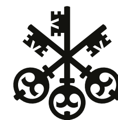
2024 Planning Guide

Advanced Planning Group



UBS

Foreword

During lunch at his Princeton home with his friend Leo Mattersdorf, Albert Einstein reportedly said, "The hardest thing in the world to understand is income taxes."[1] While that might be a matter of perspective, income taxes – and taxes more broadly – are complex. According to the National Taxpayer Advocate, who is appointed by the Secretary of the Treasury and is responsible for promoting the fair administration of federal tax laws, the complexity of those laws – which includes income, gift, estate, and other taxes – has been one of the most serious problems facing taxpayers.[2]

In this guide, we try to simplify and summarize some of the key aspects of federal and state income and wealth transfer taxes. It's a reference guide that aims to help answer questions. We focus on how these taxes apply to individuals and explore some planning strategies for potentially minimizing taxes and achieving other wealth planning objectives. Our goal is to enable readers to enhance their financial well-being through a fuller understanding of the implications of tax laws and planning strategies.

This is a collaborative work. While Jacqueline, Jessica, and I wrote it and are thus credited as the authors, other members of the Advanced Planning Group contributed invaluably in their own ways, reviewing drafts, sharing ideas, and offering insights. Also, as highlighted throughout this guide, many of them have written guides and whitepapers that delve more deeply into the strategies and topics mentioned in this guide. While all of those publications are available from UBS Financial Advisors, several are available on the Advanced Planning Group's site on ubs.com/advancedplanning, and we link to those that are.

We hope you find this guide useful in your planning. And, if we're successful, just maybe, you'll find that taxes aren't the hardest thing to understand.

Todd D. Mayo
Senior Wealth Strategist
Advanced Planning Group

[1] Leo Mattersdorf, Letter to the Editor, *Time*, February 22, 1963.
[2] National Taxpayer Advocate, *2022 Annual Report to Congress*, pp. 45-58.

Table of Contents

Todd D. Mayo
Senior Wealth Strategist
Advanced Planning Group

Jacqueline Denton
Senior Wealth Strategist
Advanced Planning Group

Jessica Mazzaro Friedhoff
Associate Wealth Strategist
Advanced Planning Group

Foreword	**2**
Income Tax	**6**
Overview	7
Gross income	7
Compensation	7
Interest income	9
Dividends	9
Alimony and separate maintenance payments	9
Prizes and awards	9
Gifts	10
Inheritances	10
Life insurance	10
Trusts	10
Recovery of tax benefit	12
Deductions	12
Standard deduction	12
Mortgage interest	13
Home equity loans	14
Investment interest	14
Student loan interest	15
State and local income, sales, and property taxes	15
Casualty losses	16
Charitable contributions	16
Medical expenses	17
Qualified business income	17
Capital gains and losses	18
Calculating gain or loss	19
Home sale gain exclusion	20
Wash-sale rule	20
Qualified small business stock	21
Qualified opportunity funds	23
Worthless securities	25
Netting gains and losses	25
Adjusted gross income	26
Taxable income	26
Filing status	26
Married individual filing jointly	26
Married individual filing separately	27
Unmarried individual (other than a surviving spouse or head of household)	27
Head of household	27
Surviving spouse	28
Tax rates	28
Ordinary income	28
Capital gain tax rates	30
Kiddie tax	33

Net investment income tax 34
Alternative minimum tax 34
Estimated and final tax payments 36
Filing the income tax return 37
Retirement planning 38
Overview 39
Contributions 39
401(k) plans, 403(b) plans, and most 457 plans 39
SIMPLE 401(k) plans and SIMPLE IRAs 40
Traditional IRAs and Roth IRAs 41
Funding a backdoor Roth IRA 42
Distributions 43
Required minimum distributions 43
Qualified charitable contributions 45
Planning considerations and strategies 45
Maximizing contributions 45
Checking beneficiary designations 45
Converting to a Roth IRA 45
Charitable giving 46
Overview 47
Deductible contributions 47
Amount of the contribution 47
Types of charitable organizations 48
Public charities 48
Private foundations 50
Substantiating charitable contributions 52
Contributions over $250 52
Contributions of property over $5,000 52
Selected planning strategies and considerations 52
Making year-end gifts 52
Bunching charitable gifts 53
Selecting assets to give to charity 53
Making qualified charitable distributions 54
Making a qualified charitable distribution to a charitable remainder trust or charitable gift annuity 56
Creating a charitable remainder trust 57
Creating a charitable lead annuity trust 58
Managing a private foundation 58
Further reading 59
Wealth transfer planning 60
Overview 61
Core estate plan 61
Advanced planning 62
Wealth transfer taxes 62
Gift tax 63
Estate tax 66
GST tax 70
Making non-taxable gifts 71
Annual exclusion gifts 71
Tuition exclusion 73
Medical expense exclusion 74
Spousal gifts 74

Charitable gifts 75
Contributions to 501(c)(4), 501(c)(5), 501(c)(6), and 527 organizations 75
Using the lifetime exemption 75
Shifting future appreciation out of the estate 77
Selling assets to a grantor trust 77
Grantor retained annuity trust 77
Charitable lead annuity trust 77
Qualified personal residence trust 78
Planning considerations for certain types of property 78
Closely held businesses 79
S corporations 79
ISOs 79
Shares acquired by exercising ISOs 79
NSOs 80
Shares acquired by exercising NSOs 80
RSUs 80
Carried interests 80
Reviewing the estate plan 81
Reviewing dispositive terms 81
Reviewing fiduciaries 81
Reviewing family limited partnerships and similar structures 81
Reviewing healthcare wishes 82
Refreshing the advanced directives 82
Organizing documents and information 82
Further reading 82
Reviewing ownership of assets 82
Reviewing beneficiary designations 82
Reviewing jointly owned property 82
Funding revocable trusts 82
Managing digital accounts and assets 82
Further reading 83
Reviewing life insurance coverage and policies 83
Checking beneficiary designations on your life insurance policies 83
Reviewing irrevocable life insurance trusts 83
Further reading 83
Planning for liquidity 83
State tax planning 84
Overview 85
Managing residency 85
Changing residency 85
Shifting income and gains out of state 85
Trust planning and administration 88
Overview 89
Sending Crummey notices 89
Considering the income tax implications of a grantor trust 89
Making year-end distributions from nongrantor trusts 90
Reviewing trust structures 90

Income Tax

Overview

In broad terms, determining an individual's income tax liability is a four-step process. First, we determine the individual's gross income. This is what someone is referring to when they're talking colloquially about an individual's income. As we'll see, gross income is expansive, but there are certain amounts that are excludable from gross income (e.g., gifts). Calculating gross income includes calculating gains and losses, including capital gains and losses.

Second, we calculate the individual's adjusted gross income. Adjusted gross income is gross income minus certain deductions. The individual's adjusted gross income potentially limits the deductibility of certain other deductions (e.g., the charitable contribution deduction).

Third, we calculate the individual's taxable income. For an individual who elects to itemize deductions, taxable income is gross income minus allowable deductions. For an individual who doesn't elect to itemize deductions, taxable income is adjusted gross income minus the standard deduction and a few other allowable deductions.

Fourth, we calculate the tax on an individual's taxable income. As we'll see, an individual's filing status – e.g., as a married individual filing jointly or an unmarried individual – affects the tax rate to which their taxable income is subject. So, too, can the character of income. In general terms, long-term capital gains potentially are subject to more favorable tax rates than ordinary income. An individual also may owe the net investment income tax or the alternative minimum tax. In some cases, an individual may have certain credits that apply against the tax (thus reducing the amount owed).

In this chapter, we cover the main elements of each of these steps, as well as some of the key rules concerning the payment of income taxes and filing an income tax return.

Planning tip
An individual who expects to have less income in 2024 than in 2025 might consider accelerating income into 2024 or deferring deductions and credits until 2025. Conversely, an individual who expects to have more income in 2024 than in 2025 might consider deferring income into 2025 or accelerating deductions and credits into 2024. Accelerating or deferring income, deductions, and credits isn't always feasible, and these actions can potentially affect state and local taxes, as well as federal taxes.

Gross income

An individual's gross income generally includes any accretion to wealth.[3] Thus, gross income generally includes any money or property an individual receives, unless its receipt is specifically excluded by a provision of the tax law. An array of provisions govern what's included in income and what's excluded. We'll explore several of these provisions, but our journey will be far from exhaustive.

Compensation

An individual's gross income generally includes salary, wages, commissions, and other compensation for services.[4] An individual's gross income generally includes the fair market value of any property the individual receives in connection with the performance of services – such as stock in the company for which the individual performs the services – unless the property is non-transferrable or is subject to a substantial risk of forfeiture.[5] If the individual pays something for the property, the amount includable in income is the property's fair market value less the amount the individual paid for the property.[6]

For example, an individual's gross income generally includes the fair market value of any virtual currency received as compensation for services.[7] For federal income tax purposes, virtual currency is any digital representation of value that functions as a medium of exchange, a unit of account, or a store of value.[8]

[3] See IRC § 61.
[4] IRC § 61(a)(1).
[5] Treas. Reg. § 1.61-2(d)(4). See also IRC § 83(a).
[6] Id.
[7] Notice 2014-21, § 4, Q&A 3. In this guide, any reference to a form, instructions, notice, or publication refers to an IRS form, instructions, notice, or publication, unless it expressly identified as originating from another source.
[8] Notice 2014-21. In Notice 2023-24, the Internal Revenue Service modified the background section of Notice 2014-21 to remove the statement that virtual currency doesn't have legal tender status in any jurisdiction due to fact that certain foreign jurisdictions have enacted laws that characterize Bitcoin as legal tender. Certain other revisions were also made. The modifications do not affect the answers to frequently asked questions set forth in Notice 2014-21.

For a more in-depth discussion of the income taxation of digital assets, see Lora Cicconi, *Federal Income Taxation of Digital Assets* (a publication of the UBS Advanced Planning Group).

Property subject to vesting and other restrictions

As mentioned above, an individual's gross income generally includes the fair market value of any property the individual receives in connection with the performance of services, unless the property is non-transferrable or is subject to a substantial risk of forfeiture.[9] A substantial risk of forfeiture exists only if the individual's rights in the property are conditioned (directly or indirectly) upon the future performance (or refraining from performance) of substantial services or upon the occurrence of a condition related to a purpose of the transfer if the possibility of forfeiture is substantial.[10] Property that's subject to vesting – for example, where shares vest over time so long as an individual continues to perform services for the company – is subject to a substantial risk of forfeiture.[11]

An individual's gross income generally doesn't include the fair market value of any property the individual receives in connection with the performance of services if the property is non-transferrable or is subject to substantial risk of forfeiture.[12] The individual, however, may elect to include the property's value (less any amount paid for the property) in the individual's gross income.[13] This is commonly called an 83(b) election. In addition to other procedural requirements, an 83(b) election must be made within 30 days after the transfer of the property to an individual.[14]

An 83(b) election is potentially advantageous when the property has a low fair market value (so there's little or nothing includable in gross income) and the individual has a high degree of confidence that the vesting conditions will be met and the property will appreciate substantially. Any gain would typically be taxable as capital gain and, if the property is held for more than one year after the election, the gain would be long-term capital gain.[15] An 83(b) election, however, isn't without risk. Once the individual makes the election, they must include the property's value in income and will owe any resulting income tax regardless of what happens after the election.

For a more in-depth discussion of the 83(b) election, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

Compensatory stock options

An individual may receive incentive stock options (ISOs) or nonqualified stock options (NSOs) in connection with the performance of services.

An individual who receives a grant of ISOs doesn't have anything to include in gross income upon the grant of the ISOs.[16] The individual doesn't have anything to include in gross income upon the vesting of the ISOs. Under a special rule, the individual doesn't have anything to include in gross income upon the exercise of the ISOs.[17] (For alternative minimum tax (AMT) purposes, however, the individual who exercises the ISOs generally includes the spread between the strike price (i.e., exercise price) and the shares' fair market value in income.[18] (We discuss the AMT below.) Upon the sale of shares acquired by exercising the ISOs, the individual will have a gain or loss, and a special rule applies for purposes of determining the character of the gain (e.g., as long-term capital gain or ordinary income).[19]

An individual who receives a grant of NSOs generally doesn't have anything to include in gross income upon the grant of the NSOs.[20] The individual doesn't have anything to include in gross income upon the vesting of the NSOs.

[9] Treas. Reg. § 1.61-2(d)(4). See also IRC § 83(a).
[10] Treas. Reg. § 1.83-3(c)(1).
[11] Treas. Reg. § 1.83-1(a)(1).
[12] Treas. Reg. § 1.61-2(d)(4). See also IRC § 83(a).
[13] IRC § 83(b).
[14] IRC § 83(b)(2).
[15] IRC §§ 1221(a) and 1222(3). The individual's basis includes the amount includable in income by reason of making an 83(b) election. Treas. Reg. § 1.83-2(a).
[16] Treas. Reg. § 1.83-3(a)(2). For purposes of IRC § 83(a), the option isn't property, so there isn't any amount to include in income upon its receipt.
[17] IRC § 421(a)(1).
[18] IRC § 56(b)(3).
[19] Treas. Reg. § 1.424-1(c)(4) Ex. 2 and Ex. 9.
[20] See Treas. Reg. § 1.83-3(a)(2). See also Notice 2004-28. For purposes of IRC § 83(a), an NSO generally isn't property, so there generally isn't any amount to include in income upon its receipt. An NSO, however, is property if it has a readily ascertainable fair market value. Treas. Reg. § 1.83-7(a). That usually only happens if the NSO is publicly traded (or, more precisely, is actively traded on an established market) but can happen if the NSO is transferrable, immediately exercisable, and exhibits certain characteristics making its value readily ascertainable. Treas. Reg. § 1.83-7(b). An NSO often isn't publicly traded, even though a share acquired by exercising the NSO may be publicly traded. When an NSO has a readily ascertainable fair market value (and thus is property for purposes of IRC § 83(a)), and the individual who receives it generally must include its value in income.

The individual generally must include the spread between the strike price and shares' fair market value in gross income upon the exercise of the NSOs.[21]

For a more in-depth discussion of ISOs and NSOs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

Restricted stock units

An individual who receives restricted stock units (RSUs) doesn't include anything in income upon their receipt.[22] Upon vesting of the RSUs, the individual must include in income:

- the amount of cash received upon the settlement of the RSU, and
- the fair market value of any shares received upon the settlement of the RSU, unless those shares are restricted stock (e.g., they are subject to vesting conditions).[23]

For a more in-depth discussion of RSUs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

Interest income

An individual's gross income generally includes interest received.[24] An individual's gross income also includes imputed interest on certain loans that bear interest below the applicable federal rate,[25] accrued original issue discount (OID) on debt instruments subject to the OID inclusion rules,[26] and certain deferred payments that, under an installment sale, bear interest below the applicable federal rate.[27] An individual's gross income, however, generally doesn't include interest on municipal bonds (e.g., bonds issued by a state, county, or local government).[28]

Dividends

An individual's gross income includes dividends received.[29] As discussed below, qualified dividends are subject to the tax rates that apply to long-term capital gains.[30]

Alimony and separate maintenance payments

An individual's gross income generally doesn't include alimony.[31] An individual's gross income, however, generally includes alimony if the divorce or separation instrument was executed before 2019, unless the instrument is modified after 2018 and doesn't expressly provide the individual's income includes the alimony.[32] These rules also apply to separate maintenance payments.[33]

Prizes and awards

An individual's gross income generally includes any amount received as a prize or award.[34] There are some exceptions. An individual's gross income doesn't include employee achievement award, so long as the employer's cost of the award is fully deductible for income tax purposes.[35] An employee achievement award generally is an item of tangible personal property transferred from an employer to an employee for purposes of recognizing length of service achievement or safety achievement and is awarded as part of a meaningful presentation.[36] It, however, can't be awarded under conditions and circumstances that a significant likelihood of the payment of disguised compensation,[37] and it can't be cash, a gift card, vacation, tickets to a sporting event, or other similar items.[38]

An individual's gross income doesn't include an amount received as an award if:

- the award was made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement,
- the individual was selected without any action on the individual's part to enter the contest,

[21] IRC § 83(a).
[22] Treas. Reg. § 1.451-1(a).
[23] Id.
[24] IRC § 61(a)(4).
[25] IRC § 7872.
[26] Treas. Reg. § 1.1272-1.
[27] IRC § 483.
[28] IRC § 103(a).
[29] IRC § 61(a)(7).
[30] IRC § 1(h)(11)(A).
[31] Pub. Law 115-97, § 11051(c). See also *Publication 504 (2022): Divorced or Separated Individuals*.
[32] IRC § 71. See Pub. Law 115-97, § 11051(c).
[33] See notes 31 and 32.
[34] IRC § 74(a).
[35] IRC § 74(c).
[36] IRC § 274(j)(3)(A)(i).
[37] Id.
[38] IRC § 274(j)(3)(A)(ii).

- the individual is not required to render substantial future services as a condition to receiving the award, and
- pursuant to a designation made by the individual, the payor pays the award to a governmental unit, a 170(c)(1) organization, or a 170(c)(2) organization.[39]

An individual's gross income also generally doesn't include the value of any medal awarded in, or any prize money received from the United States Olympic Committee on account of competition in the Olympic Games or Paralympic Games.[40]

Gifts

An individual's gross income generally doesn't include any money or other property the individual receives as a gift.[41] An individual's gross income, however, generally does include any money or other property (other than certain employee achievement awards) received from the individual's employer even if characterized as a gift.[42]

Inheritances

An individual's gross income generally doesn't include any money or other property the individual receives as an inheritance.[43] An individual's gross income, however, includes any income in respect of a decedent.[44] Income in respect of a decedent generally is income that a deceased individual had earned but not received.[45] For example, it includes a discretionary bonus awarded and paid after an individual's death.[46] If an individual's gross income includes income in respect of a decedent, they may qualify for an income tax deduction for the estate taxes attributable to the income.[47]

Life insurance

An individual's gross income generally doesn't include any life insurance proceeds (i.e., amount paid under a life insurance policy by reason of the insured's death).[48] An individual's gross income, however, does include any interest paid on life insurance proceeds.[49]

An individual's gross income includes some or all of the life insurance proceeds if the policy had been transferred for value.[50] The amount includable in gross income is the life insurance proceeds minus:

- the amount of consideration paid for the policy, and
- the amount of premiums paid by the transferee.[51]

A transfer for value generally occurs when the policy is sold or assigned for valuable consideration.[52] A transfer for value, however, doesn't occur when the transferee is the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer.[53]

For a more in-depth discussion of life insurance (including strategies dealing with the transfer-for-value rule), see Jennifer Lan, Premini Scandurra, and Hunter Peek, *Life Insurance* (a publication of the UBS Advanced Planning Group).

Trusts

A trust is classified as either a grantor trust or a nongrantor trust.[54] In the case of a grantor trust, the trust can be a grantor trust with respect to a settlor of the trust or a beneficiary of the trust.[55] A trust can be partially a grantor trust and partially a nongrantor trust, and a trust can be partially a grantor trust with respect to two or more persons.[56]

[39] IRC § 74(b).
[40] IRC § 74(d). If, however, an individual's adjusted gross income exceeds $1,000,000 (or $500,000 in the case of a married individual filing separately), then this exception does not apply.
[41] IRC § 102(a).
[42] IRC § 102(c).
[43] IRC § 102(a). This guide uses the term "inheritance" in the colloquial sense – referring to the receipt of property by reason of an individual's death – rather than its strict legal sense.
[44] IRC § 691(a).
[45] Id.
[46] *O'Daniel's Estate v. Commissioner*, 173 F.2d 966 (2d Cir. 1949).
[47] IRC § 691(c).
[48] IRC § 101(a)(1).
[49] IRC § 61(a)(4).
[50] IRC § 101(a)(2).
[51] Id.
[52] Id.
[53] Id.
[54] IRC § 671.
[55] See notes 58 and 65.
[56] IRC §§ 671 and 678(a). See also Treas. Reg. § 1.671-2(e)(1). This guide generally uses the term "person" in the same sense as the term is used for federal tax purposes. Thus, a person generally is any individual, corporation, partnership, limited liability company, trust, or estate. See IRC § 7701(a)(1).

For simplicity, we'll focus on trusts that are wholly a grantor trust with respect to one individual or wholly a nongrantor trust.

Grantor trust with respect to the settlor

When a trust is a grantor trust with respect to the settlor, the settlor must report the trust's income, deductions, and credits on the settlor's personal income tax return.[57] Accordingly (in albeit somewhat overly simplistic terms), the settlor's gross income includes the trust's gross income.

A trust is a grantor trust with respect to the settlor of the trust if the settlor or the settlor's spouse has certain rights, interests, or powers under the terms of the trust.[58] For example, a trust generally is a grantor trust with respect to the settlor if:

- the settlor can revoke the trust,
- the settlor or the settlor's spouse can receive income distributions from the trust,
- the trust holds an insurance policy on the life of the settlor or the settlor's spouse,
- the settlor has the power to borrow from the trust, or
- the settlor has the power to substitute trust property for property having equivalent value.[59]

Individuals often use irrevocable grantor trusts for wealth transfer planning purposes.

Planning tip

An individual whose gross income includes income from a trust because it's a grantor trust with respect to them might prefer to reduce their gross income by terminating a trust's grantor trust status. This is sometimes called *toggling off* grantor trust status. Toggling off grantor trust status may save income taxes for the individual, but it may have some disadvantages. It may reduce the wealth transfer tax advantages the trust otherwise might offer. In addition, it may subject the income to a higher rate of tax. A nongrantor trust is generally taxable on its capital gains and undistributed income,[60] and a trust more quickly reaches its top marginal rates than an individual. In 2024, the top marginal rate for ordinary income is 37%.[61] In 2024, a married individual filing jointly reaches the top marginal rate once their taxable income is more than $731,200, while a nongrantor trust reaches the top marginal rate once it has more than $15,200 of taxable income.[62]

To the extent a trust is a grantor trust with respect to the settlor, the gross income of a beneficiary (other than the settlor) generally doesn't include any amount the beneficiary receives as a distribution from the trust.[63]

For a more in-depth discussion of irrevocable grantor trusts, Casey Verst, *Using Irrevocable Grantor Trusts To Transfer Wealth* (a publication of the UBS Advanced Planning Group).

Grantor trust with respect to the beneficiary

When a trust is a grantor trust with respect to a beneficiary, the beneficiary must report the trust's income, deductions, and credits on the beneficiary's personal income tax return.[64] Accordingly (again in albeit somewhat overly simplistic terms), the beneficiary's gross income includes the trust's gross income.

A trust is a grantor trust with respect to a beneficiary of the trust if the beneficiary has or had the power to withdraw trust property, the beneficiary has certain rights, interests, or powers under the terms of the trust (e.g., the possibility of receiving income distributions), and the trust isn't a grantor trust with respect to the settlor.[65]

For example, a beneficiary might have had a Crummey withdrawal power – i.e., the power to withdraw some or all of each contribution to the trust – so that the contribution would qualify for the gift tax annual exclusion. If the trust is not a grantor trust with respect to the settlor, the trust would generally be wholly or partially a grantor trust with respect to the beneficiary.[66] Alternatively, a trust might be designed to be a beneficiary defective inheritor's trust or a beneficiary deemed owner trust (i.e., a section 678 trust). In that case, the trust is designed to be a grantor trust with respect to the beneficiary.

[57] IRC § 671.
[58] IRC §§ 673, 674, 675, 676, 677 and 679.
[59] Id.
[60] IRC §§ 651, 652, 661, and 662.
[61] See IRC § 1(j)(2).
[62] Rev. Proc. 2023-34.
[63] See IRC § 671.
[64] IRC § 671.
[65] IRC § 678.
[66] Id.

For a more in-depth discussion of beneficiary defective inheritor's trusts and beneficiary deemed owner trusts, see Jennifer Lan and Joanna Morrison, *Section 678 Trusts* (a publication of the UBS Advanced Planning Group).

To the extent a trust is a grantor trust with respect to a beneficiary, the gross income of another individual generally doesn't include any amount the individual receives as a distribution from the trust.[67]

Nongrantor trusts

A nongrantor trust is generally taxable on its capital gains and undistributed income, and each beneficiary is taxable on the income that the beneficiary receives as a part of a distribution from the trust.[68] Accordingly, an individual's gross income generally includes the income that is distributed to the beneficiary or is required to be distributed to the beneficiary.[69]

Recovery of tax benefit

An individual's gross income includes the any tax benefit the individual recovers.[70] If the individual deducted an amount in a prior year reducing the income taxes the individual owed, the individual's gross income includes any recovery attributable to that amount.[71]

Deductions

An individual is entitled to various deductions, which affect the calculation of their adjusted gross income and their taxable income and thus ultimately affect the amount of taxes they may owe. The tax laws abound with rules concerning what's deductible and what's not.

Standard deduction

An individual who doesn't elect to itemize deductions generally may claim the standard deduction.[72] The standard deduction indexes annually for inflation.[73] Table 1 shows the standard deduction in 2024.

Table 1

Standard deduction in 2024.

