OPTIMIZING LIFETIME GIFTS:
ADVISING CLIENTS IN UNCERTAIN TIMES

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I. INTRODUCTION

A. In General

As advisors, if we knew when clients were to pass away, who was to survive them, the assets included in their taxable estates, and what the tax laws would be at the time of their deaths, we could all design perfect estate plans. We could also advise clients, with absolute accuracy, when and how to make lifetime gifts to minimize taxes and best effectuate their non-tax objectives. Of course, we cannot know any of these things, so we must simply do the best we can with what we have. In many cases, doing so requires building flexibility into the client's gifting strategy in anticipation of potential changes to the tax laws or a client's family or financial circumstances.

B. Overview of Materials

This paper discusses how to design, implement, and report lifetime transfers, including gifting strategies and provisions that are often overlooked by advisors. Above all, this paper is designed to leave the reader with practical examples of how to add value to client relationships by providing creative and proactive solutions.

The remaining portions of this paper are organized as follows:

- Part II establishes a framework by discussing the new planning paradigm that has emerged as a result of substantial increases to transfer tax exemptions.

- Part III underscores the importance of getting to know the client by reviewing the most common gifting motivations, as well as preliminary design considerations applicable to all gifting strategies.

- Part IV reminds planners to remember the "freebies," or gifts that do not consume gift tax exemption.

- Part V explores transfer tax planning in more depth by providing a broad overview of gifts that consume gift tax exemption, including how to plan for three groups of clients—"affluent" clients, "wealthy" clients, and "super wealthy" clients.

- Part VI provides practical tips for reporting taxable gifts.
C. Disclaimers

This paper does not discuss how to design "core" estate plans that become effective upon a client's death, such as Wills and revocable trusts, in light of fluctuations to the transfer tax exemption amounts. Moreover, this paper is not intended to be a definitive resource for any one particular planning technique. Rather, it is intended to provide an overview of potential gifting strategies, with references to more comprehensive resources. This paper is not intended to be, and should not be construed as constituting, the authors' opinion with regard to any specific case or transaction or the authors' legal or tax advice with respect to any specific case or transaction. The forms included in this paper are for illustrative purposes only and may not be appropriate for any particular client or for use in any particular case or transaction. These forms should be used only by competent counsel and only as illustrations for solutions in specific circumstances.

II. UNDERSTANDING THE CONTEXT: A NEW PLANNING PARADIGM DUE TO TAX LAW CHANGES

Before considering the specifics of how to optimize a client's lifetime gifts, it is important to place the analysis in the proper context. While many clients desire to make gifts for non-tax reasons, as further discussed in Part III, other clients are primarily motivated by a desire to minimize transfer taxes. Tax-motivated gifts, however, are becoming much less common due to substantial increases in the transfer tax exemptions in recent years. In fact, as the number of taxable estates steadily dwindles, advisors must often focus on minimizing income taxes, rather than transfer taxes. The paragraphs below discuss this new paradigm in more detail, including how potential changes in the political landscape may impact transfer tax laws moving forward.

A. Increased Transfer Tax Exemptions, Portability, and Lower Transfer Tax Rates

Recall that in 2000:

- The basic exclusion amount from federal gift and estate taxes (the "BEA") was $675,000 per person;
- The generation-skipping transfer ("GST") tax exemption amount (the "GST Exemption") was $1,030,000 per person;
- The maximum estate and gift tax rate was 55% (with an additional 5% surtax on the value of certain large estates);
- The GST tax rate was 55%; and
- The BEA not used by a deceased spouse was lost and could not be used by the surviving spouse.

A series of tax law changes in 2001, 2010, and 2012 increased the BEA and GST Exemption while also decreasing the transfer tax rates.¹ In 2020, as a result of the Tax Cuts and Jobs Act of 2017 ("TCJA"):

- The BEA is $11,580,000 per person;

The GST Exemption is $11,580,000 per person;

- The maximum estate and gift tax rate is 40%;
- The GST tax rate is 40%; and
- The BEA not used by a deceased spouse is "portable" and can be used by the surviving spouse.

Increases to the BEA have far outpaced the rate of inflation. Between January 2000 and January 2019, the consumer price index increased by 49%. By contrast, the BEA (previously not indexed for inflation) increased by 1,589% and the GST Exemption (likewise) increased by 1,007%. Meanwhile, the maximum transfer tax rate decreased by 27%. The BEA and GST Exemption are indexed for inflation in future years.

In short, the federal wealth transfer tax system is no longer relevant to most taxpayers and is significantly less relevant to the remaining few. The table below illustrates the diminishing impact of the federal estate tax:

<table>
<thead>
<tr>
<th>Year</th>
<th>Estate Tax Exemption Amount</th>
<th>Number of Estate Tax Returns</th>
<th>Number of Estate Tax Returns for Taxable Estates</th>
<th>Percentage of Decedents with Taxable Estates</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>$675,000</td>
<td>109,600</td>
<td>50,500</td>
<td>2.16%6</td>
</tr>
<tr>
<td>2008</td>
<td>$2,000,000</td>
<td>29,000</td>
<td>15,100</td>
<td>0.69%</td>
</tr>
<tr>
<td>2013</td>
<td>$5,250,000</td>
<td>11,300</td>
<td>4,700</td>
<td>0.18%</td>
</tr>
<tr>
<td>2018</td>
<td>$11,180,000</td>
<td>4,000</td>
<td>1,800</td>
<td>0.06%</td>
</tr>
</tbody>
</table>


From 168.8 in January 2000 to 251.712 in January 2019.

See IRC § 2010(c)(3)(B).


While it may be true that taxpayers who have more are inclined to give more, it is also clear that the number of taxpayers impacted by the federal estate tax, and therefore the number of taxpayers motivated to make lifetime gifts simply for tax reasons, has rapidly declined in recent years.

B. Greater Focus on Income Tax Planning

Although the federal transfer tax burden has decreased, the federal income tax burden for many clients (and trusts) has increased. The maximum federal income tax rate is now 37%. Most affluent taxpayers are also subject to a 3.8% surtax on net investment income and will pay tax on long-term capital gains and dividends at a rate of 20%. Consequently, most affluent taxpayers, including many trusts, could face marginal federal income tax rates as high as 40.8% on ordinary income and 23.8% on long-term capital gains and dividends. For residents in states that impose a state income tax, like California, New York, Georgia, and Hawaii, just to name a few, effective income tax rates can be even higher, particularly with the TCJA limiting the federal deduction for state and local taxes to just $10,000.

There has always been a tension between reducing transfer tax and reducing income tax. Often, transactions or techniques designed to reduce transfer tax can result in increased income tax. A classic example is the bypass or credit shelter trust. It may reduce transfer tax at the surviving spouse's death but at the cost of (i) forgoing a new income tax basis for appreciated assets and (ii) potential increased capital gains tax.

With the BEA at the highest level ever, the TCJA has created a new paradigm. Planners can no longer assume that removing an asset from the transfer tax base will result in overall tax savings. Rather, for most taxpayers it will be more important to plan for reducing income tax than for reducing transfer tax. Part III.B.1 discusses these income tax considerations in greater detail, with a particular focus on how they may impact lifetime gifting strategies.

C. Sunset of Increased Transfer Tax Exemptions

If the increases to the BEA and GST Exemption were permanent, it would be easier to plan for clients. Of course, nothing is ever really permanent when it comes to the estate tax. The TCJA reinforced this notion by expressly providing that the doubled exemptions are only temporary. Absent a statutory change, the doubled exemptions are set to expire at the end of 2025, with the BEA and GST Exemption returning to $5 million per person in 2026, indexed for inflation with a base year of 2016. Factoring in inflation, it is estimated that the BEA and GST Exemption in 2026 will be approximately $6.4 million.

Part of the difficulty in gift planning between now and 2026 is that the doubled exemptions are "use it or lose it" amounts. In other words, when a taxpayer makes a lifetime gift, the BEA comes off the bottom, and not the top. For example, assuming the BEA drops to $6.4 million in 2026, if a taxpayer

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7 David Handler refers to an "appreciation hurdle" as the total net growth required between the date of the lifetime gift and the date of the donor's death for the estate tax savings to exceed the cost of losing the step-up in income tax basis. With some baseline assumptions (including a 40% estate tax rate and a 35% capital gains rate), a gift of a $100 asset with a $0 basis would need to appreciate by 166.667%, such that it grew to $266.67 during the donor's lifetime, in order for the estate tax savings to outweigh the income tax savings. See David Handler, Income Tax Basis: No Longer the Stepchild of Wealth Transfers, ACTEC 2019 ANNUAL MEETING, p. 13-14.

8 See IRC § 2010(c)(3) (setting the BEA); IRC § 2631(c) (setting the GST Exemption by cross-reference to the BEA).

makes a $5.4 million gift in 2025, and has made no other taxable gifts in prior years, the taxpayer would only have $1 million of BEA remaining in 2026. Thus, the taxpayer would have to make gifts in excess of $6.4 million before 2026 to receive any benefit from the temporarily doubled exemptions. Part V.B.2.a defines this as the "wealthy client gifting threshold." Few taxpayers are in a financial position to make gifts of this magnitude, yet if the law does not change, many will consider creative gifting strategies in 2025.

In many ways, planning in 2025 could look a lot like planning in 2012, when the $5 million BEA and 35% tax rate were set to expire and be replaced in 2013 with a $1 million BEA and 55% tax rate. One silver lining this time around is that the IRS, through the issuance of final Regulations in 2019, has removed any fear of "clawback" if a taxpayer makes a lifetime gift prior to 2026 that utilizes BEA available at the time of the gift, but not available at the time of the taxpayer's death. Consider, for example, a taxpayer who makes a gift of $9 million in 2020, all of which is sheltered by the taxpayer's BEA. If the taxpayer later dies in 2026, when the BEA is $6.4 million, the final Regulations generally provide that the taxpayer's BEA, for purposes of calculating any estate tax due, will be calculated as if it were $9 million, rather than $6.4 million. As a result, the taxpayer's prior gifts in excess of the taxpayer's BEA at the time of his death should not be "clawed back" to produce a higher estate tax liability.

D. Potential Legislation

Clients often ask what will happen with the estate tax. It is very tempting to respond, "I don't know," and leave it at that, but clients expect and arguably deserve a more detailed answer. Moreover, providing a detailed analysis of potential legislation should help clients better understand certain planning recommendations, which should enable them to make more informed decisions. When engaging in this discussion with clients, planners generally walk through the following scenarios.

1. Estate Tax Repeal?

When Donald Trump was elected President and the Republicans controlled both houses of Congress, rhetoric surrounding estate tax repeal reached a fever pitch. After all, Trump campaigned on repealing the "death tax" and through the years many Republicans, mostly from rural farmland communities, had, themselves, introduced bills to repeal the estate tax. It seemed like the perfect storm. And yet, even after the sweeping changes to the tax system ushered in by the TCJA, the transfer tax system remained, albeit with doubled exemptions for a seven-year window from 2018 through 2025.

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10 See Using an Enhanced Grantor Retained Income Trust (E-GRIT) To Preserve the Basic Exclusion Amount, STATE BAR OF TEXAS ADVANCED ESTATE PLANNING STRATEGIES COURSE (Apr. 2019) (discussing the "disappearing" BEA).


14 In January 2019, Senate Republican John Thune, from South Dakota, reintroduced legislation to repeal the estate tax. The legislation was co-sponsored by a number of key Republican leaders, including Senate Majority Leader Mitch McConnell and Senate Finance Committee Chairman Chuck Grassley. See Naomi Jagoda, Senate Republicans Reintroduce Bill To Repeal the Estate Tax, THE HILL, Jan. 28, 2019, available at https://thehill.com/policy/finance/427328-senate-republicans-reintroduce-bill-to-repeal-the-estate-tax.
Regardless of what happens with the next election cycle, rumors of estate tax repeal are likely to continue to surface from time to time. Any discussion with clients, however, should start with reminding them that, except for a transition year in 2010, the estate tax has existed in some form or fashion since 1916, having been repealed and reinstated several times. Consequently, and at the risk of being completely wrong, it seems unlikely that the estate tax will be repealed any time soon.

2. Democratic Tax Proposals

As long as we are speculating, it is helpful to review tax proposals from the 2020 Democratic presidential candidates. With apologies to all other Democratic presidential hopefuls, below is a brief summary of the features and unique provisions of several candidates' tax proposals.

a. Elizabeth Warren

Elizabeth Warren's tax proposal seeks to impose an "ultra-millionaire tax," structured as an annual 2% wealth tax on households with a net worth of $50 million or more, with an additional 4% tax (6% total) on households with a net worth of $1 billion or more. Warren estimates that this annual wealth tax would generate $3.75 trillion in revenue over 10 years, although her estimate has been staunchly criticized.

b. Bernie Sanders

In January 2019, in response to proposed legislation from Republican Senators to repeal the estate tax, Bernie Sanders introduced the "For the 99.8% Act." Sanders's proposal would:

- Reduce the estate tax exemption to $3.5 million;
- Reduce the lifetime gift tax exemption to $1 million;
- Reduce the GST Exemption to $3.5 million;
- Increase tax rates by imposing:
  - a 45% rate for estates under $10 million;
  - a 50% rate for estates between $10 million and $50 million;
  - a 55% rate for estates between $50 million and $1 billion; and
  - a 77% rate for estates $1 billion or more;

Limit the length of the permissible term of Grantor Retained Annuity Trust ("GRATs");

- Require a minimum remainder interest for GRATs;

- Limit dynasty trust planning by requiring trusts to terminate within 50 years; and

- Restrict the use of valuation discounts for federal transfer tax purposes.

In September 2019, perhaps in response to Elizabeth Warren's ultra-millionaire tax, Sanders introduced his own version of the wealth tax, which would reduce the threshold, increase the number of tax brackets, and increase the tax rates. Under Sanders's wealth tax proposal, a 1% annual wealth tax would apply to single persons with a net worth of $16 million or more, or married couples with a net worth of $32 million or more, with graduated rates topping out at 8% on wealth over $5 billion for a single person or $10 billion for a married couple. Sanders's wealth tax proposal is estimated to raise $5.35 trillion in revenue over 10 years, which is $1.6 trillion more than Warren's ultra-millionaire tax over the same ten-year period. The logistics of imposing and collecting an annual wealth tax are the subject of much debate.

c. Joe Biden

Joe Biden's tax proposal is less focused on the wealth tax and is generally consistent with President Obama's estate tax proposals. In addition to treating capital gains as ordinary income for certain wealthy taxpayers, Biden has proposed to eliminate the income tax basis adjustment applicable to most assets included in a client's taxable estate under Code § 1014. With the federal estate tax only applicable to a small handful of taxpayers, eliminating the basis step-up for appreciated assets at death has the potential to impact substantially more taxpayers and consequently, their gifting strategies.

E. Advising in the Face of Uncertainty: Remember the Status Quo

As discussed above, if Congress does nothing between now and 2026, the BEA and GST Exemption will return to $5 million per person, indexed for inflation with a base year of 2016. Without knowing who will occupy the White House or control Congress over the next six years, the status quo is probably the betting favorite. Recall that the BEA is estimated to be approximately $6.4 million per person in 2026, so that is probably a good number to start with when planning for clients. No one can predict the future, however, so planners must recognize that any speculation regarding the federal transfer tax system, or even the future health of clients, is just that.

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18 See Tara Golshan, Bernie Sanders's Wealth Tax Proposal, Explained, VOX, Sept. 24, 2019, available at https://www.vox.com/policy-and-politics/2019/9/24/20880941/bernie-sanders-wealth-tax-warren-2020. For married couples, Sanders's annual wealth tax would apply a 1% tax to wealth between $32 million and $50 million, a 2% tax between $50 million and $250 million, a 3% tax between $250 million and $500 million, a 4% tax between $500 million and $1 billion, a 5% tax between $1 billion and $2.5 billion, a 6% tax between $2.5 billion and $5 billion, a 7% tax between $5 billion and $10 billion, and an 8% tax on wealth over $10 billion. These thresholds are cut in half for single persons.

III. GETTING TO KNOW THE CLIENT: COMMON GIFTING MOTIVATIONS AND PRELIMINARY CONSIDERATIONS

When meeting with a new estate planning client, advisors typically begin by learning as much as possible about (i) the client's family, (ii) the client's assets and liabilities, and (iii) how the client would like assets to pass if taxes were not an issue at all. After gathering this information, the advisor can discuss how the federal transfer tax laws impact the client's estate planning goals, if at all. Ultimately, an advisor's role is to help design and implement a comprehensive estate plan that accomplishes the client's non-tax objectives while also minimizing taxes. For many clients, lifetime gifts form an integral part of this plan. The paragraphs below discuss preliminary considerations when designing a client's lifetime gifting strategy.

A. Non-Tax Reasons for Gifting

Tax planning is fun. It is so much fun, in fact, that advisors can sometimes get carried away with lifetime gifting strategies that may make sense from a tax perspective but do not make sense for the real person sitting across the table. It is important to remember, therefore, that at its core, lifetime gifting begins with a client's basic desire to benefit others. The key to all client relationships is trust, and when discussing a particular planning technique, it is vital for advisors to keep things practical while clearly communicating both the advantages and disadvantages of the technique.

With this goal in mind, advisors should assist taxpayers in identifying non-tax motivations for gifting, which all clients, regardless of their net worth, should be able to identify. Below is a non-exhaustive list of reasons a client may wish to make lifetime gifts:

- To satisfy a beneficiary's current health, educational, or other need;
- Beyond basic needs, to permit a beneficiary to enjoy assets or a certain lifestyle now, particularly while the client is alive and has a chance to enjoy the impact of the gift;
- To equalize prior or current gifts among family members;
- To forgive prior loans;
- To provide a beneficiary with an opportunity to learn how to manage finances;
- To help a beneficiary start a business or invest in an entrepreneurial endeavor;
- To supplement the income of a beneficiary who wishes to enter into a lower-paying, but socially impactful, profession;
- To help facilitate a beneficiary's charitable giving endeavors;
- To provide a beneficiary with access to capital without exposing the assets to the claims of the beneficiary's actual or potential creditors;
- To facilitate business succession planning and/or motivate younger family members to participate in a family business; and
- To provide the client with insight regarding how a beneficiary handles gifted assets.
There are, of course, many other reasons why a client may wish to make a gift to a family member, friend, or other individual. Whatever the reason, it is important to keep the client's basic objectives in mind, and, in certain cases, not let the tax tail wag the gifting dog.

B. Tax-Motivated Gifts

In addition to non-tax reasons for gifting, certain clients are motivated by tax reasons to make gifts. When making tax-motivated gifts, clients generally seek to minimize income and/or transfers taxes, each of which is discussed below.

1. Gifting to Minimize Income Taxes

As discussed in Part II.B, after substantial increases to the BEA and GST Exemption, estate planners must now place a greater focus on income tax planning than ever before. The paragraphs below review some of the most important income tax considerations when designing gifting strategies.

a. State Income Taxes

Many clients reside in states that impose a state income tax, in addition to the federal income tax that applies to all U.S. taxpayers. Clients in states with a high state income tax, such as Hawaii, California or New York, may wish to consider gifting strategies to minimize their state income tax burden. One of the more common strategies involves the creation of an irrevocable non-grantor trust, or "ING Trust," in a jurisdiction that does not impose a state income tax. ING Trusts have gained popularity in recent years, particularly in jurisdictions like Delaware, Nevada, and Wyoming, leading to the proliferation of "DING," "NING," and "WING" Trusts.

To form an ING Trust, a client generally transfers assets to a non-grantor trust in a state that (i) does not impose a state income tax and (ii) provides some level of creditor protection for self-settled irrevocable trusts. Most gifts are designed to be complete for income tax purposes, while incomplete for transfer tax purposes, meaning that the assets of the ING Trust should still be included in the client's taxable estate upon death. Because the ING Trust is a separate taxpayer, however, the goal is to avoid state income tax on the trust assets. ING Trusts, therefore, are often viewed as useful tools to minimize state income tax on passive investments. The challenge, of course, can be attempting to distribute earnings back to the client if the client continues to reside in a high income tax state.

