Roth Conversions, Charitable Giving & Estate Planning

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Outline

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ROTH CONVERSIONS

OBBBA

Rates – Made Permanent

- All TCJA rates & bracket thresholds generally made permanent
- Slight upward adjustments to the top of the 10% and 12% brackets, thereby granting a small amount of additional relief
- Effective in 2026

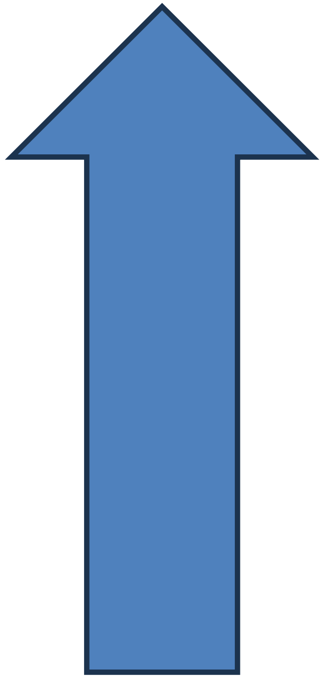
OBBBA § 70101

Standard Deduction

Made Permanent § Expanded

- TCJA standard deduction increase permanent
- Slight additional permanent increase as well
- Effective in 2025

	2025 TCJA	2025 OBBBA
Single	15,000	15,750
HoH	22,500	23,625
MFJ	30,000	31,500
MFS	15,000	15,750



OBBBA § 70102

Senior Personal Exemption

- For years 2025, 2026, 2027, & 2028 seniors are entitled to an additional $6,000 exemption.

- Limitations in the bill
  - Available to taxpayers who have attained age 65
  - Reduced by 6% of the amount modified AGI exceeds $75,000 ($150,000 MFJ)

Senate § 70103

Estate & Gift Tax Exclusion

Increased BEA Made Permanent

- The TCJA doubled the Basic Exclusion Amount (BEA) through 12/31/25 ($13,990,000 in 2025)
- TCJA sunset uncertainty made planning difficult over the last several years
- The bill will permanently increase the estate, gift and GST exclusion to $15,000,000 for 2026 and will be indexed for inflation thereafter
- This will provide meaningful relief to many families who may be subject to the estate tax but are not wealthy enough to undertake simple & effective tax planning.

OBBBA § 70106

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PEASE Limitation

Modification

- The TCJA suspended the overall limitation on itemized deductions (the PEASE limitation)

- The bill re-introduces and modifies the limitation (effective 2026+)
  - The new formula is as follows:

$$Reduction = \frac{2}{37}\ x\ the\ \mathbf{lessor}\ of \begin{cases} \textit{Total Itemized Deductions} \\ \textit{Total taxable income, plus itemized deductions, subject to the 37\% bracket} \end{cases}$$

OBBBA § 70111

State & Local Tax Deduction

Modifications

- The bill Increases the deduction cap as follows:

2025	$40,000
2026	$40,400
2027	$40,804
2028	$41,212
2029+	$10,000

- The bill also provides the deduction cap is reduced by 30% of modified AGI over $500,000;
  - The deduction is not reduced below $10,000 (i.e., a $100,000 phase-out range)
  - The income-based limitation applies 2025+

OBBBA § 70120

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0.5% Floor for Itemized Charitable Deductions

- The adds a new limitation – contributions must exceed 0.5% of the taxpayer's contribution base to be deductible
- The bill also permanently increases the cash contribution to 60% (recall, it was 50% before the TCJA)
- Effective to taxable years beginning after 12/31/25

OBBBA § 70425

Roth Conversion Critical Concepts

Practical Considerations

- **Roth Conversion Recharacterization Repeal:**
  - The opportunity to capture market fluctuations is no longer available.
    - Instead, the taxpayer undertaking a conversion now risks assets will decrease in value after conversion.
    - This encourages separating conversions into tranches spread across the calendar year.
  - Unexpected income could foul best-laid plans
    - For example, a year-end bonus could substantially increase the tax-cost of conversion and drive the marginal rate above an acceptable figure.
    - This encourages year-end conversions.

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Practical Considerations

- **Tax Payment**
  - Estimated tax payments and the underpayment penalty:
    - Taxpayers can avoid the penalty if they make estimated payments equal to the lessor of: 90% of the current year liability, or 100% the tax owed for the previous year
    - Taxpayer's with income over $150,000 have a higher standard – the lessor of: 90% of the current year liability, or 110% the tax owed for the previous year
    - The penalty also does not apply to taxpayers who will owe less than $1,000 of tax after subtracting withholdings and credits
    - A taxpayer who undertakes a year-end Roth conversion should consider electing to use the Annualized Income Installment Method which requires sufficient estimated payments in the quarter the income was recognized, rather than even payments.

Practical Considerations

- **Tax Payment**
  - Custodian Withholding
    - Taxpayers can also elect to have the taxes withheld and forwarded to the IRS by the traditional IRA custodian at the time of conversion
    - This may eliminate the underpayment issue, however using funds from the qualified account to pay the tax is substantially less tax-efficient over-time

ROTH IRA TIMELINE

1998: Taxpayer Relief Act
- Roth IRA Created


Senator Roth

2001 & 2003 EGTRRA & JGTRRA
- Income & Estate Taxes Decrease

2010: Tax Relief Act
- $100,000 AGI limit on Roth Conversions Removed
- Estate Tax Restored

2013: ACA
- Income Tax Rates Increase

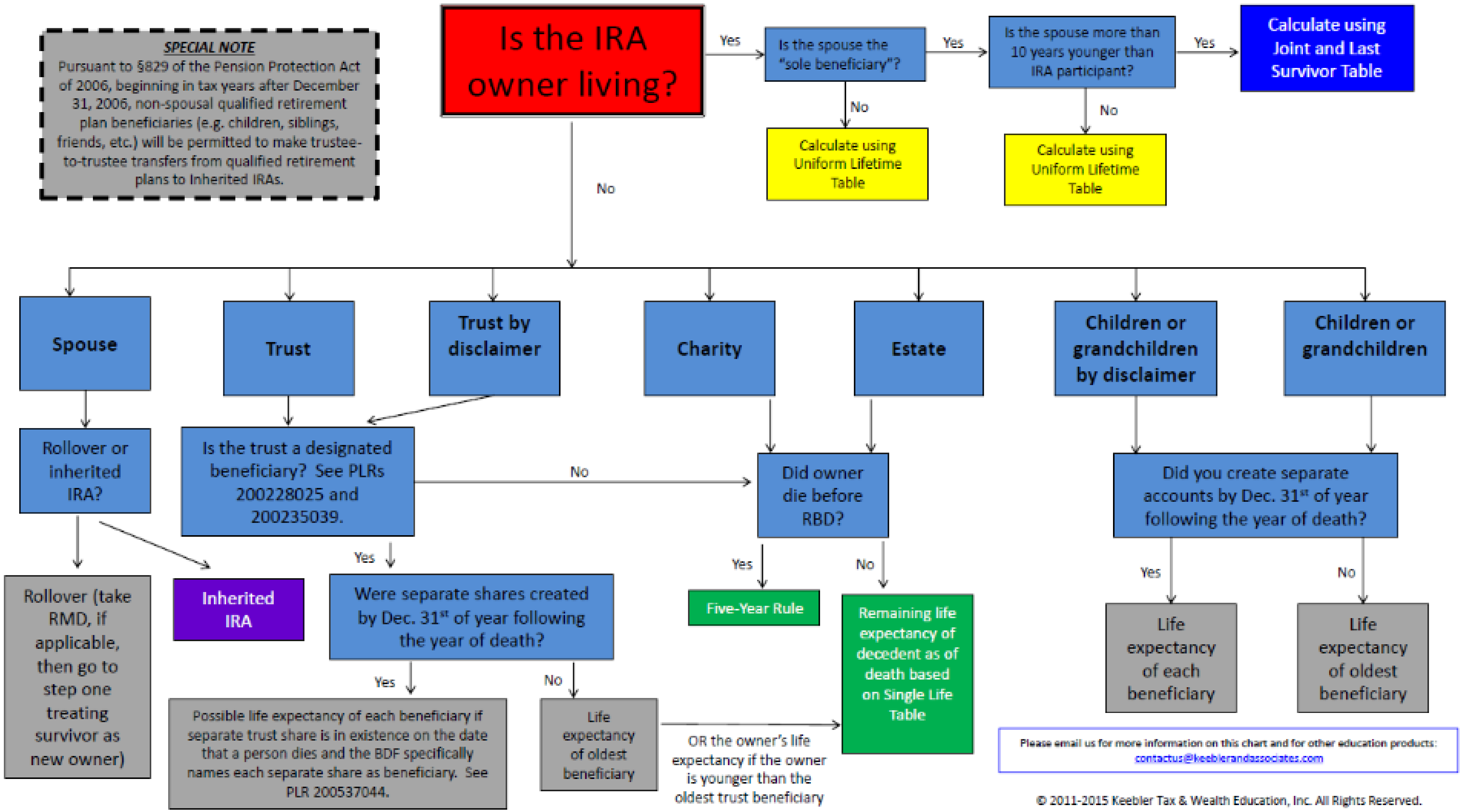
2018: TCJA
- Income & Estate Taxes Decrease

2020: SECURE Act
- 10-Year Rule

2025: ?
- Income & Estate Taxes Increase
- "MEGA RMDs"
- "Backdoor" Roth Repeal
- Roth Conversion Phaseout

Pre-Secure Law
for Post-Mortem Distributions

Pre-Secure Bill Distribution Flowchart



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Stretch Out IRAs

“Inherited” IRA

- Two Strategies
  - Spousal Rollover
  - Inherited IRA
- Advantages
  - Rollover delays RMD until spouse’s own RBD
  - Inherited IRA provisions allow distributions to occur over many years after the death of the IRA owner

Both Still Available After the Secure Act

The SECURE Act

KEY CHANGES

RMDs after Death

Basically, requires all IRAs, Roth IRAs, and Qualified Plans to be distributed within 10 years of death

EFFECTIVE DATE:

Deaths which Occur After 12/31/19

RMDs after Death

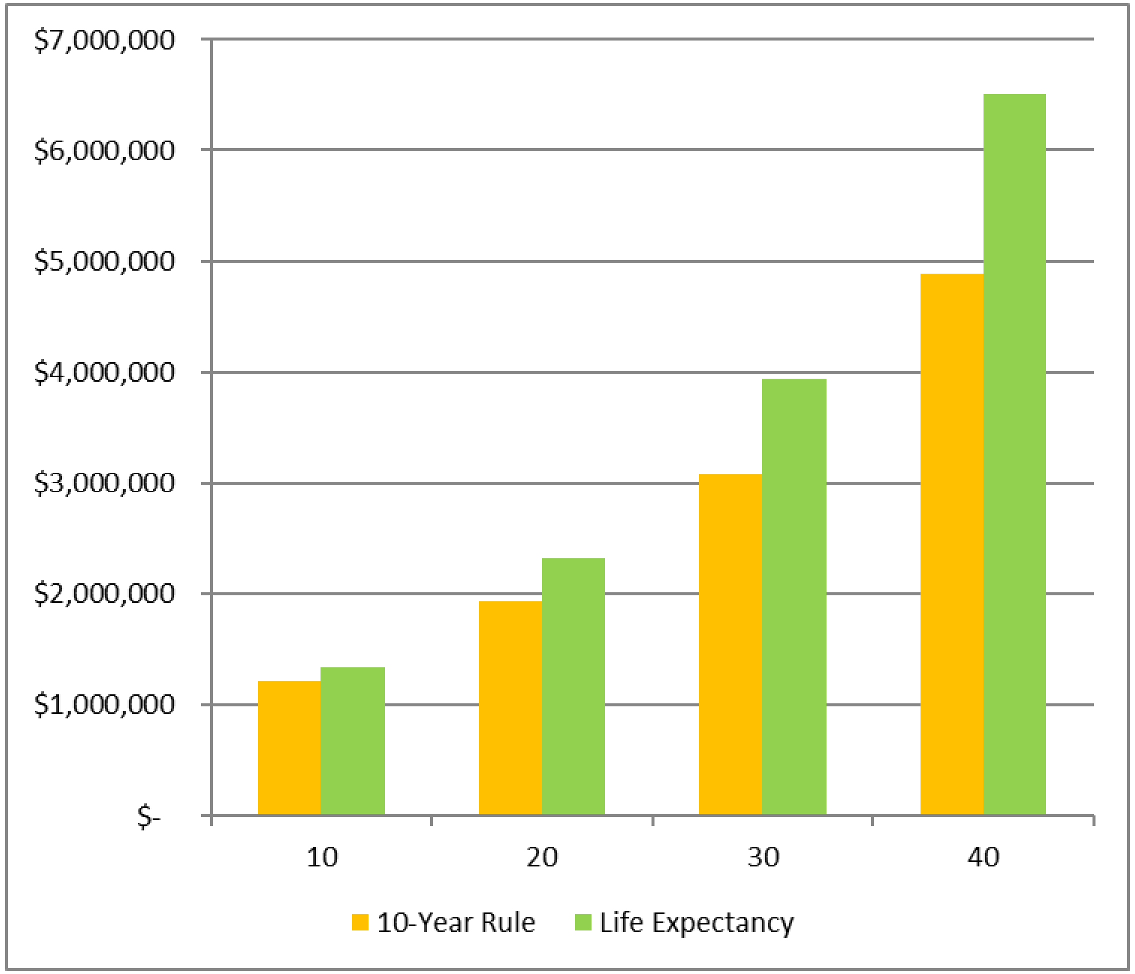
Example

Ten-Year vs. Life Expectancy

Age of (Oldest Trust) Beneficiary	40
IRA Balance	$ 1,000,000
Pre-Tax Growth Rate	6.00%
After-Tax Growth Rate	4.75%
Average Income Tax Rate - Life Expectancy Rule	24.00%
Average Income Tax Rate - Ten Year Rule	28.00%
Distributions Occur at Beginning or End of Period?	End
Lump-Sum Distribution or Amortize Payments?	Amortize

RMDs after Death

Example



RMDs after Death

Exceptions from the 10-year Rule for certain beneficiaries
("eligible designated beneficiary")

- Surviving Spouse
- The employee's Children under the age of majority *(not grandchildren or any other children)*
- Disabled
- Chronically ill
- Individual not more than ten years younger than employee

§§ 401(a)(2)(E)(ii)

TRADITIONAL IRA RMD FLOWCHART

For Deaths <u>After</u> Effective Date of SECURE Act

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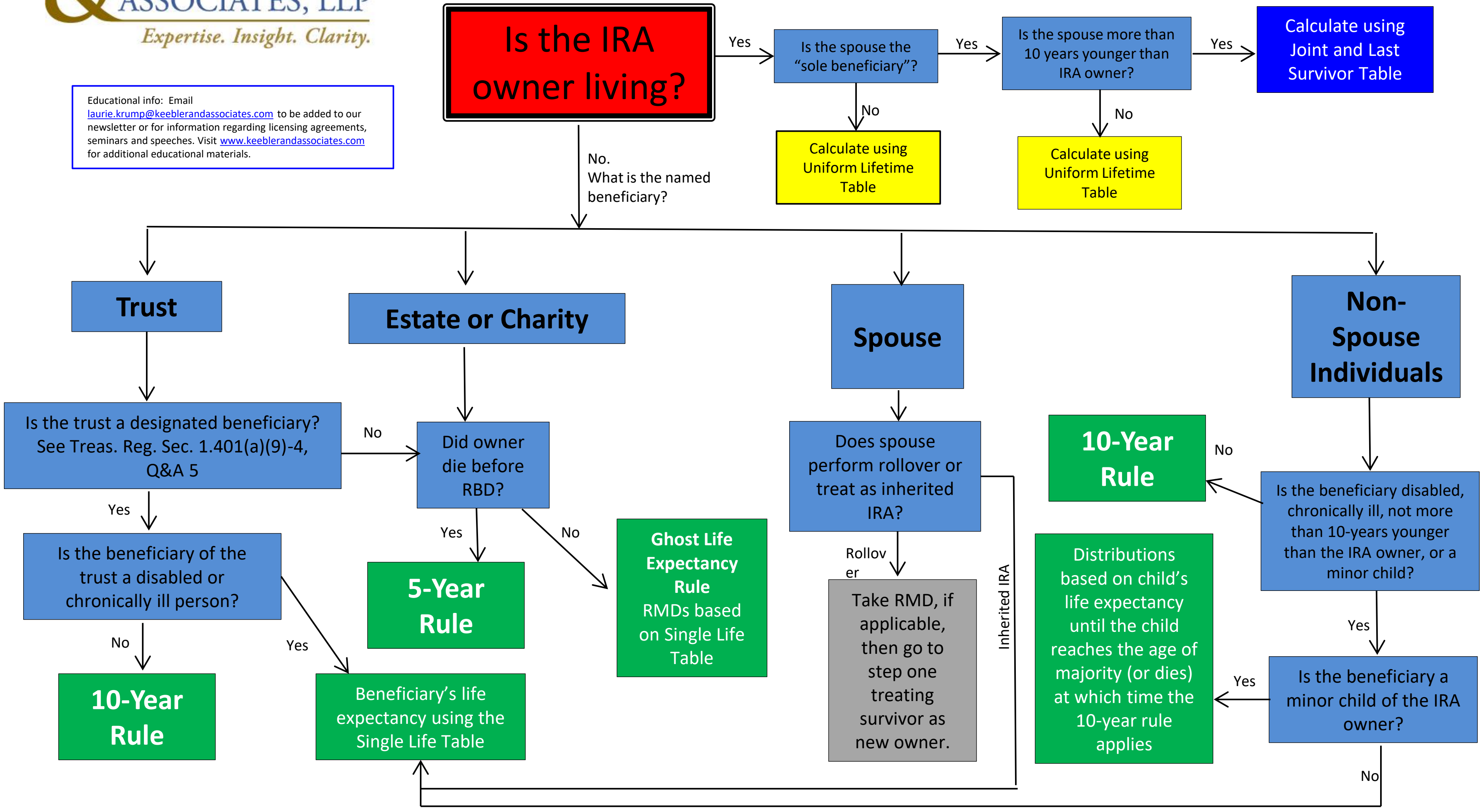

