

Estate and Trust Planning and Basic Death Tax Concepts

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A. **Brief Background on Current Federal Estate, Gift and Generation-Skipping Transfer Tax Laws**

1. **Federal Estate, Gift and GST Taxes.** On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act of 2017 (the “2017 Tax Act”), effectuating dramatic changes to federal estate tax, gift tax and generation-skipping transfer (“GST”) laws, with a sunset date of December 31, 2025. The 2017 Tax Act provides increased exemption amounts, as discussed below, but the sunset date of the 2017 Tax Act negates the prior predictability that existed under the American Taxpayer Relief Act of 2012 (the “2012 Tax Act”), which had effectuated so-called “permanent” changes to federal estate tax, gift tax and GST laws.
 - a. Under the 2017 Tax Act the \$5,000,000 federal estate tax, gift tax and GST exemption that existed under the 2012 Act was increased to \$10,000,000 for individuals dying after December 31, 2017 and before January 1, 2026, and continues to be inflation adjusted. The tax rate on estates, gifts and GST transfers above the exemption amount remains 40%. *Under the 2017 Tax Act, in 2026, without further legislation, these exemption amounts are schedule to return to the previous exemption amounts (i.e., \$5,000,000 adjusted for inflation).*
 - b. In 2023, the federal estate tax exemption (the amount one may each give away at death free of federal estate tax) is \$12,920,000 (reduced by lifetime taxable gifts); the GST tax exemption is \$12,920,000 (also reduced by lifetime use of exemption); and the amount that one could give away during life free of gift tax is \$12,920,000 (reduced by lifetime taxable gifts). As noted above, these exemption amounts will continue to be inflation adjusted going forward until 2026.
 - c. The 2017 Tax Act did not affect the provision of the 2012 Tax Act that “permanently” eliminated the state death tax credit. As a result, there is (and will continue to be) a wide variation in whether, how and at what rates states impose death taxes, making this an important consideration for individuals depending not only on their state of domicile, but also on financial and other ties that they may have to other states.
 - d. In addition, the so-called “portability” rules that simplify the use of the federal estate and gift tax exemptions (but not GST tax) for married individuals and which were made “permanent” under the 2012 Tax Act still are in effect. Under the concept of “portability,” a surviving spouse can apply his or her predeceased spouse’s unused estate/gift tax exemption amount to gifts made during the surviving spouse’s life or at the surviving spouse’s death.

Portability can potentially have the effect of increasing the exemption amount to double the exemption amount (e.g., to \$25,840,000 in 2023) for a married couple under certain circumstances, regardless of the allocation of asset ownership between the spouses. Portability may change how practitioners and clients address asset allocation between spouses.

2. **Recognition of Same-Sex Marriage.** Pursuant to the U.S. Supreme Court decisions in *United States v. Windsor* (2013) and *Obergefell v. Hodges* (2015), state bans on same-sex marriage are unconstitutional, and the federal government recognizes same-sex marriages. Accordingly, married same-sex couples are now also recognized as “married” couples for the purposes of state death taxes.

B. Asset Ownership – Probate vs. Non-Probate (Cash, Personal Property, Securities, Real Estate, Business Interests, Etc.)

1. **Outright Ownership.** Property you own in your own sole name, which you can give away or sell without restriction.
2. **Joint Ownership**
 - a. Property you own with someone else.
 - b. Depends on registration or title of assets or legal presumptions.
 - c. Typically bank accounts, brokerage accounts, real estate, household contents.
 - d. “Joint with right of survivorship” -- Co-owned property which passes at death automatically to the surviving title holder(s).
 - e. “Tenants by entirety” -- Property owned by spouses which passes at death automatically to the surviving spouse/title holder; same as paragraph d above but between married persons.
 - f. “Tenants in common” -- Interest of deceased title holder does not pass at his or her death to the surviving joint title holder(s).
3. **“In Trust For” or “Payable on Death” Designations.** Typically bank accounts, brokerage accounts, mutual funds and Treasury securities which contain a death beneficiary designation.
4. **Beneficiary Designated**
 - a. Life insurance (owner and beneficiary).

b. Retirement accounts, e.g., IRAs, 401(k)s, 403(b)s, TIAA-CREF, pension benefits, deferred compensation, etc.

c. Annuities.

5. **Trust “Ownership”**

a. “Self-Created” - Trusts created by you, for your own benefit and/or the benefit of others.

b. “Third-Party Created” - Trusts created by another for your benefit.

C. **Gifts During Lifetime**

1. **Delivery of Ownership, “Donative Intent” Issues**

2. **Gift Tax Issues**

a. **State versus Federal.** Only one state currently has a gift tax (Connecticut). Accordingly, discussion about a gift tax refers to a federal gift tax.

b. **Annual Exclusion.** This is the amount that a donor may give to any donee in a calendar year without the imposition of gift tax. For many years, the annual exclusion was \$10,000, and it has been increasing over the last many years with inflation adjustments. In 2005 it was \$11,000, and from 2006 through 2008 it was \$12,000. From 2009 through 2012 it was \$13,000. For 2013 through 2017, it was \$14,000. From 2018 to 2021, the annual exclusion amount was increased to \$15,000. In 2022, the annual exclusion is \$16,000. Thus, in 2022 each donor can give away up to \$16,000 per donee per year (\$32,000 per married couple) free of gift tax (and without using any part of the federal gift tax exemption amount). In 2023, the annual exclusion amount is \$17,000.

c. **Annual Exclusion & 529 Plans.** In certain circumstances, a donor can give \$85,000 (or \$170,000 for a married couple) in one year to a 529 Plan (often referred to as an “education IRA” but funded with after-tax dollars) established for the benefit of a donee. The gift will “count” as five years’ worth of annual exclusion gifts to the donee and will not be subject to gift tax if the donor lives the five years (although a gift tax return must be filed to elect that 5 year treatment). Under prior law, qualified expenses paid from a 529 plan included higher education expenses, but not elementary and secondary school expenses. Under the 2017 Tax Act, qualified expenses now include elementary and secondary school expenses at public, private or religious schools, but only up to \$10,000 per

student per year (this provision does not have a designated sunset date).