Not surprisingly, many states have objected to the widespread use of ING Trusts to minimize state income taxes. Even so, the IRS appears more than ready to bless ING Trusts in certain circumstances, and continues to issue private letter rulings approving of the technique. There are many

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20 For a great discussion of non-tax reasons for gifting, as well as other lifetime gifting considerations, see Ann B. Burns, They Say You Can't Take it With You – But How Do You Give It Away? Using the $5 Million Exclusion Amount, 46TH ANNUAL HECKERLING INSTITUTE (Jan. 2012).

21 This paper does not discuss other income tax deferral or avoidance techniques, such as gifts to 529 plans, structural considerations for retirement assets, or investments in qualified opportunity zones.


considerations involved in designing an ING Trust, including asset and trustee selection, and a full discussion of ING Trusts exceeds the scope of this paper.\textsuperscript{24} Advisors with clients in states that impose a high state income tax, however, should at least be aware that an ING Trust, if properly implemented, may help alleviate some income tax burden.

b. **Income Tax Basis**

Given the increasing importance of income tax planning for estate planners, it is critical to understand how income tax basis is determined in the wealth transfer context. Code § 1015 generally provides a "carryover" basis for gifted property, meaning that the donee's income tax basis is generally the same as the donor's income tax basis at the time of the gift. If gifted property has an income tax basis greater than fair market value at the time of the gift, then for purposes of determining loss upon a later sale, the donee's income tax basis is limited to the fair market value of the property at the time of the gift. If the property appreciates after the gift, however, the donor's income tax basis in excess of the fair market value at the time of the gift can be used to minimize taxable gain. Meanwhile, for most assets included a client's taxable estate, Code § 1014 provides an income tax basis adjustment, either up or down, to fair market value at the client's date of death. Thus, appreciated property receives a "step-up" at death, while depreciated property receives a "step-down."

For clients in community property states, Code § 1014(b)(6) enhances the potential step-up by providing that both halves of any community property, and not just the one-half interest passing through the deceased spouse's estate, receive an income tax basis adjustment. This has spawned many creative planning techniques designed to facilitate a double step-up for clients who are not domiciled in a community property state, but nonetheless desire to take advantage of community property laws.\textsuperscript{25}

For the 99.94% of taxpayers who will not be subject to estate tax under current law, planning should typically focus on preserving the basis step-up for appreciated assets at death, rather than avoiding the estate tax.\textsuperscript{26} Income tax basis planning generally falls into one of two categories—"downstream"


\textsuperscript{26} For an excellent discussion of how to plan to maximize income tax basis in light of the new tax laws, see Lester Law & Howard Zaritsky, *Basis After the 2017 Tax Act – Important Before, Crucial Now*, 53\textsuperscript{rd} ANNUAL HECKERLING INSTITUTE (2019); see also Jonathan Blattmachr & Madeline Rivlin, *Searching for Basis in Estate Planning: Less Tax for Heirs*, 41 EST. PLANNING (Aug. 2014); Mickey Davis, *Basis Adjustment Planning*, STATE BAR OF TEXAS 38\textsuperscript{th} ANN. ADV. EST. PL. & PROBATE COURSE, ch. 10 (2014).
planning or "upstream" planning. Downstream planning refers to techniques designed to ensure that a client's assets are included in his or her own taxable estate before being passed on to family members in the next generation. Upstream planning refers to the transfer of assets to family members in the older generation to be included in the older generation family members' taxable estates for purposes of achieving a higher income tax basis, oftentimes before being passed back down to the current generation.

(1) Downstream Planning

While a full discussion of downstream planning techniques exceeds the scope of this paper, advisors should consider the following in appropriate circumstances:

- Avoiding lifetime gifts of highly appreciated assets that would not generate estate tax;
- Preserving capital losses by gifting depreciated assets to an individual beneficiary or irrevocable grantor trust;
- Swapping high basis assets, such as a cash, for low basis assets from an irrevocable grantor trust that contains a power of substitution;
- Unwinding valuation discounts for client-owned assets;
- Causing inclusion of irrevocable trust assets in the estate of a settlor, a beneficiary, or a third party's estate;
- Causing inclusion of gifted assets (not in trust) in the donor's estate;
- Converting separate property to community property to facilitate a "double" basis adjustment at each spouse's death; and
- Changing ownership of spousal assets to achieve a new income tax basis for appreciated assets and preserve the income tax basis of loss assets, particularly for clients with a shortened life expectancy.

(2) Upstream Planning

Upstream planning can potentially benefit a client who owns assets with substantial appreciation and has an older family member, such as a parent, who has "excess" BEA. The client can create an irrevocable trust for the benefit of a parent and fund the trust with the appreciated assets. The trust is designed to ensure that the appreciated assets are includable in the parent's estate by granting the parent a testamentary power to appoint the trust's assets to the parent's creditors. Upon the parent's death, the lapse of the parent's general power of appointment should cause the assets to be included in the parent's taxable estate, under Code § 2041, entitling the appreciated assets to a basis step-up. The inclusion of the appreciated assets in the parent's estate should facilitate the use of the parent's BEA and GST Exemption, while reducing future capital gains tax. The default beneficiary upon the lapse of the parent's general power of appointment is generally a GST exempt trust for the benefit of the client or the client's family members, which is often designed to be protected from the claims of creditors and divorcing spouses.

Upstream planning is not without risk. One particular risk is Code § 1014(e), which disallows a basis step-up if appreciated property is gifted to a parent (or any other person), but the parent dies within one year of the gift and the property returns to the donor. Code § 1014(e) would not apply, however, if the appreciated property passed to a person other than the donor (e.g., a trust for the donor's descendants). It is also possible that Code § 1014(e) would not apply if the property passed to a trust that included the donor as a permissible beneficiary. The IRS could also assert that any assets that return to a trust for the benefit of the client should be included in the client's taxable estate under Code § 2036 or § 2038, as further discussed in Part V.B.3.c. In any event, with today's focus on income tax planning for many clients, upstream planning should continue to be a viable option in appropriate circumstances.  

**c. Charitable Planning**

Although the focus of this paper is not charitable giving, many clients are charitably inclined, and it is important to be familiar with basic charitable giving techniques. Setting aside the use of charitable annuity trusts for estate planning purposes, lifetime charitable planning often focuses on asset and donee selection to maximize the charitable income tax deduction, which can be as simple as advising clients to make gifts of appreciated property to public charities, rather than cash, to avoid paying the built-in capital gain tax on the donated property. It could also involve counseling clients who seek to make a long-term charitable impact regarding the differences between private foundations and donor advised funds, or educating clients with existing private foundations regarding the contribution of qualified appreciated stock to achieve a more favorable deduction. Attached as Exhibit 1 is a sample client memorandum discussing popular charitable giving strategies, including a comparison between a private foundation and a donor advised fund.

**2. Gifting to Minimize Transfer Taxes**

**a. State Estate Tax**

Approximately one-third of the states impose a separate estate or inheritance tax. While many states have tied, or "coupled," their exemption amounts to the federal BEA, certain states, such as Connecticut, Hawaii, Illinois, Maryland, Minnesota, New York, Oregon, and Washington, have not. Planning is more complex in these "decoupled" states, as estate plans must often be designed with multiple QTIP or bypass trusts as a result of the interplay between state and federal tax law.

Other than moving to another state, one strategy to avoid state estate tax is to make lifetime gifts. Unlike the state estate or inheritance tax, which exists in approximately one-third of states as described above, currently only two states, Connecticut and Minnesota, impose a lifetime gift tax. A client who lives in a decoupled state that doesn't impose a gift tax, can minimize state estate tax by making lifetime


gifts that will not incur a state gift tax and will not be subject to state estate tax at the donor's death. Of course, the client must all the while navigate federal transfer tax issues, as further discussed below.

b. Federal Transfer Tax

Gift planning to minimize federal transfer taxes involves the use of gifts that do not consume gift tax exemption, further discussed in Part III, as well as gifts that do consume gift tax exemption or result in the payment of out-of-pocket gift tax, further discussed in Part IV. As a general matter, lifetime gifts can be advantageous from a tax perspective for many reasons, including:

- Making gifts that do not consume the client's gift tax exemption in order to reduce the value of the client's taxable estate;
- Making gifts that do not consume the client's GST Exemption in order to reduce the value of the client's taxable estate and reduce potential GST taxes;
- Shifting appreciating assets, at a lower gift tax cost, from the client's taxable estate, to an irrevocable trust that is excluded from the client's taxable estate;
- Transferring assets with a valuation discount, such as minority interests in a closely held business, to an irrevocable trust that is excluded from the client's taxable estate;
- Funding irrevocable grantor trusts to facilitate the client's payment of the trust's income tax liabilities, which is not treated by the IRS as an additional gift;\(^{31}\)
- Taking advantage of certain irrevocable trusts authorized by statute, such as GRATs and qualified personal residence trusts ("QPRTs"), to shift appreciating assets to lower generations at a reduced transfer tax cost; and
- In rare circumstances, gifting an asset and paying out-of-pocket gift tax, which is calculated on a tax-exclusive basis, rather than retaining the asset in the client's taxable estate and paying estate tax, which is calculated on a tax-inclusive basis.

There are certainly more reasons why a client may be motivated by transfer tax reasons to make lifetime gifts. Specific lifetime gifting strategies are analyzed in Part III and Part IV.

C. Preliminary Gifting Considerations

Once a client communicates his or her desire to make a lifetime gift, the next step is to confirm that the gift is appropriate and, if so, to help structure the gift to achieve the client's tax and non-tax objectives. Below is a non-exhaustive list of preliminary considerations when structuring a client's lifetime gift:\(^{32}\)

- The client's financial needs, including the client's living expenses and required cash flows;

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\(^{32}\) For additional gifting considerations, see Ann B. Burns, They Say You Can't Take it With You – But How Do You Give It Away? Using the $5 Million Exclusion Amount, 46\(^{th}\) ANNUAL HECKERLING INSTITUTE (Jan. 2012).
• The client's desire, if any, to maintain control over the gifted asset;
• The client's desire to protect the transferred assets from the donee's creditors, divorcing spouses, or even the donee's own spending habits and other vices;
• The client's ability to handle complexity or, in contrast, the client's desire to keep things simple;
• The client's risk tolerance, particularly if the gifting strategy involves a more aggressive strategy designed to maintain more control and access than an outright gift;
• The client's willingness to adhere to best practices to reduce tax and creditor risk;
• The client's budget for legal, accounting, appraisal, and other professional fees;
• The donee's age and station in life;
• The donee's family and financial circumstances;
• The donee's ability to handle complexity; and
• The assets available to gift, including each asset's fair market value, income tax basis, appreciation potential, and administrative ease.

Several of these preliminary considerations merit further discussion.

1. Client's Financial Circumstances

Before advising any client to make a lifetime gift, the client should confirm that, after the gift is made, the client will retain sufficient resources to provide for his or her needs, both now and in the future. This analysis will certainly be unique for each client, and generally should include the client's financial and investment advisors. In addition to reviewing the assets and income streams to be retained by the client, the client's lifestyle should also be closely examined, including the client's spending habits, desire for future gifts, potential health care costs, and other appropriate factors.

For super wealthy clients, it should be fairly obvious that they can afford to give away substantial assets without impacting their day-to-day lives or long-term needs. Despite what should be obvious, even the wealthiest of clients may have reservations due to the unlikely, but possible, event their financial fortunes change. Super generous (but not super wealthy) clients should be advised to remember their own needs, in addition to those of their desired beneficiaries.

2. Client's Family Dynamics

It is also important to understand and consider the client's family dynamics. This goal can be difficult at times, but clients should be pressed to ensure that they are being honest, even with themselves. For example, would substantial gifts to the donee incentivize or disincetivize the donee to be a productive member of society? (Is such a goal important to the client?) Is the donee financially responsible, or would this gift contribute to the donee's already poor financial decisionmaking? Does the donee have substance abuse issues or other addictive tendencies? How strong is the donee's marriage? These can be difficult questions, but the better clients know themselves and their goals, the better we can assist in planning to help clients accomplish those goals.
3. Asset Selection

Some assets are better to transfer than others, and asset selection is a key element in designing an effective gifting strategy. As a general rule, particularly when gifts are motivated by tax reasons, clients should seek to give assets with high appreciation potential, as removing future appreciation from the client's taxable estate could result in significant transfer tax savings for the client's family. Clients should be reminded, however, that not every asset appreciates, and if an asset depreciates after a gift is made, the client's BEA could be wasted or, in the case of an installment sale transaction, the transaction could unintentionally result in a "reverse" wealth shift. With a reverse wealth shift, a client is often worse off, from a transfer tax perspective, than if the client had not made the gift at all.

Clients should also consider how an asset's income tax basis impacts its suitability for gifting, as further discussed in Part III.B.1.b. Because most gifted assets will have a carryover income tax basis, it is usually better to gift high basis assets. Low basis assets should typically be retained by the client to be distributed through the client's taxable estate to obtain the basis step-up at the client's death. Moreover, it is important to recognize that some assets, like a family farm, may never be sold, in which case a low carry-over income tax basis should not be a significant deterrent to making a gift.

Finally, clients should consider how easy (or difficult) it is to gift certain assets. For example, depending on the client's objectives, it may be more appropriate to gift separate property instead of community property, or vice versa. Some intangibles, such as cash, marketable securities, or public stock, are easy to value, easy to give, and easy to receive. Other intangibles, such as closely held business interests, are often more difficult to value, give and receive, but may offer greater appreciation potential as a result of valuation discounts at the time of the gift. The same may be true for real property and high dollar tangibles, such as collectibles or jewelry. In any case, before making a gift, the client should consider how difficulties in valuing, transferring, and administering the gifted property may impact the client's overall objectives.

4. Making Gifts Outright or in Trust

There are two basic ways to make a gift—outright or in trust. The biggest advantage to an outright gift is simplicity. To effectuate the gift, the client can simply execute any necessary paperwork to transfer the property and, if required, report the gift. At that point, the client should be finished and there should be no further administration or related costs. With an outright gift, however, the client may lose control of the gifted asset and will forfeit the opportunity to provide the donee with added creditor protection and estate tax savings.

Rather than making an outright gift, the client can transfer the property to an irrevocable trust for the benefit of the donee. Clients desiring to retain some level of control over the gifted assets may even serve as trustee of the irrevocable trust, provided the trust agreement is carefully drafted to ensure that the trustee's powers do not cause inclusion of the trust assets in the client's taxable estate. For example, the client's ability to make distributions should be limited to an ascertainable standard related to the beneficiary's health, education, maintenance, and support. Moreover, a properly structured trust could provide the donee with creditor and divorce protection, and in certain cases, preserve the donee's eligibility for federal and state governmental benefits. An irrevocable trust may also serve to remove the trust property (plus all future appreciation) from both the donor's and the donee's taxable estates. If the trust is structured as a grantor trust, the client will pay the income tax attributable the trust's income without such payments being treated as additional gifts and allowing the trust asset to appreciate more rapidly.

33 See IRC § 2514(c)(1).
On the other hand, creating and administering an irrevocable trust may increase transaction costs and add complexity, compared to an outright gift. Many clients may not have the appetite for this added complexity, and sometimes the value of the gifted property does not justify the added expense. From an income tax perspective, if the trust is a non-grantor trust, the trust will be subject to the highest income tax bracket at a much lower amount of income compared to an individual.\footnote{In 2019, a trust reaches the highest income tax bracket upon earning over $12,750 of income.}

Whether to make a gift outright or in trust is ultimately the client's decision and should reflect the client's objectives. In certain cases, such as with a minor or disabled beneficiary, the decision to utilize a trust should be relatively straightforward. In other cases, such as with a moderately valued gift to a responsible adult beneficiary, the analysis may be more difficult. Again, the more advisors know about their clients, including their clients' assets and family dynamics, the better the advisor's recommendations will be. Asking tough questions and making the effort to know a client's business and family are cornerstones of designing a suitable gifting strategy.

IV. TAKING ADVANTAGE OF THE "FREEBIES:" GIFTS THAT DO NOT CONSUME GIFT TAX EXEMPTION

To optimize a client's lifetime gifting strategy, it is important to understand the "freebies," or gifts that do not consume a client's gift tax exemption. Mastery of these rules is important when planning for all clients, regardless of their net worth. For clients who already have a taxable estate, or may have a taxable estate in the future, taking advantage of the freebies helps preserve the client's BEA and GST Exemption for more substantial transfers, either during lifetime or upon death. For clients who are unlikely to ever have a taxable estate, taking advantage of the freebies may simplify gifting by eliminating the need to prepare and file annual gift tax returns. The paragraphs below discuss all of the various freebies, including transfers that qualify for the unlimited marital and charitable deductions, qualified transfers for medical and educational purposes, and annual exclusion transfers.

A. Marital and Charitable Deduction

A taxpayer's gifts during life or bequests at death to a U.S. citizen spouse (or certain marital trusts) receive an unlimited marital deduction from federal gift and estate taxes and do not consume a taxpayer's BEA.\footnote{See IRC § 2056 and accompanying Treasury Regulations. IRC § 2516 also provides that, subject to certain exceptions, transfers made between spouses pursuant to a divorce settlement agreement shall not consume either spouse's BEA.} Similarly, gifts during life or bequests at death to a qualified charity (or certain charitable trusts) receive an unlimited charitable deduction.\footnote{See IRC § 2055 and accompanying Treasury Regulations.} Part V.B.2 discusses several strategies that make creative use of the marital deduction to facilitate lifetime gifts.

B. Health and Education Exclusion

1. In General

Certain "qualified transfers" are not treated as transfers for tax purposes. Therefore, they do not consume BEA or GST Exemption, regardless of the donee or amount of the transfer.\footnote{See IRC § 2503(e)(1); IRC § 2611(b)(1).} Code § 2503(e)(2) defines qualified transfers as any amount paid on behalf of an individual.
(i) as tuition to an educational organization described in Code § 170(b)(1)(A)(ii) for the
education or training of such individual; or

(ii) to any person who provides medical care, as defined in Code § 213(d), with respect to
such individual as payment for such medical care.

In other words, a client may make unlimited direct payments of qualified health and education
expenses (the "Health and Education Exclusion") on behalf of any number of persons, including "skip
persons" for GST purposes, without utilizing any portion of the taxpayer's BEA, GST Exemption, or
annual exclusion. This powerful planning tool should not be overlooked when advising clients. For
example, a wealthy grandparent could fund all of his or her family member's educations and provide for
all of their medical needs. Not only do these payments benefit the grandparent's family members, they
also remove the gifted assets from the grandparent's taxable estate, which should reduce the estate and
GST tax burden upon the grandparent's death.

2. **Limitations**

While very valuable, transfers intended to qualify for the Health and Education Exclusion under
Code § 2503(e) must meet several requirements. First, the payment must be made directly to the
medical service provider or educational institution. Payments made directly to an individual, who then
utilizes the payment to cover medical or education costs, do not qualify for the Health and Education
Exclusion. Similarly, contributions to a 529 plan, as described in Part IV.E.2.b, are not treated as
qualified transfers.

Second, if the payment of a medical expense is reimbursed by insurance, it does not qualify for
the Health and Education Exclusion.

Third, the Health and Education Exclusion only applies to "qualified transfers." For health care
expenses, qualified transfers only include payments made to prevent or treat a physical or mental defect
or illness, and do not include payments for cosmetic or elective treatments. While the payment of a
person's insurance premiums, hospital services, dental care, nursing care, and medications should be
considered qualified transfers, elective surgeries and other non-essential medical care should not. For
education expenses, qualified transfers only include tuition paid to educational institutions. Although
schools at any level and location may qualify as an educational institution, payments for room and board,
books, and other supplies are generally not considered qualified transfers. Whether a particular payment
is a qualified transfer depends on the unique facts and circumstances surrounding the payment. Thus, it is
important that clients consult with legal counsel or an accountant prior to making a payment to determine
whether such payment would be considered a qualified transfer.

3. **Health and Education Exclusion Trusts**

It is fairly easy for a wealthy grandparent, during his or her lifetime, to fund the health care and
education expenses of grandchildren. As discussed above, the grandparent can simply make direct
payments to health care providers and educational institutions, which should be free of gift and GST tax.

