

ESTATE, GIFT AND GST TAX BASICS FOR THE NEW ESTATE PLANNER

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Transfer Tax Basics

- **Transfer Taxes**
 - Estate tax
 - Gift tax
 - Generation-skipping transfer (GST) tax
- **Imposed only upon transfers of property**

Estate Tax

- **Assessed at death**
 - Estate tax returns and estate taxes are due nine months after the decedent's death
 - Tax is based on the fair market value of estate assets
- **Federal estate tax**
 - Applicable exclusion amount is \$5,000,000 indexed for inflation
 - \$5,450,000 in 2016
 - \$5,490,000 in 2017
 - Imposed at a flat rate of 40% on amount exceeding exclusion amount
- **Massachusetts estate tax**
 - Exemption is frozen at \$1,000,000
 - Imposed based on a progressive rate schedule with a minimum of 5% and a maximum of 16%
 - “Cliff tax” imposed on entire estate, not just amount over \$1,000,000

Federal Estate Tax

Year	Estate Tax Exclusion	Maximum Estate Tax Rate
2001	\$675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	N/A*	35%
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$5,250,000	40%
2014	\$5,340,000	40%
2015	\$5,430,000	40%
2016	\$5,450,000	40%
2017	\$5,490,000	40%

*Special Rules for 2010

Estate Tax

- **Assets subject to the estate tax**
 - **Assets owned by decedent**
 - Probate
 - Non-probate
 - **Powers of appointment**
 - Trusts over which decedent has a general power of appointment (as opposed to a limited or special power of appointment)

Estate Tax

- Taxable estate also includes certain transfers made during decedent's lifetime
 - Life estate
 - Reversionary interests
 - Revocable transfers
 - Retained power to control beneficial interest
 - Certain assets transferred within three years of death

Estate Tax

- **Valuation of estate assets**
 - **Fair market value**
 - **Valuation date: fair market value as of:**
 - Date of death; or
 - Alternate valuation date (six months after date of death)

Estate Tax

- **Deductions**
 - **Debts of the decedent**
 - **Funeral expenses**
 - **Administration expenses**
 - **State estate taxes**
 - **Charitable deductions**
 - **Marital deduction**

Estate Tax

- **Marital deduction**
 - **Unlimited**
 - **Qualifying transfers between spouses are effectively exempt from federal and Massachusetts estate taxes at the first death**
 - **Available for outright transfers and certain trusts**
 - **Provides estate tax deferral until the death of the second spouse**
 - **If the spouse is not a U.S. citizen and is a resident or non-resident alien, special rules apply**

Estate Tax

- **Massachusetts planning without using a trust**
 - Husband and wife each have \$1,000,000
 - Wife leaves everything outright to husband at her death
 - No federal or Massachusetts estate tax due at wife's death
 - Entire \$2,000,000 is includable in husband's estate at husband's subsequent death
 - Wife's \$1,000,000 Massachusetts estate exemption went unused and does not carry forward
 - Massachusetts estate tax due at husband's death: \$99,600

Estate Tax

- **Massachusetts planning using a trust**
 - Husband and wife each have \$1,000,000
 - Wife leaves her entire estate in trust for the benefit of husband at her death (trust can also include other individuals as beneficiaries)
 - No federal or Massachusetts estate tax due at wife's death
 - \$1,000,000 in trust established by wife not included in husband's estate at subsequent death
 - Wife's \$1,000,000 Massachusetts exemption was used
 - No federal or Massachusetts estate tax due at husband's death

Estate Tax

- **Federal planning with portability of exclusion amount**
 - Deceased spousal unused exclusion amount (DSUE) can be used by surviving spouse
 - Surviving spouse can only use exclusion amount of last predeceased spouse
 - Surviving spouse who remarries does not keep exclusion amount from earlier spouses
 - DSUE is frozen at available amount at time of death (not indexed for inflation)

