Dalton Education
BY CERIFI

The Dalton Review®
Estate Planning

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Estate Planning

- The process of accumulation, management, conservation, and transfer of wealth considering legal, tax, and personal objectives
- Goals
  - Effective Transfers
    - Decedent’s assets are transferred based on his wishes
  - Efficient Transfers
    - Transfer costs including taxes are minimized.
    - Maximize net to heirs

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The Unauthorized Practice of Law

- Certain activities are clearly reserved for attorneys (drafting legal documents)
- Must be licensed attorney in jurisdiction where practice is occurring
- Planner should refer client to licensed attorney for legal advice

Important Definitions

- Decedent – A deceased person
- Heirs – People who inherit under state laws
- Legatees – People who inherit under the will
- Donor – Person who gives a gift
- Donee – Person who received the gift
- Abatement – reduction of bequest
- Ademption – extinguishment of a right

Basic Documents

- Will
  - Avoids intestacy
  - Age 18 and of sound mind
- Durable General Power of Attorney
- Durable Power of Attorney for Health Care (to keep principal alive)
  - In writing, survives disability but not death
- Advance Medical Directive
  - Power to terminate life sustaining treatment

Types of Wills

- Holographic Wills (In own hand)
  - Written in testator's handwriting
  - Must be signed and dated by testator
- Noncupative Wills (Usually only covers tangible personalty)
  - Oral
  - Dying declarations made before sufficient witnesses
  - Not valid in all states
- Statutory Wills
  - Generally drawn by an attorney, complying with the laws for wills of the domiciliary state

Selected Will Provisions

- Survivorship Clause
  - Requires the beneficiary to survive the decedent for a specified period of time in order to inherit
    - Cannot be longer than six months for transfer to qualify for unlimited marital deduction
- Disclaimer Clause
  - Reminds heir they may disclaim and the clause may direct who inherits if they do disclaim

Selected Will Provisions
Rules to Disclaim

- Rules to disclaim:
  - Disclaiming party cannot have benefited
  - Must be made in writing within (9) months
  - Person disclaiming can't direct disposition of property
- Surviving spouse may disclaim so more assets go to kids and the applicable estate tax credit is utilized
- Kids may disclaim so that the surviving spouse may inherit to utilize the marital deduction

Power of Attorney and Appointment

- Power of Attorney
  - A stand-alone document that allows an
  - agent to act for the principal and may
  - include the power to appoint assets
  - Power to act
  - Ends at the death of the principal
  - May be general or limited
  - May be revoked at anytime by the principal
- Used for health care or property management

- Power of Appointment
  - A power, usually included in a trust or power of attorney, allowing the power holder to direct assets to another (eg pay bills)
  - Power to transfer assets
  - May survive the death of the grantor
  - May be general or limited to an ascertainable standard or limited in some other way
  - May be revoked at anytime by the principal

Powers of Attorney – Exam Info

- All POAs cease at death
  - Exam questions may be structured to see if you know whom you work for. Once the principal dies the accounts will be frozen until the estate administrator brings the letters testamentary to gain control over the accounts
- Planners are not required to recognize the POA
  - If the agent requests an action that is harmful to the principal, the planner can refuse to take action
    - Contacting the compliance department is also a good answer choice for these types of questions

Practice Question 1

___ Causes inclusion of assets in holder's gross estate
___ Will not cause inclusion in holder's gross estate
___ Used in a non-marital trust
___ May be used in a marital trust

A. General Power
B. Limited Power
C. Power of Attorney
D. B & C

Practice Question 2

___ Can Be Revoked
___ Survives Disability
___ Survives Death

A. Will
B. Durable Power of Attorney for Healthcare
C. Advanced Medical Directive
D. All

Methods to Transfer Property at Death

- Operation of Law
- Contract
- Trust
- Probate
  - Will
  - Intestate
  - Estate named as beneficiary

Probate

- Process of retitling assets
- Advantages
  - Clear title
  - Open orderly legal process
- Disadvantages
  - Costly
  - Delays
  - Publicity

Does NOT Avoid Probate

- No Survivorship Feature or,
- No Beneficiary Listed
  - Examples:
    - Sole Ownership Property
    - Tenancy in Common Property
    - Community Property
    - Invalid or no named beneficiary designations

Avoids Probate

- State contract law
  - Life insurance
  - Annuities
  - IRAs, SEPs, SIMPLEs, & qualified plans
  - Pay-on-Death (bank accounts) & Transfer-on-Death accounts (investment accounts)
- State titling law-if survivorship feature
- State trust law-all trusts

Exam Tip: Non-traditional (non married) relationships should always avoid probate.

Types of Property

- Sole Ownership
  - One owner
- Tenants In Common
  - Two or more undivided interest
- JTWROS
  - Two or more undivided interest with survivorship rights
  - Avoids probate
- Tenants In Entirety
  - Married couple with survivorship
  - Avoids probate
- Community Property
  - Married undivided interest, with no survivorship, no gift splitting
  - Fruits are separate or are community property
  - Step to FMV on both halves

Property Ownership Key Features (Summary 1 of 2)

Ownership Type	Sole Ownership	Tenants in Common
Number of Owners	1	2 or more
Survivorship Feature	No	No
Included in Probate	Yes 100%	Yes % owned
Included in Gross Estate	Yes	Yes
Qualified for Marital Deduction	If spouse	If spouse
Partitionable Involuntarily	N/A	Yes
Step to FMV at Death	Yes	%
Actual Contribution Rules	N/A	Yes
Deemed Contribution Rule	N/A	No

Property Ownership Key Features (Summary 2 of 2)

Ownership Type	JTWROS	Tenancy by the Entirety	Community Property
Number of Owners	2 or more	2	2
Survivorship Feature	Yes*	Yes*	No
Included in Probate	No	No	50%
Included in Gross Estate	Yes	Yes	50%
Qualified for Marital Deduction	If spouse	Yes	If spouse
Partitionable Involuntarily	Yes	No	No
Step to FMV at Death	%	%	100%
Actual Contribution Rules	Yes (except spouse)	No	No
Deemed Contribution Rule	Yes (if spouse)	Yes	Yes

*with certified death certificate

Practice Question 3

Alan and Beatrice are married and bought their personal residence for $200,000 some years ago. The current FMV is $500,000. Alan died recently and his will leaves everything to Costa (his child).

