

# 2018 Wills, Trusts and Estates Certification Course

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# Basic Overview of Fed'l Transfer Taxes Estate, Gift and GST

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# Road Map

1. Where we are
2. General Terms
3. Basic Review of Estate Tax (pages 51 - 85)
4. Basic Review of Gift Tax (pages 9 - 26)
5. SO, let's play ...

# Where we are ..

New tax law was signed by President Trump on December 22, 2017, Public Law, formally titled “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018), but commonly know as the “Tax Cuts and Jobs Act).

# Where we are ..

The House Bill called for the temporary repeal of the estate and GST transfer taxes, along with a reduction in the tax rate applicable to taxable gifts.

But the Senate Bill focused only on doubling the basic exclusion amount, an approach adopted by the Conference Bill.

Thus, the federal wealth transfer taxes survived, but once again suffer a significant reduction in scope.

# Terms

# TERMS

- A person who makes a gift during his lifetime is called a "**donor**".
- A "**gift**" in the t&e world is a transfer of property made for less than adequate and full consideration. Certain gifts are transfer tax free, and others gifts are called "**taxable gifts**".
- Transfers of property made by taxable gift or through a taxable estate are called "**taxable transfers**".

# TERMS

- The “***probate estate***” includes all items which are subject to administration in the probate court.
- The “***gross estate***” and “***taxable estate***” may include many items that are not part of the probate estate.
- The estate tax applies to property that is considered part of the decedent’s taxable estate.



# TERMS

- Tax Rates for transfer tax purposes may be “*flat*” or “*graduated*” (or “*progressive*”).
- The federal transfer tax regime has a “*Graduated Rate Scale*”.
- For estate taxes, the larger the estate, the higher the “*marginal tax rates*” (*i.e.*, the rates charged on the last \$1 of taxable property) applied, and consequently the higher the “*effective rate*” (or average rate) of tax paid.
- The “*effective tax rate*” is the total tax paid divided by the total taxable estate or inheritance and is therefore lower than the top marginal rate.

# ESTATE TAX RATE

If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Not over \$10,000	18 percent of such amount.
Over \$10,000 but not over \$20,000	\$1,800, plus 20 percent of the excess of such amount over \$10,000.
Over \$20,000 but not over \$40,000	\$3,800, plus 22 percent of the excess of such amount over \$20,000.
Over \$40,000 but not over \$60,000	\$8,200 plus 24 percent of the excess of such amount over \$40,000.
Over \$60,000 but not over \$80,000	\$13,000, plus 26 percent of the excess of such amount over \$60,000.
Over \$80,000 but not over \$100,000	\$18,200, plus 28 percent of the excess of such amount over \$80,000.
Over \$100,000 but not over \$150,000	\$23,800, plus 30 percent of the excess of such amount over \$100,000.
Over \$150,000 but not over \$250,000	\$38,800, plus 32 percent of the excess of such amount over \$150,000.
Over \$250,000 but not over \$500,000	\$70,800, plus 34 percent of the excess of such amount over \$250,000.
Over \$500,000 but not over \$750,000	\$155,800, plus 37 percent of the excess of such amount over \$500,000.
Over \$750,000 but not over \$1,000,000	\$248,300, plus 39 percent of the excess of such amount over \$750,000.
Over \$1,000,000	\$345,800, plus 40 percent of the excess of such amount over \$1,000,000.

# Transfer Tax

# TRANSFER TAXES

Under our Federal tax regime, three taxes can be imposed on the **gratuitous transfer** of a person's property during life or at death:

- **Estate tax;**
- **Gift tax;**
- **Generation Skipping Transfer Tax.**

These three taxes are called "**transfer taxes**" because they are excise taxes imposed on the gratuitous transfer of property.

# UNIFIED FEDERAL SYSTEM

- Gift and estate taxes form the two parts of a “unified” or “integrated” transfer tax system. This means that these taxes are imposed at graduated rates on the cumulative amount of taxable transfers made by one person, **counting transfers made both during life and at death.**
  - So, a single rate schedule applies to both gift and estate taxes. The rates are progressive on the basis of cumulative lifetime and death-time transfers.
  - Thus, in effect the taxable estate is treated as one final gift occurring at death.
- We have a second transfer tax (not unified), which is the GST tax.

# Tax Calculations

## CALCULATING TAXES ...

- **Tax Rate x Tax Base = Tax Payable**
- Tax Rate x (Tax Base – Deductions) = Tentative Tax.
- Tentative Tax – Credits = Tax Payable

# The Federal Estate Tax (pages 51-85)



# CALCULATION OF THE ESTATE TAX

## Calculation of the Estate Tax



# *STRUCTURE OF THE FEDERAL ESTATE TAX*

## *(PAGES 51 - 85)*

- **The Gross Estate:**

- §2031/33-Property in which decedent had an interest at death (except interests that expire by reason of death) (page 51)
- §2034-Dower/curtesy interests
- §2035-Certain gifts made within 3 years of death (life insurance) (page 61)