Trusts for Disabled and Chronically Ill Beneficiaries

- Life Expectancy Treatment is Available with an "Eligible Designated Beneficiary Trust"
- Need to Draft an Accumulation Trust
- **Roth IRAs may work better due to:**
  - **The difference in the individual and trust tax rates**
  - **The ability to pay the income tax on conversion out of nonqualified funds**
- Two trusts are advisable if the client has both a traditional IRA and a Roth IRA – this avoids "trapping" the taxable IRA income

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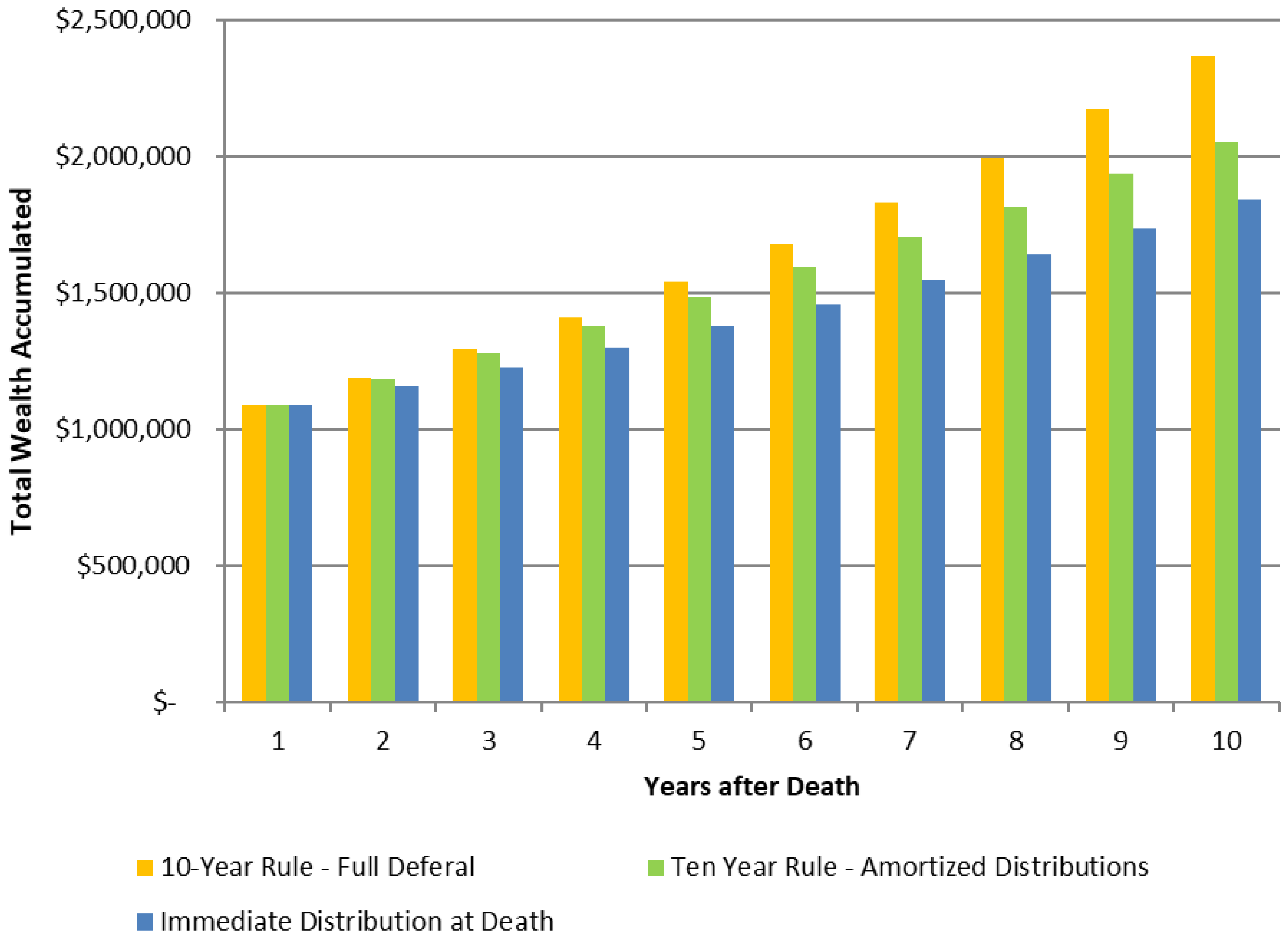
The "Roth Reprieve"

- **Consider the following example:**
  - Connie dies and leaves her $3,000,000 Roth IRA to her three children equally
  - Each child has a different understanding of the rules, but is responsible and good investor
  - Derek distributes the IRA <u>immediately</u> and reinvests the money in a brokerage account
  - Daniel computes a <u>10-year level</u> amortization schedule and makes annual transfers from the inherited IRA to his brokerage account
  - David waits the <u>full 10-years</u> to transfer the funds in the IRA to his brokerage account
  - Assume a 6% after-tax return and a 9% before tax return

The Roth Reprieve



ROTH CONVERSIONS

Core Strategic Planning

ROTH CONVERSIONS

Best practice is to use Roth Conversions to spread taxable income over many years and lower brackets

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General Concepts

- Convertible accounts
  - Traditional IRAs
  - 401(k) plans
  - Profit sharing plans
  - 403(b) annuity plans
  - 457 plans
  - "Inherited" 401(k) plans (see Notice 2008-30)
- Non-convertible accounts
  - "Inherited" IRAs
  - Education IRAs

Roth Conversions

Reasons to Convert

1. The taxpayer has special favorable tax attributes, which reduce the effective tax rate of the conversion: Charitable deductions, net operating losses, tax credits, etc.
2. Conversion can avoid higher marginal rates applying to surviving spouses.
3. Conversion can allow Taxpayers greater control over their retirement income stream to avoid phaseouts.
4. No RMDs for Roth IRAs provides a considerable advantage.
5. Favorable post-mortem treatment for Roths following the SECURE Act.
6. Paying the conversion tax from non-IRA funds effectively, mathematically, results in shift of assets to a tax-free environment.
7. Paying the income tax, before the estate tax, provides a superior mathematic result.
8. Generation Skipping Transfer (GST) allocations do not consider the built-in tax liability of a traditional IRA – Roth Accounts are more efficient.

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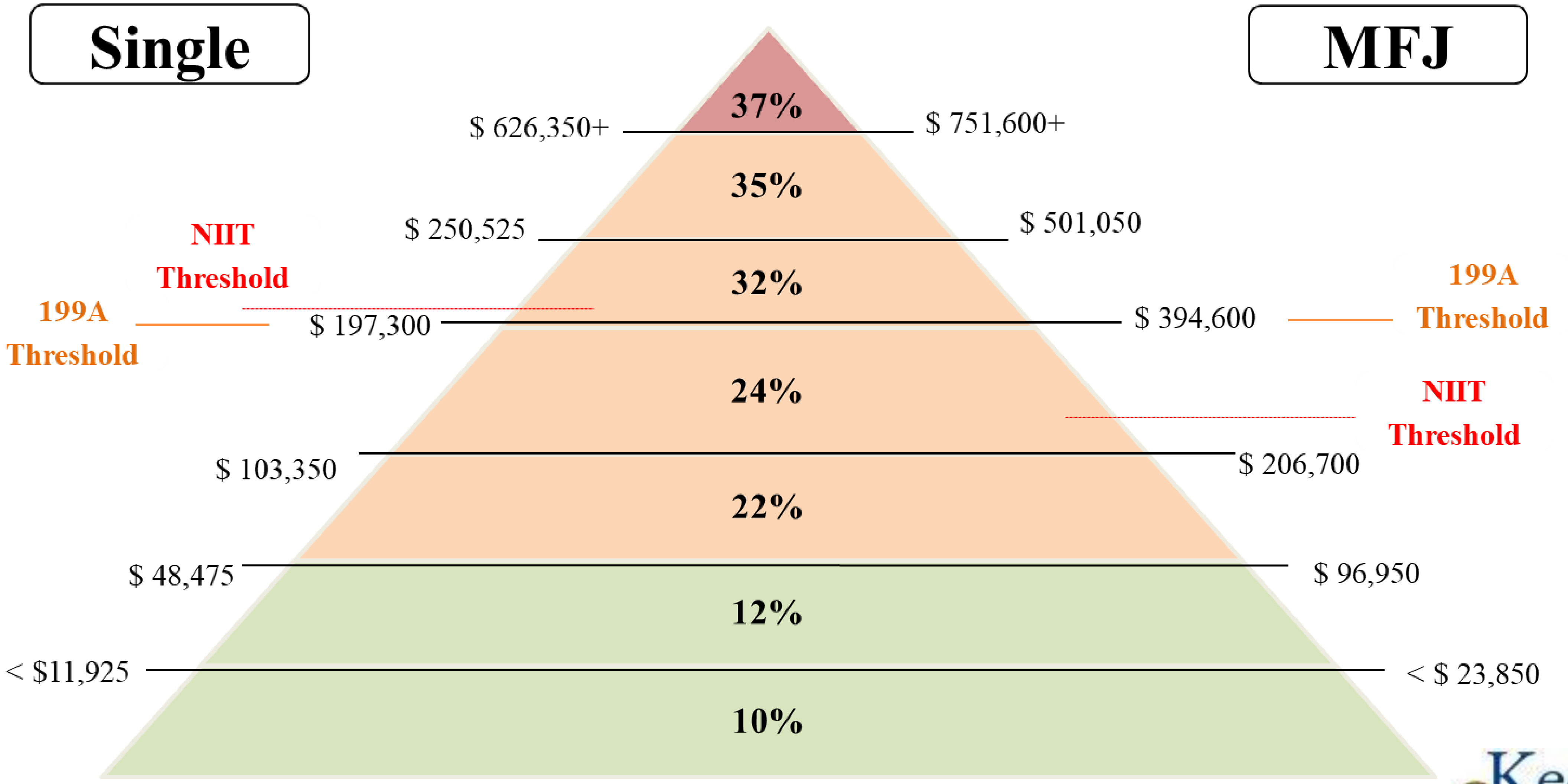
Taxation of Roth IRA Conversions

2025 Tax Brackets



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2025 Tax Brackets

TOP OF EACH CAPITAL GAINS BRACKET

	S	MFJ/QW	MFS	HOH	T&E
0%	$ 48,350	$ 96,700	$ 48,350	$ 64,750	$ 3,250
15%	$ 533,400	$ 600,050	$ 300,000	$ 533,400	$ 15,900
20%					

3.8% NIIT THRESHOLDS

S	MFJ/QW	MFS	HOH	T&E
$200,000	$250,000	$125,000	$200,000	$15,650

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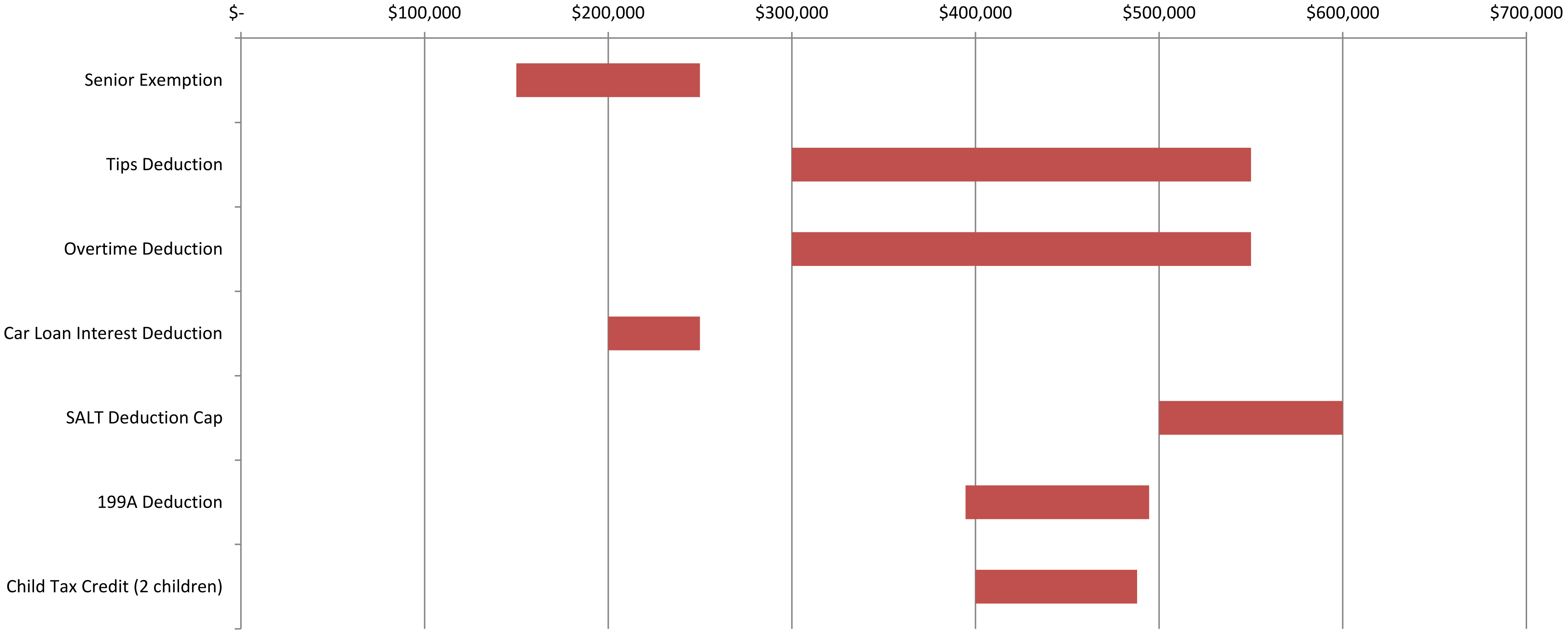
New Phaseout Ranges – MFJ 2025



FULL PART B COVERAGE

Beneficiaries who file individual tax returns with modified adjusted gross income:	Beneficiaries who file joint tax returns with modified adjusted gross income:	Income-Related Monthly Adjustment Amount	Total Monthly Premium Amount
Less than or equal to $106,000	Less than or equal to $212,000	$0.00	$185.00
Greater than $106,000 and less than or equal to $133,000	Greater than $212,000 and less than or equal to $266,000	74.00	259.00
Greater than $133,000 and less than or equal to $167,000	Greater than $266,000 and less than or equal to $334,000	185.00	370.00
Greater than $167,000 and less than or equal to $200,000	Greater than $334,000 and less than or equal to $400,000	295.90	480.90
Greater than $200,000 and less than $500,000	Greater than $400,000 and less than $750,000	406.90	591.90
Greater than or equal to $500,000	Greater than or equal to $750,000	443.90	628.90

