

Taxation of Estates



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A Tax is Applied to a Decedent's Gross Estate.



The value of the Gross Estate is the fair market value at which a willing buyer and willing seller would agree at an arm's length transaction



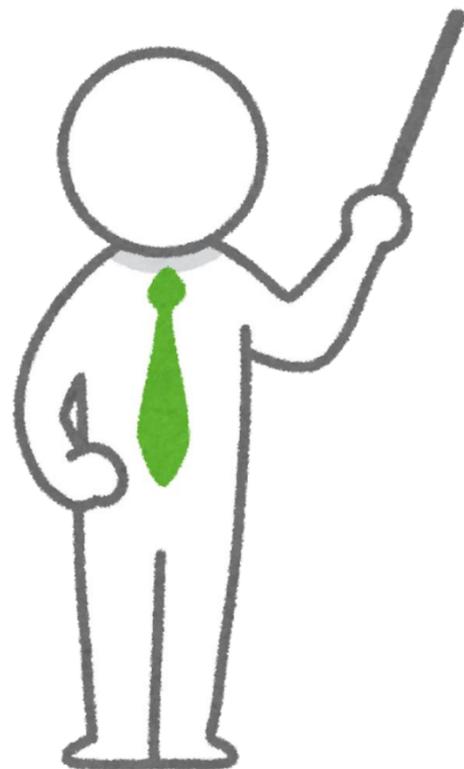
Misconception: Everything must be valued at Highest and Best Use.

Example: Farmland receiving a special agricultural valuation of the county is valued at its fair market value not the agricultural value.

This is a possible outcome but not always the case. Section 2032A provides for special use valuation for Farmland and ongoing businesses.



Factors such as deed restrictions and co-ownership or ownership structure (partnerships or LLCs) can reduce the value of assets due to discount valuations.



Estate Tax Return is Form 706



This must be filed within 9 months from the date of death if the gross estate is in excess of the unused Unified Credit amount.

This is generally sooner than most Estates will close.

An automatic 6-month extension may be granted by filing form 4768.

What is Included in the “Gross Estate?”

Section 2033 defines this the “Gross Estate” as:

“

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

”

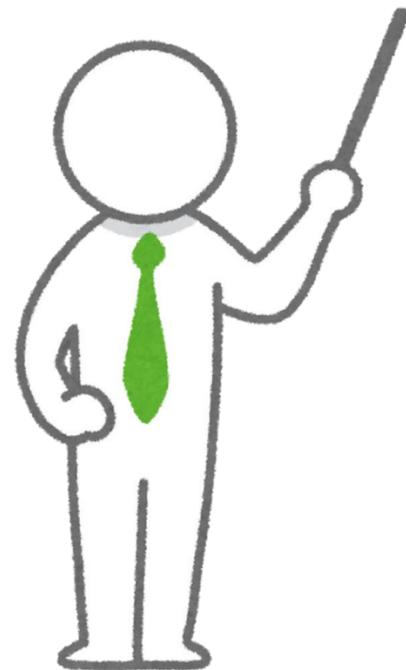
This is much broader than the probate estate and includes all interest the decedent had in any asset.



Prohibition Against Giving Everything Away

Section 2036 – 2038 proscribe a re-inclusion in the gross estate for items that transferred ownership, but for which the decedent retained some element of control or enjoyment. **This includes the whole value not just the interest retained.**

Section 2036 Transfers with retained Life Interest



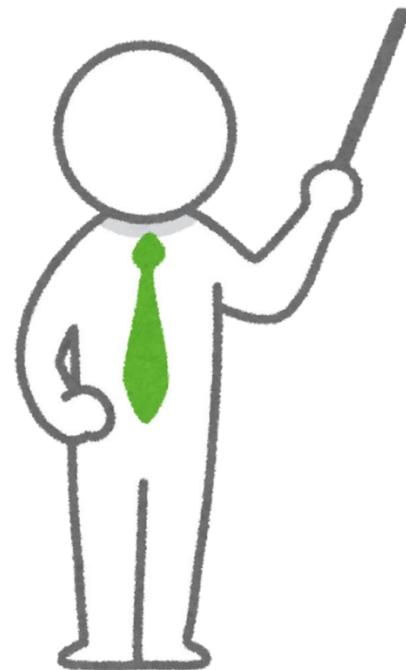
Examples:

- Right to income
- Right to Possession
- Right to enjoyment
- Right to designate who will receive income
- Right to designate who will receive possession
- Right to Designate who will receive enjoyment.

Prohibition Against Giving Everything Away (cont.)