- d. **Tuition and Medical Gifts.** In addition, a donor can make unlimited gifts for a donee by *direct* payments to providers for tuition and medical expenses (including, for instance, health insurance and qualified long term care premiums, as well as other expenses).
- e. **Federal Gift Tax Exemption.** In 2023, a US citizen or resident non-citizen can give away \$12,920,000 during life free of federal gift tax. The gift tax exemption is “unified” with the federal estate tax exemption (i.e., they are the same amount) and any taxable gifts made during life will reduce the amount of federal estate tax exemption available at death. Annual exclusion gifts and direct tuition/medical gifts do not count against the \$12,920,000 exemption, nor do most gifts to spouses and charities. The federal gift tax exemption amount is indexed for inflation and thus will likely increase periodically in the coming years until 2026. As noted above, on January 1, 2026, without further legislation, this exemption amount will return to the previous exemption amount (i.e., \$5,000,000 adjusted for inflation).
- f. **Portability.** The 2012 Tax Act extended the concept of “portability” for 2013 and beyond. Portability was first introduced under the 2010 Tax Act for years 2011 and 2012. Under the current tax regime, if a married individual dies then the surviving spouse can apply the deceased spouse’s unused exemption to gifts made during the surviving spouse’s life (or at his or her death). Under certain circumstances, portability can effectively increase the exemption amount to \$25,840,000 in 2023 for a married couple, and could potentially maintain a higher exemption amount for surviving spouses even after 2023 due to potential inflation adjustments. The executor of the decedent spouse’s estate must ***make an election on a timely filed estate tax return*** (including extensions) to preserve the deceased spouse’s federal estate and gift tax exemption amount and “port” it to the surviving spouse. The surviving spouse can only use the unused exemption of his or her most recent spouse. Thus, such benefits may be lost upon remarriage. Note that although portability can “port” the predeceased spouse’s unused federal estate and gift tax exemption to the surviving spouse – it does not do so for the predeceased spouse’s unused GST exemption.

- g. **Issues Involving Gifts to Minors.** A minor (under age 18) cannot hold assets or transact business. Also, it is ideal to avoid having to seek court appointment of a guardian of the estate (assets) of a minor. Accordingly, gifts to a minor should be made to a Uniform Transfers to Minors Act account for the minor, to a trust for the minor, or to a 529 Plan for the minor.
- h. **Payment of Gift Tax.** Under certain circumstances, it may be advantageous to make taxable gifts in excess of the gift tax exemption and pay tax. This may be especially true if the gift tax rate is lower than anticipated in the future. Gift tax is “cheaper” than the federal estate tax due to how it is calculated, and if the donor lives three years after paying the gift tax, the gift tax will not be subject to federal estate tax in the deceased donor’s estate. As always, lifetime gifts can shift the appreciation and income on the gifted assets from the donor/the donor’s estate to the recipient. The 2022 tax rate on taxable gifts over \$12,060,000 is 40%.
- i. **Gifts to Non-US Citizen Spouse.** As noted above, gifts to spouses generally do not need to qualify for the usual annual exclusion and do not “count” against and reduce the current \$12,060,000 lifetime gift tax exemption. In most cases, there is an unlimited gift tax marital deduction. In the case of a gift to a spouse who is not a US citizen, however, the rules are dramatically different. A donor is limited to a special annual exclusion for gifts to his or her non-US citizen spouse equal in 2022 to \$164,000 (which is adjusted from time to time for inflation; it will be \$175,000 in 2023). Gifts in excess of that amount in any year will be counted against and reduce the current \$12,060,000 lifetime gift tax exemption. This restriction curtails the customary ease with which spouses transfer assets back and forth between them or even make investments together (as to which contribution and tracing rules apply).
- j. **Gifts by a Non-Resident Non-Citizen.** Gifts by a non-resident non-US citizen (“NRNC”) of realty and tangible property situated in the US are subject to federal gift tax at the time of the gift, subject to any applicable gift tax treaty between the US and the country of the donor’s fiscal domicile. In other words, NRNCs can make unlimited gifts of intangibles to US citizens, resident non-US citizens and other NRNCs without incurring any federal gift tax. Note, however, that the rules by which the situs of an asset is determined and the characterization of “realty” and “tangible property” subject to tax for these purposes is not always intuitive. For example, life insurance is not a US situs asset for an NRNC. For non-US families whose younger generations are migrating to

the US, gifts by a NRNC to a US citizen can be a great wealth transfer device.

D. Passage of Assets at Death

1. Assets in Your Own Name

- a. Passage by will terms.
- b. Passage by “intestacy law” if one dies without a will (usually to spouse and children or, if none, to other family); escheat to the state is rare.

2. Joint Ownership & POD. Jointly-owned assets with right of survivorship and assets registered to pass at death pass automatically to surviving owner or owners.

3. Designated Beneficiaries. Beneficiary designated assets pass to designated beneficiaries (including your estate or trust).

- a. The big issue with qualified plans (including IRAs, § 403(b) plans, § 401(k), SEP IRA accounts and other income tax deferred retirement assets) is that in addition to being subject to death taxes, when applicable, they will also be subject to federal income tax as the assets are withdrawn. This does not result in a complete “double” tax situation because there is a deduction for federal income tax purposes of the federal estate tax paid with respect to such assets. For planning purposes the goal is often to permit the beneficiary to defer the income tax for the longest possible period.
- b. Starting in 2010, the \$100,000 income limitation for converting an IRA to a Roth IRA no longer applies. (There is still an income limitation for contributing to a Roth IRA; so, for wealthy taxpayers, conversions are sometimes referred to as “backdoor Roth IRAs.”) Factors to consider in determining whether or not to Roth an IRA include availability and source of cash with which to pay income tax, reliance on IRA assets for living expenses, time horizon, income tax bracket now versus later, identity of beneficiary or beneficiaries of IRA, and likelihood that federal estate tax will be imposed.
- c. Effective January 1, 2020, the SECURE Act instituted new rules, which, among other things:
 - (1) Changed the Required Beginning Date (“RBD”) from April 1st of the year after the participant reaches 70 ½ to April 1st of the year after the participant reaches age 72. This

change applies to all individuals who reached age 70 ½ in 2020 or later.