Assuming that the residence was titled tenants by the entirety, in a common law state. How much will be included in Alan's gross estate and what will be the tax basis of Beatrice?

A. $100,000 & $100,000
B. $200,000 & $200,000
C. $250,000 & $200,000
D. $250,000 & $350,000

Practice Question 4

Anna and Beauregard are married and bought their personal residence for $200,000 some years ago. The current FMV is $500,000. Anna died recently and her will leaves everything to Constance (her child).

Assume that the property was community property. What is included in Anna's gross estate and what is Beauregard's basis after the death?

A. $200,000 & $100,000
B. $250,000 & $500,000
C. $250,000 & $250,000
D. $500,000 & $500,000

Parties to a Gift

- Donor (person who makes a gift)
  - Must be competent to make the gift
  - Must have intent to make a voluntary transfer
- Donee (person who receives a gift)
  - Must be competent to receive the gift
  - Must take delivery
  - Must accept the property

Gifts

- Gift taxes are based on FMV at date of gift
- Normally the donor is responsible for all gift tax
- A net gift is a gift made on the condition that the donee pay any gift tax due
  - The donor will have taxable income to the extent that any gift tax paid by the donee exceeds the donor's adjusted basis in the property

Calculating "Taxable Gifts" (1 of 2)

- Assumes all gifts are present interest gifts

Value of Gift	Split	- Annual Exclusion	- Marital Deduction	- Charitable Deduction	= Taxable Gift
Son $118,000		- $18,000	x	x	= $100,000
Spouse $58,000		- $18,000	- $40,000	x	= $0
Charity $78,000		- $18,000	x	- $60,000	= $0
					Total Taxable Gifts = $100,000

Calculating "Taxable Gifts" (2 of 2)

- Assumes all gifts are present interest gifts (with gift splitting)

Value of Gift	Split	- Annual Exclusion	- Marital Deduction	- Charitable Deduction	= Taxable Gift
Son $118,000	$59,000	- $18,000	x	x	= $41,000
Spouse $58,000	N/A	- $18,000	- $40,000	x	= $0
Charity $78,000	$39,000	- $18,000	x	- $21,000	= $0
					Total Taxable Gifts = $41,000

Split Gifts

- Married spouses can elect to split gifts effectively doubling the annual exclusion to **$36,000 (for 2024)**
- Requires gift tax return (Form 709)
- Must be elected for all gifts for that year
- Only counts for the time they were married
- No gift-splitting for community property (no returns needed)

Gift Tax Issues

- Election to Split Gifts for Year of Death
  - Code allows a surviving spouse to elect to split the gifts made by the decedent in the decedent's final tax year
  - In return, the executor can consent for the decedent to split gifts
  - The spouses must have been married at the time of the gift
  - The surviving spouse cannot remarry in the year in which a split gift with the decedent is desired

Annual Exclusion

- All individuals may gift up to **$18,000 (for 2024)** tax free per donee each year (adjusted for inflation).
- Gift must be a present interest in order to qualify for annual exclusion
- Use it or lose it!
- Non-U.S. citizen spouses
  - "Super Annual Exclusion" = **$185,000 (for 2024)**

Gifts of a Present and Future Interest

- Present Interest
  - Unrestricted right to the immediate use of the property
- Future Interest
  - Interest that is limited in some way to a future date or time
  - Donee's right to the property is contingent upon some future date or time
  - Example
    - Remainder beneficiary of a trust

Crummey Provision

- Creates a present interest in a trust which then qualifies the contribution to the trust for annual exclusion
- Allows the trust beneficiary to withdraw some or all of any contribution to a trust for a limited period of time to create a present interest

Unlimited Marital and Charitable Deductions

- Marital Deduction
  - Unlimited marital deduction allows for unlimited transfers between married people without gift tax
  - Spouse must be a U.S. citizen
- Charitable Deduction
  - Unlimited gift tax deduction for gifts to qualified charities

Applicable Exclusion Amount

- Each person also has one lifetime credit equivalency amount up to **$13,610,000 (2024)** of cumulative taxable transfers
- Equals a credit against tax of **$5,389,800 for 2024**
  - Gift and estate taxes are a cumulative lifetime tax
- Credit is calculated as:
  - First 1 million = $345,800 in taxes due (Estate and Gift tax rates table, slide 31) You will need to memorize this number
  - Amount over 1 million is taxed at 40% (12.61m x 40% = 5.044m)
  - To arrive at the credit: 5,044,000 + 345,800 = 5,389,800

Form 709 – Gift Tax Return

- Must be filed – April 15 of the following year.
- Can be extended by extending income tax return
- The donor is primarily liable for gift tax but the donee can become responsible if the donor does not pay

Not provided on the CFP® Exam – must know!

