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Estate and Gift Tax*

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Introduction

Many individuals do not think about federal gift and estate taxes until it's too late. Farmers, landowners, business owners, and individuals need to consider gift and estate taxes at an early age than just at retirement or in their later years. It should be a part of some tax management strategies, in the development of estate planning, and farm, ranch and business succession and transition planning. This publication will break down federal estate and gift taxation into its basic components, which will include estate taxes, gift taxes, lifetime exclusions, annual exclusions, and portability of the deceased spouse's unused estate tax exclusion.

Estate Taxes

Estate tax is a tax based on the fair market value (FMV) of all assets (property) owned and controlled by an individual that has died (decedent). This value is known as the gross estate. The value of the gross estate needs to be determined as of the date of death or use an alternate valuation date that will allow the value to be determined six months following the date of death. A formal appraisal of all assets is the best and most accurate method for determining the value of the gross estate. Appraisal of assets including are but not limited to:

1. Land (the dirt itself separated from all improvements)
2. Minerals (oil and gas, coal, etc.)
3. Improvements to the property including but not limited to; timber on the stump, groves,

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orchards, vines, etc.; wells, fences, tiling, etc.

4. Buildings including, barns, sheds, houses, etc.
5. Machinery, equipment, vehicles, etc.
6. Cash assets such as cash accounts, investments and the like.

Once the gross estate value is determined, deductions may be used to determine the taxable value of the estate. Deductions to the gross estate may include but are not limited to, any debt that is still held by the estate and must be paid, funeral expenses, administrative expenses, any marital deduction(s) for assets that are transferred to a surviving spouse, contributions to a qualified charity, and the unified estate and gift tax credit known as the unified credit. The lifetime exclusion amounts for 2020 – 2022 can be found in Table 1.

Once the net estate value is determined, all deductions and exclusions should be applied to determine the taxable value of the estate. If no tax is due, an Estate Tax Return (IRS Form 706) is not required to be filed within nine months of the date of death, unless there is a desire to make the Portability Election of the unused spouse's estate tax exemption.

Example 1:

Mary who is divorced and single passes away at the age of 92 in April of 2022. During Mary's life she donated cash to various qualified charities, but no other gifts were made that would affect her lifetime exclusion amount. Mary's net estate value is $10,000,000 and is made up of land, stocks, bonds, and other assets. The single lifetime exclusion as found in Table 1 for 2022 is $12,060,000. Since the single lifetime exclusion amount is higher than the net estate value there will be no federal estate tax applied to the estate.

Lifetime Estate Tax Exclusion Values

The lifetime estate tax exclusion value increases from year to year, the most up to date values can be found on the IRS website and in IRS Publication 950, "Introduction to Estate and Gift Taxes". These values were doubled beginning in 2018, through the Tax Cuts and Jobs Act that was signed into law in December of 2017. Without any legislative action, the doubling that occurred due to TCJA sunsets beginning in the 2026 tax year and will revert to half of the 2026 exclusion amount.

Table 1. Lifetime Estate Tax Exclusion Amounts

	2021	2022	2023
Single Individual	$11,700,000	$12,060,000	$12,920,000

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Unified Credit

The unified credit is simply the credit applied to net estate value based on the applicable exclusion amount to determine the estate's taxable value. There are two exclusion amounts that play a role in this credit: 1) the annual exclusion amount that may be applied to any gifts made during the decedents lifetime, and 2) the lifetime exclusion allowed by Internal Revenue Code (IRC) to the FMV of the decedent's estate.

Portability

Portability refers to the present IRC section that allows the unused lifetime exclusion amount from a deceased spouse to be transferred to and combined with the surviving spouse's lifetime exclusion amount, if properly elected on estate tax return.

Example 2:

Alex passes away in June of 2022 with an estate net value of $24,000,000, following the death of his wife Ada in February of 2021. Ada did not use any of her estate tax exclusion amount and appropriately selected to use the portability provision, thus allowing Alex to use all of Ada's unused portion of the lifetime exclusion amount. This allows Alex's estate to add Ada's Exclusion of $11,700,000 (from 2021 found in Table 1) and Alex's value of $12,060,000 (from 2022 found in Table 1) for a total of $23,760,000 lifetime exclusion that can be used to decrease the taxable value of the estate, if any remains. The estate's net value of $24,000,000 will utilize all of the $23,760,000 lifetime exclusion value against the estate net value to total a taxable estate of $240,000 ($24,000,000 - $23,760,000). The Estate Tax liability for the entire estate after applying the lifetime exclusion amounts would be approximately $96,000 ($240,000 x 40%).