- (2) Permitting individuals of any age to make IRA contributions (so long as the individual has earned income) – as opposed to prohibiting contributions to IRAs starting in the calendar year an individual reaches age 70 ½.
 - (3) Limiting the ability of certain beneficiaries receiving qualified plans from participants who die in 2020 or later to defer the associated income tax. For most individual beneficiaries receiving qualified plans from participants who dies in 2020 or later, all assets of a qualified plan must now be withdrawn by December 31st of the year containing the 10th anniversary of the deceased participant’s date of death. There are exceptions for the spouse, minor children of the participant, disabled or chronically ill individuals and beneficiaries less than 10 years younger than the participant that allow for potentially greater income tax deferral.
 - (4) As a general matter, the period over which retirement plan distributions must be taken after the owner dies depends on:
 - (i) The identity of the beneficiary;
 - (ii) In some cases, whether the participant died before or after the RBD;
 - (iii) The terms of the retirement plan; and
 - (iv) If a trust, the terms of the trust.
4. **Trusts.** Passage of assets in a trust depends on the terms of the trust (or the beneficiary’s exercise of a power of appointment, if permitted under the terms of the trust). Assets held in trust can be a “safety net” for the beneficiary, can provide a good way to have better management of the assets for a beneficiary who cannot handle assets or is incapacitated, and can prevent the remaining funds held in a trust from being diverted away from the decedent’s chosen beneficiaries. Trusts can also provide creditor protection as noted below, and can shelter appreciation from later gift or death tax.
5. **Creditor Issues.** The ownership of assets by spouses can have an important impact on the ability of creditors to get to those assets, although the law differs from state to state. In Pennsylvania, assets held jointly by spouses (as “tenants by the entireties” or jointly with right of survivorship) will generally not be subject to the claims of the creditors of one of the

spouses (but will of course be subject to the couple's joint creditors). The transfer of ownership from the joint names of spouses to the sole name of one of them can potentially expose the transferred assets to the claims of creditors. Also, assets held in a trust created by a third party are generally exempt from the claims of creditors of the beneficiary (until distributed).

6. **Spousal Issues.** The ownership of assets in the sole name of one spouse, and the disposition of such assets at that spouse's death (through a will, trust, beneficiary designation, etc.) may not be controlling depending on the laws of certain states.
 - a. **Elective Share.** In many states, a spouse, even if completely disinherited, may be entitled to claim a portion (known as an "elective share," "statutory share" or "forced share") of the deceased spouse's assets. Often this is one-third of the deceased spouse's estate or some other fraction.
 - b. **Pretermitted Spousal Share.** If the decedent spouse executed his or her will prior to marrying the surviving spouse, the surviving spouse may be entitled to claim a portion of the deceased spouse's assets under the "pretermitted spousal share" laws of the state. Often this one-third or one-half of the deceased spouse's estate or some other portion of the deceased spouse's estate.
 - c. **Waivers.** Prenuptial and postnuptial agreements (and other agreements) may limit or waive these spousal rights.

E. Provisions of a Will

1. **Age.** Must be age 18 to make a will; may be challenged even if over 18 for lack of capacity or undue influence.
2. **Writing.** Typically must be in writing, dated and signed at the end.
3. **Formalities.** Other formalities vary from state to state as to witnesses and so on; in Pennsylvania a will need not be witnessed but preferable to have at least two witnesses and a notary public.
4. **Fiduciaries.** In addition to provisions which provide for passage of assets, a will should also include provisions for appointment of guardian(s) of minor children, executor(s) and, if trusts, trustee(s), all generally known as "fiduciaries."
5. **Trust Provisions.** A will may include trust provisions, although a trust can also be a stand-alone document which is not a will.

F. Current Federal Estate Tax

1. **Laws Applicable 2018 through 2025 (and Beyond?)**

- a. **World Wide Assets.** Federal estate tax is imposed on virtually all assets owned by a US citizen or resident (that is, a resident non-US citizen) or as to which the individual has substantial control (e.g., individually owned assets, life insurance, pensions and deferred compensation, interests in certain trusts, some jointly owned assets), wherever located.
- b. **Valuation Date.** Tax is based on value of assets as of date of death (or in some cases the lower “alternate value” six months later or some interim point if sold).
- c. **Tax Cost Basis.** The estate tax value of an asset becomes its tax cost basis for purposes of computing capital gain and loss upon sale of the asset (that is, there is “free” step-up in tax cost basis if the value has increased). Step-down rules apply to loss property (that is, if a decedent dies owning property that has declined in value, its basis will be lowered to the date of death value). Thus, it may be beneficial for an individual to sell loss property during his or her lifetime to reap the income tax benefits of such loss. The basis rules apply differently in the case of community property assets owned jointly by a husband and wife versus non-community property they own jointly.
- d. **Deductions.** Tax is reduced by certain deductions, including funeral expenses, debts, administration expenses, executor and legal fees and, most importantly, property passing outright to or in trust for the surviving spouse (with certain exceptions as to non-US citizen spouses as noted below) or charity.
- e. **Federal Estate Tax Exemption.** In 2023, a US citizen or resident non-citizen can give away up to \$12,920,000 respectively (reduced by certain lifetime gifts) upon death or during life free of federal estate and gift tax. The exemption amount is indexed for inflation and thus will likely increase until 2026 (when the sunset provision of the 2017 Tax Act is scheduled to reduce the exemption amount to about half that amount, as outlined above). The estate and gift tax exemptions are “unified” (or more precisely, “re-unified”) because they are again the same amount; taxable gifts made during life will reduce the amount of federal estate tax exemption available at death. The exemption amount is often held in trust for a surviving spouse to take full advantage of both spouses’ respective exemptions (but see portability below). Asset allocation

as between spouses can be critical to ensure that each spouse's exemption is fully utilized.