Estate and Gift Tax Rates

Taxable Gifts/Estate are...	Then Tentative Gift/Estate Tax Equals...
Over \$0 but not over \$10,000	18% of such amount
Over \$10,000 but not over \$20,000	\$1,800 plus 20% of the excess of such amount over \$10,000
Over \$20,000 but not over \$40,000	\$3,800 plus 22% of the excess of such amount over \$20,000
Over \$40,000 but not over \$60,000	\$8,200 plus 24% of the excess of such amount over \$40,000
Over \$60,000 but not over \$80,000	\$13,000 plus 26% of the excess of such amount over \$60,000
Over \$80,000 but not over \$100,000	\$18,200 plus 28% of the excess of such amount over \$80,000
Over \$100,000 but not over \$150,000	\$23,800 plus 30% of the excess of such amount over \$100,000
Over \$150,000 but not over \$250,000	\$38,800 plus 32% of the excess of such amount over \$150,000
Over \$250,000 but not over \$500,000	\$70,800 plus 34% of the excess of such amount over \$250,000
Over \$500,000 but not over \$750,000	\$155,800 plus 37% of the excess of such amount over \$500,000
Over \$750,000 but not over \$1,000,000	\$248,300 plus 39% of the excess of such amount over \$750,000
Over \$1,000,000	\$345,800 plus 40% of the excess of such amount over \$1,000,000

Calculation of Gift Tax

- Cumulative Gift Tax Calculation
  - Year 1 (2023): Taxable Gift of $3,000,000
  - Year 2 (2024): Taxable Gift of $11,000,000
- Answer:
  - Year 1: No Tax Due (under the lifetime exemption)
  - Year 2: $390,000 over the lifetime exemption
    - $11,000,000 + 3,000,000 (previous gift) = $14M
    - $5,545,800 (Tentative Tax)
    - ($5,389,800) (Credit)
    - $156,000 Tax Due

Gifting Strategies (Slide 1 of 3)

- Achieving client goals with direct gifts
  - Effective and efficient
- Gifts of appreciating property
  - Removes appreciation and transfer taxes from net worth
  - Reduces future gross estate
- Gifts to spouses
  - Often used to equalize the estates
- Gifts to minors
  - May need trusts or custodial accounts

Gifting Strategies (Slide 2 of 3)

- Single party strategies
  - Rarely wise to gift cash
  - The donor should prepare a current balance sheet with a forecast of what is likely to appreciate the most
  - Transfer the asset likely to appreciate the most
  - This will remove highly appreciating assets from the donor's gross estate and the appreciation will occur in the hands of the donee
  - Unless the donor is very close to death, such a strategy should generally be superior to receiving a step up in basis for transfers at death

Gifting Strategies (Slide 3 of 3)

- Multi-party strategies
  - Never gift property in a loss position…sell it instead
  - Gift property with the greatest appreciation potential to the youngest donee
  - Gift appreciated property to charities to avoid the capital gain taxes
  - Gift income-producing property to the donee in the lowest marginal income tax bracket so that the income is subject to the lowest possible income tax

Practice Question 5

Assume Mike, age 50, wants to gift $35,000 to each of his mom, his son, his alma mater, and his lifelong girlfriend who is the same age. Which assets below should he gift to whom?

	Asset	FMV	Basis	Yield	Holding Period	Expected Appreciation Rate
A	Stock	$35,000	$42,000	0	LT	3%
B	Stock	$35,000	10,000	3%	LT	6%
C	Bond	$35,000	$35,000	7%	LT	1%
D	Stock	$35,000	$28,000	1%	ST	12%
E	Real Estate	$35,000	$34,000	1%	LT	4%

___ Alma Mater ___ Son ___Mother ___Girlfriend

Advantages of Lifetime Gifts vs. Bequests

- Advantage to lifetime gifting
  - Ability to use annual exclusion
  - Gifting appreciating assets out of the estate
  - Any future income from property gifted is taxable to donee

The Gross Estate

(1)	Gross Estate		$__________	Gross Estate
	Less: Deductions from the Gross Estate			
(2)	Last Medical Expenses	$__________		
(3)	Administrative Expenses	$__________		
(4)	Funeral Expenses	$__________		
(5)	Debts of the Decedent	$__________		
(6)	Losses Incurred During the Administration of the Estate	$__________	$__________	Total Deductions from the Gross Estate
(7)	Equals: Adjusted Gross Estate		$__________	Adjusted Gross Estate
(8)	Less: State Death Tax Deduction	$__________		
(9)	Less: Unlimited Charitable Deduction	$__________		
(10)	Less: Unlimited Marital Deduction	$__________		
(11)	Equals: Taxable Estate		$__________	Taxable Estate
(12)	Add: Previous (post 1976) Taxable Gifts		$__________	Post-1976 Gifts
(13)	Equals: Tentative Tax Base		$__________	Tentative Tax Base
(14)	Tentative Tax		$__________	Tentative Tax
	Less: Allowable Credits			
(15)	Credit for Previous Gift Tax Paid	$__________		
(16)	Applicable Estate Tax Credit (Unified Credit)	$__________		
(17)	Credit for Tax Paid on Prior Transfers	$__________		
(18)	Foreign Death Tax Credit	$__________	$__________	
(19)	Equals: Federal Estate Tax Liability		$__________	

Note: An additional credit may be available for gift tax paid before 1977. The state death tax credit may be available for years before 2005.