PART D COVERAGE

Beneficiaries who file individual tax returns with modified adjusted gross income:	Beneficiaries who file joint tax returns with modified adjusted gross income:	Income-related monthly adjustment amount
Less than or equal to $106,000	Less than or equal to $212,000	$0.00
Greater than $106,000 and less than or equal to $133,000	Greater than $212,000 and less than or equal to $266,000	13.70
Greater than $133,000 and less than or equal to $167,000	Greater than $266,000 and less than or equal to $334,000	35.30
Greater than $167,000 and less than or equal to $200,000	Greater than $334,000 and less than or equal to $400,000	57.00
Greater than $200,000 and less than $500,000	Greater than $400,000 and less than $750,000	78.60
Greater than or equal to $500,000	Greater than or equal to $750,000	85.80

ACA Subsidy for Marketplace Plans

- The premium tax credit reduces the cost of medical insurance coverage

- Starting in 2026, pandemic-era relief expires and households with income over 400% of the federal poverty-line (FPL) lose eligibility for the credit
  - The credit is reduced for households with income of 150% - 400% of the FPL; i.e., a greater percentage of their income is required to be paid towards insurance premiums
  - For households with income over 400% of the FPL, the contribution percentage of household income is 8.5% - effectively a marginal tax rate increase

Non-Deductible Contributions: Basis

- When a traditional IRA has non-deductible contributions, a portion of the conversion to a Roth IRA will be non-taxable “basis” to the IRA owner
- In determining the non-taxable portion of a Roth IRA conversion, all traditional IRAs and IRA distributions during the year (including outstanding rollovers) must be combined for apportioning “basis”
  - See IRS Form 8606

Non-Deductible Contributions: Basis

Current year non-deductible IRA contributions	$	1,000
Prior year non-deductible IRA contributions		6,000
Total non-deductible IRA contributions	$	7,000
FMV of all IRAs	$	580,000
Outstanding rollovers		20,000
Distributions		-
Roth IRA conversions		100,000
Total value of IRAs, distributions and Roth IRA conversions	$	700,000
"Basis apportionment" factor		**0.0100**
Gross Roth IRA IRA conversion	$	100,000
Non-taxable portion		(1,000)
Taxable Roth IRA conversion	$	99,000

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Roth Conversions

Frustrating Traps for the Unwary – a Review

- Consider the impact of Roth Conversion income on:
  - The taxation of Social Security benefits
  - Medicare Part B & Medicare Part D premiums
  - ACA health insurance premium credit
  - SALT phaseout
  - 199A phaseout
  - Senior deduction phaseout

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Mathematics of Roth IRA Conversions

Mathematics of Roth IRA Conversions

- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
  - The annual growth rates are the same
  - The tax rate in the conversion year is the same as the tax rate during the withdrawal years (i.e. A x B x C = D; A x C x B = D)

Mathematics of Roth IRA Conversions

	Traditional IRA	Roth IRA	Life Insurance
Current Account Balance	$ 1,000,000	$ 1,000,000	$ 1,000,000
Less: Income Taxes @ 40%	-	(400,000)	(400,000)
Net Balance	**$ 1,000,000**	**$ 600,000**	**$ 600,000**
Growth Until Death	300.00%	300.00%	300.00%
Account Balance @ Death	$ 3,000,000	$ 1,800,000	$ 1,800,000
Less: Income Taxes @ 40%	(1,200,000)	-	-
Net Account Balance to Family	**$ 1,800,000**	**$ 1,800,000**	**$ 1,800,000**

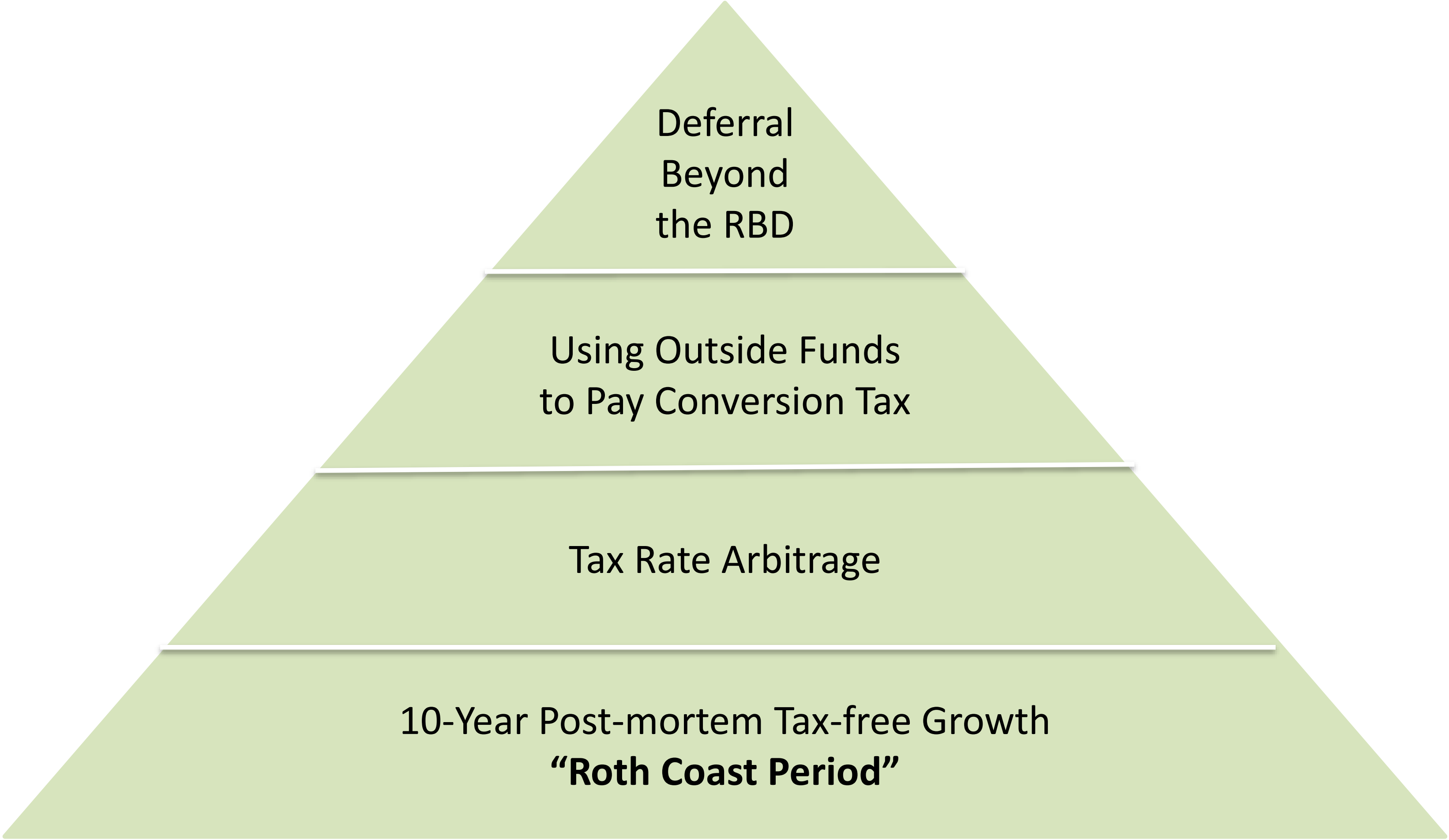
Mathematics of Roth IRA Conversions

- Tactical considerations
  - Unused charitable contribution carryovers
  - Current year ordinary losses
  - Net Operating Loss (NOL) carryovers from prior years
  - Alternative Minimum Tax (AMT)
  - Credit carryovers
  - Dollar-cost averaging to reduce the risk that the amount converted will decrease in value

Mathematics of Roth IRA Conversions

- Critical decision factors
  - Tax rate differential (year of conversion vs. withdrawal years)
  - Use of “outside funds” to pay the income tax liability
  - Need for IRA funds to meet annual living expenses
  - No RMDs
  - Time horizon
  - Tax-free post-mortem distributions
  - Ten Year “Roth Reprieve” period
  - Estate tax considerations

Mathematics of Roth IRA Conversions



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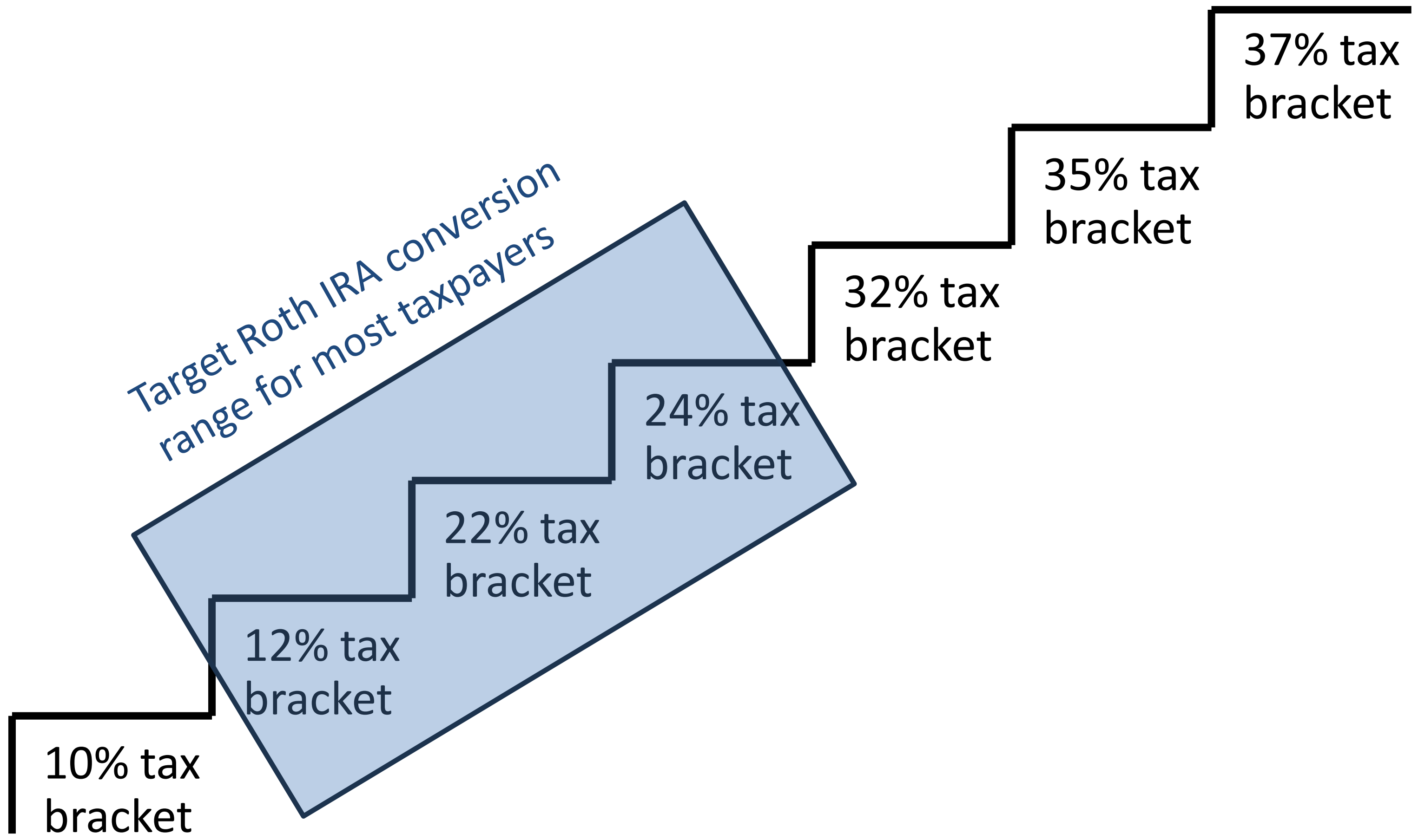
Mathematics of Roth IRA Conversions

- The key to successful Roth IRA conversions is usually to avoid large jumps in brackets (e.g. converting at a 32% when distributions will likely be subject to a 24% rate will often be ineffective)

- Although brackets are the primary consideration, there are others: capital gains, AMT, NIIT, 199A, etc.

- Timing conversions is critical

Mathematics of Roth IRA Conversions



Bracket Management Example

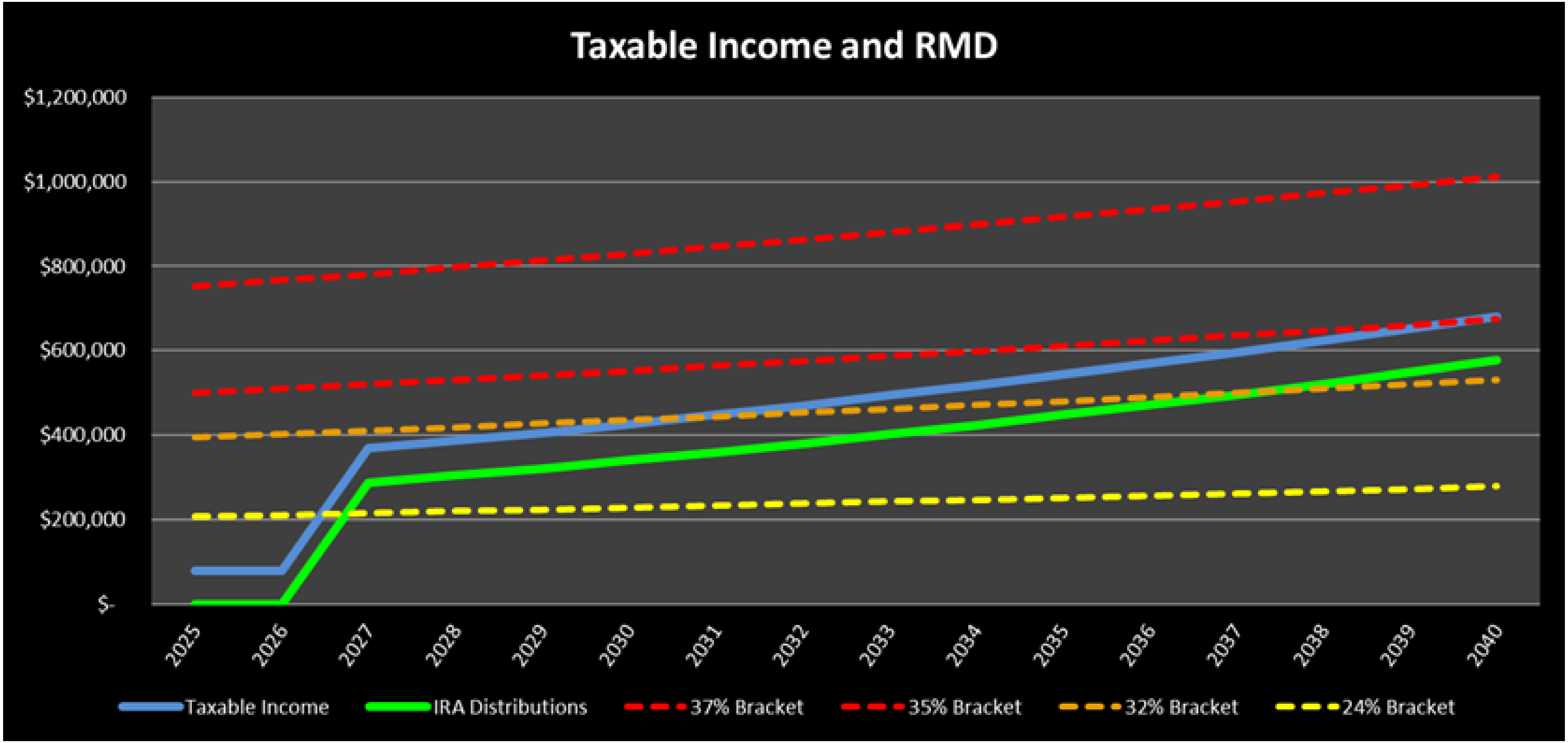
A very common, and illustrative, bracket management issue occurs when retirement savers reach their required beginning date. This is because required minimum distributions can be quite large and “catapult” taxpayers to a much higher average tax rate. The tax rate is higher due to a number of factors including: (1) a greater portion of social security is taxed; (2) the § 199A limits apply; (3) higher ordinary income tax brackets apply; (4) higher capital gain tax brackets apply; (5) the AMT can apply; (6) the NIIT applies.

