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New federal transfer tax numbers

For 2025, the amount exempt from federal estate and gift tax grows to $13.99 million. The annual exclusion from the gift tax jumps to $19,000.

—Rev. Proc. 2024-40

COMMENT: In 2023 and 2024, the inflation adjustment came to almost $1 million each year, reaching $13.61 million in 2024. Lower inflation in 2024 meant the adjustment was smaller than in the immediately preceding years. This is last the inflation adjustment before the exempt amount is cut in half, with the expiration of the 2017 tax reforms.

Study update

On July 18, 2024, the Treasury issued final regulations dealing with most of the issues covered by the 2022 proposed regulations, and they issued additional proposed regulations addressing various reserved provisions in the 2024 final regulations, chiefly reflecting changes to the Code made by SECURE 2.0 that was enacted on December 29, 2022. The discussion in this outline reflects these regulations. The following is a list of changes made by the final regulations and proposed regulations that affect our earlier Estate Planning Study on this subject.

The proposed regulations clarify that the required retirement date for individuals born in 1959 is April 1 of the calendar year following the calendar year in which he or she reaches age 73 [Prop. Reg. § 1.401(a)(9)-2(b)(v)].

The final regulations provide that separate shares can be created by having a trust divided at the death of the participant, eliminating the requirement that the separate trusts must be designated in the beneficiary designation form [Treas. Reg. § 1.401(a)(9)-8(a)(1)(iii)(B)]. The proposed regulations clarify that pursuant to the division, a beneficiary’s share can be distributed outright and not necessarily continue to be held in a subtrust [Prop. Treas. Reg. § 1.401(a)((9)-8(a)(1)(iii)(D)].

The statement in the study concerning the special rule for a situation where a beneficiary will receive the full distribution when the beneficiary reaches age 31 requires that the beneficiary be a primary beneficiary for this rule to apply [Treas. Reg. § 1.401(a)(9-4(e)(2)(ii), -5 (f)(2)(ii), -5(f)(1)(i)].

The final regulations provide that in a case where there is more than one minor beneficiary, the ten-year rule only kicks in when the surviving minor beneficiary dies or the youngest minor beneficiary reaches age 21 [Treas. Reg. § 1.401(a)(9-4(e)(2)(ii), -5 (f)(2)(ii), -5(f)(1)(i)].

The final regulations eliminated the distinction between a Type I and a Type II applicable multi-beneficiary trust because the revised separate share rule in the final regulations that allows a trust to be divided into separate shares made the distinction unnecessary [Preamble to final regulations, I, D, 3, c].

In addition, the termination of the interest in an applicable multi-beneficiary trust of a disabled or chronically ill beneficiary prior that beneficiary's death will not cause the trust to fail to be treated as an applicable multi-beneficiary trust, but only if no beneficiary other than a disabled or chronically ill beneficiary has any right to the participant's benefit until the death of all such individuals [Treas. Reg. § 1.401(a)(9)-4(g)(2)].

Upon the death of the last to survive of all the disabled or chronically ill beneficiaries, the trust will be treated as modified as of that date to add the other trust beneficiaries that are not disabled or chronically ill [Treas. Reg. § 1.401(a)(9)-4(g)(2)]. In this case, if adding the new beneficiaries requires that the remaining benefit must be distributed as a result, such as adding a charity as a countable beneficiary, the distribution of the remaining benefit is not required until the following calendar year after the calendar year of the event causing the distribution [Treas. Reg. § 1.401(a)(9)-4(g)(2) and Treas. Reg. § 1.401(a)(9)-4(f)(5)(iv),(v)].

The definition of a designated beneficiary in the case of an applicable multi-beneficiary trust includes a charitable organization described in Code § 408(d)(B)(i), generally public charities other than supporting organizations or donor advised funds. Consequently, such organizations can be residual beneficiaries in an applicable multi-beneficiary trust [Treas. Reg. § 1.401(a)(9)-4(g)(3)].

The "smell test"

A Virginia couple purchased 85 acres in Georgia for $1.35 million. They subdivided the property into two parcels, 44 and 41 acres. Next they donated a conservation easement over the 41-acre parcel to Liberty County, Georgia.

On their 2007 partnership tax return, the couple claimed a charitable deduction of $5.1 million for the conservation easement donation. Only $748,702 could be claimed in that tax year; the rest was carried forward.

The IRS audited the couple in 2015, and disallowed the carryforwards for tax years 2010 and later (the statute of limitations had expired for earlier years). The couple took the matter to the Tax Court and lost [TC Memo 2022-122].

The couple appealed to the Fourth Circuit with no better luck. The Court identified a variety of errors in their legal arguments. "But more remarkable was their attempt to claim a $5.1 million deduction for a limited easement estate on property that they had purchased in fee simple for $652,000 only a year earlier. Such a claim simply does not pass any reasonable smell test, much less the tax law's requirements."

COMMENT: The Court also sustained a 40% gross valuation misstatement penalty.

—Brooks v. Comm'r, CA-4, July 15, 2024

Extension allowed for GSTT election

Taxpayer created irrevocable trusts for two children – trusts that potentially had exposure to the generation-skipping transfer tax. Taxpayer employed an accountant to report the funding of the trusts to the IRS on Form 709. Evidently the accountant did not discuss the issue of allocating the GST exemption to the trusts, because the Form did not elect out of the automatic allocation.

In a later year, new accountants hired by Taxpayer noticed the oversight, and suggested that Taxpayer ask for an extension of time to correct the filing. In private advice, the IRS granted the extension.

