ksm
CPAs & Advisors

Estate, Gift, and GST Tax – Planning for a Reduced Exemption Transition

Stephen Schnelker, JD, CPA
Director

May 15, 2025

Agenda

1. Overview of Gift, Estate, and GST Tax
2. Estate Tax Planning Strategies
3. Annual Gifting Strategies

Overview of Gift, Estate, and GST Tax

Gift Tax Overview

- Gift tax is imposed on gratuitous transfers of property during a person's lifetime
- Each year, a person is able to gift a certain amount without making a taxable gift
  - 2025 amount is $19,000 per donee
  - Gift must be of a "present interest"
- Exclusion for tuition and medical payments
- Generally unlimited marital deduction for gift tax
- Unlimited charitable deduction
- Spouses may be able to "split" gifts
- Gifts over the annual exclusion amount reduce the donor's lifetime gift/estate tax exemption

ksm

Gift Splitting Eligibility

- Both residents or citizens of US at time gift was made
- Must be married at time of gift
  - No splitting post-death gifts
- If divorced during the year, must not remarry
- Both spouses must consent to election
  - Both spouses don’t necessarily need to file gift tax returns
- Does not apply to gifts to spouse
- Must be elected on the first filed return for the tax year
- No Notice of Deficiency for gift tax has been sent to either spouse

Estate Tax Overview

- A taxpayer has a "basic exclusion amount" which shields assets from gift and estate taxes
- Lifetime gifts reduce the amount of exclusion available upon death
- A decedent's estate is allowed an unlimited marital deduction and an unlimited charitable deduction
- If the fair market value of a decedent's assets exceed the remaining exclusion amount, after expenses, marital deduction, and charitable deduction, the decedent's estate is subject to estate tax
- If the fair market value of a decedent's assets does not exceed the remaining exclusion amount, and the decedent was married on the date of death, the decedent's unused exemption can be passed to the decedent's spouse (with some limitations)
- Basis of assets included in a decedent's gross estate is the fair market value on the date of death

TCJA Changes to Estate Tax

- TCJA increased the basic exclusion amount from $5M to 10M, indexed for inflation
    - 2025 exemption amount is $13.99M
    - TCJA also temporarily increased the generation skipping transfer tax exemption to $13.99M for 2025
- Increased exemption reverts to $5M + inflation for estates of decedents arising after December 31, 2025
- Tax rate remained unchanged at 40%

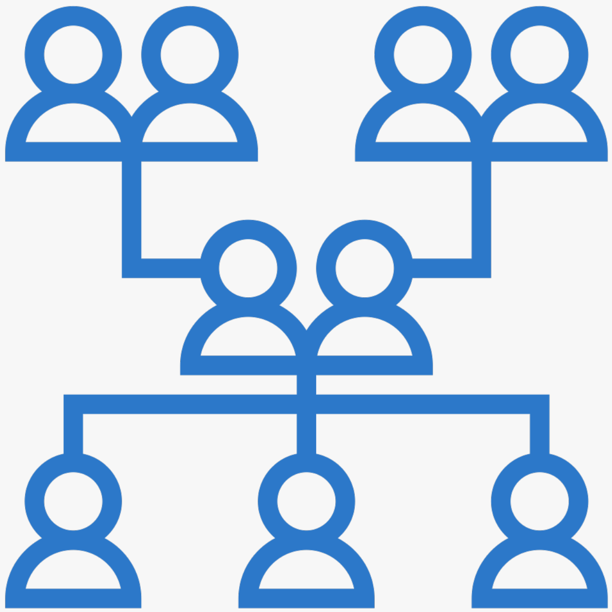
State Tax Differences

- Be aware of state tax exemption amounts that differ from federal

- Examples:
  - New York exemption amount is $7,160,000 for 2025
    - $358,000 “cliff”
  - Illinois exemption amount is $4,000,000
  - Massachusetts exemption is $2,000,000
  - Minnesota exemption is $3,000,000
  - Washington DC exemption is $4,873,200
  - New Jersey inheritance tax

Generation Skipping Transfer Tax (GSTT)

- Additional tax on transfer to a skip person
  - Tax rate is the highest marginal estate tax rate in effect at the end of the tax year
- Goal of GSTT is to capture wealth transfers that will not be included in the next generation's estate for estate tax purposes
- Example:
  - If a grandparent gives wealth to a grandchild, that wealth will not be subject to estate tax until the death of the grandchild
  - GSTT "makes up" for skipping the parents by adding an additional tax on the gift or bequest from grandparent to grandchild