Section 2037 Certain Reversionary Interests

Holding the right to revert an asset back to the decedent should another person not survive the decedent will cause re-inclusion.



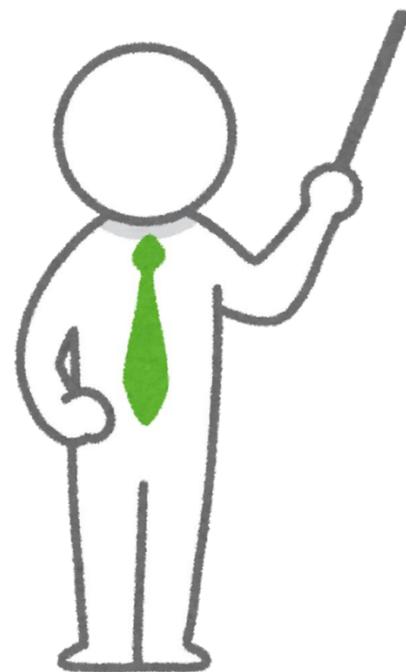
Example:

- George creates a trust that says his son may live in a residence for the remainder of the son's life and then pass to the son's descendants.
- If son dies with no descendants, then the house passes to George or George's estate.
- Because this interest could revert back to George it is includable in his gross estate.

Prohibition Against Giving Everything Away (cont.)

Section 2038 Revocable Transfers

Very similar to 2036. If the decedent has the power to revoke a transfer or later amend a transfer then it is reincluded in the gross estate.



Example:

- George creates a trust that pays income to Peter for life and George retains a power to designate who receives the remainder at the death of Peter.
- Even though the income stream cannot be altered, because George can alter or amend the ultimate disposition of the gift 2038 is triggered.

Three Year Look Back



Section 2035(a) provides that two types of gifts are pulled back into the gross estate if made within 3 years of death.

1. Gifts of Life insurance

2. Gifts that would otherwise be included under **section 2036-2038.**

a) 2036 - Transfers with a retained life interest

b) 2037- Transfers taking effect at death usually a Reversionary Interest

c) 2038 - Revocable Transfers, includes power to revoke or amend.

Examples

- Grey creates a trust with \$50,000 and retains the income for his lifetime with the remainder to go to Betty.
- Grey give up that interest 2 years before his death.
- Because he has retained an interest in the asset it will be included in his gross estate.

- Grey gifts betty a life insurance policy one year before his death.
- This is includable as it was transferred withing 3 years.

- Grey gifts Betty \$50,000 in cash.
- This is not includable as it is not life insurance and is not covered under 2036-2038.

Jointly Owned Property



Generally section 2040(a) provides that the entire value is included in the gross estate, except for spouses which are assumed to be 50/50. This value is reduced by the contribution percentage of the co-owner.



Examples:

- Ben purchases a home with Mary and pays 100% of the purchase price.
- Result is 100% of the value is included in Ben's gross estate.
- (Default is 50/50 but Ben can show the source of funds)

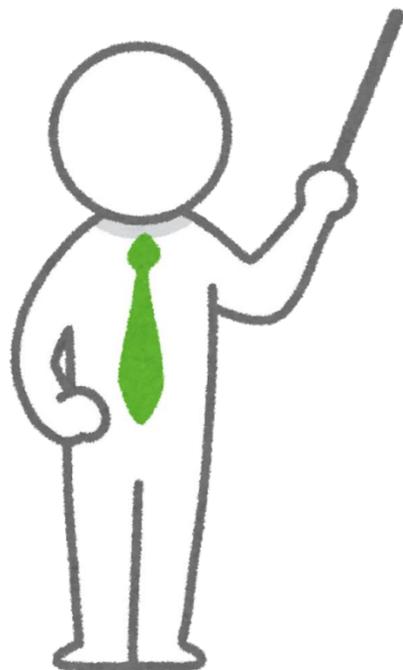
- Same as before, but Mary predeceases Ben.
- 100% is by default included in Mary's gross estate but is reduced to 0% as she provided no funds for the purchase. (Maybe we would want the default rule here??)

Power of Appointment



Section 2041 provides that any asset for which a decedent holds a “General Power of Appointment” is included in the Gross Estate.

A General Power of Appointment is defined as the power to appoint to one’s self, Estate, Creditors, or the Creditors of one’s estate. Anything else is not a general power of appointment. Broadness or narrowness has no impact.