- **Incomplete Transfers:**

- §2040-Jointly owned property/Rights of survivorship property (page 51)
- §2041-Property over which decedent possessed a general POA (page 53)
- §2042-Life insurance on decedent's life (page 55)
- §2039-Annuities (page 56)
- §2036-Transfers with retained life estate (page 57)
- §2038-Revocable transfers (page 58)
- §2037-Transfers taking effect at death (page 60)
- §2044-QTIP Property of Surviving Spouse (page 62)

- **Equals: Gross Estate**

# *STRUCTURE OF THE FEDERAL ESTATE TAX*

## *(PAGES 51 - 85)*

- **Less: Deductions:**
  - §2053-Funeral and administrative expenses, debts
  - §2054-Casualty losses
  - §2055-Charitable Contributions (amount ascertainable at time of death)
  - §2056-Marital Deduction
  - §2057-Certain Family-Owned Business Deduction
- **Equals: Tentative Taxable Estate**
- **Less: State Tax Deduction**
  - § 2058-Deduction for State Death Tax
- **Equals: Taxable Estate**
- **Add: Adjusted Taxable Gifts**
- **Equals: "Line 5 Taxable Amount" x Rate Schedule**
- **Equals: Tentative Tax on Total Transfers**

# *STRUCTURE OF THE FEDERAL ESTATE TAX*

## *(PAGES 51 - 85)*

- **Less: Prior Gift Tax Paid on Taxable Gifts added back**
- **Less: Tax Credits:**
  - §2010-Unified Tax Credit
  - §2011-State Death Tax Credit (pre-2005 estates)
  - §2012-Gift Tax Credit for pre '77 Gifts Included
  - §2013-Credit for Tax on Prior Transfers
  - §2014-Foreign Death Tax Credit
- **Equals: Estate Tax Due**

# *VALUATION OF THE GROSS ESTATE*

## *(PAGES 71 -74)*

- **Property is included in the gross estate at its fair market value.**
  - Highest and best use.
- **Alternate valuation method**
- **Special use valuation**
- **Buy-Sell agreements**

# Step-up Basis

## *RETENTION OF STEPPED-UP BASIS*

- Neither the House Bill nor the Senate Bill proposed any changes to the application of Section 1014, which provides a fair-market-value-at-death basis for property acquired from a decedent.

# Exclusions and Deductions



# *THE BIG FEDERAL ESTATE TAX EXCLUSIONS AND DEDUCTIONS*

- Charitable Deductions (charitable deduction planning discussed in later presentation)

# ***THE BIG FEDERAL ESTATE TAX EXCLUSIONS AND DEDUCTIONS (65 -70)***

- Marital Deductions (marital deduction planning discussed in later presentation)
- To qualify:
  - Recipient must be the decedent's spouse (as determined by state law);
  - Recipient must survive the decedent (check applicable presumptions of death);
  - Recipient must be a US citizen (otherwise property must be transferred to QDOT);
  - The property must be included in Decedent's Gross Estate;
  - The property must pass to the surviving spouse; and
  - The interest must not be a terminable interest.

# ***THE BIG FEDERAL ESTATE TAX EXCLUSIONS AND DEDUCTIONS***

- Marital Deductions Con't ...
- Exceptions to the terminable interest rule:
- Survivorship conditions (§ 2056(b)(3));
- Life Estate with power of appointment (§ 2056(b)(5))
- Right to payment of life insurance or annuity with power of appointment (§ 2056(b)(6))
- Income interest to spouse of CRUT or CRAT when the spouse is the only non-charitable beneficiary (§ 2056(b)(8))
- QTIP Trust (§ 2056(b)(7))

# The Unified Credit (pages 70 - 71)

## *UNIFIED CREDIT (PAGES 70 - 71)*

A **unified credit** equal to the “**applicable credit amount**” is available. The credit, which is not discretionary, is available to offset estate tax liability to the extent it is not used against taxable gifts during life.

The applicable credit amount is equal to the tax under the unified rate schedule on the “applicable exclusion amount.” Currently, the basic exclusion amount is **\$5,450,000**.

Correspondingly, the applicable credit amount (unified credit) is **\$2,124,800**.

- portability (discussed in later presentation)

# The Federal Gift Taxes (pages 9-22)

## *Legal Requirements for a gift*

- Donative intent;
  - Actual or constructive delivery; and
  - Acceptance by donee (usually presumed)
- 
- Avoid strings ....

# *Taxes on Transfers*

## *(page 9)*

- The gift tax applies only to transfers of property (not to gratuitous renderings of services).
- **Transfers subject to the gift tax:**
  - **Irrevocable Transfers**—outright or in trust (as long as complete)
  - **Transfers for less than full and adequate consideration**
  - **Holder of General Power of Appointment** exercises or releases the power. Generally, lapses are treated as releases. **Exceptions:**
    - Power which permits holder to consume only HEMS standards
    - Power requires the consent of a party w/ an adverse interest
    - Power which may be exercised only with consent of the creator



## *Transfers not subject to taxes* *(page 12-14)*

- **Qualified Disclaimers**—must meet requirements
- **Incomplete Transfers**—if grantor may revoke; has a right of reversion; appoint a new donee; or except for a power held as a fiduciary and limited to an ascertainable standard, alter the respective shares of existing donees.
- **Joint Tenancies with noncitizen spouse**
- **Transfers for full consideration**
- **Transfers incident to divorce**
- **Qualified tuition and medical expenses payments**—tuition only, not books, dorm fees, or similar expenses.