GST Exemption

- Same as estate/gift exemption
- $13.99M per person
- Indexed for inflation
- Will revert to pre-TCJA amount on 1/1/2026
    - $5M + inflation (effectively cut in half from 12/31/2025 amount)
- Taxpayer can choose how to allocate GST exemption
    - Important to efficiently allocate GST exemption
    - Can allocate by means of a formula
        - E.g. least amount of GST exemption necessary to produce an inclusion ratio of zero
- Internal Revenue Code provides default rules for allocation of GST exemption absent affirmative decision by a taxpayer

Timely Allocation vs. Late Allocation

- Applicable Fraction = GST Exemption Allocated / Value of Property Transferred

- Timely filed gift tax return
  - Value of Property Transferred = Value on date of gift

- Late filed gift tax return
  - Value of Property Transferred = Value on date the late gift tax return is filed

Timely Allocation vs. Late Allocation Example

- $200,000 gift to ILIT (not a direct or indirect skip to which GST exemption was automatically allocated) on January 16, 2023, to pay premium on $20 million life insurance policy
- Due date of gift tax return is April 15, 2024
- Insured dies on October 1, 2023, and ILIT receives $20 million
- On timely filed return, taxpayer needs to allocate $200,000 of GST exemption to fully exempt the trust from GST
- On a late-filed gift tax return, ILIT cannot be fully exempt from GSTT as it would take $20M of GST exemption (Value of property transferred on date of late filing)

Relief From Late Elections

- IRS can grant extensions of time for taxpayers to make the election to allocate GST tax exemption based on the value of the property at the date of the gift
- Requires private letter ruling

Estate Tax Inclusion Period (ETIP)

- ETIP:
  - Period of time beginning on date of transfer and ending on first to occur of:
  - Time after which the transferred property would no longer be included in the transferor's gross estate if the transferor were to die after such time,
  - Occurrence of a GST with respect to the property, or
  - Transferor's death
- Most common transfers subject to ETIP:
  - GRATs and QPRTs

ETIPs and Allocation of GST Exemption

- No allocation of GST exemption may be made to transferred property that would be includible in the transferor's gross estate (other than under the three-year rule of section 2035) if the transferor were to die immediately after the transfer, until the end of the ETIP
- If any part of a trust is subject to an ETIP, the entire trust is subject to the ETIP
- Value of property for GST exemption allocation purposes is value at end of ETIP if allocation is made on a timely filed gift tax return for the period that includes the end of the ETIP
- An allocation of GST exemption made before the end of an ETIP is not effective until the end of the ETIP

Estate Tax Planning Strategies

Portability

- Deceased spouse's unused exclusion amount ("DSUE") can be used by surviving spouse
- Must timely file estate tax return
- "Portable" amount is not indexed for inflation
- GST exemption amount is not portable
- Surviving spouse may lose DSUE amount if surviving spouse remarries
- State exemptions may not be portable

Qualified Terminable Interest Property Trust ("QTIP")

- **Can be established during lifetime or at first spouse's death**
- **Qualifies for unlimited marital deduction if:**
  - Spouse is entitled to all the income from the trust, at least annually
    - Can be a unitrust amount under state law
    - Spouse can demand that non-incoming producing property be made productive
  - Spouse is the only beneficiary during their lifetime
  - Spouse is a US citizen
- **Value of trust assets included in Spouse's estate upon their death**

Intentionally Defective Grantor Trust (“IDGT”)

- **Trust designed so that assets are not included in grantor’s gross estate**
  - Grantor uses lifetime exemption upon gifting to trust
- **Grantor retains certain power(s) causing grantor to be deemed owner for income tax purposes**
  - e.g., swap power
- **Grantor is liable for income tax generated by trust assets**
  - Benefit because Grantor uses “estate taxable” assets to pay tax while trust grows “tax-free” outside Grantor’s estate
  - IRS has ruled the Grantor does not make an additional gift when paying the taxes

ksm

Spousal Lifetime Access Trusts ("SLATs")

- **Use exemption by making lifetime gift to trust**
  - Hedge against exemption amount decreasing
- **Independent trustee can distribute assets to spouse**
- **When spouse dies, assets immediately transferred to remainder beneficiary**
- **Risks**
  - Spouse pre-deceases donor
  - Divorce
- **Be careful of the reciprocal trust doctrine**

ksm

Irrevocable Life Insurance Trusts (“ILITs”)

- **Trust created to own life insurance**
- **If a life insurance policy is owned by ILIT and ILIT is the beneficiary of policy, then proceeds are not part of gross estate of the insured decedent**
- **If the life insurance policy is acquired by gift, the decedent must survive for three years to avoid estate inclusion**
- **Generally, donor will make annual contributions to ILIT to fund premium payments**
    - Beneficiaries can be given Crummey powers over annual contributions

