SOUTH DAKOTA
TRUST ASSOCIATION

Turning Theory into Practice for Trusts and Estates

The Lodge, Deadwood, South Dakota
Friday, October 18, 2024

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& Consulting LLC

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Michael Miranda CPA QKA NQPC AEP

MIRANDA CPA
& Consulting LLC

- CPA / Consultant and owner of Miranda CPA & Consulting LLC; resides in Sioux Falls SD
- 48 years of experience with tax consulting, estate planning and employee benefit services
- Consulting practice includes niche areas and client representation before governmental agencies
- Maintains an active speaking schedule on tax law, estate and employee benefit plannings
- Professional designations include CPA, QKA and NQPA (Employee Benefits), and AEP (Estate Planning)
- Professional affiliations include AICPA, SDCPA, ASPPA, NAEA, NATP and NAEPC

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Quote of the Day

"People think you are crazy if you talk about things they don't understand."

-- Elvis Presley --

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Learning Objectives

- How to prepare for the TCJA Sunset
- Understand Final Regulations … Consistent Basis and Basis Reporting (9/16/2024)
- Understand Common Types of Trusts by Purpose
- Review Post-mortem planning
  - IRC §645 election
  - Use of an Estate's fiscal year and various tax accounting options
- Understand Estate Planning using Special "Types" of Trusts
- Questions and Answers

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Types of Trusts by Purposes

Asset Protection Trusts
- A trust created to protect assets from creditors
- In most cases an irrevocable trust with situs in a state with favorable trust and tax provisions

Special Needs Trusts
- A trust created to provide for a disabled person
- Structured to allow the beneficiary to be eligible for government programs

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Types of Trusts by Purposes

Irrevocable Life Insurance Trust (ILIT)
- A trust to pay the premiums and receive the death benefit of an insured from a life insurance policy
- Often the funding is structured to utilize the annual exclusion Crummey gifts

Dynasty Trust
- An irrevocable trust designed to transfer wealth to future generations
- Allocated GST exemption to limit the GST exposure
- Formed in a jurisdiction with favorable trust and tax code provisions
- In a jurisdiction that is favorable or lacked any prohibition against the rule of perpetuities

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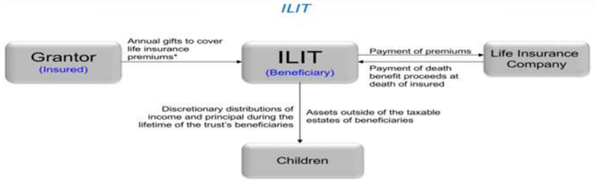
Types of Trusts by Purposes



Note: Gifts to the ILIT will use the grantor's annual gift exclusion and/or lifetime gift exemption.

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Types of Trusts by Purposes

- Crummey Trust
  - Grantors often want to give large sums of money via trusts with restrictive distributions rights
  - However, only present interest gifts qualify as annual exclusion gifts
  - The drafting attorney will include a Crummey Power which allows a beneficiary to withdraw the gift from the trust without restriction for a certain period of time – ***this will create a gift of a present interest***
  - Crummey is the name of the taxpayer who won the Tax Court case approving this strategy
  - Crummey gifts and Crummey interests refer to the same type of planning technique

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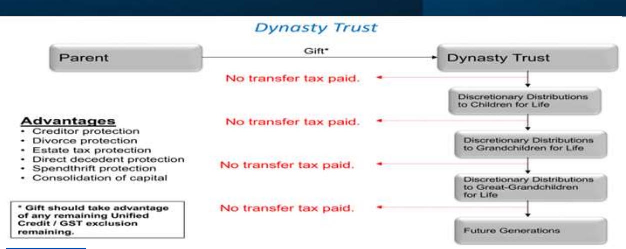
Types of Trusts by Purposes



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Types of Trusts by Purposes

- Intentionally Defective Grantor Trust (IDGT)
  - A trust intentionally made defective for income tax purposes – the grantor pays any income tax due to yield or capital gain attributable to the trust assets
  - Beneficial because payment of the trust's tax is not a taxable transfer for gift or estate tax purposes
  - Sales to the trust are not a recognition event for income tax purposes

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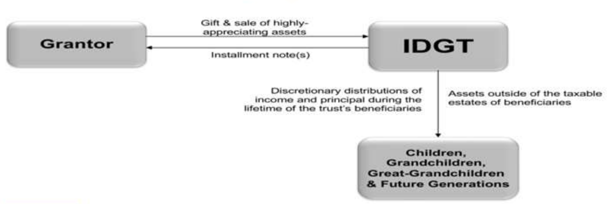
Types of Trusts by Purposes

IDGT – Example of a Sale to the Trust



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Types of Trusts by Purposes

- Qualified Terminable Interest Property Trust (QTIP)
  - Enables a grantor to provide for a surviving spouse while maintaining control of the disposition of the assets after the spouse's death
  - Qualifies for the marital deduction (for estate tax purposes) and therefore no estate tax is incurred with respect to the QTIP until the second death
  - Surviving spouse receives all income from the trust for life and reports it on their personal income tax return

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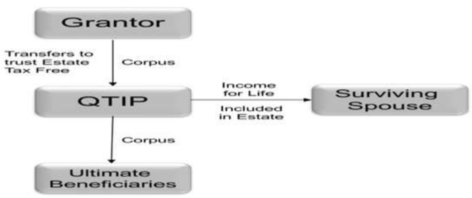
Types of Trusts by Purposes