Married individual filing jointly	$29,200
Married individual filing separately	$14,600
Unmarried individual (other than surviving spouse or head of household)	$14,600
Head of household	$21,900
Surviving spouse	$29,200

Source: Rev. Proc. 2023-34

An individual can't claim the standard deduction if the individual is a married individual filing separately and either spouse itemizes deductions.[74] An individual also can't claim the standard deduction if the individual is a nonresident alien.[75]

Individuals who have attained 65 years of age

An individual who attained 65 years of age before the end of the calendar year may claim an additional standard deduction.[76] The amount of the additional standard deduction is:

- $1,550 for married individuals filing jointly,
- $1,550 for a married individual filing separately,
- $1,950 for an unmarried individual (other than a surviving spouse or head of household),
- $1,950 for a head of household, and
- $1,550 for a surviving spouse.[77]

An individual whose spouse who attained 65 years of age before end of the calendar year may claim an additional standard deduction.[78] The individual must file separately, the individual's spouse must not have any gross income during the calendar year, and the individual's spouse must not be the dependent of another taxpayer.[79]

Individuals who are blind

An individual who is blind at end of the calendar year may claim an additional

[67] See IRC § 671.
[68] IRC §§ 651, 652, 661, and 662.
[69] IRC §§ 652 and 662.
[70] See IRC § 111.
[71] Id.
[72] IRC §§ 63(a) and (b).
[73] IRC § 63(c)(7)(B).
[74] IRC § 63(c)(6)(A).
[75] IRC § 63(c)(6)(B).
[76] IRC § 63(f)(1).
[77] IRC § 63(f) and Rev. Proc. 2023-34.
[78] IRC § 63(f)(1).
[79] IRC §§ 63(f)(1)(B) and 151(b).

standard deduction.[80] The amount of the additional standard deduction is:

- $1,550 for married individuals filing jointly,
- $1,550 for a married individual filing separately,
- $1,950 for an unmarried individual (other than a surviving spouse or head of household),
- $1,950 for a head of household, and
- $1,550 for a surviving spouse.[81]

An individual whose spouse is blind at end of the calendar year may claim an additional standard deduction.[82] The individual must file separately, the individual's spouse must not have any gross income during the calendar year, and the individual's spouse must not be the dependent of another taxpayer.[83]

Dependents

An individual's standard deduction is limited if the individual can be claimed as another individual's dependent.[84] The deduction is limited to the greater of:

- $1,300 or
- the sum of $450 and the individual's earned income.[85]

Mortgage interest

An individual can deduct mortgage interest, which is more precisely known as qualified residence interest.[86] Qualified residence interest is interest on acquisition indebtedness,[87] which is indebtedness incurred in acquiring, constructing, or substantially improving a qualified residence[88] and is secured by the residence.[89] When an individual refinances acquisition indebtedness, the new debt qualifies as acquisition indebtedness to the extent it doesn't exceed the refinanced debt.[90]

A qualified residence is an individual's principal residence or a second residence.[91] An individual may not have more than two qualified residences at a time.[92] A house, condominium, boat, recreational vehicle, or interest in a co-op can qualify as a qualified residence, so long as it contains a sleeping area and cooking facilities.[93] A residence that's under construction can qualify as a qualified residence for a period of 24 months, so long as it becomes a qualified residence once it's ready for occupancy.[94]

An individual elects which residence is the individual's second residence.[95] An individual may elect a different residence (other than the individual's principal residence) to be the second residence each calendar year.[96] An individual needn't use the second residence during the calendar year, unless the individual rents the residence, holds it out for rental, holds it out for sale, or is repairing or renovating it with the intent to hold it out for rental or sale.[97] In any calendar year in which the individual rents the residence or engages in any of those other rental-related activities, however, the individual must use the residence for the greater of 14 days or 10% of the days during which the individual engages in those activities.[98] Otherwise, the residence won't qualify as a second residence.[99]

A married couple may claim only two residences as qualified residences regardless of their filing status. If a married couple doesn't file a joint return, each spouse may claim one residence as a qualified residence,

[80] IRC § 63(f)(2).
[81] IRC § 63(f) and Rev. Proc. 2023-34.
[82] IRC § 63(f)(2).
[83] IRC §§ 63(f)(2)(B) and 151(b).
[84] IRC § 63(c)(5) and Rev. Proc. 2023-34.
[85] Id.
[86] IRC §§ 163(a), (h)(1), and (h)(3)(A)(i).
[87] IRC § 163(h)(3)(A). Qualified residence interest also includes interest on home equity indebtedness, but the interest on home equity indebtedness currently is nondeductible. IRC § 163(h)(3)(F)(i)(I). It was deductible before 2018 and, absent further legislative changes, will again be deductible after 2025. IRC § 163(h)(3)(F)(i).
[88] IRC § 163(h)(3)(B)(i)(I).
[89] IRC § 163(h)(3)(B)(i)(II). Treas. Reg. § 1.163-10T(o).
[90] IRC § 163(h)(3)(B)(i) (flush language).
[91] IRC § 163(h)(4)(A)(i).
[92] Treas. Reg. § 1.163-10T(p)(3)(i) (flush language).
[93] Treas. Reg. §§ 1.163-10T(p)(3)(ii) and (q)(1).
[94] Treas. Reg. § 1.163-10T(p)(5)(i).
[95] IRC § 163(h)(4)(A)(i)(II).
[96] Treas. Reg. § 1.163-10T(p)(3)(iv).
[97] Treas. Reg. § 1.163-10T(p)(3)(iii).
[98] IRC § 280A(d) and Treas. Reg. § 1.163-10T(p)(3)(iii).
[99] Id.

unless one spouse consents to the other spouse claiming two residences as qualified residences.[100] The consent must be in writing.[101]

There are limits on how much debt qualifies as acquisition indebtedness. For acquisition indebtedness incurred before 2018, no more than $1 million of the indebtedness (or $500,000 in the case of a married individual filing separately) can qualify as acquisition indebtedness during a calendar year.[102] For acquisition indebtedness incurred after 2017, no more than $750,000 of an individual's indebtedness (or $375,000 in the case of a married individual filing separately) can qualify as acquisition indebtedness during a calendar year.[103] Absent further legislative changes, the limit on acquisition indebtedness will again be $1 million (or $500,000 in the case of a married individual filing separately) after 2025, and these limits will again apply regardless of when the debt was incurred.[104]

For a more in-depth discussion of the deduction for qualified residence interest, see Todd D. Mayo, *Tax-Aware Borrowing* (a publication of the UBS Advanced Planning Group).

Home equity loans

An individual currently can't deduct interest on home equity indebtedness.[105] The interest on home equity indebtedness was deductible before 2018 and, absent further legislative changes, will again be deductible after 2025.[106]

Investment interest

An individual generally may deduct investment interest.[107] Investment interest is any interest that the individual pays on indebtedness allocable to property that the individual holds for investment.[108] Investment interest, however, doesn't include any qualified residence interest.[109]

Property held for investment generally includes any property that produces income from taxable interest, dividends, annuities, or royalties.[110] The property that the individual holds doesn't actually have to produce income; it just must be the type of property that normally would produce income.[111] For example, stock in a corporation can qualify as property held for investment regardless of whether the corporation is paying dividends.[112] Property held for investment also generally includes property that produces capital gain or loss upon its sale or disposition.[113]

An individual can only deduct investment interest against net investment income. During a calendar year, an individual can deduct investment interest to the extent that it doesn't exceed the individual's net investment income.[114] The individual may carry forward the excess, deducting it in future years subject to this same limitation.[115]

An individual's net investment income is the individual's investment income reduced by the individual's investment expenses.[116] Investment income generally includes income from property that the individual holds for investment.[117] Investment expenses generally include expenses (other than interest) directly connected with the production of investment income.[118]

[100] IRC § 163(h)(4)(A)(ii).
[101] Id.
[102] IRC §§ 163(h)(3)(B)(ii), (h)(3)(F)(i)(II), and (h)(3)(F)(i)(III). In some cases, this limit applies to acquisition indebtedness incurred to buy a principal residence before April 1, 2018. IRC § 163(h)(3)(F)(i)(IV).
[103] IRC §§ 163(h)(3)(B)(ii) and (h)(3)(F)(i)(II).
[104] IRC §§ 163(h)(3)(F)(i)(II) and (h)(3)(F)(ii).
[105] IRC § 163(h)(3)(F)(i)(I).
[106] IRC § 163(h)(3)(F)(i).
[107] IRC §§ 163(a) and (d)(1).
[108] IRC § 163(d)(3)(A).
[109] IRC § 163(d)(3)(B). Investment interest also doesn't include any passive activity interest.
[110] IRC § 163(d)(5).
[111] *Russon v. Commissioner*, 107 T.C. 263 (1996).
[112] Id.
[113] IRC § 163(d)(5).
[114] IRC § 163(d)(1).
[115] IRC § 163(d)(2).
[116] IRC § 163(d)(4)(A).
[117] IRC § 163(d)(4)(B). Long-term capital gain and qualified dividend income is generally excluded from investment income, unless the individual makes an election to include all or part of that income in investment income. IRC § 163(d)(4)(B)(ii). Long-term capital gain and qualified dividend income that is included in investment income is taxed at ordinary income rates. IRC § 1(h)(2).
[118] IRC § 163(d)(4)(C).

Student loan interest
An individual potentially can deduct interest on student loans.[119] The individual must have incurred the loan solely to pay their, their spouse's, or their descendant's qualifying higher education expenses.[120] If the individual refinances such a loan, the new loan (and any subsequent refinancing) qualifies.[121] An intrafamily loan, however, doesn't qualify.[122] A married individual may deduct the interest on student loans only if they and their spouse file jointly.[123] An individual who is another person's dependent cannot deduct any interest on student loans (but the person claiming them as a dependent potentially can deduct that interest).[124]

An individual generally can deduct up to $2,500 of interest on student loans.[125] The deduction, however, phases out based on the individual's modified adjusted gross income.[126] Modified adjusted gross income is adjusted gross income calculated without regard to certain exclusions (e.g., the exclusion for certain foreign earned income) and without regard to certain deductions (e.g., the deduction for contributions to a traditional individual retirement account (IRA)).[127] Table 2 shows the phase-out of the deduction in 2024.

Table 2

Phase-out of deductibility of student loan interest in 2024.

	The phase-out begins when modified adjusted gross income exceeds	The deduction is fully phased out when modified adjusted gross income exceeds
Married individual filing jointly	$165,000	$195,000
Married individual filing separately	$80,000	$95,000
Unmarried individual (other than a surviving spouse or head of household)	$80,000	$95,000
Head of household	$80,000	$95,000
Surviving spouse	$80,000	$95,000

Source: Rev. Proc. 2023-34

State and local income, sales, and property taxes
An individual generally may deduct any state and local income and property taxes that the individual pays during the calendar year.[128] Alternatively, an individual may elect to deduct state and local general sales taxes in lieu of deducting state and local income taxes.[129] In 2024, an individual generally can deduct no more than $10,000 of state and local property and income taxes.[130] In the case of a married individual filing separately, the individual generally can deduct no more than $5,000 of state and local property and income taxes.[131]

Many states have enacted a workaround, which enables some individuals to avoid the limitation on the deductibility of state and local taxes with respect to certain income allocated to them through pass-through entities. The workaround involves an entity-level tax and a (generally) offsetting tax benefit for its owners. The state imposes an income tax on a pass-through entity, such as a partnership, a limited liability company that's classified as a partnership for federal tax purposes, or an S corporation.[132] This tax, which is sometimes called a pass-through entity tax, is elective.

[119] IRC §§ 221(a) and (b)(1).
[120] IRC § 221(d)(1).
[121] IRC § 221(d)(1) (flush language).
[122] Id.
[123] IRC § 221(e)(2).
[124] IRC § 221(c).
[125] IRC §§ 221(a) and (b)(1).
[126] IRC § 221(b)(2).
[127] IRC § 221(b)(2)(C).
[128] IRC § 164(a).
[129] IRC § 164(b)(5).
[130] IRC § 164(b)(6)(B). In 2025, an individual generally can deduct no more than $10,000 of state and local property and income taxes (or $5,000 in the case of a married individual filing separately). In 2026, however, an individual generally can deduct an unlimited amount of state and local property and income taxes. IRC § 164(b)(6).
[131] Id.
[132] An S corporation is an entity that's classified as a corporation for federal tax purposes and elects to be taxable as an S corporation. IRC § 1361(a).

For a more in-depth discussion of the workarounds, see Todd D. Mayo, *SALT Cap Workarounds* (a publication of the UBS Advanced Planning Group).

Casualty losses
An individual generally can deduct any casualty losses relating to business or investment property.[133] An individual generally can deduct any casualty losses relating to non-business, non-investment property (e.g., a house used for personal use) if the loss exceeds $100 and is caused by a federally declared disaster.[134]

The amount of the loss generally is the lesser of:
- the decline in the property's fair market value as a result of the casualty (i.e., the fair market value immediately before the casualty minus the fair market value immediately after the casualty), or
- the individual's adjusted basis in the property.[135]

The amount of the loss, however, is the individual's adjusted basis in the property if:
- the property is used in a trade or business and is totally destroyed by the casualty,
- the property is held for investment and is totally destroyed by the casualty, or
- the fair market value of the property immediately before the casualty was less than the individual's adjusted basis in the property.[136]

The amount of the loss is reduced by the property's salvage value[137] and any insurance or other compensation for the loss is received or reasonably recoverable.[138]

The loss of value may be substantiated by a competent appraisal of the property's fair market values before and after the casualty.[139] Alternatively, the loss of value may be substantiated by the cost of repairs if four conditions are met.[140] First, the repairs must be necessary to restore the property to its condition immediately before the casualty. Second, the amount spent for the repairs can't be excessive. Third, the repairs must be limited to fixing the damage suffered by the casualty. Fourth, the repairs can't cause the value of the property after the repairs to exceed the value of the property immediately before the casualty.

In the case of a loss occurring in a disaster area as the result of a federally declared disaster, an individual may claim the casualty loss deduction in the year of the loss or may elect to claim the deduction in the year immediately preceding the year of the loss.[141]

Charitable contributions
Subject to a myriad of rules, an individual can deduct a contribution to a charitable organization.[142] In the case of a contribution of property other than money, the amount of the contribution depends on the type of property contributed, the type of charitable organization to which it's contributed, and, in some cases, the purposes for which the property will be used.[143] The individual's deduction is subject to percentage limitations, which limit the deduction based on the type of organization to which the contribution is made and on the individual's adjusted gross income.[144] The amount of contributions that exceed these percentage limitations are carry forward for up to five years.[145]

For a more in-depth discussion of the income tax charitable deduction, see the chapter entitled "Charitable Giving."

[133] IRC §§ 165(a), (c)(1), and (c)(2).
[134] IRC §§ 165(a), (c)(3), (h)(1), and (h)(5)(A). In addition, an individual can only deduct personal casualty losses to the extent that the net amount of such losses exceeds 10% of the individual's adjusted gross income. IRC § 165(h)(2)(A).
[135] Treas. Reg. § 1.165-7(b)(1).
[136] Id.
[137] Treas. Reg. § 1.165-1(c)(4).
[138] IRC § 165(a).
[139] Treas. Reg. § 1.165-7(a)(2)(i).
[140] Treas. Reg. § 1.165-7(a)(2)(ii).
[141] IRC § 165(i).
[142] IRC § 170.
[143] See, e.g., IRC §§ 170(b), (c), and (e).
[144] Id.
[145] IRC §§ 170(b)(1)(C)(ii), (b)(1)(D)(ii), and (d)(1).

Medical expenses
An individual generally may only deduct unreimbursed medical expenses that exceed 7.5% of their adjusted gross income.[146]

Planning tip
To the extent possible, an individual might bunch medical expenses together in a single year, so that, in the aggregate, more of the expenses exceed the 7.5% floor and are thus deductible.

Qualified business income
An individual potentially may deduct a portion of the income received from a sole proprietorship or pass-through entity. More specifically and subject to various limitations, an individual may deduct the lesser of (1) 20% of their qualified business income (QBI) plus 20% of the sum of their qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income or (2) 20% of the amount by which their taxable income exceeds their net capital gain.[147]

QBI generally is the net amount of income, gain, deduction, and loss from a qualified trade or business, including income from a sole proprietorship, partnership, or S corporation.[148] QBI, however, doesn't include certain items. For example, it does not include portfolio income, such as capital gains, dividends, and interest (other than interest that is properly allocable to a trade or business).[149] It also does not include wage income, reasonable compensation from an S corporation, or guaranteed payments from a partnership.[150] QBI doesn't include qualified REIT dividends or qualified publicly traded partnership income (to which separate rules apply).

A qualified trade or business is any trade or business other than:

- a trade or business conducted by a C corporation,
- the trade or business of performing services as an employee, or
- under certain conditions, a specified service trade or business.[151]

The trade or business generally must be conducted within the United States.[152]

For QBI from a specified service trade or business, an individual's deduction phases out based on taxable income. In 2024, the individual's deduction phases out if their taxable income exceeds:

- $483,900 in the case of a married individual filing jointly, or
- $241,950 in the case of any other individual.[153]

In 2024, the individual's deduction is fully phased out and the specified service trade or business doesn't qualify as a qualified trade or business if the individual's taxable income exceeds:

- $583,900 in the case of a married individual filing jointly, or
- $291,950 in the case of any other individual.[154]

These amounts adjust annually for inflation.[155]

A specified service trade or business includes:

- farming (including raising or harvesting trees),
- providing healthcare services,
- providing accounting, actuarial science, consulting, law, or professional services,
- providing performing arts or athletics services,
- providing financial services or brokerage services,
- engaging in banking, insurance, financing, leasing, investing, or a similar business,
- producing or extracting oil, natural gas, or minerals,
- operating a hotel, motel, restaurant, or similar business, and
- any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.[156]

[146] IRC § 213(a).
[147] IRC § 199A(a) and (b). For purposes of this deduction, taxable income is calculated without regard to this deduction. IRC § 199A(e)(1).
[148] IRC § 199A(c).
[149] IRC § 199A(c)(3)(B).
[150] IRC § 199A(c)(4).
[151] IRC §§ 199A(a) and (d)(1).
[152] IRC § 199A(c)(3)(A)(i).
[153] IRC §§ 199A(b)(3) and Rev. Proc. 2023-34.
[154] Id.
[155] IRC § 199A(e)(2)(B)(ii).
[156] IRC § 199A(d)(2).

Capital gains and losses

Capital gains potentially enjoy more favorable treatment than ordinary income. In 2024, the top marginal rate for long-term capital gain generally is 20% (although that notches up to 23.8% if the net investment income tax applies). In contrast, the top marginal rate for ordinary income is 37%.[157] This more favorable treatment, however, doesn't extend to short-term capital gains, which generally are subject to the same tax rate as ordinary income but are also potentially subject to the net investment income tax. Thus, the top marginal rate for short-term capital is 37% (which notched up to 40.8% if the net investment income tax applies).

Capital gain is the gain from the sale or disposition of a capital asset.[158] Similarly, a capital loss is the loss from the sale or disposition of a capital asset.[159] A capital asset generally is any property held for personal use or investment and any non-depreciable property used in a trade or business.[160] Upon a sale or exchange of a capital asset, an individual's gain or loss will be either short-term or long-term. If the individual has held the asset for one year or less, it's a short-term gain or loss.[161] If the individual has held the asset for more than one year, it's a long-term gain or loss.[162] An individual's holding period typically begins when they acquire the property, but it sometimes includes the period that someone else held the property or they held different property.[163]

A special rule applies to profits interests in certain partnerships issued in connection with the performance of services. This rule applies to a profits interest received in exchange for providing substantial services in the trade or business of (1) raising or returning capital and (2) investing in, disposing of, or developing certain specified assets. Specified assets include securities, commodities, real estate held for rental or investment, cash and cash equivalents, and some options or derivative contracts.[164] Subject to certain exceptions, this rule generally applies to carried interest holders in many hedge funds and private equity funds but doesn't apply service partners in partnerships engaged in non-real estate trades or businesses.[165]

For a profits interest subject to this special rule, there's generally a three-year holding period requirement (rather than a one-year requirement) for purposes of obtaining long-term capital gain treatment. If the individual has held the profits interest for three years or less, any gain from the sale or exchange of the profits interest generally is short-term capital gain.[166] If the individual has held the profits interest for more than three years, any gain from the sale or exchange of the profits interest generally is long-term capital gain, subject to certain anti-abuse rules.[167] In addition, gain that flows through from the partnership to the individual holding the profits interest is treated as short-term capital gain if the partnership has held the asset giving rise to the gain for less than three years.[168]

An individual's long-term capital gains potentially include their net gains from the sale, exchange, or involuntary

[157] See IRC §§ 1(h), (j)(2), and 1411(a). As discussed below, certain types of capital gain may be subject to a 25% or 28% top marginal rate. Although the net investment income tax does not apply to ordinary income, the Medicare tax (at a 2.9% rate) and Medicare surtax for highly compensated individuals (at a 0.9% rate) apply to self-employment income (thus collectively imposing an additional 3.8% tax on that income). IRC §§ 1401(b)(1) and (2). One half of those taxes are deductible in calculating adjusted gross income. IRC § 164(f). An individual's wages are also subject to the Medicare tax and Medicare surtax, but the employer is responsible for one-half of those taxes. IRC § 3101(b). Employees and self-employed individuals pay social security taxes as well, which apply to the first $168,600 of income in 2024. IRC §§ 1401(a) and 3101(a).
[158] See IRC §§ 1001, 1221, and 1222.
[159] See IRC §§ 1001, 1221, and 1222.
[160] IRC § 1221. Inventory, property held primarily for sale to customers, self-created patents, inventions, formulas, and models, and accounts or notes receivable, however, aren't capital assets. IRC §§ 1221(a)(1), (a)(3), (a)(4), and (b)(3).
[161] IRC §§ 1222(1) and (2).
[162] IRC §§ 1222(3) and (4).
[163] IRC § 1223.
[164] IRC §§ 1061(c)(2) and (3). In tax parlance, this is an *applicable partnership interest*.
[165] Treas. Reg. §§ 1.1061-1 and -3. While this rule ostensibly covers real estate funds, the gain often earned by real estate ventures is excluded from the three-year holding period requirement. See Treas. Reg. § 1.1061-4(b)(7)(i).
[166] IRC § 1061(a) and Treas. Reg. §§ 1.1061-4(a)(1), (2), and (4). Again, certain types of gain are excluded from this special rule. Treas. Reg. § 1.1061-4(b)(7).
[167] IRC § 1061(a) and Treas. Reg. §§ 1.1061-4(a)(1), (2), and (4). An anti-abuse look-through rule may recharacterize this gain as short-term capital gain if (1) the holding period would be less than three years without including periods before an unrelated service provider was required to contribute capital or (2) transactions were entered into with the purpose of avoiding potential short term gain recognition under section 1061. Treas. Reg. § 1.1061-4(b)(9)(i)(A). In addition, special rules apply in the case of a transfer to a related party. IRC § 1061(d) and Treas. Reg. § 1.1061-5.
[168] IRC § 1061(a) and Treas. Reg. §§ 1.1061-4(a)(1), (2), and (3). Again, certain types of gain are excluded from this special rule. Treas. Reg. § 1.1061-4(b)(7).

conversion of depreciable property used in a trade or business.[169] Similarly, an individual's long-term capital loss potentially includes their net losses from the sale, exchange, or involuntary conversion of depreciable property used in a trade or business.[170]

In some cases, the gain or loss from a sale or disposition isn't recognized (i.e., taken into account for purposes of calculating gross income). These nonrecognition events include tax-free corporate reorganizations, like-kind exchanges, and involuntary conversions.[171] In addition, certain gains are excludable, and certain losses are disallowed or limited.[172] We explore some of these rules below.

Calculating gain or loss

Upon the sale or disposition of property, an individual generally realizes gain to the extent their amount realized exceeds their adjusted basis in the property.[173] Similarly, upon the sale or disposition of property, an individual generally realizes loss to the extent their adjusted basis in the property exceeds their amount realized.[174]

Property includes digital assets. For federal income tax purposes, digital assets are virtual currency and non-fungible tokens (NFTs).[175] Virtual currency is any digital representation of value that functions as a medium of exchange, a unit of account, or a store of value.[176] An NFT is unique digital code that generally denotes digital ownership of a piece of media (such as a work of art, song, or video), provides the holder with a right to attend an event, or certifies ownership of a physical item.

For a more in-depth discussion of the income taxation of digital assets, see Lora Cicconi, *Federal Income Taxation of Digital Assets* (a publication of the UBS Advanced Planning Group).

Amount realized

The amount realized from the sale of disposition of property generally is the amount of money received plus the fair market value of any property received.[177] Thus, it's commonly the sale price.

Basis

An individual's adjusted basis is their initial basis after various adjustments.[178] There's an array of expenditures, allowable deductions, and transactions that can require an adjustment to basis.[179] For example, in the case of real property, these include adjustments for certain capital improvements, allowable depreciation and depletion deductions.[180]

An individual's initial basis depends on how they acquired the property. While an individual can acquire property in a variety of ways having an effect on the individual's initial basis in the property, we'll focus on three common ways: (1) by purchase, (2) by gift, and (3) by inheritance.

If the individual purchased the property, their basis typically is their cost of acquiring the property.[181] This is *cost basis*.

If the individual received the property as a gift, their basis generally is the donor's adjusted basis (increased by any gift tax paid with respect to the gift).[182] This is *carryover basis*. Things get a little more complicated, however, if the property's fair market value was less than the donor's adjusted basis at the time of the gift. In that case, the individual's basis is the donor's adjusted basis (increased by any gift tax paid with respect to the gift) for purposes of calculating gain and the fair market value of the property on the date of the gift (increased by any gift tax paid with respect to the gift) for purposes of calculating any loss.[183]

[169] IRC § 1231(a)(1). In tax parlance, these are section 1231 gains and section 1231 losses. To the extent section 1231 losses exceeds section 1231 gains, the net loss is an ordinary loss. IRC §§ 65 and 1231(a)(2).
[170] Id.
[171] See, e.g., IRC §§ 354, 1031, and 1033.
[172] See, e.g., IRC §§ 121, 267, and 1202.
[173] IRC § 1001(a).
[174] Id.
[175] "Digital Assets," IRS, https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets.
[176] Notice 2014-21. See note 8.
[177] IRC § 1001(b).
[178] IRC § 1011(a).
[179] IRC § 1016(a).
[180] Id.
[181] IRC § 1012(a).
[182] IRC §§ 1015(a) and (d).
[183] Id.