The Gross Estate

- Includes the fair market value at the date of death or alternate valuation date of the following:
  - Property owned by the decedent
  - General powers of appointment
  - Life insurance
    - Death benefit if policy transferred within 3 years before death
  - Joint tenancy property
    - Actual or deemed contribution rule applies
  - Joint and survivor annuities
  - Retained life interests
  - Retained power to amend or revoke
  - Reversionary interest
  - Gift taxes paid within 3 years of death

Powers of Appointment

- General power of appointment
  - Causes inclusion in the holder's gross estate
- To avoid inclusion in gross estate limit to ascertainable standard (HEMS)
    - Health
    - Education
    - Maintenance
    - Support

Valuation of Assets (Slide 1 of 5)

- Fair market value at date of death or alternate valuation date (6 months from death)
- Real estate
  - Appraisals
- Closely held business
  - Valuation discounts
    - Minority discount
    - Lack of marketability discount
    - Blockage discount
    - Key person discount

Valuation of Assets (Slide 2 of 5)

- Financial Securities
  - Average of the High and Low FMV on the trading day
  - Accrued Interest – Included in value
  - Accrued Dividends – Included in value
  - Stock that is not actively traded

$$\text{Valuation included in decedent's gross estate} = \frac{\left(\begin{array}{c}\text{Trading price}\\ \text{after decedent's}\\ \text{date of death}\end{array} \times \begin{array}{c}\text{Number of days between}\\ \text{decedent's date of death}\\ \text{and the first preceding}\\ \text{trade}\end{array}\right) + \left(\begin{array}{c}\text{Trading price}\\ \text{before decedent's}\\ \text{date of death}\end{array} \times \begin{array}{c}\text{Number of days between}\\ \text{decedent's date of death}\\ \text{and the next subsequent}\\ \text{trade}\end{array}\right)}{\text{The sum of the days before and after the date of death*}}$$

Example (Slide 3 of 5)

- Gift of Stock on Wednesday, Feb 4. The stock did not trade that day.
- The stock traded on Monday Feb 2 and on Tuesday Feb 10. On Feb 2, the high was $29, the low was $19 and the closing price was $28.50.
- On Feb 10, the high was $32, the low was $28 and the closing was $32.
- What is the value of the gift?

Answer (Slide 4 of 5)

The gift is valued at: $26
[(24 x 4) +
(30 x 2)] / 6

Day	Date	Event	Average of high and low
Monday	Feb 2	Trade Day	24 = [(29 + 19) / 2]
Tuesday	Feb 3		
Wednesday	Feb 4	Date of Gift	
Thursday	Feb 5		
Friday	Feb 6		
Saturday	Feb 7	Non-trading days	
Sunday	Feb 8	Non-trading days	
Monday	Feb 9		
Tuesday	Feb 10	Trade Day	30 = [(28 + 32) / 2]

Valuation of Assets (Slide 5 of 5)

- Value of life insurance in gross estate
  - Policy owned on another
    - Depends on pay status of premiums
      - Premium Pay Status: interpolated terminal reserve + unearned premium
      - Paid up status: replacement value
  - Policy owned on decedent
    - Death benefit (face value)

Incidents of Ownership

- The gross estate of the decedent includes a life insurance policy if at death the decedent held any incidents of ownership
- What constitutes an "incident of ownership"?
  - Name or change a beneficiary
  - Surrender or cancel the policy
  - Receive dividends
  - Borrow against the cash value
  - Pledge the policy as collateral
  - Assign or revoke these rights in others

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Practice Question 6

Billy, John's son, purchased a $1 million life policy on his dad. John gifted Billy $10,000 annually to pay the premiums. John dies 6 years after the policy was acquired and the death benefit is payable to Billy. How much of the death benefit is included in John's gross estate?

A. None
B. $10,000
C. $60,000
D. $1,000,000

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Alternate Valuation Date

- 6 months after date of death
- Executor must make the election by the filing date of the estate tax return
- Election must lower the gross estate and estate tax due
- Election applies to all assets in gross estate
- Exceptions
  - Wasting assets [Notes, patents, annuities]
  - Assets disposed of between death and alternate valuation date

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Practice Question 7

Item	Date of Death	Alternative Valuation Date
Land	5,000,000	4,500,000
Stock	3,000,000	3,100,000
Annuitized Annuity	1,000,000	950,000
Condo	3,000,000	Sold @ 2 months for 2,950,000

How much is the gross estate using the alternate valuation date (assumption)?

A) $11.40M

B) $11.55M

C) $12.00M

D) $12.06M

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Deductions from the Gross Estate

- Funeral expenses
- Last medical expenses 1040 / 706
- Administration expenses 1041 / 706
- Debts
- Casualty losses during Administration 1041 / 706

Estate Formula

- Adjusted Gross Estate
- Less unlimited
  - Charitable deduction
  - Marital deductions
- Equals Taxable Estate
- Plus sum of all Post ‘76 gifts [keeps taxation cumulative]
- Equals Tentative Tax Base

The Marital Deduction Defined (Slide 1 of 2)

- The single economic unit
- Advantages of the unlimited marital deduction:
  - Defers payment of estate tax
  - Ability to fund the estate of the second-to-die spouse

The Marital Deduction Defined (Slide 2 of 2)

- Requirements of the unlimited marital deduction:
  - Married at date of death or gift
  - Citizen requirement – discussed later
- Limitations of the unlimited marital deduction:
  - Remember – net value!!!
    - Only the assets the spouse actually receives are qualified for the unlimited marital deduction

Qualification for the Marital Deduction

- Inclusion in the decedent's gross estate
  - Must actually be included in the gross estate
- Property transferred to a surviving spouse
  - Must go to the spouse...not just in trust for someone else
- The terminable interest rule
  - Must later be included in the surviving spouse's GE
  - Surviving spouse's interest cannot terminate at a future date