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38 For an excellent discussion of the Health and Education Exclusion, including specific examples of qualified
transfers, see Susan Bart, David Pratt, & Lauren Wolven, *ANTI-Trust Planning: Competition for Trusts, 45th
ANNUAL HECKERLING INSTITUTE* (2011).
Clients who wish to continue funding health and education expenses for future generations after their deaths in a tax-efficient manner may consider creating a health and education exclusion trust ("HEET").

A HEET is an irrevocable trust created during lifetime or at death that substantially benefits charity while providing a source of payment for the health and education needs of individual beneficiaries free of GST tax. Transfers to a HEET will not qualify for an estate or gift tax charitable deduction, but should not consume GST Exemption because charity's interest should prevent the HEET from being considered a skip person. Further, distributions from the HEET for the benefit of skip persons should not be subject to GST tax because such distributions must meet the requirements of the Health and Education Exclusion.

Although a HEET can preserve substantial assets for the health care and education needs of future generations, while also facilitating a taxpayer's charitable objectives, there are several potential disadvantages to HEETs. First, transfers to a HEET are not the most transfer tax-efficient method of providing for charity because the charity's interest in the HEET will not qualify for the transfer tax charitable deduction. One potential workaround is for the client to form a HEET to receive the remainder interest upon termination of a GRAT. A GRAT is generally considered to be a poor multi-generational planning vehicle because the donor cannot allocate GST Exemption until the close of the estate tax inclusion period (i.e., the termination of the GRAT). However, because a HEET is not a skip person, the client does not need to allocate GST Exemption, which can make the combined use of a GRAT and HEET particularly tax-efficient. These tax efficiencies are enhanced because distributions from the HEET to charity qualify for the income tax charitable deduction.

Second, the HEET must be carefully drafted. Not only must charity have a "significant" beneficial interest, which can be difficult to define, the HEET must avoid creating two separate shares for GST purposes—one for charity and one for individual beneficiaries.

Third, HEETs have been targeted by the Department of Treasury, which has recommended that only payments from an individual (and not a trust) to a medical service provider or educational institution qualify for the Health and Education Exclusion. If Congress adopted Treasury's proposal, it would effectively eliminate HEETs.

C. Annual Gift Exclusion

1. In General

Code § 2503(b)(1) provides that a donor may make annual gifts of up to $10,000 per donee without utilizing any portion of the taxpayer's BEA (the "Annual Gift Exclusion"). Code § 2503(b)(2) indexes the Annual Gift Exclusion for inflation. In 2020, the Annual Gift Exclusion is $15,000 per donor,

39 For further reading on HEETs, see Wendy Goffe, An Introduction to Lesser Known but Useful Trusts, LEIMBERG INFORMATION SERVICES, INC., Estate Planning Newsletter #1764 (Jan. 19, 2011).

40 The charitable income tax deduction is taken by the grantor if the HEET is structured as a grantor trust or by the HEET itself if it is structured as a non-grantor trust.

41 In their General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals (commonly called the "Greenbook"), Treasury recommended an amendment to IRC § 2611(b) to provide that only payments from an individual to a medical service provider or educational institution would qualify for the Health and Education Exclusion. Distributions from a trust, including a HEET, would not qualify for the Health and Education Exclusion. The proposal, however, was designed to apply only to trusts created after the introduction of the bill proposing this change, as well as to transfers after such date to pre-existing trusts. Thus, transfers to and from pre-existing HEETs should be grandfathered and not subject to GST tax.
per donee. In other words, a donor may give as much as $15,000 in 2020 to as many individuals as the donor likes without gift tax consequences. If the donor is married and the donor's spouse consents to split the gift under Code § 2513, or if the gift is of community property, the donor (and the donor's spouse) may give as much as $30,000 in 2020, per donee, using the Annual Gift Exclusion.

2. Limitations

When used systematically, gifts that qualify for the Annual Gift Exclusion can be a powerful tool to transfer substantial amounts of wealth over a period of years, especially for a large family with many beneficiaries. There are, however, several traps for the unwary.

First, a gift will qualify for the Annual Gift Exclusion, only if the donee receives a "present interest" in the gifted property. Treasury Regulation § 25.2503-3(b) defines a present interest as an "unrestricted right to the immediate use, possession, or enjoyment of property." So-called "future interests" in property, which Treasury Regulation § 25.2503-3(a) defines as interests "limited to commence in use, possession, or enjoyment at some future date or time," do not qualify for the Annual Gift Exclusion. How to ensure that certain gifts, including gifts to trusts, qualify for the Annual Gift Exclusion is further discussed in Part IV.E.

Second, clients should avoid being too aggressive in attempting to multiply the number of donees whose interest in the gifted property may be illusory. The IRS has denied the Annual Gift Exclusion for a number of unconventional (and in the Service's view, abusive) gift transactions. In this regard, it is important to recognize that the Annual Gift Exclusion is largely a matter of administrative convenience for the Service, which recognizes that taxpayers often make gifts to friends and family members in the form of birthday and holiday gifts, meals, clothing, or transportation expenses. For the most part, these small gifts would be too administratively difficult to track and report. If a client gifts property to each of her children in an amount equal to the full Annual Gift Exclusion on January 1st, should everyday gifts made later in that year be reported and consume the client's BEA? In the Service's view, the answer is yes. To avoid any such issues, it may be prudent for a client to give property with a value somewhat less than the Annual Gift Exclusion each year (e.g., $13,000 of the $15,000 available in 2020), to save Annual Gift Exclusion for all of the "extra gifts" that may be made throughout the year.

D. Annual GST Exclusion

Similar to the Annual Gift Exclusion, Code § 2642(c), enables a donor to give up to $15,000 of property per year to as many skip persons (i.e., persons two or more generations below the donor) as the donor likes without paying GST tax or utilizing any portion of the donor's GST Exemption (the "Annual GST Exclusion"). For example, if a grandparent gives $15,000 cash to a grandchild in 2020, the gift

42 See, e.g., Heven v. United States, 945 F.2d 359 (10th Cir. 1991) (Annual Gift Exclusion denied for gifts of stock to 27 unrelated individuals who immediately re-gifted the stock to members of the decedent's family); Estate of Bies v. Comm'r, T.C. Memo. 2000-338 (Nov. 2, 2000) (Annual Gift Exclusion denied for gifts of stock to spouses of donor's children who immediately re-gifted the stock to donor's children); Sather v. Comm'r, T.C. Memo. 1999-309 (Sept. 17, 1999) (Annual Gift Exclusion denied for reciprocal gifts by siblings to each other's children); Estate of Cidulka v. Comm'r, T.C. Memo. 1996-149 (Mar. 25, 1996) (Annual Gift Exclusion denied for gifts to daughter-in-law and grandchildren who immediately re-gifted assets to donor's son).

43 Weddings provide an interesting case study for the Annual Gift Exclusion, particularly when wealthy parents choose to foot the bill for the couple. On the one hand, many weddings far exceed the Annual Gift Exclusion available that would typically be available to make gifts to the couple. On the other hand, there could be a large number of wedding guests, and it is arguable that the wedding benefits the parents and the guests, and not just the marrying couple.
should qualify for both the Annual Gift Exclusion and the Annual GST Exclusion (together, the "Annual
Exclusions"). There are, however, special requirements for transfers in trust to qualify for the Annual
GST Exclusion, which are further discussed in Part IV.E.3.

E. Using the Annual Exclusions

1. Outright Gifts

The simplest way for a client to take advantage of the Annual Exclusions is to make outright gifts
of easy-to-value assets, such as cash or marketable securities, directly to an individual. Clients may also
utilize the Annual Exclusions by forgiving a debt, paying an obligation on behalf of a beneficiary, or
allowing a beneficiary to live in a residence rent-free. For example, if a son had previously borrowed
money from his parents with interest at the applicable federal rate, in 2020 the parents could forgive up to
$30,000 of interest and principal under the Annual Gift Exclusion, assuming it was a bona fide loan at the
outset. Alternatively, the parents could pay up to $30,000 of their son's mortgage for the year or permit
their son to live in a home owned by the parents so long as the fair market rent for the home did not
exceed $30,000 per year.

Clients who regularly make gifts to fully utilize their Annual Exclusions, should facilitate
continued gifts in the event of their incapacity. This may be accomplished by the client signing (i) a
durable power of attorney that specifically authorizes an agent to make annual exclusion gifts or (ii) a
funded revocable trust that specifically authorizes the trustee to make annual exclusion gifts.

2. Gifts for the Benefit of Beneficiaries, but not in Trust

Many clients who make annual exclusion gifts desire to retain control of the gifted assets and
minimize complexity and costs. These clients often resist using an irrevocable trust, instead gifting assets
to a Uniform Transfers to Minors Act ("UTMA") account, Code § 529 plan, or, for disabled beneficiaries,
an Achieving a Better Life Experience Act ("ABLE") account, each of which is briefly discussed below.44

a. UTMA Accounts

Most states have legislation authorizing the creation of UTMA accounts. An UTMA account
involves three parties—a donor, custodian, and beneficiary. The UTMA account can only have one
current beneficiary, but it can receive contributions from multiple donors. The custodian has a duty to
invest and distribute funds for the beneficiary, with broad discretion regarding the timing and manner of
distributions. While there is variation among states, the UTMA account assets must usually be distributed
to the beneficiary when the beneficiary reaches age 21. If the beneficiary dies before reaching age 21, the
UTMA account assets will be distributed to the beneficiary's estate.

Often, a client funding the UTMA account desires to control investments and distributions by
serving as custodian. Because the statutory powers of the custodian are so broad, however, the client
should be aware that serving as custodian of assets contributed the UTMA account could cause
unexpected adverse tax consequences. For example, if the client serves as custodian, the property gifted
by the client to the UTMA account could be incomplete due to the client's broad discretion to make
distributions or the ability of the client to utilize the UTMA account assets to satisfy his or her obligation
of support. In addition, the UTMA account assets could be includible in the client's gross estate if he or

44 For a more thorough discussion of UTMA Accounts, 529 plans, and all things in between, see Susan Bart,
David Pratt, & Lauren Wolven, ANTI-Trust Planning: Competition for Trusts, 45th ANNUAL HECKERLING
INSTITUTE (2011).
she dies before the beneficiary reaches age 21 and the UTMA account terminates.\textsuperscript{45} Finally, there may be issues in qualifying gifts to an UTMA account for the Annual Gift or GST Exclusions depending on when the UTMA account terminates.\textsuperscript{46}

The client can avoid these potential tax issues by designating a third party as custodian. However, the client must weigh any potential tax certainty against the client's loss of control over the UTMA account. Many clients are willing to assume the tax risks in order to serve as custodian and retain control.

b. 529 Plans

Code § 529 plans refer to state-sponsored qualified tuition programs. Clients typically contribute cash to 529 accounts to provide for the education of a child, grandchild, or other beneficiary. The client can retain broad control over investments in and distributions from the 529 account. As long as distributions are made for qualified higher education expenses at an eligible institution, earnings in the 529 account are not subject to federal income tax. If a distribution is not used for qualified higher education expenses, the distribution will be subject to income tax and a 10% penalty.\textsuperscript{47}

In addition to controlling investments and distributions the client can change the beneficiary of the 529 account. If a client's child, for example, does not pursue a college education, the client can designate another child as beneficiary of the 529 account. Further, while the Health and Education Exclusion only permits tax-advantaged payments of tuition directly to the educational institution, 529 accounts can be utilized for much broader purposes, including room and board, meals, and books.

Unlike any other completed gift transfer, the client can reacquire the 529 account assets, albeit subject to potential income tax and a penalty, as discussed above. Despite the client's control and access, 529 account assets are generally protected from creditors, not included in financial aid calculations for the beneficiary, and not included in the client's taxable estate. While investment options for 529 account assets may be somewhat limited, the flexibility, tax efficiency and low-costs associated with a 529 account make them very attractive to clients.

From a transfer tax perspective, contributions to a 529 account should qualify for both the Annual Gift Exclusion and the Annual GST Exclusion. The client can also "front-load" contributions to a 529 account by contributing up to five times the annual exclusion amount (currently $75,000 per donor, per donee, or $150,000 per married couple) without utilizing any BEA.\textsuperscript{48} The client must make the five-year election on a gift tax return, and must prorate the 529 contribution equally over a five-year period. If the client dies prior to the beginning of the fifth year, the portion allocated to future years is included in the client's taxable estate.\textsuperscript{49} Otherwise, 529 accounts are generally excluded from the client's estate.\textsuperscript{50}

\textsuperscript{45} See IRC § 2038; Rev. Rul. 57-366, 1957-2 C.B. 618; see also IRC § 2036(a) (potentially applicable if the custodian has a legal obligation to support the beneficiary).

\textsuperscript{46} See IRC § 2503(c); IRC § 2642(c)(3).

\textsuperscript{47} See IRC § 529(c)(6); IRC § 530(d)(4).

\textsuperscript{48} See IRC § 529(c)(2)(A)(i).

\textsuperscript{49} See IRC § 529(c)(4)(C); Prop. Treas. Reg. § 1.529-5(d)(2).

\textsuperscript{50} See IRC § 529(c)(4)(A).
c. ABLE Accounts

ABLE accounts were authorized in 2014 under Code § 529A to provide donors with a state-sponsored, tax-advantaged savings accounts for disabled beneficiaries. An individual is an eligible beneficiary of an ABLE account if, during the taxable year, the individual is entitled to Social Security benefits based on a disability that occurred before the individual reached age 26. Most qualified distributions from an ABLE account should not impact the beneficiary's eligibility for governmental benefits, and earnings inside the ABLE account should be exempt from income tax.

Similar to a 529 account, contributions to an ABLE account should qualify for both the Annual Gift Exclusion and Annual GST Exclusion. ABLE accounts, however, are not as flexible as 529 accounts. A beneficiary may only have one ABLE account for his or her benefit (regardless of the number of donors), and donors may only contribute cash to this single ABLE account. There are also strict limitations, depending on governing state law, on the annual amount of contributions to and total amount of the ABLE account. Finally, ABLE accounts are generally subject to claims for Medicaid payments made by the relevant state.

Due to these disadvantages, clients may prefer to utilize a special needs trust to make annual exclusion gifts for the benefit of a beneficiary. In general, a special needs trust is an irrevocable trust that provides the trustee with absolute discretion to make distributions for a disabled beneficiary, without causing the trust assets to be included as part of the beneficiary's resources in determining eligibility for governmental benefits. Not only can the client contribute substantial funds to a special needs trust over time, such a trust is not restricted by contribution limits, asset limits, or state Medicaid payback provisions.

3. Gifts to Trusts

As discussed above, the Annual Exclusions are only available for gifts of property in which the beneficiary has a present interest to enjoy, such as an outright gift of property. A beneficiary's interest in property transferred to an irrevocable trust is typically a future interest that does not qualify for the Annual Exclusions. There are, however, exceptions to this general rule, discussed below.

a. 2503(c) Trusts for Minors (under Age 21)

Code § 2503(c) provides that a gift to a trust for the benefit of a beneficiary who is under the age of 21 shall be treated as a gift of a present interest, and therefore qualify for the Annual Gift Exclusion, as long as:

(i) the trustee has broad discretion to make distributions of income and principal to the beneficiary before the beneficiary reaches age 21;

See IRC § 529A(e)(1).

See IRC § 529A(a).

See IRC § 529A(b)(2).


For an overview of special needs planning, see Bernard A. Krooks, Special Needs – Special Planning: What You Don't Know Can Hurt You and Your Client!, 50th ANNUAL HECKERLING INSTITUTE (Jan. 2016).
(ii) the beneficiary is entitled to withdraw all of the trust property at age 21; and

(iii) if the beneficiary dies before reaching age 21, the trust assets are included in the beneficiary's estate.

Although a client may transfer any type of property to a 2503(c) trust, the statutory requirements and tax aspects of 2503(c) trusts limit their use. Not only must the trust assets be used for only one beneficiary, but also the beneficiary must be entitled to withdraw the entire trust property at age 21, which requirement is often contrary to the client's wishes in funding a trust. In addition, because the Treasury Regulations require that the trustee of a 2503(c) trust be able to make distributions without "substantial restrictions," a donor should refrain from serving as trustee of a 2503(c) trust if the donor wishes to avoid inclusion of the trust assets in the donor's estate.56

b. Crummey Trusts

(1) In General

A "Crummey" trust, which takes its name from the historic Crummey case,57 is an alternative technique that clients can use to take advantage of the Annual Exclusions when transferring property to a beneficiary, while enabling the client to impose restrictions on when the beneficiary can access the gifted property.

A Crummey trust permits a trust beneficiary to withdraw the donor's contribution for a short period of time, such as 30 days after the transfer. If the beneficiary does not withdraw the contribution within that time period, all or a portion of the withdrawal right will lapse and the property is retained in trust, subject to the terms of the trust agreement, the tax consequences of which are discussed in Part IV.E.3.b(2). For example, the Crummey Trust can provide that the beneficiary can only withdraw ½ of the trust assets at age 25 and the balance of the trust assets at age 30. The withdrawal right should cause the beneficiary to have a "present interest" in the donor's gift to the trust that qualifies the gift for the Annual Gift Exclusion. Note, however, that a Crummey Trust may be structured to qualify gifts for the Annual Gift Exclusion, but such gifts may not always qualify for the Annual GST Exclusion, as further discussed below.

(2) Advantages to a Crummey Trust

One advantage to a Crummey trust, compared to a 2503(c) trust, a 2642(c) trust (discussed below), or an UTMA account, is that a Crummey trust can benefit more than a single beneficiary. Irrevocable life insurance trusts, or "ILITs," are very often structured to provide multiple beneficiaries with Crummey withdrawal rights that enable the donor to utilize multiple Annual Gift Exclusions to facilitate payment of higher annual policy premiums. And in contrast to 2503(c) trusts and UTMA accounts, Crummey Trusts are not required to grant a beneficiary the right to withdraw assets upon a beneficiary attaining a certain age. Rather, the Crummey Trust assets can be retained in trust throughout the beneficiary's lifetime. Despite these advantages, several issues can arise in the design and administration of Crummey Trusts, as outlined below.

56 See Reg. § 25.2503-4(b); see also Louis S. Harrison, Structuring Trusts to Permit the Donor to Act as Trustee, ESTATE PLANNING (Nov./Dec. 1995) (discussing how an ascertainable standard could be deemed a substantial restriction for purposes of IRC § 2503(c)).

57 See Crummey v. Comm'r, 397 F.2d 82 (9th Cir. 1968).
(3) Lapsing Withdrawal Rights

A beneficiary, who fails to exercise a withdrawal right with respect to a trust contribution and allows the withdrawal right to lapse, may be deemed to have made a taxable gift. A Crummey trust will often grant each beneficiary a withdrawal power equal to the full Annual Gift Exclusion, reduced by the value of all previous present interest gifts to or for the benefit of the beneficiary by the same donor during the same calendar year. If the beneficiary releases or allows the withdrawal right to lapse, the beneficiary may be considered to have made a transfer to the trust because the release or lapse of a withdrawal right is considered a release of a general power of appointment. However, Code § 2514(e), provides that the lapse of a beneficiary's withdrawal right will be considered a transfer to the trust only to the extent the lapsed withdrawal right exceeds the greater of $5,000 or 5% of the total value of the trust.

There are 3 approaches to prevent a beneficiary from making a current taxable transfer upon the lapse or release of a withdrawal right.

First, some trust agreements simply limit the beneficiary's withdrawal rights over property contributed to the trust to the lesser of (i) the full Annual Gift Exclusion or (ii) the greater of $5,000 or 5% of the aggregate value of the assets subject to the withdrawal power. While this structure limits gift tax free transfers to a trust in an amount equal to the greater of $5,000 or 5% of trust assets, it may be appropriate for a client who intends to make annual trust contributions of $5,000 or less per beneficiary.

Second, the trust agreement can prevent the beneficiary from making a current taxable gift upon the lapse or release of the withdrawal right if the trust agreement grants the beneficiary a continuing limited power of appointment over the portion of the contributed assets that would be otherwise considered a gift by the beneficiary, thus resulting in an incomplete gift. Ultimately, the lapse of the withdrawal right will be a completed transfer at the beneficiary's death, at which time a portion of the trust will be included in the beneficiary's estate.