If the individual received the property from a deceased individual and the property was included in the deceased individual's gross estate for estate tax purposes, their basis generally is the property's fair market value on (1) the date of the deceased individual's death or (2) the alternate valuation date if the deceased individual's estate elects to use the alternative valuation.[184] This is *stepped-up basis*, although it's possible the individual inheriting the property will have an initial basis that's less than the deceased individual's basis. If, however, the property is income in respect of a decedent, the individual inheriting the property doesn't get a stepped-up basis.[185] In addition, if the individual inheriting the property or their spouse had given the property to the deceased individual within one year of the deceased individual's death, the individual inheriting the property doesn't get a stepped-up basis.[186] Instead, their basis is the deceased individual's adjusted basis.[187]

Home sale gain exclusion

An individual potentially can exclude some or all of the gain from the sale or exchange of a principal residence. Married individuals filing jointly generally may exclude up to $500,000 of gain.[188] Other individuals generally may exclude up to $250,000 of gain.[189] An individual can't claim the exclusion more than once every two years.[190]

During the five-year period ending on the sale or exchange, the individual must have owned and used the property as their principal residence for a period aggregating two or more years.[191] For purposes of this exclusion, an individual generally is treated as owning a property that's owned by a revocable trust or other trust that's a grantor trust with respect to the individual[192] or an entity that's disregarded for federal income tax purposes (e.g., a single-member limited liability company that hasn't elected to be classified as a corporation for tax purposes and is wholly owned by the individual).[193]

A houseboat, a house trailer, or the house or apartment that the taxpayer is entitled to occupy as a tenant-stockholder in a cooperative housing corporation can qualify as a residence.[194] If an individual has more than one residence, their principal residence generally is the residence they use the majority of the time, although other factors also are relevant in determining which residence is the principal residence.[195]

Wash-sale rule

Under the wash-sale rule, a loss upon a sale of securities is generally disallowed if, within 30 days before the sale and 30 days after the sale:

- the individual buys substantially identical securities,[196]
- the individual acquires substantially identical securities in an exchange that's fully taxable for income tax purposes,[197]
- the individual enters into a contract or option to buy substantially identical securities,[198]
- the individual acquires substantially identical securities in a traditional IRA or Roth IRA,[199] or
- a corporation that the individual controls acquires substantially identical securities.[200]

In addition, under the wash-sale rule, a loss upon a sale of securities is potentially disallowed if, within 30 days

[184] IRC § 1014(a).
[185] IRC § 1014(c).
[186] IRC § 1014(e).
[187] Id.
[188] IRC §§ 121(a) and (b)(2).
[189] IRC §§ 121(a) and (b)(1).
[190] IRC §§ 121(a) and (b)(3).
[191] IRC § 121(a). See Treas. Reg. § 1.121-1(a).
[192] Treas. Reg. § 1.121-1(c)(3)(i).
[193] Treas. Reg. § 1.121-1(c)(3)(ii).
[194] Treas. Reg. § 1.121-1(b)(1).
[195] Treas. Reg. § 1.121-1(b)(2).
[196] IRC § 1091(a). The statute uses the phrase "stock or securities." For simplicity, we will use the term "securities."
[197] IRC § 1091(a). See also Treas. Reg. § 1.1091-1(f).
[198] Id.
[199] Rev. Rul. 2008-5.
[200] *Kaplan v. Commissioner*, 21 T.C. 134, 141-42 (1953). See also *Publication 550 (2022): Investment Income and Expenses* ("If you sell stock and … a corporation you control buys substantially identical stock, you also have a wash sale").

before the sale and 30 days after the sale the individual's spouse acquires substantially identical securities.[201] There are limited exceptions for a sale in connection with a trade or business and for a sale by a dealer in securities.[202] A redemption of shares of a money market fund is not subject to the wash-sale rule.[203]

Whether two securities are substantially identical depends on the facts and circumstances.[204] In the most obvious situation, shares of a company's stock are substantially identical when they are the same (i.e., issued by the same company and of the same type and class). In contrast, a bond or preferred stock issued by a company usually isn't substantially identical to common stock issued by the company.[205] Under certain conditions, however, a convertible bond or convertible preferred stock might be substantially identical to common stock.[206] For example, convertible preferred stock is substantially identical to common stock if it:

- has the same voting rights as the common stock,
- is subject to the same dividend restrictions,
- sells at prices that do not vary significantly from the conversion ratio, and
- is unrestricted as to convertibility.[207]

Securities issued by a company typically aren't substantially identical to the securities issued by another company.[208] An actively managed fund typically isn't substantially identical to a passively managed fund. A fund that tracks an index, however, might be substantially identical to another one that tracks the same index.

An individual who owns shares of a company's stock, wants to recognize the unrealized loss in those shares, but doesn't want to wait 31 days to buy back the shares might consider replacing the shares with a security that's tied to the company's industry or sector. This investment potentially can serve as a temporary, approximate proxy for the company shares while enabling the individual to recognize the loss on their original position.

If the wash-sale rule applies, the individual's basis in the substantially identical securities generally includes the disallowed loss, allowing the individual to recognize loss when the investment is ultimately closed out.[209] The basis of substantially identical securities acquired in a traditional IRA or Roth IRA, however, don't include the disallowed loss.[210]

Qualified small business stock

An individual who owns qualified small business (QSB) stock can potentially defer or exclude gain on the sale or disposition of the stock. They can generally defer gain by reinvesting it in other QSB stock, and they can generally avoid any income tax on any excludable gain.

For shares to qualify as QSB stock, they must satisfy an intricate array of company-level requirements and shareholder-level requirements. In terms of the company-level requirements for QSB stock, a company must be organized in the United States, and it must be classified as a C corporation.[211] The shares of a company organized outside of the United States, thus, won't qualify as QSB stock. Likewise, the equity of a company that's classified as a partnership for federal income tax purposes won't qualify as QSB stock.

201 *Estate of Mitchell v. Commissioner*, 37 B.T.A. 161 (1938) (losses disallowed because a husband exercised dominion and control over securities bought by his wife). See also *Publication 550 (2022): Investment Income and Expenses* ("If you sell stock and your spouse … buys substantially identical stock, you also have a wash sale"). The wash-sale rule, however, might not apply if the spouses act sufficiently independently of one another. *Young v. Commissioner*, 34 B.T.A. 648, 652–53 (1936), and *Behan v. Commissioner*, 32 B.T.A. 1088, 1091–92 (1935).
202 The wash-sale rule does not apply to a (1) a person (other than a corporation) who sells or disposes of the security in connection with their trade or business or (2) a dealer in stock or securities who sells or disposes of the security in in the ordinary course of their business as a dealer. Treas. Reg. § 1.1091-1(a).
203 Rev. Proc. 2023-35
204 Treas. Reg. § 1.1233-1(d)(1). See also Rev. Rul. 77-201 (noting that Treas. Reg. §1.1233-1(d) "defin[es] the term 'substantially identical property' for purposes of Section 1091 of the [Internal Revenue] Code").
205 Id.
206 Id.
207 Rev. Rul. 77-201, 1977-1 C.B. 250.
208 Treas. Reg. § 1.1233-1(d)(1).
209 IRC § 1091(d). See also Treas. Reg. § 1.1091-2 and IRC § 1223(4) (including the period in which the taxpayer held the original securities in the holding period for the reacquired securities).
210 Rev. Rul. 2008-5.
211 IRC § 1202(c)(1). A C corporation is an entity that is classified as a corporation for federal tax purposes and for which an election to be taxable as an S corporation is not in effect. IRC § 1361(a)(2).

For example, membership interests in a multi-member limited liability company won't qualify as QSB stock if the company is classified as a partnership for tax purposes.[212]

The company also must engage in a qualified trade or business.[213] A qualified trade or business generally is a trade or business other than:

- farming (including raising or harvesting trees),
- providing healthcare services,
- providing accounting, actuarial science, consulting, law, or professional services,
- providing engineering or architecture services,
- providing performing arts or athletics services,
- providing financial services or brokerage services,
- engaging in banking, insurance, financing, leasing, investing, or a similar business,
- producing or extracting oil, natural gas, or minerals, or
- operating a hotel, motel, restaurant, or similar business.[214]

In addition, the company's gross assets must not exceed $50 million immediately after it issues the shares

> A shareholder's ability to defer or exclude gain upon the sale of QSB stock is based in part on the shareholder's holding period.

(and generally must not have exceeded that amount any time before then).[215] If they do, the shares won't qualify as QSB stock. The company's gross assets are its cash and, subject to certain adjustments, the aggregate adjusted basis of its other assets.[216]

In terms of the shareholder-level requirements for QSB stock, the shareholder must have acquired the shares from the company either in exchange for money or other property (other than stock) or for the performance of services to the company.[217] Alternatively, the shareholder must have acquired the shares by gift, upon the death of another shareholder, or from a partnership of which the shareholder was a partner, and the shares must have qualified as QSB stock in the prior shareholder's hands.[218] (For this purpose, a partnership is an entity classified as a partnership for tax purposes.) Shares acquired by purchase from another shareholder in a taxable transaction will not qualify as a QSB stock.[219] Moreover, shares that previously qualify as QSB stock may cease to be QSB stock if the company engages in certain redemption transactions.[220] The company must have issued the shares after August 10, 1993.[221]

A shareholder's ability to defer or exclude gain upon the sale of QSB stock is based in part on the shareholder's holding period. A shareholder who has held shares of QSB stock for more than six months potentially can defer the gain from the sale or disposition of those shares.[222] A shareholder who has held shares of QSB stock for more than five years potentially can exclude some or all of the gain from the sale or disposition of those shares.[223] A shareholder's holding period generally begins when the company grants the shares to them.[224]

[212] A company that's classified as a partnership can convert into a company that's classified as a C corporation, and the converted company's shares potentially could qualify as QSB stock. The converted company must meet all of the requirements for a QSB issuer at the time of the conversion, and the stock must meet all of the requirements of QSB stock. IRC §§ 1202(c)(1) and (i)(1).
[213] IRC § 1202(c)(1).
[214] IRC § 1202(e)(3).
[215] IRC §§ 1202(d)(1)(A) and (B). For this purpose, gross assets means the amount of cash and the aggregate adjusted tax basis of other property held by the corporation, except in the case of property contributed to a corporation, in which case the fair market value governs rather than tax basis. IRC §§ 1202(d)(1)(2)-(3).
[216] IRC § 1202(d)(2)(A).
[217] IRC § 1202(c)(1)(B).
[218] IRC § 1202(h)(2).
[219] See IRC §§ 1202(h)(1) and (2). See also IRC § 1202(g).
[220] IRC § 1202(c)(3).
[221] IRC § 1202(c)(1).
[222] IRC § 1045(a).
[223] IRC §§ 1202(a) and (b).
[224] IRC § 1202(c)(1)(B).

A shareholder who has held shares of QSB stock for more than six months can defer the gain from the sale or disposition of those shares by investing the gain in other shares that qualify as a QSB stock.[225] Those shares may be shares of either a startup or a more established company. The shareholder must invest the gain within 60 days after the sale or disposition.[226] This deferral is elective, and the shareholder makes the election on their income tax return.[227]

A shareholder who has held shares of QSB stock for more than five years can exclude the gain from the sale or disposition of those shares.[228] The shareholder generally can exclude the greater of:
- $10 million or
- 10 times the shareholder's adjusted basis in the QSB stock.[229]

The exclusion applies on a per-company basis.

A married individual filing separately can generally exclude the greater of $5 million or 10 times their adjusted basis in the QSB stock.[230] There's uncertainty around the amount that a married couple filing jointly can exclude. On the one hand, the rule that applies to a married individual filing separately might be read to imply that a married couple filing jointly generally can exclude the greater of $10 million or 10 times their adjusted basis in the QSB stock. On the other hand, other aspects of federal income taxation potentially support the position that a married couple filing jointly generally can exclude the greater of $20 million or 10 times their adjusted basis in the QSB stock.

For purposes of the 10-times basis limitation, a shareholder's basis of QSB stock received in exchange for a contribution of property (other than money or stock) is the fair market value of the property contributed to the corporation.[231] In addition, a shareholder's adjusted basis of QSB stock is determined without regard to any addition to their basis after the date on which the stock was originally issued.[232] Accordingly, certain basis adjustments, such as stepped-up basis (but not stepped-down basis) on shares includable in a decedent's gross estate for estate tax purposes, are disregarded.

For shares of QSB stock issued after September 27, 2010, 100% of the gain is excludable. For shares issued after February 17, 2009, and before September 28, 2010, a shareholder can exclude 75% of the gain. For shares issued after August 10, 1993, and before February 18, 2009, a shareholder can exclude 50% of the gain.

For a more in-depth discussion of QSB stock, see Todd D. Mayo, *Qualified Small Business Stock* (a publication of the UBS Advanced Planning Group).

Qualified opportunity funds

A qualified opportunity fund is an entity that's organized for the purpose of investing in qualified opportunity zone property (other than other qualified opportunity funds).[233] An individual who realizes capital gains and invests in a qualified opportunity fund generally may elect to defer those gains.[234] The individual generally must invest in the fund within a 180-day period beginning on the day on which they realized the gains they are electing to defer.[235] The amount of deferred gains can't exceed the amount of the investment in the qualified opportunity fund.[236]

[225] IRC § 1045(a).
[226] IRC § 1045(a)(1).
[227] IRC § 1045(a); Rev. Proc. 98-48, 1998. See also Treas. Reg. § 1.1045-1(h). Under certain circumstances, the IRS has allowed a shareholder to make a late election. For example, in one case, the IRS allowed a late election where the shareholder's accountant failed to make the election on the appropriate income tax return, even though the accountant was aware the shareholder intended to make the election. PLR 202245003 (November 11, 2022).
[228] IRC §§ 1202(a) and (b).
[229] Id.
[230] IRC § 1202(b)(3)(A).
[231] IRC § 1202(i)(1)(B).
[232] IRC § 1202(b) (flush language).
[233] IRC § 1400Z-2(d)(1) and Treas. Reg. § 1.1400Z2(d)-1(a)(1)(i). A qualified opportunity fund must be classified as a corporation or partnership for federal income tax purposes, it generally must be organized in the United States, and it must hold at least 90% of its assets in qualified opportunity zone property. Treas. Reg. § 1.1400Z2(d)-1(a)(1)(i) and (ii).
[234] IRC § 1400Z-2(a)(1)(A) and Treas. Reg. § 1.1400Z2(a)-1(b)(13). A comment on word usage. It may be more precise to say an individual who realizes capital gains and invests in a qualified opportunity fund generally may elect to defer the *recognition* those gains. For simplicity, however, we'll often speak in terms of the person deferring gains.
[235] IRC § 1400Z-2(a)(1)(A). See also Treas. Reg. § 1.1400Z2(a)-1(b)(7).
[236] Treas. Reg. § 1.1400Z2(a)-1(c)(6)(i). To the extent the amount of the investment exceeds the deferred gain, the excess is a non-qualifying investment. Id.

An individual can defer eligible gains.[237] Eligible gains are short-term and long-term capital gains recognized before 2027[238] other than gains that are characterized as ordinary income.[239] Eligible gains also don't include gains from a sale or exchange with a related person.[240] The deferral ends on the earlier of:

- an inclusion event (e.g., a sale, exchange, or, in certain cases, transfer of an interest in the qualified opportunity fund);[241] and
- December 31, 2026.[242]

For an individual who holds a qualifying investment (which generally is an interest a qualified opportunity fund to the extent an election to defer eligible gains has been properly made) for five or more years, 10% of the deferred gain is forgiven. More specifically, once the individual has held the qualifying investment for five years, there's a basis adjustment; the individual's basis in the investment generally is increased by an amount equal to 10% of the deferred gain.[243] Since all remaining deferred gains will be recognized on December 31, 2026, this partial forgiveness benefits only individuals who invested in a qualifying investment on or before December 31, 2021. An individual who invested on January 1, 2022, or later won't qualify for the 10% basis adjustment, but they will not have held the investment for five or more years when the gains are recognized on December 31, 2026.

For an individual who holds a qualifying investment for seven or more years, an additional 5% of the deferred gain is forgiven. More specifically, once the individual has held the qualifying investment for seven years, there's another basis adjustment; the individual's basis in the investment generally is increased by an amount equal to 5% of the deferred gain.[244] Thus, for an individual who holds a qualifying investment for seven or more years, a total of 15% of the deferred gain is forgiven. Since all remaining deferred gains will be recognized on December 31, 2026, this partial forgiveness benefits only individuals who invested in a qualifying investment on or before December 31, 2019. An individual who invested on January 1, 2020, or later won't qualify for the additional 5% basis adjustment, because they will not have held the investment for seven or more years when the gains are recognized on December 31, 2026.

The deferral from investing in a qualified opportunity fund is not indefinite. An individual recognizes deferred gains on the earlier of:

- an inclusion event; and
- December 31, 2026.[245]

An inclusion event generally occurs upon:

- a sale, exchange, or (in certain cases) transfer of a qualifying investment;[246]
- a distribution of property from the qualified opportunity fund;[247]
- a claim for a deduction based on the interest in the qualified opportunity fund having become worthless;[248] and
- the fund ceasing to qualify as a qualified opportunity fund.[249]

When there's an inclusion event, the individual who holds the qualifying investment generally realizes the deferred gain, regardless of whether they receive any money or other property in connection with the inclusion event.[250] An individual who realizes gains upon an inclusion event and subsequently invests those gains in a qualified opportunity fund generally may elect to defer those gains.[251]

[237] Id. See also Treas. Reg. § 1.1400Z2(a)-1(a)(1).
[238] Treas. Reg. §§ 1.1400Z2(a)-1(b)(11)(i)(A) and (B).
[239] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(i)(A)(2).
[240] IRC § 1400Z-2(a)(1). See also Treas. Reg. § 1.1400Z2(a)-1(b)(11)(i)(C).
[241] Treas. Reg. § 1.1400Z2(b)-1(b)(1).
[242] Treas. Reg. § 1.1400Z2(b)-1(b)(2).
[243] IRC § 1400Z-2(b)(2)(B)(iii). See Treas. Reg. §§ 1.1400Z2(a)-1(b)(34) and 1.1400Z2(b)-1(g)(2). An individual's holding period generally begins when the individual makes the investment in the qualified opportunity fund. Treas. Reg. § 1.1400Z2(b)-1(d)(1)(i).
[244] IRC § 1400Z-2(b)(2)(B)(iv). See Treas. Reg. § 1.1400Z2(b)-1(g)(2). An individual's holding period generally begins when the individual makes the investment in the qualified opportunity fund. Treas. Reg. § 1.1400Z2(b)-1(d)(1)(i).
[245] Treas. Reg. § 1.1400Z2(b)-1(b).
[246] Treas. Reg. § 1.1400Z2(b)-1(c)(1)(i). More precisely, any event that, for income tax purposes, reduces a person's direct equity interest in a qualified opportunity fund generally is an inclusion event.
[247] Treas. Reg. § 1.1400Z2(b)-1(c)(1)(ii). The distribution must be treated as a distribution for income tax purposes.
[248] Treas. Reg. § 1.1400Z2(b)-1(c)(1)(iii).
[249] Treas. Reg. § 1.1400Z2(b)-1(c)(1)(iv).
[250] Treas. Reg. § 1.1400Z2(b)-1(b).
[251] IRC § 1400Z-2(a)(1)(A).

For a more in-depth discussion of qualified opportunity funds, see Todd D. Mayo, *Qualified Opportunity Funds* (a publication of the UBS Advanced Planning Group).

Worthless securities

An individual potentially can recognize a capital loss for any worthless securities that they hold. If a security is a capital asset and becomes worthless during 2024, then the individual is treated as having sold the security on December 31, 2024, and the individual recognizes a capital loss in 2024.[252] To be allowable, the loss must be evidenced by a closed and completed transaction, fixed by an identifiable event, and actually sustained during the tax year.[253] The taxpayer must have evidence that the security is worthless.[254]

An individual can't claim a loss in 2024 for a security that became worthless in a prior year, but the individual potentially may claim the loss by amending the tax return for the year in which the loss occurred.[255] Although an individual usually must file a refund claim within three years after filing their income tax return, the individual potentially can file a refund claim with respect to worthless securities within seven years after filing their income tax return.[256]

Netting gains and losses

An individual must net their recognized gains and losses. A short-term capital gain or loss arises upon the sale or exchange of a capital asset held for one year or less.[257] A long-term capital gain or loss arises upon the sale or exchange of a capital asset held for more than one year.[258] If their short-term capital gains exceed their short-term capital losses, the individual will have a net short-term capital gain.[259] Otherwise, the individual will have a net short-term capital loss.[260] Similarly, the individual must net their long-term capital gains and long-term capital losses. If their long-term capital gains exceed their long-term capital losses, the individual will have a net long-term capital gain.[261] Otherwise, the individual will have a net long-term capital loss.[262]

If an individual has a net long-term capital gain and that gain exceeds their net short-term capital loss, the excess is their net capital gain.[263] As we discuss below, net capital gain is taxed at a more preferential rate than ordinary income. In contrast, if the individual has a net short-term capital gain and that gain exceeds their net long-term capital loss, the excess is taxed as ordinary income.[264] In 2024, the top marginal rate for net capital gain generally is 20% (or 23.8% if the net investment income tax also applies), and the top marginal rate for ordinary income is 37%.[265]

If the individual's capital losses exceed their capital gains, the individual can deduct up to $3,000 (or $1,500 if the individual is a married individual filing separately) of the excess against ordinary income.[266] The individual can carry the nondeductible losses forward to offset net capital gains and ordinary income in future years indefinitely.[267] In each year into which they carry those losses forward, the individual can only deduct up to $3,000 (or $1,500 if the individual is a married individual filing separately) of those losses against ordinary income.[268] The losses that an individual carries forward retain their character as short-term or long-term capital losses.[269]

[252] IRC §§ 165(a) and (g).
[253] Treas. Reg. § 1.165-1(b).
[254] *Morton v. Commissioner*, 38 B.T.A. 1270, 1278-79 (1938)
[255] IRC § 6511(a).
[256] IRC §§ 6511(a) and (d)(1).
[257] IRC §§ 1222(1) and (2).
[258] IRC §§ 1222(3) and (4).
[259] IRC § 1222(5).
[260] IRC § 1222(6).
[261] IRC § 1222(7).
[262] IRC § 1222(8).
[263] IRC § 1222(11).
[264] See IRC § 1(h) and (j)(2).
[265] See IRC §§ 1(h), (j)(2), and 1411(a).
[266] IRC §§ 165(f) and 1211(b).
[267] Id.
[268] Id.
[269] IRC § 1212(b)(1).

Adjusted gross income

An individual's adjusted gross income is their gross income minus certain allowable deductions.[270] Commonly are called above-the-line deductions, these include deductions for:

- certain amounts attributable to a trade or business carried on by the individual (e.g., ordinary expenses, interest, taxes, and bad debts) other than a trade or business of being an employee,[271]
- certain losses from the sale or exchange of property, including certain casualty and theft losses that aren't compensated by insurance,[272]
- certain expenses attributable to property held for the production of rents or royalties,[273]
- alimony paid if the divorce occurred before 2019,[274]
- contributions to a health savings account,[275]
- contributions to a traditional IRA,[276]
- in the case of a self-employed individual, contributions to a SIMPLE IRA, simplified employee pension, or other pension, profit-sharing, annuity, or other qualified retirement plan,[277] and
- student loan interest (up to $2,500).[278]

In each case, various rules govern the deductibility of those amounts. For example, there are limits on deductible contributions to IRAs[279] and business interest.[280]

An individual can deduct above-the-line deductions regardless of whether they itemize their other deductions.[281] An individual's adjusted gross income affects the deductibility of some other deductions. For example, it determines the phaseout of the personal exemption,[282] the limitation on the casualty loss deduction,[283] and the limitation on the medical expense deduction.[284]

Taxable income

For an individual who elects to itemize deductions, taxable income is their gross income minus allowable deductions (other than the standard deduction).[285] For an individual who doesn't elect to itemize deductions, taxable income is their adjusted gross income minus:

- the standard deduction, and
- the deduction for qualified business income.[286]

As we'll see below, an individual's income tax is calculated, in part, on the basis of their taxable income.

Filing status

An individual's filing status determines whether the individual qualifies for certain tax benefits, and it determines the tax brackets to which the individual will be subject. There are five different statuses:

- Married individual filing jointly
- Married individual filing separately
- Unmarried individual (other than a surviving spouse or head of household)
- Head of household
- Surviving spouse

We examine the qualifications for each of these filing statuses below.