Estate Tax

- **Federal planning without using a trust**
 - Husband and wife each have \$5,450,000
 - Wife leaves everything outright to husband at her death
 - No federal or Massachusetts estate tax due at wife's death
 - Entire \$10,900,000 includable in husband's estate at his subsequent death
 - If husband dies without having remarried
 - Husband can use predeceased wife's \$5,450,000 DSUE amount
 - No federal estate tax due at husband's death
 - Issue: value of the assets is not static – may be more than \$10,900,000

Estate Tax

- **Federal planning using a trust**
 - **Portability of exclusion amount**
 - Same facts as before, but wife's former assets grow to \$8,000,000 after her death and before husband's death
 - Federal estate tax due at husband's death: \$1,020,000*
 - Had wife used a trust to shelter her \$5,450,000 federal exclusion amount, there would be no federal estate tax (but no income tax basis step-up) at husband's death
 - Conversely, if wife's assets decreased in value, portability would be beneficial

*Assumes there is no Massachusetts estate tax

Gift Tax

- **Applies to**
 - Transfers in trust
 - Outright transfers
 - Direct and indirect transfers
 - All types of property (real and personal, tangible and intangible)

Gift Tax

- Applicable exclusion amount applies to transfers during life and at death
- \$5,000,000 adjusted for inflation
 - \$5,450,000 for 2016
 - \$5,490,000 for 2017
- Federal tax rate imposed on gifts over the exclusion amount: 40%
- Massachusetts does not impose a gift tax
 - Other states may impose a gift tax

Gift Tax

- Valuation is based on fair market value as of date of gift
- Other exclusions and deductions
 - Annual exclusion from gift tax - \$14,000 for 2016 and 2017
 - Applies to gifts in trust if certain conditions met
 - Donee must have a present interest in gift
 - Educational expenses paid directly to organization
 - Medical expenses paid directly to provider
 - Marital deduction
 - Charitable deduction

Gift Tax Reporting

- Gifts reported on Form 709
- Due date for gift tax returns is same as due date for income tax returns, with extensions
- Gifts may be split with spouse with spouse's consent by making an election on Form 709

Gift Tax

- **Benefits of making gifts**
 - Remove appreciation on gifted assets from donor's estate between date of gift and date of death
 - Gift tax is “tax exclusive”
 - Donor pays any resulting gift tax
 - Some gifts can obtain discounted valuations
- **Disadvantages of making gifts**
 - No income tax basis “step-up” at death
 - Could incur tax sooner – gift tax due now vs. estate tax due after death

Generation-Skipping Transfer Tax

- Separate tax imposed on transfers of property to individuals of two or more generations younger than the transferor
 - e.g. grandmother to grandchildren
- Exclusion is \$5,000,000, indexed for inflation (separate from but same amount as applicable exclusion amount for estate and gift tax)
 - \$5,450,000 in 2016
 - \$5,490,000 in 2017

GST Tax

- **Generation assignment**
 - **Skip persons vs. non-skip persons**
 - **Relatives' generations are determined based on actual relation**
 - **Special rule for donee with predeceased parent**
 - **If donee is descendant of parent of transferor and donee's predeceased parent is descendant of parent of transferor, donee steps into parent's shoes**

GST Tax

- **Generation assignment**
 - **Nonrelatives' generations determined by difference in age**
 - Donee born not more than 12 ½ years after donor is same generation
 - Donee born more than 12 ½ years but not more than 37 ½ years after donor is one generation younger than donor
 - Similar rules for new generation every 25 years

GST Tax

- **Types of generation-skipping transfers**
 - **Direct skips**
 - **Taxable distributions**
 - **Taxable terminations**
- **Allocation of GST exemption**
 - **Automatic allocation**
 - **Otherwise allocated on gift tax return or estate tax return**

GST Tax

- **Exclusions**
 - Educational expenses paid directly to organization
 - Medical expenses paid directly to provider
 - Annual exclusion gifts
 - Applies to gifts in trust if certain requirements met
 - Donee must have a present interest in gift
 - Does not apply to all present interest gifts in trust
 - More restrictive than gift tax annual exclusion