The Terminable Interest Rule

- Exceptions:
  - 6 month survival contingency
  - Terminable interest where spouse has general power of appointment
  - QTIP trust.
  - CRT where spouse is the only noncharitable beneficiary

Planning for the Non-Citizen Spouse

- Unlimited marital deduction not available for non-U.S. citizen spouse
  - Remedy – Non-U.S. citizen spouse becomes a U.S. citizen before the due date of the return and maintains residency following the death of the spouse
  - Or utilize a Qualified Domestic Trust (QDOT)
    - At least one U.S. trustee
    - Must prohibit distribution unless U.S. trustee has right to withhold taxes
    - Trustee must keep sufficient assets to pay taxes
    - Executor must elect marital deduction
      - Election made post-mortem

Credits

- Applicable estate tax credit
  - **$5,389,800 for 2024 ($13,610,000 exemption)**
- Prior transfer credit
  - Credit for estate taxes paid within the last 10 years
- Foreign death taxes credit – tax paid on property outside the U.S.

Paying and Reporting Taxes

- Estate Tax Return
  - Form 706 is due 9 months after death
  - Extension to file (but not to pay) can be granted for an additional 6 months
- Penalties
  - Failure to file: 5% per month up to 25%
  - Failure to pay: 0.5% per month up to 25%
  - Failure to file is reduced by failure to pay
- If penalties are concurrent, the reduction of failure to file does not elevate paying the failure to pay penalty.

Estate Tax Portability

- Issues
  - You have to actually file a timely 706 to make the portability election
  - Remarriage issues – the election is based on the last deceased spouse
    - A remarriage in and of itself would not impact the portability; however, if the second spouse dies then they would be considered the last deceased spouse
    - If multiple spouses are deceased, then the calculation can be complicated

Example

Harold dies on January 15, 2024, survived by his spouse, Wilma. Neither has made any taxable gifts. Harold's executor elects portability of Harold's DSUE amount ($13,610,000).

On June 31, 2024, Wilma makes taxable gifts to her children valued at $2,610,000. Wilma is considered to have applied $2,610,000 of Harold's DSUE amount to the amount of taxable gifts and, therefore, Wilma owes no gift tax. Wilma has an applicable exclusion amount remaining in the amount of $24,610,000 ($11,000,000 of Harold's remaining DSUE amount plus Wilma's own $13,610,000 basic exclusion amount).

Example Continued

Wilma marries Hector in July of 2024 and he dies a few months later. Hector's executor elects portability of Hector's DSUE amount, which is properly computed on Hector's estate tax return to be $2,500,000.

Wilma dies in October 2024. The DSUE amount to be included in determining the applicable exclusion amount available to Wilma's estate is $5,110,000, determined by adding the $2,500,000 DSUE amount of Hector and the $2,610,000 DSUE amount of Harold that was applied by Wilma to Wilma's 2024 taxable gifts.

Thus, Wilma's applicable exclusion amount is $5,110,000 + 13,610,000 = $18,720,000.

Income in Respect of a Decedent

- Income in respect of a decedent (IRD) is income a decedent was entitled to be paid, but did not receive before his or her death
- The asset is included in the gross estate of the decedent BUT there is **no step-up in basis**
- Income tax must be paid by the recipient

IRD Assets

- All IRAs and qualified retirement accounts
  - Excluding Roth IRAs, Roth 401(k)s, Roth 403(b)s and Roth 457s
- Dividends declared but not received
- Commissions earned but not paid
- Rents and royalties owed but not yet paid
- Partnership income of a deceased partner
- S corporation income of a deceased shareholder
- Continuing payments from an annuity
  - Period-certain annuity
- Unpaid debt on an installment note

Intra-Family Transfers

- Transfers not subject to gift tax
- Gifts outright and in trust
- Partial sales/gifts
- Full consideration transfers/sales
  - SCIN vs. private annuity
- Family limited partnerships (FLP)
- Trusts

Transfers Not Subject to Gift Tax

- Not considered a gift, does not utilize annual exclusion
  - Legal Support
  - Qualified Transfers
    - Direct payment to medical/educational institution
  - Below-Market Rate Loans
    - Deminimis
  - Transfers to U.S. citizen spouses will generally result in no tax because of the unlimited marital deduction

Gifts Outright and in Trust

- Can be used to:
  - Utilize annual exclusion
    - Requires a present interest
  - Remove future appreciation
  - Reduce gross estate

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Partial Sale-Gift Transactions

- Sell an asset for less than the fair market value
- Gift for difference between the fair market value and the sale price will be a gift

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Full Consideration Transfers/Sales

- Private Annuities
  - Transaction between two private (but usually related) parties
  - Unsecured promise from the buyer to make payments to the annuitant for the remainder of the annuitant's life
  - Effective when the actual life expectancy is less than the IRS life expectancy table
  - Used when the seller is in poor health
  - Can't be terminally ill...but if the seller lives > 18 months then it is presumed that the annuitant was not terminally ill
  - Risk that the seller/annuitant will live longer

Full Consideration Transfers/Sales

- SCIN
  - Installment sale with payments of interest and principal over term
  - SCIN premium paid to cancel note at seller's death
  - No gift if the PV of the note is = to the value of the underlying property & the SCIN premium is appropriate
  - Interest can be deductible
  - Used when the seller is in poor health

