

Gift and Estate Tax Overview

Estate Planning

Each US person¹ is entitled to transfer via gift or bequest a certain amount of assets free of federal gift or estate tax. This lifetime exemption is \$12.92 million per individual and \$25.84 million for married couples in 2023. Note that the gift and estate tax law changes made by the 2017 legislation will sunset on January 1, 2026, causing the base estate and gift exemption to revert to \$5 million (adjusted for inflation from 2010) if there are no further changes in the law. Each person may also make a gift of up to \$17,000 a year (\$34,000 for a married couple electing to split gifts) per individual. In addition, one may pay tuition directly to an institution and medical expenses directly to the provider for any person free of federal gift tax. As well as federal estate and gift taxes, there is a separate federal tax called the Generation-Skipping Transfer (GST) Tax. GST taxes may be incurred when a donor makes a transfer to a person who is two or more generations below the donor or to a trust for such person's benefit. Therefore, a gift to a grandchild or a trust for a grandchild may be subject to this additional tax. Estate planning may minimize transfer taxes and allow one to retain some control over gifted property. Which estate planning strategies are employed (and when) depends on one's particular circumstances, priorities, and goals.

Wealth and Estate Planning Strategists
Family Office Resources

Gift Tax

Generally, all transfers prior to death (except those to charity or a U.S. citizen spouse) are subject to federal gift tax. Excluded from gift tax are gifts of a present interest in property of up to \$17,000 per year (as of 2023), per recipient (the “annual exclusion”). Direct payments of certain medical and educational expenses on anyone’s behalf also are excluded from gift tax. In addition to the annual exclusion per donee, each US person has an exemption from the federal gift and estate tax, which may be used during life or at death. Under the Tax Cuts and Jobs Act of 2017 (the “2017 Act”), that amount is \$10 million per individual, adjusted for inflation (\$12.92 million per individual in 2023). Absent further legislation, the increase in the gift and estate tax exemption under the 2017 Act will sunset on January 1, 2026, and revert back to the exemption under prior law, which is an exemption of \$5 million per person, indexed for inflation. If a donor makes taxable gifts equal to the available exemption (\$12.92 million per individual in 2023), the credit is fully used and additional taxable gifts will be subject to the federal gift tax (except to the extent of any increase in the exemption amount). The maximum rate of the federal gift tax for any gifts in excess of the exemption amount is 40%. Only one state, Connecticut, also imposes a state gift tax in addition to the federal gift tax.

Estate Tax

Any amount of the federal gift tax exemption remaining unused at death may be used to shelter assets from the estate tax. In other words, the gift and estate taxes are unified in that assets can pass via lifetime gifts and/or at death, with one exemption (\$12.92 million per individual in 2023). As with the federal gift tax, the maximum federal estate tax rate on any estate in

excess of \$12.92 million is 40%. Certain states also impose an estate tax and/or inheritance tax in addition to the federal estate tax. The income tax basis of assets included in a decedent’s gross estate will be adjusted to fair market value on the date of the decedent’s death, which is referred to as a “step-up” in basis when the property has appreciated in value.

Generation-Skipping Transfer Tax

The generation-skipping transfer (GST) tax is an additional layer of tax imposed on transfers to grandchildren or anyone else treated as being two or more generations younger than the transferor. Under the 2017 Act, the GST exemption is also \$12.92 million per individual in 2023. The federal GST tax rate on transfers in excess of the GST exemption is 40%.

Estate Planning Process

Given their importance, the necessities of estate planning (Wills, Revocable Living Trusts, etc.) usually are addressed first. Individuals expecting to have an estate in excess of the federal estate tax exemption amount often consider making gifts because a lifetime gift can remove the asset and any of its future appreciation from the donor’s taxable estate, potentially minimizing the aggregate federal transfer tax due. Other techniques, like a Grantor Retained Annuity Trust and sales to intentionally defective grantor trusts, can be used to transfer assets in excess of the gift and estate tax exemption (or where the donor wants to preserve the exemptions for later use).

Gifts may be outright or in trust, depending upon the level of control and creditor protection to be given to the beneficiary.

Important Disclosure

Morgan Stanley Smith Barney LLC does not accept appointments nor will it act as a trustee but it will provide access to trust services through an appropriate third-party corporate trustee.

This material has been prepared for informational purposes only and is subject to change at any time without further notice. Information contained herein is based on data from multiple sources and Morgan Stanley Smith Barney LLC ("Morgan Stanley") makes no representation as to the accuracy or completeness of data from sources outside of Morgan Stanley. It does not provide individually tailored investment advice. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. Be aware that the particular legal, accounting and tax restrictions, margin requirements, commissions and transaction costs applicable to any given client may affect the consequences described.

Tax laws are complex and subject to change. This information is based on current federal tax laws in effect at the time this was written. Morgan Stanley Smith Barney LLC, its affiliates, and Financial Advisors do not provide tax or legal advice. Clients should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trust and estate planning and other legal matters.

¹ For purposes of this article, US person means a US citizen or person domiciled in the US. For federal transfer tax purposes, a person is domiciled in the US if the person is living in the US with no present definite intention of living elsewhere. Determining whether a person is domiciled in the US is a facts and circumstances test