

Chapter 4

Estate, Gift, and GSTT And Subchapter J

- Estate, Gift, and GSST relief by doubling basic exclusion amount (BEA) from **\$5 mil. to 10 mil.** (inflation adjusted after 2011).
- So **\$11.2 Mil. BEA in 2018** (instead of \$5.6 mil).
- Married couple, with portability or bypass trust, can shield **\$22.4 mil.**
- For estates of decedents dying and gifts made between **January 1, 2018 and December 31, 2025.**

2019 Projected Exemption:

- \$11,400,000
- \$15,000 gift tax exclusion (same).

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REG-106706-18 Supp.
(11/20/2018) – IRS
Proposes to
Eliminate post-2026
Clawback Threat

Estate Tax Clawback Issue. Does a gift made during 2018 – 2025 that was sheltered from gift tax by the increased **basic exclusion amount (BEA)** inflate a post-2025 estate tax liability given that the post-2025 estate tax computation is based on the BEA in effect at the decedent's DOD?

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Example

- After 2025, the BEA falls back down to \$5 million (inflation adjusted).
- For example:
 - In 2019, D makes a gift to C of \$11,000,000 (no prior gifts).
 - In 2027, after the prior law returns, D dies and assume that the BEA amount (inflation adjusted) is \$6 million.
 - The estate may owe estate tax on prior taxable gifts in excess of the \$6,000,000 BEA.

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Congress Contemplated Clawback

“As a conforming amendment to section 2010(g) (regarding computation of estate tax), the TCJA provides that the IRS “shall prescribe regulations as may be necessary or appropriate to carry out the purposes of the section with respect to differences between the basic exclusion amount in effect: (1) at the time of the decedent's death; and (2) at the time of any gifts made by the decedent.” (TCJA Conference Agreement.)

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Prop. regs. solve the clawback problem by increasing the post-2025 estate tax BEA, where necessary, to match the prior gift BEA.

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Proposed Regs. Answer Other Concerns

- 1) For **gift tax purposes**, is the increased basic exclusion amount [BEA], available during **2018 thru 2025**, reduced by **pre-2018 gifts on which gift tax actually was paid**?

No, per the existing rules says IRS.

- 2) For **estate tax purposes**, is the increased basic exclusion amount [BEA], available during 2018 thru 2025, **reduced by pre-2018 gifts on which gift tax actually was paid**?

No, per the existing rules says IRS.

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- 3) Is the gift tax on a gift made after 2025 inflated by a theoretical gift tax on a gift made during 2018 thru 2015 that was sheltered from gift tax when made?

No, per the existing computation rules.

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TCJA

- **No change** in ability to step-up (or down) income tax basis at death.
- **No change** in current rules for **non-resident aliens** (\$60K exclusion from estate tax and no exemption from gift tax).

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Planning Points—

- **Most estates:** Take another look at old wills and trusts to make sure that the Bypass Trust is not overfunded.
- Bypass Trust escapes estate of surviving spouse and **thus is denied a basis step-up on survivor's death.**
- Make gifts while the basic exclusion amount is high, but consider loss of basis step-up at death.
 - Both halves of community property are stepped up at death.
- Consider eliminating family limited partnership interests to eliminate discounts at death.

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- **Portability** more important because more to “port” to surviving spouse.
 - May not matter for average estates.
- **GSTT**. Consider allocating the newly available GST exemptions to trusts that are not entirely exempt.
- **Noncitizen spouse. Option to QDOT**: The increased exemption allows more assets to be funneled into the Bypass Trust for the benefit of the noncitizen spouse (instead of marital deduction trust).

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- **Leverage all available gifting techniques:**

For example, with an **Intentionally Defective Grantor Trust** (a complete transfer for estate/gift purposes but a grantor trust for income tax purposes):

- Payment of income tax is an additional gift that avoids gift tax.
- Grantor can swap high-basis assets owned by the grantor for low-basis assets owned by the trust.

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Misc. I.D. Disallowance Impact on Trusts and Estates

Notice 2018-61 (July 13, 2018) – Clarification With Respect to Trusts and Estates

Prior Law Background:

Sec. 67 (e) Determination of **adjusted gross income in case of estates and trusts.**

“...the **adjusted gross income** of an estate or trust shall be computed in the same manner as in the case of an individual, **except that-**

(1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which **would not have been incurred if the property were not held in such trust or estate, ... shall be treated as allowable in arriving at adjusted gross income”.**

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- Issue #1: IRS concludes that “the suspension of the deductibility of miscellaneous itemized deductions under section 67(a) **does not affect the deductibility [by the trust or estate for AGI] of payments described in section 67(e) (1).**”
 - Conversely, “an expense that **commonly or customarily would be incurred by an individual** (including the appropriate portion of a bundled fee) is **...not deductible to the estate or non-grantor trust during the suspension of section 67 (a).**”

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- Issue #2: “The Treasury [is aware that the **elimination of miscellaneous itemized deductions (MIDs) for beneficiaries**] will affect a beneficiary's ability to deduct **section 67 (e) expenses** upon the **termination of the trust or estate as provided in section 642 (h).**”
 - A section 642 (h) (2) excess deductions “may include” section 67(e) expenses (for AGI expenses).
 - Such expenses -- **per prior law** -- are **treated as a miscellaneous itemized deductions [MIDs]** of the beneficiaries, despite being above AGI deductions of the trust or estate. See §§ 63(d) and 67(b)

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“Treasury Department and the IRS request comments concerning whether the separate amounts comprising the section 642 (h) (2) excess deduction, such as any amounts that are section 67 (e) deductions [for AGI deductions] should be separately analyzed when applying section 67.”

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Non-TCJA Cases and Rulings

Security Bank & Trust Co. v. Larkin
(Minn. 2018), File June 27, 2018
Attorney Malpractice Involving GSTT

- The trust devised about 45% of the trust property to a beneficiary more than 37.5 years younger than the trustor.
- The distribution resulting from the grantor's death triggered a generation-skipping transfer tax (GSTT) of about \$1.645 million.
- The attorney was accused of never advising the client about the tax.
- Holding: Trustee lacked the capacity to sue.

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Estate of Streightoff, TC Memo 2018-178
Interest Includible In Estate Was a Limited
Partnership Interest

Supp.

- The Tax Court determined that the decedent's 88.9% partnership interest was a limited partnership interest (whether the grantor trust held an assignee interest or not)
- Because a 75% limited partner could remove the GP and thus terminate the partnership, no discount for lack of control was appropriate.
- The Tax Court determined that an 18% discount for lack of marketability was appropriate.

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