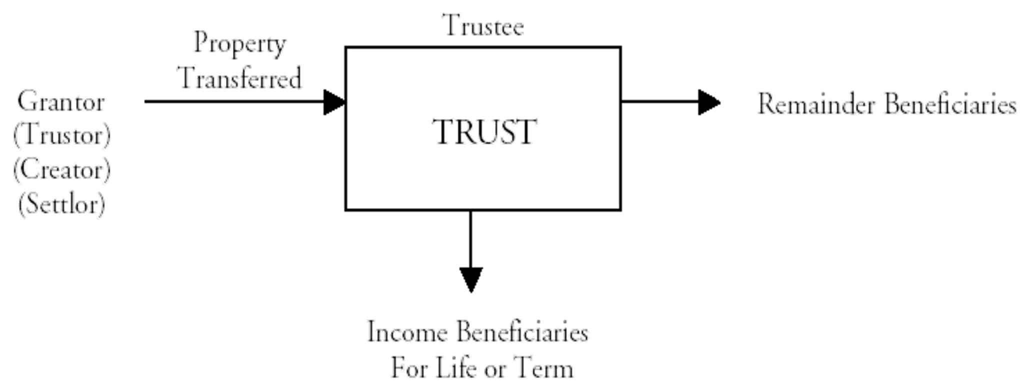
SCIN vs. Private Annuity

Feature	SCIN	Private Annuity
Term of payment	Determined by seller	Life of Annuitant
Deductibility of interest	Depends on Property	None
Buyer's ATB	Purchase Price of Property	Sum of Annuity Payments Paid
Collateral interest	Yes	No

Family Limited Partnerships (FLP)

- Partnership created to transfer assets to the younger generation
- 1% general partner – parent
- 99% limited partner – gift these to the child (make use of annual exclusion)
- Take advantage of minority shares and marketability discounts
- Use when transferor is intent on gifting asset while maintaining control

Introduction to Trusts



Definitions

- Legal title – Held by the trustee
  - Trustee is a fiduciary (acts in the best interest of the beneficiaries)
- Beneficial title – Held by the beneficiaries
- Grantor – The person who creates and initially funds the trust

Why Use a Trust? (1 of 3)

- Management
  - Assist those not capable of managing assets.
- Creditor protection
  - Spendthrift clause
    - States beneficiary cannot assign, pledge or promise to give the assets of the trust to anyone, and if a promise is made, it is void
  - Also should allow the trustee to make distributions on a discretionary basis
  - Most states do not allow the grantor to create a spendthrift trust for protecting his assets

Why Use a Trust? (2 of 3)

- Split interests in property
  - Valuable asset that grantor does not want to sell or split up (e.g., gifting farm to 5 kids where only 2 will participate)
- Avoid taxes
  - Transfer future appreciation
  - Avoid transfer tax on subsequent generations
  - Reduce gross estate (if applicable)

Why Use a Trust? (3 of 3)

- Avoid probate (living trust)
  - Revocable living trust – managed by the grantor and is for the benefit of the grantor during lifetime.
  - Becomes irrevocable at death
  - Does not avoid estate taxes (if applicable for year of death)

Taxation of Trusts

- Revocable – not a completed gift
- Irrevocable – generally completed (unless retained interests)
- Income tax
  - Grantor trust = income taxed to grantor
  - Non-grantor trust = hybrid entity
    - Distributed – Taxed to beneficiaries
    - Accumulated – Taxed at trust rates
      - Simple trust – mandates distribution of income
      - Complex trusts – permits accumulation of income

Grantor Trust Powers

- The following powers, if held by a grantor, will make a trust a grantor trust:
  - The trust income is paid to the grantor or to his or her spouse
  - The trust income may be payable to the grantor or his or her spouse
  - The trust income is accumulated for future distribution to the grantor or his or her spouse
  - The trust income is or may be used to purchase life insurance on the grantor or his or her spouse

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Grantor Trust Powers, Cont.

- The trust income is or may be used to discharge a legal obligation of the grantor or the grantor's family except where the income may be, but is not, used for the support of dependents
- The trust principal or corpus will return to the grantor or spouse
- The grantor retains the power to revoke or amend the trust
- The grantor can dispose of income or corpus at less than full value
- The grantor can borrow from the trust without adequate security or interest.
- The grantor retains the right, without the consent of an adverse party, to alter the beneficial enjoyment of the trust property or its income

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Classification of Trust Arrangements

- Revocable trusts
  - Grantor can revoke the trust
- Irrevocable trusts
  - Grantor can't revoke the trust
- Inter vivos trust
  - Created during life
- Testamentary trusts
  - Created at death

Classification of Trust Arrangements

- Standby trust
  - Unfunded or minimally funded
  - Waiting for triggering event – usually incapacity
- Pourover trust
  - Receives assets from another source
- Grantor trust
  - Inter vivos trust for the grantor
  - Grantor pays all income tax
- Funded or Unfunded

Classification of Trust Arrangements

- Inter Vivos Revocable
  - Avoids probate
  - Provides for management of the grantor's assets if grantor is incapacitated
  - Important in states with high probate costs
  - Privacy is maintained
    - No notice requirements
    - Terms are confidential
  - Will contests are discouraged
    - State law controls, but generally more difficult
  - NOT effective for reducing estate taxes

Classification of Trust Arrangements

- Inter Vivos Irrevocable
  - Used to achieve estate and gift objectives
  - Completed gift
  - Use annual exclusion – remember need present interest
    - Distributions of income are considered a present interest.
    - Crummey (do not forget "5-and-5" power)

Specific Trusts Used in Estate Planning (Slide 1 of 9)