QTIP



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Types of Trusts by Purposes

- Qualified Personal Residence Trust (QPRT)
  - Used to transfer a grantor's residence out of their estate at a low gift value
  - Irrevocable split interest trust
  - Grantor retains the right to live in the residence for a number of years rent free and then the remainder beneficiaries become fully vested in the personal residence
  - Grantor pays rent after the remainder beneficiaries have vested in the personal residence

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Types of Trusts by Purposes

- Grantor Retained Annuity Trust
  - Freezes the estate tax return value of assets transferred to the trust
  - Annuity is paid to the grantor annually or more frequently for a term of one or more years
  - Income is reported by the grantor during the term of the annuity
  - Income is usually reported by the trust after the term of the annuity is complete

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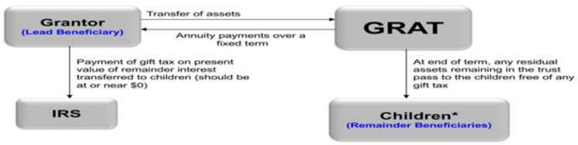
Types of Trusts by Purposes

Grantor Retained Annuity Trust



*Instead of naming the children as outright remainder beneficiaries of the GRAT, a grantor trust could be used (thus producing a greater estate tax benefit).

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Types of Trusts by Purposes

- Bypass or Credit Shelter Trust
  - Transfer a portion of a married couple's property in a testamentary irrevocable trust for the benefit of the children, typically, at the death of the first spouse
  - Designed to capture all or a portion of the estate tax exemption at the first death
  - More popular before portability was added, but it remains a useful estate tax planning technique
  - Pays its own tax

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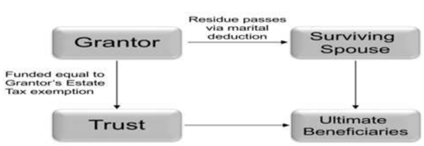
Types of Trusts by Purposes

Bypass Trust



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Types of Trusts by Purposes

- Charitable Remainder Trust
  - Distributes assets on an annual or more frequent basis to a non-charitable beneficiary
  - For a term of years
  - For the life of the non-charitable beneficiary (ies)
  - Unitrust or Annuity Trust
  - Upon the termination of the annuity to the non-charitable beneficiary (ies) and CRT distributed the assets to charity
  - Can be used to manage income taxation, however charitable intent is almost always required

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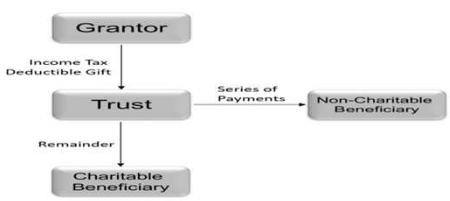
Types of Trusts by Purposes

CRT



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Types of Trusts by Purposes

- Charitable Lead Trust
  - Distributes assets on an annual or more frequent basis to a charitable beneficiary
  - For a term of years
  - Unitrust or Annuity Trust
  - Distributes remaining assets to a non-charitable beneficiary (usually a younger family member)
  - Can be used to manage estate taxation, however charitable intent is almost always required

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Types of Trusts by Purposes

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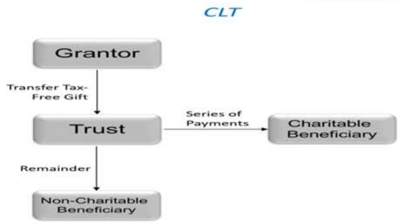

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Postmortem Planning – IRC §645 Election

- Treat a Decedent's Revocable Trust as Part of the Estate
  - Allows the trustee to treat a "qualified revocable trust" (a revocable trust owned by the decedent at the time of death) as part of the estate for income tax purposes
  - Both executor and trustees of all revocable trusts making the election must sign on by filing Form 8855 by the due date including extension for filing the estate's first income tax return
  - If no executor or estate, the trustee can sign on behalf of the estate
  - Revocable trusts must obtain a new EIN after the decedent's death, even if it had a prior EIN assigned

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Form **8855** (Rev. December 2020) Department of the Treasury Internal Revenue Service

Election To Treat a Qualified Revocable Trust as Part of an Estate

► Go to www.irs.gov/Form8855 for the latest information.

OMB No. 1545-1881

Part I Estate (or Filing Trust) Information

Name of estate (or the filing trust, if applicable (see instructions)) Estate of William O. Smith	Employer identification number (see instructions) 82-1122334
Name of executor (or the filing trustee, if applicable) Harriett Smith	Type of entity prior to the election: ☑ Domestic estate ☐ Foreign estate ☐ Domestic trust ☐ Foreign trust
Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address) 1234 57th Street	
City or town, state, and ZIP code (if a foreign address, see instructions) Sioux Falls SD 57108	Date of executor's appointment August 15, 2023

Under penalties of perjury, I, as executor (or filing trustee):

- Confirm that under applicable local law or the governing document, I have the authority to make this election for the estate (if executor) or trust (if filing trustee) and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for the above-named estate (or filing trust, if applicable);
- Confirm that an agreement has been reached with the trustees of each qualified revocable trust (QRT) joining in the election to allocate the tax burden of the combined electing trusts and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that the related estate's (or filing trust's, if applicable) share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Agree to accept responsibility for filing a complete, accurate, and timely income tax return, when required by law, for the combined electing trust(s) and related estate, if any, for each tax year during the election period;
- (If I am the filing trustee) confirm that if there is more than one QRT making this election, that I have been appointed by the trustees of each QRT making this election to be the filing trustee and I agree to accept the responsibility of filing the appropriate income tax return for the combined electing trust(s) for each tax year during the election period and all other responsibilities of the filing trustee;
- (If I am the filing trustee) represent that no executor has been appointed for a related estate and to the best of my knowledge and belief, one will not be appointed;
- (If I am the filing trustee) agree that, if an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the late appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of executor (or filing trustee)	Date