- f. **Portability.** As discussed above with respect to the gift tax exemption, the 2010 Tax Act introduced the concept of "portability" for 2011 and 2012, and the 2012 Tax Act extended portability indefinitely. If a married individual dies during 2022, the surviving spouse can apply the deceased spouse's unused exemption to gifts made during the surviving spouse's life or at his or her death. Several requirements must be met. Portability can essentially have the effect of increasing the exemption amount to \$24,120,000 in 2022 for a married couple in certain circumstances. For various tax and non-tax reasons, portability does not eliminate the need for estate/trust planning, asset allocation, etc. Reliance on portability instead of "old fashioned" asset allocation between spouses, and a trust created at the first death for the surviving spouse's benefit, can backfire. For instance: the tax laws can change; the surviving spouse can remarry and then survive her new spouse which under certain circumstances can cause the "ported" exemption of the first predeceased spouse to be wiped out; the surviving spouse can divert assets away from the children in the absence of a trust, and so on. However, portability can be very important to a couple who cannot divide assets between them for a variety of reasons, or for a couple that has generally not addressed their estate planning.
- g. **Tax Rate.** The 2023 federal estate tax rate is 40% for estates in excess of \$12,920,000; however, there is no federal estate tax on charitable and spousal gifts in any amount.
- h. **Non-US Citizen Spouse**
 - (1) In the case of a surviving spouse who is not a US citizen, the marital deduction deferring federal estate tax until the surviving spouse's death is only available under two circumstances: the spouse becomes a US citizen following the first death but before the federal estate tax return is due, including extensions (thus, effectively, within 15 months of death), and has remained a US resident through the date of citizenship; or assets pass into a certain type of trust known as a "Qualified Domestic Trust" or "QDOT", which has highly circumscribed terms and restrictions.
 - (2) A QDOT can be created by the deceased spouse (by will or trust) or can be created by the surviving non-US citizen spouse before the 9 month anniversary of the deceased spouse's death. A QDOT must otherwise qualify as a

marital trust and include certain other requirements, including of note the following: at least one trustee must be a US citizen or corporation; no distribution can be made unless the US trustee has the right to withhold tax from the distribution; federal estate tax must be paid upon distribution on any principal distribution from the trust, except for “hardship” distributions (although income distributions are not subject to federal estate tax), and -- for QDOTs over \$2,000,000 -- certain security provisions must be satisfied. If the non-US citizen spouse later becomes a US citizen (and has resided continuously in the US), the QDOT provisions essentially will no longer apply. Any principal remaining in the QDOT upon the death of the non-US citizen spouse’s death is subject to federal estate tax.

- (3) As to non-probate assets furnished by the deceased spouse that pass directly to the non-US citizen spouse (and thus do not pass directly to the QDOT), such as jointly held assets and insurance, the non-US citizen spouse can either add them to the deceased spouse’s QDOT or create his or her own QDOT; there are also special QDOT treatment rules for retirement plan assets that cannot be transferred to a QDOT without adverse income tax consequences.
- (4) The impact of an applicable death tax treaty, if any, should also be considered.

- i. **Non-Resident Non-Citizen.** In the case of a person who is a non-resident non-US citizen (“NRNC”), federal estate tax is imposed as a general matter only on property situated in the US at the time of death. Note, however, that the rules by which the situs of an asset is determined for these purposes are not always intuitive. For example, life insurance is not a US situs asset for a NRNC. Certain deductions may not be available in computing the tax. Again, the impact of an applicable death tax treaty, if any, should also be considered.
- j. **2026 and Beyond.** As discussed above, the 2017 Tax Act has a sunset provision which as of January 1, 2026 would reduce the federal estate tax exemption amount to the pre-2018 exemption amounts (i.e., \$5,000,000 adjusted for inflation). Accordingly, we will need to see whether additional legislation is enacted to make these changes “permanent” or whether the exemptions will revert to the pre-2018 amounts.

G. Federal Generation-Skipping Transfer Tax

1. The GST tax is imposed on many but not all gifts made during life and at death from grandparent generation to grandchild or later generation, whether outright or in trust, to the extent in excess of an applicable GST exemption.
2. So-called “skip persons” are not only grandchildren and later generations, but also unrelated persons who are 37 ½ years or more younger than the donor/transferor/decedent, such that a gift made during life or at death to such an unrelated skip person would be subject to the GST tax, to the extent in excess of the applicable GST exemption.
3. There is a GST exemption. That exemption was also increased substantially by the 2017 Tax Act. In 2023, each taxpayer has a \$12,920,000 GST exemption. Under the 2017 Tax Act, in 2026, without further legislation, the GST exemption amount is scheduled to return to the previous exemption amount (i.e., \$5,000,000 adjusted for inflation).
4. The GST tax is imposed at the highest marginal federal estate tax rate then in effect (40% in 2023). In 2010, there was GST tax “holiday” (0% tax rate).
5. Between December 17, 2010 (the enactment of the 2010 Tax Act) and December 31, 2010, many trustees scrambled to take advantage of the GST tax “holiday” by terminating trusts subject to GST tax (that is, non-GST exempt trusts) and making distributions to younger generation beneficiaries at the 0% GST tax rate.
6. Part or all of this exemption may be used to create a “dynasty” or generation-skipping tax exempt trust for your descendants, which can escape any further estate or generation-skipping tax for generations. Such a trust would first benefit the child for the child’s life, then upon the child’s death drop down in further trust for the grandchild, then on the grandchild’s death to the great-grandchild, and so on, with NO estate tax *or* generation skipping tax due on any descendant’s death.
7. The GST tax rules applicable to non-resident non-citizens (“NRNC”) follow the estate and gift tax rules.