- GRAT
- Pays fixed annuity to grantor for defined term
- Remainder to noncharitable beneficiary at the end of term
- Gift = PV of remainder interest
- If grantor dies during term, then value of trust is included in gross estate, so no tax saved
- Use property that is expected to appreciate at a rate greater than the 7520 rate
- Risk – grantor dies too early

Specific Trusts Used in Estate Planning (Slide 2 of 9)

- GRUT
- Similar to GRAT except pays fixed percentage of assets each year that are revalued on an annual basis
- Not suitable for hard to value assets
- Used very infrequently

Specific Trusts Used in Estate Planning (Slide 3 of 9)

- QPRT
- Form of GRAT for personal residence
- Grantor receives use of the house transferred
- Ideal if house is appreciating faster than the 7520 and family plans to keep home
- Gift = PV of the remainder interest
- If Grantor dies during term then included in Grantor’s Gross Estate

Specific Trusts Used in Estate Planning (Slide 4 of 9)

- Life Insurance (ILIT)
- Trust holds life insurance policy
- Utilizing the annual exclusion
  - Crummey provision
- Avoid requiring the trust to pay proceeds to estate for taxes or administration expenses because it causes inclusion in the gross estate
- In order to provide liquidity:
  - Allow trust to purchase assets of the estate
  - Allow trust to loan money to the estate
- Not included in the gross estate of the insured if there is no incidence of ownership

Specific Trusts Used in Estate Planning (Slide 5 of 9)

- Trusts for minors-Sec. 2503(b) and Sec. 2503(c)
  - Minors are not generally permitted to own property
  - 2503(b) – May hold assets for beneficiary's lifetime but must distribute income annually
    - Annual exclusion available for the PV of the income interest
  - 2503(c) – Allows income to be accumulated but assets must be available to child when they turn 21
    - Annual exclusion available for the contribution

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Specific Trusts Used in Estate Planning (Slide 6 of 9)

- ABC Trust Arrangement
  - A Trust – power of appointment trust
    - Gives surviving spouse general power of appointment over trust's assets
      - Avoids terminable interest rule
    - Value of property qualifies for marital deduction

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Specific Trusts Used in Estate Planning (Slide 7 of 9)

- B Trust (Credit Shelter or Bypass trust)
  - Taxable beneficiaries to ensure use of applicable credit amount
  - Spouse can still get the income, HEMS, "5-and-5"

Specific Trusts Used in Estate Planning (Slide 8 of 9)

- C Trust (Qualified Terminable Interest Property-QTIP
- Allows decedent to qualify a transfer for the marital deduction at his death yet still control the ultimate disposition
- Taxed in the estate of the second spouse to die
- Property must qualify for marital deduction
- Spouse entitled to trust income for life and the income must be paid annually
- Spouse must be able to compel the trustee to sell non-income-producing assets
- During the spouse's lifetime no one can appoint property to anyone other than the spouse

Specific Trusts Used in Estate Planning (Slide 9 of 9)

- Must file an election on the 706
- QTIP is election
- Executor has 15 months to determine the applicability of the QTIP election
  - 9 months plus extension
- QDOT
- A QDOT allows a noncitizen spouse to qualify for the marital deduction
- Requires a domestic trustee

General Issues Regarding Charitable Contributions

- No transfer tax on charitable contributions during life or at death
- Lifetime transfer – generally get a charitable income tax deduction
- A gift tax return is required if there is a split gift between charity and non charitable beneficiary

Charitable Gifts of a Split Interest (Slide 1 of 5)

- Pooled Income Funds (PIF)
  - Contributions are pooled in a trust maintained by the charity
  - Income for life to donor
  - Remainder to charity
  - Good for small gifts

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Charitable Gifts of a Split Interest (Slide 2 of 5)

- Charitable Remainder Annuity Trust (CRAT)
  - Less flexible
  - Fixed annuity ≥ to 5% initial FMV
  - Annuity must be paid annually
  - Life or term (term cannot be more that 20 years)
  - Donor can change charitable beneficiary
  - No contributions after inception
  - Remainder Interest ≥ 10% of initial fair market value

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Charitable Gifts of a Split Interest (Slide 3 of 5)

- Charitable Remainder Unitrust (CRUT)
  - More flexible
  - Fixed percentage of at least 5% of the annual FMV
  - Annual valuation
  - Donor can contribute after inception
  - Catch up provisions allowed if only distribute income if less than stated %
  - Remainder Interest ≥ 10% of initial value

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Charitable Gifts of a Split Interest (Slide 4 of 5)

- Calculation of the gift and remainder interest
  - CRAT
    - Multiply annuity by IRS table to get income interest
    - Deduct income interest from FMV to get remainder
  - CRUT
    - Complex calculation
- Non-Trust Split Interest Charitable Gifts
  - Donate the property but retain the right to use it
  - Similar to a QPRT
  - Personal residence or farm

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Charitable Gifts of a Split Interest (Slide 5 of 5)

- Charitable Lead Trusts
  - Charity receives income, remainder to noncharitable beneficiary
  - Used by high net worth individuals who do not need current income
  - Use appreciating assets!
  - Must be grantor trust to receive charitable income tax deduction

Testamentary Giving to Charities

- No deduction for income tax purposes
- For estate deduction (if applicable)
  - Must be mandatory
  - Amount must be certain and included in the gross estate
- Some items are more beneficial at death
  - Papers of political figures
    - During life – Income tax deduction is limited to AB which is 0
    - At Death – No income tax deduction, but no estate tax either
    - Potentially Better: Get adjustment to basis, give to an heir and let heir donate and get higher income tax deduction

Installment Payments of Estate Tax
Sections 6166 & 6161 (Slide 1 of 2)

- Closely held business
- Extend the payment of estate taxes over a 14 year period
- First four years of payments are interest-only, followed by 10 payments that amortize the estate tax liability over the payment period
- The value of the business interest must be at least 35% of the value of decedent’s Adjusted Gross Estate

Installment Payments of Estate Tax
Sections 6166 & 6161 (Slide 2 of 2)

- The business interest must be a closely held business
  - A sole proprietorship;
  - A partnership if at least 20% of the capital interest is included in the decedent’s gross estate or if the partnership has fewer than 45 partners; or
  - A corporation if at least 20% of the voting stock is included in the decedent’s gross estate or if the corporation has 45 or fewer shareholders.