—Private Letter Ruling 202428002

No tax on QTIP termination

Sally and Alvin created the Anenberg Family Trust in 1987 to manage their family business. When Alvin died in 2008, the Family Trust divided into new trusts, including a marital trust and a QTIP trust for Sally and trusts for Alvin's descendants. A QTIP marital deduction was elected for Sally's trust.

In 2011, the trustee for Sally's trusts filed a petition to terminate the marital trusts, which was granted in 2012. In August 2012, Sally made two gifts of stock worth $1.6 million each to two trusts, and in September 2012 she sold the balance of her holdings, worth about $22 million, to the trusts for Alvin's descendants in exchange for promissory notes. The gift tax return reported the $3.6 million transfers.

After Sally died in 2016, the IRS took a hard look at the 2012 transfers, and concluded that she owed a $9 million gift tax on the termination of the QTIP trust. In the usual case, a QTIP termination accelerates the remainder interest in the trust, but that did not happen here. The remainder interest was dissolved, and Sally took full ownership of the trust assets after the termination.

The estate took the matter to the Tax Court, which ruled that "The Commissioner would have us treat the circumstances here the same from a gift tax perspective as we would treat a termination of the Marital Trusts that was followed by a hypothetical distribution to Sally of the value of her qualifying income interest only, with the value of the remainder interests distributed to Steven and Neil. But the two situations are not remotely the same." No gift tax was due on this QTIP termination.

—Estate of Sally Anenberg v. Comm'r, 162 T.C. No. 9

On the failure of last-minute planning

Anne Milner Fields was born in Winnsboro Texas. She moved to Dallas after graduating from high school. Following a stint as a secretary, Anne met and married Bert Fields, Sr., an oil businessman. He died in 1963; the couple had no children.

Anne inherited the family business, for which she had no preparation. She enrolled in accounting and business classes at Southern Methodist University, and she enlisted business partners and advisers to bring her up to speed on the oil business. According to the Tax Court, "Her schooling, charisma, drive, and curiosity yielded good business decisions, which over time compounded into considerable personal wealth."

Anne never remarried, never had any children. She took a special interest in a great-nephew, Bryan Milner. She paid for his undergraduate and graduate education, as well as providing mentoring in his career as a banker.

In 2010 Anne signed her last will and testament, a statutory durable power of attorney for financial affairs, and a medical power of attorney. Bryan was named the executor of her estate as well as the holder of the powers of attorney. In 2011 Anne was diagnosed with Alzheimer's dementia. After questions were raised about Bryan's authority to buy a house for Anne, he had her examined by two doctors in 2012. They provided the medical opinion that Anne had been competent to sign the powers of attorney in 2010, but that by 2012 she was no longer competent. This gave Bryan the needed authority to act under the power of attorney.

During the week of May 2, 2016, Anne fell in the presence of one of her caregivers. On or about May 11, 2016, Bryan made contact with an estate planner. On May 13, Anne fainted and was sent to the hospital, where it was discovered that she had had a heart attack and had a spine fracture. On May 25, Bryan formed AM Fields Management, of which he was a 100% owner. On the same day he created a limited partnership, AM Fields. His management company contributed $1,000 to the partnership for a 0.0059% general partnership interest. As Anne's agent, Bryan contributed $17 million of her assets to the partnership in exchange for a 99.9941% limited partnership interest. The doctors sent Anne to hospice on June 15, and she died eight days later.

Bryan obtained an appraisal of the value of Anne's interest in the limited liability company for her federal estate tax return. The appraiser applied a 15% discount for lack of control over the partnership, and a 25% discount for the lack of marketability. The reported value for the partnership interest was $10.8 million, which, combined with other assets, triggered an estate tax liability of $4,617,800.

The IRS audited the estate tax return and concluded that the planning steps taken in the weeks before Anne's death had no meaningful effect; the entire value of the partnership must be included in her estate under IRC §2036. The Tax Court agreed.

—Estate of Fields v. Comm'r, T.C. Memo 2024-90

COMMENT What's more, an accuracy-related penalty was imposed upon the estate, even though the executor relied upon an appraiser for the value. Said the Tax Court: "Moreover, a reduction of approximately $6.2 million in the Estate's reportable assets thanks to the seemingly inconsequential interposition of a limited partner interest between Ms. Fields and her assets on the eve of her death would strike a reasonable person in Mr. Milner's position as very possibly too good to be true."

Scorecards

The Congressional Budget Office (CBO). For fiscal 2024, the CBO has estimated that the federal deficit came to $1.8 trillion. That was $139 billion larger than the 2023 deficit. Revenue was up 11% on the year, but spending rose 10%.

Estimated tax revenue for the fiscal year was $4.9 trillion, up by $479 billion. Spending was $6.7 trillion, up $617 billion. Individual income taxes raised $2.4 trillion, up 11%, and the payroll tax receipts rose 6%, to $1.7 trillion. Corporate income tax collections shot up 26%, to $529 billion.

Totals of federal estate and gift taxes were too small to merit a line item in the report.

The IRS. A new analysis from the IRS projected that the "tax gap" in 2022 came to $696 billion. The gap is the amount of federal tax that went unpaid illegally. The largest component of the tax gap, at 77%, was underreporting of income on timely filed returns. Some 14% was tax that reported on time but not paid on time. The remaining 9% was nonfilers.

Although that sounds like a big number, the IRS stated that it is consistent with past measurements of the tax gap. Roughly 85% of taxpayers voluntarily comply with the tax laws, reporting and paying their taxes on time. This measure has remained consistent, but that means that as the economy grows, the tax gap grows as well.

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