Example. Consider a taxpayer who files single, has $6,000,000 in his 401k and begins RMDs in two years. Assume inflation of 2%, asset growth of 7% and that the taxpayer is limited to the standard deduction (plus the additional deduction for those over 65 or blind).

INCOME	2025	2026	2027	2028	2029	2030
Wages	$ -	$ -	$ -	$ -	$ -	$ -
Taxable Interest Income	50,000	51,000	52,020	53,060	54,122	55,204
Non-Qualified Dividends	-	-	-	-	-	-
Qualified Dividends	20,000	20,400	20,808	21,224	21,649	22,082
Short-Term Capital Gains	-	-	-	-	-	-
Long-Term Capital Gains	50,000	51,000	52,020	53,060	54,122	55,204
IRA Distributions	-	-	287,051	303,776	321,457	340,145
Roth IRA Conversions	-	-	-	-	-	-
Pension & Annuity Distributions	-	-	-	-	-	-
Social Security (Gross)	25,000	25,500	26,010	26,530	27,061	27,602
Less: Social Security (Non-Taxable Portion)	(3,750)	(3,825)	(3,902)	(3,980)	(4,059)	(4,140)
Other Income	40,000	40,800	41,616	42,448	43,297	44,163
Subtotal	$ 181,250	$ 184,875	$ 475,624	$ 496,120	$ 517,647	$ 540,260
Less: Adjustments	-	-	-	-	-	-
Adjusted Gross Income (AGI)	$ 181,250	$ 184,875	$ 475,624	$ 496,120	$ 517,647	$ 540,260
Itemized Deductions/Standard Deduction	$ 33,200	$ 33,900	$ 34,600	$ 35,300	$ 36,000	$ 36,700
Total Deductions	$ 33,200	$ 33,900	$ 34,600	$ 35,300	$ 36,000	$ 36,700
Taxable Income	**$ 148,050**	**$ 150,975**	**$ 441,024**	**$ 460,820**	**$ 481,647**	**$ 503,560**
Regular Income Tax	$ 16,554	$ 16,874	$ 84,405	$ 88,729	$ 93,286	$ 98,099
Alternative Minimum Tax (AMT)	-	-	-	-	-	-
3.8% Net Investment Income Tax	-	-	4,744	4,839	4,936	5,035
TOTAL INCOME TAX	**$ 16,554**	**$ 16,874**	**$ 89,149**	**$ 93,568**	**$ 98,222**	**$ 103,133**

Note the effects of the RMD income "spike." It's very possible that with better bracket management during, and especially before, retirement the taxpayer might lose far less of their wealth to taxation.

	2025	2026	2027	2028	2029	2030
MARGINAL INCOME TAX RATE	12.00%	12.00%	24.00%	24.00%	24.00%	24.00%
MARGINAL CAPITAL GAINS RATE	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
CURRENTLY SUBJECT TO NIIT	No	No	Yes	Yes	Yes	Yes
MARGINAL INCOME TAX RATE w/NIIT	12.00%	12.00%	27.80%	27.80%	27.80%	27.80%
MARGINAL CAPITAL GAIN RATE w/NIIT	15.00%	15.00%	18.80%	18.80%	18.80%	18.80%
AVERAGE RATE	**9.13%**	**9.13%**	**18.74%**	**18.86%**	**18.97%**	**19.09%**
DISTANCE TO PREVIOUS BRACKET	$ (54,200)	$ (55,275)	$ (153,196)	$ (167,235)	$ (182,177)	$ (198,074)
DISTANCE TO NEXT BRACKET	$ 18,900	$ 19,325	$ 42,404	$ 32,265	$ 21,323	$ 9,426
DISTANCE TO FOLLOWING BRACKET	128,650	131,225	153,104	145,165	136,423	126,826
AMOUNT ABOVE 37% BRACKET	-	-	-	-	-	-
MAGI LESS THRESHOLD (A)	$ -	$ -	$ 225,624	$ 246,120	$ 267,647	$ 290,260
NET INVESTMENT INCOME (B)	120,000	122,400	124,848	127,345	129,892	132,490
LESSOR OF A OR B	$ -	$ -	$ 124,848	$ 127,345	$ 129,892	$ 132,490
NIIT @ 3.8%	**$ -**	**$ -**	**$ 4,744**	**$ 4,839**	**$ 4,936**	**$ 5,035**



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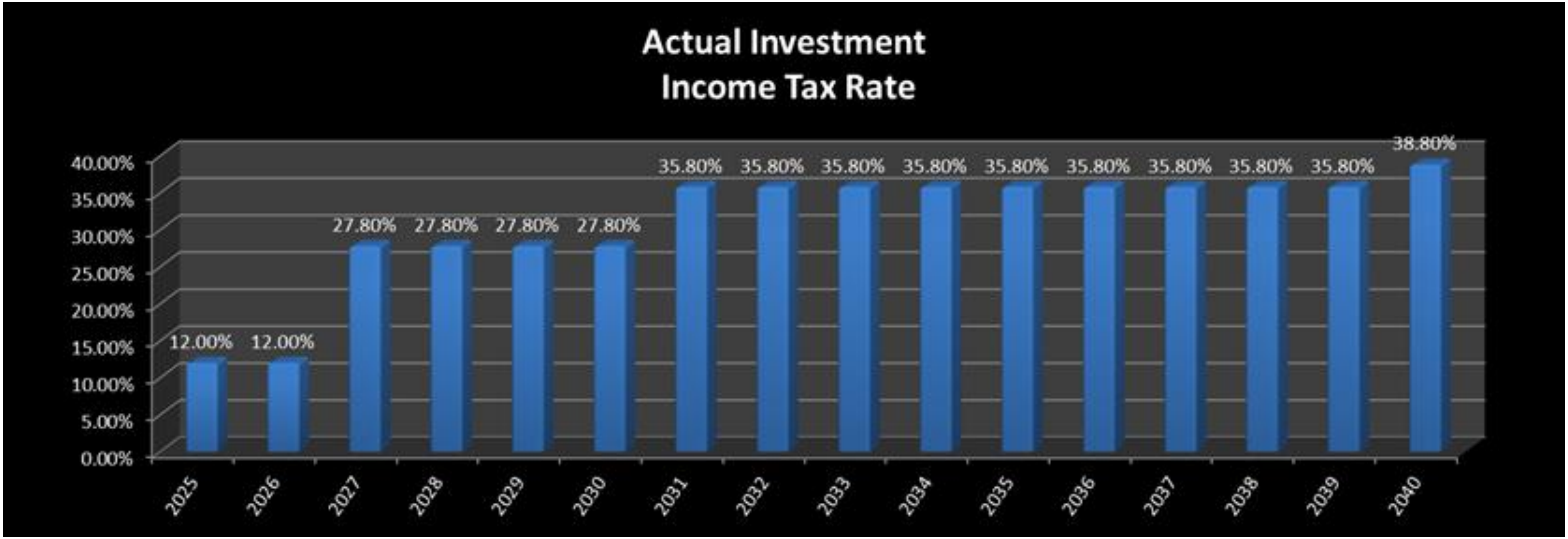
Actual Investment
Income Tax Rate
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
12.00%
12.00%
27.80%
27.80%
27.80%
27.80%
35.80%
35.80%
35.80%
35.80%
35.80%
35.80%
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35.80%
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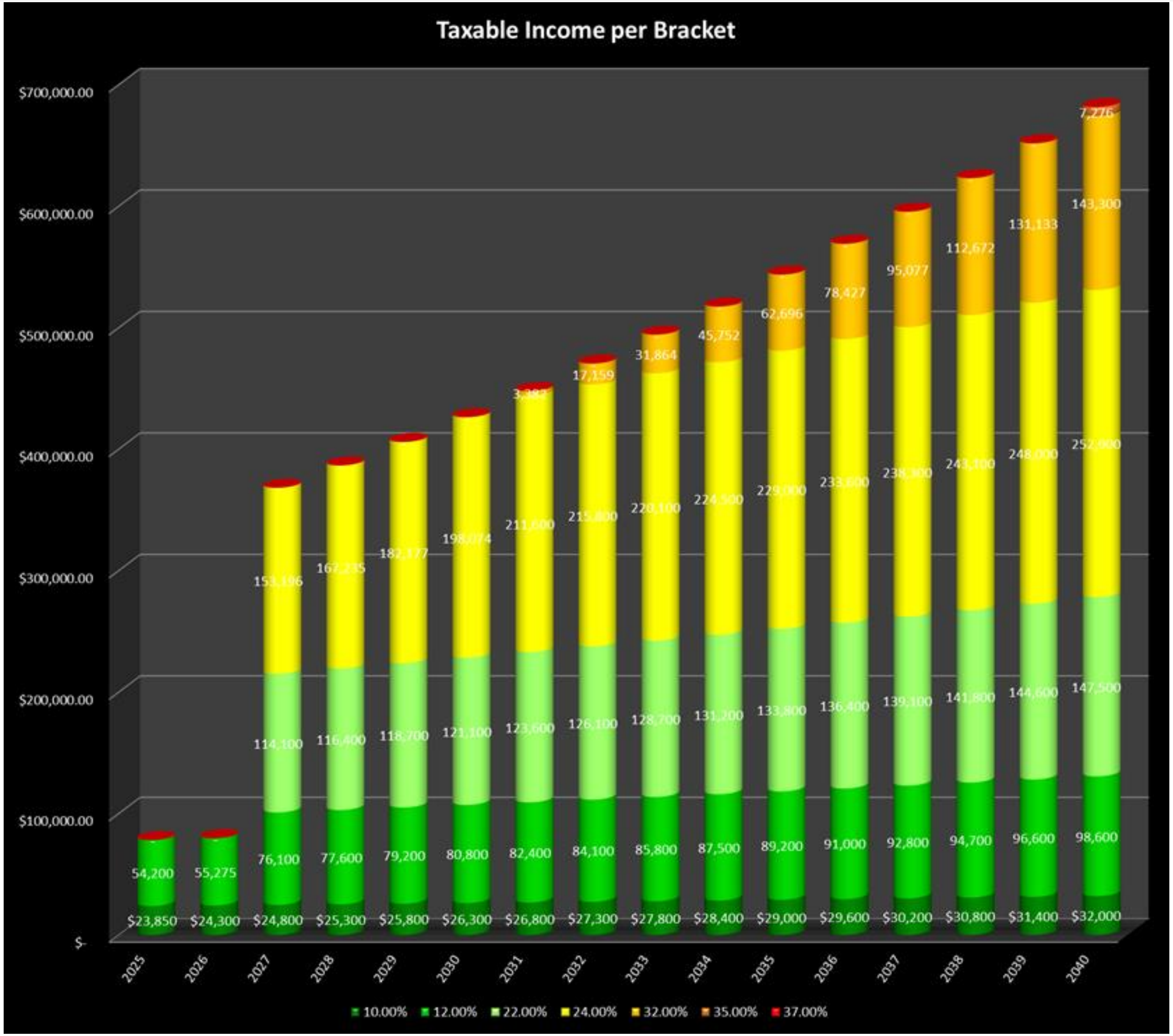

Taxable Income per Bracket
$700,000.00
$600,000.00
$500,000.00
$400,000.00
$300,000.00
$200,000.00
$100,000.00
$-
2025
2026
2027
2028
2029
2030
2031
2032
2033
2034
2035
2036
2037
2038
2039
2040
$23,850
$24,300
$24,800
$25,300
$25,800
$26,300
$26,800
$27,300
$27,800
$28,400
$29,000
$29,600
$30,200
$30,800
$31,400
$32,000
54,200
55,275
76,100
77,600
79,200
80,800
82,400
84,100
85,800
87,500
89,200
91,000
92,800
94,700
96,600
98,600
114,100
116,400
118,700
121,100
123,600
126,100
128,700
131,200
133,800
136,400
139,100
141,800
144,600
147,500
153,196
167,235
182,177
198,074
211,600
215,800
220,100
224,500
229,000
233,600
238,300
243,100
248,000
252,900
17,159
31,864
45,752
62,696
78,427
95,077
112,672
131,133
143,300
7,276
10.00%
12.00%
22.00%
24.00%
32.00%
35.00%
37.00%

CHARITY &
THE TAX CODE

Basics

The Statutes - Individual income tax deduction

- IRC §170 (a) Allowance of deduction

  (1) General rule

  There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year.

Basics

Types of Gifts

- Outright gifts
- Testamentary gifts
- Split-interest gifts
- “Endowment-type” gifts

Basics

Types of Gifts

- Outright gifts
  - Most common type.
  - Gifts of cash.
  - Gifts of tangible or intangible property.
  - Very easy & simple.
  - Some taxpayers qualify for an income tax deduction.
  - Amount given will not be included in the taxpayer's estate.

Basics

Types of Gifts

- Outright gifts
  - Qualified Charitable Distributions (QCDs) from an IRA
    - Taxpayer must be age 70½ or older.
    - Distribution must be direct to charity.
    - Distribution cannot exceed $108,000 (2025).
    - Distribution can count towards RMD.
    - Distributions to donor advised funds & supporting organizations do not qualify.

IRC § 408(d)(8)

Basics

Types of Gifts

- Outright gifts
  - Qualified Charitable Distributions (QCDs) from an IRA
    - For many years Congress renewed this provision annually and it was therefore unclear whether it was available.
    - The 2015 “extenders” legislation made this provision permanent.

IRC § 408(d)(8)

Basics

Types of Gifts

- Outright gifts
  - Qualified Charitable Distributions (QCDs) from an IRA
    - Income is never recognized by the taxpayer and no deduction is claimed on the return.
    - Generally more or equally as tax efficient as a distribution from the IRA and then a contribution to charity because QCDs are not subject to the other limits on deductions for charitable contributions.

IRC § 408(d)(8)

Basics

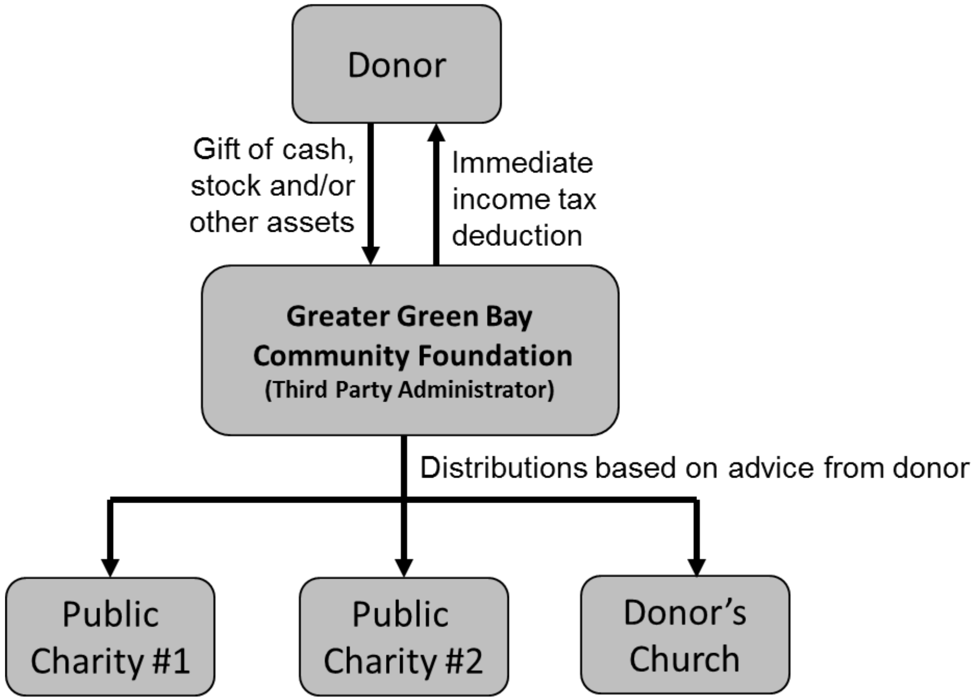
Types of Gifts

- "Endowment-Type" Gifts
  - Donor Advised Funds
    - A donor enters into a written agreement with a sponsoring charity to establish an account to benefit the donor's causes.
    - The donor makes a contribution to the fund and receives an income tax deduction equal to the value of the donation.
    - The donor then, over a period time, **requests** the sponsoring organization to make grants to various charities.
    - More prudent after the Tax Cuts and Jobs Act as it allows the "lumping" of multiple years of charitable intent into a single year thereby overcoming standard deduction "hurdle."