Part II Decedent Information

Name of decedent	SSN of the decedent	Date of death
William O. Smith	445-56-6541	August 14, 2023

For Paperwork Reduction Act Notice, see page 4. Cat. No. 24542R Form **8855** (Rev. 12-2020)

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Form 8855 (Rev. 12-2020) Page 2

Part III **Qualified Revocable Trust Information**

Name of trust	Employer identification number (see instructions)
Smith Family Trust	82-4332211

Name of trustee
Harriett SMith

Number, street, and room or suite no. (or P.O. box number if mail is not delivered to street address)
1234 57th Street

City or town, state, and ZIP code (if a foreign address, see instructions)
Sioux Falls, SD 57108

Under penalties of perjury, I, as trustee of the above-named trust:

- Confirm that under applicable local law or the governing instrument, I have the authority to make this election for the trust and to agree to the conditions of the election;
- Elect the treatment provided under section 645 for this trust;
- Agree to timely provide the executor (or filing trustee if there is no executor) with all the trust information necessary to permit the executor (or filing trustee, if applicable) to file a complete, accurate, and timely Form 1041 (or Form 1040-NR for a foreign estate) for the combined electing trust(s) and the related estate, if any, for each tax year during the election period;
- Confirm that an agreement has been reached with the trustees of each QRT joining in the election, and the executor of the related estate, if any, to allocate the tax burden of the combined electing trust(s) and related estate, if any, for each tax year during the election period in a manner that reasonably reflects each entity's tax obligation;
- Agree to ensure that this trust's share of the tax obligations of the combined electing trust(s) and related estate, if any, is timely paid to the United States Treasury;
- Confirm that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855, the trustee that completed Part I has been appointed the filing trustee, and to the best of my knowledge and belief, an executor has not been appointed to administer a related estate and one will not be appointed;
- Agree that if a filing trustee (and not an executor for a related estate) has completed Part I of this Form 8855 and an executor is appointed for the related estate after this Form 8855 is filed, that I will complete and file an amended Form 8855 if the later appointed executor agrees to the election, and I agree to cooperate with the executor in filing any amended returns required to be filed as a result of the executor's appointment; and
- Confirm to the best of my knowledge and belief, that all information of the electing trust contained in this election and any accompanying statements or schedules is true, correct, and complete.

Signature of trustee	Date

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Postmortem Planning – IRC §645 Election

- Effective as of the date of death and ends on the earlier of –
  - The date when all assets of the electing Trust and Estate have been distributed and
    - If no Form 706 filing – up to the second anniversary of the decedent's death, or
    - If Form 706 filing – the later of (i) 2 years or (ii) all the tax years of the Estate until 6 months after the final determination of the Form 706 return
  - Upon termination, final distribution to a new Trust carries out DNI and capital gain of the Trust as if the Estate was in its termination year

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Postmortem Planning – IRC §645 Election

Trust can use fiscal year of the Estate and defer income	Trust can utilize Estate's charitable income tax deduction or set-aside	Trust, as part of the Estate, can own S Corporation stock
Only one tax return to file	Trust can benefit from Estate's $25,000 rental loss allowance for the first two (2) years after death (IRC §469(h)(4))	Payment of decedent's medical expenses made by the Trust within one (1) year after death can be claimed on the decedent's income tax return

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Postmortem Planning –
IRC §645 Election

EXAMPLE – FACTS

James Nichols passed away on May 24, 2023. His spouse passed away several years earlier. James and his spouse created the Nichols Revocable Trust (NQRT) in January of 2005. James also had several assets that were not titled in the name of the NQRT. This required the opening of an estate and the filing of an estate income tax return (Form 1041).

On February 4, 2024, the personal representative for Nichols visits your office to wrap up various compliance related matters associated with Nichol's death. What post-mortem planning strategies do you recommend to the personal representative?

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Postmortem Planning –
IRC §645 Election

No Postmortem Planning Strategies Are Applied (IRC §645 Election)

- Nichols must file a final 2023 Form 1040 return (due 4/15/2024)
- Two NQRT returns (Form 1041) must be filed –
  - Short period 5/25/2023 through 12/31/2023 return
  - Short period 1/1/2024 to date of termination (assume 4/30/2024)
  - Must make any estimated tax payments as required of a trust
  - Trust may only use a calendar year to reporting it income, deduction, credits, etc.
- Probably one Estate Form 1041 return is required (May 25, 2023, through the date of wind up, but not later than April 30, 2024)
- Beneficiaries –
  - Must include income from NQRT for calendar year 2023 and calendar year 2024, respectively
  - Must include income from the Estate in calendar year 2024
- Tax Returns – At least four (4) returns are required where no postmortem planning is in play

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Postmortem Planning –
IRC §645 Election

Postmortem Planning Strategies Are Applied

- Nichols must file a final 2023 Form 1040 return (due 4/15/2024)
- Elect via Form 8855 to treat the NQRT (and all its assets, liabilities, income, and expense) as part of Nichol's Estate
- Eliminates the two Form 1041 returns for the NQRT (one ending on 12/31/2023 and the short period ending on 4/30/2024)
- Elect to use a fiscal year end of March 31st for the Estate. Now you have consolidated all the decedent's assets, liabilities, income, and expense into one accounting period – May 25, 2023, through March 31, 2024
- Prepare, review and deliver an "initial" and "final" Form 1041 (Estate Income Tax Return) to the personal representative