H. Summary of Exemption Amounts and Tax Rates

The following is a summary of the federal gift, estate and GST tax exemption amounts and maximum tax rates in recent years:

Year	Gift Tax Exemption*	Max Gift Tax Rate	Estate Tax Exemption*, **	Max Estate Tax Rate	GST Exemption*	Max GST Tax Rate
2008	\$1,000,000	45%	\$2,000,000	45%	\$2,000,000	45%
2009	\$1,000,000	45%	\$3,500,000	45%	\$3,500,000	45%
2010***	\$1,000,000	35%	\$5,000,000 or \$0	35% or 0%	\$5,000,000	0%
2011	\$5,000,000	35%	\$5,000,000	35%	\$5,000,000	35%
2012	\$5,120,000	35%	\$5,120,000	35%	\$5,120,000	35%
2013-2017	\$5,250,000 to \$5,490,000	40%	\$5,250,000 to \$5,490,000	40%	\$5,250,000 to \$5,490,000	40%
2018	\$11,180,000	40%	\$11,180,000	40%	\$11,180,000	40%
2019	\$11,400,000	40%	\$11,400,000	40%	\$11,400,000	40%
2020	\$11,580,000	40%	\$11,580,000	40%	\$11,580,000	40%
2021	\$11,700,000	40%	\$11,700,000	40%	\$11,700,000	40%
2022	\$12,060,000	40%	\$12,060,000	40%	\$12,060,000	40%
2023	\$12,920,000	40%	\$12,920,000	40%	\$12,920,000	40%
2026	\$5,000,000 plus inflation	40%	\$5,000,000 plus inflation	40%	\$5,000,000 plus inflation	40%

* Beginning in 2012, the gift tax, estate tax and GST exemption amounts were adjusted for inflation based on the 2011 exemption amount of \$5,000,000 each; beginning in 2018, those exemption amounts are adjusted for inflation based on the 2018 exemption amount of \$10,000,000 each, but slated to be reduced starting January 1, 2026 to \$5,000,000 adjusted for inflation.

** In all cases the federal estate tax exemption available at death is reduced by the amount of gift tax exemption used during lifetime.

*** On December 17, 2010, President Obama signed the “Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010,” which addressed the federal estate, gift and GST taxes for 2010, 2011 and 2012. In 2010, executors were given the choice between an “estate tax” regime (with a \$5 million exemption and 35% tax rate) or a “modified carryover basis regime” (with no federal estate tax and no corresponding step-up in basis, but \$1.3 million in basis to allocate to inherited assets and an additional \$3 million in basis to allocate to assets left to a surviving spouse in certain ways).

I. State Death Taxes

1. Effective in 2005, the federal state death tax credit, long included in the computation of the federal estate tax -- which essentially operated to “share” with the states some of the federal estate tax collected by the IRS - - was eliminated and replaced with a deduction for state death taxes paid. This means that in the case of those states that previously based their death tax solely on the amount of the federal state death tax credit (so-called “slack tax” or “pick up tax” states), there is no longer a state death tax (for instance, Florida and many other states).
2. Some former slack tax states “decoupled” their state death tax from the federal estate tax and now collect a state death tax based on the federal estate tax law (including the state death tax credit) as it existed at a prior time. The primary result in such decoupled states is that the state death tax is or can be computed based on prior federal law, for instance when the federal estate tax exemption amount was \$1. Note that:
 - a. New Jersey used to have both an estate tax and an inheritance tax. However, the estate tax was eliminated as of January 1, 2018. The inheritance tax remains (0% on spouses, descendants and charities, and between 11 – 16% on inheritances of other beneficiaries, including siblings and in-laws, subject to certain thresholds).
 - b. New York previously had a state exemption of \$1,000,000, but changed its laws to increase its state exemption amount – now \$6,110,000 in 2022.
 - c. Delaware also repealed its estate tax as of January 1, 2018.
3. Some states, such as Pennsylvania, still have a separate death tax that is not computed based on the federal estate tax. Often the state death tax depends on the relationship of the beneficiary to the decedent.

Pennsylvania inheritance tax:

- (1) 0% to spouse, charity, child under 21 (or child under 21 to parent)
- (2) 4.5% lineal descendants
- (3) 12% siblings
- (4) Life insurance proceeds are exempt

- (5) Gifts within a year of death (less a \$3,000 exclusion) are subject to inheritance tax
 - (6) No inheritance tax on real property in another state (although the situs state may separately impose a death tax on the property, depending on that state's laws)
4. State death taxes are generally imposed on the assets of a resident of that state, usually excluding real and tangible personal property located in another state; a state's death tax will also generally be imposed on a non-resident of the state, but only to the extent of real and tangible personal property of the non-resident located in the state.
5. As noted above, state death taxes are now deductible on the federal estate tax return.
6. The death taxes of many states are in flux, so one must check the applicable current laws.

J. Trusts

1. **Trusts Created With Your Own Assets.** Living trusts or trusts created with your own assets for your benefit during your lifetime.
 - a. No tax savings/significance.
 - b. May replace will at death.
 - c. May simplify estate administration process.
 - d. May be a good management tool in the event that you become incapacitated (although a general power of attorney is still advisable).
2. **Trusts Created by Others; "Third Party" Trusts.** Trusts created for others as an estate planning tool, for instance for your spouse, younger children, adult children who cannot handle money, children who do not need the money (to get assets to grandchildren without an extra layer of death tax), children over whom to impose protection from creditors (including a spouse) and disabled beneficiaries.
3. **Creditor Protection Opportunities Through Trusts**
 - a. **Self-Settled Trusts.** Most trusts created with one's own assets (a "self-settled trust") are fully available for the claims of creditors so long as any part of the trust assets (income or principal) may be distributed to or for the creator of the trust. This is so whether the trust is revocable or irrevocable, whether the rights reserved by the

creator of the trust are broad or narrow and whether the trustee is friendly, hostile or independent. In some jurisdictions, this longstanding rule has been modified so that certain self-settled trusts may be exempt from creditors' claims. These include a number of foreign jurisdictions (notably the Cook Islands, Gibraltar, Lichtenstein and several others), as well as several American states (including Delaware, Alaska and about fourteen others).

