March 2024

TAX AND TRUSTS & ESTATES ALERT

2023 GIFT TAX RETURN FILING REMINDER

Gift tax returns can be an important part of your yearly tax return filing responsibilities. Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return) is filed on a calendar-year basis and is due April 15th of the year following the year in which the gifts were made (unless an effective extension applies). As you determine whether or not you are required to file a gift tax return for 2023, consider the following frequently asked questions:

How much can I give without having to file a gift tax return?

An individual donor is entitled to an annual exclusion from federal gift tax on total gifts made in 2023 of up to $17,000 per donee. There is no limit on the number of annual exclusion gifts that can be made to different donees in any year. For example, if you have three children, you can give each of them $17,000 in 2023 and not have to file a gift tax return. Note that the annual gift tax exclusion increased in 2024 from $17,000 to $18,000.

What kinds of gifts would not qualify for the annual exclusion?

Total gifts to any donee in excess of $17,000 will require a 2023 gift tax return to be filed. And bear in mind that only gifts of "present interests" qualify for the annual exclusion. Outright gifts are gifts of present interests, but gifts to trusts that do not include what are known as "Crummey" withdrawal powers for beneficiaries often are not. And even gifts to trusts that include Crummey powers should be reviewed to ensure that a return is not required - often in order to allocate federal Generation Skipping Transfer (“GST”) tax exemption to those trust gifts. The GST tax is a federal tax imposed on transfers of wealth to individuals that the IRS considers to be two or more generations below that of the donor. This would include direct gifts to grandchildren or funding a trust for children that later passes to grandchildren or more remote descendants. Generation skipping tax considerations should be taken into account in determining whether a gift tax return needs to be filed, and how to properly report the gift for gift and generation-skipping tax purposes.

My spouse and I both have annual exclusions - can we transfer $34,000 to a donee and not have to file gift tax returns?

If each of you and your spouse makes a separate gift of $17,000 from his or her own separate assets, that is correct. But the IRS also allows "gift-splitting". That can occur when one spouse makes a gift of (for example) $34,000 to an individual. If the donor's spouse consents, he or she can "split" that gift, so that each is deemed to be making a gift of only $17,000. In that way, the split gift does not exceed the annual exclusion amount for either spouse. However, gift splitting will require a gift tax return to be filed to record the split and the spousal consent. And gift-splitting will then generally apply to all gifts made by either spouse in that year.

Will I have to pay gift tax?

You will be required to pay gift tax only if your aggregate taxable gifts in prior years plus your 2023 gifts (in excess of allowable annual exclusions) exceed the amount of the gift/estate tax exemption available to you in 2023, i.e., $12,920,000. If, for example, you have made $3,000,000 of taxable gifts after January 1, 1977 (and no taxable gifts before that date), you used up $3,000,000 of your exemption, but you would still

be able to make taxable gifts (i.e., gifts that do not qualify for the annual exclusion or any applicable deduction) in 2023 of $9,920,000 and still not have to pay gift tax.

What deductions are available?

Regardless of amount, outright gifts to your spouse or to qualifying charities qualify for deductions from the gift tax. In fact, if you made outright gifts in 2023 only to your spouse or to qualifying charities, you will not have to file a gift tax return. The only exception would be if you transferred less than 100% of an asset to a charitable organization (e.g., half of a residence property).

Are there any other reasons to file a gift tax return?

Suppose you made a $17,000 gift in 2023 to a trust that included a "Crummey" withdrawal provision. Assuming notice was provided to the beneficiary of that trust, that gift would qualify for the annual exclusion, so a gift tax return would not need to be filed. But suppose that trust is intended to last for multiple generations but does not qualify for automatic allocation of your GST exemption. In that case, you may want to file a timely gift tax return to allocate your GST exemption to that gift. Or, if that trust is not intended to last for multiple generations but fits the IRS definition of a "GST Trust" so that your GST exemption is automatically allocated by statute, you will likely want to file a gift tax return to "opt out" of automatic allocation - for that gift and for future gifts to that trust - to ensure that your GST exemption is not wasted.

For example, a common trust that holds life insurance on your life and provides a trust for your spouse after your death and a further trust for children after your spouse's death but is expected to completely distribute the trust assets to your children during their respective lifetimes fits the IRS definition of a "GST Trust". As a result, any contribution to that trust will have GST exemption automatically allocated to it unless a gift tax return is filed to opt out of that allocation.

Moreover, even if automatic allocation of GST exemption is desired and useful, filing a gift tax return can help keep track of what amount of exemption was automatically allocated and when.