Married individual filing jointly

A married individual filing jointly generally is an individual who was married as of the end of the calendar year and the individual and the individual's spouse elect to jointly file an income tax return.[287] A married individual filing jointly also is an individual who was widowed during

[270] IRC § 62(a). See IRC §§ 162(a), 164(a), and 165(a).
[271] IRC § 62(a)(1).
[272] IRC § 62(a)(3).
[273] IRC § 62(a)(4).
[274] IRC § 62(a)(10) (before its repeal by Pub. Law 115-97, § 11051(b)(2)(A)).
[275] IRC § 62(a)(19).
[276] IRC § 62(a)(7). For a discussion of the limitations on deductible contributions, see the section entitled "Contributions" in the chapter entitled "Retirement Planning."
[277] IRC § 62(a)(6). A SIMPLE IRA is an IRA that's set up for an employee under a savings incentive match plan for employees of small employers (SIMPLE) IRA plan. See IRC § 408(p)(1). For a discussion of the limitations on deductible contributions, see the section entitled "Contributions" in the chapter entitled "Retirement Planning."
[278] IRC § 62(a)(17). For a more in-depth discussion of this deduction, see the section entitled "Student Loan Interest" later in this chapter.
[279] IRC § 219.
[280] IRC § 163(j).
[281] See IRC § 62(a).
[282] IRC § 151(d)(3).
[283] IRC § 165(h).
[284] IRC § 213(a).
[285] IRC § 63(a).
[286] IRC § 63(b). The deduction for personal exemptions also is subtracted from gross income for purposes of calculating taxable income. IRC § 63(b)(2). In 2024 and 2025, however, there isn't any allowable deduction for personal exemptions. IRC § 151(d)(5).
[287] IRC § 6013. See IRC § 7703.

the calendar year and didn't remarry during the calendar year.[288]

A married couple filing jointly report their combined incomes and deduct their combined allowable expenses on one return, regardless of whether the spouses lived together or if only one spouse had income.[289] Once a married couple files jointly for a calendar year, they generally can't file separately for that year.[290] The personal representative for a decedent's estate, however can change from a joint return elected by the surviving spouse to a separate return for the decedent.[291] The personal representative must make the change within one year after the due date (including extensions) of the return.[292]

Married individual filing separately
A married individual filing separately is an individual who was married as of the end of the calendar year and the individual and the individual's spouse file separate income tax returns.[293]

A married individual who files separately can subsequently file jointly by filing an amended income tax return.[294] The individual and the individual's spouse must qualify to file jointly.[295] They can generally change to a joint return any time within three years from the due date (without regard to any extensions) of the separate return or returns.[296]

Unmarried individual (other than a surviving spouse or head of household)
An unmarried individual generally is an individual who (1) was not married as of the end of the calendar year, (2) was legally separated or divorced as of the end of the calendar year, (3) was widowed before the calendar year and didn't remarry during the calendar year, or (4) qualifies as an abandoned spouse.[297] However, an individual whose spouse is deceased may potentially qualify as a married individual filing jointly or a surviving spouse.[298]

Head of household
A head of household generally is an individual who was not married as of the end of the calendar year, is not a surviving spouse, and maintains a household that meets certain conditions.[299] The individual must maintain a household that, for more than half of the year, served as a principal place of abode for certain dependents and must have contributed to more than half the costs of maintaining the household.[300] Alternatively, the individual must maintain a household that was the principal place of abode of one or both of the individual's parents, and the individual must be able to claim the parent living in the household as a dependent.[301]

Under certain conditions, a married individual is treated as unmarried and thus may potentially qualify as a head of household. An individual is treated as unmarried if (1) the individual doesn't file a joint return with their spouse, (2) the individual maintains a household that, for more than half of the year, served as a principal place of abode for certain dependents, (3) the individual contributed to more than half the costs of maintaining the household, and (4) during the last six months of the calendar year, the individual's spouse is not a member of the household.[302]

[288] Id.
[289] IRC § 6013(a).
[290] IRC § 6013(a)(3) and Treas. Reg. § 1.6013-1(a)(1).
[291] IRC § 6013(a)(3) and Treas. Reg. § 1.6013-1(d)(5).
[292] Id.
[293] IRC § 6013. See IRC § 7703.
[294] IRC § 6013(b).
[295] Id.
[296] IRC § 6013(b)(2)(A).
[297] See IRC § 7703.
[298] See IRC §§ 2(a) and 6013.
[299] IRC § 2(b).
[300] IRC § 2(b)(1)(A).
[301] IRC § 2(b)(1)(B).
[302] IRC § 7703(b).

Surviving spouse

A surviving spouse generally is an individual (1) whose spouse died during one of the two preceding calendar years, (2) who didn't remarry during the calendar year, (3) who had a child or stepchild that they claim or could claim as a dependent, and the child or stepchild lived in the individual's home for the entire calendar year, and (4) who could have filed a joint return with their deceased spouse for the year in which the deceased spouse died.[303]

Tax rates

The tax rate on an individual's income varies based on a few factors, including the character of the income – that is, whether it is ordinary income or capital gain – and the individual's filing status. In some cases, a special rate may apply.

Ordinary income

Ordinary income is income other than capital gain.[304] The following tables show the tax rates on an individual's ordinary income in 2024. The tax brackets vary based on filing status. In 2024, the highest marginal tax rate is 37%.[305]

[303] IRC § 2(a).
[304] IRC § 64.
[305] See IRC § 1(j)(2). In 2025, the highest marginal tax rate will again be 37%. In 2026 and subsequent years, however, the highest marginal tax rate will be 39.6%. See IRC §§ 1(a), (b), (c), (d), and (i).

Table 3

Ordinary income tax rates for married individuals filing jointly in 2024.

Taxable Income		Tax		
is over	but isn't over	Amount	plus	of the taxable income over
$0	$23,200		10%	$0
$23,200	$94,300	$2,320.00	12%	$23,200
$94,300	$201,050	$10,852.00	22%	$94,300
$201,050	$383,900	$34,337.00	24%	$201,050
$383,900	$487,450	$78,221.00	32%	$383,900
$487,450	$731,200	$111,357.00	35%	$487,450
$731,200		$196,669.50	37%	$731,200

Source: Rev. Proc. 2023-34.

Table 4

Ordinary income tax rates for a married individual filing separately in 2024.

Taxable Income		Tax		
is over	but isn't over	Amount	plus	of the taxable income over
$0	$11,600		10%	$0
$11,600	$47,150	$1,160.00	12%	$11,600
$47,150	$100,525	$5,426.00	22%	$47,150
$100,525	$191,950	$17,168.50	24%	$100,525
$191,950	$243,725	$39,110.50	32%	$191,950
$243,725	$365,600	$55,678.50	35%	$243,725
$365,600		$98,334.75	37%	$365,600

Source: Rev. Proc. 2023-34.

Note: Rev. Proc. 2023-34 appears to contain a typographic error. In the ruling, Table 4 (setting forth the rates for married individuals filing separately) contains the phrase "the excess over $191,150." This phrase apparently should be "the excess over $195,950." This is consistent with the rest of the table and the IRS press release. (See "IRS Provides Tax Inflation Adjustments for Tax Year 2024," IRS, November 9, 2023, https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2024.) More importantly, $195,950 is mathematically correct.

Table 5

Ordinary income tax rates for an unmarried individual (other than surviving spouse or a head of household) in 2024.

Taxable Income		Tax		
is over	but isn't over	Amount	plus	of the taxable income over
$0	$11,600		10%	$0
$11,600	$47,150	$1,160.00	12%	$11,600
$47,150	$100,525	$5,426.00	22%	$47,150
$100,525	$191,950	$17,168.50	24%	$100,525
$191,950	$243,725	$39,110.50	32%	$191,950
$243,725	$609,350	$55,678.50	35%	$243,725
$609,350		$183,647.25	37%	$609,350

Source: Rev. Proc. 2023-34.
Note: Rev. Proc. 2023-34 appears to contain a typographic error. In the ruling, Table 3 (setting forth the rates for unmarried individuals (other than surviving spouses and heads of households)), contains the phrase "the excess over $191,150." This phrase apparently should be "the excess over $195,950." This is consistent with the rest of the table and the IRS press release. (See "IRS Provides Tax Inflation Adjustments for Tax Year 2024," IRS, November 9, 2023, https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2024.) More importantly, $195,950 is mathematically correct.

The tax rate on an individual's income varies based on a few factors, including the character of the income – that is, whether it is ordinary income or capital gain – and the individual's filing status. In some cases, a special rate may apply.

Table 6

Ordinary income tax rates for a head of household in 2024.

Taxable Income		Tax		
is over	but isn't over	Amount	plus	of the taxable income over
$0	$16,550		10%	$0
$16,550	$63,100	$1,655.00	12%	$16,550
$63,100	$100,500	$7,241.00	22%	$63,100
$100,500	$191,950	$15,469.00	24%	$100,500
$191,950	$243,700	$37,417.00	32%	$191,950
$243,700	$609,350	$53,977.00	35%	$243,700
$609,350		$181,954.50	37%	$609,350

Source: Rev. Proc. 2023-34.
Note: Rev. Proc. 2023-34 appears to contain a typographic error. In the ruling, Table 2 (setting forth the rates for heads of households) contains the phrase "the excess over $191,150." This phrase apparently should be "the excess over $195,950." This is consistent with the rest of the table and the IRS press release. (See "IRS Provides Tax Inflation Adjustments for Tax Year 2024," IRS, November 9, 2023, https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2024.) More importantly, $195,950 is mathematically correct.

Table 7

Ordinary income tax rates for a surviving spouse in 2024.

Taxable Income		Tax		
is over	but isn't over	Amount	plus	of the taxable income over
$0	$23,200		10%	$0
$23,200	$94,300	$2,320.00	12%	$23,200
$94,300	$201,050	$10,852.00	22%	$94,300
$201,050	$383,900	$34,337.00	24%	$201,050
$383,900	$487,450	$78,221.00	32%	$383,900
$487,450	$731,200	$111,357.00	35%	$487,450
$731,200		$196,669.50	37%	$731,200

Source: Rev. Proc. 2023-34.

Capital gain tax rates

For purposes of determining the tax on capital gains, individual must divide long-term capital gains and long-term capital losses into three groups:

- 28% rate gain,
- 25% rate gain, and
- other gain.

Within each group, long-term capital gains and long-term losses are netted.[306] Any net short-term capital loss is subsequently netted against net long-term 28% rate gain, then against net long-term 25% rate gain, and finally against other net long-term capital gain.[307] After these netting exercises, any net gain within a group generally is subject to the tax rates applicable to the group.

The 28% rate gain and 25% rate gain essentially are special rates that apply to certain types of capital gain. In 2024, the highest marginal tax rate on other capital gain is 20%.[308] As discussed below, certain capital gains are also subject to the 3.8% net investment income tax.

28% rate gain

Twenty-eight percent rate gain is the sum of collectibles gain and section 1202 gain reduced by the sum of collectible loss, net short-term capital loss, and long-term loss carryforward.[309] In 2024, the tax rate on net 28% rate gain is 28%.[310]

Collectibles. Collectibles gain is the gain from the sale or exchange of collectibles.[311] Collectibles generally include works of art, rugs, antiques, metals, gems, stamps, coins, and alcoholic beverages.[312] Collectibles, however, do not include certain gold, silver, and platinum coins minted by the United States (i.e., American Eagles coins) or coins issued under the laws of a state.[313] An NFT is a collectible if its associated right or asset is a collectible[314] For example, an NFT is a collectible if it certifies ownership of a work of art or a gem.[315]

Section 1202 gain. Section 1202 gain is certain gain from the sale or exchange of QSB stock held for more than five years.[316] An individual potentially can exclude some or all of the gain from such a sale or exchange. An individual generally can exclude the greater of $10 million or 10 times the

[306] IRC §§ 1(h)(3), (h)(4), (h)(6), and 1222.
[307] IRC §§ 1(h)(4)(B) and (h)(6)(A).
[308] IRC § 1(h)(1).
[309] IRC §§ 1(h)(1)(F) and (h)(4).
[310] IRC § 1(h)(1)(F).
[311] IRC § 1(h)(5)(A).
[312] IRC §§ 1(h)(5)(A) and 408(m)(2).
[313] IRC §§ 1(h)(5)(A) and 408(m)(3).
[314] Notice 2023-27.
[315] Id.
[316] IRC § 1(h)(4)(A)(ii). More specifically, the 28% rate applies to the sum of collectibles gain and certain non-excludable gain from the sale or exchange of QSB stock reduced by the sum of collectible loss, net short-term capital loss, and long-term loss carryforward.

shareholder's adjusted basis in the QSB stock.[317] For shares issued after February 17, 2009, and before September 28, 2010, the individual can exclude 75% of the gain. For shares issued after August 10, 1993, and before February 18, 2009, the individual can exclude 50% of the gain. Section 1202 gain is the portion of the gain that's not excludable because either the 50% or 75% limitation applies.[318]

An example may help illustrate this point. Let's assume an unmarried individual owns 1,000 shares of QSB stock issued on July 1, 2009, doesn't own any other shares in the company that issued the QSB stock, and sells all of those shares on January 2, 2024, realizing $15 million of gain. Let's also assume the 10-times basis limitation doesn't apply and the individual doesn't have any other 28% rate gain or loss during the year. Since the 75% limitation would apply (because the stock was issued after February 17, 2009, and before September 28, 2010), the individual would be able to exclude $7.5 million of gain, would have $2.5 million of section 1202 gain subject to the special 28% tax rate, and would have $5 million of gain that's subject to the regular 20% capital gains tax rate. In addition, the non-excludable gain would potentially be subject to the net investment income tax.

For shares of QSB stock issued after September 27, 2010, an individual can exclude 100% of the gain (up to $10 million).[319] The special 28% rate doesn't apply when 100% of the gain is excludable.[320]

For an in-depth discussion of QSB stock, see Todd D. Mayo, *Qualified Small Business Stock* (a publication of the UBS Advanced Planning Group).

25% rate gain

Twenty-five percent rate gain is unrecaptured section 1250 gain,[321] which generally is gain from the sale or exchange of certain depreciable real property to the extent the gain is attributable to depreciation deductions.[322] In 2024, the tax rate on net 25% rate gain is 25%.[323]

Other gain

The following tables show the tax rates on an individual's adjusted net capital gain. An individual's adjusted net capital gain is their net capital gain reduced by 28% rate gain and 25% rate gain and increased by qualified dividends.[324]

Table 8

Maximum capital gains tax rates for married individuals filing jointly in 2024.

Taxable Income		**Maximum tax rate**
is over	**but isn't over**	**Amount**
$0	$94,050	0%
$94,050	$583,750	15%
$583,750		20%

Source: Rev. Proc. 2023-34.

[317] Id.
[318] IRC §§ 1202(b)(1), (b)(2), and 1(h)(7).
[319] IRC § 1202(a)(4)(A).
[320] See IRC § 1(h)(7).
[321] IRC § 1(h)(1)(E).
[322] IRC § 1(h)(6)(A). To the extent gain on the sale or exchange of depreciable real property is attributed to accelerated depreciation deductions allowed or allowable with respect to the property, the gain is ordinary income. IRC § 1250(a). Consequently, section 1250 gain generally is the amount of straight line depreciation deductions allowed or allowable with respect to the property. Certain depreciable real property is section 1245 property, and the gain from a disposition of section 1245 generally is ordinary income. See IRC § 1245(a)(1). It isn't section 1250 gain.
[323] IRC § 1(h)(1)(E).
[324] IRC § 1(h)(3).

An individual's filing status determines whether the individual qualifies for certain tax benefits, and it determines the tax brackets to which the individual will be subject.

Table 9

Maximum capital gains tax rates for a married individual filing separately in 2024.

Taxable Income		Maximum tax rate
is over	**but isn't over**	**Amount**
$0	$47,025	0%
$47,025	$291,850	15%
$291,850		20%

Source: Rev. Proc. 2023-34.

Table 10

Maximum capital gains tax rates for an unmarried individual (other than a surviving spouse or head of household) in 2024.

Taxable Income		Maximum tax rate
is over	**but isn't over**	**Amount**
$0	$47,025	0%
$47,025	$518,900	15%
$518,900		20%

Source: Rev. Proc. 2023-34.

Table 11

Maximum capital gains tax rates for a head of household in 2024.

Taxable Income		Maximum tax rate
is over	**but isn't over**	**Amount**
$0	$63,000	0%
$63,000	$551,350	15%
$551,350		20%

Source: Rev. Proc. 2023-34.

Table 12

Maximum capital gains tax rates for a surviving spouse in 2024.

Taxable Income		Maximum tax rate
is over	but isn't over	Amount
$0	$94,050	0%
$94,050	$583,750	15%
$583,750		20%

Source: Rev. Proc. 2023-34.

Qualified dividends

Qualified dividends enjoy the preferential tax rates that apply to net capital gains.[325] (See Tables 8 to 12.) A qualified dividend generally is a dividend that is received from a US corporation or a qualified foreign corporation.[326] if the individual satisfies certain holding period requirements with respect to the stock against which the dividend was paid.[327] A dividend, however, is not a qualified dividend to the extent the individual is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.[328]

A qualified foreign corporation generally is a foreign corporation incorporated in a US possession, a foreign corporation whose dividend-paying stock is readily traded on an established securities market in the United States, or a foreign corporation entitled to the benefits of a tax treaty with the United States which includes an exchange of information requirement.[329] A corporation that currently is a passive foreign investment company (PFIC) or was a PFIC during the preceding year can't qualify as a qualified foreign corporation.[330]

An individual generally must have held the stock for more than 60 days during the 121-day period that began 60 days prior to the ex-dividend date.[331] In the case of preferred stock, an individual generally must have held the stock for more than 90 days during the 181-day period that began 90 days prior to the ex-dividend date.[332]

Kiddie tax

Under what's commonly called the "kiddie tax," an individual's income potentially is taxable at a parent's tax rates if those rates are higher than the rates to which the individual would be subject. The kiddie tax applies to certain individuals who haven't attained 24 years of age before the end of the year. In 2024, the kiddie tax only applies if the individual's net unearned income exceeds $1,300.[333]

The kiddie tax applies to:

- any individual who has not attained 18 years of age before the end of the calendar year,[334]
- any individual who attains 18 years of age during the calendar year and doesn't have net earned income that exceeds 50% of their support,[335] and
- any individual who has attained 19 years of age before the end of the calendar year but has not attained 24 years of age before the end of the calendar year, doesn't have net earned income that exceeds 50% of their support, and is a full-time student.[336]

The kiddie tax applies only if one or both the individual's parents is living at the end of the calendar year and, in the case of an individual has attained 18 years of age before the end of the year, the individual doesn't file a joint return (which would generally be possible only if the individual was married).[337]

[325] IRC § 1(h)(11)(A).
[326] IRC § 1(h)(11)(B)(i).
[327] IRC § 1(h)(11)(B)(iii)(I).
[328] IRC § 1(h)(11)(B)(iii)(II).
[329] IRC §§ 1(h)(11)(C)(i) and (ii).
[330] IRC § 1(h)(11)(C)(iii)(I). A PFIC generally is a foreign corporation in which 75% or more of its income is passive or 50% or more of its assets are investments that produce interest, dividends, or capital gains. IRC § 1297(a).
[331] IRC §§ 1(h)(11)(B)(iii)(I) and 246(c).
[332] Id.
[333] IRC § 1(g)(1). See also IRC § 1(g)(4) and Rev. Proc. 2023-34.
[334] IRC § 1(g)(2)(A)(i).
[335] IRC §§ 1(g)(2)(A)(ii), 152(c)(3)(A)(i), and 152(c)(1)(D).
[336] IRC § 1(g)(2)(A)(ii), 152(c)(3)(A)(ii), and 152(c)(1)(D).
[337] IRC §§ 1(g)(2)(B) and (C). See IRC § 7703.

If, in 2024, the kiddie tax applies, the first $1,300 of the individual's net unearned income is non-taxable (because of the standard deduction for an individual who's a dependent),[338] the next $1,300 of the individual's net unearned income generally is taxed at individual's tax rate,[339] and the remainder of the individual's net unearned income generally is taxed at individual's parent's tax rate.[340]

In some cases, a parent may elect to report their child's income on their own income tax return. In 2024, a parent generally may make this election if:

- the child is subject to the kiddie tax,[341]
- the child's gross income only includes interests and dividends (including capital gain distributions and Alaska Permanent Fund dividends),[342]
- the child's gross income exceeds the standard deduction for a dependent (which, in 2024, is $1,300) and doesn't exceed ten times the standard deduction for a dependent (i.e., $13,000 in 2024),[343]
- no estimated tax payments were made in the child's name or social security number during the year,[344] and
- no federal income taxes were withheld from the child's gross income during the year.[345]

If this election is made, the child is treated as not having any gross income for the year and doesn't have any obligation to file a federal income tax return.[346]

Net investment income tax

An individual's net investment income potentially is subject to an additional 3.8% tax. Net investment income generally includes interest, dividends, annuities, royalties, rents, capital gains.[347] It also includes income from the business of trading in financial instruments or commodities and income from passive activities.[348] It, however, generally excludes capital gains and other income from an active trade or business.[349]

An individual is subject to the net investment income tax if their modified adjusted gross income exceeds the threshold amount.[350] Modified adjusted gross income generally is adjusted gross income excluding foreign earned income.[351] The threshold amount is:

- $250,000 for married individuals filing jointly,
- $125,000 for a married individual filing separately,
- $200,000 for an unmarried individual (other than a surviving spouse or head of household),
- $200,000 for a head of household, and
- $250,000 for a surviving spouse.[352]

The net investment income tax is 3.8% of the lesser of (1) the net investment income and (2) the excess of modified adjusted gross income over the threshold amount.[353]

For a more in-depth discussion of the net investment income tax, see Ann Bjerke, *Net Investment Income Tax* (a publication of the UBS Advanced Planning Group.)

Alternative minimum tax

The alternative minimum tax (AMT) operates in parallel to the regular income tax, limiting certain tax benefits that high income taxpayers would otherwise enjoy. Through various adjustments and additions, an individual's taxable income for AMT purposes is more inclusive than an

338 IRC § 63(c)(5)(A). See Rev. Proc. 2023-34.
339 IRC §§ 1(g)(1) and (g)(4).
340 Id.
341 IRC § 1(g)(7)(A)(i).
342 Id.
343 IRC § 1(g)(7)(A)(ii) and Rev. Proc. 2023-34. See also Instructions to Form 8814.
344 IRC § 1(g)(7)(A)(iii).
345 Id.
346 IRC § 1(g)(7)(A)(iv).
347 IRC §§ 1411(a) and (c)(1).
348 Id.
349 IRC § 1411(c)(1) and (2).
350 See IRC § 1411(a)(1)(B).
351 IRC § 1411(d).
352 IRC § 1411(b).
353 IRC § 1411(a)(1).

individual's taxable income for purposes of the regular income tax.[354] For example, an individual who exercises incentive stock options must include the spread between the exercise price and the shares' fair market value as income for AMT purposes but not regular tax purposes.[355] Similarly, an individual who excludes capital gain from the sale of qualified small business stock acquired before September 28, 2010, must include 7% of the excluded gain in income for AMT purposes.[356]

After calculating their taxable income for AMT purposes, an individual subtracts the exemption amount.[357] In 2024, the exemption amount is:

- $133,300 for married individuals filing jointly,
- $66,650 for a married individual filing separately,
- $85,700 for an unmarried individual (other than a surviving spouse or head of household),
- $85,700 for a head of household, and
- $133,300 for a surviving spouse.[358]

The exemption amount, however, phases out. In 2024, an individual's exemption amount begins phasing out when the individual's alternative minimum taxable income exceeds:

- $1,218,700 for married individuals filing jointly,
- $609,350 for a married individual filing separately,
- $609,350 for an unmarried individual (other than a surviving spouse or head of household),
- $609,350 for a head of household, and
- $1,218,700 for a surviving spouse.[359]

An individual's exemption amount phases out by 25% of the amount by which the individual's alternative minimum taxable income exceeds the amount at which the phase-out begins.[360] For example, in 2024, a married individual filing jointly would see their exemption amount reduced from $133,300 to $108,300 (i.e., by $25,000) if their alternative minimum taxable income is $1,318,700 (and thus exceeds $1,218,700 by $100,000).

In 2024, an individual's exemption amount is fully phased out when the individual's alternative minimum taxable income exceeds:

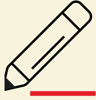
- $1,751,900 for married individuals filing jointly,
- $875,950 for a married individual filing separately,
- $952,150 for an unmarried individual (other than a surviving spouse or head of household),
- $952,150 for a head of household, and
- $1,751,900 for a surviving spouse.[361]

For AMT purposes, an individual's top marginal rate is 28%.[362] When an individual's tax for AMT purposes exceeds their tax for regular income tax purposes, the individual must pay their regular income tax plus that excess.[363] In future years, the individual may be able to claim that excess as a credit against their regular income.[364]

Planning tip

An individual who expects to be subject to the AMT in 2024 but not in 2025 might consider accelerating ordinary income and short-term capital gains into 2024, so that they can take advantage of the lower AMT rates. The individual also might consider deferring charitable deductions until 2025, when those deductions might be more valuable. Of course, the individual should consider the potential impact on federal, state, and local taxes.

[354] IRC § 55(b)(2). In this guide, we speak in terms of an individual being subject to the AMT when their tax for AMT purposes exceeds their tax for regular income tax purposes. Similarly, we speak in terms of an individual avoiding the AMT when they are avoiding a situation in which (either in the current year or a future year) their tax for AMT purposes exceeds their tax for regular income tax purposes.
[355] IRC §§ 56(b)(3) and 421(a).
[356] IRC § 57(a)(7).
[357] IRC § 55(b)(1)(B).
[358] IRC § 55(d)(1) and Rev. Proc. 2023-34.
[359] IRC § 55(d)(2) and Rev. Proc. 2023-34.
[360] Id.
[361] Rev. Proc. 2023-34.
[362] IRC § 55(b)(1)(A)(ii).
[363] IRC § 55(a).
[364] IRC § 53(a).



Planning tip
An individual who expects to be subject to the AMT in 2025 but not in 2024 might consider deferring ordinary income and short-term capital gains until 2025, so that they can take advantage of the lower AMT rates. This isn't always feasible. The individual also might consider accelerating charitable deductions into 2024, when those deduction might be more valuable. Here again, the individual should consider the potential impact on federal, state, and local taxes.

Estimated and final tax payments

An individual may have an obligation to pay estimated taxes if they have income that isn't subject to withholding, such as interest, dividends, capital gains, and self-employment income. For 2024 income taxes, an individual generally must pay (either through withholding or estimated taxes) the lesser of:

- 90% of the tax to be shown on their 2024 tax return,
- 100% of the tax shown on their 2023 tax return if their 2023 adjusted gross income doesn't exceed $150,000 (or, in the case of a married individual filing separately, $75,000), or
- 110% of the tax shown on their 2023 tax return if their 2023 adjusted gross income exceeds $150,000 (or, in the case of a married individual filing separately, $75,000).[365]

An individual, however, isn't required to pay estimated taxes if they will owe $1,000 or less of tax (after subtracting any taxes withheld).[366] An individual who doesn't make sufficient tax payments during the year (either through withholding or estimated taxes) is subject to a penalty.[367]

For 2024 income taxes, the estimated tax payments generally are due:

- April 15, 2024 (or, in the case of a resident of Maine or Massachusetts, April 18, 2024),
- June 17, 2024,
- September 16, 2024, and
- January 15, 2025.[368]

If an individual doesn't pay the final estimated payment that's due January 15, 2025, the individual can avoid the penalty for not making their final payment by filing their 2024 income tax return and paying the taxes in full by January 31, 2025.[369] In some cases, the IRS postpones filing and payment deadlines for individuals affected by natural disasters and other major events.