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Postmortem Planning – IRC §645 Election

Postmortem Planning Strategies Are Applied

- Personal representative distributes all the assets to the beneficiaries prior to March 31, 2024
- The decedent's Estate and Trust matters have been completed and the administration has been reduced to one Form 1041 return (with consolidated trust / estate accounting) and one final Form 1040 return
- The beneficiaries include "2023 NQRT net income from 5/25/2021 to 12/31/2021" on their 2024 Form 1040 return. The IRC §645 election permits a fiscal year end of March 31, 2024, for the estate and includes all the NQRT assets, liabilities, income, and expense. Without the election, there would have been two (2) separate Form 1041 return filings – one for 2023 (for the NQRT) and one for 2024 (for the NQRT).

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Postmortem Planning – Estate's Fiscal Year

- Individual Filing Requirements?
  - Final Form 1040 Return
  - Filing Status?
- Estate Returns (Form 1041) – Do You File a Short Tax Year?
- Estate Returns (Form 1041) – Fiscal Year or Calendar Year?
- Estate Returns (Form 1041) – Accounting Method?

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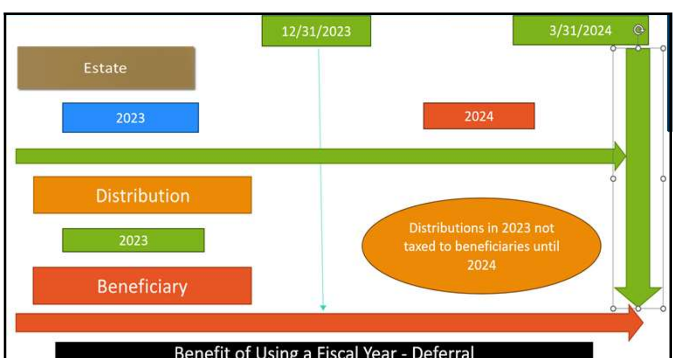

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Postmortem Planning – Use of Fiscal Year

EXAMPLE – *Election of an Estate's Fiscal Year End*

Wheat Farmer X in central South Dakota passes away on August 30, 2021. Harvest is complete and all the revenue is reported on Farmer X's final 2021 Form 1040 filed by April 15, 2022.

Planting for wheat crop that will be harvested in the summer of 2022 begins in early April of 2022. Farmer X's estate incurs $2,500,000 in expense from the period of August 31, 2021, through June 30, 2022. Wheat crop generates income of $4.0M in August of 2022.

Planting for wheat crop to be harvested in the summer of 2023 begins in early April of 2023 and the estate incurs $3,000,000 in expense. The 2023 summer wheat crop harvest generates $4,500,000 in August of 2023. The estate for Farmer X is finalized and the assets are transferred to the heirs of Farmer X prior to June 30, 2023.

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Postmortem Planning – Use of Fiscal Year

- *Election of Estate's Fiscal Year End – June 30th*
  - June 30, 2022 – creates an $2,500,000 net operating loss (NOL) that we can carryforward to FYE June 30, 2022 *($2.5M of planting expense)*
  - June 30, 2023 –
    - Wheat harvest income of August 2022 of $4,000,000 is combined with the $2,500,000 NOL carryover from FYE 6/30/22 and the $3,000,000 expense from the 2023 planting to create another NOL of $1,500,000
    - The $1,500,000 NOL is passed through to the heirs with the final Form 1041 estate income tax return
    - Heirs recognize $3,000,000 of taxable income ($4,500,000 of 2023 harvest income less the $1,500,000 NOL from the final Form 1041 estate income tax return and pay the balance of tax due on April 15, 2024

NOTE – The $4,500,000 of wheat crop income harvested in August 2023 is recognized by the heirs directly on their income tax return and outside the Estate entity

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Postmortem Planning – Use of Fiscal Year

- *Election of Estate's Fiscal Year End – **WHAT DID WE ACCOMPLISH?***
  - If Farmer X generated $1,500,000 of taxable income from the wheat crop each calendar year (2022 and 2023), the FYE allowed for a significant deferral of income for the heirs
  - Farmer X paid tax on April 15, 2022, for the 2021 wheat crop income and the heirs did not make a tax payment on the wheat crop income until April 15, 2024 (or for a two-year period)
  - Also, the FYE strategy permitted the Estate to recognize expense in a period where there was no income (FYE June 30, 2022)
  - This strategy deferred $1,500,000 of taxable income until calendar year 2023

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Intentionally Defective Grantor Trust (IDGT)

- Sell your closely held business to an IDGT
- Can provide substantial benefits to wealthy individuals and families seeking to transfer assets from one generation to the next
- Can minimize income, estate and gift tax liabilities
- Particularly effective in business succession planning for families with closely held businesses structured as partnerships or S corporations
- **STAY ALERT …** HW&M committee on 9/13/2024 Mark-Up would have eliminated the tax favored benefit of IDGTs (a similar provision has been included in Vice-President Harris' "Green Book" proposals)

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Intentionally Defective Grantor Trust (IDGT)

- What is the planning goal?
- Transfer assets to a trust for the benefit of children or future generations without incurring any gift or estate taxes on the sale
- Shift the value of assets sold that exceed the purchase price, due to valuation discounts, to your children
- Any future appreciation on the assets transferred remain outside of the grantor's estate for **estate tax purposes**