Also, if you made a gift of assets that are difficult to value or for which you took a valuation discount, you may want to file a gift tax return to begin the running of the statute of limitations period. If no return is filed, the IRS has an unlimited amount of time to challenge the value of that gift. If a return is filed and the gift (and its valuation) is adequately disclosed, the IRS has only three years from filing the gift tax return (in most cases) to challenge the value of that gift. Even a sale transaction (e.g., a sale of assets to an intentionally defective grantor trust) might be appropriate to report on a gift tax return, so that - after the statute of limitations has run - the IRS cannot revalue the assets sold and assert that part of the transaction was a gift.

TO GIVE OR NOT TO GIVE (BEFORE THE ESTATE TAX EXEMPTION IS REDUCED AT THE END OF 2025)?

That is the question. The current federal gift and estate tax exemption is now $13.61 million, but it is scheduled to be reduced in half after 2025. [i]

Do you need to make a substantial gift between now and the end of 2025 to take advantage of the current federal gift and estate tax exemption before it's reduced in half at the end of 2025?

The short answer to this question is that current gifts to consume some of the federal gift and estate tax exemption will only have an overall tax benefit if the total taxable gifts made prior to the end of 2025 are greater than the approximately $7 million exemption amount that is expected to be available after 2025. [ii]

So, that tax savings strategy requires a big gift today – i.e., something in excess of $7 million. [iii]

By way of example, let's assume that Jean, who has never previously made any taxable gifts, makes a $10 million gift in 2024. Assume that Jean dies in 2026, after the gift and estate tax exemption has been halved, from approximately $14 million in 2025 to $7 million in 2026. Assume also that Jean dies with a $2 million estate (after making the $10 million gift). The estate tax on her estate would be $800,000 (i.e., 40% of $2 million). Since Jean's $10 million gift exceeds the 2026 available exemption amount of $7 million, she would be treated as having used up 100% of her exemption prior to death, and the entire $2 million in her estate at death would be subject to estate tax. Her estate will not be penalized for the fact that she made an earlier gift well in excess of the exemption available in 2026. The net effect is that Jean will have transferred $11.2 million net of federal gift and estate tax ($10 million + 2 million less $800,000 of estate tax), but only paid estate tax on $2 million, even though the exemption amount at the time of her death was only $7 million.

Contrast this with the situation where Jean keeps her entire $12 million estate, makes no gifts, and then dies in 2026. Her estate would be subject to the (then) $7 million exemption, leaving a $5 million net estate, and her estate would pay $2 million in tax (40% of $5 million), rather than the $800,000 her estate pays in the scenario above. The net effect is that Jean will have only transferred $10 million net of federal gift and estate tax ($12 million less $2 million of tax), rather than $11.2 million.

For those that find tables easier to follow:

Scenario	Estate Tax Paid	Amount Passed to Heirs After Tax
Jean makes a $10m gift in 2024 and dies with $2m estate in 2026	$800,000 (40% tax rate x $2 million, which is the amount in excess of the $7 million exemption in place on the date of Jean's	$11,200,000
Jean makes no gifts prior to her death and dies with $12m estate in 2026	$2,000,000 (40% tax rate x $5 million, which is the amount in excess of the $7 million exemption in place on the date of Jean's	$10,000,000

Jean could have saved $1.2 million for her heirs by taking at least some advantage of the larger gift and estate tax exemption before the end of 2025.

But suppose Jean was not comfortable with making such a large gift in 2024. She was concerned about keeping enough for herself, and she also considered that tax laws might easily change before the end of her life such that the gift might not have been recommended in retrospect. Given these concerns, Jean is nevertheless prepared to make a $7 million gift in 2024. Since her $7 million gift is equal to the 2026 available exemption amount of $7 million, Jean would

be treated as having used up 100% of her exemption prior to death, and her $5 million estate would bear a tax of $2 million. That's exactly the same after-tax consequence as would be the case if Jean made no gifts whatsoever and died with a $12 million estate.

Once again, the examples show that in order to take advantage of the higher exemption rates before 2026, a "big gift" of at least $7 million (or the remainder of your exemption amount, if you've already done some gifting in excess of $7 million) is needed.

Who should at least consider making that "big gift" before the end of 2025?

If you're single, and you expect your taxable estate to be less than $7 million, the post-2025 gift and estate tax exemption will shelter your estate from an estate tax. If you're married, and you expect your aggregate taxable estates to be less than $14 million, you and your spouse's estate would similarly not be subject to federal estate tax post-2025. So, people under these limits do not need to be concerned about making the big gift before the end of 2025.