Grantor Retained Annuity Trusts (“GRATs”)

- **Irrevocable trust established for a term of years selected by grantor**
- **Grantor receives an annuity at a rate selected by the grantor for the specified term**
- **Any amount remaining at the end of the term is transferred to the remainder beneficiary free of gift and estate tax**
  - Generally, grantor’s children
- **If grantor does not survive the term, GRAT value included in the grantor’s estate**

Sale to IDGT

- **Initial sale is disregarded for income tax purposes**
  - No gain/loss and no interest income/expense for income tax purposes
  - Not disregarded for transfer tax so interest should be paid
- **Future growth out of estate**
- **Uncertainty as to consequences if grantor dies holding note**
- **Need to "seed" trust**

ksm

Take Advantage of Applicable Valuation Discounts

- **Family LLC**
  - Transfer assets not needed for personal living expenses
  - LLC may insulate assets from taxpayer's personal liabilities
  - Facilitates transfers among family members
  - May allow taxpayer to retain some management control

Family LLC Savings Illustration

Value before discount	$ 1,000,000
Minority/marketability discount	25%
Discount value	$ 250,000
Estate tax rate	40%
Tax savings	$ 100,000

Family LLC Risks

- **IRS does not like**
  - Valuation discounts
  - Potential “retained interest” arguments
- **Need to comply with formalities surrounding creation and operation of LLC**

Retained Interests

- **Sections 2036, 2037, and 2038 cause assets within its provisions to be included in the gross estate**
  - Retained life estates
    - Right to vote shares of a controlled corporation
  - Right to designate who can possess or enjoy property
  - Right to income from the property
  - Right to alter, amend, revoke, or terminate an interest in the property

- **Examples**
  - Grantor ceases to pay rent for use of residence previously gifted to QPRT
  - Donor retains interest in gifted artwork by hanging on wall of personal residence

“Upstream” Gifting

- **Gift assets up a generation**
- **If donor (or donor’s spouse) receives assets back upon death of donee within one year, no basis step-up is allowed**
  - Consider having donee leave assets to someone other than donor
    - Trust for a grandchild
  - If donee dies within one year of gift and leaves assets to donor, donor can disclaim
- **Gift or sell assets to trust for benefit of older generation**
  - Grant beneficiary GPOA

Reverse QTIP

- **Why make a reserve QTIP election?**
  - GST exemption is not "portable" between spouses
- **Testamentary reverse QTIP**
  - Grantor's executor wants to allocate Grantor's GST exemption to a QTIP
  - Executor must make a "reverse QTIP election" to treat Grantor, rather than spouse, as transferor for GST tax purposes
- **Inter-vivos reverse QTIP**
- **No partial reverse QTIP elections allowed**

Annual Gifting Strategies

Annual Gifting Strategies

2025 annual gift and GST exclusion is $19,000

- Example 1 – married couple can gift $76,000 to their child and their spouse without using any gift/estate tax exemption
- Example 2 – same as above but married couple also gifts to their two grandchildren. $152,000 can be gifted each year

Unlimited tuition and medical expenses

- Must be made directly to the provider
- For tuition exclusion, only tuition counts
  - e.g., room and board, even if paid directly to university, is not excluded

ksm

Gift to Trust

Generally gift of future interest

- Not eligible for annual exclusion

Many trusts include “Crummey” withdrawal rights

- Allows gift to trust to qualify for annual exclusion
- Only qualifies for GST under very specific circumstances
  - Generally will not qualify for GST annual exclusion
- Watch for hanging powers

Adequate disclosure

- IRS requires the EIN of the trust
- Attach entire trust document to return (attach to both returns if gift splitting)

Medical and Tuition Expenses

Medical expenses paid directly are not subject to gift tax

- Most medical expenses qualify

Tuition paid directly to educational institution is not subject to gift tax

- Note payment of supplies, books, room and board does not qualify

Reimbursement payments do not qualify for either exclusion

If only gifts during the tax year are qualified medical or tuition payments, no gift tax return is required

ksm

529 Plans

Gift to beneficiary of the 529 plan, not the owner

Completed gift

- Eligible for annual exclusion for both gift and GST

Election available to spread gift to 529 plan over 5 years

- Can contribute up to $95,000 per beneficiary ($190,000 if married) in 2025

Broader range of expenses that can be paid vs. tuition exclusion

ksm

Presenter

Stephen Schnelker

Director, Tax Services Group

sschnelker@ksmcpa.com