Basics

Types of Gifts

- "Endowment-Type" Gifts
  - Donor Advised Funds



Basics

Percentage Limitations

- Contributions to "Public Charities:"

Type of Property	Deductible Amount	AGI Limitation
Cash	Fair Market Value	60%
Property, if sold, would generate ordinary income or short-term capital gain.	Lesser of Basis or Fair Market Value	50%
Property, if sold, would generate long-term capital gain.	Fair Market Value*	30%*
Tangible personal property used by charity for its exempt purpose.	Fair Market Value*	30%*
Tangible personal property charity sells or doesn't use for its exempt purpose.	Lesser of Basis or Fair Market Value	50%

*Donor can elect to have 50% of AGI limit apply if amount of deduction is limited to basis.

THE OLD RULE WAS TO

ACCELERATE DEDUCTIONS

THE NEW RULE IS TO

TIME DEDUCTIONS

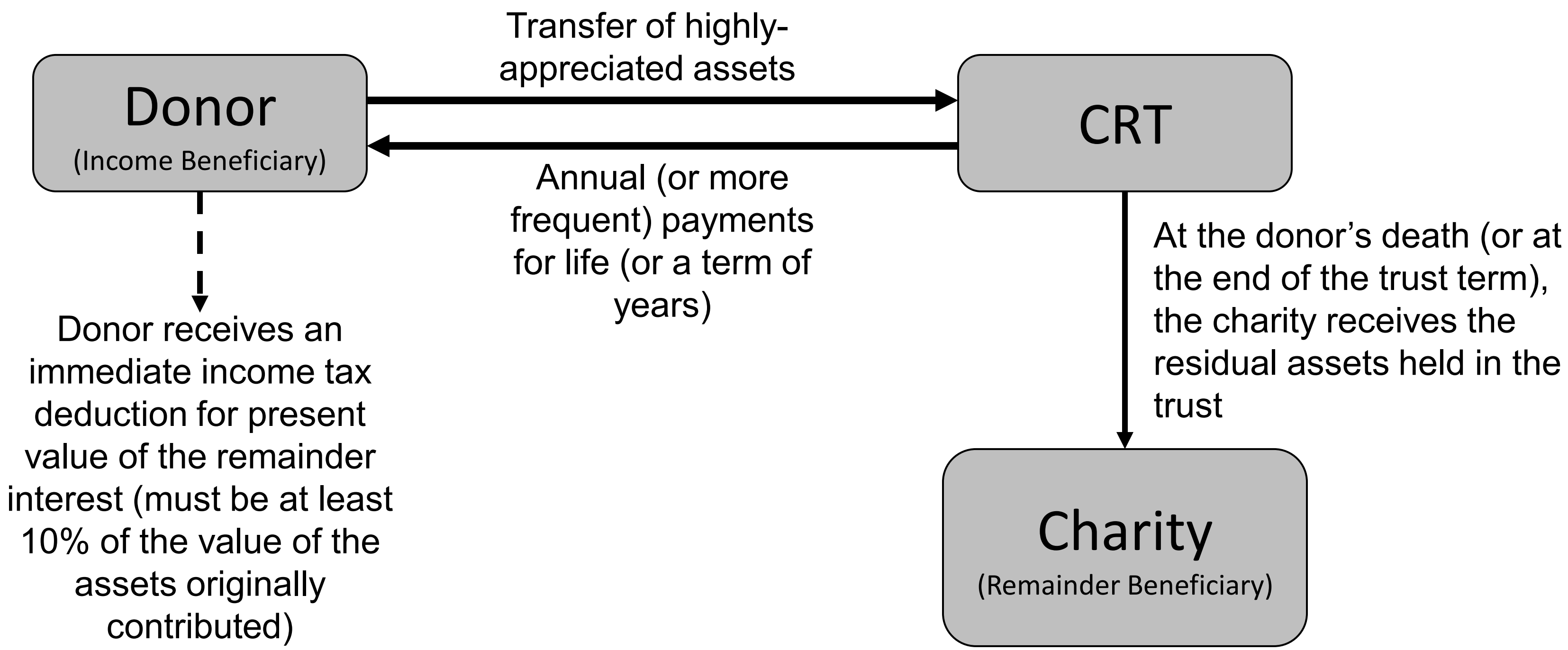
CHARITABLE REMAINDER TRUSTS

Effective for those without charitable intent?

Charitable Remainder Trusts

Overview

- Charitable Remainder Trust (CRT)



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Charitable Remainder Trusts

Types of CRTs

- Charitable Remainder Annuity Trust (CRAT)
  - The beneficiaries receive a fixed percentage of the initial trust value or a stated amount annually or more frequently.
  - The amount paid doesn't change from year to year.
  - The annual payment must be 5-50% of the fair market value of the assets at the time of contribution.
  - The term of the annuity can be:
    - For a term up to 20 years,
    - Over the life of the annuitant(s),
    - Over the shorter of the two, or
    - Over the longer of the two.

Charitable Remainder Trusts

Types of CRTs

- Charitable Remainder Unitrust (CRUT)
  - Income beneficiaries receive a stated percentage of the trust's assets revalued each year.
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn.

Charitable Remainder Trusts

Taxation of the Donor & Trust

- Donor generally does *not* realize gain or loss when property is transferred to the trust
- The donor generally will *not* realize gain or loss if and when the transferred assets are subsequently sold by the trustee of the CRT*
- Distributions in kind are treated as a sale of the property distributed, resulting in gain recognition by the CRT. [Reg. §1.664-1(d)(5)]

*Need to consider the binding commitment issue. See Rev. Rul. 78-197.

Charitable Remainder Trusts

Taxation of the Donor & Trust

- However, the grantor may be required to recognize gain if:
  - Property transferred is subject to indebtedness that exceeds grantor basis. 26 CFR 1.1001-2
  - Grantor receives property from the trust in exchange for the transfer to the trust

Charitable Remainder Trusts

Taxation of the Donor & Trust

- Avoiding a recognition event is a significant factor in maximizing the income tax advantages of a CRT; the most efficient transactions:
  - Involve a highly appreciated or tax-depreciated asset -> avoids significant taxation
  - Diversifies a concentrated position -> risk adjusted return increased without a recognition event
  - Transforms a growth asset to a needed income asset -> avoids recognition otherwise necessary

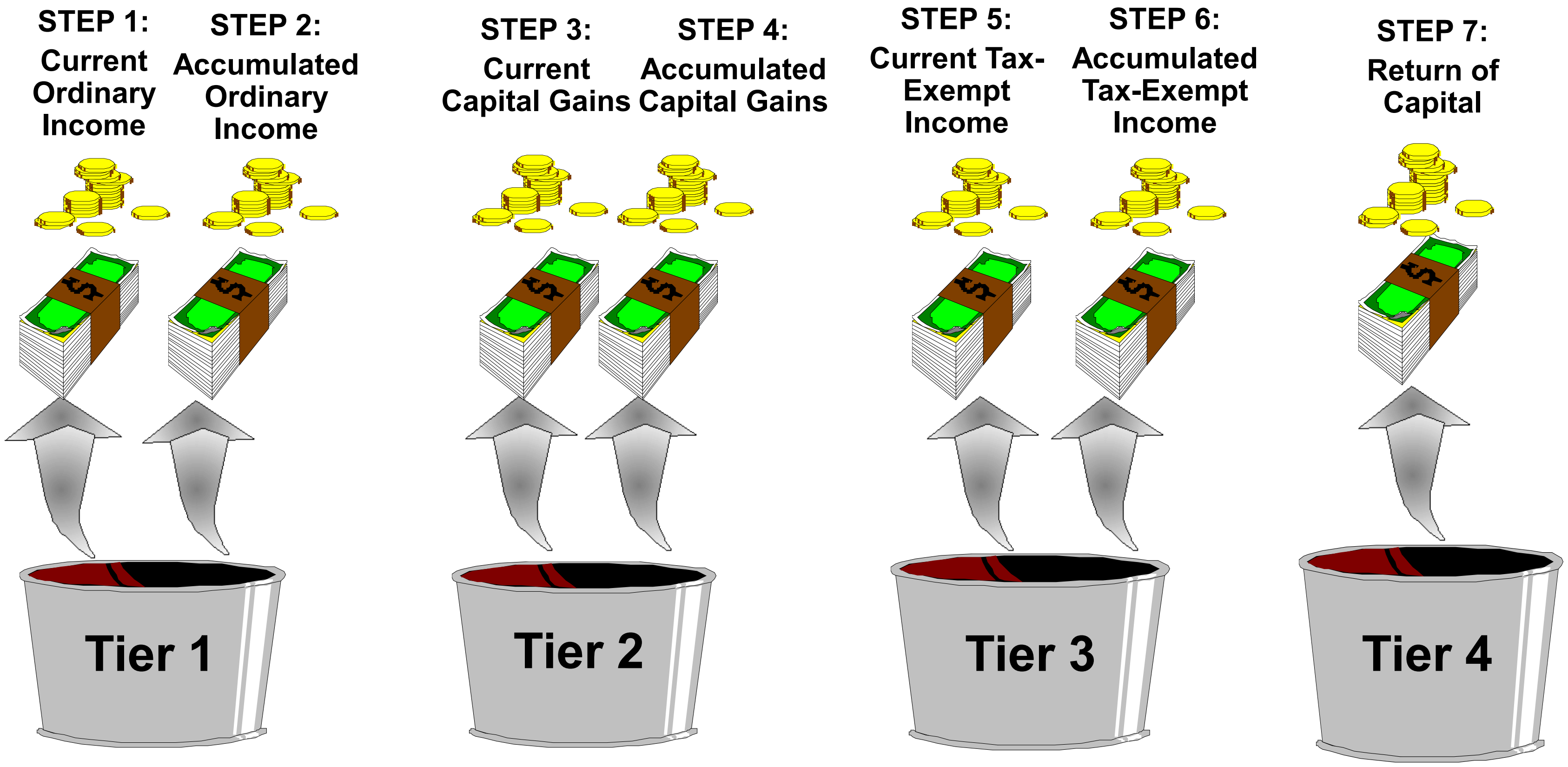
Charitable Remainder Trusts

Taxation of Distributions

- The character of income received by the recipient is subject to and controlled by the tier rules of IRC §664(b):
  - First, distributions are taxed as ordinary income
  - Second, distributions are taxed as capital gains
  - Third, distributions are taxed as tax-exempt income (e.g. municipal bond income)
  - Finally, distributions are assumed to be the non-taxable return of principal

Charitable Remainder Trusts

Taxation of Distributions



CHARITABLE LEAD TRUSTS

Effective for those without charitable intent?

Charitable Lead Trusts

Overview

- A Charitable Lead Trust (CLT) is a split interest trust consisting of an income interest and a remainder interest.
- During the term of the trust, the income interest is paid out to a named charity.
- At the end of the trust term, the remainder (whatever is left in the trust) is paid to non-charitable beneficiaries (e.g. children of the donor) that have been designated in the trust document.

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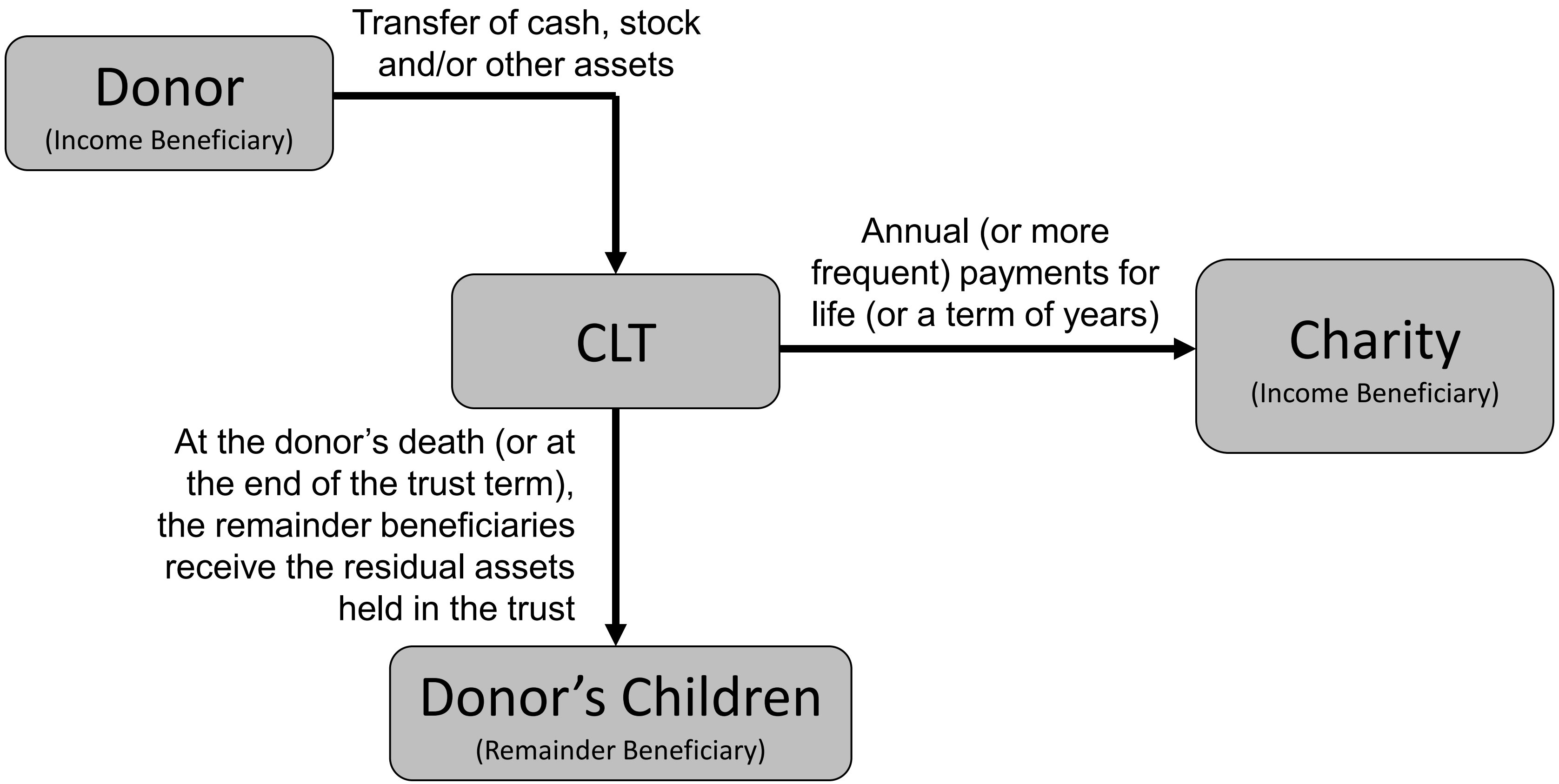
Charitable Lead Trusts

Overview



Charitable Lead Trusts

Types

- Charitable Lead Annuity Trust (CLAT)
  - The charitable beneficiary receives a stated amount of the initial trust assets each year
    - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)
- Charitable Lead Unitrust (CLUT)
  - The charitable beneficiary receives a stated percentage of the trust's assets each year.
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn

GIFTS FROM TRUSTS/ESTATES & THE INCOME TAX DEDUCTION

"MAGIC LANGUAGE"

Gifts from Trusts / Estates

Qualifying for the Income Tax Deduction

- Gifts must be made from the gross income of the trust or estate to qualify for the income tax deduction.

- Very problematic for gifts to charity that will be fulfilled with items of IRD.

IRC § 642(c)

Gifts from Trusts / Estates

Qualifying for the Income Tax Deduction

- Example
  - Whether the income recognized due to any IRA distributions can be offset with a charitable deduction depends on the language in the will:
    - The contribution might be deductible if the will provides that charitable contributions are to be made from income.
    - If the will does not have such a provision, the contribution is not deductible.