Examples:

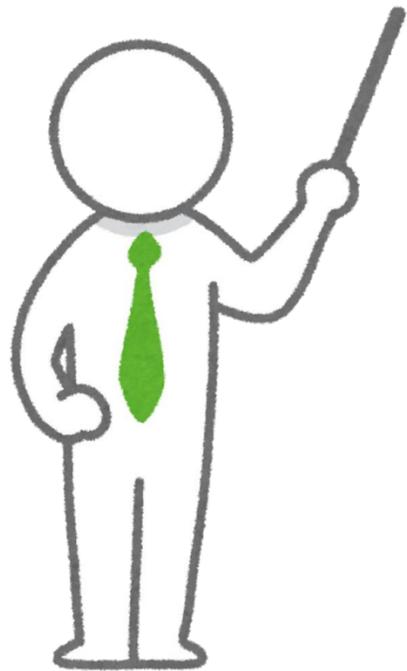
- Trust gives Ben the power to appoint to anyone in the world except himself, his estate, his creditors or the creditors of his estate- This is NOT a general power of appointment.
- Trust gives Ben the power to appoint William or Mary and the creditors of his estate. This is a general power of appointment.

Life Insurance



Governed under Section 2024

- If payable to the estate of a decedent, it is included in the gross estate.
- If the decedent holds rights to change the policy it is also includable.



Examples:

- Don owns a Life insurance policy with Betty as the beneficiary.
- Don has the power to surrender the policy but not change the beneficiary. This is includable.
- Don's Life insurance policy is payable to Betty and Don can not change any aspect of the policy.
- This is not includable.

Basic Strategies to Minimize Estate Tax Exposure



Strategies are based on the goal of the estate plan and the overall make up of the assets of the estate. **An estate holding farmland may have a drastically different strategy than own make up of pharmaceutical patents.**

Spousal Deduction

- Just like the gift tax, a decedent has an unlimited spousal deduction. (See IRC 2056)
- ***Just because you can do something does not mean you should.***
 - Don't get married just to pass on your estate to someone tax free.

Basic Strategies to Minimize Estate Tax Exposure



Gifts

1. Gift assets to move future appreciation out of the estate.
 - a) This is asset specific. A Growth Stock for instance is more appropriate than cash or a fixed income security such as a CD or Bond.
2. Gifts to CRATS, CRUTS or CLT. Previously mentioned in the Gift tax portion of this presentation. This will move assets out of an estate and create a stream of income.
3. Gifts to charities. Excess unified credit amount may be given to charities upon death or during lifetime to reduce the overall gross estate.
4. Leverage Annual Exclusion amounts: gifts to many people at or below the annual exclusion amount.

Basic Strategies to Minimize Estate Tax Exposure



Life Insurance

1. Purchase of a life insurance policy that is not part of the gross estate to pay estate tax liability.
2. Purchase should be made in an Irrevocable Life Insurance trust that will not be clawed back.

Basic Strategies to Minimize Estate Tax Exposure



Credit Shelter Trust AKA- AB Trust

1. Most common method of planning
2. Transfer of the maximum unused exemption amount to a trust. The remaining assets pass amount to a spouse either in a qualified terminal interest trust or outright free of trust.
3. Different techniques and provision may be employed, but certain rules should be followed to create an ascertainable standard for distributions from the Credit Shelter Trust.

Basic Strategies to Minimize Estate Tax Exposure



Deceased Spouse Unused Exemption (DSUE)

1. Transfer any unused exemption amount to the surviving spouse by making an election on the 706 estate tax return.
2. Must timely file and estate tax return even if nothing is owed.
3. If the surviving spouse remarries, the unused exemption is no longer available.

Cost Basis Adjustment (Hidden Wealth Builder)



1. IRC Section 1014 covers the cost basis adjustment
 - a) Assets covered under 1014 take a new basis that is the fair market value at the date of death.
 - b) This is typically referred to as a “Step-up in basis” as most assets usually appreciate in value. But this can also result in a “Step-down in basis.”
2. Property that is held by the decedent or property that he or she has reserved the right to income or the ability to alter or amend the transfer will receive a cost basis adjustment.
 - a) This does not include Qualified Retirement accounts or Annuities.
3. Recent Revenue Ruling holds that the property must also be includable in the Gross estate of the Decedent.

Questions?

More Information visit:

[LawyerLisa.com](https://lawyerlisa.com)

or call 803-563-5163

Take Action!



QUIZ

- Review your current plan or create your first one.
- Don't wait until a crisis.
- We created a quiz to help you determine which type of estate plan best suits your current needs.

<https://lawyerlisa.com/quiz>

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