An individual who has sizable capital gains from a nonrecurring event – such as the sale of a business – generally doesn't need to make any estimated payments of the tax on those gains. So long as the individual pays (either through withholding or estimated taxes) 100% (or, in some cases 110%) of the tax shown on their prior year's tax return, the individual would avoid the penalty for underpaying estimated taxes.

An individual who expects to owe taxes should plan for how to pay those taxes. For an individual who already has liquidity, little action may be required. An individual who doesn't have sufficient liquidity might sell assets to raise the cash to pay the taxes. Selling assets may not be the most efficient approach if those sales would cause the

[365] IRC §§ 6654(d)(1)(B) and (C).
[366] IRC § 6654(e)(1).
[367] IRC § 6654(a).
[368] IRC §§ 6654(c)(2) and 7503. For an individual who is not a US citizen, is not a US resident, and is not subject to withholding, however, the estimated tax payments are due June 17, 2024, September 16, 2024, and January 15, 2025. IRC §§ 6654(j)(2) and 7503.
[369] IRC § 6654(h).

individual to recognize capital gains. An individual who doesn't have sufficient liquidity might consider borrowing to pay the taxes. Borrowing against eligible securities in a portfolio may enable an individual access to needed funds – for the payment of taxes – while allowing them to pursue their long-term financial strategy without creating an additional tax obligation in the following year.[370]

Filing the income tax return

An individual's 2024 income tax return is due April 15, 2025.[371] An individual may apply for an extension to file their income tax return. The IRS grants an automatic six-month extension so long as the individual files an application for extension before the original due date for the income tax return.[372] With the extension, the 2024 income tax return is due October 15, 2025.[373] An extension of time to file doesn't extend the date on which the individual must pay their taxes.[374] In some cases, the IRS postpones filing and payment deadlines for individuals affected by natural disasters and other major events.

[370] **Borrowing using securities as collateral involves special risks, is not suitable for everyone and may not be appropriate for your needs.** All loans are subject to credit approval, margin requirements, and margin call and other risks; credit lines may be subject to breakage fees. For a full discussion of the risks associated with borrowing using securities as collateral, review the Loan Disclosure Statement included in your application package/account opening package. **UBS Financial Services Inc. (UBS-FS) and its Financial Advisors have a financial incentive to recommend the use of securities backed loans, rather than the sale of securities to meet cash needs because we receive compensation related to the loan as well as the investments used to secure the loan.** We benefit if you draw down on your loan to meet liquidity needs rather than sell securities or other investments, and have a financial incentive to recommend products or manage an account in order to maximize the amount of the loan. UBS-FS and its Financial Advisors and employees offer banking and lending products to clients through our affiliates and third-party banks in our capacity as a broker-dealer and not as an investment adviser.
UBS-FS, their employees and affiliates do not provide legal or tax advice. You should contact your personal tax and/or legal advisors regarding their particular situations, including the legal and tax implications of borrowing using securities as collateral for a loan.

[371] IRC §§ 6072(a) and 7503. See also Treas. Reg. §§ 1.6072-1(a) and (d). For an individual who is a US citizen or a US resident but lives outside the United States and Puerto Rico, the 2024 income tax return is due June 16, 2025. Treas. Reg. § 1.6081-5(a)(5). More precisely, the IRS grants an automatic two-month extension, so long as the individual attaches a statement explaining their qualification for this extension. Treas. Reg. §§ 1.6081-5(a)(5) and (b)(1). For an individual who is not a US citizen, is not a US resident, and is not subject to withholding, the 2024 income tax return is due June 16, 2025. IRC § 6072(c).

[372] Treas. Reg. § 1.6081-4(a). For an individual who is a US citizen or a US resident but lives outside the United States and Puerto Rico, the IRS grants the automatic extension, so long as the individual files the application on or before June 16, 2025. Treas. Reg. § 1.6081-5(b)(2).

[373] Treas. Reg. § 1.6081-4(a). See also IRC § 7503.

[374] Treas. Reg. § 1.6081-4(c).

Retirement planning

Overview

For many individuals, retirement accounts play an important role in their accumulation of wealth.[375] Retirement accounts include qualified plans, which are tax-advantaged, employer-sponsored retirement plans, such as 401(k) plans, 403(b) plans, and 457 plans. They also include traditional IRAs and Roth IRAs, which are tax-advantaged personal retirement plans. In this chapter, we'll examine some of the notable rules governing contributions to retirement accounts and distributions from retirement accounts.

Contributions

Contributions to a retirement account are limited based on the type of retirement account and the age of the individual with respect to whom the contributions are being made. For this purpose, an individual's age is determined on the last day of the year in which the contributions are made.[376]

> Contributions to a retirement account are limited based on the type of retirement account and the age of the individual with respect to whom the contributions are being made.

401(k) plans, 403(b) plans, and most 457 plans

For 401(k) plans, 403(b) plans, and most 457 plans, there's a limit on elective deferrals and a limit on total contributions. An elective deferral is a contribution that, as an employee, an individual makes to a retirement plan out of the salary that the individual otherwise would receive.[377] Total contributions include employee contributions, employer contributions (e.g., matching contributions), and forfeitures but don't include catch-up contributions.[378]

Limit on elective deferrals

In 2024, the total elective deferrals that an individual may make to 401(k) plans, 403(b) plans, and most 457 plans and exclude from their gross income generally can't exceed:

- $23,000 if the individual has not attained 50 years of age, or
- $30,500 if the individual has attained 50 years of age (i.e., $23,000 plus a $7,500 catch-up contribution).[379]

When applying this contribution limit, the individual generally must aggregate all of their contributions to the plans in which they participate.[380]

Limit on total contributions

For 2024, the total contributions to these retirement plans can't exceed the lesser of:

- $69,000, or
- the individual's taxable compensation for the year.[381]

As noted above, total contributions include employee contributions, employer contributions (e.g., matching contributions), and forfeitures but don't include than catch-up contributions.[382]

Treatment of catch-up contributions

Catch-up contributions are the additional elective deferrals that an individual who's attained 50 years of age is permitted to make to a retirement plan.[383] In 2024, catch-up contributions to a 401(k), 403(b), or 457 plan can be made on a pre-tax basis (i.e., excluded from gross income).[384] Under tax law changes enacted in 2022, this treatment of catch-up contributions was set to change for certain high-income individuals.[385] The IRS, however, delayed the implementation of this change.[386] Accordingly, for 2024 and 2025, an individual's catch-up contribution to a 401(k), 403(b),

[375] In this guide, we'll refer to qualified plans, 403(b) plans, and IRAs as retirement accounts.
[376] IRC §§ 219(b)(5)(B)(i) and 414(v)(5)(A).
[377] Treas. Reg. § 1.402(g)-(1)(b).
[378] IRC §§ 414(v)(3)(A)(i) and 415(c)(2).
[379] IRC §§ 402(g)(1) and 414(v)(2); and Notice 2023-75. Beginning in 2025, the limit on total elective deferrals for an individual who has attained 60, 61, 62, or 63 years of age will be higher. IRC § 414(v)(2)(B)(i) as amended by Pub. Law 117-328, div. T, § 109(a)(1). Beginning in 2027, certain contributions may qualify for up to $2,000 of federal matching. IRC § 6433 as enacted by Pub. Law 117-328, div. T, § 103(a). This matching contribution is called the *saver's match*.
[380] IRC § 408(d)(2).
[381] IRC § 415(c)(1) and Notice 2023-75.
[382] IRC §§ 414(v)(3)(A)(i) and 415(c)(2).
[383] See IRC § 414(v)(1).
[384] IRC § 402(g)(1)(C).
[385] IRC § 414(v)(7) as added by Pub. L. 117-328, div. T, § 603(a).
[386] Notice 2023-62.

or 457 plan can be made on a pre-tax basis regardless of the individual's income.[387]

Beginning in 2026, however, an individual's catch-up contribution to a 401(k), 403(b), or 457 plan can be made on a pre-tax basis only if the individual's taxable compensation doesn't exceed $145,000 (adjusted for inflation).[388] An individual's catch-up contribution to a 401(k), 403(b), or 457 plan will be treated as a Roth contribution (and thus made on an after-tax basis) if the individual's taxable compensation exceeds $145,000 (adjusted for inflation).[389]

SIMPLE 401(k) plans and SIMPLE IRAs

For 2024, the total elective deferrals that an individual may make to a SIMPLE 401(k) plan or SIMPLE IRA generally can't exceed:

- $16,000 if the individual has not attained 50 years of age, or
- $19,500 if the individual has attained 50 years of age (i.e., $16,000 plus a $3,500 catch-up contribution).[390]

Under certain conditions, however, higher limits apply. Under these higher limits, the total elective deferrals that an individual may make to a SIMPLE 401(k) plan or SIMPLE IRA generally can't exceed:

- $17,600 if the individual has not attained 50 years of age, or
- $21,450 if the individual has attained 50 years of age (i.e., $17,600 plus a $3,850 catch-up contribution).[391]

These higher limits apply if:

- the employer has 25 or fewer employees who receive at least $5,000 of compensation during the preceding year, or
- the employer has more than 25 employees who receive at least $5,000 of compensation during the preceding year and elects to make either 4% matching contributions or 3% nonelective contributions.[392]

The individual's employer must make certain matching contributions or nonelective contributions. The employer generally must match the individual's elective contributions dollar-for-dollar up to 3% of the individual's compensation[393] or make nonelective contributions in an amount equal to 2% of the individual's compensation regardless of whether the individual makes any elective contributions during the year.[394] If, however, the employer has more than 25 employees who receive at least $5,000 of compensation during the preceding year, it may elect to have higher percentages apply. If it makes the election, the employer generally must match the individual's elective contributions dollar-for-dollar up to 4% of the individual's compensation[395] or make nonelective contributions in an amount equal to 3% of the individual's compensation regardless of whether the individual makes any elective contributions during the year.[396] If it makes the election, the higher limits on total elective deferrals also apply.

In addition to the matching contributions or nonelective contributions, the employer generally may contribute the lesser of (1) $5,000 or (2) a percentage of the individual's compensation.[397] The percentage can't exceed 10%.[398]

[387] Id.
[388] IRC § 414(v)(7) as added by Pub. Law 117-328, § 603. See Notice 2023-62. For this purpose, an individual's taxable compensation is their wages (as defined in Section 3121(a) of the Internal Revenue Code) for the preceding calendar year from the employer sponsoring the plan.
[389] Id.
[390] IRC §§ 408(p)(2)(A)(i), 408(p)(2)(E)(i), and 414(v)(2)(B)(ii); and Notice 2023-75. A SIMPLE 401(k) plan is a type of savings incentive match plan for employees of small employers (SIMPLE) plan that an employer maintains in accordance with Section 408(p)(2) of the Internal Revenue Code. A SIMPLE IRA also is a type of SIMPLE plan that an employer maintains in accordance with Section 408(p)(2) of the Internal Revenue Code. Beginning in 2025, the limit on total elective deferrals for an individual who has attained 60, 61, 62 or 63 years of age will be higher. IRC §§ 414(v)(2)(B)(ii) as amended by Pub. Law 117-328, div. T, § 109(a)(2).
[391] IRC §§ 408(p)(2)(A)(i), 408(p)(2)(E)(i), and 414(v)(2)(B)(ii); and Notice 2023-75. Beginning in 2025, the limit on total elective deferrals for an individual who has attained 60, 61, 62 or 63 years of age will be higher. IRC §§ 414(v)(2)(B)(ii) as amended by Pub. Law 117-328, div. T, § 109(a)(2).
[392] IRC §§ 408(p)(2)(E)(i)(I) and (II).
[393] IRC §§ 408(p)(2)(A)(iii) and (C)(ii). Under certain conditions, the employer may elect to reduce the percentage of compensation (but not below 1%) that caps its matching contributions for the year. An employer making this election must apply the lower percentage to all eligible employees.
[394] IRC § 408(p)(2)(B)(i). An employer electing to make nonelective contributions in lieu of matching contributions must do so for all eligible employees.
[395] IRC §§ 408(p)(2)(A)(iii) and (C)(ii). Under certain conditions, the employer may elect to reduce the percentage of compensation (but not below 1%) that caps its matching contributions for the year. An employer making this election must apply the lower percentage to all eligible employees.
[396] IRC § 408(p)(2)(B)(i). An employer electing to make nonelective contributions in lieu of matching contributions must do so for all eligible employees.
[397] IRC § 408(p)(2)(A)(iv). An employer electing to make this additional contribution must do so for all eligible employees and must use the same percentage for all employees.
[398] Id.

Traditional IRAs and Roth IRAs
A traditional IRA is a personal retirement plan in which contributions may be tax deductible.[399] A Roth IRA is a personal retirement plan in which contributions are not deductible but qualified distributions may be tax free.[400] Contributions to traditional IRAs and Roth IRAs are limited. In addition, tax-deductible contributions to traditional IRAs are limited. We'll explore these limitations below.

Limit on total contributions
For 2024, the total contributions an individual may make to traditional IRAs and Roth IRAs can't exceed the lesser of:

- $7,000 if the individual has not attained 50 years of age,
- $8,000 if the individual has attained 50 years of age (i.e., $7,000 plus a $1,000 catch-up contribution), or
- the individual's taxable compensation for the year.[401]

Limit on deductible contributions to traditional IRAs
An individual's contributions to traditional IRAs generally are tax-deductible, but their deduction may be limited if they or their spouse participates in a workplace retirement plan.[402] The following table shows these limits.

These limits are based on an individual's modified adjusted gross income.[403] An individual's modified adjusted gross income is their adjusted gross income increased by any student loan interest deduction, foreign earned income exclusion, foreign housing exclusion, foreign housing deduction, certain savings bond interest, and certain employer-provided adoption benefits.[404]

An individual can make 2024 contributions to traditional IRAs on or before April 15, 2025.[405]

Table 13

Limits on the deductibility of contributions to traditional IRAs in 2024 based on the individual's modified adjusted gross income.

	Contributions are fully deductible	Contributions are partially deductible	Contributions are not deductible
A married individual who doesn't participate in a workplace retirement plan but whose spouse participates in a workplace retirement plan	$230,000 or less	more than $230,000 but less than $240,000	more than $240,000
A married individual who participates in a workplace retirement plan and files jointly	$123,000 or less	more than $123,000 but less than $143,000	more than $143,000
A married individual who participates in a workplace retirement plan and is a surviving spouse	$123,000 or less	more than $123,000 but less than $143,000	more than $143,000
A married individual who participates in a workplace retirement plan and files separately		less than $10,000	more than $10,000
An unmarried individual who participates in a workplace retirement plan and isn't a surviving spouse	$77,000 or less	more than $77,000 but less than $87,000	$87,000 or more

Source: IRC § 219(g) and Notice 2023-75.

[399] See, generally, IRC § 408.
[400] See, generally, IRC § 408A.
[401] IRC §§ 219(b)(1), 219(b)(5), and 408A(c)(2); and Notice 2023-75. Beginning in 2024, the $1,000 catch-up contribution for an individual has attained 50 years of age will adjust annually for inflation. IRC § 219(b)(5)(C)(iii). Beginning in 2027, certain contributions may qualify for up to $1,000 of federal matching. IRC § 6433.
[402] IRC § 219(g). More precisely, the limitation applies based (in part) on whether the individual or the individual's spouse is an active participant. IRC § 219(g)(1). An active participant generally is an individual who (1) in the case of a defined benefit plan, is eligible to participate in the plan or (2) in the case of a defined contribution plan, participates in the plan. A special rule applies to a purely discretionary profit-sharing plan or stock bonus plan. IRC § 219(g)(5) and Notice 87-16.
[403] IRC § 219(g)(3)(A).
[404] Id.
[405] IRC § 219(f)(3).

Limit on contributions to Roth IRAs

An individual's contributions to Roth IRAs may be limited if their income exceeds certain levels.[406] The following table shows these limits.

These limits are based on an individual's modified adjusted gross income.[407] An individual's modified adjusted gross income is their adjusted gross income increased by any student loan interest deduction, foreign earned income exclusion, foreign housing exclusion, foreign housing deduction, certain savings bond interest, and certain employer-provided adoption benefits.[408]

An individual can make 2024 contributions to Roth IRAs on or before April 15, 2025.[409]

Planning tip

An individual whose income is too high to make a Roth IRA contribution might consider a backdoor Roth conversion or a mega backdoor Roth conversion.

Funding a backdoor Roth IRA

If an individual's income is too high to contribute directly to a Roth IRA, they potentially can make a nondeductible contribution to a traditional IRA and subsequently convert the funds in the traditional IRA to a Roth IRA.[410] This strategy is often referred to as a "backdoor Roth IRA." The individual generally must pay income tax on the converted amount, and there are several factors to be considered when deciding to make a conversion. (We discuss conversions below.)

Similarly, an individual who participates in a 401(k) plan may be able to convert after-tax amounts into a Roth 401(k) or, alternatively, roll over after-tax amounts into a Roth IRA.[411] This strategy is often referred to as a "mega backdoor Roth conversion." It is possible only if the plan allows for after-tax contributions and it allows either in-plan Roth conversions or in-service distributions. Again, there are several factors to be considered when deciding to make a conversion. (We discuss conversions below.)

Table 14

Limits on contributions to Roth IRAs in 2024 based on the individual's modified adjusted gross income.

	Contributions allowed up to the full limit	Contributions allowed up to a reduced limit	Contributions are not allowed
A married individual filing jointly	$230,000 or less	more than $230,000 but less than $240,000	more than $240,000
A married individual filing separately		less than $10,000	more than $10,000
An unmarried individual (other than a surviving spouse or head of household)	$146,000 or less	more than $146,000 but less than $161,000	$161,000 or more
Head of household	$146,000 or less	more than $146,000 but less than $161,000	$161,000 or more
Surviving spouse	$230,000 or less	more than $230,000 but less than $240,000	more than $240,000

Source: IRC § 219(g) and Notice 2023-75.

[406] IRC § 408A(c)(3).
[407] IRC § 219(g)(3)(A).
[408] Id.
[409] IRC §§ 219(f)(3) and 408A(c)(6).
[410] IRC § 408A(d)(3) and Treas. Reg. § 1.408A-4.
[411] Notice 2014-54.

Distributions

Retirement accounts are subject to an array of rules governing distributions. Let's explore some of the key rules governing when distributions must begin.

Required minimum distributions

An individual who is the original owner of a retirement account generally must begin taking required minimum distributions (RMDs) after attaining a certain age.[412] An individual, however, is not required to take RMDs from a Roth 401(k) or Roth IRA.[413] An individual who inherited a retirement account generally must take RMDs from the inherited account.[414]

Original owner

An individual who is the original owner of one or more retirement accounts (including a traditional IRA rolled over from a deceased spouse) generally must begin taking RMDs in the year in which they attain:

- 70½ years of age if they attained that age before 2020,[415]
- 72 years of age if they attained 72 in 2021 or 2022 (and hadn't attained 70½ years of age before 2020),[416]
- 73 years of age if they attain 72 years of age after 2022 and attain 73 years of age before 2033,[417] and
- 75 years of age if they attain 74 years of age after 2032.[418]

There's an exception. An individual who isn't a five-percent owner generally isn't subject to the RMD rules with respect to an employer-sponsored plan while they continue to work. The individual instead generally must begin taking RMDs in the year in which they retire from employment with the employer maintaining the plan.[419] A five-percent owner generally is:

- if the employer is a corporation, a person who owns more than five percent of the corporation's outstanding stock or owns stock possessing more than five percent of the total combined voting power of all of the corporation's stock,[420] or
- if the employer is partnership, a person who owns more than five percent of the partnership's capital or profit interest.[421]

An individual generally must take each year's RMD by the last day of the year.[422] An individual, however, may defer their first year's RMD until April 1 of the second year (i.e., the year after RMDs must begin).[423] An individual who defers their first year's RMD into the second year must still take their second year's RMD by December 31 of the second year.[424] For example, an individual who attains 73 years of age in 2024 and is thus required to begin taking RMDs may defer their 2024 RMD until April 1, 2025. They must take their 2025 RMD on or before December 31, 2025.

An individual who has two or more IRAs and is the original account owner of each of the IRAs may take the RMDs from only one of those IRAs or from any two or more of those IRAs.[425] This is also true for 403(b) plans.[426] It, however, is not true for employer-sponsored retirement plans, such as a 401(k) plans and 457(b) plans. If an individual who has one or more IRAs of which they are the original account owner also has one or more inherited IRAs, the individual must exclude the inherited IRAs when calculating the RMDs from the other IRAs (i.e., the IRAs of which the individual is the original account owner).[427] (We discuss RMDs from inherited IRAs below.)

Retirement accounts inherited by an individual before 2020

An individual who inherited a retirement account before 2020 generally must take RMDs based on their life

[412] IRC § 401(a)(9)(A).

[413] IRC §§ 408A(c)(4) and 402A(d)(5). Before 2024, an individual was required to take RMDs from a Roth 401(k). IRC § 402A(d)(5) before its amendment by Pub. Law 117-328, div. T, § 325(a).

[414] IRC § 401(a)(9)(B).

[415] IRC §§ 401(a)(9)(C)(v)(i)(I) and (II) before their amendment by Pub. L. 116-94, div. O, §§ 114(a) and (b).

[416] IRC §§ 401(a)(9)(C)(v)(i)(I) and (II) before their amendment by P.L. 117-328, div. T, §§. 107(b) and (b).

[417] IRC § 401(a)(9)(C)(v)(I).

[418] IRC § 401(a)(9)(C)(v)(II). The statute is ambiguous, but this apparently reflects what Congress intended and what we should expect in a legislative fix. Letter from Jason Smith et al. to Janet Yellen et al. dated May 23, 2023.

[419] IRC § 401(a)(9)(C)(i)(II) and Treas. Reg. § 1.401(a)(9)-2 A-2.

[420] IRC § 416(i)(1)(B)(i)(I).

[421] IRC § 416(i)(1)(B)(i)(II).

[422] Treas. Reg. § 1.401(a)(9)-5 A-1(c).

[423] IRC § 401(a)(9)(C)(i). See also Treas. Reg. § 1.401(a)(9)-5 A-1(c).

[424] Id.

[425] Treas. Reg. § 1.408-8, A-9. The individual must *calculate* the RMD for each of those IRAs separately but may *take* the total amount of RMDs from any one or more of them.

[426] Treas. Reg. § 1.403(b)-6(e)(2).

[427] Treas. Reg. § 1.408-8, A-9.

expectancy.[428] A deceased account owner's surviving spouse, however, may delay the start of RMDs until the later of the year in which the deceased account owner would have attained the applicable age or the year in which the surviving spouse would have attained the applicable age.[429]

Retirement accounts inherited by an individual who is an eligible designated beneficiary after 2019

An individual who inherits a retirement account after 2019 and is an eligible designated beneficiary generally must take RMDs based on their life expectancy.[430] An eligible designated beneficiary is:

- the deceased account owner's surviving spouse,
- a child of the deceased account owner who has not attained the age of majority (which, for this purpose, is 21 years of age),
- an individual who is disabled or chronically ill, or
- an individual who is not more than 10 years younger than the deceased account owner (which includes an individual who is older than the deceased account owner).[431]

A deceased account owner's surviving spouse, however, may delay the start of RMDs until the later of the year in which the deceased account owner would have attained the applicable age or the year in which the surviving spouse would have attained the applicable age.[432] A deceased account owner's child must receive the remaining balance of the retirement account by the end of the 10th year after the child attains the age of majority.[433] An eligible designated beneficiary generally is not subject to the 10-year rule, which we explore below.[434]

An individual who has two or more inherited IRAs from the same decedent may take the RMDs from only one of those IRAs or from any two or more of those IRAs.[435] For purposes of satisfying the RMD rules, an individual can't aggregate distributions from an inherited IRA with distributions from an IRA of which they are the original account owner, and the individual can't aggregate distributions from an inherited IRA from one decedent with distributions from an inherited IRA from another decedent.[436]

Retirement accounts inherited by an individual who isn't an eligible designated beneficiary after 2019

An individual who inherits a retirement account after 2019 and isn't an eligible designated beneficiary must receive the account assets in full by the end of the 10th calendar year after the deceased account owner's death.[437] Although the statute enacting this 10-year rule doesn't expressly require the beneficiary to take RMDs during the 10-year period, the IRS issued proposed regulations in which they interpret the statute as requiring the beneficiary to take RMDs (based on the beneficiary's life expectancy) in each of the first nine years and take the remaining balance of the retirement account by the end of the 10th year if the beneficiary inherited the retirement account from a deceased account owner who died on or after the date on which they were required to take their first RMD.[438] The IRS hasn't yet finalized these regulations but strongly encourages individuals to comply with them.[439] Nonetheless, it effectively waived any requirement to make an RMD to the beneficiary in 2021, 2022, and 2023.[440]

[428] Treas. Reg. § 1.401(a)(9)-5, A-5(a).
[429] IRC § 401(a)(9)(e)(ii)(I) (2019).
[430] IRC §§ 401(a)(9)(B)(iii) and (H)(ii).
[431] IRC § 401(a)(9)(E)(ii). In this guide, a deceased account owner refers only to the original account owner (e.g., an individual who made contributions to an IRA or an employee who made contributions to a qualified plan), and it doesn't include a deceased beneficiary of an inherited retirement account. The determination of whether an individual is an eligible beneficiary is made at the time of the deceased account owner's death. IRC § 401(a)(9)(E)(ii) (flush language). The statute doesn't define the age of majority. In 2022, however, the IRS issued proposed regulations in which it proposes to define the age of majority as 21 years. See *Required Minimum Distributions*, 87 Fed. Reg. 10,504, 10,509 (February 24, 2022).
[432] IRC § 401(a)(9)(B)(iv).
[433] IRC § 401(a)(9)(H). See also Treas. Reg. § 1.401(a)(9)-3, A-3.
[434] A plan may require distributions to be made under the 10-year rule, or it may permit an eligible designated beneficiary to elect to receive distributions either over their lifetime or under the 10-year rule. See Prop. Reg. §§ 1.401(a)(9)-3(c)(5)(ii) and (iii).
[435] Treas. Reg. § 1.408-8, A-9. The individual must *calculate* the RMD for each of those IRAs separately but may *take* the total amount of RMDs from any one or more of them. See also Prop. Reg. § 1.408-8(e).
[436] Id.
[437] IRC § 401(a)(9)(H). In addition to the 10-year rule, there is a five-year distribution rule, which generally applies to beneficiaries who are not individuals (such as estates and certain trusts). In such a case, the balance of the retirement account must be distributed by December 31 of the year containing the fifth anniversary of the deceased account owner's death.
[438] Prop. Reg. §§ 1.401(a)(9)-5(d) and (e).
[439] *Required Minimum Distributions*, 87 Fed. Reg. 10,504, 10,521 (February 24, 2022). In the preamble to the proposed regulations, the IRS reminded individuals that, when making RMDs, they must apply the existing regulations, taking into account a reasonable, good faith interpretation of the relevant, amended statute. Importantly, the IRS stated that "compliance with these proposed regulations will satisfy that requirement."
[440] Notice 2022-53 and Notice 2023-54.