Gifts from Trusts / Estates

Qualifying for the Income Tax Deduction

- Example (cont.)
  - If her will has the "magic language," 100% of her IRA will pass to charity.
  - If her will does not have the "magic language," approximately 40% of the IRA will be lost to income taxation.
- *The simple and safe solution is to name the charity as the IRA beneficiary because then the value of the IRA isn't taxable income to the estate so there isn't any need for a 642(c) deduction.*

TESTAMENTARY GIFTS & THE ESTATE TAX DEDUCTION

Estate Taxation & Charity

Overview

- IRC § 2055
  - Allows a deduction against the gross estate for charitable bequests, legacies, devises, or transfers.
  - Does not contain any sort of percentage limitations.
  - Organizations that can receive contributions deductible under § 2055 are very similar, but not exactly the same as under § 170.

Estate Taxation & Charity

Overview

- Computation:

Gross Estate

+Prior taxable gifts

<Exemption>

<Deductions>

Taxable Estate

x40%

Estate Tax

Estate Taxation & Charity

Overview

- Potential tax benefit of an inter vivos gift which qualifies for the § 170 deduction:

$1 x 37% = 37¢ income tax savings

$1 x 40% = 40¢ estate tax savings

<37¢ x 40% = 14.8¢ estate tax on income tax savings>

62.2¢ tax savings per $1 donated

Fiduciary Income Taxation

Income Taxation of Trusts & Estates

Overview

- Foundational concepts
- Grantor trusts
- Charitable Remainder Trusts (CRTs)
- Bracket Management
- Shifting Income with Trust Distributions
- Limits on Itemized Deductions
- State Income Tax Planning for Trusts
- Form 1041 Examples

Tax Reform – Key Points

- $40,000 SALT deduction cap
- Permanent repeal of miscellaneous itemized deductions (TCJA extension):
  - A specific and specific example of a non-deductible expense for trusts and estates are most investment management fees
  - Other costs incurred because the property is in trust, such as legal and accounting fees, remain deductible for trusts and estates
- New overall limitation on itemized deductions ("2/37 limitation"):
  - Essentially, if a trust has total income in excess of $15,650 itemized deductions will not be fully deductible
  - **This is a new and significant problem as it causes a disparity between taxable income and fiduciary accounting income**
  - In the past, trusts and estates have been excluded from these types of deduction limits

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Form **1041** Department of the Treasury—Internal Revenue Service

U.S. Income Tax Return for Estates and Trusts

2024 OMB No. 1545-0092

Go to www.irs.gov/Form1041 for instructions and the latest information.

A Check all that apply:
- ☐ Decedent's estate
- ☐ Simple trust
- ☐ Complex trust
- ☐ Qualified disability trust
- ☐ ESBT (S portion only)
- ☐ Grantor type trust
- ☐ Bankruptcy estate—Ch. 7
- ☐ Bankruptcy estate—Ch. 11
- ☐ Pooled income fund

For calendar year 2024 or fiscal year beginning , 2024, and ending , 20

Name of estate or trust (If a grantor type trust, see the instructions.)

C Employer identification number

Name and title of fiduciary

D Date entity created

Number, street, and room or suite no. (If a P.O. box, see the instructions.)

E Nonexempt charitable and split-interest trusts, check applicable box(es). See instructions.
- ☐ Described in sec. 4947(a)(1). Check here if not a private foundation ☐
- ☐ Described in sec. 4947(a)(2)

City or town, state or province, country, and ZIP or foreign postal code

B Number of Schedules K-1 attached (see instructions)

F Check applicable boxes: ☐ Initial return ☐ Final return ☐ Amended return ☐ Net operating loss carryback ☐ Change in trust's name ☐ Change in fiduciary ☐ Change in fiduciary's name ☐ Change in fiduciary's address

G Check here if the estate or filing trust made a section 645 election ☐ Trust TIN

Income	1	Interest income	1
	2a	Total ordinary dividends	2a
	b	Qualified dividends allocable to: (1) Beneficiaries (2) Estate or trust	
	3	Business income or (loss). Attach Schedule C (Form 1040)	3
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	5
	6	Farm income or (loss). Attach Schedule F (Form 1040)	6
	7	Ordinary gain or (loss). Attach Form 4797	7
	8	Other income. List type and amount	8
	9	**Total income.** Combine lines 1, 2a, and 3 through 8	9
Deductions	10	Interest. Check if Form 4952 is attached ☐	10
	11	Taxes	11
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions	12
	13	Charitable deduction (from Schedule A, line 7)	13
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions	14
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	15a
	b	Net operating loss deduction. See instructions	15b
	16	Add lines 10 through 15b	16
	17	Adjusted total income or (loss). Subtract line 16 from line 9 [17]	
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20
	21	Exemption	21
	22	Add lines 18 through 21	22
Tax and Payments	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23
	24	**Total tax** (from Schedule G, Part I, line 9)	24
	25	Current year net 965 tax liability paid from Form 965-A, Part II, column (k) (see instructions)	25
	26	**Total payments** (from Schedule G, Part II, line 19)	26
	27	Estimated tax penalty. See instructions	27
	28	**Tax due.** If line 26 is smaller than the total of lines 24, 25, and 27, enter amount owed	28
	29	**Overpayment.** If line 26 is larger than the total of lines 24, 25, and 27, enter amount overpaid	29
	30	Amount of line 29 to be: **a Credited to 2025** ; **b Refunded**	30

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of fiduciary or officer representing fiduciary | Date | EIN of fiduciary if a financial institution

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Preparer's name | Preparer's signature | Date | Check ☐ if self-employed | PTIN

Firm's name | Firm's EIN

Firm's address | Phone no.

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2024)

Schedule A Charitable Deduction. Don't complete for a simple trust or a pooled income fund.

1	Amounts paid or permanently set aside for charitable purposes from gross income. See instructions	1	
2	Tax-exempt income allocable to charitable contributions. See instructions	2	
3	Subtract line 2 from line 1	3	
4	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes	4	
5	Add lines 3 and 4	5	
6	Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes. See instructions	6	
7	**Charitable deduction.** Subtract line 6 from line 5. Enter here and on page 1, line 13	7	

Schedule B Income Distribution Deduction

1	Adjusted total income. See instructions			1	
2	Adjusted tax-exempt interest			2	
3	Total net gain from Schedule D (Form 1041), line 19, column (1). See instructions			3	
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)			4	
5	Capital gains for the tax year included on Schedule A, line 1. See instructions			5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number			6	
7	**Distributable net income.** Combine lines 1 through 6. If zero or less, enter -0-			7	
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8			
9	Income required to be distributed currently			9	
10	Other amounts paid, credited, or otherwise required to be distributed			10	
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions			11	
12	Enter the amount of tax-exempt income included on line 11			12	
13	Tentative income distribution deduction. Subtract line 12 from line 11			13	
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-			14	
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18			15	

Schedule G Tax Computation and Payments (see instructions)

Part I — Tax Computation

1	**Tax:**				
a	Tax on taxable income. See instructions	1a			
b	Tax on lump-sum distributions. Attach Form 4972	1b			
c	Alternative minimum tax (from Schedule I (Form 1041), line 54)	1c			
d	Amount from Form 4255, Part I, line 3, column (q)	1d			
e	**Total.** Add lines 1a through 1d			1e	
2a	Foreign tax credit. Attach Form 1116	2a			
b	General business credit. Attach Form 3800	2b			
c	Credit for prior year minimum tax. Attach Form 8801	2c			
d	Bond credits. Attach Form 8912	2d			
e	**Total credits.** Add lines 2a through 2d			2e	
3	Subtract line 2e from line 1e. If zero or less, enter -0-			3	
4	Tax on the ESBT portion of the trust (from ESBT Tax Worksheet, line 17). See instructions			4	
5	Net investment income tax from Form 8960, line 21			5	
6a	Amount from Form 4255, Part I, line 3, column (r)			6a	
b	Recapture tax from Form 8611			6b	
c	Other recapture taxes:			6c	
7	Household employment taxes. Attach Schedule H (Form 1040)			7	
8	Other taxes and amounts due			8	
9	**Total tax.** Add lines 3 through 8. Enter here and on page 1, line 24			9	

Form **1041** (2024)

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Schedule G Tax Computation and Payments (see instructions) *(continued)*

Part II — Payments

10	Current year's estimated tax payments and amount applied from preceding year's return	10	
11	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	11	
12	Subtract line 11 from line 10	12	
13	Tax paid with Form 7004. See instructions	13	
14	Federal income tax withheld. If any is from Form(s) 1099, check here ☐	14	
15	Current year net 965 tax liability from Form 965-A, Part I, column (f) (see instructions)	15	
16	Payments from Form 2439	16	
17	Payments from Form 4136	17	
18a	Elective payment election amount from Form 3800	18a	
b	Other credits or payments (see instructions)	18b	
19	**Total payments.** Add lines 12 through 18b. Enter here and on page 1, line 26	19	

Other Information

		Yes	No
1	Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses.		
	Enter the amount of tax-exempt interest income and exempt-interest dividends $		
2	Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement?		
3	At any time during calendar year 2024, did the estate or trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country?		
	See the instructions for exceptions and filing requirements for FinCEN Form 114. If "Yes," enter the name of the foreign country		
4	During the tax year, did the estate or trust receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the estate or trust may have to file Form 3520. See instructions		
5	Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see the instructions for the required attachment		
6	If this is an estate or a complex trust making the section 663(b) election, check here. See instructions ☐		
7	To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here. See instructions ☐		
8	If the decedent's estate has been open for more than 2 years, attach an explanation for the delay in closing the estate, and check here ☐		
9	Are any present or future trust beneficiaries skip persons? See instructions		
10	Was the trust a specified domestic entity required to file Form 8938 for the tax year? See the Instructions for Form 8938		
11a	Did the estate or trust distribute S corporation stock for which it made a section 965(i) election?		
b	If "Yes," did each beneficiary enter into an agreement to be liable for the net tax liability? See instructions		
12	Did the estate or trust either make a section 965(i) election or enter into a transfer agreement as an eligible section 965(i) transferee for S corporation stock held on the last day of the tax year? See instructions		
13	At any time during the tax year, did the estate or trust (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? See instructions		
14	**ESBTs only.** Does the ESBT have a nonresident alien grantor? If "Yes," see instructions		
15	**ESBTs only.** Did the S portion of the trust claim a qualified business income deduction? If "Yes," see instructions		

Form **1041** (2024)

661117

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0092

Schedule K-1 (Form 1041) **2024**

Department of the Treasury
Internal Revenue Service

For calendar year 2024, or tax year

beginning / / ending / /

Beneficiary's Share of Income, Deductions, Credits, etc.

See back of form and instructions.

Part I Information About the Estate or Trust

A Estate's or trust's employer identification number

B Estate's or trust's name

C Fiduciary's name, address, city, state, and ZIP code

D ☐ Check if Form 1041-T was filed and enter the date it was filed

E ☐ Check if this is the final Form 1041 for the estate or trust

Part II Information About the Beneficiary

F Beneficiary's identifying number

G Beneficiary's name, address, city, state, and ZIP code

H ☐ Domestic beneficiary ☐ Foreign beneficiary

Part III Beneficiary's Share of Current Year Income, Deductions, Credits, and Other Items

1 Interest income	11 Final year deductions
2a Ordinary dividends	
2b Qualified dividends	
3 Net short-term capital gain	
4a Net long-term capital gain	
4b 28% rate gain	12 Alternative minimum tax adjustment
4c Unrecaptured section 1250 gain	
5 Other portfolio and nonbusiness income	
6 Ordinary business income	
7 Net rental real estate income	13 Credits and credit recapture
8 Other rental income	
9 Directly apportioned deductions	14 Other information
10 Estate tax deduction	

* See attached statement for additional information.

Note: A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. www.irs.gov/Form1041 Cat. No. 11380D **Schedule K-1 (Form 1041) 2024**

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Foundational Concepts
General Tax Rules

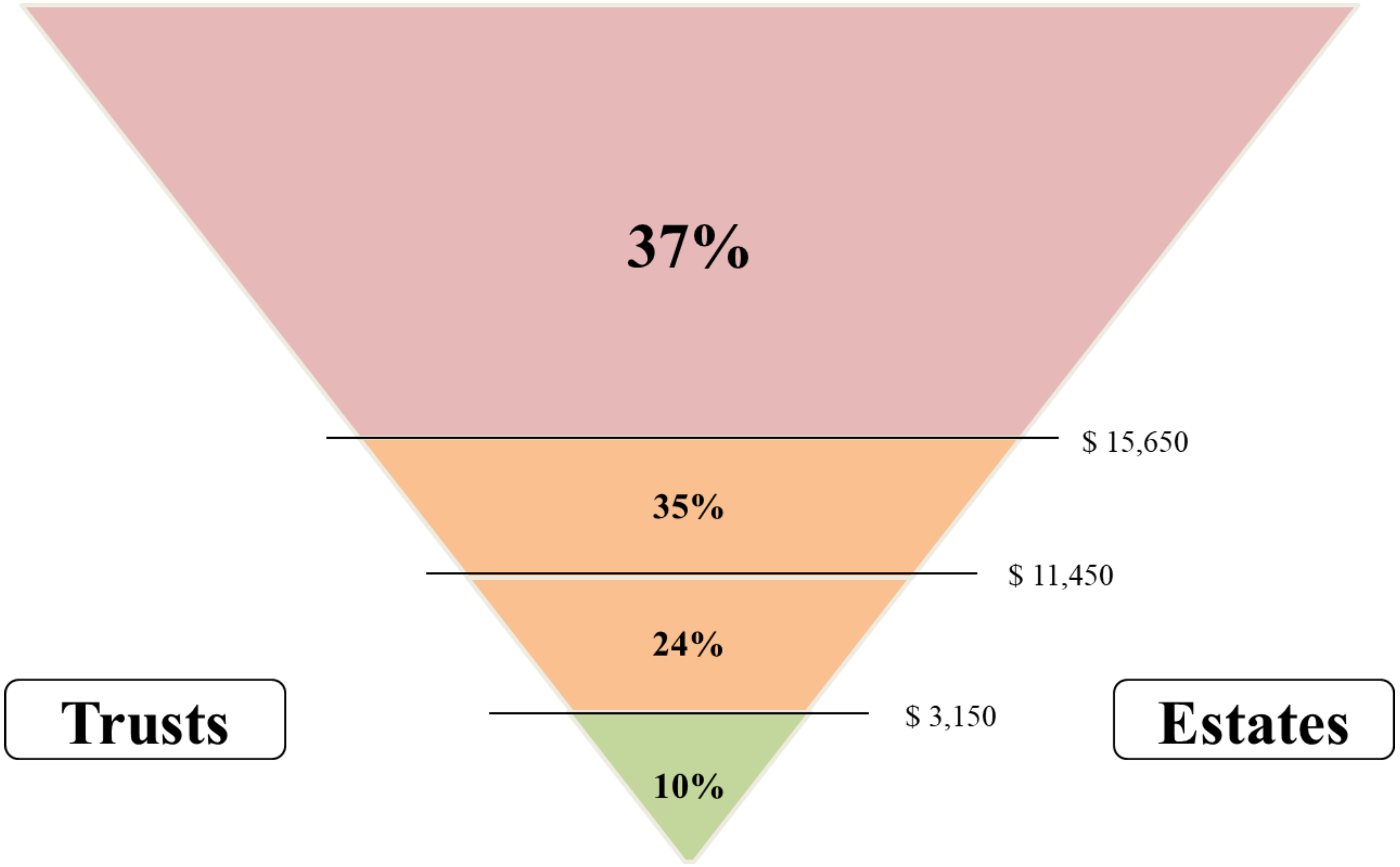
- Trusts and estates are separate taxable entities
  - Receive income and pay expenses
- Taxable income computed similar to individuals
  - Exemption
    - $100 complex trust
    - $300 simple trust
    - $600 estate
- Method of tax accounting
  - Trusts – Calendar year (i.e. Jan. 1st – Dec. 31st)
  - Estates – Fiscal or calendar year

Foundational Concepts
General Tax Rules

- Income taxed to either the trust/estate or the beneficiary
  - If income is accumulated, then the income is taxed to the trust/estate
  - If income is distributed, then the trust/estate gets an income tax deduction and beneficiaries report taxable income

Foundational Concepts

2025 Ordinary Income Tax Rates for Estates & Trusts



Accounting in the Year of Death
Partial Checklist

- File final 1040 as due as usual for income received prior to death; account for income and deductions actually and constructively received
- Apply for an EIN for the estate & file 1041 for income received after death
- File Form 56 - Notice Concerning Fiduciary Relationship
- Review “open” state & federal 1040s, 1041s, & 709s
- Review prior gift tax returns & begin marshaling other materials for filing 706
- Review prior RMDs for correctness and plan for future distributions [notice 2022-53 penalty waiver]
- Review IRAs for Prohibited Transactions

Accounting in the Year of Death
Allocating Income 1040 v. 1041

- Allocated to Final 1040
  - Decedents medical expenses (generally)
  - Unused charitable contributions / other deductions
  - Capital & net operating losses
- Allocated by date of receipt
  - Wages/salary
  - IRA distributions
  - Installment sale payments
  - Interest & dividends

Kenan v. Commissioner,
114 F.2d 217 (2d Cir. 1940).