But if you expect your estates(s) to exceed these post-2025 exemption amounts, you should consider the big gift before the end of 2025.

Some individuals will be particularly logical candidates for the big gift. For example, if a couple has $70 million in assets, but with a lifestyle they can sustain with assets of only $30 million, they should definitely consider using up all of the current exemptions before the end of 2025.

If each spouse makes a $14 million gift in 2024, and then they die after 2025 with a remaining estate of $42 million, their estates would bear an aggregate estate tax of $16.8 million.

If, instead, they decide not to make any gifts at all before the end of 2025, their estates would bear an aggregate estate tax of $28 million. That means $11.2 million less for their heirs after tax than if they had made the larger gifts prior to the end of 2025.

The course of action will not be as obvious for individuals with anticipated estates greater than the post-2025 exemption amount, but with estates that are not so sizable that they feel comfortable giving away the entirety of the larger exemption amount now. Those individuals may want to at least make some use of the currently larger exemption today, even if they are not prepared to make a full $14 million gift. Additionally using lifetime gift (and generation-skipping) exemptions early has and will continue to be good estate tax planning. Early gift tax advantage of the value of money by getting earnings and appreciations of gift assets outside of the taxable estate.

Married couples should also be mindful to avoid "gift splitting" between the spouses if they are making gifts of less than two times to currently larger exemption. For example, suppose the couple is comfortable with a current gift of $14 million. That gift should be arranged so that it comes exclusively from one spouse, so at least one spouse's current exemption will be completely consumed. If that gift is instead split between the two spouses, each will be deemed as having only given a gift of $7 million, which accomplishes nothing in terms of making use of the currently larger exemption.

Is there some way to retain a "string" on the gifted assets to get them back if needed?

The short answer is no – the donor can't retain the right to get the gift back. Nevertheless, if the donor is married, he or she can make that sizable gift into a trust controlled by his/her spouse as trustee, of which the spouse (but not the donor) is a beneficiary. That may give the donor sufficient comfort to proceed with the gift. The risks, though, are 1) the trustee spouse dies while the donor lives, or 2) the donor and the

trustee spouse have different ideas about making any distributions to the trustee spouse (which would be a decision completely controlled by the trustee spouse), or 3) the other trust beneficiaries exercise their right to object if distributions are made to the trustee spouse, or 4) the couple divorces.

This sort of trust is commonly referred to as the "spousal lifetime access trust" or "SLAT", and may appeal to people who (notwithstanding the risks noted above) are prepared to make the sufficiently large gift so long as the other spouse can at least access the trust for support during his/her lifetime.

Which assets are not good candidates for lifetime gifts?

Let's say that you've taken a good look at your balance sheet, and you're pretty sure that you can "afford" to make that big gift in the next couple of years. You still need to consider what that gift might be. IRAs and other qualified retirement accounts are not good candidates, since you would first need to take an income taxable distribution and withdraw anything you wanted to give away. Appreciated assets are not necessarily a good idea either, since if you keep those and give those to your heirs at death, they get a new income tax cost basis equal to their date of death value (in contrast to things you give them while you are alive, which retain your income tax cost basis). Certain other assets (for example, your principal residence) can be problematic to give, too, for various practical or tax-related reasons. Finally, in evaluating which assets to gift, you need to remember that gifted assets have a "carry-over" tax basis to the donee, whereas assets that you pass to your heirs at death generally receive an income tax basis equal to fair market value as of the date of death. So if there is a choice between gifting cash or high-basis assets to a trust or appreciated marketable securities, it is more income-tax efficient to gift the cash and/or high-basis assets.

Why do I need to worry about this now? 2026 is two years away!

Those who fail to plan, plan to fail.

Assuming no intervening legislative changes, there will be a scramble to get these gifts consummated before the end of 2025. Under current "know your customer" (KYC) rules that govern financial institutions, it can sometimes take months to establish trust or other accounts necessary to consummate gifts. You will need appraisals in advance of any gift of closely-held property (LLC or partnership interests, real estate, etc.), and those transfers may require pre-approval of third parties (other co-owners, lenders, etc.), which don't always move as quickly as anticipated. Individuals interested in this potentially valuable strategy are well-advised to finalize any pre-2026 gifts long before the end of 2025 when we anticipate many folks will be trying (and potentially failing!) to do the same.