Third, the trust agreement can grant the beneficiary a withdrawal right over property contributed to the trust in an amount equal to the full Annual Gift Exclusion (again reduced by prior present interest gifts during the same year to the same beneficiary by the same donor), while also providing that the beneficiary's withdrawal right lapses only to the extent of the $5,000 or 5% limitation. In such case, the beneficiary will retain the withdrawal right over the excess contribution until such "hanging" withdrawal right can lapse in subsequent years, perhaps when additional gifts are not made to the trust or when the trust principal has substantially increased. While this structure may prevent the beneficiary from making a current gift with respect to a portion of each contribution to the trust, upon the beneficiary's death, the beneficiary's gross estate will include a portion of the trust's assets based on the amount of any hanging withdrawal rights.

(4) Existing Trusts without Appropriate Crummey Withdrawal Rights

At times, a client may wish to make contributions to an existing irrevocable trust that does not include "appropriate" withdrawal rights (i.e., the trust agreement contains no withdrawal rights, limits withdrawal rights to $5,000, or grants withdrawal rights that are too extensive). While the client typically cannot amend the trust agreement to alter (or include) the withdrawal rights, the client can overrule the trust agreement's withdrawal right provisions in a Deed of Gift that sets out new withdrawal rights as a condition to the gift to the trust. The trustee would then provide the beneficiaries with a letter informing them of the contribution and the applicable withdrawal rights. Examples of a Deed of Gift and a Withdrawal Notice Letter that create hanging withdrawal rights in a trust are included as Exhibit 2 and Exhibit 3.
c. Requirements for Transfers in Trust to Qualify for Annual GST Exclusion

An outright gift to a skip person (e.g., a grandchild) may easily qualify for the Annual Exclusions. However, Code § 2642(c)(2) provides that a transfer of property to a trust for the benefit of a skip person will qualify for the Annual GST Exclusion only if the trust agreement satisfies 2 additional requirements:

(i) during the life of the beneficiary, no trust assets may be distributed to any other person; and

(ii) if the trust does not terminate before the beneficiary dies, the trust assets are included in the beneficiary's estate.

In other words, a 2642(c) trust can only benefit one individual, and all of the trust assets must be included in the beneficiary's taxable estate. A contribution to a trust that fails to satisfy one or both of these requirements may still qualify for the Annual Gift Tax Exclusion, while needlessly wasting GST Exemption.

4. Gifts of Closely Held Business Interests

Annual exclusion gifts of closely held business interests, such as limited partnership ("LP") or limited liability company ("LLC") interests, can be a very effective estate planning tool for clients with large families. A gift of an entity interest, however, may not always qualify for the Annual Gift Exclusion. Code § 2503(b) provides that the Annual Gift Exclusion applies only to gifts of a "present interest," which are specifically those gifts that are "other than gifts of [a] future interest in property." A gift of an interest in property qualifies as a present interest only if the gift meets one of two prongs, referred to as the "Property Prong" and the "Income Prong" of the present interest test.

To meet the Property Prong, the donee must have an "unrestricted and noncontingent right to the immediate use, possession, or enjoyment of [gifted] property." 58 And to meet the Income Prong, the donee must have an "unrestricted and noncontingent right to the immediate use, possession, or enjoyment of the income from the [gifted] property." 59

For example, if a limited partner has no voting rights and has no right to transfer a gifted entity interest, the Service may determine that the gift of such an interest is not a present interest. 60 On the other hand, if a limited partner has the right to transfer the interest, even if subject to the approval of other owners, or the right to receive income distributions, a gift of such an interest should be considered a gift of a present interest that qualifies for the Annual Gift Exclusion. 61

Consider one or more of the following provisions when seeking to qualify gifts of entity interests for the Annual Gift Exclusion:

59 See id.
• Limit others' control over the donee's enjoyment or use of the gifted entity interest;62

• Confirm that (i) the entity will generate income, (ii) some portion of that income will flow steadily to the donee, and (iii) the portion of income flowing to the donee can be readily ascertained;63

• Allow transfers of entity interests to permitted transferees, such as existing partners, members, or family members;

• Give the donee the right to compel the entity to redeem the donee's interest for an amount equal to its fair market value; or

• Gift the entity interest to a Crummey Trust and have the donor transfer, pledge, or loan other property to the trust that can be used to satisfy the transferee's withdrawal right.

V. PLANNING FOR THREE GROUPS OF CLIENTS: GIFTS THAT CONSUME GIFT TAX EXEMPTION

After identifying a client's non-tax objectives and, if applicable, making lifetime transfers that do not consume gift tax exemption, advisors can assist clients in planning for more substantial gifts that do consume gift tax exemption. The paragraphs below discuss how advisors can group clients into three categories based on net worth, as well as lifetime gifting strategies specifically tailored to each client group.

A. Three Client Groups

Before designing and implementing a client's taxable gifting strategy, advisors should first work with the client to gain a comprehensive understanding of the client's current financial status (including any assets excluded from the client's taxable estate), appreciation potential, and remaining BEA and GST Exemption. This information should enable the advisor to classify the client in one of three categories — "affluent" clients, "wealthy" clients, and "super wealthy" clients. As further described below, different tax planning strategies will be appropriate for each group of clients. Advisors should recommend specific tax planning strategies only after considering the client's non-tax objectives, including the client's tolerance for complexity, transaction costs, and potential loss of control.

Attempting to group clients into neat categories is an inexact science. Moreover, the categories themselves are moving targets. For example, unexpected increases or decreases to a client's net worth could make certain strategies more or less attractive, while changes to the transfer tax laws could materially impact a client's taxable posture. Not only is it important that the advisor learn as much as possible about the client's financial position at the outset of the relationship, the advisor should also monitor changes to the client's financial circumstances over time that would merit an update to their gifting strategy.

62 See, e.g., Estate of Turner, 102 T.C.M. (CCH) at 228 (citing Treas. Reg. § 25.2503-3(c)).
63 See, e.g., Estate of Wimmer v. Comm'r, 103 T.C.M. (CCH) at 1842 (citing Calder v. Comm'r, 85 T.C. 713, 727-28 (1985)).
1. "Affluent" Clients

Recall that, in 2026, the BEA is set to return to $5 million per person, which is estimated to be $6.4 million per person after adjusting for inflation. "Affluent" clients are unlikely to have a taxable estate, even though they may have the financial means to make lifetime gifts that consume BEA. For purposes of this paper, affluent clients are projected to have an estimated net worth in 2026 of $6.4 million or less (or $12.8 million or less for married couples).

Taxable gift planning for affluent clients is relatively straightforward. Because the client is unlikely to have a taxable estate under most circumstances, the client's gifts are not typically motivated by transfer tax savings. Rather, the client's non-tax objectives usually dictate the planning. As further discussed in Part III.A, gifts from affluent clients are often intended to satisfy a beneficiary's specific need or desire. Common taxable transfers from affluent clients include cash gifts to assist a beneficiary with making a down payment on a home or starting a business, the forgiveness of prior loans, or specific gifts of valuable property, such as jewelry, real estate, or a business interest.

When working with affluent clients to make taxable gifts, advisors should consider the potential income tax consequences associated with those gifts, as discussed in Part III.B.1, as well as any state transfer tax issues that could arise, as discussed in Part III.B.2.a. Because the taxable estate of an affluent client is unlikely to exceed the client's BEA, it is typically more important to minimize income taxes, rather than to plan for transfer taxes. This new planning paradigm is discussed in Part II.B.

Finally, after an affluent client makes a taxable gift, advisors should be prepared for the inevitable question from the client, "if I don't owe any gift tax, why do I have to file a gift tax return?" Although there is no monetary penalty for filing a late gift tax return when there is no tax due, filing the return is nonetheless a legal requirement. Advisors can also remind clients that filing a gift tax return helps track the use of their BEA and GST Exemption, which would be helpful if changes to the law or their net worth later subjected them to the transfer tax system. Finally, certain elections can only be made on a timely filed gift tax return, such as consenting to split gifts for a married couple, making a QTIP election for an inter vivos QTIP trust, timely allocating GST Exemption, or opting out of the automatic allocation of GST Exemption.64

Affluent clients who wish to make taxable gifts need to recognize that gift tax reporting is simply the cost of doing business. If an affluent client can afford to make a taxable gift, the client can also afford to pay a professional for preparing a gift tax return. Additional considerations for gift tax returns are discussed in Part VI.

2. "Wealthy" Clients

"Wealthy" clients do not have a taxable estate under current law, but are likely to have a taxable estate once the doubled exemptions expire in 2026. Wealthy clients, therefore, have a net worth today between $6.4 million and $11.58 million (or between $12.8 million and $23.16 million for married couples) but are projected to have an estimated net worth in 2026 of $6.4 million or more (or $23.16 million or more for married couples).

When planning for the three different groups of clients, wealthy clients present the most challenges. Unlike super wealthy clients, discussed below, wealthy clients cannot afford to give away the bulk of their net worth just to make use of the currently doubled BEA. Recall that, because BEA comes

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64 See generally Christine S. Wakeman & Lora G. Davis, GRRR (Gift Return Reporting Requirements): Taming the Wild 709 Tiger (2019).
off the bottom and not the top, a client only begins to experience the benefit of the doubled BEA when the client's gifts exceed $6.4 million. On the other hand, unlike affluent clients, discussed above, wealthy clients are likely to have taxable estates as long as they survive until 2026. Planning for a wealthy client's use of the GST Exemption may be especially important given that the GST Exemption is set to drop to $6.4 million in 2026, and unlike the BEA, is not portable between spouses.

Wealthy clients are clearly the most challenging group of clients for which to plan and they face difficult choices. They generally cannot afford to make large taxable gifts and they face a looming estate tax obligation if they die after 2025 without having engaged in active tax planning. Planning for wealthy clients between now and 2026 should focus on lifetime gifts that provide clients with flexibility. Creative gifting strategies are further discussed in Part V.B.

3. "Super Wealthy" Clients

"Super wealthy" clients currently have a taxable estate, and are likely to have a taxable estate as long as the estate tax exists. Super wealthy clients, therefore, have a net worth today in excess of $11.58 million (or in excess of $23.16 million for married couples).

Super wealthy clients can generally afford to make substantial lifetime gifts to make use of the currently doubled BEA and GST Exemption, and may not require as much flexibility or access to capital as wealthy clients, given their additional net worth. Consequently, super wealthy clients have the luxury of implementing more common and conservative gifting strategies than wealthy clients. For example, a super wealthy client may be able to give his entire BEA to a trust for the benefit of his children and grandchildren, whereas a wealthy client may stretch to make a gift of slightly more than $6.4 million to a spousal lifetime access trust, as further described in Part V.B. Some super wealthy clients, however, regardless of their net worth, may never be comfortable making substantial lifetime gifts for fear of needing the money at some distant point in the future.

Planning for super wealthy clients is, in many respects, business as usual. Advisors should continue to recommend traditional lifetime gifting strategies, but with more urgency given the scheduled expiration of the doubled BEA and GST Exemption in 2026. Now that the estate tax has survived the TCJA in 2017, after President Trump campaigned on repealing the death tax and Republicans controlled both houses of Congress, many super wealthy clients may finally be willing to address their potential estate tax bills through lifetime gifting. While it exceeds the scope of this paper to provide a complete explanation of gifting strategies available to super wealthy clients, advisors should consider the following techniques, among others:

- Substantial outright gifts to descendants and other beneficiaries;
- Gifts to grantor trusts for the benefit of spouses, descendants, and/or other individuals;
- Installment sales to grantor trusts;
- GRATs;
- Remainder Purchase Marital Trusts ("RPM Trusts").

• QPRTs and split purchase QPRTs ("SP-QPRTs"),\textsuperscript{66} 
• ILITs; 
• Beneficiary defective inheritor's trusts ("BDITs"); 
• Beneficiary deemed owned trusts ("BDOTs");\textsuperscript{67} 
• Charitable lead trusts ("CLTs") and charitable remainder trusts ("CRTs"); 
• Family limited partnerships ("FLPs"); 
• Intra-family loans and loan forgiveness;\textsuperscript{68} 
• Private annuities; 
• For spouses with a significant disparity in wealth, elect gift splitting for the wealthier spouse's gifts to facilitate the use of both spouses' BEAs and GST Exemptions;\textsuperscript{69} and 
• In rare circumstances, making gifts to intentionally trigger a gift tax to take advantage of the tax-exclusive nature of the gift tax compared to the tax-inclusive nature of the estate tax.

Most gifting strategies for super wealthy clients attempt to "freeze" the value of the client's taxable estate by transferring an appreciating asset, which would otherwise generate additional estate tax (if it remained in the client's estate), to an irrevocable trust that should be excluded from the client's estate. In other words, a client can freeze the value of his taxable estate by shifting future appreciation to an estate tax protected vehicle.

Many gifting strategies for super wealthy clients also attempt to "leverage" the use of the client's BEA and GST Exemption by relying on valuation discounts for transfer tax purposes. Such valuation discounts generally include fractional interest, minority interest, and/or lack of marketability discounts, among many others.

It can be hard to achieve certainty when gifting hard-to-value property, such as real estate, artwork, or a closely held business interest. To avoid making too large a gift and unintentionally


\textsuperscript{67} See S. Stacy Eastland, \textit{A Comparison of the Best Freeze Planning Techniques We See Out There in the Age of Tax Reform}, 2019 ACTEC ANNUAL MEETING (2019).


\textsuperscript{69} For further discussion of this and two additional techniques to utilize both spouses' BEAs and GST Exemptions, see Richard S. Franklin & George D. Karibianian, \textit{The Lifetime QTIP Trust – the Perfect (Best) Approach to Using Your Spouse's New Applicable Exclusion Amount and GST Exemption}, BLOOMBERG ESTATES, GIFTS, AND TRUSTS, NUMBER 2 (Mar. 14, 2019).
incurred out-of-pocket gift tax, clients can utilize formula clauses in their gift documents, such as defined valued clauses,\textsuperscript{70} or structure gifts with the beneficiary executing a disclaimer of any amount that exceeds the donor's remaining BEA, with the disclaimed amount returning to the donor or the donor's estate.\textsuperscript{71} Each of these techniques attempts to achieve a gift of a specific dollar amount, with a built-in adjustment to the percentage interest actually gifted in case of an IRS audit. One of the practical benefits of the temporarily doubled BEA and GST Exemption, beyond the increased amounts themselves, is the ability for super wealthy clients to make significant gifts of property that is hard to value, but that the client is comfortable has a value well below the client's remaining BEA. This extra cushion can oftentimes alleviate the need for a complex formula clause in the client's gifting documents.\textsuperscript{72}

Super wealthy clients often ask advisors whether they should utilize the doubled exemptions now or defer planning until 2025. On the one hand, deferred planning certainly provides the client with more flexibility by retaining ownership of the assets. On the other hand, gifting assets now removes future income and appreciation from the client's taxable estate and, if the assets are transferred to a grantor trust, facilitates a greater potential wealth shift through the client's payment of income tax generated by the trust assets. Many super wealthy clients decide to utilize the doubled exemptions now, rather than waiting until 2025, and may already have existing trusts that are appropriate vehicles for such gifts.

B. Creative Gifting Strategies for Wealthy Clients

As explained above, gifting strategies for wealthy clients should strike the right balance between minimizing transfer taxes and preserving sufficient assets to support the client's lifestyle and future needs. This balance can be very difficult to achieve. Unlike super wealthy clients, who often decide to utilize the doubled exemptions now, wealthy clients may be more comfortable deferring their gifting strategies. Planning for wealthy clients should generally focus on maximizing flexibility inside a gifting trust and, in certain cases, providing the client with some opportunity to access the trust funds at a later date. In other words, wealthy clients may need to "eat their cake and have it too."

Wealthy clients who wish to avoid potential estate tax upon death should consider making gifts to irrevocable trusts before 2026 that consume more than $6.4 million of their BEA and GST Exemption (or $12.8 million for married couples), but also provide them with some potential access to trust assets in case of significant financial need. Naturally, these strategies carry a greater risk of IRS scrutiny, where the IRS is likely to argue that transferred assets should be included for estate tax purposes under Code § 2036 or § 2038, because of retained interests in or rights over the assets. This risk may not be present with transactions designed for super wealthy clients, where clients can forgo beneficial interests in transferred property. The paragraphs below explain some general considerations when designing trusts for increased flexibility, before discussing specific gifting strategies for wealthy clients.

1. Designing Trusts for Flexibility, Generally

Designing trusts for flexibility is a balancing act. On the one hand, the client typically prefers to have significant input as to trust investments and distributions and for the trust to be flexible enough to respond to unanticipated changes in circumstances, particularly if they impact the client's own finances.


\textsuperscript{71} See Ann B. Burns, They Say You Can't Take it With You – But How Do You Give It Away? Using the $5 Million Exclusion Amount, 46th ANNUAL HECKERLING INSTITUTE, p. 32-33 (Jan. 2012).

\textsuperscript{72} Steve Akers refers to this as the "cushion effect." See Steve Akers, Heckerling Musings 2019 and Estate Planning Current Developments, p. 60 (April 2019).
On the other hand, the client also desires transfer tax savings, which often requires the client to give up some level of control over and access to the trust assets. This balancing act is even more difficult for a client who seeks to dictate his family's use and enjoyment of trust assets from the grave. Given the current legislative uncertainty, however, irrevocable trusts for wealthy clients (compared to super wealthy clients) should generally be as flexible as possible, at least during the client's lifetime, while securing transfer tax savings. Consider the following, among other factors, when designing trusts for flexibility:

- Providing for an independent trustee who may make distributions of income and principal for any purpose whatsoever;
- Providing for a trust protector or advisor who can modify the trust (in certain ways), change trust situs, change governing law, add or remove beneficiaries, or grant powers of appointment;
- Including limited powers of appointment with a broad class of permissible appointees;
- Including formula general powers of appointment designed to maximize income tax basis or minimize GST taxes;
- Authorizing trust decanting, perhaps beyond what is already permitted by state statute;
- For grantor trusts, authorizing an independent trustee to reimburse the grantor for income taxes paid on behalf of the trust;
- Giving the grantor the right to swap assets with the trust or borrow from the trust;
- Facilitating the release of certain powers and interests to turn off grantor trust status if the income tax burden becomes too great for the grantor;
- Giving the grantor the right to serve as trustee (with certain tax-related restrictions), remove and replace trustees, and appoint successor trustees; and
- Limiting certain powers and provisions to apply only during the grantor's lifetime, thereby locking in certain provisions after the grantor's death.

Some of these features may increase the risk that the trust assets are subjected to the claims of the client's creditors and/or included in the client's taxable estate. Ultimately, the client must decide the level of risk that is appropriate to best accomplish the client's goals. When designing trusts for flexibility, advisors should educate clients regarding available alternatives and associated risks, draft trust agreements to best effectuate clients' objectives, and counsel clients regarding appropriate trust funding, administration, and reporting.

2. Strategies for Spouses

For two reasons, more planning options are available for wealthy clients who are married, compared to a wealthy client who is single. First, two persons have two BEAs and two GST Exemptions at their disposal (instead of just one). Second, and more importantly, many clients are comfortable

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naming spouses as beneficiaries of irrevocable trusts, with the hope (or, perhaps more accurately, the expectation) that if the client or the client's family has a financial need, the client's spouse will be able to receive a trust distribution to satisfy the need. The paragraphs below discuss gifting strategies that may be suitable for wealthy married clients.

a. Utilize Only One Spouse's BEA and GST Exemption

Advisors often view married couples as a single unit for wealth transfer purposes, but it is important to remember that each spouse has a separate BEA and GST Exemption. Advisors must also remember that transfer tax exemptions come off the bottom, not the top, such that a wealthy client must give more than $6.4 million (or $12.8 million) for a married couple before 2026 to capture any benefit associated with the doubled BEA and GST Exemption prior to its expiration in 2026. For purposes of this discussion, advisors can think of this as the "wealthy client gifting threshold."