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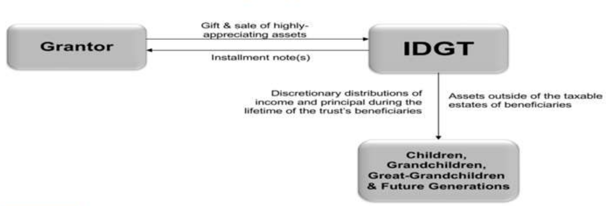
Types of Trusts by Purposes

IDGT – Example of a Sale to the Trust



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Intentionally Defective Grantor Trust (IDGT)

- How does an IDGT work?
  - IDGT – An irrevocable trust often structured as a "Dynasty Trust" for the benefit of grantor's children and future generations
  - Structured to benefit grantor's children during Grantor's lifetime and children's descendants after their death
  - When properly structured the result is –
    - A "defective" trust for income tax purposes, and
    - An "effective" trust for estates tax purposes
  - **Grantor is taxed on the IDGT's income** (as if the IDGT is not considered separate from the grantor for income tax purposes)
  - IDGT may hold S corporation stock without jeopardizing the S corporation election

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Intentionally Defective Grantor Trust (IDGT)

- Grantor trust provisions that create a "defective" grantor trust
  - Power to require trust property (IRC §675(4)(c))
  - Power to borrow trust assets without adequate interest or security (IRC §675(2))
  - Power to use the IDGT's income for purposes of paying insurance premiums (IRC §677(a)(3))
- Outright gift to an IDGT
  - In lieu of a sale of assets, grantor can simply make an outright gift to an IDGT (using gift and estate tax exclusions / exemptions)
  - Such strategy results in a completed gift for federal "gift" tax purposes, but incomplete when it comes to the income taxes (on the income generated from the assets gifted to the IDGT)

CAUTION: *Do not forget the "three year look back rule" for any gift (or sale) to an IDGT (a Trust)*

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Intentionally Defective Grantor Trust (IDGT)

- Structuring the sale using an IDGT
  - For IRS to respect the sale, certain attributes must exist –
    - IDGT must have assets that provide economic substance prior to the sale
    - This means, IDGT should have assets worth as least 10% of the value of the assets being sold to the IDGT
    - Generally, grantor will gift the "seed money" to the IDGT so that there is enough economic substance to support an installment sale and payments under a promissory note from IDGT to the Grantor
    - Grantor will use some of his or her lifetime gift tax exemption

Planning tip - structure the sale to take advantage of valuation discounts which may apply to different classes of stock

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Intentionally Defective Grantor Trust (IDGT)

EXAMPLE - FACTS

- Todd has an estate worth $20,000,000
- Todd is the sole owner of an S corporation worth $10,000,000
- Todd is married to Barbara, and they have three (3) children
- Todd recapitalizes the S corporation stock –
  - Non-voting stock is worth $9,000,000
  - Voting stock is worth $1,000,000
- Todd makes a gift of $1,000,000 in cash to the IDGT
- IDGT is created for the benefit of his children and future generations
- Assume the S corporation will generate income at a rate of 10% each year on the non-voting stock or $900,000 of income each year

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Intentionally Defective Grantor Trust (IDGT)

EXAMPLE

IDGT Transactions

- On October 1, 2024, Todd sells the $9,000,000 in S corporation non-voting stock valued for $7,000,000 (after valuation discount) to the IDGT
- The interest rate is based on Revenue Ruling 2024-21 for October 2024. In return Todd receives a promissory note with ten-year term and an interest only payment of 4.10% of the principal
- The balance of the note ($7,000,000) will be paid at the end of the note's term
- Annual interest to be paid will be $287,000

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Intentionally Defective Grantor Trust (IDGT)

- **Revenue Ruling 85-13 – "Todd cannot sell property to himself"**
  - A transaction cannot be recognized as a sale if the same person is treated as owning the purported consideration both before and after the transaction
  - IRS ruled that the receipt of the entire corpus of a trust in exchange for an individual's unsecured promissory note constituted an indirect borrowing of the trust corpus which caused the individual to be the owner of the entire trust (IRC §675(3))
  - The transfer of trust assets to the individual **was not a sale** for federal income tax purposes and the individual did not acquire a cost basis in those assets

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Intentionally Defective Grantor Trust (IDGT)

What Did Todd Accomplish?

- Retained 100% control of the S corporation
- Sold 90% of the S corporation stock at a discounted value
- Receives interest payments and principal from the note ($2,870,000 in interest and $7,000,000 in principal payments)
- Sold his S corporation to the beneficiaries of the IDGT (which were his three (3) children)
- Income from the operations of the S corporation was used to pay interest and principal – limiting the amount of financial burden to the S corporation
- Removed from his estate the non-voting portion of stock (except for the 10% controlling interest)
- Rights in promissory note held by his revocable trust pass to his spouse upon death

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Federal Gift Tax Annual Exclusion Amount

Date of Gift		Amount of Annual Exclusion
2001		$10,000
2002 – 2005		11,000
2006 – 2008		12,000
2009 – 2012		13,000
2013 – 2017		14,000
2018 – 2021		15,000
2022		16,000
2023		17,000
2024		**18,000**

2025 - $19,000

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Federal Wealth Transfer Tax – Basic Exclusion Amount (BEA)

Date of Death		Basic Exclusion Amount (BEA)
2011		$5,000,000
2012		5,120,000
2013		5,250,000
2014		5,340,000
2015		5,430,000
2017		5,490,000
2018		11,180,000
2019		11,400,000
2020		11,580,000
2021		11,700,000
2022		12,060,000
2023		**12,920,000**
2024		**13,610,000**