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[i] The exact amount of the 2026 exemption is not yet set. For purposes of all of our illustrations, we have assumed that the exemption would be $7 million in 2026 after inflation adjustments. That amount will vary a bit, based on the particular inflation adjustments that are ultimately made, but $7 million is a reasonable "ballpark" number to use based on current assumptions.

[ii] U.S Treasury Regulations issued in 2019 confirmed that individuals taking advantage of the gift and estate tax exemption amount in effect through 2025 will not be adversely impacted after 2025 when the exemption is scheduled to be reduced.

[iii] Prior taxable gifts would reduce the amount necessary to make the necessary larger gift to use up a part of today's larger exemption. For example, if you have already used $6 million of exemption, you would only need to make current gifts in excess of $1 million to at least take some advantage of the current larger exemption.

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Sherman Atlas is Proud to Announce the Election of Allison Clayton to the Partnership

We are very pleased to announce that Allison Clayton of our Tax and Trusts & Estates Group has been elected as a new Sherman Atlas partner, effective January 1. Allison joined us in 2015, having previously practiced at Katten Muchen Rosenman LLP in New York and Lowenstein Sandler LLP in New Jersey. She has extensive experience preparing complex instruments for high-net-worth clients to implement their estate planning goals while minimizing transfer taxes, as well as counseling executors and trustees in connection with all aspects of estate and trust administrations. She also assists clients in achieving their charitable objectives through the creation of donor advised funds, charitable split-interests trusts and private foundations. Allison is the current Chair of the Real Property, Trust and Estate Law Section of the New Jersey State Bar Association. She lives in Chatham with her husband and two children.

Sherman Atlas Proudly Announces that Kathleen Clark has Joined the Firm's Tax and Trusts & Estates Group

We are pleased to welcome Kathleen Clark to the Tax, Trusts & Estates Group. Kate has been with the firm as a corporate attorney since our founding in 2014 and has recently expanded her practice to serve clients in the areas of estate planning and estate administration, in addition to her longstanding practice advising on business succession planning, business counseling (including planning for closely held businesses and their owners), business sale transactions, and corporate governance matters for both "for profit" and nonprofit entities. Kate's extensive experience representing individuals and family business clients, combined with her new focus on estate planning matters, will help clients achieve their personal, business, and charitable goals while transferring wealth and family legacy to successive generations. Prior to joining Sherman Atlas, Kate practiced at Riker Danzig Scherer Hyland & Perretti LLP, and she began her career as an associate at Weil, Gotshal & Manges LLP. Kate lives in Maplewood with her husband, John, and in her spare time she enjoys knitting and cycling, and is an avid reader.

Sherman Atlas Proudly Welcomes Joanna Kessler to the Firm's Tax and Trusts & Estates Group

We are pleased to welcome Joanna Kessler to the firm and to our Tax and Trusts & Estates Group. Prior to joining Sherman Atlas, Joanna worked in the corporate department of Cravath, Swaine & Moore, where she gained experience in corporate matters, capital markets, and finance. Joanna is excited to expand her skills to represent families and individuals in connection with their estate planning and trust & estate administration while taking advantage of her earlier experience as a corporate lawyer assisting the team's representation of entrepreneurs, closely held and family businesses in connection with their tax, estate and succession planning.

FOR FURTHER INQUIRIES

Jane L. Brody
PARTNER
jbrody@shermanatlas.com

Allison S. Clayton
PARTNER
aclayton@shermanatlas.com

Alison Schrag
PARTNER
aschrag@shermanatlas.com

Andrew J. Stamelman
PARTNER
astamelman@shermanatlas.com

Raymond Schrag
OF COUNSEL
rschrag@shermanatlas.com

Sandra Brown Sherman
OF COUNSEL
ssherman@shermanatlas.com

Kathleen E. Clark
COUNSEL
kclark@shermanatlas.com

James A. Mohoney
COUNSEL
jmohoney@shermanatlas.com

Michele Fiorentino
ASSOCIATE
mfiorentino@shermanatlas.com

Joanna Kessler
ASSOCIATE
jkessler@shermanatlas.com

Monika Hilliard
FIDUCIARY SPECIALIST
mhilliard@shermanatlas.com

Marci Racaniello
FIDUCIARY SPECIALIST
mracaniello@shermanatlas.com

Elrie du Plessis
PARALEGAL
eduplessis@shermanatlas.com

Betty Kleiman
PARALEGAL
bkleiman@shermanatlas.com

Beatrice Kwok
PARALEGAL
bkwok@shermanatlas.com

Cindy Scibilia
PARALEGAL
cscibilia@shermanatlas.com

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