One simple solution for married couples is to have only one spouse make gifts, rather than both spouses. That way, the wealthy client gifting threshold is only $6.4 million, instead of $12.8 million. Consider, for example, a husband and wife with a net worth of $20 million. The couple wishes to take advantage of the currently doubled exemptions, but they are only comfortable making a total gift of $10 million. If each spouse gifts $5 million, the spouses would not exceed the wealthy client gifting threshold. If the doubled exemptions expire in 2026, the spouses combined BEAs would total only $2.8 million. In contrast, if husband made a gift of $10 million, and wife made no gifts, husband's gift would exceed the wealthy client gifting threshold by $3.6 million. If the doubled exemptions expire in 2026, husband would have $0 of his BEA (and potentially GST Exemption) remaining, but wife would have her entire $6.4 million BEA and GST Exemption. In this example, therefore, if only one spouse made gifts, the couple could make total tax-free transfers of $16.4 million, compared to $12.8 million if the couple made gifts using the more traditional split gift method.

A spouse will often transfer assets to an irrevocable trust in which the other spouse is a beneficiary. Oftentimes the trust will be structured, for income tax purposes, as a grantor trust as to the donor spouse. This trust structure requires the advisor and client to carefully consider practical consequences. A transfer of assets from one spouse in excess of the wealthy client gifting threshold is likely to result in one spouse having access to substantially more wealth than the other spouse. While this dynamic may be tolerable if the spouses remain married, substantial inequities or difficulty could arise when the marriage terminates by death or divorce. While it may be possible to navigate around these issues, such as equalizing gifts between spouses before or after the initial gifting transaction, advisors must avoid possible application of the step transaction doctrine, which could undermine any potential transfer tax benefits. Moreover, advisors often represent both spouses with regard to their estate planning matters and must be mindful of the ethical duties involved in such a joint representation. Despite these potential challenges, there may be certain circumstances where utilizing only one spouse's BEA and GST Exemption makes sense.\(^\text{74}\)

b. Spousal Lifetime Access Trusts

One of the most common planning techniques for wealthy clients involves at least one spouse creating an irrevocable trust for the primary benefit of the other spouse and possibly other beneficiaries, such as children and more remote descendants. These trusts are often referred to as Spousal Lifetime Access Trusts, or "SLATs." Although SLATs have existed for many years, they became extremely popular in 2011 and 2012, when the $5 million BEA was set to be replaced in 2013 with a $1 million

\(^{74}\) For further discussion of this technique, see Austin Bramwell & Katie Lynagh, *The Paradoxical New Gift Splitting Calculus*, LEMBERG ESTATE PLANNING NEWSLETTER #2713 (Apr. 1, 2019).
BEA and a 55% estate tax rate. With the same dynamic at play in the years leading up to 2026, many wealthy clients are likely to consider funding SLATs with gifts in excess of the wealthy client gifting threshold.

A SLAT is, in essence, a pre-funding of the bypass or credit shelter trust traditionally formed upon the death of the first spouse to die. By funding a SLAT during lifetime, instead of waiting until death, the client can take advantage of the doubled BEA and GST Exemption amounts set to expire in 2026, while also removing appreciating assets from the transfer tax system. SLATs are often designed as grantor trusts for income tax purposes, obligating the donor spouse to pay all income tax attributable to trust income, while allowing the trust assets to grow and appreciate income tax-free. If the donor spouse is concerned he may lack sufficient funds in the future, he may take some comfort that his spouse is the primary beneficiary of the SLAT and presumably could receive a discretionary distribution that is sufficient to support the client's family (and indirectly, as a result, the client himself).

SLATs have widespread appeal as a means to save transfer taxes while also preserving assets for family use. As discussed in Part V.B.2.a, however, married clients should be mindful of how substantially funding a SLAT may impact each spouse's access to capital, particularly in the case of an unexpected death or divorce. For this reason, many married couples desire that each spouse create and fund a SLAT so that both spouses are permissible beneficiaries of transferred assets, instead of just one spouse.

A client may create and fund a trust that benefits a spouse for life and avoids inclusion of the trust assets in the spouse's taxable estate at death. If a client creates and funds a trust for the client's own benefit, however, the trust assets are generally included in the client's taxable estate under Code § 2036 or § 2038, unless the trust is properly structured as a domestic asset protection trust, as discussed in Part V.B.3.b. If each spouse creates and funds a trust for the benefit of the other spouse, the IRS may attempt to apply the "reciprocal trust doctrine," a judicially created doctrine that developed in response to the potential for gift and estate tax abuse where two transferors create trusts for each other. Where applicable, this doctrine allows the IRS to uncross each trust and treat each spouse as the creator of the trust for his or her own benefit. Accordingly, if both spouses seek to create and fund a SLAT, the SLATs must be substantially different in their structure and funding to avoid the application of the reciprocal trust doctrine.

Below is a list of some, but certainly not all, of the features that planners should consider when designing SLATs:

- To add general flexibility to the SLAT, consider the provisions listed in V.B.1;
- To facilitate broader access to the SLAT assets by the donee spouse (and possibly other beneficiaries), consider:

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o Permitting the donee spouse to serve as a trustee, with distributions limited by an ascertainable standard;
o Giving the donee spouse the power to withdraw the greater of $5,000 or 5% of the SLAT assets each year; and
o Authorizing an independent trustee to make distributions to the donee spouse for any purpose whatsoever, and not just for health, education, maintenance, or support;

- To give the donor spouse more control over the SLAT and, potentially, some access to the SLAT assets, consider:
  
o Permitting the donor spouse to serve as a trustee, with distributions limited by an ascertainable standard;
o Allowing the donor spouse to swap assets with the SLAT;
o Allowing the donor spouse to borrow assets from the SLAT;
o Giving the donee spouse or other beneficiary a limited power of appointment, exercisable during lifetime or at death (possibly only with the consent of a non-adverse party) and including the donor spouse in the class of permissible appointees;
o Funding the SLAT with a residence that can be used by the donee spouse and the donor spouse without paying rent; and
o In states that permit self-settled spendthrift trusts, authorizing an independent powerholder to add the donor spouse as a beneficiary or grant the donor spouse a limited power of appointment at a later date;

- To reduce the risk that the reciprocal trust doctrine applies when each spouse creates a SLAT, consider:
  
o Making only one spouse a beneficiary, which is the most conservative approach;
o Making only one spouse a beneficiary initially, but authorizing an independent powerholder to add the other spouse as a beneficiary at later date;
o Naming different trustees for each SLAT;
o Including both spouses as beneficiaries, but with significantly different distribution provisions, such as mandatory vs. discretionary distributions, income vs. principal distributions, ascertainable vs. unlimited distribution standards, "may" consider other resources vs. "shall" consider other resources, sole beneficiary vs. multiple beneficiaries, and powers of appointment vs. no powers of appointment;
o Creating the SLATs on different dates and funding the SLATs with different assets; and
o Varying the timing and amount of distributions to each spouse;

- To address potential issues upon death or divorce, consider:
  
o Having the donee spouse fund an ILIT to obtain an insurance policy on the donee spouse's life, which could provide funds for the donor spouse if he or she survives the donee spouse;
o Requiring that the donee spouse be living and married to the donor spouse to receive distributions from the trust;
Defining the donor's "spouse" as the person to whom the donor is married at the time of a distribution, thereby permitting the identity of the donor's spouse to change over time; and

- To maximize creditor protection for all beneficiaries, consider:
  - Including a spendthrift provision;
  - Providing for discretionary distributions of income and principal among various beneficiaries;
  - Naming an independent person who is not related or subordinate to the grantor or any beneficiary to serve as the sole trustee or to consent to any distributions;
  - Authorizing beneficiaries to use assets, such as residential real property, rather than requiring a distribution from the SLAT; and
  - Expressly providing that any distribution is considered the beneficiary's separate property; and

- To facilitate split gifts to a SLAT, structure the spouse's beneficial interest so that it is severable, ascertainable, and de minimis.

Again, the appropriate SLAT design will be unique to each client, and certain design features carry a greater risk of estate inclusion or creditor exposure. Advisors should assist clients in carefully weighing the advantages of broader control of and access to SLAT assets against potential creditor and estate inclusion risks.

3. Strategies for All Clients Desiring Access to Gifted Property

Some wealthy clients do not have a spouse, or even if they do, a SLAT may not be an appropriate planning vehicle. These clients should consider other planning techniques, all of which are designed to utilize the doubled BEA and GST Exemption while providing the client with some opportunity to access the gifted property in the event of financial need.

Whenever a wealthy client retains a right, however attenuated, to access gifted property, the risks of creditor exposure and estate inclusion increase. Advisors, therefore, should proceed with caution when recommending the strategies discussed below to wealthy clients, recognizing that some strategies may only be effective under the laws of certain states. Even so, some wealthy clients may be willing to assume these risks and, in fact, may not engage in any planning at all unless there is some assurance that the assets will be available if they later need them. If the planning risks materialize and assets are eventually included in the client's taxable estate, the client may view himself as no worse off than if he had done no planning at all, minus transaction costs and the opportunity cost of not pursuing other strategies.

a. Simple Methods To Preserve Access to Funds

Before getting too enamored with more exotic planning strategies, planners should remember that providing a donor with access to funds may be relatively easy. For example, if a wealthy client wishes to fund an irrevocable grantor trust for the benefit of his family members but wishes to retain some access to funds, the trust agreement could grant the client a swap power to reacquire trust assets for assets of an
equivalent value, or an independent trustee could be given the ability to reimburse the grantor for income taxes paid on the trust assets.77

Another method of providing the client with access to trust funds is to give the client the ability to borrow assets from the trust at the applicable federal rate. A borrowing power, while simple, could provide the client with a reliable source of liquidity during times of financial need. If a loan were to be outstanding at the client's death, the client's estate should be entitled to claim an estate tax deduction for the outstanding balance.78 Many wealthy clients may be comfortable relying on this borrowing power, with nothing more. In this sense, advisors should keep in mind to not let "perfect" get in the way of "good enough."

In addition to basic design considerations, a wealthy client may also favor estate planning transactions that provide the client with a steady cash flow. The most common example is an installment sale to a grantor trust, in which the client sells assets to a trust in exchange for a promissory note (or in some cases, a private annuity). Interest and principal payments on the note (or annuity payments) should provide the client with liquidity, while any future appreciation in the transferred property should occur outside of the transfer tax system as to that client. Moreover, for wealthy clients who are not ready to consume their entire BEA and GST Exemption now, but may wish to give more prior to 2026, a current installment sale would facilitate a quick and easy future gift through the client's forgiveness of all or a portion of the outstanding promissory note. There are many considerations in structuring an installment sale transaction, including initial trust funding, designing the purchase agreement and promissory note, and, if applicable, navigating guarantee fees.79

b. Domestic Asset Protection Trusts

If a wealthy client could describe the ultimate "eat your cake and have it too" transaction, it likely would be an irrevocable trust created by the client, that is funded by the client with assets that consume the doubled BEA and GST exemption, is protected from the client's creditors, is excluded from the client's taxable estate at death, and yet still permits the client to be a permissible beneficiary. Well, such trusts do exist and are often referred to as self-settled spendthrift trusts, or more colloquially, asset protection trusts.80 Before 1997, asset protection trusts were only available offshore in jurisdictions such as the Bahamas, Bermuda, and the Cayman Islands. In 1997, however, Alaska authorized asset protection trusts. Since then, a flurry of other states enacted similar legislation, resulting in 19 jurisdictions currently authorizing some form of "domestic" asset protection trust, or "DAPT.81


78 For a good discussion of how loans from a trust can provide a "back-door" for cash flow, along with deductibility of an outstanding loan in the client's estate, see Steve Akers, Estate Planning for Clients $10 Million and Under Estates, HAWAII TAX INSTITUTE, p. 84 (Nov. 4, 2014).

79 For further discussion of installment sale planning, see Ann B. Burns, They Say You Can't Take it With You – But How Do You Give It Away? Using the $5 Million Exclusion Amount, 46TH ANNUAL HECKERLING INSTITUTE, p. 27-29 (Jan. 2012).

80 See PLR 200944002 (Oct. 30, 2009) (finding that an asset protection trust formed under an applicable state statute should not be included in the grantor's taxable estate, but declining to rule on whether other facts, including a pre-existing arrangement between the grantor and trustee, would cause estate inclusion under IRC § 2036).

81 DAPT states include Alaska, Delaware, Nevada, New Hampshire, South Dakota, and Virginia, among others. For a general discussion of DAPTs, including citations to DAPT statutes, see Alexander A. Bove, Jr. & Melissa Langa, The Growing Asset Protection Trust Movement Adds Indiana and Connecticut to the List, LEIMBERG
A DAPT, in its purest form, would allow an independent trustee to make discretionary distributions of income and principal to or for the benefit of the grantor. A more conservative approach, however, would be to create a DAPT that does not name the grantor as a beneficiary but authorizes an independent powerholder to add the grantor as a discretionary beneficiary at a later date. This approach should provide another layer of insulation between the grantor and the trust, which may help if the trust is challenged by a creditor or the IRS.

However, DAPTs are not for the faint of heart. Even if a client forms a DAPT in a state that authorizes self-settled spendthrift trusts, the DAPT is not immune from challenge, in particular if the grantor does not reside in the state in which the DAPT is created or otherwise maintain sufficient minimum contacts with the state. Depending on the client's solvency at the time the DAPT is created, there may also be fraudulent transfer concerns. Because DAPTs have been challenged successfully in bankruptcy courts, wealthy clients should first consider whether more conservative alternatives are available to accomplish their planning goals.

c. Special Power of Appointment Trusts

Some wealthy clients may believe DAPTs are too risky, despite their potential benefits. An alternative technique involves the creation of an irrevocable spendthrift trust for the benefit of one or more beneficiaries, not including the grantor, in which a beneficiary or non-beneficiary is given a limited power to appoint the trust assets among a class of persons, including the grantor. Trusts with this feature are sometimes referred to as special power of appointment trusts, or "SPATs." This technique, if it works as intended, should enable a wealthy client to currently make use of the doubled BEA while having the possibility to benefit from the assets.

Conceptually, SPATs are similar to the upstream planning discussed in Part III.B.1.b(2) in that each technique involves a transfer of property to a beneficiary, with the possibility that the transferred property returns to the donor (or a trust for the donor's benefit). Unlike upstream planning, however, which is primarily designed to maximize income tax basis for the transferred assets through inclusion of those assets in the estate of an older beneficiary with excess BEA, a SPAT is typically structured to avoid inclusion of the assets in the beneficiary's estate. Specifically, upstream trusts will often grant beneficiaries a general power of appointment to cause estate inclusion, while SPATs usually only grant beneficiaries or third parties limited powers of appointment to avoid a taxable gift or estate inclusion.

SPATs offer considerable appeal for wealthy clients given the possibility that the trust assets could be available to the donor, or pass to a trust for the donor's benefit, through a third party's exercise of a lifetime or testamentary limited power of appointment. There are, however, several risks associated with SPATs. If a portion of the SPAT assets are appointed back to a donor, the IRS could argue that the all of the trust's assets should be included in the donor's taxable estate under Code § 2036 pursuant to an

INFORMATION SERVICES, INC., Asset Protection Newsletter #393 (Sept. 26, 2019); see also Richard S. Franklin & George D. Karibjian, The Lifetime QTIP Trust – the Perfect (Best) Approach to Using Your Spouse's New Applicable Exclusion Amount and GST Exemption, BLOOMBERG ESTATES, GIFTS, AND TRUSTS, NUMBER 2 (Mar. 14, 2019).


implied agreement between the donor and the powerholder at the time the SPAT was created. In addition, if a donor creates a SPAT and the holder of a limited power of appointment directs the SPAT assets to an appointive trust for the benefit of the donor, the appointive trust should not grant the donor a lifetime or testamentary power of appointment. The IRS could assert that the donor essentially retained the right to alter, amend, revoke, or terminate the trust and, therefore, the assets should be included in the donor's taxable estate under Code § 2038.84

In addition to estate inclusion issues under Code § 2036 and § 2038, there is a separate, but related creditor rights issue under state law. Under the law of some states, there is a risk that the appointive trust "relates back" to the original donor of the SPAT, such that the appointive trust is actually a self-settled trust and therefore exposed to the claims of the donor's creditors.85 This issue might be avoided if the appointive trust (and potentially the SPAT) is governed by the law of a state permitting DAPTs or the applicable state law offered specific protection to appointive trusts under these facts. A number of states, including Delaware, Florida, Virginia, and Wyoming, protect appointive trusts created pursuant to an inter vivos QTIP trust. A more limited number of states, including Arizona, Ohio, and Texas, extend this protection to other trusts, such as SLATs.86

If a wealthy client is considering a SPAT, it would be best to situs the SPAT (and subsequent appointive trust) in a DAPT state, or a state, like Texas, that would extend spendthrift protection to the appointive trust. As an added layer of protection, the appointive trust could not name the client as an initial beneficiary, but could provide that an independent person may add the client as a beneficiary at a later date. Regardless of the client's preferred structure, the planner should also take care to avoid application of the step transaction doctrine.

d. Retained Interest Gifts

(1) In General

Under the estate tax "string provisions" contained in Sections 2035 - 2039, and 2042 of the Code, a taxpayer can make a completed taxable gift during lifetime, but the gifted asset can still be included in the taxpayer's gross estate upon death.87 For example, if a parent gifts a remainder interest in property to a child, but retains a life estate in the property, the property will still be included in the parent's estate under Code § 2036. This basic concept, combined with the anti-clawback provision in the Regulations88 and the exception of assets included in the gross estate from adjusted taxable gifts,89 may enable wealthy

84 For further reading regarding potential estate inclusion issues associated with SPATs, see Steve Akers, Estate Planning for Clients $10 Million and Under Estates, HAWAII TAX INSTITUTE, p. 87-89 (Nov. 4, 2014).
86 See, e.g., TEX. PROP. CODE § 112.035(d)(2) (providing that a settlor is not considered a trust beneficiary by reason of a third party's exercise of a power of appointment); § 112.035(g) (providing that the original donor is not considered the settlor of an inter vivos QTIP trust or SLAT after the death of the donor's spouse).
88 See Treas. Reg. § 20.2010-1(c) (providing that if a taxpayer makes a lifetime gift utilizing BEA in excess of the BEA at the taxpayer's death, the taxpayer's BEA will be the higher gifted amount for purposes of calculating any estate tax due).
89 See IRC § 2001(b) (providing that gifts includible in the gross estate of a decedent shall not be counted as adjusted taxable gifts for purposes of calculating estate tax).
clients to make use of the doubled BEA by making completed taxable gifts prior to 2026, while still enjoying the property during their lifetimes.

In theory, retained interest gifts should not generate any additional estate tax. Code § 2001(b) removes assets included in the gross estate from adjusted taxable gifts. Although the asset itself, at its date-of-death value, is included in the gross estate, its inclusion is offset under the Regulations by the increased BEA utilized when the lifetime gift was made. Consequently, the only amount that should be subject to estate tax is the post-gift appreciation.90 As further explained below, this type of planning could be particularly advantageous when combined with the valuation rules of Chapter 14 of the Code.

(2) Retained Income Gift Trusts

Many wealthy clients would be interested in a gifting strategy that (i) currently utilizes their doubled BEA, (ii) entitles the client to receive all income generated by the gifted assets for life, (iii) shifts future asset appreciation to descendants so that it is excluded from the client's gross estate, and (iv) upon the client's death the remaining assets pass to the client's descendants free of any additional estate tax but with an income tax basis adjustment. The Retained Income Gift Trust, or "RIGT," if it works as intended, may achieve those objectives.91

A RIGT closely resembles a pre-chapter 14 Grantor Retained Income Trust, or "GRIT," except it lasts for the lifetime of the donor. The client transfers property to an RIGT, retaining an income interest for the client's lifetime. The client's descendants are often discretionary principal beneficiaries, and the trustee should consider distributing all appreciation to the descendants (or a trust for their benefit). The client's descendants (or trusts for their benefit) receive the remaining RIGT assets upon the client's death.

The client's transfer to the RIGT should be a completed gift in an amount equal to the full value of the property contributed to the trust because the client's retained income interest is not a "qualified interest" under Code § 2702. At the client's death, the RIGT assets should be included in the client's estate, with the assets receiving an income tax basis adjustment. Any appreciated principal that was distributed to the client's descendants during the client's lifetime should be excluded from the client's estate, but should not be treated as additional gifts because the gift was complete at the time the RIGT was created. Although the RIGT assets are included in the client's estate, they do not generate additional estate tax (beyond undistributed appreciation) because they are not treated as adjusted taxable gifts.