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Preparing for the TCJA Sunset

Tax Cuts Jobs Act (TCJA) – Now is the Time for Tax Planning

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Tax Strategies for 2024 and Beyond

Tax Cuts Jobs Act (TCJA) – Now is the Time for Tax Planning

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Preparing for the TCJA Sunset

- Understand the estate and gift tax changes
- Review a simple case study to highlight the impact of the TCJA Sunset and Estate and Gift Tax Planning

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Preparing for the TCJA Sunset

- Remember – *The same amount of GST exemption must be allocated to a Traditional IRA or a ROTH IRA. However, the ROTH IRA is much more efficient*

Description	Traditional IRA	ROTH IRA
Value of the Asset / Account	$2,000,000	$2,000,000
Income Tax @ 37%	(740,000)	-
Net to a GST Trust	$1,260,000	$2,000,000
Amount of GST Exemption Allocation	$2,000,000	$2,000,000

Example of a GST Trust using IRAs and the importance of the GST Exemption allocation

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Preparing for the TCJA Sunset

- *Missing* IRC §691(c) deduction
  - To prevent double-taxation, a beneficiary of a Traditional IRA may claim an income tax deduction for estate taxes paid on IRD (income in respect of a decedent)
  - However, the deduction is equal to the amount of **federal** estate tax paid
  - *Unfortunately, the state **estate tax** deduction is **not** allowed as a deduction at the federal income tax level*

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Understanding the IRD Deduction – Using a $20M Estate

TAXES DUE WITH NO IRD DEDUCTION

- **Estate - $1MM IRA Account**
  - **40% Estate Tax**
- **Beneficiary - $1MM IRA Account**
  - **37% Income Tax**

Total Results –

- **$400K Estate Tax**
- **$370K Income Tax**
- **Aggregate Tax Rate … 77%**

TAXES DUE WITH IRD DEDUCTION

- **Estate - $1MM IRA Account**
  - **40% Estate Tax**
- **Beneficiary - $1MM IRA Account**
  - **IRD deduction of $400K**
  - **$600K Taxable Income**
  - **37% Income Tax**

Total Results –

- **400K Estate Tax**
- **222K Income Tax**
- **Aggregate Tax Rate … 62.2%**

Overall Tax Savings $148K

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Estate Tax Considerations – Missing IRC §691(c) Example

	Traditional IRA	Roth IRA
IRA balance	$ 1,000,000	$ 1,000,000
Less: Federal and state income taxes on Roth IRA conversion (40%)	-	(400,000)
Taxable Estate	$ 1,000,000	$ 600,000
Federal estate tax (40%)	$ 400,000	$ 240,000
State death tax (10%)	100,000	60,000
Total estate taxes	$ 500,000	$ 300,000
Post-death traditional IRA balance	$ 1,000,000	
Less: IRC § 691(c) deduction	(400,000)	
Post-death traditional IRA balance subject to income tax	$ 600,000	
Federal and state income taxes on IRA distributions (40%)	$ 240,000	$ -
Net IRA balance to beneficiaries	**$ 260,000**	**$ 300,000**

Reconciliation: $100,000 state death tax x 40% post-death income tax rate = $40,000 (double-tax component) *OR* $400,000 income tax on conversion x 10% state death tax rate = $40,000 (estate tax savings)

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Estate Tax Considerations

- IRC §691(c) deduction … Fades Over Time …
  - The deduction is calculated on the date of death value
  - Post-death appreciation of pre-tax assets is not offset
  - This results in a relatively smaller amount of deduction in relationship to the value of the asset being recognized

The IRC §691(c) deduction is associated with the fair market value of the asset at the time of the decedent's death

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Estate Tax Considerations – Fading IRC §691(c) Example

	No Planning	Roth IRA Conversion at Death
Traditional IRA balance at death	$ 1,000,000	$ 1,000,000
Less: IRC §691(c) deduction	-	(450,000)
Taxable portion of Roth IRA conversion	$ 1,000,000	$ 550,000
Federal and state income taxes on Roth IRA conversion (40%)	$ -	$ 220,000
IRA balance available for future distributions	$ 1,000,000	$ 780,000
Total future IRA distributions	$ 2,000,000	$ 1,560,000
Less: IRC §691(c) deduction	(450,000)	-
Less: Amounts not subject to income tax	-	(1,560,000)
Taxable portion of future IRA distributions	$ 1,550,000	$ -
Federal and state income taxes on future IRA distributions (40%)	$ 620,000	$ -
After-tax total future IRA distributions	**$ 1,380,000**	**$ 1,560,000**

Reconciliation: $1,560,000 - $1,380,000 = $180,000 *OR* $620,000 future income tax liability - $440,000 future value of income tax liability on Roth IRA conversion (i.e. $220,000 x 2).