Tax Basis

It is important to track tax basis on all assets acquired. The tax basis of an asset is dependent on how those assets are acquired, whether through a purchase, inherited through an estate, or as a gift.

1. **Purchase**. Tax Basis in an asset is based on the purchase price of the asset. The basis is then reduced by tax depreciation if it is used in a trade or business and increased by any improvements made.
2. **Gifting**. The tax basis of the property/asset that is gifted does not change as the asset changes hands. Whatever the tax basis was for the gifting individual will be the same for the person receiving the gift. If Alex purchased property in 1960 for $100,000 and gives that land to his son Jerry in 2022, Jerry's basis in the property will also be $100,000, even though its fair market value has increased and may have a current market value of $1 million dollars.

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3. **Pass through the estate**. If assets are passed through an estate, the assets will receive a "step-up" in tax basis under IRC in 2022. The step-up in basis to FMV takes place as of the date of death (or six months following the day of death if using the alternate valuation date). This means that if Alex, in the above example, had a tax basis of $100,000 of property/asset(s) with a FMV of $500,000, and those assets are passed through Alex's estate following his death to his son Jerry, Jerry's tax basis in the property will be $500,000.

Gift Tax

Gifts of assets including cash (money), services, land and other assets may be subject to a gift tax. There are multiple variables that will come into play to determine if there is a tax liability for the gifting of cash or other assets.

First, there is a 2022 annual gift exclusion amount per individual of $16,000. The annual exclusion amount is adjusted each year, so review IRS Form 709 Instructions for the most up-to-date values and exclusion amounts. You may gift up to the current amount to any one person without any gift tax liability being triggered. If an individual is married, the married couple may use gift splitting and gift up to the current amount, $32,000 (in 2022) in cash or FMV of other assets to any individual. You may gift that amount to any number of individuals in a single year without any gift tax liability being triggered.

Second, just because the annual exclusion amount for 2022 is $16,000, it does not necessarily mean that if you provide a gift higher than that value, that the gift tax will be triggered. The lifetime estate and gift tax exclusion would need to be fully used before an actual gift tax payment would be due, as discussed below.

Taxable Gift

When the value of a gift is greater than the annual exclusion, the amount of the gift in excess of the annual gift tax exclusion is subject to the gift tax. In most cases, the gift may not result in a gift tax being due; rather, the unified estate and gift tax credit will be used to offset the amount of the gift tax due. In other words, a portion of the $12,060,000 (for 2022) unified credit is used to offset the gift taxes due. For example, if a gift of property in 2022 results in a taxable gift of $60,000, the unified credit reduces the gift tax due to zero, and the remaining unified credit available at the time of death or for offsetting future taxable gifts is $12,000,000.

Gifts to a spouse, a political organization, a charity, or used to pay college tuition or medical expenses are not subject to the annual gift tax exclusion. Thus, the only time a gift tax return will be due is when a gift is larger than the annual exclusion, and the only time gift tax will be owed is when the total amount of the unified credit has been used over the gift giver's lifetime.

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It is important to note again that the tax basis that the gifting individual has in that gift is also given to the receiver of the gift. Please see the above “Tax Basis” section of this publication.

Gift Tax Return

When gifts are made with a value greater than the annual exclusion amount, a gift tax return will need to be filed using IRS Form 709: United States Estate Tax Return. Form 709 is due by April 15th and is filed along with the gift giver’s individual tax return.

Gift Recipients

An individual receiving a gift needs to begin to track their tax basis in the asset received. The recipient of assets via a gift or as an inheritance through an estate do not owe any of the estate, gift, or income tax liability, the tax is to be paid by the gift giver or estate of the decedent. Each state has their own laws surrounding tax liability dealing with inheritance, estate, gifts, etc. It is up to the receiver to review the laws in your specific state of residence and the state of residence of the giver for any local tax liabilities that may be owed by the receiver of the property.

IRS Publications

For more information on estate and gift taxes, see IRS Publication 950 “Introduction to Estate and Gift Taxes,” found on the IRS website at www.irs.gov. Also refer to the instructions for IRS Form 706, “United States Estate (and Generation-Skipping Transfer) Tax Return,” and IRS Form 709, “United States Gift (and Generation- Skipping Transfer) Tax Return.” To view or download publication or forms, click on “Forms and Publications.” Then click on “Publication number” under “Download forms and publications by.” Type the publication number in the find box to search for the publication. Publications may be viewed online or downloaded by double clicking on the publication.

Additional Topics

This fact sheet was written as part of Rural Tax Education a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

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