Estates and Trust Tax Planning Overview

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Key Take-Aways

- Planning for smaller (non-taxable) estates is crucial
  - Everyone should have basic documents
- Focus shifts from estate tax planning to income tax planning
- It is not just how much you leave your heirs; it is also the character of assets that you pass along to them
- Portability is a game-changer
- Use of elections can save $$$

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Taxpayers are Re-Thinking the Need for Planning

> Fewer are subject to the Federal Estate Tax since the exemption is so high ($12,920,000 in 2023)

> Many states follow the Federal rules, thus eliminating any state death tax

However, . . .

> Non-taxable estates today may become taxable in the future
  > Assets grow (naturally or by inheritance)
  > Laws change
  > Some people actually win the lottery!

> As time passes and life events occur, most estate plans become out of date

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Excuses We Hear Why Clients Don't Think They Need To Plan

- If there are no taxes due, what is the need for planning?
- I'm too young
- All of my property is jointly held with my spouse
- Estate planning is only for the wealthy taxpayers
- It's too expensive (cost v. value)
- We had our wills drawn up when we were married (probably more than 15 or 20 years ago!)
- I don't want to think about "it"

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Reasons Why Estate Planning is Critical for the Modest Estate Owner

- Several states have estate exclusions well below the Federal level
- Several states (i.e., PA) impose a state inheritance tax
- Need to provide for surviving spouse
- Special needs family member
- Care for minor children
- Second (or third, or fourth) marriage
- Asset protection (predators and spend thrifts)
- Divorce planning
- Life insurance planning
- Recent changes in law
- Planning for IRAs and employer plan benefits
- Roth conversion opportunities

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Reasons Why Estate Planning is Critical for the Modest Estate Owner – Continued

- Closely held business/farming operations
- Use of discounts
- Hard to value assets
- Provide for future education needs
- Planned charitable giving
- Family dynamics (alcohol and drug addiction)
- Disposition of tangible personal property
- Dictate how YOU want to dispose of your estate
- Planning for pets
- Long-term care planning
- Medicaid planning

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Basic Estates Planning Documents

- Will
- Durable Power of Attorney
- Advance Medical Directive

Everyone ages 18 and over should have these basic documents

- Revocable Trusts (Living Trusts)
  - Depends on individual situation and state probate laws
  - When owning out-of-state real estate
  - Provides privacy
- Other trusts to accomplish specific goals
  - Special needs
  - Asset protection

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Beneficiary Designations

- Applicable to
  - IRAs, Roth IRAs
  - Employer plans
  - Life Insurance
  - Annuities
  - Bank and brokerage accounts
- Review and update as needed
  - Birth
  - Death
  - Divorce
  - Marriage
  - Other

IRC Section 2010(c)(4) – "Portability"

Deceased Spousal Unused Exclusion (DSUE) amount

> TRA 2010 – for decedents dying on or after January 1, 2011

> Estate and gift tax exclusions were reunited
("use it now" or "use it later")

> "Portability" became permanent with the 2012 Tax Act

> Final regulation became effective on June 12, 2015

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Portability Election

- The election is made on a timely and complete 706 showing DSUE and there is a surviving spouse
- Election is made by the executor (Form 706, Part 6)
- Not available to a non-resident surviving spouse who is not a U.S. citizen, except to the extent allowable by treaty with his or her country

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Estate Tax vs. Income Tax Planning

- Highest Estate Tax Rate is 40%
- Highest Marginal Personal Income Tax Rate is 37%
    - 3.8% surtax
    - State income tax
- Since most taxpayers will not be subject to the estate tax, more focus needs to be on the income tax aspects
- Planning on an asset-by-asset basis
    - "BASIS" planning is the new normal
    - Best assets to have in your estate (i.e., Roth IRA, tax-exempt bonds)
    - Worse assets to have in your estate (i.e., traditional IRA, E/EE Bonds)
- Need to consider the tax implications to the beneficiaries
- May drive which assets to spend down first

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1041 Income Taxation

- Income
  - Interest, dividends, capital gains and loss, rents, royalties, & partnership income, business income, ordinary gain, farm income, and other income
- Deductions
  - Interest expense, taxes ($10,000 cap), fiduciary fees, charitable deductions, attorney and accountants, and other deductions
- Extremely compressed tax brackets in comparison to individuals
- Consideration for annual distributions
  - Does trust agreement allow for distributions?
  - Does it fit in with the beneficiary's estate planning?
  - Does the beneficiary have creditor issues to worry about?
  - Will the income taxes be less?
- State income tax residence

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Fiduciary Tax Elections

> Taxable year of the estate

> Section 645 election to treat revocable trust part of the estate

> Deducting administrative expenses on fiduciary tax return

> Disclaimers

> Section 643(g) allocation of estimated taxes to beneficiaries

> Treatment of charitable donations made in subsequent year

> Recognition of gain upon distribution of in-kind assets

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Creating or Terminating a Fiduciary Relationship

- Use Form 56 to create or terminate the fiduciary relationship (Section 6903)
- Notifies IRS of Trustee/Executor's address
- Avoid notices being sent to incorrect address and missing statutory response dates
- Form 56 vs. Form 8822-B

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Administrative Elections

- Use Form 4810 to request a prompt assessment of the decedent's income tax and gift tax liability (Section 6501(d))
  - Filed by the executor or administrator
  - Filed within 3-year statue of limitations
  - Filed after Forms 1040 and 709 are filed
  - IRS assessment of tax or court proceeding must be made within 18 months after filing of form
- Use Form 5495 to request discharge of executor from personal liability of decedent's income and gift taxes (Section 6905)
  - Filed after Forms 1040 and 709 are filed
  - Upon payment of taxes as notified by IRS, or, if no notice within 9 months of filing, executor is discharged from personal liability

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Partnerships

- Section 754 election allows step-up in basis to be assigned to assets inside of partnership
- Section 732(d) election alternative to be made by estate

Estate & Trust as Shareholder of S Corporation

> General Rules
  > Estate can own S Corporate stock indefinitely
  > Only certain trusts can own S Corp stock
    > Testamentary trust can only own S Corp stock for 2-years
    > Exception – QSST and ESBT

> Estate is the owner, not the beneficiaries
  > Beneficiaries, if otherwise ineligible shareholders, do not negate S status

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Qualified Subchapter S Trust (QSST)

- Requirements
  - Trust can only (and is required to) distribute all income annually to only one (1) beneficiary, who must be a U.S. citizen or resident
  - Only the income beneficiary can receive principal distributions
  - The income beneficiary's interest must terminate upon the earlier of the death of the income beneficiary or the termination of the trust
  - Upon termination, all trust assets go to the income beneficiary
  - The income beneficiary must elect to be treated as the owner of that portion of the trust consisting of the S Corporation stock
  - QSST status terminates at the time any of the above requirements are not satisfied

Section 1361(d)

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QSST Election Made By The Income Beneficiary

> Separate election required for each S Corporation owned by the trust

> Generally, the election must be made within 2 ½ months after the S Corporate stock is transferred to the trust or from the time the S election is made

> The election is irrevocable

> Covers successive beneficiaries unless they affirmatively refuse to the consent within 2 ½ months of becoming an income beneficiary

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Electing Small Business Trust

- Can have an estate as a beneficiary
- Election made by trustee within 2½ months of the later of the S stock being transferred to the trust or the beginning of the first tax year which the S election is effective (Reg. 1.1361-1(m)(2))

Qualified Beneficiaries of an ESBT

- TCJA allows a nonresident alien individual to be a potential current beneficiary of an ESBT (in addition to resident individuals, estates, and certain charitable organizations)

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Thank You!

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