- b. **Third Party Trusts.** Trusts created for others ("third party trusts") are normally quite safe from the claims of the beneficiaries' creditors. With certain narrow exceptions, a trust created for a family member (spouse, child, grandchild, etc.), so long as it cannot be unilaterally revoked by the beneficiary, will not be subject to claims against the beneficiary. In some states, this rule is relaxed with respect to special classes of claims; one example is support or other domestic relations claims by spouses, former spouses and dependent children. Once a beneficiary has the power to withdraw assets of the trust in excess of 5% of the trust, then the creditor protection expires as to those assets which may be withdrawn and the trust assets may normally be claimed by creditors. For example if a beneficiary has the power to withdraw trust assets one-third at age 25 and the balance at 30, following age 25 a creditor can reach one-third of the assets and can reach all the assets after the beneficiary is 30, even if the beneficiary does not withdraw those assets.
- c. **Trusts as Marital Agreements.** Are trusts for children the "new" parentally imposed nuptial agreement? Such family concerns exist whether or not a federal estate tax applies.

4. **Irrevocable Life Insurance Trust ("ILIT")**

- a. Life insurance owned by a decedent on his or her life is includable in his or her estate for federal estate tax purposes.
- b. Life insurance purchased in, owned by and payable to an ILIT is not includable in taxable estate for federal estate tax purposes if properly administered.
- c. Life insurance transferred by the insured to an ILIT within three years of death includable in estate for federal estate tax purposes.
- d. An ILIT is usually created by the insured, or might be created by both insureds in the case of a second to die policy. The creator of an ILIT is usually referred to as a "settlor."

- e. It is critical to make sure that in funding an ILIT with life insurance that the owner and the beneficiary of the ILIT is the trust (and not the insured or anyone else). Review the paperwork to make sure that this is the case. The owner and beneficiary designations for the policy held by the trust should be similar to the following:

_____ [Name of Trustee] and his/her Successors as Trustee of the _____ [Name of Trust] dated _____ [Date of Execution].

For example:

John Smith and his Successors as Trustee of the Deed of Trust of Jane Smith dated July 22, 2020.

- f. It is crucial to adhere to the “best practices” for administering an ILIT; without the proper formalities, the IRS could take the position that the ILIT is not effective, and attempt to include the insurance in the estate of the settlor/insured, and/or treat the additions to the trust as taxable gifts. For instance:
- (1) **EIN.** The ILIT should have its own Federal Tax/Employer Identification Number (TIN or EIN; this is the trust’s equivalent of your Social Security Number).
 - (2) **Checking Account.** The trustee should open a checking account in the name of the trust, using the trust’s TIN/EIN. The trustee should sign bank signature cards and order checks in the name of the trust. If there are no other assets of the ILIT, a non-interest bearing checking account should be used to avoid having to file any income tax returns.
 - (3) **Payment of Premium.** Invoices for premium payments should be billed to and mailed to the trustee. The trustee should pay the premium from the trust checking account. If the account does not have sufficient funds to pay the premium, the settlor should make a gift to the trust (by writing a check payable to the trust which the trustee would then deposit into the trust checking account or wire the fund to the trust account) to cover the premium.
 - (4) **Crummey Withdrawal Notices.** A “Crummey power” is a beneficiary’s right to withdraw all or part of any contribution to the trust for a certain period of time after the contribution is made. The name of these withdrawal notices is based on the name of an IRS case regarding such

withdrawals. It is the presence (and proper administration) of the Crummey provisions in an ILIT that will qualify all or part of the contributions for the gift tax annual exclusion (currently \$16,000 per beneficiary or \$32,000 if the settlor is married and the settlor's spouse joins the settlor in making the gift). When a gift is made to the trust, the trustee should send a "Crummey notice" (that is, a notification that an addition has been made to the trust) to the person or persons who have Crummey powers under the trust instrument informing him or her of the amount of principal he or she is entitled to withdraw. If any such person is a minor (under eighteen years of age), the trustee should designate a Special Guardian (other than the settlor) to receive the Crummey notice on behalf of the minor. As noted above, failure to send appropriate Crummey notices may cause the insurance premiums to be treated as taxable gifts, so the trustee should keep evidence in the ILIT's permanent records to prove that the notices were sent. Most ILITs define the amount each beneficiary may withdraw by reference to certain provisions of the Internal Revenue Code. The trustee should confirm the correct withdrawal amounts with counsel when gifts are made to the trust. It is best for the trustee not to rely on a "one time" notice at the beginning of the trust. As always the terms of the trust should be followed.

- g. **Gift Tax Returns.** The settlor of the ILIT may have to file a gift tax return (IRS Form 709) to report the gifts he or she made to the trust by April 15th of the following year (or upon extension within the next 6 months). The gift tax return is generally used for three purposes: (i) to report a married couple's decision to "split" gifts to qualify a gift to a beneficiary in excess of \$16,000 and up to \$32,000 for the annual exclusion (\$17,000 and up to \$34,000 in 2023); (ii) to report taxable gifts (i.e., gifts in excess of the annual exclusion) and (iii) to allocate or to elect not to allocate the GST tax exemption. A gift tax return is not required if all of the settlor's gifts to the trust qualify for the annual exclusion of \$16,000 (\$17,000 in 2023) per beneficiary but it may nevertheless be advisable to allocate or to prevent the automatic allocation of GST exemption. If a policy with cash value is transferred to the trust, the settlor should attach a form 712 along with the gift tax return. This form, which the settlor should request from the insurance company, states the "interpolated terminal reserve" value, or gift tax value, of the policy. Determining whether a gift tax return is necessary or advisable is often complicated. The settlor should consult his or her counsel in making this decision.

