

TAX ISSUES IN ESTATES AND TRUSTS

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Welcome to a brief walking-tour of tax issues to consider in the planning for, and the administration of, trusts and estates! We will hit some of the highlights of (i) estate, gift, and GST tax, the so-called "wealth transfer taxes"; (ii) individual income tax; and (iii) fiduciary income tax implications frequently encountered by estate planners, fiduciaries, and probate court judges and administrative staff.

1. UPDATE ON TAX CHANGES IN 2025: The big news in 2025, of course, was the enactment of the ONE BIG BEAUTIFUL BILL ACT ("OBBBA"), which President Trump ceremoniously signed into law on July 4, 2025. The adjective "big" is appropriate, as it spans a whopping 329 pages full of major changes and minutia. Here are some of its key features:
 - a. Basic Exclusion Amount and GST Exemption. Staring down the barrel of the dreaded "sunset" of the 2017 Tax Cut and Jobs Act ("TCJA") with its historically large wealth transfer tax exemptions, which was scheduled to expire on 12/31/2025, OBBBA makes some "permanent" and some temporary changes to the tax code. For estate planners and all the clients they serve, OBBBA establishes a \$15,000,000 basic exclusion amount and GST exemption for each decedent dying and each donor making gifts after 12/31/2025. The \$15 million exclusion amount will be indexed for inflation for 2027 and subsequent years. (Note: the annual gift tax exclusion of \$19,000 per recipient per year for 2026 was not changed.) The basic exclusion amount is "permanent" – simply meaning that it will remain in effect until Congress changes its mind!
 - b. "SALT" Deduction. The "applicable limitation amount" under IRC Section 164 for state and local taxes is raised from \$10,000 to \$40,000. But (i) the increased deduction is subject to reduction for any taxpayer with modified adjusted gross income ("MAGI") over \$500,000; (ii) the limitation amount and MAGI threshold will increase by 1% in years 2026, 2027, 2028, and 2029, then reverts to \$10,000 in 2030; and (iii) applies for taxable years beginning after 12/31/2024.

- c. Charitable Contributions Deduction for Individuals. Charitable contributions under IRC Section 170 are deductible only to the extent they exceed 0.5% of the taxpayer's "contribution base" (basically, their adjusted gross income or "AGI") for years beginning after 12/31/2025. It makes "permanent" the deductibility of charitable contributions up to 60% of the taxpayer's contribution base. OBBBA also allows taxpayers who do not itemize deductions to take an above-the-line deduction of up to \$1,000 (\$2,000 if married and filing jointly) of contributions to public charities but not to donor-advised funds.
- d. Itemized Deduction Restrictions. OBBBA makes permanent the IRC Section 67 disallowance of "miscellaneous itemized deductions" for taxpayers whose AGI exceeds a certain threshold, but makes it more complex. And a new rule under IRC Section 68 says an individual taxpayer's itemized deductions are reduced by 2/37 (you read that correctly, "two thirty-sevenths") of the lesser amount of such itemized deductions or the amount of the individual's taxable income (adding back the itemized deductions) that exceeds the amount at which the 37% marginal rate applies. Suffice it to say that revised Section 68 is full of complexities and confusion, leaving it unclear whether it applies to estates and trusts by the elimination of Section 68(e) which said, "this section shall not apply to any estate or trust." Both the Section 67 disallowance of miscellaneous itemized deductions and the Section 68 reduction of allowable itemized deductions affect trusts, estates, and beneficiaries of such entities.
- e. **Qualified Small Business Stock.** OBBBA expands the benefits available for taxpayers who sell "qualified small business stock ("QSBS") under IRC Section 1202. The U.S. Small Business Administration defines a QSBS as (i) a C corporation in the U.S. – it can't be an S corporation; (ii) whose assets are less than \$50 million at all times after creation; (iii) which is an active business, not a holding company; (iv) which is NOT a personal services business, such as banking, insurance, farming, etc., - basically manufacturing, retailing, technology, and wholesaling; (iv) whose stockholder acquired the stock in exchange for his or her money or services provided to the corporation. Upon the sale of QSBS, varying percentages of the capital gain (100%, 75%, or 50%, depending on when the stock was

acquired) was excluded from tax, up to the greater of \$10 million or 10 times the taxpayer's adjusted basis in the stock sold. The old rules (listed above) continue to apply for QSBS stock acquired before July 4, 2025. For QSBS acquired after the date of enactment, the capital gain on sale is reduced 50% for stock held 3 to 4 years, 75% for stock held 4-5 years, and 100% for stock held for 5 or more years, up to a limit of \$15 million or 10 times the taxpayer's adjusted basis in the stock sold. NOTE: a person who receives ownership of the stock by gift or inheritance from another person cannot take advantage of the tax break for gain on the sale of the stock.