- A testamentary trust satisfied a pecuniary (dollar amount) bequest with a mix of cash and securities.
- The issue was whether the distribution of securities required the trust to realize the unrecognized capital gains?
- The court agreed with the Service that the distribution required the trust to recognize capital gain.
- The appeals court affirmed, reasoning that there was never a chance that securities distributed would change in value between the date of death and the date of distribution.

Protecting the Executor
Request for Prompt Assessment Using Form 4810

- For income tax and gift tax
- Can request prompt assessment when filing or for a previously filed “open” return
- Shortens the statute of limitations from 3-years to 18-months
- Reduces the risk of the executor receiving a notice of deficiency after the estate is distributed.
- *See* I.R.C. § 6501(d)

Protecting the Executor

Forms to File

Form **4810** (Rev. August 2022)
Department of the Treasury Internal Revenue Service

Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)
See instructions on back.
Go to *www.irs.gov/Form4810* for the latest information.

OMB No. 1545-0430

For IRS Use Only

Requester's name

Title

Kind of tax
- ☐ Income
- ☐ Gift
- ☐ Employment
- ☐ Excise

Number, street, and room or suite no. (If a P.O. box, see instructions.)

City, town, or post office, state, and ZIP code | Daytime phone number

Tax Returns for Which Prompt Assessment of Any Additional Tax Is Requested

Form Number	Tax Period Ended	SSN/EIN on Return	Name and Address Shown on Return	Service Center Where Filed	Date Filed

If applicable, provide the name of decedent's spouse (surviving or deceased). | **Spouse's social security number**

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Protecting the Executor

Request for Discharge From Personal Liability Using Form 5495

- For income, gift & estate tax
- Service has nine months from filing to inform the executor if any tax is due
- Doesn’t relieve the estate from liability or lien, but allows the executor to distribute the estate without taking on the risk of being held personally liable for decedent's unpaid taxes
- *See* Treas. Reg. § 20.2002-1; IRC §§ 2204, 6905(a)

Protecting the Executor

Forms to File

Form **5495** (Rev. December 2008) Department of the Treasury Internal Revenue Service

Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905

▶ See instructions on back.

OMB No. 1545-0432

For IRS Use Only

Decedent's name	Date of death	Social security number

Requester's name

Title

Number, street, and room or suite no. (If a P.O. box, see instructions.)

City, town, or post office, state, and ZIP code

Kind of Tax

☐ Income

☐ Gift

☐ Estate

Daytime phone number

Tax Returns for Which Discharge From Personal Liability is Requested

Form Number	Tax Period Ended	SSN/EIN on Return	Name and Address Shown on Return	Service Center Where Filed	Date Filed

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Foundational Concepts
Types of Trusts

- Simple trusts
  - Required to distribute accounting income annually
  - Cannot make principal distributions
  - Cannot make distributions to charity
- Complex trusts
  - May accumulate income
  - May make either discretionary or mandatory distributions of income and/or principal
  - May make distributions to charity
- ESBT – Electing Small Businesses Trust
- QSST – Qualified Subchapter "S" Trust

Foundational Concepts
Types of Trusts

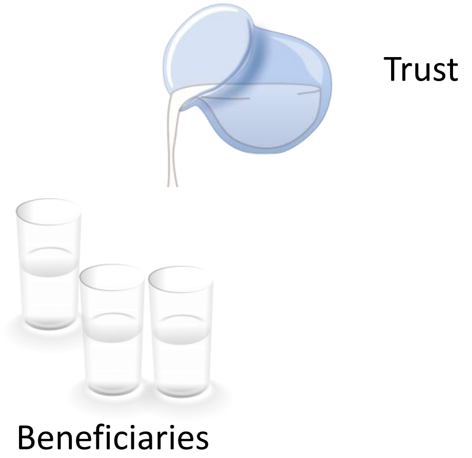
- Grantor trusts
  - Trust and grantor treated as one taxpayer
  - Income taxed to grantor
- Charitable trusts
  - Split-interest trusts consisting of an income beneficiary and a remainder beneficiary
    - Charitable Lead Trust (CLT) – charity is the income beneficiary
    - Charitable Remainder Trust (CRT) – charity is the remainder beneficiary
  - Last for a term of years or life

Foundational Concepts
Types of "Income"

- Fiduciary accounting income
  - Governed by state law and the trust instrument
  - Determines the amount that may or must pass to the trust's or estate's beneficiaries
- Tax accounting income
  - Governed by state and federal income tax law
  - Determines who is taxed on the income

Foundational Concepts
Distributable Net Income (DNI)

- Determines the amount of the trust's or estate's income distribution deduction.
- Determines how much the beneficiaries must report as income on their tax returns.
- Determines the character (e.g. interest, dividends, etc.) of the taxable income in beneficiaries' hands.



IRC § 661

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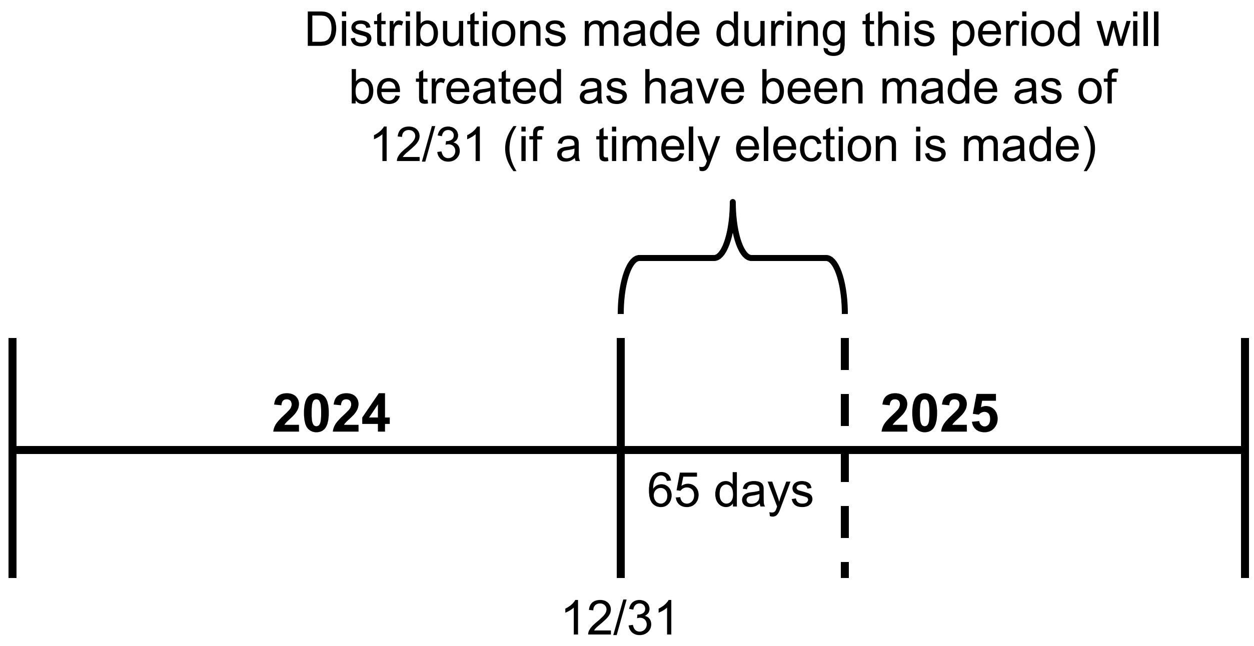
Foundational Concepts
“65-Day” Rule (IRC §663(b))



Foundational Concepts

Specific Bequests

- Do <u>not</u> carry out DNI
- Not taxable to trust/estate or beneficiaries
- Requirements
  - Paid at once OR
  - Paid in not more than three installments

<u>Examples</u>

"I leave my brother Randy $250,000."

"I leave my sister Mary my boat"

Foundational Concepts

Charitable Deduction (IRC §642(c))

- Requirements
  - Paid from gross income
  - Paid pursuant to the governing document
- Must be actually be paid in the current year
  - Exception – pre-1969 trusts
- Unlimited in amount
- Taken as a deduction in computing adjusted gross income (AGI)
- New "2/37 limitation"

Foundational Concepts

Income in Respect of a Decedent (IRD)

Income in respect of a decedent (IRD) – is all items of gross income in respect of a decedent which were not properly included as taxable income in a tax period falling on or before a taxpayer’s death and are payable to his/her estate and/or another beneficiary

IRC § 691(c)

Foundational Concepts

Income in Respect of a Decedent (IRD)

Specific Types of IRD

- IRAs and other qualified retirement plans
- Unpaid salaries/wages at the time of death
- Dividends and interest earned, but not taxed, prior to death
- Unrecognized capital gain on an installment note at the time of the seller's death
- Net Unrealized Appreciation (NUA) on employer securities

Foundational Concepts
IRC §691(c) Deduction

- To the extent that a decedent's taxable estate includes items of IRD and a federal estate tax is assessed, the estate and/or its beneficiaries are entitled to an income tax deduction for the estate tax attributable to IRD

- The income tax deduction computation for estate taxed paid on IRD is determined on a "with and without" basis
  - In essence, the total deduction allowed is the difference between: (a) the estate tax liability <u>with</u> all items of IRD included in the taxable estate and (b) the estate tax liability <u>without</u> the IRD included in the taxable estate

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Foundational Concepts
Trust/Estate Termination

- In the year of termination, all Net Operating Losses (NOLs), capital losses and “excess deductions” pass to the beneficiaries.
  - Only applies in the year of termination.
  - NOLs subject to carryover rules that apply to individual taxpayers.
  - No time limit on beneficiaries to use capital loss carryovers.

Notice 2018-61

IRC §§ 642(h), 67(b), 67(e), 67(g)

Foundational Concepts
“Excess Deductions”

- “Excess deductions” occur when trust/estate expenses exceed income in the year of termination.
- Deduction passes to the beneficiaries

ESTATE TAX PLANNING

Lifetime Gifting Strategies

Estate & Gift Tax Exclusion

The One Big Beautiful Bill Act

- The TCJA doubled the Basic Exclusion Amount (BEA) through 12/31/25 ($13,990,000 in 2025; scheduled to be about $7,000,000 in 2026)
- TCJA sunset uncertainty made planning difficult
- The bill will permanently increase the estate, gift and GST exclusion to $15,000,000 for 2026 and will be indexed for inflation thereafter
- This will provide meaningful relief to many families who may be subject to the estate tax but are not wealthy enough to undertake simple & effective tax planning.

OBBBA § 70106

BALANCING BET-TO-LIVE AND

BET-TO-DIE STRATEGIES

It's a Balancing Act …
Bet to Live? Bet to Die?

Key Strategies

Bet-to-Live Strategies

- Lifetime Gifts
  - Annual Exclusion Gifts
  - Lifetime Gift Tax Exemption Gifts
  - Taxable Gifts
- Grantor Retained Annuity Trust (GRAT)
- Dynasty Trust
- Sale To An Intentionally Defective Grantor Trust (IDGT)

Key Strategies

Bet-to-Die Strategies

- Self-canceling Installment Note (SCIN)
- Private Annuity
- Charitable Lead Trusts
- Life Insurance

Annual Exclusion Gifts

- Each year a taxpayer may gift up to a specified amount ($19,000 in 2025) to another person (a.k.a. “Donee”) without the gift being subject to gift tax
  - This transfer is referred to as an “annual exclusion gift”
  - For married taxpayers, the annual exclusion gift per each donee is basically doubled

- Neither the gift, nor the future appreciation on the gift is included in the taxpayer’s gross estate

Lifetime Gift Tax

Exemption Gifts

- During a taxpayer's lifetime, he/she may make "taxable gifts" (i.e., gifts that exceed the annual exclusion gift amount) up to a specified amount without having to pay gift tax
  - This transfer is referred to as a "lifetime gift tax exemption gift"
  - For married taxpayers, the aggregate lifetime gift tax exemption is basically doubled

Lifetime Gift Tax

Exemption Gifts

- Although lifetime taxable gifts may be sheltered from gift tax because of the lifetime gift tax exemption, the aggregate of such lifetime taxable gifts made by the taxpayer is included in the taxpayer's gross estate
  - However, only the original values of the taxable gifts are included in the gross estate
  - Not the current values of the gifts
- The post-gift future appreciation is not included in the taxpayer's gross estate

Lifetime Gift Tax Exemption Gifts — Example

- A single taxpayer makes a $5,000,000 taxable gift to a trust for the benefit of his children
- The table below illustrates the total amount that is removed from the taxpayer's gross estate over a period of time

Total Wealth Removed From Gross Estate

	0% Growth Rate	4% Growth Rate	8% Growth Rate
Year 5	$ 5,000,000	$ 6,083,265	$ 7,346,640
Year 10	$ 5,000,000	$ 7,401,221	$ 10,794,625
Year 20	$ 5,000,000	$ 10,955,616	$ 23,304,786

Portability Basics

Portability allows the executor to either utilize the decedent's estate tax exclusion amount or to transfer it to the decedent's surviving spouse.

*However, the law does not allow the decedent to transfer his/her unused GST tax exemption to the surviving spouse.

See 26 USC 2010(c)(4).

Portability Basics

Basic Exclusion Amount (BEA)

- Prior to 2011, the basic exclusion amount was referred to as the "applicable exclusion amount"
- In simple terms, the BEA is the minimum estate tax exclusion amount allowed for a single decedent
- Like the prior "applicable exclusion amount", the BEA is reduced by prior taxable gifts

Portability Basics

Deceased Spousal Unused Exclusion Amount (DSUE)

DSUE is the unused estate tax exclusion that the deceased spouse transfers to his/her surviving spouse.