For example, assume that a settlor creates and funds a RIGT with $11.58 million in 2020. Settlor retains the mandatory right to receive all trust accounting income for his lifetime. Settlor dies in 2026 when the RIGT is worth $16 million and the settlor's estate (outside of the RIGT) is worth $4 million. If the 2026 BEA is $6.4 million, the resulting estate tax savings generated by the RIGT is $2.07 million [($11.58 million – $6.4 million) x 40% = $2.07 million]. The estate tax payable upon the settlor's death in 2026 will be $3.37 million [($20 million – $11.58 million) x 40% = $3.37 million].


91 For additional discussion on RIGTs, see Steve Akers, Estate Planning for Clients $10 Million and Under Estates, HAWAII TAX INSTITUTE, p. 99-100 (Nov. 4, 2014) (citing a discussion between Igor Potym and Richard Covey in the mid-1990s).
(3) **Enhanced Grantor Retained Income Trust**

An Enhanced Grantor Retained Income Trust, or "E-GRIT," is an irrevocable self-settled trust that is intended to (i) utilize a client's doubled BEA, (ii) allow the client to retain broad lifetime access to the assets contributed to the E-GRIT, (iii) enable the client to direct the distribution of the E-GRIT assets upon death, and (iv) secure a new income tax basis under Code § 1014(b). Like the RIGT, an E-GRIT, if it works as intended, may be suitable for a wealthy client who seeks to utilize the doubled BEA before its expiration in 2026.

The E-GRIT takes the RIGT concept a step further by having a wealthy client retain not only an income interest in the trust, but also a right to receive discretionary distributions of principal. The trust agreement creating the E-GRIT will generally include the following provisions:

- The settlor may serve as the sole trustee of the E-GRIT;
- The settlor is required to receive all of the E-GRIT's net income for life and may be entitled to receive discretionary distribution of principal;
- The E-GRIT will include an "undistributed principal amount" and will prohibit principal distributions to the settlor if such distributions would reduce the value of the E-GRIT's assets to an amount that is less than the undistributed principal amount. This provision should ensure that a portion of the contribution to the E-GRIT is a completed gift and that Code § 2702 applies in determining the value of the settlor's gift to the E-GRIT;
- The settlor will retain a power of substitution to ensure that the E-GRIT is wholly a grantor trust for income tax purposes. This provision should require the settlor to pay income tax on all E-GRIT income and facilitate transactions between the settlor and the E-GRIT that are disregarded for federal income tax purposes;
- The settlor may retain a broad testamentary power of appointment; and
- The remainder beneficiaries, entitled to receive the unappointed E-GRIT assets upon the settlor's death, must be individuals (or trusts for their benefit) who are considered "members of the transferor's family" as defined in Code § 2704(c)(2). This provision should ensure that the assets transferred to the E-GRIT are valued in accordance with Code § 2702.

The intended tax consequences of an E-GRIT are as follows:

- The assets transferred to the E-GRIT should be valued pursuant to Code § 2702;
- Code § 2702 imposes the subtraction method in valuing settlor's gift to the E-GRIT. The settlor's taxable gift equals the full value of assets contributed to the E-GRIT minus the value of settlor's qualified retained interest in the E-GRIT assets. Because settlor's retained interest is not an annuity or unitrust interest, it is valued at zero, resulting in a taxable gift equal to the full amount contributed to the E-GRIT;

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• Upon the settlor's death, the E-GRIT assets should be included in the settlor's taxable estate. The settlor's retained mandatory income interest should cause the assets to be included in settlor's estate under Code § 2036(a)(1). The settlor's testamentary power of appointment and right to receive discretionary distributions of principal should also cause the assets to be included in the settlor's estate under Code § 2038(a)(1);

• The E-GRIT assets should receive an income tax basis adjustment under Code § 1014(b);

• The initial gift to the E-GRIT should be excluded from adjusted taxable gifts under Code § 2001(b), which provides that taxable gifts made to the E-GRIT are excluded from "adjusted taxable gifts" in calculating the estate tax; and

• If the settlor dies after 2025, when the BEA has been reduced by 50%, the Regulations provide that the BEA used to calculate the estate tax will be increased to an amount equal to the BEA used by all post-1976 taxable gifts if the total BEA used for such gifts exceeds the BEA in effect at the settlor's death.93 In other words, there should be no clawback of settlor's use of the temporarily doubled BEA.

For example, assume settlor gifts $11.58 million to an E-GRIT in 2020 and dies in 2026 when the E-GRIT is worth $16 million and the settlor's estate (outside of the E-GRIT) is worth $4 million. If the 2026 BEA is $6.4 million, the resulting estate tax savings generated by the E-GRIT is $2.07 million [($11.58 million – $6.4 million) x 40% = $2.07 million]. The estate tax payable upon the settlor's death in 2026 will be $3.37 million. This amount is determined by first adding the value of the E-GRIT assets ($16 million) and the settlor's own assets ($4 million) to arrive at a gross estate of $20 million. Then, $11.58 million is subtracted from the $20 million gross estate ($8.42 million). Finally, the result is multiplied by the 40% estate tax rate [($20 million – $11.58 million) x 40% = $3.37 million].

(4) Intentionally Defective 2701 Transaction

Code § 2701 was enacted in 1990 to eliminate the historic partnership or corporation recapitalization estate freeze technique. Prior to Code § 2701, a parent who owned a business that was expected to appreciate in value would attempt to freeze the value of the parent's interest in the business and shift all future appreciation to descendants (or trusts for their benefit). First, the parent would recapitalize the entity with two classes of equity (e.g., preferred stock and common stock). The preferred stock would be granted rights (e.g., noncumulative dividend right, put right, conversion right, liquidation right, etc.) that would never be exercised but would cause the preferred stock to have a fair market value approximating the total value of the business. The parent would then transfer the common stock to trusts for the benefit of children with a nominal value for gift tax purposes. Upon the parent's death, the parent's estate would only include the value of the preferred stock. The appreciation in the value of the business after the date of the recapitalization would accrue solely to the common stock held in the children's trusts.

Today, this historic estate freeze transaction does not work. Code § 2701 imposes the subtraction method in valuing the common stock (i.e., subtracting the § 2701 special value of the parent's retained preferred stock–generally zero–from the value of the business), effectively accelerating the gift tax. Normally, planners seek to avoid the application of the special valuation rules of Code § 2701, which can cause innocent clients to make unintentionally large gifts with potentially disastrous consequences. Wealthy clients seeking to utilize the currently doubled BEA, however, while also retaining access to the transferred property, may engage in a gifting strategy that intentionally trips Code § 2701.

Consider, for example, a wealthy client who gives the common stock in a corporation to a trust for the benefit of her descendants, but retains the preferred stock. Under Code § 2701, the value of the client's retained preferred stock is zero for purposes of calculating the value of the client's gift of common stock, meaning that the client is treated as gifting the value of the client's entire interest in the corporation. During the client's lifetime, she can access liquidity by receiving preferred dividends or exercising a right to put the stock to the corporation. At the client's death, the preferred stock is included in the client's gross estate, thereby receiving an income tax basis adjustment, but does not increase the estate tax due (except for post-gift appreciation). As a result, wealthy clients could utilize their doubled BEAs while still retaining the right to receive preferred payments or put proceeds from the entity.

(5) Potential Disadvantages & Risks

Even though retained interest gifts may be attractive to wealthy clients, they do have some disadvantages. First, retained interest gifts, if effective, only utilize the doubled BEA, but not the GST Exemption, given that the GST Exemption cannot be allocated until the close of the estate tax inclusion period ("ETIP"). With a retained interest gift, the ETIP does not close until the client's death, at which point the increased GST Exemption may have already expired. Therefore, retained interest gifts are not appropriate for clients who desire to utilize their doubled GST Exemption.

Second, retained interest gifts may be inherently risky. These planning techniques rely on provisions in the Code and Regulations that are principally designed to curb taxpayer abuse in other areas. By relying on these provisions to utilize the doubled BEA, wealthy clients would be using complex tax rules as a sword, when they were intended for use by the IRS as a shield. In fact, before the Regulations were finalized, the Tax Section of the New York State Bar Association advised the IRS that the Proposed Regulations, as drafted, "would permit individuals to make relatively painless taxable gifts that lock in the increased exclusion amount, even though they retain beneficial access to the transferred property." They asked the IRS to "consider further whether gifts included in a decedent's gross estate should successfully lock in the temporarily increased exclusion amount available before 2026." The IRS declined to include an anti-abuse provision in the final Regulations, but did note that such a provision was within the scope of its regulatory authority. Furthermore, the IRS noted that an anti-abuse provision would benefit from prior notice and comment and, accordingly, reserved the issue to allow further consideration.

VI. REPORTING GIFTS TO THE IRS: SELECTED ISSUES

Even after working with a client to design and implement a flexible gifting strategy that best accomplishes the client's tax and non-tax objectives, the advisor's work is not yet done. If a client made taxable gifts during the year, the client must file a United States Gift (and Generation-Skipping Transfer) Tax Return (IRS Form 709). Even if the client did not make a taxable gift, but engaged in a non-gift transaction, it may be advisable for the client to file a Form 709 to adequately disclose the transfer and

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thus start the statute of limitations running on the Service's ability to challenge it. The paragraphs below highlight some selected issues when reporting gifts to the Service.98

A.  Gift Splitting

Code § 2513 permits spouses to split gifts for gift tax purposes. As discussed in Part IV.C, this essentially enables spouses to double their gifting power, which often comes in handy when qualifying gifts for the Annual Gift Exclusion. While gift splitting seems like a simple concept, its implementation is fraught with peril. Tax return preparers should keep the following general principles in mind when dealing with split gifts:

• Gifts of community property are automatically deemed to be made one-half by each spouse without the need to split the gift under Code § 2513;99

• To split gifts, each spouse must be a U.S. citizen or resident;100

• Absent extraordinary relief, the election to split gifts must be made on a timely filed Form 709 (i.e., by April 15th of the year following the gift, or October 15th if the Form 709 is extended);

• Both spouses must typically file a Form 709 to split gifts, although in limited circumstances a single Form 709 may be filed;

• Spouses can only split gifts to third parties and cannot split gifts to each other;

• A gift to a trust for the benefit of a spouse and third parties can only be split if the amount of the gift allocated to the spouse is ascertainable and severable from the amount of the gift to the third parties;101

• Spouses cannot pick and choose which gifts to split—all gifts to third parties must be split, or none at all;

• Spouses must split gifts 50/50, and not in any other proportion; and

• One-half of the value of all gifts made by the donor spouse are treated as made by the consenting spouse for GST tax purposes, regardless of whether the full amount of the gift was eligible for gift splitting.102

98 For a much more thorough discussion of gift tax reporting issues, see Christine S. Wakeman & Lora G. Davis, GRRR (Gift Return Reporting Requirements): Taming the Wild 709 Tiger (2019); see also Scott A. Bowman, Timothy K. Bronza, Stephanie Loomis-Price, & David Pratt, Wrapping Up Your Gift Tax Return with a Tidy Bow: Reporting Gifts with an Eye Toward Audit, 48TH ANNUAL HECKERLING INSTITUTE (Jan. 15, 2014).


100 See IRC § 2513(a)(1).

101 See Reg. § 25.2513-1(b)(4).
B. Disclosing Charitable Gifts

1. In General

The instructions to Form 709 provide that "[i]f you are required to file a return to report noncharitable gifts and you made gifts to charities, you must include all of your gifts to charities on the return.” In other words, if a client is required to file a Form 709, the instructions require the client to disclose all charitable gifts as well. Charitable gifts should be listed in Part 1- Gifts Subject Only to Gift Tax.

2. Potential Consequences of Omission

Although taxpayers are required to report gifts to charity, even if those gifts fully qualify for the charitable deduction, clients and their tax preparers often omit charitable gifts from the Form 709. Failing to report charitable gifts could potentially lead to the application of a six-year statute of limitations (instead of a three-year statute of limitations) if the unreported charitable gifts amount to more than 25% of the total amount of the gifts made by the taxpayer.¹⁰³ This pitfall may be even more of a concern if the client is only reporting a small gift (such as a nominal gift to a GRAT), reporting no gift but allocating GST Exemption (as may be the case with an annual exclusion gift to an ILIT), or simply disclosing a non-gift transaction (such as an installment sale or asset swap), because gifts to charity would make up a greater percentage of the total "gifts" in such a year, thereby increasing the risk that the unreported charitable gifts comprise more than 25% of the client's gifts for the year. Best practice, therefore, is for the client to report all charitable gifts on the client's Form 709, as the instructions require.

C. Disclosing Installment Sale Transactions

1. In General

Installment sales to grantor trusts continue to be a popular wealth transfer technique. As explained in Part V.B.3.a, the transaction involves a sale of assets (often limited partnership interests or other discounted assets) to grantor trusts created for the benefit of the client's family members or other third-party beneficiaries. The general rule of thumb utilized by most estate planners is that the purchasing trust should have equity equal to at least 10% of the value of the purchased interest to enhance the likelihood that the sale will be respected.¹⁰⁴ This initial funding could be satisfied with a contribution of cash or other assets. The trust can retain the initial contribution (to be used as additional security for the promissory note) or, if the initial contribution is satisfied with cash, can use the initial cash funding to make a down payment on the purchase price.

2. Whether To Disclose Transaction

The initial funding of the trust, assuming it exceeds the Annual Gift Exclusion, is reportable on a Form 709. The sale to the grantor trust (if properly structured and respected) is not a gift and, therefore, is not required to be disclosed on a Form 709. However, the Code permits the disclosure of non-gift

¹⁰² See Reg. § 26.2652-1(a)(4). For additional gift splitting considerations, see Christine S. Wakeman & Lora G. Davis, GRRR (Gift Return Reporting Requirements): Taming the Wild 709 Tiger (2019); see also Diana Zeydel, Gift-Splitting: A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules, 106 J. TAX’N 6 (June 2007).

¹⁰³ See Reg. § 301.6501(e)-1(b)(1), (2).

¹⁰⁴ This 10% "seed money" convention is based upon the IRS requirement that the trust be seeded with 10% equity as a condition for the favorable ruling in PLR 9535026 (May 31, 1995).
transactions for purposes of commencing the statute of limitations.\textsuperscript{105} Accordingly, proper disclosure of the installment sale transaction on a Form 709 should commence the statute of limitations with respect to that transaction.

Historically, many taxpayers chose not to disclose installment sale transactions despite the fact that such disclosure could commence the statute of limitations, rationalized as follows: If the transaction was never reported on a Form 709 and if the note was paid in full prior to the taxpayer's death, there would not be any reported evidence of the transaction that could generate IRS scrutiny.

The current United States Estate (and Generation-Skipping Transfer) Tax Return (IRS Form 706) includes a question (Part 4, Question 13(e)) that asks "Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in question 13a or 13b?" In light of this question, which requires disclosure of even "old and cold" transactions, taxpayers may be more inclined to report such transactions on Forms 709 in order to commence the statute of limitations. Moreover, because the audit rate on non-taxable Forms 709 is significantly lower than the audit rate on taxable Forms 706, many clients may feel safer disclosing a non-gift transaction on a Form 709, rather than forcing their personal representatives to assume the audit risk on the Form 706.\textsuperscript{106}

3. Completing the Form 709

Schedule A, Question A, which is on top of page 2 of Form 709, requires a taxpayer to disclose whether any item listed on Schedule A reflects a "valuation discount." Some planners believe that answering this question in the affirmative may generate additional IRS scrutiny of the return. If a grantor trust is initially funded with limited partnership interests or other discounted assets or if the installment sale is disclosed on Schedule A (and the assets sold were discounted assets), the answer to this question will necessarily be "Yes". If the trust is not funded with discounted assets, Question A would still need to be answered "Yes" if the installment sale transaction were reported on Schedule A.

An affirmative answer to Question A can be avoided through the following means: First, the grantor trust is funded with cash or other non-discounted assets. Second, the installment sale transaction is disclosed (assuming the taxpayer elects to disclose the transaction) on an attachment to the return – not on Schedule A itself.\textsuperscript{107} By structuring and reporting the transaction in this fashion, the installment sale transaction can still be disclosed for purposes of commencing the statute of limitations, but no item reported on Schedule A will reflect a valuation discount and Question A can be answered "No."\textsuperscript{108}

\textsuperscript{105} See Reg. § 301.6501(c)-(1)(f)(4).


\textsuperscript{108} For an example of a gift tax return utilizing this reporting option, see Derek L. Fletcher and Cheryl Cain Crabbe, Installment Sale Panel – Forms, STATE BAR OF TEXAS ADVANCED ESTATE PLANNING AND PROBATE COURSE (June 11-13, 2008).
D. "Adequately Disclosed" vs. "Adequately Shown"

1. Adequately Disclosed

The applicable statute of limitations on the IRS's ability to challenge a transfer will not begin to run unless and until the transfer is "adequately disclosed" on a Form 709.\(^{109}\) To satisfy the adequate disclosure requirements, the Form 709 must adequately apprise the IRS of the nature of the transfer and the basis for the reported value.\(^{110}\) While this sounds simple, it most assuredly is not. Plus, the stakes are high. IRS officials have informally stated that when a Form 709 fails to meet adequate disclosure requirements, it is "flagged" so that any issues can be revisited upon the client's death if a Form 706 is filed.\(^{111}\)

Given the importance of adequate disclosure, this paper attaches several resources designed to aid the tax return preparer in satisfying the adequate disclosure requirements:

- Exhibit 4 is a list of preliminary questions for any Form 709;
- Exhibit 5 is an adequate disclosure checklist; and
- Exhibit 6 is a condensed checklist when reviewing "qualified appraisals."

2. Adequately Shown

As described above, it is often in the best interest of the client to start the statute of limitations within which the IRS may challenge the tax results of a client's estate planning transactions. Therefore, it is usually good practice to disclose gifts to a GRAT, even a zeroed-out GRAT that is intended to result in no tax. Most practitioners are aware of the requirement that a transaction must be adequately disclosed to begin the period of limitations, as further discussed above.\(^{112}\) For GRATs and other transactions governed by Code § 2701 and § 2702, the transaction must also be "adequately shown."

To begin the period of limitations for transfers to a GRAT, the Form 709 must include:

- A description of the transactions, including a description of transferred and retained interests and the method (or methods) used to value each.\(^{114}\)
- The identity of, and relationship between, the transferor, transferee, all other persons participating in the transactions, and all parties related to the transferor holding an equity interest in any entity involved in the transactions.\(^{115}\)

\(^{109}\) See IRC § 6501(c)(9); Reg. § 301.6501(c)-1(f)(1).
\(^{110}\) See Reg. § 301.6501(c)-1(f); Reg. § 25.2504-2.
\(^{112}\) IRC § 6501(c)(9); Reg. § 301.6501(c)-1(f)(1).
\(^{113}\) Reg. § 301.6501(c)-1(e)(2)(i).
\(^{114}\) Reg. § 301.6501(c)-1(e)(2)(i).
• A detailed description (including all actuarial factors and discount rates used) of the method used to determine the amount of the gift arising from the transfer (or taxable event), including, in the case of an equity interest that is not actively traded, the financial and other data used in determining value. Financial data should generally include balance sheets and statements of net earnings, operating results, and dividends paid for each of the 5 years immediately before the valuation date.116

• The trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument.117

E. Penalties

1. Return Preparer Penalties

Historically, the tax preparer penalties did not apply to preparers of estate and gift tax returns. The Small Business and Work Opportunity Tax Act of 2007 (the "2007 Act") extended the tax return preparer penalties to all types of tax returns, including estate and gift tax returns. The changes made by the 2007 Act are generally effective for returns prepared after May 25, 2007. However, the IRS, in advance of the publication of regulations, issued interim guidance to reflect the changes made in the 2007 Act. This guidance is effective January 1, 2008, as to most issues.120

A tax return preparer who prepares a return or refund claim for which any part of a tax liability understatement is due to an "unreasonable position" must pay a penalty for each return or claim equal to the greater of $1,000 or 50% of the income derived (or to be derived) by the tax return preparer for preparing the return or claim. A position is "unreasonable" unless there is or was "substantial authority" for the position.122

Prior to the 2007 Act, penalties could be avoided if the position was adequately disclosed so long as the position was not frivolous. Now there must be a reasonable basis for positions taken on a tax

115 Reg. § 301.6501(c)-(e)(2)(ii).
116 Reg. § 301.6501(c)-(e)(2)(iii).
117 Reg. § 301.6501(c)-(f)(2)(iii).
119 On June 11, 2007, the IRS issued Notice 2007-54, which provided guidance and transitional relief for all returns and claims for refund due on or before December 31, 2007. On December 31, 2007, the Service issued three additional notices: (i) Notice 2008-11 clarified the effective date provisions in Notice 2007-54; (ii) Notice 2008-12 listed the types of tax returns that must be signed by return preparers pursuant to section 6695; and (iii) Notice 2008-13 provided interim guidance regarding application of section 6694. Notice 2008-13 has since been supplemented by Notice 2008-46, modified and clarified by Notice 2009-5, and ultimately modified and superseded by Rev. Proc. 2009-11.
121 IRC § 6694(a)(1). In the case of willful or reckless conduct, the penalty is increased to the greater of $5,000 or 75% of the income derived (or to be derived) by the tax return preparer for preparing the return or claim. IRC § 6694(b)(1).
122 IRC § 6694(a)(2).
return. The 2007 Act increases the standard for avoiding penalties from a "realistic probability of success" to "more likely than not."