- f. **Qualified Business Income.** OBBBA extends and expands the benefits of IRC Section 199A for qualified business income ("QBI") which was going to expire at the end of 2025. It makes permanent the deduction of QBI, which is defined as net income from a qualified trade or business such as a sole proprietorship, partnership, or S corporation that is a specified service trade or business ("SSTB"), which provides services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any business where the principal asset is the reputation or skill of one or more of its employees or owners . It also increased the amount of qualifying taxable income from \$100,000 for married individuals filing jointly (\$50,000 for single) to \$150,000 for MFJ (\$75,000 for S taxpayers). The section allows taxpayers to deduct the lesser of (a) 20% of QBI; or (b) the greater of (i) 50% of the W-2 wages derived from the business or (ii) the sum of 25% of such wages plus 2.5% of the taxpayer's unadjusted basis after acquiring all qualified property. The deduction phases out after the taxpayer reaches a taxable income "threshold amount" of \$403,500 or taxpayers MFJ (\$201,775 for single taxpayers).

- g. **Cuts to Energy Credits under the Inflation Reduction Act.** OBBBA substantially reduces the energy credits provided under the IRA by (a) accelerating expiration of credits for new "clean" vehicles and residential credits; (b) phasing out incentives for solar and wind facilities placed in service after 2027, unless construction starts by mid-2026, favoring nuclear, geothermal and storage facilities; and (c) adding new rules for any Foreign Entity of Concern ("FEOC") such as those with ties to China, Russia, Iran,

and North Korea, among other changes. The point is that tax policy is being overtly used to support specific domestic technologies and entities.

- h. Trump Accounts. OBBBA creates “Trump Accounts” which allow parents, guardians, and other authorized individuals to establish a new type of individual retirement account for a child who has not turned 18 before the end of the calendar year in which the election is made. It also features a pilot program for the U.S. Treasury to contribute \$1,000 for children born between January 1, 2025, and December 31, 2028, who are U.S. citizens and have a valid Social Security number, and also allowing parents to contribute up to \$5,000 per year to accelerate growth. The Treasury Department will launch a program and website on July 5, 2026 to promote and facilitate the creation of such accounts.

- 2. FREQUENTLY ASKED QUESTIONS (“FAQs”). Here are some of the frequently asked questions I hear from clients and tax advisors alike:
 - a. Should estate planners continue to encourage clients to make large lifetime taxable gifts to reduce their gross estate? Yes. Even though the panic that gripped taxpayers in 2024 and early 2025 facing the sunset of the 2017 Tax Cut and Jobs Act has abated, high net worth clients should still consider large gifting strategies. The changes will only last until Congress changes its mind! And transfers now also avoid wealth transfer tax on the future appreciation of the assets gifted to the next generation.

 - b. Are marital deduction formulas still necessary or appropriate? The use of marital deduction formulas to maximize the applicable lifetime exemptions have been widely used since the Economic Recovery Tax Act of 1981. The introduction of portability in the Tax Relief Act of 2010, allowing the deceased spouse’s unused exclusion amount (“DSUEA”) to be transferred to the surviving spouse by filing a federal estate tax return (Form 706) to elect portability, greatly simplified the task of capturing both spouses’ exemptions. Now with OBBBA’s historically high and not-scheduled-to-sunset exemption amount, the old formula approach may be obsolete. Multiple factors must be analyzed, including the potential loss of step-up in basis at the second spouse’s death for assets held in a traditional credit-shelter trust, the costs,

complexities and time deadlines of capturing the DSUEA with a portability election, and possible disadvantages of portability, because the DSUEA is not adjusted for inflation, lack of portability for the GST exemption, and non-availability of portability for unmarried couples.

- c. What tax year should a personal representative or trustee choose? An estate may have a fiscal year that ends on the last day of any month within 11 months after the decedent's date of death. A trust must use the calendar year as its fiscal year. I've noticed that most probate lawyers like to pick a fiscal year for an estate that is as far out as possible (e.g., if the decedent died in April 2025, select March 31, 2026, as the end of the estate's fiscal year) in hopes that only one fiduciary income tax return will be necessary. I've noticed that many accountants like to select December 31 as the end of the first, "short" tax year, to stay on track with the normal filing deadlines for returns.
 - d. If there is a pour-over will and a revocable trust, are two taxpayer identification numbers necessary? No. IRC Section 645 allows an estate and a qualified revocable trust ("QRT") to use the same TIN for simplified reporting. The election is made by the fiduciary filing IRS Form 8855.
 - e. Can an estate be closed before the filing of all tax returns and payment of all tax liabilities? No, the fiduciary remains personally liable for any taxes owed if the estate is closed and the residual beneficiaries refuse to pay their proportionate share of the outstanding tax, penalties and interest. Due to the breakdown of the effectiveness and responsiveness of the Internal Revenue Service in recent years, this has become a significant frustration for professional advisors, client, and the probate court personnel who love them!
3. CONCLUSION: After all is said and done: (a) the things assured are death and taxes; (b) there are no "one-size-fits-all" estate planning strategies; and (c) never let the tax tail wag the dog!