.
  3. GST trust. These are trusts under which beneficial interests are primarily held by persons described in 1 and/or 2 above.
- D. Generation skipping transfer.
  1. Direct skip.
    - a. Direct gift or bequest to a skip person.
    - b. Grandparent gives \$100,000 during life or upon death directly to a grandchild.
    - c. Donor/donor's estate pays the GST tax.
  2. Taxable distribution.
    - a. Trust makes a distribution to a skip person.
    - b. Trust distributes \$100,000 to the grantor's grandchild.

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- c. Grandchild pays the GST tax.
  - 3. Taxable termination.
    - a. The interests of all nonskip persons in a trust terminate.
    - b. Dynasty trust for the benefit of children and grandchildren and the last living child dies, leaving only skip persons as beneficiaries (regardless of whether any assets are distributed outright from the trust at that time).
    - c. Trust pays the GST tax.
- E. Exemption.
  - 1. \$13,990,000 for 2025.
  - 2. \$15,000,000 for 2026.
  - 3. Exemption is often applied to gifts to irrevocable trusts that are designed to benefit grandchildren or more remote descendants.
- F. Exclusions.
  - 1. These amounts are not treated as taxable gifts and do not use GST tax exemption.
  - 2. Annual exclusion.
    - a. \$19,000 per donee, per year.
    - b. Adjusted for inflation.
    - c. Be careful, because the GST annual exclusion is somewhat different from the gift tax annual exclusion.

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- d. A gift to a trust with Crummey withdrawal powers does not necessarily qualify for the annual GST exclusion. Instead, the gift must be made to a trust under which the skip person is the sole beneficiary and the assets must be included in the skip person's estate for estate tax purposes.
- 3. Tuition – same as the gift tax exclusion.
- 4. Medical expenses – same as the gift tax exclusion.
- G. Reporting.
  - 1. Report GST events on IRS Form 706 or 709, depending on the GST event.
  - 2. Be mindful of automatic allocations of GST exemption.
  - 3. Trusts may end up only partially exempt from GST (i.e., have an “inclusion ratio” of more than zero).