In Notice 2008-13,\textsuperscript{123} the IRS and Treasury addressed the potential conflict of interest between a taxpayer's standard to avoid a penalty (substantial authority in some cases) and the return preparer's standard (more likely than not). Under Notice 2008-13, a tax return preparer will be deemed to satisfy the Code section 6694 requirements with respect to a position with a "reasonable basis," but for which the preparer does not have a reasonable belief that the position would more likely than not be sustained on its merits, provided one of the following requirements is met:

- The position is disclosed in accordance with Treas. Reg. § 1.6662-4(f).
- The tax return that the preparer provides to the taxpayer includes a disclosure of the position in accordance with Reg. § 1.6662-4(f).
- There is substantial authority for the position (other than a "tax shelter" as defined in Code § 6662(d)(2)(C)) and the preparer (i) advises the taxpayer of the difference between the penalty standards applicable to the taxpayer under Code § 6662 (substantial authority) and the penalty standards applicable to the tax return preparer under Code § 6694 (reasonable belief that the position would more likely than not be sustained on its merits), and (ii) contemporaneously documents in the preparer's files that this advice regarding differing standards was given to the taxpayer.
- If the position may be described as a "tax shelter" in Code § 6662(d)(2)(C) and, therefore, the taxpayer may not avoid the Code § 6662 penalty by disclosure, the tax return preparer: (i) advises the taxpayer of the penalty standards applicable to the taxpayer under Code § 6662(d)(2)(C) and the difference, if any, between these standards and the standards under Code § 6694, and (ii) contemporaneously documents in the preparer's files that this advice was given to the taxpayer.

For non-signing tax return preparers, Notice 2008-13 indicates that a non-signing preparer will be deemed to satisfy the Code § 6694 requirements with respect to advice given to a taxpayer on a position that satisfies the reasonable basis but not the more likely than not standard if the non-signing preparer provides a statement advising the taxpayer of any opportunity for the taxpayer to avoid a Code § 6662 penalty through disclosure, if relevant, and of the requirements for such disclosure.

\section*{2. Appraiser Penalties}

The appraiser penalties historically did not apply in connection with an estate or gift tax return. For more than a decade, anyone who provides an "appraisal of the value of property" on a Form 706 or Form 709 may be subject to penalties.\textsuperscript{124} The Code no longer limits the application of the penalty to only persons who hold themselves out as "appraisers."\textsuperscript{125}

\textsuperscript{123} 2008-3 IRB 282.

\textsuperscript{124} Sec. 3(e),(j), PL 110-172, Dec. 29, 2007; IRS Chief Counsel Memo (Oct. 31, 2007) (concluding that the IRS could assess the incorrect appraisal penalty against an appraiser for appraisals prepared after May 25, 2007 that were used in connection with an estate or gift tax return or claim for refund or credit that resulted in a gross valuation misstatement).

The 2006 Pension Protection Act ("PPA") created Code § 6695A imposing a penalty on any person (i) who prepared a property appraisal and knew, or reasonably should have known, that the appraisal would be used in connection with a return or a refund claim, and (ii) the claimed property value on the return or refund claim that was based on the appraisal resulted in a substantial valuation misstatement under Code § 6662(e) or a gross valuation misstatement under Code § 6662(h) for the property.\(^{126}\)

The penalty is the lesser of (i) 125% of the gross income for preparing the appraisal received by the person who prepared it, or (ii) the greater of (A) 10% of the underpayment (as defined in Code § 6664(a)) attributable to the misstatement, and (B) $1,000.\(^{127}\) If a tax return preparer values an asset by including an estimated discount (e.g., a fractional interest discount for a community one-half interest), the preparer may be an "appraiser" for purposes of the PPA and, therefore, subject to possible penalties if the discount is disallowed.

VII. CONCLUSION

Designing a comprehensive gifting strategy has always been hard. It is even harder now in the face of legislative uncertainty and constantly changing exemption amounts. The right approach requires learning as much about the client as possible, including the client's tax and non-tax motivations for gifting, as well as the client's ongoing financial needs and cash flow. For most clients, it is more appropriate to plan for income tax savings, rather than transfer tax savings, and planners must learn to adapt to this new planning paradigm.

Clients and their advisors should be familiar with and take advantage of lifetime transfers that do not consume gift tax exemption. When considering a transfer that will consume gift tax exemption, advisors may group clients into three categories—affluent clients, wealthy clients, and super wealthy clients—in order to suggest techniques that are appropriate for each client group. Wealthy clients are the most challenging group to plan for because they are stuck in the middle of the expiring exemption amounts. Transfer tax planning for wealthy clients may require creative solutions designed to utilize the client's increased BEA and GST Exemption prior to 2026, while potentially permitting the client to access the gifted property directly or indirectly in the future. Finally, once the transfers are complete, advisors should take care in reporting the transfers in a manner that begins the statute of limitations on the Service's ability to challenge the transaction.

As evident from this paper, no one approach fits all, and each client's lifetime gifting strategy should be specifically tailored to that client's unique financial and family situation. Flexibility is key, balanced with a heavy dose of practicality. Planners should take comfort that, regardless of the future of the transfer tax system, good advice will always be in demand.

\(^{126}\) IRC § 6695A(a).

\(^{127}\) IRC § 6695A(b).
Exhibit 1

MEMORANDUM

TO: Client
FROM: Estate Planning Attorney
DATE: January 1, 2020
RE: Overview of Charitable Giving Strategies

INTRODUCTION

We understand that you are considering a substantial charitable gift to offset potential capital gains from the impending sale of Company. We also understand that you are considering making substantial charitable gifts at your death as part of your overall estate plan. The purpose of this memorandum is to provide you with a very broad overview of charitable giving strategies.128 If and when you are ready to implement one or more of these strategies, we can engage in further discussions regarding asset selection, design strategy, and tax reporting, among any other questions you may have.

There are four basic ways to make charitable gifts, briefly described below. Note that each type of charitable gift, if properly structured, should qualify for (i) an immediate income tax deduction, if made during your lifetime and subject to certain adjusted gross income ("AGI") limitations, and (ii) the unlimited charitable deduction from federal gift and estate taxes.

1. Gifts to Public Charities – The simplest way to make a charitable gift is to donate directly to a public charity. Cash gifts to public charities may be deducted up to 60% of a taxpayer's AGI, with a 5-year carryforward for any excess. Gifts of long-term appreciated property may be deducted up to 30% of a taxpayer's AGI, again with a 5-year carryforward. Other than obtaining a contemporaneous receipt, gifts to public charities do not require significant administration, recordkeeping, or expense.

2. Gifts to Charitable Trusts – An alternative to a public charity is the creation and funding of a charitable trust. Taxpayers considering a charitable trust generally seek to benefit charity, while also benefitting certain individuals, such as spouses, family members, or friends, in a tax-preferred manner. These "split interest" trusts require more administration, recordkeeping, and expense than direct gifts to public charities, and are typically created for estate planning purposes.

3. Gifts to Private Foundations – Private foundations are common vehicles for wealthy individuals and families who desire to implement their charitable goals over time, with control vested in a hand-selected group of family members, friends, or colleagues. With more control, however, comes more responsibility, resulting in significantly higher administrative costs. Private foundations are subject to a strict set of rules enforced by the IRS, which can create a barrier to entry for more modest charitable gifts. In addition, deduction limits for gifts to private foundations are not as favorable as those for gifts to public charities.

128 More specifically, this memorandum is only intended to start the conversation. It does not attempt to address all charitable giving strategies, discuss all details for each strategy, or analyze all potential tax consequences. We anticipate the need to engage in further analysis before implementing a particular charitable giving strategy.
4. **Gifts to Donor Advised Funds** – Taxpayers who desire to spread distributions to charity over time, but avoid the administrative burdens of a private foundation, may create a donor advised fund ("DAF."). DAFs can be established through a local community foundation or a third party financial institution. Currently, there are certain advantages to a DAF, including limited reporting obligations for donors and more favorable AGI limitations for public charities. The key difference between a DAF and a private foundation, however, is that a taxpayer only has the right to make recommendations with a DAF, while the taxpayer may retain control over a private foundation.

Based on our discussions, we have assumed that you are more seriously considering the creation of a private foundation or DAF, rather than making gifts to public charities or funding a charitable trust.129 The paragraphs below describe private foundations and DAFs in more detail, before concluding with a summary chart that compares the two strategies.

**PRIVATE FOUNDATIONS**

The primary benefit of a private foundation can be summarized in one word—control. Through a private foundation, you, together with family members, friends, and colleagues whom you select, may control and directly carry out your charitable goals in perpetuity. The downside to this level of control is that private foundations are generally only appropriate for significant charitable gifts. While there is no magic number at which the administrative costs of a private foundation are justified, you should first consider whether your charitable goals may be accomplished through simpler means. We have briefly described the formation and basic operation of a private foundation below, along with some applicable rules and restrictions.

**Formation.** While a private foundation can be established as a trust, we typically recommend that it be organized as a non-profit corporation under the Texas Business Organizations Code (or other applicable state law). The governing documents would include, at a minimum, a certificate of formation (or articles of incorporation), bylaws, a conflict-of-interest policy, and other organizational consents. During your lifetime, you could be the only member (or shareholder) of the foundation, although the foundation should have at least three directors (if established in Texas). Upon your death, the foundation could convert to a corporation without members, which would be sustained by a self-perpetuating board of directors. Preparing and filing the necessary documents to implement the foundation would require some time and expense.

**Applications for Tax-Exempt Status.** Before contributions to a private foundation can qualify for a charitable tax deduction, the foundation must file an Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code (Form 1023) with the IRS. Form 1023 requires various representations concerning the intended exempt activities of the foundation, the composition of its board of directors, and the expected source of funds. While a timely filed Form 1023 would relate back to the foundation's date of incorporation, the IRS can take some time in its response. Once federal tax-exempt status is obtained, the foundation must also file with the Texas Comptroller's Office (or similar state organization) to obtain an exemption from Texas franchise tax. These applications would require additional preparation costs and filing fees.

**Basic Operation.** Most private foundations are "non-operating" foundations, meaning that the foundation does not operate its own charitable programs. Rather, the foundation will make distributions, or grants, to other charitable organizations, such as public charities and private operating foundations, to

129 Note, however, that these charitable giving strategies are not mutually exclusive, meaning that you may utilize a combination of strategies, including periodic gifts to public charities, to accomplish your charitable objectives.
carry out its charitable mission. There should be some form of grant-making process in place by which applications are received, reviewed, and awarded.

**Annual Filing Requirements.** Each year, a private foundation is required to file an informational return (Form 990-PF) with the IRS and the state attorney general. The 990-PF shows contributions, earnings, and distributions, among other information regarding the foundation. The foundation is required to make its Form 990-PF, as well as its Form 1023, available for public inspection at any time. In other words, despite its name, private foundations are public in nature.

**Annual Federal Excise Tax.** Private foundations are required to pay an annual federal excise tax equal to 2% of their net investment income. A foundation may be able to reduce its annual excise to 1%, but only if certain distribution requirements, which are highly technical, have been satisfied.

**Minimum Annual Distributions.** Each year, a private foundation must distribute a minimum amount of its assets for tax-exempt purposes (i.e., to public charities, private operating foundations, etc.). The current minimum payout requirement is 5% of the average value of the foundation's net assets for the year. Failure to distribute this 5% minimum amount triggers a 30% tax on the amount that was improperly accumulated.

**Operating Restrictions.** Primarily because of past abuses by certain private foundations, a number of restrictions exist to preclude the use of a private foundation to accomplish primarily private, rather than tax-exempt, purposes. The most applicable restrictions are described below:

- **Taxable Expenditures.** Private foundations are prohibited from making "taxable expenditures," which include educational, travel, or study grants to individuals (unless advance approval is obtained from the IRS). In addition, if a foundation desires to make a grant to another organization, but that organization is not a public charity, the foundation must undertake fairly strict supervision of the grantee's expenditure of the funds.

- **Jeopardy Investments.** Private foundations are required to make investments in a manner that does not jeopardize its ability to carry out its exempt purposes. This restriction is designed to prevent foundations from making speculative investments, and imposes a 10% initial tax if such a "jeopardy investment" is made. Certain types of investments, such as commodity futures, marginalized securities, working interests in oil and gas wells, puts, commas, straddles, warrants, and short sales of securities, will be closely scrutinized.

- **Self-Dealing.** Private foundations are generally prohibited from engaging in transactions with "disqualified persons," unless an exception applies. Disqualified persons include (i) substantial contributors to the foundation (those persons whose contributions total $5,000 or more), (ii) the foundation's members, (iii) the foundation's directors, (iv) certain family members of substantial contributors, members, or directors, and (v) businesses and trusts in which substantial contributors, members, directors, or their family members hold significant interests. Prohibited transactions with disqualified persons are characterized as "self-dealing," which may result in penalties or even the loss of tax-exempt status for the foundation.

- **Excess Business Holdings.** If a private foundation invests in entities in which disqualified persons are also investors, this can cause the foundation to have "excess
business holdings," which may result in significant penalties. The rules regarding excess
business holdings are extremely technical.

**Contribution Deductions.** Cash contributions to a private foundation are deductible up to 30% of
a taxpayer's AGI, with a 5-year carryforward for any excess. Contributions of appreciated property to a
foundation, however, are only deductible up to 20% of a taxpayer's AGI. Furthermore, the deduction is
typically equal to the donor's cost basis—not the fair market value of the contributed property—unless the
contributed property is "qualified appreciated stock." Qualified appreciated stock, which may be
deducted at fair market value subject to a 20% AGI limitation, is stock for which market quotations are
readily available on an established securities market as of the date of the gift. The stock must also be
long-term capital gain stock in the hands of the donor, and the donor (and the donor's family) must not
own more than 10% of the stock of the corporation.

In sum, there are strict limitations on the manner in which a private foundation must be operated
in order to maintain its tax-exempt status. Compliance with these operating limitations is the biggest
drawback to a private foundation, as there are numerous traps for the unwary that can result in taxation of
the foundation's income and the assessment of penalties. Certain individuals and families, however,
simply view these compliance requirements as the "cost" of retaining greater control over the investment
and distribution of the donated funds.

**DONOR ADVISED FUNDS**

A donor advised fund, or DAF, is a charitable giving vehicle sponsored by a public charity, which
would serve as the fund's administrator. After contributing funds to the DAF, you (and, if desired, your
family members, friends, and colleagues) could work with the fund administrator to recommend grants to
public charities over time.

Creating a DAF is much simpler than creating and maintaining a private foundation. There are
generally no filing fees, public reporting requirements, or ongoing maintenance costs for donors, and
DAFs are not required to distribute 5% of their assets each year. Moreover, DAFs qualify for the more
favorable deduction rules of public charities, including the 60% AGI deduction limit (compared to 30%)
and the ability to deduct appreciated property at fair market value (compared to the donor's cost basis,
except for qualified appreciated stock).

Given their many advantages, the popularity of DAFs has increased significantly in recent years.
Not surprisingly, the IRS has also increased its scrutiny of DAFs, and has suggested that it may subject
DAFs to more stringent requirements in the future. At present, however, DAFs are still more lightly
regulated by the IRS, which make them a suitable vehicle for many taxpayers who wish to spread their
charitable contributions over time, without the administrative burdens of a private foundation.

The biggest disadvantage of a DAF is that the donor only has the right to make recommendations,
which the fund administrator is not legally required to follow. As a practical matter, however, it is rare
for a fund administrator to reject a donor's recommendation.

**CONCLUSION**

As described at the beginning of this memorandum, there are several strategies available to
accomplish your charitable goals, and the right approach may involve a combination of such strategies.

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130 See, for example, IRS Notice 2017-73, in which the IRS requested public comments on the application of excise
taxes to DAFs in certain situations.
Based on our discussions, however, it appears that you intend to make significant charitable gifts during lifetime and at death to either a private foundation or DAF. To this end, we have included the below comparison chart of private foundations and DAFs for your ready reference:

<table>
<thead>
<tr>
<th>Design Consideration</th>
<th>Private Foundation</th>
<th>Donor Advised Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Setup</td>
<td>Legal creation of non-profit corporation or charitable trust and filing of applications for tax-exempt status</td>
<td>Simple gift to fund administrator in the name of a new DAF</td>
</tr>
<tr>
<td>Minimum Initial Contribution</td>
<td>None, but most taxpayers contribute at least several million dollars</td>
<td>Depends on fund administrator, but significantly less than most initial contributions to private foundations</td>
</tr>
<tr>
<td>Income Tax Deduction for Cash Gifts</td>
<td>Up to 30% of adjusted gross income</td>
<td>Up to 60% of adjusted gross income</td>
</tr>
<tr>
<td>Income Tax Deduction for Qualified Appreciated Stock Gifts</td>
<td>Fair market value up to 20% of adjusted gross income</td>
<td>Fair market value up to 30% of adjusted gross income</td>
</tr>
<tr>
<td>Income Tax Deduction for Real Estate and Closely Held Stock Gifts</td>
<td>Cost basis up to 20% of adjusted gross income</td>
<td>Fair market value up to 30% of adjusted gross income</td>
</tr>
<tr>
<td>Donor Control</td>
<td>Donor may appoint board to control investments and grants</td>
<td>Donor makes recommendations regarding investments and grants to fund administrator</td>
</tr>
<tr>
<td>Minimum Annual Distributions</td>
<td>5% of assets</td>
<td>None</td>
</tr>
<tr>
<td>IRS Annual Reporting</td>
<td>Annual 990-PF</td>
<td>None for donor</td>
</tr>
<tr>
<td>Design Consideration</td>
<td>Private Foundation</td>
<td>Donor Advised Fund</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>--------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------</td>
</tr>
<tr>
<td>Anonymous Grant-Making</td>
<td>Limited, most grants are reported on publicly available 990-PF</td>
<td>DAF grants can be anonymous</td>
</tr>
<tr>
<td>Administrative Responsibilities</td>
<td>Private foundation responsible for its own administration, including grant-making process</td>
<td>Fund administrator handles all administration</td>
</tr>
<tr>
<td>Investment Restrictions</td>
<td>Significant, with taxes and penalties for failure to comply</td>
<td>Less significant</td>
</tr>
<tr>
<td>Excise Taxes</td>
<td>Significant</td>
<td>Less significant</td>
</tr>
<tr>
<td>Operating Fees and Expenses</td>
<td>Varies, but could be significant based on size and scope of private foundation</td>
<td>Varies, but typically much less than operating costs of private foundation</td>
</tr>
</tbody>
</table>
EXHIBIT 2

DEED OF GIFT

STATE OF TEXAS

COUNTY OF HARRIS

KNOW ALL MEN BY THESE PRESENTS THAT:

SUSAN A. BROWN hereby transfers to JIM BROWN, as Trustee of The ABC Trust (the "Trust"), Fifteen Thousand and No/100 Dollars ($15,000.00) (the "Gift"), subject to the following terms and conditions:

1. The withdrawal rights granted under Paragraph 4.3(a)(i) of the Trust Agreement creating the ABC Trust (the "Trust Agreement") shall not apply to the Gift.