An individual who has two or more inherited IRAs from the same decedent may take the RMDs from only one of those IRAs or from any two or more of those IRAs.[441] For purposes of satisfying the RMD rules, an individual can't aggregate distributions from an inherited IRA with distributions from an IRA of the they are the original account owner, and the individual can't aggregate distributions from an inherited IRA from one decedent with distributions from an inherited IRA from another decedent.[442]

Qualified charitable contributions
A qualified charitable distribution is a distribution from a traditional IRA to a qualifying charitable organization, charitable remainder trust, or charitable gift annuity.[443] The IRA owner must have attained 70½ years of age.[444] A qualified charitable distribution counts toward the individual's RMD.[445] A qualified charitable distribution to a charitable remainder trust or a charitable gift annuity is subject to certain limitations and requirements that don't apply to a qualified charitable distribution directly to a qualifying charitable organization.[446] (We explore qualified charitable distributions in more detail in the chapter entitled "Charitable Giving.")

Planning considerations and strategies

Retirement accounts offer some opportunities for planning, potentially having a bearing on current and future income taxes. In addition, it's a good practice to periodically review retirement accounts with an eye toward planning considerations.

Maximizing contributions
An individual might consider maximizing those contributions to the extent they aren't already doing so. By maximizing their contributions, they may reduce their current income taxes (to the extent that the contributions are deductible), they may more fully take advantage of employer contributions (to the extent their employer makes matching contributions), and they may help themselves better prepare financially for their retirement years.

Checking beneficiary designations
An individual should periodically review the primary and contingent beneficiary designations on their retirement accounts. The individual should confirm that those designations reflect their current wishes. A change of circumstances – especially a significant life event such as a marriage, divorce, birth, or death – might warrant a change to the beneficiary designations. When designating a beneficiary of a qualified retirement plan, an individual's spouse usually must consent if the individual designates a non-spouse primary beneficiary.[447] If an individual hasn't designated any beneficiaries (or everyone whom the individual has designated is deceased), then the account will pass according to the retirement plan's default rules.

Converting to a Roth IRA
In some situations, an individual might consider converting a traditional IRA to a Roth IRA. A Roth IRA potentially offers significant benefits, most notably tax-free growth of assets, tax-free distributions, and no RMDs during the individual's life.[448] When converting from a traditional IRA to a Roth IRA, the converted amount is taxable to the IRA owner as ordinary income in the year in which the conversion occurs.[449]

When deciding whether to make a conversion, an individual should consider potential changes to the income tax rates that may occur over their life. A conversion may not be optimal if the individual expects to pay income taxes at a lower rate after they retire when they will receive distributions (e.g., after retirement). The individual also should consider the liquidity needs that a conversion may create. A conversion may be less advantageous if the individual must draw from the converted amount – instead of other liquid assets – to pay the taxes caused by the conversion.

For a more in-depth discussion of Roth conversions, see Carrie J. Larson, *Roth Conversions* (a publication of the UBS Advanced Planning Group).

[441] Treas. Reg. § 1.408-8, A-9. The individual must *calculate* the RMD for each of those IRAs separately but may *take* the total amount of RMDs from any one or more of them. See also Prop. Reg. § 1.408-8(e).
[442] Id.
[443] IRC § 408(d)(8)(B).
[444] IRC § 408(d)(8)(A)(i).
[445] Notice 2007-7, A-42.
[446] IRC § 408(d)(8)(F).
[447] IRC § 401(a)(11)(B)(iii)(I).
[448] IRC § 408A.
[449] IRC § 408A(d)(3).

Charitable giving

Overview

Philanthropy plays an important role in the lives of many individuals. Federal tax law incentivizes charitable giving, allowing donors to deduct certain charitable contributions for income, gift, and estate tax purposes. In this chapter, we'll focus on the rules governing the income tax charitable deduction. These rules unfortunately can be complex and even convoluted. This complexity tends to reflect tax policy choices to favor certain types of gifts and certain types of charitable donees. In some places, it also reflects legislative efforts to foreclose potentially abusive arrangements.

Deductible contributions

A contribution of money or other property to a charitable organization by an individual generally qualifies for an income tax charitable deduction. There, however, are special rules that apply to certain types of property and certain types of gifts. For example, a gift of a partial interest in property – that is, a gift in which the donor retains an interest in the property – generally is non-deductible.[450] Some partial interests, however, can qualify for the income tax charitable deduction. A contribution of a remainder interest in a personal residence or farm, a contribution of an undivided portion of the taxpayer's entire interest in property, or a qualified conservation contribution (e.g., a contribution of a conservation easement that meets certain requirements) are deductible.[451]

A contribution in trust is sometimes deductible. To the extent of the charitable remainder interest that's created by the contribution, a contribution to a charitable remainder trust or pooled income fund generally is deductible.[452] To the extent of the charitable income interest (sometimes called the *lead interest*), a contribution to a charitable lead trust generally is deductible so long as the trust is a grantor trust with respect to the donor.[453]

Amount of the contribution

For a contribution of money, the amount of a contribution is the amount of money contributed. For a contribution of property other money, the amount of the contribution generally is the property's fair market value.[454] Fair market value is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."[455] In some cases, the fair market value of the property reflect discounts or premiums, such as a discount for blockage, lack of control discount, lack of marketability, or fractional interest. The IRS seems to be increasingly wary of charitable contributions that don't properly reflect applicable discounts.

In some cases, the amount of the contribution is the property's fair market value reduced by certain amounts. For example, to the extent gain upon the sale of the contributed property would not have been long-term capital gain, the amount of the contribution is the property's fair market value reduced by the amount of gain that's not long-term capital gain (e.g., short-term capital gain).[456] For example, if an individual contributes publicly traded stock held for one year or less, the amount of their contribution would be the lesser of (1) their adjusted basis in the stock and (2) the fair market value of the stock on the date of the gift. Given the effect of this rule often is to limit a donor to their basis, it's commonly described as a limitation to basis rule.

Similarly, for certain contributions, the amount of the contribution is the property's fair market value reduced by the amount of long-term capital gain that would be realized if the property was sold.[457] This rule generally applies to any contribution of:

- tangible personal property (e.g., artwork) if charitable donee doesn't use the property for a purpose related to its charitable or other tax-exempt purposes,[458]

[450] IRC § 170(f)(3)(A).
[451] IRC § 170(f)(3)(B).
[452] IRC § 170(f)(2)(A).
[453] IRC § 170(f)(2)(B).
[454] Treas. Reg. § 1.170A-1(c)(1).
[455] Treas. Reg. § 1.170A-1(c)(2).
[456] IRC § 170(e)(1)(A).
[457] IRC § 170(e)(1)(B).
[458] IRC § 170(e)(1)(B)(i)(I).

- tangible personal property if charitable donee sells or otherwise disposes of the property before the end of the year in which the contribution is made,[459]
- tangible personal property to a private foundation,[460]
- a patent, copyright, trademark, trade name, trade secret, know-how, or software,[461] and
- taxidermy property which is contributed by (1) the person who prepared, stuffed, or mounted the property or (2) any person who paid or incurred the cost of the preparation, stuffing, or mounting.[462]

Here, too, given the effect of this rule often is to limit a donor to their basis, it's commonly described as a limitation to basis rule.

Types of charitable organizations

The universe of tax-exempt charitable organizations – more specifically, 501(c)(3) organizations – comprises public charities and private foundations.[463] The deductibility of an individual's charitable contributions turns in part on the type of charitable organization to which the contributions were made and in part on the individual's adjusted gross income.

Public charities

A public charity is a type of tax-exempt charitable organization. A public charity generally is an organization that qualifies as a public charity by reason of its specific activities (e.g., a hospital, school, or church) or by reason of having a requisite level of public support.[464] In contrast, a private foundation usually is supported predominantly or exclusively by one donor or family.[465] Contributions to public charities generally receive more favorable tax treatment than contributions to private foundations. Also, donor advised funds and supporting organizations are public charities, but certain contributions to them are treated differently from contributions to other public charities.[466]

An individual who contributes cash to one or more public charities generally can deduct those contributions up to 60% of their adjusted gross income.[467] An individual who contributes the following property to one or more public charities generally can deduct those contributions up to 50% of their adjusted gross income:

- ordinary income property,
- capital assets that the individual has held for one year or less,
- tangible personal property that the charity doesn't use as a part of its charitable activities,
- capital gain property if the individual elects to use their basis in the property as the amount of the contribution, and
- capital assets in which there isn't any unrealized gains.[468]

For those types of property, the amount of the contribution is based on the individual's basis in the property.[469] An individual who contributes long-term capital gain property to one or more public charities generally can deduct those contributions up to 30% of their adjusted gross income.[470] When an individual contributes long-term capital gain property to a public charity, the amount of the individual's charitable contribution generally is the property's fair market value.[471] When an individual contributes tangible personal property that the donor has held for more than one year to a public charity, the amount of the individual's charitable

[459] IRC § 170(e)(1)(B)(i)(II).
[460] IRC § 170(e)(1)(B)(ii).
[461] IRC § 170(e)(1)(B)(iii).
[462] IRC § 170(e)(1)(B)(iv).
[463] IRC § 509(a). See, e.g., *Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated*, 80 Fed. Reg. 79684 (December 23, 2015) ("An organization described in section 501(c)(3) is classified as either a private foundation or a public charity"). A 501(c)(3) organization is an organization that is organized and operated exclusively for religious, charitable, scientific, or another qualifying purpose and is exempt from tax under Section 501(c)(3) of the Internal Revenue Code.
[464] IRC § 509(a)(1).
[465] Id.
[466] More precisely, a contribution to a donor advised fund is treated as a contribution to a public charity because the sponsoring organization that sponsors the fund is a public charity. For simplicity, we will generally speak in terms of a donor advised fund as if it is itself a public charity.
[467] IRC § 170(b)(1)(G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[468] IRC § 170(b)(1)(A).
[469] IRC § 170(e)(1).
[470] IRC § 170(b)(1)(C). Long-term capital gain property is capital gain property that the donor has held for more than one year.
[471] Treas. Reg. § 1.170A-1(c).

contribution is the donor's basis in the property unless the charity uses the property as a part of its charitable activities.[472] When an individual contributes property other than long-term capital gain property to a public charity, the amount of the individual's charitable contribution generally is the donor's basis in the property.[473]

A public charity is generally exempt from income tax.[474] Thus, it generally won't incur any tax upon the sale of assets that it receives as a gift from a donor. A public charity, however, is subject to the unrelated business income tax.[475] This tax may apply if the public charity has income from a trade or business or it has income from debt-financed property.[476] This tax applies to a public charity's proportionate share of income from an S corporation.[477]

Donor advised funds

A donor advised fund is a fund or account that is sponsored by a public charity and to which a donor makes contributions.[478] The donor or someone whom the donor designates – such as one or more members of the donor's family – generally can advise on distributions from the fund.[479] Distributions generally are made to public charities.[480] The donor or someone whom the donor designates potentially may advise on the investment of the assets in the fund.[481] The ability to advise on investments may be either in addition to or in lieu of being able to advise on distributions.[482] A donor advised fund generally enables a donor to make a charitable contribution, claim an income tax charitable deduction for that contribution, and maintain a pool of assets from which grants to public charities can be made over time.

> A donor generally can deduct gifts to a donor advised fund to the same extent that the donor can deduct gifts to other public charities.

Although a donor can generally make a qualified charitable distribution to a public charity, a donor can't make a qualified charitable distribution to a donor advised fund.[483] (We discuss qualified charitable distributions below.)

A donor generally can deduct gifts to a donor advised fund to the same extent that the donor can deduct gifts to other public charities. Accordingly, an individual can generally deduct cash contributions to a donor advised fund (and other public charities) up to 60% of their adjusted gross income[484] and generally can deduct non-cash contributions to a donor advised fund (and other public charities) up to either 50% or 30% of their adjusted gross income depending on the type of property, how long the individual has held the property, and, in the case of tangible personal property, how the charity will use the property.[485] (We discuss these rules in more detail above.)

A donor advised fund is generally exempt from income tax.[486] Thus, it generally won't incur any tax upon the sale of assets that it receives as a gift

[472] IRC § 170(e)(1)(B)(i)(I).
[473] IRC § 170(e)(1)(A).
[474] IRC § 501(a).
[475] IRC § 511.
[476] See IRC § 512.
[477] IRC § 512(e).
[478] IRC § 4966(d)(2). More precisely, a donor advised fund is separately identified by reference to contributions of one or more donors, and it is owned and controlled by a sponsoring organization. Id. A sponsoring organization is a public charity other than a governmental body. IRC § 4966(d)(1). A sponsoring organization must notify the IRS that it maintains donor advised funds. IRC § 508(f).
[479] Id.
[480] A donor advised fund is prohibited from making distributions to individuals but is permitted to make distributions to other persons for charitable purposes. IRC §§ 4966(c)(1) and (c)(2). A sponsoring organization must exercise expenditure responsibility – essentially a comprehensive set of due diligence obligations – for a distribution to a person other than a public charity. IRC § 4966(c)(1)(B)(ii). Many sponsoring organizations won't permit distributions to persons other than to public charities.
[481] IRC § 4966(d)(2)(A)(iii).
[482] Id.
[483] IRC § 408(d)(8)(B)(F)(i). A donor also can't make a qualified charitable distribution to a supporting organization.
[484] IRC § 170(b)(1)(G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[485] IRC §§ 170(b)(1)(A) and (1)(C).
[486] IRC § 501(a).

from a donor. A donor advised fund, however, is subject to the unrelated business income tax.[487] This tax may apply if the fund has income from a trade or business or it has income from debt-financed property.[488] This tax applies to a fund's proportionate share of income from an S corporation.[489] Some sponsoring organizations won't accept contributions of property that would cause it to be subject to the unrelated business income tax. Some may accept the contribution but allocate any taxes to the donor advised fund to which the contribution was made.

For a more in-depth discussion of donor advised funds, see Rebecca Sterling, *Donor Advised Funds and Private Foundations* (a publication of the UBS Advanced Planning Group).

Supporting organizations

A supporting organization is a tax-exempt charitable organization that vicariously enjoys public charity status, because of its close relationship with a public charity.[490] A supporting organization generally includes:

- an organization that's controlled by a public charity (i.e., a subsidiary of a public charity),[491]
- an organization that's under common with a public charity (i.e., an entity that's a sibling of a public charity),[492] and
- subject to certain conditions, an organization that operates in connection with a public charity.[493]

The donor and the donor's family generally can participate in the governance of a supporting organization but cannot control it.[494]

A donor generally can deduct gifts to a supporting organization to the same extent that the donor can deduct gifts to other public charities. Accordingly, an individual can generally deduct cash contributions to a supporting organization (and other public charities) up to 60% of their adjusted gross income[495] and generally can deduct non-cash contributions to a supporting organization (and other public charities) up to either 50% or 30% of their adjusted gross income depending on the type of property, how long the individual has held the property, and, in the case of tangible personal property, how the charity will use the property.[496] (We discuss these rules in more detail above.)

Although a donor can generally make a qualified charitable distribution to a public charity, a donor can't make a qualified charitable distribution to a supporting organization.[497] (We discuss qualified charitable distributions below.)

A supporting organization is generally exempt from income tax.[498] Thus, it generally won't incur any tax upon the sale of assets that it receives as a gift from a donor. A supporting organization, however, is subject to the unrelated business income tax.[499] This tax may apply if the supporting organization has income from a trade or business or it has income from debt-financed property.[500] This tax applies to a supporting organization's proportionate share of income from an S corporation.[501]

Private foundations

A private foundation is a tax-exempt charitable organization other than a public charity.[502] A private foundation

[487] More precisely, the sponsoring organization is subject to the unrelated business income tax. IRC § 511. A sponsoring organization generally will pay any unrelated business income tax attributable to a donor advised fund from the fund.
[488] See IRC § 512.
[489] IRC § 512(e).
[490] IRC § 509(a)(3).
[491] IRC § 509(a)(3)(B)(i).
[492] IRC § 509(a)(3)(B)(ii).
[493] IRC § 509(a)(3)(B)(iii).
[494] IRC § 509(a)(3)(C).
[495] IRC § 170(b)(1)(G)(i). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[496] IRC §§ 170(b)(1)(A) and (1)(C).
[497] IRC § 408(d)(8)(B)(i).
[498] IRC § 501(a).
[499] IRC § 511.
[500] See IRC § 512.
[501] IRC § 512(e).
[502] IRC § 509(a). See, e.g., *Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated*, 80 Fed. Reg. 79684 (December 23, 2015) ("An organization described in section 501(c)(3) is classified as either a private foundation or a public charity").

usually is supported predominantly or exclusively by one donor or family. The donor and the donor's family generally run or oversee the foundation, serving as the foundation's directors or trustees and making decisions concerning grants and investments. A private foundation may make grants to public charities, administer scholarship programs, or, in some cases, directly engage in charitable activities. A private foundation generally enables a donor to make a charitable contribution, claim an income tax charitable deduction for that contribution, and manage a pool of assets from which to make grants for charitable purposes to individuals, public charities, and other persons over time.

There are two types of private foundations. A private nonoperating foundation, which is more common, typically supports charitable purposes through grants to individuals, public charities, and other persons. In contrast, a private operating foundation, which is less common, directly conducts charitable activities, devoting a substantial portion of its financial resources directly to those activities.[503] Some museums, libraries, research laboratories, parks, and think tanks are private operating foundations. Contributions to private operating foundations receive more favorable treatment than contributions to private nonoperating foundations.

Private foundations are subject to various rules that effectively restrict their activities. These include the self-dealing and excess business holding rules. The self-dealing rule effectively prohibits an array of transactions between a private foundation and its donors and certain related individuals and entities.[504] The excess business holdings rule generally forces a private foundation to divest itself of certain privately held business interests in which the donors and certain related individuals and entities have ownership interests.[505] (We summarize these differences in more detail below.)

A private foundation is subject to a 1.39% tax on its investment income.[506] Thus, it may incur a tax upon the sale of assets that it receives as a gift from a donor. Let's assume that Alex gifts $1 million of publicly traded stock to a private foundation, Alex's basis in the stock is $200,000, and, immediately after receiving the gift, the foundation sells the stock. The foundation would incur a tax of $11,120 (i.e., 1.39% of $800,000) on the sale, so it would net $988,880.

Private nonoperating foundation

In the case of a private nonoperating foundation, an individual generally can deduct cash contributions up to 30% of their adjusted gross income.[507] In the case of publicly traded securities held for more than one year, an individual generally can deduct the securities' fair market value, and the individual generally can deduct those gifts up to 20% of their adjusted gross income.[508] In the case of any other property, the individual generally can deduct their basis in the property, and the individual generally can deduct those non-cash gifts up to 30% of their adjusted gross income.[509]

For a more in-depth discussion of private foundations, see Rebecca Sterling, *Donor Advised Funds and Private Foundations* (a publication of the UBS Advanced Planning Group), and Ann Bjerke, *Managing a Private Foundation* (a publication of the UBS Advanced Planning Group).

Private operating foundation

In the case of a private operating foundation, a donor generally can deduct contributions to the same extent that the donor can deduct gifts to public charities. Accordingly, an individual

[503] IRC § 4942(j)(3).
[504] See IRC § 4941.
[505] See IRC § 4943.
[506] IRC § 4940(a). Under limited conditions, a private operating foundation is exempt from this tax. IRC § 4940(d). For tax years beginning before December 20, 2019, a private foundation was subject to a 2% tax on its net investment income or, if it met certain minimum distribution requirements, a 1% tax on its net investment income.
[507] IRC § 170(b)(1)(B). More precisely, these percentage limitations are based on the donor's contribution base, which is the donor's adjusted gross income calculated without regard to any net operating loss carrybacks. IRC § 170(b)(1)(H).
[508] IRC § 170(b)(1)(D)(i).
[509] IRC § 170(b)(1)(B).

generally can deduct cash contributions to a private operating foundation up to 60% of their adjusted gross income[510] and generally can deduct non-cash contributions to a supporting organization (and other public charities) up to either 50% or 30% of their adjusted gross income depending on the type of property, how long the individual has held the property, and, in the case of tangible personal property, how the charity will use the property.[511] (We discuss these rules in more detail above.)

For a more in-depth discussion of private operating foundations, see Catherine McDermott and Julie Binder, *Private Operating Foundations* (a publication of the UBS Advanced Planning Group).

Substantiating charitable contributions

An individual who makes a charitable contribution and wishes to claim an income tax charitable deduction for the contribution must properly substantiate the contribution. In recent years, several court cases have denied taxpayers a charitable deduction for failing to comply strictly with these substantiation requirements.[512]

Contributions over $250

For a gift in excess of $250, a donor must obtain a receipt.[513] This is so even if the donor made the gift to their own private foundation. The donor must obtain the receipt before filing the income tax return on which they claim the income tax charitable deduction.[514] The receipt must be in writing, state the amount donated, describe any non-cash property that the donor donated, and indicate the value of any goods or services provided by the charity as consideration for the gift.[515] A canceled check does not meet these requirements.[516]

Contributions of property over $5,000

For a gift of property (other than publicly traded securities) having a value of more than $5,000, a donor generally must obtain a qualified appraisal.[517] The donor must obtain the appraisal before filing the income tax return on which they claim the income tax charitable deduction.[518]

Selected planning strategies and considerations

Charitable giving encompasses a vast array of planning strategies and considerations. Let's explore some.

Making year-end gifts

If an individual wishes to obtain an income tax charitable deduction for 2024, the individual must make their gift on or before December 31, 2024.[519] A gift typically is made once the charitable organization receives it.[520] A special rule applies to a check sent via the US Postal Service. If the individual writes a check payable to a charitable organization, mails the check (via the US Postal Service) to the organization on or before December 31, 2024, and the organization cashes the check in due course, then the individual generally can claim the deduction for that gift in 2024.[521]

When contemplating year-end gifts, an individual should be mindful of the practical issues with completing the gift. For example, a gift of stock for which the donor has a physical stock certificate may take several weeks to complete. Similarly, a gift of real estate involves preparing a deed, signing it, and delivering it to the charitable organization.

Just as there are a number of different assets that can be used to make gifts, there are also several types of charitable organizations to receive those gifts. Below, we explore various types of charitable organizations and the differences between them.

[510] IRC §§ 170(b)(1)(A)(vii) and (G)(i). After 2025, this 60% limitation expires, and the 50% limitation will apply to these contributions. IRC § 170(b)(1)(G)(i).
[511] IRC §§ 170(b)(1)(A) and (1)(C).
[512] See, e.g., *Albrecht v. Commissioner,* T.C. Memo 2022-53, Ohde v. *Commissioner*, T.C. Memo 2017-137, and *Durdan v. Commissioner,* T.C. Memo 2012-140.
[513] IRC 170(f)(8)(A).
[514] Id.
[515] IRC § 170(f)(8)(B).
[516] Treas. Reg. § 1.170A-15(a).
[517] IRC § 170(f)(11)(C).
[518] Id.
[519] IRC § 170(a)(1).
[520] Treas. Reg. § 1.170A-1(b).
[521] Id.

Bunching charitable gifts

An individual who typically makes annual charitable gifts but doesn't have itemized deductions in excess of the standard deduction might consider bunching multiple years of charitable gifts into a single year. Since 2018, many individuals do not have sufficient itemized deductions to exceed the standard deduction.[522] Bunching multiple years of charitable gifts may cause the individual's itemized deductions to exceed the standard deduction and therefore maximize their income tax charitable deduction. The individual might consider contributing the bunched amount to a donor advised fund so that the individual can make grants periodically to one or more charities in future years.

Selecting assets to give to charity

For many individuals, the selection of assets to give to charity often comes down to a choice between cash (largely due to simplicity) and appreciated, long-term publicly traded securities (largely due to being able to benefit from the income tax charitable deduction while avoiding the unrealized capital gains). But the choice isn't always so simple, and there are several factors that a donor might wish to consider. When selecting assets to give to charity, some key factors to consider include:

- the extent to which the contribution provides tax benefits,
- the extent to which the contribution would be deductible under the percentage limitations,
- the ease or complexity of making the contribution, and
- the ease or complexity of substantiating the contribution.

The selection of assets can affect the tax benefits that the donor enjoys. For purposes of evaluating those benefits, there are four questions that a donor may wish to ask.