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Preparing for the TCJA Sunset

Gift and Estate Taxes

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Estate and Generation Skipping Transfer Taxes

- Tax Reform … Critical Changes
  - The TCJA "DOUBLED" the exemption from 2018 through 2025 ($13.61M in 2024)
  - The TCJA "DOUBLING" sunsets on December 31, 2025
  - **NO** "CLAWBACK" FOR THOSE WHO GIFT BEFORE SUNSET … ***BUT DIE AFTER SUNSET***
  - **Portability** … Don't Forget the DSUE … Requires the filing of a Form 706
  - Step-up in basis retained at the date of death

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Estate and Generation Skipping Transfer Taxes

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Estate and Generation Skipping Transfer Taxes

Exemption Reduction Math: "Use It or Lose It"

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Gifted Property – Basis Rules

- Let Us Revisit the Basis Rules for Gifted Property
  - When computing **gain** on the sale of gifted property by the Donee … *The basis is the same as the donor's basis*
  - However, when computing **loss** on the sale of gift property by the Donee, the basis is the lesser of …
    - Donor's basis, or
    - Fair market value (FMV) on the date of gift (Treas Regs §1.1015-1(a))

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Basis – Sale of Property as a Gain

- When property gifted as a basis greater than the FMV at the time of gift, any **gain**, is limited by applying the Donor's basis at the time of the gift

EXAMPLE

Perry purchased 100 shares of stock for $27,000. Perry gifted the shares sometime later to his son, Roger. At the time of the gift, the value of the stock was $18,000. Roger sold the shares of stock for $30,000. Roger will report his gain on the sale using the $27,000 (rather than the FMV at the time of the gift (i.e., $18,000)) as the basis in the shares of stock. Roger's capital gain on the sale of the shares will be $3,000.

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Basis – Sale of Property at a Loss

- When property gifted has a basis greater than the FMV at the time of gift, any **loss**, is limited to the value of the property at the time of the gift

EXAMPLE

Perry purchased 100 shares of stock for $27,000. Perry gifted the shares sometime later to his son, Roger. At the time of the gift, the value of the stock was $18,000. Roger sold the shares of stock for $15,000. Roger will report his loss on the sale using the $18,000 (rather than the basis of the shares in the hands of his father (i.e., $27,000)) as the basis in the shares of stock. Roger's capital loss on the sale of the shares will be $3,000.

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Gifted Property – Basis Rules

- Remember – basis is increased by all, or a portion of the federal gift tax paid with respect to the gift
- The increase is the amount of gift tax attributable to the net appreciation in the value of the gift

Basis increase formula – $\dfrac{\text{(gift tax paid) times (net appreciation)}}{\text{amount of gift}}$

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Gifted Property – Basis Rules

- Basis is generally FMV on date of decedent's death or, if elected, the alternative valuation date (IRC §1014(a))
- Appreciated assets receive a *step-up* in basis at death – saves income tax when the property is sold by *heirs*
- Depreciated assets receive a *step-down* in basis – deprives *heirs* of the income tax benefit of claiming a loss when the property is sold

Note: *Less common than stepped-up basis because taxpayers have an incentive to realize losses during lifetime*

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Step-Up in Basis Concept

- What is the Value of a "STEP-UP"?
  - Tax Savings –
    - Federal Capital Gains Tax
    - Federal Net Investment Income Tax (NIIT)
    - State Capital Gains Tax

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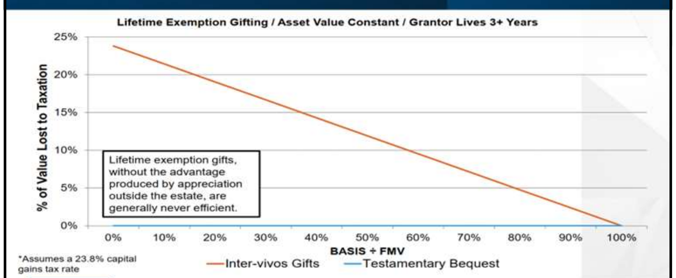
Step-Up in Basis Concept



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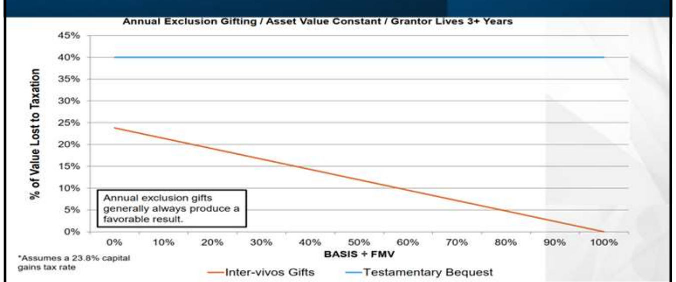
Step-Up in Basis Concept



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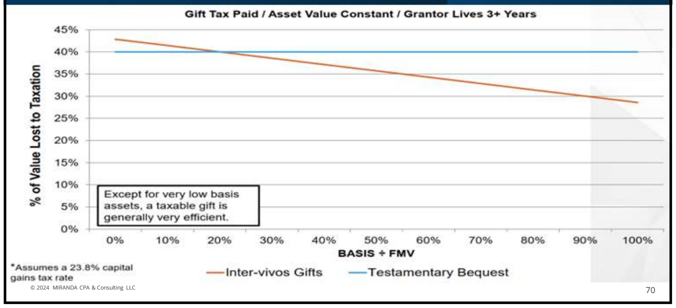
Step-Up in Basis Concept



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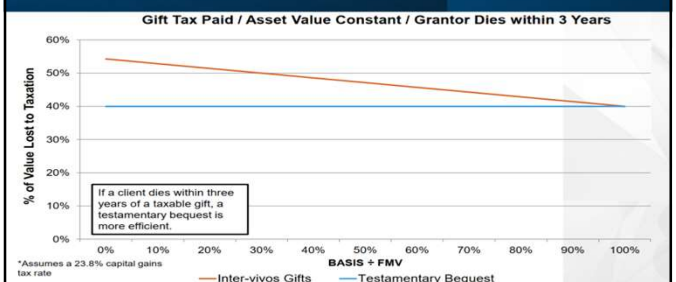
Step-Up in Basis Concept