2. Each Beneficiary (as that term is defined in Section 1.4 of the Trust Agreement) shall have the right to withdraw the Gift, subject to the provisions of Subsections 4.3(c) and (d) of the Trust Agreement and the provisions of this Deed of Gift.

3. The Trustee shall promptly provide written notice to the Beneficiary as provided in Subsection 4.3(b).

4. If the Beneficiary does not exercise the withdrawal right within thirty (30) days of receipt of the written notice of the withdrawal right described in Subsection 4.3(b), the unexercised right shall lapse at that time, but only to the extent such unexercised withdrawal right does not exceed the Unused Five and Five Amount. To the extent that the Beneficiary's withdrawal right does not lapse completely as provided in the previous sentence, such excess amount shall be added to and aggregated with the balance of Beneficiary's Unlapsed Withdrawal Rights and shall continue to be subject to the Beneficiary's right of withdrawal until such rights lapse as provided in paragraph 5 below.

5. The amount of a Beneficiary's Unlapsed Withdrawal Rights shall lapse on January 1 of each calendar year, but only to the extent that such lapse shall not exceed the Five and Five Amount. The excess portion of the Unlapsed Withdrawal Rights shall continue to be subject to the Beneficiary's right of withdrawal until January 1 of the next calendar year, on which date the current balance of the Beneficiary's Unlapsed Withdrawal Rights shall lapse as provided in the previous sentence.

6. The following definitions shall apply to this Deed of Gift:

   a. **Five and Five Amount.** The term "Five and Five Amount" means, with respect to a Beneficiary, the greater of (A) Five Thousand Dollars ($5,000), or (B) Five Percent (5%) of the total value of the ABC Trust determined as of the date the current withdrawal right is to lapse or (C) any greater withdrawal right, the lapse of which would not constitute a release of such withdrawal right under Sections 2041(b)(2) and 2514(e) of the Internal Revenue Code or any similar subsequent statute.

   b. **Unlapsed Withdrawal Rights.** The term "Unlapsed Withdrawal Rights" means the cumulative balance of a Beneficiary's withdrawal rights over the assets of the ABC Trust that have not lapsed.
c. **Unused Five and Five Amount.** The term "Unused Five and Five Amount" means the amount of a Beneficiary's cumulative withdrawal rights with respect to any other gifts from any transferor that are either currently outstanding or that have previously lapsed (but not including the present right of withdrawal) during the same calendar year less the Five and Five Amount.

EFFECTIVE this 31st day of December, 2019.

______________________________
SUSAN A. BROWN

JIM BROWN hereby acknowledges and accepts the receipt of this Deed of Gift in his capacity as Trustee of the ABC Trust.

______________________________
JIM BROWN
Exhibit 3

Jim Brown, Trustee
The ABC Trust
1234 Avenue B
Houston, Texas 77002

December 31, 2019

Mary Brown
1234 8th Street
Houston, Texas 77002

Re: The ABC Trust (the "Trust")

Dear Mary:

In my capacity as Trustee, I am sending this letter to you as a beneficiary of the above-referenced Trust.

Please be advised that on April 1, 2018, your mother transferred property to the Trust. As a beneficiary of the Trust, you have a right to withdraw a portion of such property. Your withdrawal rights are set forth in the attached Deed of Gift. The description of the property added to the Trust, the amount or portion thereof over which you have a present right of withdrawal, and the date of expiration of this right are described below:

1. **Description of property and value:** Fifteen Thousand and No/100 Dollars.

2. **Amount over which you hold a right of withdrawal:** The amount described in the attached Deed of Gift.

3. **Date of expiration of right of withdrawal:** 30 days from the date you receive this letter.

You may withdraw all or any portion of the amount over which you hold a right of withdrawal at any time prior to the date of expiration. In the event you wish to make a withdrawal, please advise me in writing at the above address of the amount you wish to withdraw. To be effective, such exercise of a right of withdrawal must be postmarked or received by me no later than the date of expiration. In the event this notice is received by a natural or appointed guardian of an incompetent, whether because of minority or some other infirmity, and this right of withdrawal is to be exercised, the guardian shall obtain the signature of the minor or ward in addition to his or her own, if at all possible and after explaining the rights contained herein.

This notice is a condition to the contribution to the Trust of the above-described property. The amount subject to this withdrawal right is payable in cash immediately upon receipt by me, as Trustee, of your demand in writing. Should the Trust not contain sufficient liquid assets to satisfy a demand when made, I can and will borrow funds (from the settlor of the trust or another source) in order to satisfy the withdrawal and can, if necessary, pledge trust property to secure the loan.
Whether or not this withdrawal right is exercised, please sign and date the bottom of this letter and return a copy to me for my records. The natural or appointed guardian may sign and date the bottom of this letter on behalf of an incompetent, whether because of minority or some other infirmity. If possible, the guardian should obtain the signature of the minor or ward in addition to his or her own in acknowledging receipt of this notice.

Sincerely,

________________________________________________________________________

Jim Brown, Trustee

I hereby acknowledge receipt of the foregoing notice.

Date:__________________________________________

Mary Brown, Beneficiary
Your Client Wants You to Prepare Form 709*: What Information and Items Do You Need?*

1. Has the client previously filed a Form 709? If so, you need a copy of AT LEAST the most recently filed Form 709 but all prior returns if possible. Were there transfers in prior years that should have been on a gift tax return but were not reported?

2. What is the client's social security number?

3. What is the client's mailing address and legal domicile (residence in which he or she currently lives with no present intention to leave)?

4. Date, amount, description and basis of property transferred, beneficiary name, beneficiary date of birth (for GST purposes), beneficiary address, and beneficiary relationship to client for EACH gift.

5. If gift is to trust:
   - Copy of trust agreement;
   - Current trustee name;
   - Trust address (usually the same as the trustee's address);
   - EIN of trust (or if a grantor trust does the trustee use the trust EIN and file an informational Form 1041 or the grantor's social security number?);
   - List of any withdrawal rights that trust beneficiaries may have, along with information regarding EACH withdrawal beneficiary (i.e., name, address, relationship to client), section of trust agreement providing withdrawal right, and copies of signed withdrawal right notice letters (if available); and
   - CHECK TO SEE IF TRUST AGREEMENT ACTUALLY CREATES MULTIPLE SEPARATE SHARE TRUSTS OR IF IT IS ONE TRUST FOR THE BENEFIT OF MULTIPLE BENEFICIARIES.

6. Were there any charitable gifts to report for the client? Political contributions that do not qualify as non-gift transfers?

7. Do any transfers during the year have part gift / part sale components?

8. Have appraisals been obtained for any transfers? Should there be appraisals obtained? If no appraisal is obtained for a gift of an interest in a closely held entity, has the client provided detailed financial information (including financial statements) to substantiate the calculation of value for the gift and the EIN of the entity? Have you reviewed the adequate disclosure checklist and can you meet the standard for adequate disclosure?
9. Was there a discount taken in determining the value of any gift made during the year?

10. For gifts of real estate, has the client provided the legal description of the property as well as the physical address (if applicable), the type of interest in real estate transferred, and a brief description of the improvements on the property?

11. Were the client's gifts community property gifts, separate property gifts, or both? Is his or her spouse also filing a return? If there are separate property gifts, do the spouses want to elect to gift split those gifts? Do you have the spouse's social security number?

12. Do you have the information you might need for special types of gifts (e.g., Form 712 for gift of life insurance policy, 529 plan information and whether the client is making a large up-front gift that will use his or her annual exclusion amounts for up to 5 years, CUSIP information if gift of actively traded stock or bond, entity EIN if gift of an interest in an entity, etc.)?

13. Have there been any generation-skipping transfers during the year? Does automatic allocation apply or has the client made any opt in or opt out decisions with respect to the automatic allocation rules?

14. Were there transfers in prior years that qualified for the gift tax annual exclusion (eliminating reporting requirement) that did not qualify for the GST tax exclusion and thus GST exemption was automatically allocated (CAUTION: important question when the client has an ILIT).

15. Does the client have a DSUE Amount from a prior deceased spouse (who died after December 31, 2010 and whose executor timely filed Form 706)?

16. Are there any completed non-gift transactions that it would benefit the client to report? If so, do you have transaction details to substantiate that it is a non-gift transaction? Are there any items that you should attach to substantiate the claim that the transaction was a bona fide sale (e.g., assignment, promissory note, security agreement, guaranty, guaranty fee agreement, appraisal, real estate closing documents).

*NOTICE: This page is a sample list of questions. It is by no means comprehensive and does not cover all questions that should be asked, information that should be obtained, and documents that should be obtained in order to accurately and completely prepare Form 709 in all situations. It is designed to be a short form that will cover several important circumstances in a limited number of questions. For a more comprehensive sample checklist (spanning seven pages!), please see the AICPA Gift Tax Return Checklist 2013 available at the following link (you may be required to provide AICPA login information to access the checklist):

Exhibit 5

ADEQUATE DISCLOSURE CHECKLIST

STEPHANIE LOOMIS-PRICE
WINSTEAD PC
600 Travis Street
1100 JPMorgan Chase Tower
Houston, Texas 77002
713.650.2750
713.650.2400 fax
sloomisprice@winstead.com
ADEQUATE DISCLOSURE CHECKLIST FOR
TRANSFER TAX RETURN

Client: 
Appraiser/Date: 
Asset Transferred: 
Date of Gift: 

ADEQUATE DISCLOSURE, GENERALLY

If a gift or bequest (defined as "transfer" for purposes of this set of checklists) is not adequately disclosed for the calendar year period in which the transfer occurred, the statute of limitations is not tolled on the transfer, and the Internal Revenue Service is free to audit the transfer at any time, which could result in additional tax and interest, potential penalties, and even additional tax on later transfers, given that the gift tax computation takes into account earlier gifts.

On the other hand, if adequate disclosure occurs, the statute of limitations will run its course, and the nature of the transfer and the basis for the value reported may not be examined by the Service after the statute's expiration. This general rule is applicable to transfers made after August 5, 1997. For gifts made prior to that date, the Service was barred from revaluation related to any transfer in a year in which a gift tax return was filed, gift tax was paid or assessed, and the statute of limitations had run.

<table>
<thead>
<tr>
<th>Adequate Disclosure Requirements</th>
<th>Support</th>
<th>Y/N</th>
<th>Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Description of transferred property and any consideration received by transferor</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(f)(2)(i)</td>
</tr>
<tr>
<td>2. Identity of, and relationship between, transferor and transferee(s)</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(f)(2)(ii)</td>
</tr>
<tr>
<td>3. If property is transferred in trust, trust's tax identification number and either: (a) brief description of terms governing trust, or (b) copy of trust instrument</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(f)(2)(iii)</td>
</tr>
<tr>
<td>(a) Appraisal meeting these requirements:</td>
<td>(b) Detailed description meeting</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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131 Original format created by Tom Overbey, ACTEC Fellow; toverbey@artaxlaw.com; re-formulated by Stephanie Loomis-Price, ACTEC Fellow, sloomisprice@winstead.com.
<table>
<thead>
<tr>
<th>Adequate Disclosure Requirements</th>
<th>Support</th>
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<th>Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Is prepared and signed by individual who: (1) holds himself out to public as appraiser or regularly performs appraisals; (2) is qualified to make appraisals of type of property being valued, based on qualifications described in appraisal; and (3) is someone other than donor, donee, member of family of donor or donee, or employee of donor, donee, or member of family of donor or donee. (ii) Provides: (1) date of transfer, date of appraisal, and purpose of appraisal; (2) description of transferred property; (3) description of appraisal process; (4) description of assumptions, conditions, and restrictions affecting appraisal; (5) all information considered in determining appraised value; (6) procedures followed and underlying reasoning; (7) valuation method used, rationale for method, and procedure used in determining fair</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>these requirements: (i) Includes: (1) financial data (e.g., balance sheets with explanations of adjustments) utilized in determining value; (2) restrictions on transferred property considered in determining fair market value; and (3) description of adjustments claimed in valuing transferred property (e.g., discounts for blockage, minority or fractional interests, and lack of marketability). (ii) If transferred property is interest in actively traded entity on established exchange, includes: (1) recitation of exchange where interest is listed; (2) CUSIP number of</td>
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</tr>
<tr>
<td>Adequate Disclosure Requirements</td>
<td>Support</td>
<td>Y/N</td>
<td>Authority</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------------------------</td>
<td>---------</td>
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<tr>
<td>market value of transferred property; and (8) specific basis for valuation.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>security; and (3) mean between highest and lowest quoted selling prices on valuation date.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) If transferred property is interest in entity not actively traded, includes:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) discounts claimed in valuing interests in entity or assets owned by entity;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) net asset value of entity;</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>(3) pro rata portion of entity transferred; and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(4) fair market value of interest transferred as reported on return.*</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) If entity in which interest was transferred is not actively traded and owns interest in non-actively traded entity, provides information required in (ii) above for second entity if</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Adequate Disclosure Requirements

<table>
<thead>
<tr>
<th>Support</th>
<th>Y/N</th>
<th>Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>information is relevant and material in determining value of first entity.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5. Statement describing any position taken contrary to proposed, temporary, or final Treasury Regulations or revenue rulings published at time of transfer.  

<table>
<thead>
<tr>
<th>Support</th>
<th>Y/N</th>
<th>Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(f)(2)(v)</td>
</tr>
</tbody>
</table>

* This statement may be omitted if the fair market value of the entity is properly determined without regard to net asset value. However, the Regulations place the burden on the taxpayer for demonstrating that the value is properly determined by some other method.

**Pursuant to Treas. Reg. § 1.1704-13(c)(5)(iv), the following persons cannot be qualified appraisers:**

1. Donor or taxpayer reporting sale on income tax return; member of family of donor or donee or selling taxpayer;
2. Party to transaction in which donor or seller acquired subject property, unless property is transferred within two months of acquisition and appraised value does not exceed acquisition price;
3. Person(s) or business entities receiving or purchasing subject property;
4. Employee of person or organization listed above;
5. Person related to, or married to person related to, person or organization listed in I.R.C. § 267(b); or
6. Appraiser regularly used by excluded person described in categories 1-3 above and who does not perform majority of appraisals made during taxable year for other persons.
**Gifts of Interests in Corporations, Partnerships, and Trusts Only**

Gifts of interests in a corporation, partnership, or trust on or after January 28, 1992 (i.e., gifts subject to the special valuation rules of I.R.C. §§ 2701, 2702) or the occurrence of a subsequent taxable event due to a failure to make timely payments of qualified payments under § 2701 (i.e., taxable events described in Treas. Reg. § 25.2701-4) must provide the information below, in addition to that listed above, in order to adequately disclose the transfer. Note that the entire transaction or series of transactions (including any transaction affecting the transferred interest) of which the gift was a part should be disclosed. See Treas. Reg. § 301.6501(c)-1(e)(2).

<table>
<thead>
<tr>
<th>Adequate Disclosure Requirements Specific to Transfers of Interests in Corporations, Partnerships, Trusts (subject to Chapter 14)</th>
<th>Support</th>
<th>Y/N</th>
<th>Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Description of transaction, including description of transferred and retained interests and method(s) used to value each</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(e)(2)(i)</td>
</tr>
<tr>
<td>2. Identity of, and relationship among: (a) transferor, (b) transferee, (c) all persons participating in transaction, and (d) all parties related to transferor holding equity interest in any entity involved in transactions</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(e)(2)(ii)</td>
</tr>
<tr>
<td>3. Detailed description, including actuarial factors and discount rates used, of method used to determine amount of gift arising from transfer or taxable event</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(e)(2)(iii)</td>
</tr>
<tr>
<td>4. If transfer is of entity interest not actively traded, detailed description of financial and other data used in determining value, generally including: (a) balance sheets, (b) statements of net earnings, (c) operating results, and (d) dividends paid for each of 5 years immediately before valuation date</td>
<td></td>
<td></td>
<td>Treas. Reg. § 301.6501(c)-1(e)(2)(iii)</td>
</tr>
</tbody>
</table>

132 Note that these adequate disclosure provisions, by their terms, only apply to Chapter 12 (gifts) (and apparently not to Chapter 11 (bequests)).
Exhibit 6

Reprinted from:
Christine S. Wakeman & Lora G. Davis,
GRRR (Gift Return Reporting Requirements): Taming the Wild 709 Tiger
(2019)

Appraisal Checklist for: ________________
By: ________________
Date: ________________

Client: ________________

Adequate Disclosure Geared Questions (See Treas. Reg. § 301.6501(c)-1(f)(2)(iv))

___ Has the appraiser attached a CV or resume that indicates he or she holds himself/herself out to the public as an appraiser OR he or she regularly performs appraisals?

___ Has the appraiser attached a CV or resume that indicates he or she is qualified to make appraisals based on experience, professional affiliation, education, etc.?

___ Has the appraiser stated in the report that he or she is not the donor, the beneficiary of the transfer, or a member of the family of either donor or the beneficiary or any person employed by the donor, the beneficiary, or a member of the family of either?

___ Does the report state that the valuation is effective as of the date of the transfer?

___ Does the report state the correct transfer date?

___ Does the report state the date the report was issued?

___ Does the report state that the purpose of the report is valuation for federal transfer tax purposes - see Treas. Reg. §§ 20.2031-1(b) and 25.2512-1?

___ Does the report describe the interest transferred (both in property description and ownership) correctly?

___ Does the report describe the standard for fair market value for transfer tax purposes?

___ Does the report specify the assumptions, limiting conditions, and restrictions made that may affect the conclusion in that report?

___ Does the report contain the information reviewed and considered in determining the appraisal value?

___ Does the report describe the valuation method used (e.g., income approach, market approach)?

___ Does the report describe the appraiser's rationale for selecting the particular appraisal method selected, including why other possible valuation methods would be less appropriate?

___ Has the appraiser signed the report?
Other Items to Look For:

___ Does the report correctly name the client name, trust name, or entity name (as applicable)?

___ Does the report correctly communicate the rights, benefits, restrictions, limitations, and caveats associated with an ownership interest of the subject property (e.g., business purpose; election, removal of partners/members, managers, officers; approval rights for major and non-major decisions; capital calls; allocation of income and loss; distribution provisions; presence or absence of first right of refusal; § 754 election provisions; withdrawal rights and restrictions on withdrawal; term of entity (if any); liquidation provisions; transfer restrictions, requirements for consent necessary for an assignee to be admitted as member/partner; restrictions on ownership; buy-sell or other restrictive agreements)?

___ Does the report include an assessment of the general economic conditions of the time and is that assessment for the correct period of time (e.g., a Q1 economic outlook for a May transfer)

___ Have you checked the report for errors and typos?

___ If discounts applied, are the reasons for the discounts set forth?

___ Do you think all relevant discounts have been considered (e.g., lack of control discount, lack of marketability discount, investment attractiveness discounts, discounts for undivided interest in real estate, built-in-gain discounts, blockage discounts, key person discounts, market absorption discounts)?

___ Do the discounts seem applicable and reasonable?

___ Have you checked the cross references both to provisions in governing documents and references within the report (including those to exhibits and charts)

___ Have you double checked the calculation of the subject interest subject to discounts?

___ Does the report pass the smell test?
**Value Calculation Double Check**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Value of 100% of Entity</td>
<td></td>
</tr>
<tr>
<td>Pro Rata Net Asset Value of a ____% interest</td>
<td></td>
</tr>
<tr>
<td>Discount Type 1: ___________ (e.g., lack of control)</td>
<td></td>
</tr>
<tr>
<td>Interim value after Discount Type 1 applied:</td>
<td></td>
</tr>
<tr>
<td>Discount Type 2: ___________ (e.g., lack of marketability)</td>
<td></td>
</tr>
<tr>
<td>Value after Discount Type 2 applied:</td>
<td></td>
</tr>
<tr>
<td>Rounded Value of Transferred Interest (if applicable)</td>
<td></td>
</tr>
<tr>
<td>Total discount applied</td>
<td></td>
</tr>
</tbody>
</table>