- h. **GST Allocation.** A trap for the unwary involves the failure to “opt out” of the automatic GST exemption allocation rules in many ILIT situations when a settlor would not normally want to allocate any GST exemption to his or her additions to the insurance trust (primarily related to premium payments). This is alluded to above. To “opt out,” one must file a timely federal gift tax return for the year of the transfers or just the initial transfer, depending on the matter involved. Another option, which is somewhat complex, is the intentional “late” filing of a gift tax return if less GST exemption can be allocated due to the reduction in the value of the ILIT after a premium payment.
- i. **Trust Income Tax Returns.** Most life insurance trusts are “grantor trusts” for federal income tax purposes because the trustee has authority to use trust income to pay insurance on the settlor’s life. This means that the settlor is treated as the owner of the trust assets for federal income tax purposes and therefore must pay the tax on that income. The settlor and trustee should consult with their tax advisors to determine how trust income, if any, should be reported.
- j. **ILIT to ILIT Sale.** If an ILIT is defective or the terms are no longer desirable for some reason, the settlor can consider creating a new ILIT and funding that new ILIT with cash which it can use to purchase the insurance from the old ILIT. This has many advantages and will also avoid the three year look back. Possible modification of the ILIT should be considered if permitted by statute, mindful especially of any gift and GST tax issues.

5. **Qualified Personal Residence Trust (“QPRT”)**

A vacation home or personal residence can be placed in such a trust to transfer it at a substantially reduced death tax cost, utilizing actuarial tables and interest rates. The trust holds the residence for a specified number of years, during which the creator of the trust retains full use of the property, and then terminates to the named “remainder” beneficiaries.

6. **Grantor Retained Annuity Trust (“GRAT”)**

- a. This type of trust is most effective for someone who wants to give away the growth on appreciating assets with little or no gift or estate tax. A GRAT is created by transferring one or more appreciating assets into an irrevocable trust while retaining the right to an annuity interest for a fixed term of years or for the shorter of fixed term or life. When the retention period ends, assets in the trust (including all appreciation) pass to the named “remainder” beneficiaries. Often GRATs are constructed so that

there are several “rolling” one after the other, each for a short period, and thus geared to benefit from valuation volatility upswings.

- b. In the last few years both the U.S. House of Representatives and Senate proposed bills that would have mandated a minimum 10-year term for GRATs. This provision was not included in the 2012 Tax Act. Thus, short-term GRATs are still a viable planning technique. There has been no indication whether the 2012 Tax Act or 2017 Tax Act reflects Congressional policy not to impose a 10-year minimum term on GRATs or whether Congress is saving this “revenue raiser” to offset the cost of some new bill.

7. **Intentionally Defective Grantor Trust (“IDGT”)**

Such a trust is drafted so that although the transfer/gift is complete, the creator-grantor is still responsible for paying the federal income taxes, including capital gains tax, on the underlying assets, and the transactions between the grantor and the trust are disregarded for federal income tax purposes. This is achieved by including in the trust certain powers, for instance, the power to distribute to or accumulate income for the grantor’s spouse, the power to use income to pay life insurance premiums on the life of the grantor or grantor’s spouse, the power of the grantor or the grantor’s spouse to borrow trust funds without adequate security, the power of the grantor to swap trust property for other property of equivalent value, and the power of a non-adverse party to add beneficiaries.

8. **Fractionalized Ownership**

There are a number of planning opportunities that involved fractionalizing the ownership of assets such that valuation discounts can apply -- in making a gift and/or upon death -- to take into account a minority or non-control ownership and/or lack of marketability. The amount of the applicable discounts varies based on the facts and circumstances, including control, attribution, willing buyer/willing seller, the market and so on. A discount should be established based on the opinion of a qualified appraiser and consideration should be given to the use of gift tax returns with respect to lifetime gifts to run the IRS’ statute of limitations. A common and easy way to fractionalize ownership of real estate, for instance, is simple tenants-in-common ownership. More complex vehicles can be used, including the proverbial family limited partnership (“FLP”) or a limited liability company (“LLC”), which in fact is the short form reference to ownership by an entity such as a partnership, corporation and so on. The IRS is on the attack as to discounts of this sort when the various owners are all family members, directly or indirectly. Nevertheless, this is a valuable tool.

9. Layering

- a. A number of different estate planning tools can and sometimes should be used in concert, even beyond the bread and butter federal estate tax exemption trust/marital trust/ILIT/GST exempt trust combination.
- b. For instance, a client might create an FLP or LLC, perhaps with her children, into which she transfers assets in exchange for partnership interests. The underlying assets must be appraised (if the underlying value is not readily apparent, for instance is not publicly traded stock), as must the actual partnership interest. Client might then sell all or part of her partnership interests to a grantor trust she creates, which might or might not be GST exempt. The new trust would be funded, probably with assets worth 10% of the value of the assets sold; this will give rise to gift tax and, if the trust will not be GST exempt, GST tax. The client might then take back an interest-only promissory note with a balloon payment; the term of the note will determine the interest rate. The sale will not result in capital gains tax nor will the interest be taxable income to the client. There would probably be no step-up in basis at the client's death with respect to the promissory note. Assuming that interest need not be paid or, if paid, comes from new gifts to the trust each year, the trust uses part of the cash flow to pay the carrying charges on the assets (for instance real estate) and uses the balance to acquire a policy of insurance on the client's life to repay the IOU and to create a fund to support the asset/real estate carrying charges or simply to create cash after the client's death.
- c. Some of the purposes of the above transaction would including the following:
 - (1) To accomplish a substantial discount in the values of the assets for federal transfer tax purposes;
 - (2) To "freeze" the values of the assets so that post-transfer appreciation is not taxed as part of the client's estate at her death; and
 - (3) To create a vehicle for management of the assets by the children and their families following the client's death.

K. Related Planning Documents

1. General Durable Power of Attorney

- a. Designation of individual(s) to handle financial and personal affairs when you are unable to act.
- b. May include health care or similar powers in same or separate power of attorney document.
- c. General power of attorney will typically make a court appointed guardian unnecessary if you become incapacitated.
- d. One can designate preferred guardian(s) of estate and person in power of attorney.

