

Gift and Estate Tax Overview

Estate Planning

Each person is entitled to transfer via gift or bequest a certain amount of assets free of federal gift or estate tax. This exemption is \$12.06 million in 2022. Note that the gift and estate tax law changes made by the 2017 legislation will sunset on January 1, 2026 so that the base exemption will revert to \$5 million (adjusted for inflation from 2010) if there are no further changes in the law. In addition to this exemption, each person may make a gift of up to \$16,000 a year (\$32,000 for a married couple electing to split gift) 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. In addition to estate and gift taxes, there is a separate tax called the Generation-Skipping Transfer (GST) Tax. GST taxes may be incurred when a grantor makes a transfer to a person who is two or more generations below the grantor 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.

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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 \$16,000 per year (as of 2022), 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 a lifetime exemption from the federal gift and estate tax. Under the Tax Cuts and Jobs Act of 2017 (the “2017 Act”), that amount is \$10 million, adjusted for inflation (\$12.06 million in 2022). 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 (\$12.06 million in 2022), the credit is fully used and all future taxable gifts will be subject to the federal gift tax. 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 gift tax in addition to the federal gift tax.

Estate Tax

As mentioned earlier, any amount of the unused federal gift tax exemption remaining at death will 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 (\$12.06 million in 2022). As with the federal gift tax, the maximum federal estate tax rate on any estate in excess of \$12.06 million is 40%. Certain states also

impose an estate 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 ¹, 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 also is \$12.06 million in 2022. 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 estate 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 exclusions and/or credits 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.

Notes:

¹ Special rules apply to estates of decedents who passed away in 2010, as the estate tax was repealed for that year (at the election of the estate).

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