# Exclusions and Deductions

# *THE BIG FEDERAL EXCLUSIONS AND DEDUCTIONS*

- **Annual Exclusion** (pages 15 - 19)
- **Marital Deductions** (pages 19 - 20)
- **Charitable Deductions** (pages 20)

# ***THE BIG FEDERAL EXCLUSIONS AND DEDUCTIONS***

- Annual Exclusions (pages 15 – 19): The first **\$15,000** of gifts per year per donee are excluded from the gift tax.
- Present interest requirement (page 17). A gift is a present interest only if the donee has the unrestricted right to immediate possession and enjoyment of the property or its income.
- Three ways to qualify:
  - Outright gifts
  - Custodianship accounts
  - Trusts:
    - Minor Trusts: 2503 (c) (pages 16)
    - Crummey Trusts (pages 16-18)

## *Minors Trust 2503 (c)* *(pages 16)*

Qualifies for the Annual Exclusion

Requires:

- Trust is for a **single** beneficiary under age 21:

- The trustee has the authority to use trust income and principal for the benefit of the minor;

- The minor is entitled to the outright distribution of the trust property no later than age 21; and

- If the minor dies before 21, the trust property is either distributed to the minor's estate or as the minor appoints under a general power of appointment

# The Unified Credit (pages 20-22)

## *UNIFIED CREDIT*

### *(PAGE 20)*

A **unified credit** equal to the “**applicable credit amount**” is available. The credit, which is not discretionary, is available to offset estate tax liability to the extent it is not used against taxable gifts during life.

The applicable credit amount is equal to the tax under the unified rate schedule on the “applicable exclusion amount.”

## *UNIFIED CREDIT*

### *(PAGE 20)*

- The American Taxpayer Relief Act of 2012 made permanent the \$5,000,000 basic exclusion amount for federal estate, gift, and GST transfer taxes. The basic exclusion amount adjusted for inflation after 2011.
- The basic exclusion amount for 2018 was set to be \$5,600,000. But the new law doubles the basic exclusion amount from \$5 million to \$10,000 million, with adjustments for inflation after 2011.
- Thus, the basic exclusion amount for 2018 may be \$11,200,000 (actual figures may be different due to rounding in inflation adjustments)



## *UNIFIED CREDIT*

### *(PAGE 20)*

- The estimated revenue loss from doubling the basic exclusion amount is \$83 billion over ten years)
- Portability is discussed in later presentation.

# Estate Tax vs. Gift Tax

## *Tax Inclusive vs. Tax Exclusive*

- The tax base for estate and gift tax to which the tax rate is applied is different.
  - Gift Tax = tax **exclusive** (no tax on the tax)
  - Estate Tax = tax **inclusive** (tax paid on after tax dollar)

## *Tax Free Appreciation*

- All income from, and appreciation of, the gifted property escape any further gift and estate taxes.

# Generation Skipping Transfer Tax

## *Background on GST Tax*

- **Purpose:** To limit dynasty tax-planning by subjecting wealth to some kind of transfer tax at least once each generation.
- **Implementation:** Impose a tax on each “generation-skipping transfer.”
- Examples of GST Transfers include:
  - An outright gift or bequest to a grandchild of the donor or testator;
  - A distribution from a trust to the grantor’s grandchild; and
  - A termination of a life-interest in a child when the remainder interest is in a grandchild

# Terms

## (pages 113 -115)

**Generation-skipping transfer:** A transfer to a “skip person.”

**Skip Person:** A grandchild or any person assigned to a generation that is two or more generations below the transferor’s generation. A trust can also be a skip person

**Trust:** A distribution or a termination of an interest in a trust may be a taxable event under the GST Tax. A trust includes “any arrangement (other than an estate) that has substantially the same effect as a trust).

**Interest in a trust:** A person has an interest in a trust only if:

She has a present to right to receive income or principal; or

She is a current permissible distribute of trust property.

## Generation Assignment (pages 117 -120)

Lineal descendants, spouses and other persons:

- Lineal Descendants

- Charities and Spouses

- Current or former Spouses of a lineal descendant

- Other natural persons (12 and a half years)

Exception for predeceased ancestors:



# Triggering Events (pages 120 - 124)

- **Direct Skip:** A transfer of property (outright or in trust) to a skip person.
- **Taxable Termination:** A termination of any interest in property held in trust unless:
  - an interest in the property is retained by a non-skip person; or
  - no distribution may be made to a skip person.
- **Taxable Distribution:** A distribution made from a trust to a skip person (other than a “taxable termination” or a “direct skip”).

# Exemptions and Exclusions (pages 124 - 125)

- **Section 2503(e) equivalents:** exclusion for certain transfers for educational expenses or medical expenses.
- **Section 2503(b) equivalents:** annual exclusion.
- **GST Exemption:** same