Portability Basics

DSUE is limited to the lessor of:

A. The basic exclusion amount (BEA):

____

$13.99 M in 2025

B. The excess of:

(i) the BEA of the last deceased spouse of the surviving spouse over

(ii) The taxable estate of the last deceased spouse

____

Example:

- BEA = $13.99 M
- Deceased's estate = $3.50 M
- $13.99 M – $3.50 M = $10.49 M

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Portability Basics

<u>Indexing for Inflation</u>

- The basic exclusion amount (BEA) is indexed for inflation
- DSUE ***<u>is not indexed</u>*** for inflation
- Consider a spouse who died in 2023:

	BEA	DSUE
2023	$ 12,920,000	$ 12,920,000
2024	$ 13,610,000	$ 12,920,000
2025	$ 13,990,000	$ 12,920,000
2026	$ 15,000,000	$ 12,920,000

Mathematics of Portability

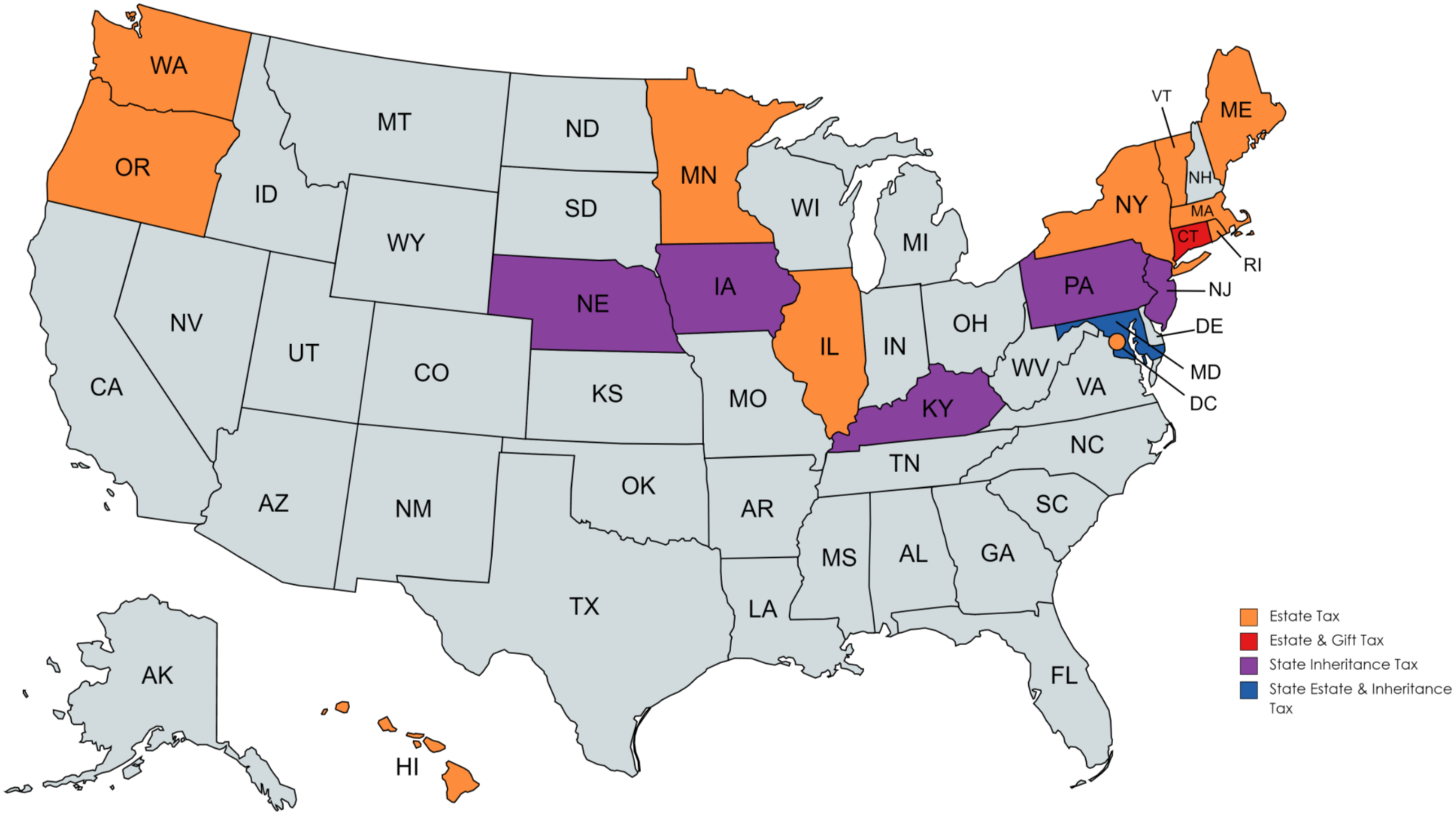
"It's a balancing Act"

Estate Tax

Income Tax

Mathematics of Portability

- Core Concepts – Saving Transfer Tax
  - Estate Tax: 40%
  - GST Tax: 40%
  - Gift Tax: 40%
  - State Estate/Inheritance Tax: 0% - 20%
  - State Gift Tax: 0% - 12%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ME
MA
CT
RI
NJ
DE
MD
DC
AK
HI
Estate Tax
Estate & Gift Tax
State Inheritance Tax
State Estate & Inheritance Tax

Mathematics of Portability

- Core Concepts – Protecting Property
  - Asset Protection
  - Bloodline Protection
  - Spendthrift Protection
  - Power of Appointment

Mathematics of Portability

- Core Concepts – Saving Income Tax
  - Carryover basis – IRC §1015
  - Step-up in basis – IRC §1014
  - Federal Capital Gains Tax
  - State Capital Gains Tax
  - Taxation of Trusts and Estates
- State Estate Tax
  - State Portability
  - State Exemption

Sale To An Intentionally Defective Grantor Trust (IDGT)

Sale to an IDGT

- An IDGT is a type of dynasty trust where all income earned by the trust is taxed to the grantor because the trust is "defective" for income tax purposes, thus allowing for a tax-free gift to the trust's beneficiaries

Summary of Strategy

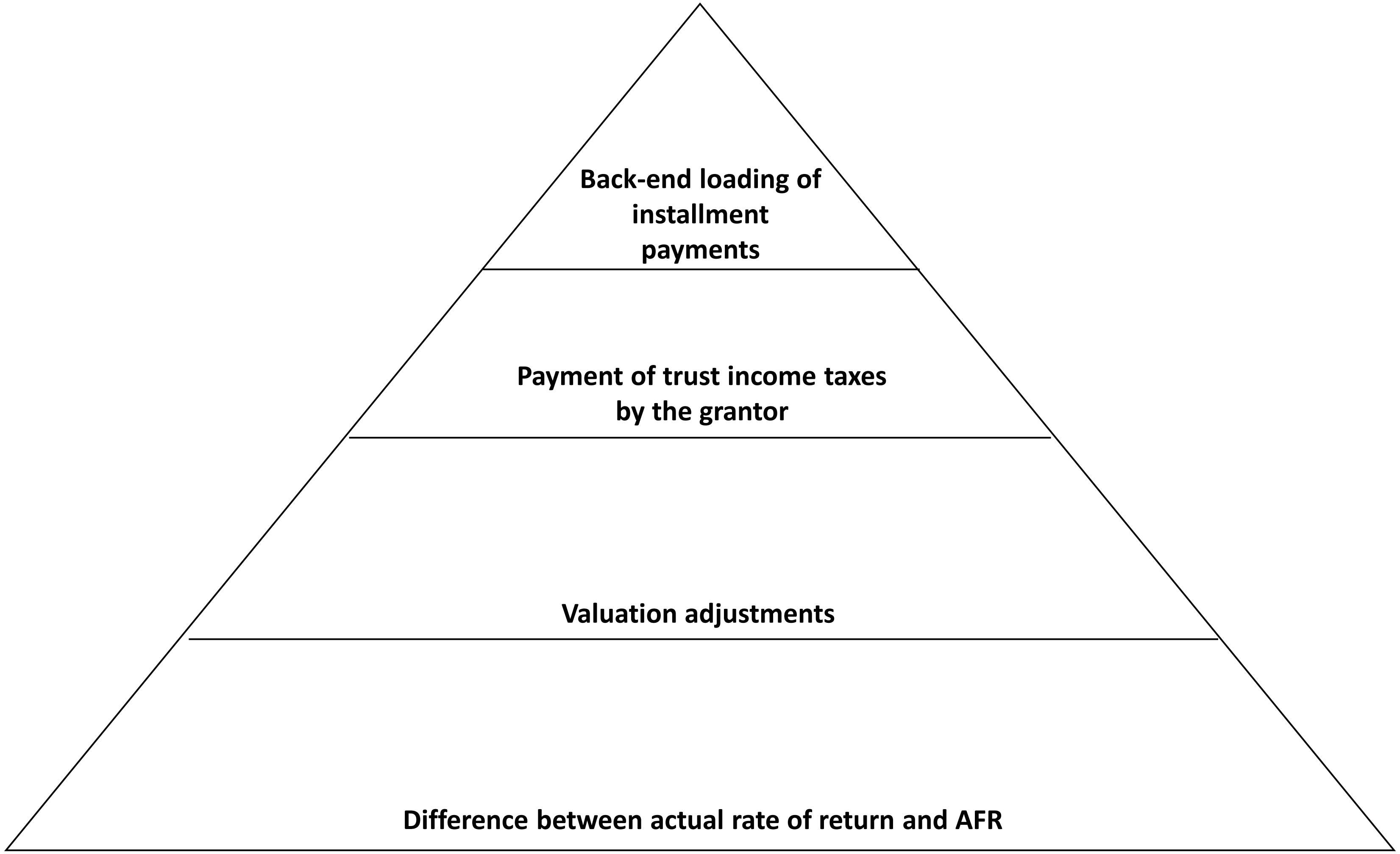
- A type of transaction whereby a grantor sells a highly-appreciating asset to an IDGT in exchange for an installment note
    - However, the grantor should make an initial gift (at least 10% of the total transfer value) to the trust so that it has sufficient capital to make its payments to the grantor
- To the extent that the growth rate on the assets sold to the IDGT is greater than the interest rate on the installment note taken back by the grantor, the “excess” is passed on to the trust beneficiaries free of any gift, estate and/or GST tax

Summary of Strategy

- No capital gains tax is due on the installment sale to the trust because the trust is "defective" for income tax purposes

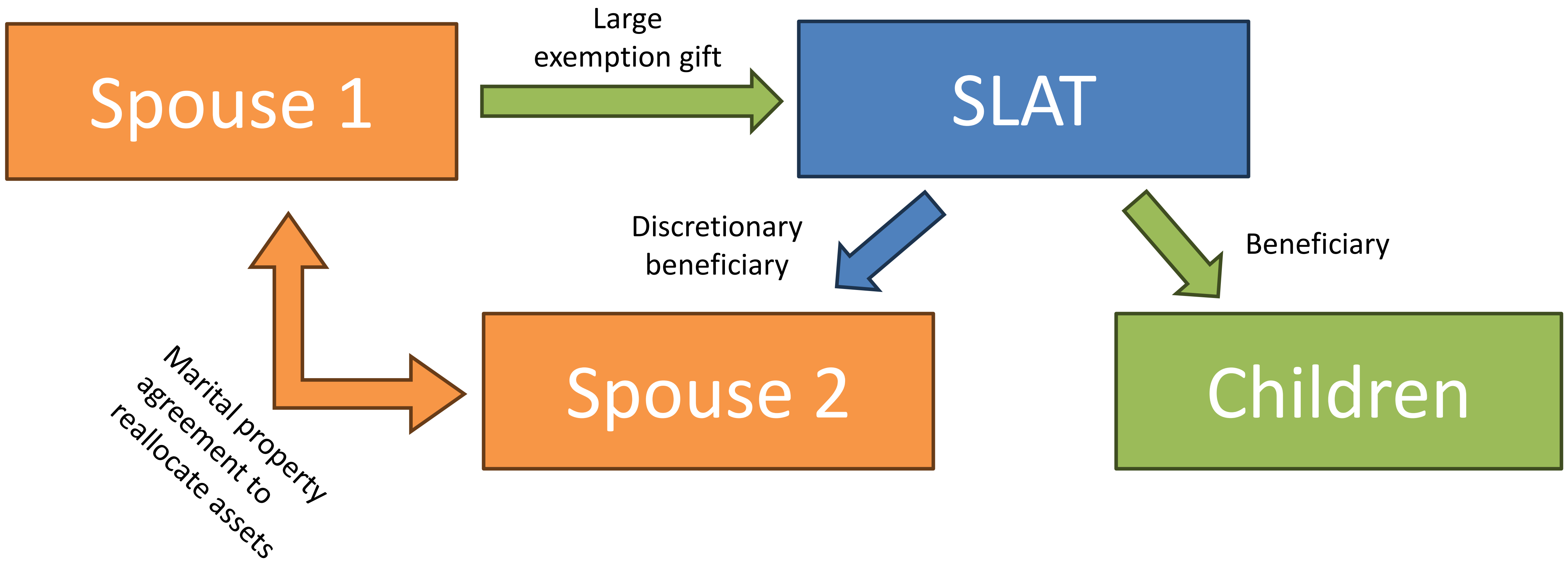
- Interest income on installment note is not taxable to the grantor because the trust is "defective" for income tax purposes

Why an IDGT Sale Works



Effective SLAT Design

SLAT Flowchart



Suggested SLAT Protocol:

- Prepare an estate tax balance sheet to determine the amount of estate tax before and after sunset. This should be done immediately, and your clients need to determine if $5,000,000 of additional taxes is too bitter a pill.
- Next, prepare after cash-flow projections to determine whether your clients can afford to make large gifts.
- Next, life is not all spreadsheets, and ask your clients whether they are "comfortable" gifting away a major portion of their net worth – this is a real question when dealing with humans. While Spock would predictably reply "that is the most logical course of action," your client's may not be so logical.

Suggested SLAT Protocol Continued:

- Explain that the Gordian knot of gifting can be partly solved by using a SLAT or SLANT for your spouse. In the hands of an adroit draftsperson, you can transfer property out of your taxable estate to a trust for your spouse. In even better news, in some states if your spouse dies you can be a beneficiary of the SLAT/SLANT trust[1]. Further, if the Gordian knot is truly tight your spouse might be able to design a trust for your benefit. The best minds, like Jonathan Blattmachr, Edwin Morrow, Steve Oshins, and Marty Shenkman, have all written extensively on these techniques. The Hybrid DAPT is another tool to address the Gordian knot of gifting.

1 See Analysis of the Viability of Statutes Creating "Back-End SLATS" Leimberg Information Services Webinar October 20, 2023, George D. Karibjanian, Franklin Karibjanian & Law, PLLC

States That Allow Back-End SLAT

1. Arizona
2. Delaware
3. Florida
4. Kentucky
5. Mississippi

- 6. North Carolina
- 7. South Dakota
- 8. Tennessee
- 9. Texas
- 10. Wisconsin

1 See Analysis of the Viability of Statutes Creating "Back-End SLATS" Leimberg Information Services Webinar October 20, 2023, George D. Karibjanian, Franklin Karibjanian & Law, PLLC

SPAT

Special Power of Appointment Trust (SPAT)

- Offers flexibility by using an "Appointer"
  - The appointer can distribute assets from the trust to anyone but themselves, their estate, their creditors, or creditors of their estate
- The settlor is not a beneficiary to the trust
  - Settlor can have the appointer give assets back from the trust
- Normally SPATs are grantor trusts
  - Income from the SPAT is recorded on the settlor's personal income tax return
- Hybrid DAPT
  - Standard SLAT in DAPT state
  - Special power held by third party to add grantor as a beneficiary

Avoiding Disaster – IRC § 2036

(a) General rule

The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

“Floating” Spouses

- Defining the spouse as: “Whomever the settlor is married to” can mitigate the risk of divorce/death and remarriage.
  - Allows settlor to re-marry and yet retain indirect access
  - Eliminates ex-spouse’s access in the event of divorce
- May cause state law complications

Funding

- The property used to fund the SLAT is critical
  - It should be the sole property of the settlor
  - Funding with community or joint property may cause inclusion
  - Funding with community or joint property may allow creditor access
  - Property agreements between spouses can be critical
  - Funding with settlor-controlled FLP interests could cause inclusion
  - Funding with settlor-controlled closely-held business interests could cause inclusion

Reciprocal Trusts

- The Reciprocal Trust Doctrine is a judicial principal developed to limit abusive tax avoidance.
- Basically, if spouses create identical SLATs which benefit each other the IRS can arguably collapse the transaction – and treat the trusts as self-settled.
- To avoid this result, thoughtful planning is required to draft trusts which are sufficiently different.

Reciprocal Trusts

- ***Estate of Grace,* 395 U.S. 316 (1969).**
  - Trusts created with nearly identical terms and close in time.
  - The trust settled by each spouse provided the other a life interest.
  - The IRS determined the trusts were reciprocal and included the value of the trust settled by the wife in the husband’s gross estate.
  - The Supreme Court agreed with the IRS, reasoning that the trusts were inter-related, part of single transaction, and in substance didn’t change either party's economic position.

“Caveman” SLAT

- **Basic problem:**
  - Married clients have insufficient assets to both satisfy potential future living expenses and make $27.98M of taxable gifts.
  - Clients unsure which spouse will die first and want each spouse to have access to assets in trust but are concerned about the reciprocal trust doctrine collapsing their planning.
- **Simple Solution**
  - Each spouse divides their BEA taxable gifts between a bypass dynasty trust and a spousal limit access trust.
  - SLAT gifts/assets limited to the amount which may be needed for living expenses, thereby limiting the risk of the reciprocal trust doctrine will be applied.

"Caveman" SLAT

EXAMPLE

Lorraine and Harold are both 85 years old and have a $28,000,000 net worth and each need $100,000 to live on.

They insist on spousal access trusts for each other and plan to live to age 100.

- Option A - Two $14,000,000 SLATS with the risk of the reciprocal trust doctrine on the entire $28,000,000.
- Option B – Two $1,500,000 SLATs for each other and one $25,000,000 trust for children and grandchildren. (Reciprocal trust risk is reduced to $3,000,000 x 40%.)[1, 2]

*15 years x $100,000 = $1,500,000
*$1,500,000 in each SLAT to be invested conservatively (e.g., "Laddered" Bonds)

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CONCLUSION