First, does the gift provide an income tax charitable deduction? Most gifts do, but there are some that don't (such as a gift of transferrable, unvested NSOs or a gift of a remainder interest in undeveloped land that isn't farmland).[523]

Second, in the case of a non-cash gift, is the deduction based on the property's fair market value or something less (such as the donor's basis in the property)? For example, an artist who gives artwork that they created generally can deduct only their basis in the artwork.[524] Similarly, a donor who gives publicly traded stock held for one year or less can deduct only their basis in the stock,[525] but a donor who gives publicly traded stock held for more than one year generally can deduct the stock's fair market value.[526]

Third, does the donor get the income tax deduction while avoiding tax on unrealized capital gains? For many donors, this is the essential reason they choose to give appreciated, long-term capital gain property (rather than cash) when making gifts to donor advised funds, supporting organizations, and other public charities or appreciated, long-term publicly traded securities when making gifts to private nonoperating foundations.[527]

Fourth, would the donor lose a tax benefit by making the gift? For example, an individual who owns publicly traded stock in which there's an unrealized loss typically would be better off selling the stock, recognizing the loss, and donating the proceeds to charity. If the individual contributes the stock to charity, the amount of the individual's contribution would be the stock's fair market value, and the individual would lose the ability to claim the loss.

When picking assets to give to charity, some individuals may consider the extent to which their gifts would be deductible under the percentage limitations. An example may help illustrate this point. Let's assume that an individual wishes to minimize their taxable income as much as possible through gifts to a public charity.[528] The individual might give cash in

[522] See IRC § 63(c).
[523] See Rev. Rul. 98-21.
[524] IRC § 170(e)(1)(A).
[525] Id.
[526] Treas. Reg. 1.170A-1(c).
[527] See IRC § 170(e)(5)(A).
[528] Let's also assume that the individual doesn't have any net operating loss carrybacks, so that the individual's contribution base is their adjusted gross income.

an amount equal to 60% of their adjusted gross income. Alternatively, the individual might choose to give a mix of cash and property. To that end, the individual might choose to give (1) publicly traded stock that has a fair market value equal to 30% of the donor's adjusted gross income and has been held by the donor for more than one year and (2) cash in an amount equal to 20% of their adjusted gross income.

The ease or complexity of making a contribution may affect a donor's choice of assets to give to charity. Sometimes, it's a matter of how fast and easy it is to transfer the asset to charity. For example, donating publicly traded stock that a donor holds through a brokerage or other investment account typically is straightforward. In contrast, donating publicly traded stock that the donor holds as physically certificated shares is more involved. Sometimes, it's a matter of how much work the charity needs to do to decide whether it should accept the gift. For example, a charity typically conducts due diligence before accepting a gift of real property or an interest in a privately held business.

The ease or complexity of substantiating the contribution also may affect a donor's choice of assets to give to charity. When a donor gives property (other than publicly traded securities) to a charity, the donor generally must obtain a qualified appraisal to substantiate the value of the property.[529] This increases the cost and inconvenience of making the gift. Thus, when choosing between publicly traded stock and privately held stock, a donor might favor publicly traded stock, because the donor can avoid the need for an appraisal. Of course, a donor might choose the privately held stock – even though the donor will need to obtain an appraisal – if the donor anticipates a sale of the business later in the year, because the amount of the contribution potentially would be the stock's fair market value (so long as the donor has held the stock for more than one year) and the donor potentially would avoid the capital gains on the future sale of the stock.[530]

Making qualified charitable distributions

An individual who has attained 70½ years of age and is charitably inclined might consider making a qualified charitable distribution, which is a distribution from a traditional IRA to a qualifying charity.[531] In 2024, an individual generally can make up to $105,000 of qualified charitable distributions.[532] Beginning in 2024, this limit indexes for inflation.[533] This limit applies separately to each IRA owner regardless of the IRA owner's filing status. Accordingly, in 2024, each spouse in a married couple generally can make up to $105,000 of qualified charitable distributions (regardless of whether they file jointly or separately).[534] An individual's qualified charitable distributions count toward the individual's RMDs.[535]

A distribution qualifies as a qualified charitable contribution if:

- the IRA owner has attained 70½ years of age,[536]
- the distribution is made from an IRA directly to a public charity (other than a donor advised fund or supporting organization),[537]
- the distribution would be includible in the IRA owner's income (ignoring the rule that excludes a qualified charitable distribution from income),[538] and

[529] IRC § 170(f)(11)(C).

[530] A donor, however, potentially is taxable on the capital gain if the donor contributes the stock after the sale is all but a done deal. For a more in-depth discussion of this issue (which, in tax parlance, is called the assignment of income doctrine), see Ann Bjerke, *When to Give to Charity: Before or after the Sale of a Business* (a publication of the UBS Advanced Planning Group).

[531] IRC § 408(d)(8)(B). A distribution from an active SEP IRA or an active SIMPLE IRA, however, doesn't qualify as a qualified charitable contribution. A SEP IRA is an IRA that's set up by or for an employee under a simplified employee pension (SEP). See IRC § 408(k)(1). A SIMPLE IRA is an IRA that's set up for an employee under a savings incentive match plan for employees of small employers (SIMPLE) IRA plan. See IRC § 408(p)(1). A SEP IRA or SIMPLE IRA is active (or, in the IRS's parlance, ongoing) if the employer makes a contribution to it during the plan year that ends in the calendar year in which the employee would make a qualified charitable distribution. Notice 2007-07, A-36.

[532] IRC § 408(d)(8)(A). See Notice 2023-75. This cap may be less if the individual has made contributions to IRAs after attaining 70½ years of age.

[533] IRC § 408(d)(8)(G).

[534] Notice 2007-7, A-34.

[535] Notice 2007-7, A-42.

[536] IRC § 408(d)(8)(B)(ii).

[537] IRC § 408(d)(8)(B)(i).

[538] IRC § 408(d)(8)(B) (flush language).

Excluding a qualified charitable deduction from income and allowing an income tax deduction for the distribution would be a double tax benefit.

- the distribution would qualify for an income tax charitable contribution (ignoring the rule that disallows an income tax charitable deduction for a qualified charitable distribution and ignoring the percentage limitations that limit the deductibility of charitable contributions).[539]

An IRA owner may make qualified charitable distributions even though they aren't required to take RMDs. For example, an individual who attains 70½ years of age in 2024 may make a qualified charitable distribution, even though the individual won't be required to take RMDs from their traditional IRA until they attain 73 years of age. (We discuss RMDs in more depth above.)

To qualify as a qualified charitable distribution, the distribution must be made from an IRA directly to a qualifying charity.[540] There are a couple ways to satisfy this direct payment requirement. The IRA trustee can transfer the funds directly to the charity (e.g., by sending a check directly to the charity or via electronic funds transfer). Alternatively, the IRA trustee can provide to the IRA owner a check from the IRA made payable to the charity and the IRA owner can deliver that check to the charity.[541]

A distribution qualifies as a qualified charitable distribution only if it would be includible in the IRA owner's income (ignoring the rule that excludes a qualified charitable distribution from income).[542] Accordingly, to the extent that a distribution is from non-deductible contributions that the IRA owner made to an IRA, the distribution won't qualify as a qualified charitable distribution. For these purposes, distributions are treated as coming first from amounts that would be includible in the IRA owner's income.[543]

In 2024, the total amount of qualified charitable distributions can't exceed $105,000.[544] This amount, however, is reduced by any deductible contributions that the individual has made to one or more IRAs in the years after attaining 70½ years of age (to the extent those contributions didn't reduce the qualified charitable distributions that the IRA owner made in prior years).[545] To the extent the individual makes non-deductible contributions to the IRAs, those contributions are ignored for purposes of calculating this reduction.

An example may help. Let's assume an individual who attained 70½ years of age in 2023 made a $7,000 deductible contribution to a traditional IRA in 2023. Consequently, the individual's qualified charitable distributions couldn't exceed $93,000 in 2023 (i.e., the $100,000 limit in effect in 2023 reduced by the amount of the deductible contributions). If the individual made a $93,000 qualified charitable distribution in 2023 and doesn't make any deductible contributions to an IRA in 2024, then the individual may make up to $105,000 of qualified charitable distributions in 2024.

A qualified charitable distribution isn't includible in the IRA owner's income and thus isn't subject to income tax.[546] A qualified charitable distribution doesn't qualify for an income tax charitable deduction.[547] This makes

[539] IRC § 408(d)(8)(C).
[540] IRC § 408(d)(8)(B)(i).
[541] Notice 2007-7, A-41.
[542] IRC § 408(d)(8)(B) (flush language).
[543] IRC § 408(d)(8)(D).
[544] IRC § 408(d)(8)(A). See Notice 2023-75.
[545] Id.
[546] IRC § 408(d)(8)(A).
[547] IRC § 408(d)(8)(E).

sense, because it also isn't included in income. Excluding a qualified charitable deduction from income *and* allowing an income tax deduction for the distribution would be a double tax benefit.

Making a qualified charitable distribution to a charitable remainder trust or charitable gift annuity

An IRA owner might consider making a qualified charitable distribution to a charitable remainder trust or charitable gift annuity, although there may be some practical considerations.[548] In 2024, qualified charitable distributions to a charitable remainder trust or charitable gift annuity can't exceed $53,000, and those distributions counts toward the overall limit for qualified charitable distributions (generally $105,000).[549] This limit indexes for inflation.[550] The IRA owner must make an election to treat the distribution to the charitable remainder trust or charitable gift annuity as a qualified charitable distribution, and the IRA owner can make such an election only once during their lifetime.[551] The distribution must be made from a traditional IRA directly to the trustee of the charitable remainder trust or the charitable organization that issues the charitable gift annuity.[552]

In the case of a charitable remainder trust, the trust would be either a charitable remainder annuity trust (which distributes a fixed amount to the income beneficiaries each year) or a charitable remainder unitrust (which generally distributes a fixed percentage of the value of its assets each year). (We discuss charitable remainder trusts in more depth below.) In the case of a charitable gift annuity, the annuity would be designed so that annuity payments would begin upon inception (rather than being deferred) and would pay at least 5% of the amount that funds the charitable gift annuity.

The charitable remainder trust or charitable gift annuity must be funded exclusively by qualified charitable distributions.[553] It can't be funded with any other money or property. Thus, for example, an individual who created a charitable remainder unitrust in 2020 can't make a qualified charitable distribution to the trust (because the trust would've been funded with assets other than a qualified charitable distribution). Similarly, an individual can't create a charitable remainder annuity trust in 2023 and fund it with publicly traded securities and a qualified charitable distribution.

> An individual who owns appreciated property, wishes to diversify in a tax-efficient manner, and is charitably inclined might consider creating a charitable remainder trust.

The IRA owner isn't entitled to an income tax charitable deduction for a qualified charitable distribution to a charitable remainder trust or charitable gift annuity. In the case of a qualified charitable distribution to a charitable remainder trust, the trust must be designed so that the remainder would qualify for an income tax charitable deduction if a deduction were allowed.[554] Similarly, in the case of a qualified charitable distribution to a charitable gift annuity, the charitable gift annuity must be designed so that the amount of the distribution in excess of the present value of the annuity would qualify for an income tax charitable deduction if a deduction were allowed.[555]

[548] IRC § 408(d)(8)(F)(i). A distribution from an active SEP IRA or an active SIMPLE IRA, however, doesn't qualify as a qualified charitable contribution. See note 531.

[549] IRC § 408(d)(8)(F)(i)(II). See Notice 2023-75. We discuss the overall limit for qualified charitable distributions above.

[550] IRC § 408(d)(8)(G).

[551] IRC §§ 408(d)(8)(F)(i)(I) and (II).

[552] IRC § 408(d)(8)(F)(i). The statute speaks in terms of the distribution being made directly to the trustee of the charitable remainder trust or the trustee of the charitable gift annuity. Unlike a charitable remainder trust, a charitable gift annuity isn't a trust. It is a contractual arrangement between the donor and the charitable organization. Thus, in the context of a charitable gift annuity, the statute presumably means the distribution must be made directly to the charitable organization that issues the charitable gift annuity.

[553] IRC § 408(d)(8)(F)(ii).

[554] IRC § 408(d)(8)(F)(iii)(I).

[555] IRC § 408(d)(8)(F)(iii)(II).

The IRA owner and the IRA owner's spouse are the only permissible income beneficiaries of the charitable remainder trust or annuitants of the charitable gift annuity.[556] The income or annuity interest of the IRA owner and the IRA owner's spouse must be non-assignable.[557] All distributions from the charitable remainder trust to the IRA owner and the IRA owner's spouse would be ordinary income, and all annuity payments to the IRA owner and the IRA owner's spouse would be ordinary income.[558]

Given the $53,000 limit and other rules, a qualified charitable distribution to a charitable remainder trust may be impractical.[559] The costs of creating and administering the charitable remainder trust could easily outweigh the benefits. An IRA owner might find that it potentially more advantageous to make a smaller qualified charitable distribution (or other charitable contribution) directly to a qualifying charitable organization and take distributions from the IRA. For the donor, a charitable gift annuity typically involves minimal administrative and other costs, so a qualified charitable distribution to a charitable gift annuity might be economically practical.

Creating a charitable remainder trust

An individual who owns appreciated property, wishes to diversify in a tax-efficient manner, and is charitably inclined might consider creating a charitable remainder trust. The trust potentially enables the individual to sell the appreciated property, defer recognition of the capital gains, and receive a stream of income (typically for life). This may be an attractive strategy for someone who owns a low-basis concentrated stock position or a business owner who anticipates that there may be a sale of the company in the not-too-distant future.

A charitable remainder trust is an irrevocable trust that pays income to one or more individuals for life (or a term of up to 20 years) after which it distributes any remaining assets to one or more charitable organizations or holds the assets in trust for charitable purposes.[560] A charitable remainder trust pays income either in the form of an annuity (in which case the trust is a charitable remainder annuity trust) or a unitrust (in which case the trust is a charitable remainder unitrust). A charitable remainder annuity trust pays an annuity (i.e., a fixed dollar amount) to the income beneficiaries.[561] A charitable remainder unitrust generally pays a fixed percentage of its value to the income beneficiaries (although there are some permissible exceptions and variations).[562] The present value of the remainder interest must equal at least 10% of the fair market value of contributed property at the time of contribution.[563]

An individual generally doesn't recognize any capital gain upon contributing appreciated property to a charitable remainder trust.[564] In addition, a charitable remainder trust is generally tax-exempt, so it typically can sell the property without incurring any tax and can reinvest the proceeds in a diversified portfolio.[565] As the individual receives distributions from the trust, the individual generally includes those distributions in income.[566] In the year in which the individual funds the trust, the individual generally can claim an income tax charitable deduction for the present value of the trust's remainder interest.[567]

For a more in-depth discussion of charitable remainder trusts, see Jennifer Lan, *Charitable Remainder Trusts* (a publication of the UBS Advanced Planning Group).

[556] IRC § 408(d)(8)(F)(iv)(I).
[557] IRC § 408(d)(8)(F)(iv)(II).
[558] IRC § 408(d)(8)(F)(v).
[559] The $53,000 limit is the limit for qualified charitable distributions made in 2024 to a charitable remainder trust or charitable gift annuity, and it adjusts for inflation.
[560] See IRC § 664.
[561] IRC § 664(d)(1).
[562] IRC §§ 664(d)(2) and (3).
[563] IRC §§ 664(d)(1)(D) and (d)(2)(D).
[564] See Treas. Reg. § 1.1011-2.
[565] IRC § 664(c).
[566] IRC § 664(b).
[567] IRC § 170(f)(2)(A).

For more information about using charitable remainder trusts to manage a concentrated stock position, see Rebecca Sterling, *Concentrated Stock Positions* (a publication of the UBS Advanced Planning Group). For more information about using charitable remainder trusts in pre-sale planning, see David Leibell, *Planning for the Sale of a Closely Held Business* (a publication of the UBS Advanced Planning Group and UBS Family Office Solutions).

Creating a charitable lead annuity trust

An individual who is charitably inclined and likes the idea of shifting wealth on a gift and estate tax free basis to children (or others) might consider creating a charitable lead annuity trust. A charitable lead annuity trust is a trust that annually pays an annuity (that is, a fixed dollar amount) to one or more charities for a period of time (often, 10 or 20 years), after which the remaining property is distributed (either outright or in trust) to one or more non-charitable beneficiaries (typically, the donor's children). The trust could pay the annuity to the individual's donor advised fund or private foundation, or it could pay the annuity to one or more charities that the trustee selects each year.

A charitable lead annuity trust usually is designed as a zeroed-out charitable lead annuity trust, which means that the present value of the remainder interest (i.e., the interest of the donor's children or other non-charitable beneficiaries when the annuity term ends) is zero. To the extent that, over the annuity term, the trust's property grows in value at a rate that exceeds the section 7520 rate that applied when the trust was funded, the trust will generally shift that appreciation to the non-charitable beneficiaries free of any gift and estate taxes. The section 7520 rate, which is the interest assumption that's used for valuing certain interests for gift and estate tax purposes, thus acts like a hurdle rate.[568] The IRS publishes the section 7520 rate monthly.[569]

If the trust is designed as a grantor trust, then the donor generally can claim an income tax charitable deduction for the present value of the charitable interest in the trust (i.e., the annuity interest).[570] Thus, in a zeroed-out charitable lead annuity trust, the donor generally can claim an income tax charitable deduction for the full value of the property that the donor contributes to the trust.[571] Of course, if the trust is designed as a grantor trust, then the donor must include the trust's income, deductions, and credits on the grantor's income tax return.[572] If, in contrast, the trust is designed as a nongrantor trust, then the donor can't claim an income tax charitable deduction for the donor's contribution to the trust, but the trust generally can claim an income tax charitable deduction for the annuity payments that it makes.[573]

For a more in-depth discussion of charitable lead annuity trusts, see Jennifer Lan, *Charitable Lead Annuity Trusts* (a publication of the UBS Advanced Planning Group).

Managing a private foundation

An individual who created a private foundation and remains involved in its management (such as a director or trustee) should review the foundation's investments and operations before year end.[574] Some key things to consider doing:

- Confirm that the directors and trustees have or will have had any meeting that the foundation's governing documents or state law may require and that those meetings have been properly documented (e.g., through minutes of those meetings).

[568] More specifically, the 7520 rate is 120% of the federal midterm rate (subject to rounding). IRC § 7520(a)(2). The federal midterm rate is based on the average market yield on outstanding marketable obligations of the United States with a remaining maturity period of more than three years and not more than nine years. IRC § 1274(d)(1)(C)(ii).
[569] Treas. Reg. § 1.7520-1(b)(1)(i).
[570] IRC § 170(f)(2)(B).
[571] Id. If the donor dies before the end of the annuity term, then a portion of the income tax charitable deduction is includible as income and is reportable the donor's final income tax return. See Treas. Reg. § 1.170A-6(c)(4).
[572] IRC § 671.
[573] IRC § 642(c).
[574] For simplicity, we will assume that the foundation's taxable year is the calendar year, which is commonly the case.

- If there have been any changes affecting who is serving as a director, officer, or trustee, confirm that any appointment, resignation, or removal has been properly documented.
- Calculate an estimated amount of grants that the foundation must make this year.
- Confirm that, before year end, the foundation made (or will have made) all of the grants that it was required to make for last year.
- Consider making a grant from the private foundation to a donor advised fund before year's end if there isn't time to decide which charities should receive some or all of the amount that the foundation must grant this year.
- Consider making grants of low-basis stock instead of selling the stock to raise cash for the grants, so that the foundation avoids the 1.39% excise tax on the gain from such sales.
- If the foundation recognized any losses during the year, consider selling appreciated property, so that the foundation can offset those losses (because the foundation can't carry losses forward to next year).

For a more in-depth discussion of managing private foundations, see Ann Bjerke, *Managing a Private Foundation* (a publication of the UBS Advanced Planning Group),

Further reading

For a comprehensive discussion of charitable giving, see David Leibell, *Charitable Giving: Rules of the Road* (a publication of the UBS Advanced Planning Group, UBS Family Office Solutions, and UBS Family Advisory and Philanthropy Services).

Wealth transfer planning

Overview

Wealth transfer planning is an ongoing process. It's often an iterative process, involving the evaluation and reevaluation of evolving objectives, changing circumstance, and the efficacy of any past planning.

An individual's estate plan has two main stages:
- Core estate plan
- Advanced planning

Broadly speaking, the core estate plan focuses on decision-making in the event of incapacity and on basic wealth transfer, and advanced planning generally focuses on wealth transfer tax mitigation. We'll explore these stages of planning, wealth transfer taxes, and some notable planning strategies.

Core estate plan

For many individuals, their core estate plan (sometimes called the foundational estate plan) consists of six key elements:
- Revocable trust
- Will
- Advance directives
  - Power of attorney for financial and legal matters
  - Power of attorney for healthcare
  - Living will
  - Nomination of guardians

For many individuals, a revocable trust is the cornerstone of their estate plan, facilitating the management of assets during life if they become incapacitated and directing the transfer of assets after their death. A *revocable trust* is a trust in which the settlor (i.e., the person who creates and funds the trust) can reacquire the trust property by revoking the trust. The settlor ordinarily has the power to amend the terms of the trust – which typically are set forth in a trust instrument, such as a trust agreement or declaration of trust – so the settlor has the flexibility of changing those terms any time while they are living and have capacity.

When funded during life, a revocable trust can provide a means of transferring wealth while avoiding probate. Probate is a court-supervised process for transferring assets. A revocable trust typically is a more advantageous method of transferring wealth than probate. A revocable trust generally provides more privacy, potentially avoids certain legal and administrative costs, and potentially facilitates a more expeditious transfer of wealth after an individual's death.

For a married couple living in a community property state (such as Arizona, California, Texas, or Washington), they would typically have a joint revocable trust, which wouldn't affect the character of property (as community property or separate property) they contribute to the trust and would be designed to specifically handle both types of property. For a married couple living in a non-community property state, each spouse would generally have their own, separate revocable trust. If the couple previously lived in a community property state, they might have a joint revocable trust for their community property and separate revocable trusts for their separate property.

A *will* is a document governing a deceased individual's probate estate. A will serves three main purposes. First, it directs the distribution of the probate assets. These include assets that were held in the individual's name and assets payable to the probate estate. When an individual has a revocable trust, their will typically directs any probate assets to be distributed to their revocable trust. In this case, the will is sometimes called a *pour-over will*, because the probate assets pour into the revocable trust. Second, the will is where an individual can nominate one or more individuals or institutions to be the personal representative of their estate. The personal representative is the person responsible for administering the estate (to varying degrees, under

the probate court's supervision), which generally includes collecting (marshalling) the probate assets, paying debts, expenses, and taxes, and distributing the remaining assets in accordance with the terms of the will. Third, for an individual with minor children, they can use their will to nominate a guardian for those children. (In some cases, an individual might address the nomination of guardians of minor children in a separate document.)

While an individual's revocable trust and will primarily address the transfer of assets after death, an individual's advance directives address on how financial, legal, and healthcare decisions are made on the individual's behalf. A *power of attorney for financial and legal matters* is a document by which an individual appoints someone (usually called an *agent* or *attorney-in-fact*) to make financial and legal decisions for them. A *general power of attorney* grants broad powers to the agent. In contrast, a *limited power of attorney* grants specific (limited) powers, such as the power to engage in a specific transaction (such as the purchase or sale of real estate) or the power to deal with a specific account or asset (such as a specific investment account). A *durable power of attorney* is a power of attorney that remains effective even if the individual granting the power becomes incapacitated.

A *power of attorney for healthcare* (sometimes called a *healthcare proxy*) is a document by which an individual appoints someone to make healthcare decisions for them if they become incapacitated and thus unable to make those decisions for themselves. A *living will* is a document by which an individual expresses their wishes concerning life-sustaining care.

A *nomination of guardian* is a document by which an individual nominates someone to serve as their guardian for financial matters (sometimes called a conservator), their guardian for healthcare and other non-financial matters, or both. A nomination of guardian usually is a backstop to the power of attorney for financial and legal matters and the power of attorney for healthcare. In some cases, an individual might nominate their guardians in their powers of attorney rather than in a separate, standalone document.

For a more in-depth discussion of the core estate plan, see Joanna Morrison, *Estate Planning: An Overview* (a publication of the UBS Advanced Planning Group). For a more in-depth discussion of the probate process, see Casey Verst, *Probate Primer* (a publication of the UBS Advanced Planning Group).

Advanced planning

Advanced planning generally focuses on minimizing wealth transfer taxes to the extent consistent with an individual's non-tax objectives. In broad terms, advanced planning can be viewed in three phases:

- Making non-taxable gifts
- Using the lifetime exemption
- Shifting future appreciation out of the estate

An individual shouldn't let taxes be the tail that wags the dog. An individual should consider engaging in advanced planning only to the extent they feel they're able to take care of their own financial needs and wishes during their life and are comfortable making gifts or undertaking other advanced planning strategies.

Wealth transfer taxes

Wealth transfer planning often involves consideration of various taxes. At the federal level, there are three wealth transfer taxes:

- Gift tax
- Estate tax
- Generation-skipping transfer (GST) tax

Many states also impose wealth transfer taxes. More than one-third of the states impose estate or other death taxes (i.e., estate taxes, inheritance taxes, and similar taxes).[575] One state imposes a gift tax, although some states impose death taxes on gifts made with a certain time before death.[576] (In this chapter, we'll focus on federal wealth transfer taxes.)

In addition to wealth transfer taxes, planning often has income tax implications. For example, an individual might transfer assets to an irrevocable trust that's designed to be outside of the individual's estate for estate tax purposes. When the individual dies, the assets shouldn't be includable in the individual's estate for estate tax purposes (so long as the trust was properly designed and administered), but they also typically wouldn't qualify

[575] "State Death Tax Chart," American College of Trust and Estate Counsel, May 3, 2023, https://www.actec.org/resources/state-death-tax-chart/.
[576] Id.

for stepped-up basis (or, more precisely, basis adjustment). Thus, there's a trade-off between potential estate tax savings and potential income tax savings. (We discuss stepped-up basis in the section entitled "Basis" in the chapter entitled "Income Tax.")

For a discussion of some of the income tax aspects of wealth transfer planning, see Rebecca Sterling, *Income Tax Basis Considerations in Estate Planning* (a publication of the UBS Advanced Planning Group).