Special Use Valuation
Section 2032A (1 of 3)

- Fair market value implies the value of a property in its highest and best use
- The value included in the decedent's gross estate will be the current use value of the property, subject to a limitation that the highest and best use value cannot be reduced by more than **$1,390,000 for 2024**

Special Use Valuation
Section 2032A (2 of 3)

- Conditions for special use valuation:
  - Decedent must be a U.S. citizen or resident at death
  - Property must be used in a farming operation or trade or business that was actively managed by the decedent or the decedent's family 5 out of the 8 years immediately preceding decedent's death
  - Value of real and personal property used in qualifying manner must equal or exceed 50% of decedent's gross estate (adjusted only for secured mortgages for the special use property)

Special Use Valuation
Section 2032A (3 of 3)

- The value of the real property must equal or exceed 25% of the gross estate (as adjusted)
- The qualifying property must pass to qualifying heirs (a member of the decedent's family who acquires the property from the decedent) who must actively participate in the farming activity or trade or business
- Executor must file the election with the estate tax return, complete with a recapture agreement

- Qualifying heirs must continue to use the property in its qualified use, as stated in the election included with the estate tax return for a period of at least 10 years following decedent's death

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Corporate Stock Redemption
Section 303

- Under IRC § 303, stock may be redeemed from an estate up to the total amount of:
  - estate and inheritance taxes, estate administration costs, and funeral expenses without being treated as a dividend
- To qualify for this treatment the business must be a corporation and the value of said corporation must be more than 35% of the decedent's adjusted gross estate

EXAM TIP: Question is likely to ask about the percent of the estate that the corporate makes up. Also, it is only applicable to corporations

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Generation Skipping Transfer Tax

- Three tax systems – Estate, Gift, and GSTT
  - See comparison of the three tax systems
- GSTT is an excise tax imposed on the transfer of property to a donee who is two or more generations younger than the donor
- GSTT rate is equal to the maximum estate tax rate in effect at the time the generation-skipping transfer (GST) occurs times the “inclusion ratio” (**2024** = 40%)

Transferee (Slide 1 of 2)

- The person who receives the property
- Non-Skip Person
  - A non-skip person is any natural person or trust that is not a skip person
- Skip Person
  - Lineal Descendants
    - Two or more generations younger than the transferor
  - Unrelated transferees that are 37 ½ years younger than the transferor

Transferee (Slide 2 of 2)

- Skip Person
  - Trust may be skip person if:
    - All interests in the trust are held by skip persons, or
    - If distributions can only be made to skip persons
- Predeceased Ancestor Rule
  - If a child of the transferor is deceased at the time of the transfer, then the deceased child's descendents are moved up one generation

Types of Taxable Transfers

- Direct Skip
  - Outright gift to a skip person
  - Direct skips are taxed only once regardless of how many generations are skipped
  - GSTT on a direct skip is imposed only on the amount received by the transferee
  - Any GSTT associated with a direct skip that is paid by the transferor is treated as a taxable gift by the transferor
  - The transferor is generally liable for the GSTT on a direct skip
  - If a direct skip is made from a trust, the trustee is liable

Types of Taxable Transfers

- Taxable Termination
  - A taxable termination is any termination of a trust interest unless at the termination of the trust:
    - The trust property transferred is subject to federal estate or gift tax,
    - A non-skip person receives an interest in the property transferred out of the trust, or
    - The distribution from the trust will never be made to a skip person.
  - The taxable amount equals the value of the trust property transferred less any expenses, indebtedness, and taxes attributed to the termination
  - The trustee is liable for the GSTT on a taxable termination

Types of Taxable Transfers

- Taxable Distribution
  - Any distribution from a trust to a skip person that is not a taxable termination or a direct skip
  - The taxable amount equals the amount received by the recipient, reduced by any expenses incurred by the recipient in connection with the determination, collection or refund of the GSTT imposed on such distribution
  - Transferee is liable for the GSTT on a taxable distribution

Exclusions

- Qualified Transfers
- Annual Exclusions **$18K** (and split gifts)
- Lifetime Exemption **$13,610,000 (2024)**

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Exemption

- GST Exemption
  - The transferor may elect out.
  - Automatically allocated at death to the extent not actually allocated on or before the due date for the transferor's estate tax return.
    - First allocated pro rata to direct skips.
    - Remaining GST exemption allocated pro rata to trusts.

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Applicable Rate, Inclusion Ratio and Applicable Fraction

- See Applicable Fraction formula

$$\text{Applicable Fraction} = \frac{\text{GST exemption allocated}}{\text{Value of property transferred} - \text{Death taxes} - \text{Charitable deductions} - \text{Nontaxable gift portion}}$$

Inclusion Ratio = 1 – Applicable Fraction

Applicable Rate = Inclusion Ratio x Maximum Transfer Tax Rate

End of Estate Planning

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