2. Living Will

- a. End of life decisions.
- b. May combine general health care powers of attorney provisions and living will provisions.
- c. May deal with wishes concerning anatomical gifts.

L. Fiduciaries

1. Executor(s)

- a. Duties.
- b. Individual or bank/trust company or combination.
- c. Compensation.

2. Trustee(s)

- a. Duties.
- b. Need for investment expertise; delegation.
- c. Individual or bank or combination.
- d. Power to hire and fire.
- e. Traditional income/principal versus total return

f. Compensation.

3. **Guardian(s)**

a. Minors -- Of the estate and/or person of a minor.

b. Incapacitated (adult) persons -- Of the estate and/or person of an incapacitated person.

M. Charitable Gifts

1. **Fully Deductible for Death Tax Purposes**

a. Federal estate and gift tax.

b. Pennsylvania inheritance tax.

2. **Certain Gifts May be Deductible for Income Tax Purposes as Well**

a. Deductions for contributions of cash to certain types of charitable organizations are generally limited to an aggregate of 60% of the donor's Adjusted Gross Income (this is a defined term) (the 2017 Tax Act increased this limitation from 50%). The 60% limitation applies to contributions to churches, educational organizations, hospitals or medical research organizations, college and university endowments, government organizations, and certain other organizations, including donor-advised funds (generally in the category of "public charities").

b. Deductions for contributions of capital gains property to the types of organizations listed in subparagraph a above (generally, public charities) are limited to 30% of the donor's Adjusted Gross Income.

c. Deductions for cash contributions to most "private foundations" are limited to the lesser of (a) 30% of Adjusted Gross Income, or (b) 50% of Adjusted Gross Income reduced by amounts allowed as deductions for gifts to public charities. In other words, gifts to public charities are counted "first" in a sense for purposes of the percentage limitations. Deductions for contributions of certain categories of appreciated assets (mostly marketable securities) to private foundations are limited to the lesser of (a) 20% of Adjusted Gross Income, or (b) 30% of Adjusted Gross Income reduced by gifts of such appreciated assets allowed as deductions for gifts to public charities.

- d. Individuals may carry charitable deductions forward for up to five years.
 - e. See below regarding possible enhanced deduction rules for donations of conservation easements.
3. **Income Producing.** Certain gifts may “convert” an asset which does not produce income to an income producing asset during your life and beyond for your heirs.
4. **At Life or Upon Death.** Gifts may be made during life or upon death.
5. **Lifetime Gifts.** Gifts made during life remove future appreciation and income from donor’s taxable estate.
6. **Types of Gifts**
- a. Outright gifts of cash, life insurance or other property.
 - b. Outright gifts of securities to save income tax.
 - c. Outright gifts of appreciated property, for example, securities, real estate, art, to avoid capital gain tax, including, for instance, foundations and donor advised funds.
 - d. Pooled income funds.
 - e. Gift annuities.
 - f. Charitable remainder trusts (“CRUT” or “CRAT”).
 - g. Charitable remainder trust in combination with life insurance (for “wealth replacement”).
 - h. Charitable lead trust (“CLUT” or “CLAT”).
 - i. Remainder interests.
 - j. Conservation easements. Beginning in 2007, the contribution of a conservation easement to a charity could be used as an enhanced income tax deduction by the donor limited to 50% of Adjusted Gross Income (AGI) in any year (or more for farmers, ranchers and forest landowners), with a 15 year carry forward (versus the more typical 30% and 5 year carry forward). The 2010 Tax Act extended this larger deduction to 2010 and 2011. This regime was again renewed for 2012, 2013 and 2014 as part of the 2012 Tax Act, but expired at the end of 2014. On December 18, 2015,

President Obama signed into law the “Protecting Americans from Tax Hikes Act of 2015” (the “PATH Act”), which made this deduction “permanent” for 2015 and beyond. Note that there may also be a special additional deduction for federal estate tax purposes for conservation easement donations made during life, depending on the circumstances.

7. Gifts from IRAs to Charities

- a. IRAs, 401(k)s and similar income tax deferred accounts can be paid to charities upon death thereby avoiding both death taxes and income taxes that would otherwise be due because a charity does not pay income tax, whereas non-charitable beneficiaries would have to pay income tax on the assets as they are withdrawn.
- b. In recent years there was a “temporary” change in tax law to permit persons who are at least 70 ½ to give up to \$100,000 in a calendar year from an IRA directly to a qualified charity without paying income tax on that charitable gift. The PATH Act (signed into law on December 18, 2015), made this deduction “permanent” in 2015 and beyond. The SECURE Act did not change the age at which a person can make these charitable gifts from an IRA.
- c. For an applicable year, including 2020 and beyond, the following applied or apply:
 - (1) The transfer must be made directly from the IRA to the charitable organization.
 - (2) In the past, there was no “additional” charitable income tax deduction and any such charitable gift(s) counted against the donor’s required minimum distribution (RMD) from the IRA (which would otherwise be taxable income to the account holder). However, the SECURE Act now permits individuals of any age to make IRA contributions (so long as the individual has earned income) and, correspondingly, any distributions to charity directly from an IRA will only be a qualified charitable distribution to the extent that the distribution exceeds the aggregate additions to the IRA after the participant has reached age 70 ½. Any distributions attributable to additions after such age will be treated as income payable to the participant (and still count towards the donor’s RMD), and the participant can take a related charitable income tax deduction.
 - (3) Employer-sponsored retirement plans, including SIMPLE IRAs and SEP plans are not eligible.

- (4) Not all charities are eligible, including for instance donor-advised funds and supporting organizations, and distributions must be payable directly to the charity. In addition, the donor cannot make a qualified distribution in exchange for a charitable gift annuity or to a charitable remainder trust.
- (5) Given the higher standard deduction amounts under the 2017 Tax Act, using an IRA rollover to fund charitable gifts will allow a taxpayer who may not benefit from a charitable income tax deduction (because his or her itemized deductions are less than the standard deduction) to, in effect, indirectly achieve a charitable deduction.

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