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Turning Theory into Practice for Trusts and Estates

Analysis of Gift versus Death (Step-Up) – Single Client – Age 90

SIMPLE BREAKEVEN ANALYSIS

Description	Gift Basis $2M	Gift Basis $6M	Gift Basis $12M
Value of Estate	$30,000,000	$30,000,000	$30,000,000
FMV of Gift	12,000,000	12,000,000	12,000,000
Basis of Gift Transfer	2,000,000	7,000,000	12,000,000
Built in Gain (BIG)	10,000,000	5,000,000	0
BIG Taxed @ 25%	2,500,000	1,250,000	0
Appreciation Required to Match Step-up Value	6,250,000 (a)	3,125,000 (b)	0 (c)
Percentage of Appreciation (Gift)	52.083%	26.042%	Not Applicable

(a) $2,500,000 / 40%. (b) $1,250,000 / 40% (c) 40% Estate tax exceeds the 25% income tax

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Analysis of Gift versus Death (Step-Up) – Single Client – Age 90

INTERRELATED BREAKEVEN ANALYSIS

Description	Gift Basis $2M	Gift Basis $6M	Gift Basis $12M
Value of Estate	$30,000,000	$30,000,000	$30,000,000
FMV of Gift	12,000,000	12,000,000	12,000,000
Basis of Gift Transfer	2,000,000	7,000,000	12,000,000
Built in Gain (BIG)	10,000,000	5,000,000	0
BIG Taxed @ 25%	2,500,000	1,250,000	0
Appreciation Required to Match Step-up Value	16,666,667 (a)	8,333,333 (b)	0 (c)
Percentage of Appreciation (Gift)	138.889%	69.444%	Not Applicable

(a) $2,500,000 / (40% - 25%). (b) $1,250,000 / (40% - 25%) (c) 40% Estate tax exceeds the 25% income tax

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TCJA Sunset – Simple Case Study

- Facts
  - William is not married and age 80
  - William's net worth is approximately $18,000,000 and the basis of the property held is $9,000,000 (or ½ of the fair market value)
  - Assume no growth in William's net worth during the period of analysis – 2025 and 2026
  - Estate tax rate (assume federal tax only) or 40%
  - Capital gain tax rate of 30% (23% for federal and 7% for state)
  - The 2025 Basic Exclusion Amount - $14,000,000 (estimate)
  - The 2026 Basic Exclusion Amount - $7,500,000 (estimate)

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TCJA Sunset – Simple Case Study
2025 Funding and 2025 Death

Option 1 Fund Trust	
Gift	$12,000,000
Built In Gain (BIG)	6,000,000
Future Income Tax Liability	1,800,000
Assets at Death	6,000,000
Add Prior Gifts	12,000,000
Minus Basic Exclusion Amount	(14,000,000)
Taxable Estate	4,000,000
Estate Tax	1,600,000
Total Tax Liability	$3,400,000

Option 2 – No Planning	
Gift	$0
Built In Gain (BIG)	N/A
Future Income Tax Liability	N/A
Assets at Death	18,000,000
Add Prior Gifts	N/A
Minus Basic Exclusion Amount	(14,000,000)
Taxable Estate	4,000,000
Estate Tax	1,600,000
Total Tax Liability	$1,600,000

$1,800,000 in overall tax savings with **no planning**

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TCJA Sunset – Simple Case Study
2025 Funding and 2026 Death

Option 1 Fund Trust	
Gift	$14,000,000
Built In Gain (BIG)	7000,000
Future Income Tax Liability	2,100,000
Assets at Death	4,000,000
Add Prior Gifts	14,000,000
Minus BEA with Claw Back	(14,000,000)
Taxable Estate	4,000,000
Estate Tax	1,600,000
Total Tax Liability	$3,700,000

$500,000 in overall tax savings with **Fund Trust**

Option 2 – No Planning	
Gift	$0
Built In Gain (BIG)	N/A
Future Income Tax Liability	N/A
Assets at Death	18,000,000
Add Prior Gifts	N/A
Minus Basic Exclusion Amount	(7,500,000)
Taxable Estate	10,500,000
Estate Tax	4,200,000
Total Tax Liability	$4,200,000

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TCJA Sunset – Concluding Remarks

- Consider the significant impact of income tax basis and recognize capturing the disappearing exemption has a cost to your client
- Prepare to fund a trust now, but delay actual funding until an appropriate time (e.g., the fall of 2025 under current law)

PLEASE DON'T WAIT UNTIL DECEMBER 2025 TO START ESTATE, GIFT AND TAX PLANNING FOR YOUR CLIENT!

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TD 9991 Final Regulation – Decedent Basis Reporting

- IRC §1014(f) – provides that the recipient's basis acquired from a decedent must be the value of property as finally determined for federal estate tax purposes PRE-SECURE 1.0 Act – Stretch Death Distributions
- IRC §6035 – representatives of the estate must provide basis information to IRS and the property recipients
- Final regulations remove the zero-basis rule for unreported property

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TD 9991 Final Regulation – Decedent Basis Reporting

(1) Adopt a suggested interpretation of the term "acquiring" under IRC §6035(a)(1) for reporting purposes

(2) Eliminate a reporting requirement for subsequent transfers of property for all beneficiaries other than trustees

(3) Except additional type of property interest from the consistent-basis and the IRC §6035 reporting requirements

Effective date of the final regulation … September 17, 2024

THREE OTHER SIGNIFICANT REVISIONS IN THE FINAL REGULATIONS (1) (2) and (3)

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QUESTIONS & ANSWERS

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Thank You!

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