Gift tax

The gift tax is a 40% tax on taxable gifts in excess of the gift tax exemption.[577] As we'll explore in more depth below, certain gifts are non-taxable. These include gifts that qualify for:

- the gift tax annual exclusion,[578]
- the exclusion for the payment of tuition,[579]
- the exclusion for the payment of medical expenses,[580]
- the gift tax marital deduction,[581] or
- the gift tax charitable deduction.[582]

The gift tax applies to the extent an individual's taxable gifts exceed their gift tax exemption.[583] In 2024, the gift tax exemption is $13.61 million.[584] This amount adjusts annually for inflation.[585] For simplicity, we often refer to the gift and estate tax exemption as the *lifetime exemption*. The gift and estate taxes are unified. To the extent an individual doesn't use their lifetime exemption during life, they effectively can use it upon death.

The lifetime exemption, however, currently includes a temporary additional amount of exemption.[586] This increase, which roughly doubled the exemption, ends after 2025. Accordingly, in 2026, the lifetime exemption will be about one-half of what it was the year before.[587] To the extent an individual hasn't used this additional amount before it expires, they will lose that tax benefit. To the extent they have used the additional amount, it generally won't adversely affect the amount of gift and estate taxes to which the individual will be subject after the temporary addition expires.[588] This is sometimes called the *anti-clawback rule*. (In 2022, the IRS released proposed regulations that would establish an anti-abuse exception to the anti-clawback rule, so the anti-clawback rule would generally apply only where the individual does not retain possession and enjoyment of the transferred asset.[589])

For a discussion of the advantages of using this temporary additional amount of exemption, see Jacqueline Denton, *The Looming Cliff: Temporary Increase in the Lifetime Exemption Scheduled to Sunset at the End of 2025* (a publication of the UBS Advanced Planning Group).

Gifts

A gift generally is a transfer of money or other property to the extent the transferor doesn't receive something of value in exchange.[590] Donative intent – that is, an intent to make a gift – isn't determinative of whether a transfer is a gift for gift tax purposes.[591] As the gift tax regulations observe, "the application of the [gift] tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor."[592] Accordingly, determining whether a transfer is a gift tends to focus on the value of the property transferred and the value (if any) of property or services received.

[577] IRC §§ 2501(a) and 2502(a). The tax rates are progressive, but the top marginal rate of 40% applies to taxable transfers over $1 million. IRC § 2502(c).
[578] IRC § 2503(b)(1).
[579] IRC § 2503(e)(2)(A).
[580] IRC § 2503(e)(2)(B).
[581] IRC § 2523.
[582] IRC § 2522(a).
[583] IRC §§ 2501(a), 2502(a), and 2505(a).
[584] Rev. Proc. 2023-34. This assumes the individual is a US citizen or otherwise a US person for gift and estate tax purposes.
[585] IRC § 2010(c)(3)(B). See IRC § 2505(a)(1).
[586] IRC § 2010(c)(3)(C).
[587] Id.
[588] Treas. Reg. § 20.2010-1(c).
[589] Prop. Reg. § 20.2010-1(c)(3).
[590] Treas. Reg. § 25.2511-1(a).
[591] Treas. Reg. § 25.2511-1(g)(1). In contrast, the transferor's intent is the controlling factor in determining whether a payment is a gift for income tax purposes. *Commissioner v. Duberstein*, 363 U.S. 278 (1960).
[592] Id.

In some cases, a transfer labeled as a gift may, in fact, be something else. For example, a gift generally isn't includable in the recipient's gross income,[593] so people sometimes attempt to treat a bonus or other compensation as a gift.[594] Unsurprisingly, things sometimes get messy when there's a family business and a family member might receive both compensation and gifts. The determination of whether a transfer is compensation or a gift can turn on whether the transferor and transferee are consistent in how they treat the payment for tax purposes.[595]

Indirect gifts

A gift may be made directly or indirectly.[596] A gift in trust generally is a gift to the trust's beneficiaries.[597] Similarly, a gift to a corporation generally is a gift to the corporation's shareholders in proportion to their ownership interests, and a gift to a limited liability company generally is a gift to the company's members in proportion to their membership interests.[598] (A transfer to a corporation or limited liability company potentially is a gift if the transferor doesn't receive something of comparable value – e.g., an increased ownership interest – in return.[599]) Conversely, a gift from a corporation to an individual generally is a gift from the corporation's shareholders to the individual.[600]

Disclaimers

An individual generally makes a gift to the extent they disclaim or otherwise decline to accept the receipt of an interest in property, unless the disclaimer is a qualified disclaimer.[601] A disclaimer generally is a qualified disclaimer if:

- the disclaimer is made within nine months of the transfer creating the interest in the property the individual is disclaiming,
- the individual hasn't accepted the property or any benefits from the property,
- without any direction from the individual making the disclaimer, the disclaimed property passes to someone other than the individual (unless the individual is the transferor's surviving spouse), and
- the disclaimer is made in writing and delivered to the transferor, the personal representative of the transferor's estate, or potentially another person.[602]

The creation-of-the-interest rule, which defines when the nine-month period for making a qualified disclaimer, is nuanced. In some situations, the rule's application is straightforward. If, for example, an individual who owns an insurance policy on their life names a child as the beneficiary of the policy, the child generally must disclaim the insurance proceeds within nine months of their parent's death.[603] Otherwise, the disclaimer won't qualify as a qualified disclaimer. In other situations, things get more complicated. If, for example, an individual creates an irrevocable trust for the benefit of their only child and, upon the child's death, the trust divides into separate trusts for each of the individual's grandchildren, a grandchild's disclaimer within nine months of their parents death ordinarily won't be timely, because a grandchild's interest was created when the trust was created.[604]

Incomplete gifts

A transfer is subject to the gift tax only if it's completed gift. A completed gift is a gift in which the transferor has relinquished the power to control the property's disposition.[605] For example, a gift is incomplete if the transferor can revoke the gift and reacquire the property.[606] Similarly, a gift is incomplete if the transferor contributes property to a trust, retaining the power to appoint the property during life and upon death.[607] Sometimes, issues with incomplete gifts arise because an individual purports to make a gift (in an effort to potentially minimize estate taxes) but is unwilling to part with control. In other cases, the issue arises as a part of deliberate planning. Such is the case with incomplete nongrantor

[593] IRC § 102(a). But see IRC § 102(c).
[594] See, e.g., *Commissioner v. Duberstein*, 363 U.S. 278 (1960).
[595] See, e.g., *Cullen v. Commissioner*, T.C. Memo 1992-516.
[596] IRC § 2511(a).
[597] Treas. Reg. § 25.2511-1(a).
[598] Treas. Reg. § 25.2511-1(h)(1).
[599] Treas. Reg. § 25.2511-1(a).
[600] Treas. Reg. § 25.2511-1(h)(1).
[601] Treas. Reg. § 25.2511-1(c)(1).
[602] IRC § 2518(b).
[603] Treas. Reg. § 25.2518-2(c)(3)(i).
[604] Id.
[605] Treas. Reg. § 25.2511-2(b).
[606] Treas. Reg. § 25.2511-2(c).
[607] Treas. Reg. § 25.2511-2(b).

(ING) trusts. With an ING trust, one of the main objectives is to ensure the transfer of property into the trust isn't a completed gift, so that the transfer doesn't consume any of the settlor's lifetime exemption or incur any gift tax. (We discuss ING trusts below.)

For a more in-depth discussion of donor control, see Todd D. Mayo, *Retaining Control over Gifted Property* (a publication of the UBS Advanced Planning Group). For a more in-depth discussion of ING trusts, see Ann Bjerke and Todd D. Mayo, *ING Trusts* (a publication of the UBS Advanced Planning Group) and Todd D. Mayo, *ING Trusts: Key Decision Points for Settlors* (a publication of the UBS Advanced Planning Group).

Valuation

For gift tax purposes, the value of property generally is its fair market value.[608] Fair market value of property is "the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts."[609]

In the case of publicly traded stock, a share's fair market value is the mean between the highest and lowest quoted selling prices on the date of the gift.[610] If, however, there weren't any sales on the date of the gift but there were sales within a reasonable period before and after the date of the gift, a share's fair market value is the weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the date of the gift. The average is weighted inversely by the respective numbers of trading days between the selling dates and the date of the gift.

In some cases, the fair market value of property reflects certain discounts or premiums. For example, a large block of artwork or publicly traded stock might reflect a blockage discount.[611] Similarly, a minority or nonvoting interest in a privately held business might reflect discounts for lack of control discount and lack of marketability.[612] An undivided partial interest in real estate might reflect a fractional interest discount.[613] The IRS is understandably wary of excessive discounts (and omitted premiums), and disputes concerning valuation often become battles of appraisal experts.

For a discussion of the application of discounts in the context of privately held businesses, see David Leibell and Jacqueline Denton, *Business Succession Planning* (a publication of the UBS Advanced Planning Group).

When a gift is adequately disclosed on a gift tax return, the IRS generally can challenge the gift only within three years after the return is filed.[614] For purposes of satisfying the adequate disclosure rule, an individual may wish to obtain a qualified appraisal of the property. By satisfying this rule, an individual potentially limits the period during which the IRS may challenge a gift's value.[615] A qualified appraisal, which is an appraisal that's prepared by a qualified appraiser and contains certain information about the gift, the property, the appraiser, and the valuation methodology, can play an important role in satisfying the adequate disclosure rule.[616]

For an in-depth discussion of adequate disclosure rule and qualified appraisals, see Todd D. Mayo, *Reporting Requirements for Gifts and Other Transfers* (a publication of the UBS Advanced Planning Group).

Reporting obligations

An individual who makes a gift may have an obligation to file a gift tax return for the year in which they made the gift.[617] Generally speaking, an

[608] Treas. Reg. § 25.2512-1.
[609] Id.
[610] Treas. Reg. § 25.2512-2(b)(1).
[611] With respect to the application of a blockage discount to the value of artwork, see, e.g., *Calder v. Commissioner*, 85 TC 713 (1985) and *Estate of O'Keeffe v. Commissioner*, TC Memo 1992-210. With respect to the application of a blockage discount to the value of stock, see Treas. Reg. § 25.2512-2(e).
[612] See, e.g., *Grieve v. Commissioner*, T.C. Memo. 2020-28.
[613] See, e.g., *Estate of Stewart v. Commissioner*, 617 F3d 148 (2d Cir. 2010).
[614] IRC § 6501(a). More precisely, the statute of limitations begins on (1) the gift tax return's original due date if it's filed on or before that date or (2) the date on which the gift tax return is filed if it's filed after the original due date. IRC § 6501(b)(1). See also Treas. Reg. § 301.6501(b)-1(a). If a transfer isn't adequately disclosed on an initial gift tax return, the transferor potentially can start the statute of limitations by adequately disclosing the transfer on an amended gift tax return. Rev. Proc. 2000-34. A return isn't filed unless it's filed in accordance with the regulations. See, e.g., *Seaview Trading LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023).
[615] IRC §§ 6501(a) and (c)(9).
[616] See Treas. Reg. § 301.6501(c)-1(f)(3). These regulations don't use the term "qualified appraisal," but it's a useful shorthand for an appraisal that meets the requirements of these regulations. Likewise, the regulations don't use the term "qualified appraiser," but it's a useful shorthand for an appraiser who meets the requirements of these regulations.
[617] IRC § 6019.

individual doesn't have an obligation to file a gift tax return if they made only non-taxable gifts.[618] They, however, may wish to file a gift tax return for purposes of making certain elections (e.g., the election to split gifts with a spouse) or reporting a non-gift transfer (and potentially limiting the period during which the IRS can contest whether it was a non-gift transfer).[619]

For an in-depth discussion of these reporting rules, see Todd D. Mayo, *Reporting Requirements for Gifts and Other Transfers* (a publication of the UBS Advanced Planning Group).

Estate tax

The estate tax generally is a 40% tax on the amount by which a deceased individual's taxable estate exceeds their unused lifetime exemption.[620] (As we discussed above, the lifetime exemption is the gift and estate tax exemption.) An individual's taxable estate is their gross estate minus certain allowable deductions.[621]

The gross estate is what someone usually is referring to when, in the context of estate taxes, they're talking colloquially about an deceased

Intangible personal property includes securities, intellectual property, and contractual rights.

individual's estate. As we'll explore in more detail below, the gross estate broadly includes anything that an individual owed at death and anything in which they had an interest.

The allowable deductions include:

- the deduction for administrative expenses, debts, and taxes,[622]
- the deduction for losses,[623]
- the marital deduction,[624]
- the charitable deduction,[625]

As noted above, the estate tax is generally calculated on the amount by which a deceased individual's taxable estate exceeds their unused lifetime exemption (i.e., the portion of the lifetime exemption the individual didn't use during their life).[626] In 2024, the lifetime tax exemption is $13.61 million.[627] This amount adjusts annually for inflation.[628] To the extent an individual didn't use their lifetime exemption during life, they effectively can use it upon their death.

Gross estate

A decedent's gross estate generally includes any property to the extent they owned an interest at the time of death.[629] Property includes real property, tangible personal property, and intangible personal property.[630] Intangible personal property includes securities, intellectual property, and contractual rights. For example, it includes any amounts the decedent was owed, even if the debt is forgiven under the terms of the decedent's will.[631] A decedent's gross estate, however, potentially excludes a portion of land subject to a qualified conservation easement.[632] A decedent's gross estate also includes certain property that they transferred during life while retaining certain interests, and it includes certain property in which they possessed an interest. We'll explore some of the more common situations below.

[618] Id.
[619] See, e.g., IRC §§ 529(c)(2)(B) and 2513(b)(1). See also Treas. Reg. §§ 301.6501(c)-1(f)(2) and (f)(4).
[620] IRC § 2502(a). Perhaps unsurprising, the precise calculation is more convoluted than this. Nonetheless, this is a workable summary. The tax rates are progressive, but the top marginal rate of 40% applies to taxable transfers over $1 million. IRC § 2502(c).
[621] IRC § 2051.
[622] IRC § 2053.
[623] IRC § 2054.
[624] IRC § 2056.
[625] IRC § 2055.
[626] IRC § 2502(a). Perhaps unsurprising, the precise calculation is more convoluted than this. Nonetheless, this is a workable summary. The tax rates are progressive, but the top marginal rate of 40% applies to taxable transfers over $1 million. IRC § 2502(c).
[627] Rev. Proc. 2023-34. This assumes the individual is a US citizen or otherwise a US person for gift and estate tax purposes.
[628] IRC § 2010(c)(3)(B).
[629] IRC §§ 2031 and 2033. More precisely, a decedent's the gross estate includes the *value* of certain property that the decedent owned or in which they had an interest. For brevity, however, we'll speak in terms of the gross estate including such property.
[630] Treas. Reg. § 20.2033-1(a).
[631] Treas. Reg. § 20.2033-1(b). The fair market value of a promissory note owed to the decedent generally is the amount of unpaid principal plus interest accrued to the date of death. Treas. Reg. § 20.2031-4. In some cases, however, the fair market value of the note reflects a discount for the riskiness of the note. See, e.g., *Estate of Hoffman v. Commissioner*, TC Memo. 2001-109.
[632] IRC § 2031(c).

Retained income. A decedent's gross estate generally includes property in which the decedent retained the right to receive income.[633] For example, the gross estate generally includes the property in an irrevocable trust of which the decedent was the settlor if the terms of the trust require the trust's income to be distributed to the decedent.

Power to control beneficial interests. A decedent's gross estate generally includes property in which the decedent retained the right to designate the persons who will enjoy the property or income from that property.[634] For example, the gross estate of a settlor of an irrevocable trust generally includes the trust property if the settlor is trustee of the trust and has unfettered discretion to distribute trust property to the trust's beneficiaries.[635] This, however, isn't the case if the settlor-trustee's discretionary distribution powers are limited by an ascertainable standard (such as making distributions to a beneficiary only for purposes of the beneficiary's health, education, maintenance, or support).[636] A power to control beneficial interest can arise indirectly. For example, the gross estate of a settlor of an irrevocable trust generally includes the trust property if the trustee has unfettered discretion to distribute trust property to the beneficiaries and the settlor can remove the trustee and appoint someone who's related or subordinate to the settlor as the successor trustee.[637]

Power to vote shares of a controlled corporation. A decedent's gross estate generally includes shares of a controlled corporation to the extent the decedent transferred those shares while retaining (directly or indirectly) the right to vote those shares.[638] This can potentially arise when a decedent transfers shares into an irrevocable trust and serves as trustee of the trust. A controlled corporation is a corporation in which the decedent, the decedent's family members, and certain other related persons own 20 percent or more of the total combined voting power of all classes of stock.[639]

Power of revocation. A decedent's gross estate generally includes property that they transferred to the extent they can revoke the transfer.[640] It's for this reason (and others) that the property in a decedent's revocable trust generally is includable in their gross estate.

Joint interests. In the case of property owned by the decedent and their spouse as joint tenants with rights of survivorship or as tenants by the entirety, the decedent's gross estate generally includes one-half of the property.[641] In the case of any other property owned by the decedent as a joint tenant with rights of survivorship, the decedent's gross estate generally includes:

- to the extent the property was acquired by the decedent and the other joint owner or owners by gift or inheritance, the decedent's fractional share of the property,[642] or
- to the extent that property was acquired by any other means (e.g., purchase), the entire property, excluding only any portion attributable to what the other joint owner or owners paid.[643]

Powers of appointment. A decedent's gross estate generally includes property over which, at the time of death, they had a general power of appointment.[644] A power of appointment generally is the power to direct the distribution or transfer of property.[645] Subject to some exceptions, a general power of appointment is the power to appoint property to the decedent, the decedent's

[633] IRC § 2036(a)(1).
[634] IRC § 2036(a)(2).
[635] See Rev. Rul. 73-143.
[636] Id.
[637] Rev. Rul. 95-58. Persons who are related or subordinate to the settlor include the settlor's spouse (if they are living together), parents, siblings, descendants, and employees. IRC § 672(c).
[638] IRC § 2036(b)(1).
[639] IRC § 2036(b)(2).
[640] IRC § 2038. In some irrevocable trusts, the settlor has a substitution power (sometimes called a swap power), which allows the settlor to reacquire trust property by substituting other property of equivalent value. This isn't the same as being able to take back the property. A substitution power generally doesn't cause the trust property to be includible in the settlor's gross estate. Rev. Rul. 2008-22 and Rev. Rul. 2011-28.
[641] IRC § 2040(b). This rule doesn't apply to property acquired before 1977. *Gallenstein v. United States*, 975 F.2d 286 (6th Cir. 1992). See *Hahn v. Commissioner*, 110 T.C. 140 (1998), acq., AOD 2001-06, 2001-42 I.R.B. 319. This rule applies only if the decedent's spouse is a US citizen. IRC § 2056(d)(1)(B).
[642] Treas. Reg. § 20.2040-1(a)(1).
[643] Treas. Reg. § 20.2040-1(a)(2).
[644] IRC § 2041(a).
[645] Treas. Reg. § 20.2041-1(b)(1).

estate, the decedent's creditors, or the creditors of the decedent's estate.[646] For example, the decedent's power to withdraw property from an irrevocable trust usually is a general power of appointment.

Life insurance. A decedent's gross estate generally includes the proceeds from any life insurance policy on the decedent's life if the decedent owned the policy when they died, the decedent held any incident of ownership in the policy when they died, or the proceeds are payable to the decedent's estate.[647] An incident of ownership includes:

- the power to change the beneficiary,
- the power to surrender or cancel the policy,
- the power to assign the policy,
- the power to revoke an assignment,
- the power to pledge the policy for a loan, and
- the power to obtain from the insurer a loan against the surrender value of the policy.[648]

A decedent generally has an incident of ownership in any insurance policy held in a trust of which the decedent is a trustee and, as trustee, has any power with respect to the policy.[649] Accordingly, an individual who serves a trustee of an irrevocable trust that owns an insurance policy on their life may find the proceeds includable in their gross estate. If an irrevocable trust held an insurance policy on the decedent's life, the proceeds are includable in the decedent's gross estate if the terms of the trust require the trustee to pay any taxes, debts, or other charges enforceable against the decedent's estate.[650]

For a more in-depth discussion of life insurance, see Jennifer Lan, Premini Scandurra, and Hunter Peek, *Life Insurance* (a publication of the UBS Advanced Planning Group).

QTIP property. A decedent's gross estate generally includes QTIP property.[651] QTIP property is property for which an election was made to qualify it for the gift tax marital deduction or the estate tax marital deduction.[652] Commonly, it's property in a marital trust that was created by the decedent's spouse during their life or upon their death.

Transfers made within three years of death. In certain limited situations, a decedent's gross estate includes property transferred within three years of their death. These sometimes are described as transfers made in contemplation of death. Once upon a time, nearly any gratuitous transfer made within three years of death were pulled into a decedent's gross estate. In the 1980s, however, the sweep of this rule was substantially curtailed. Now, the two situations in which this rule probably most commonly arise are life insurance and gift taxes. Under current law, a decedent's gross estate generally includes the proceeds of a life insurance policy on the decedent's life if the policy was transferred by gift by the decedent within three years of death.[653] In addition, a decedent's gross estate includes any gift taxes paid by the decedent within three years of death.[654]

Valuation

For estate tax purposes (as for gift tax purposes), the value of property generally is its fair market value.[655] Fair market value of property is "fair the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[656]

Publicly traded stock is valued in the same manner for purposes of the estate tax as it is for the gift tax (i.e., generally the mean of the high and low sale prices on the valuation date).[657] In addition, fair market value of property sometimes reflects certain discounts or premiums, such as a discount for

[646] IRC § 2041(c).
[647] IRC § 2042.
[648] Treas. Reg. § 20.2042-1(c)(2).
[649] Treas. Reg. § 20.2042-1(c)(4).
[650] Treas. Reg. § 20.2042-1(b)(1).
[651] IRC § 2044(a). The term *QTIP* is the somewhat whimsical abbreviation for the inscrutable term *qualified terminable interest property*.
[652] See IRC § 2044(b).
[653] IRC § 2035(a). See IRC § 2042.
[654] IRC § 2035(b).
[655] Treas. Reg. § 20.2031-1(b).
[656] Id.
[657] Treas. Reg. § 20.2031-2(b)(1). If, however, the shares are a part of a large block, the fair market value might reflect a blockage discount.

blockage, lack of control discount, lack of marketability, or fractional interest. Real property used for farming purposes or in a trade or business may qualify for special valuation.[658]

For purposes of valuing property includable in a decedent's gross estate, the valuation date generally is the date of the decedent's death.[659] The decedent's estate, however, potentially may elect to use the alternate valuation date. The alternate valuation date generally is:

- the date that's sixth months after the date of the decedent's death,
- if an item of property is distributed, sold, exchanged, or otherwise disposed of within six months after the decedent's death, the date on which it is distributed, sold, exchanged, or otherwise disposed of.[660]

If the election is made, the alternate valuation date must be used for all property includable in the gross estate.[661] The election to use the alternate valuation date is only available if it would have the effect of reducing (1) the value of the gross estate and (2) the total amount of estate taxes and GST taxes that would be owed by the decedent's estate.[662]

Reporting obligations

An estate tax return must be filed if the decedent's gross estate exceeds the estate tax exemption that's in effect on the date of death.[663] An estate tax return also must be filed if the decedent's spouse wishes to elect portability of the decedent's unused lifetime exemption.[664] The estate tax return is due nine months after the decedent's death.[665] If a timely request is made, the IRS will automatically grant a six-month extension.[666] Accordingly, the extended due date would generally be fifteen months after the decedent's death.

Payment of estate taxes

The estate tax generally is due nine months after the decedent's death.[667] If there isn't sufficient liquidity to pay the estate taxes, this can pose some vexing problems. The estate may be able to borrow money from a third party for purposes of paying the estate taxes. If properly structured, the interest on the loan may be deductible for estate tax purposes.[668] Such a loan is often called a *Graegin loan*.

Under Section 6166 of the Internal Revenue Code, an estate that owns an interest in a closely held business might be able to defer the payment of the estate taxes.[669] The value of the business interest must exceed 35% of the value of the adjusted gross estate.[670] The business must be:

- a sole proprietorship,
- a corporation with either (1) 45 or fewer shareholders or (2) 20% or more of its voting stock included in the decedent's gross estate; or
- a partnership (including a limited liability company that, for federal tax purposes, is classified as a partnership) with either (1) 45 or fewer partners or (2) 20% or more of its capital interest included in the decedent's gross estate.[671]

The business must engage in an active trade or business.[672]

If the estate qualifies for deferral, it generally may defer estate tax payments attributable to the closely held business for five years. The first estate tax installment generally is due on or before the fifth anniversary of the due date for filing the decedent's federal estate tax return (i.e., nine months after the decedent's death), and the balance must be paid in annual installments over the next nine years.[673] Interest must be paid annually on the deferred tax.[674]

[658] IRC § 2032A.
[659] IRC § 2031(a).
[660] IRC § 2032(a).
[661] Id.
[662] IRC § 2032(c).
[663] IRC § 6018(a)(1). Under certain conditions, the filing threshold is less than the estate tax exemption.
[664] Treas. Reg. § 20.2010-2(a)(2).
[665] IRC § 6075(a).
[666] Treas. Reg. § 20.6081-1(b).
[667] IRC § 6151(a). See IRC § 6075(a).
[668] *Estate of Graegin*, T.C. Memo 1988-477.
[669] See IRC § 6166.
[670] IRC § 6166(a)(1). The adjusted gross estate is the gross estate reduced by any allowable deductions for expenses, indebtedness, taxes and losses. IRC § 6166(b)(6).
[671] IRC § 6166(a)(1). The adjusted gross estate is the gross estate reduced by certain debts, expenses, and taxes. IRC § 6166(b)(6). Also, under certain conditions, a decedent's estate may aggregate interests in two or more closely held businesses. See IRC § 6166(c).
[672] IRC § 6166(b)(1).
[673] IRC § 6166(f).
[674] IRC § 6166(b)(1).

For a more in-depth discussion Graegin loans and section 6166 (and, more broadly, strategies for planning to have liquidity to pay estate taxes), see Rebecca Sterling, *Planning for Estate Liquidity* (a publication of the UBS Advanced Planning Group).

GST tax

Broadly speaking, the GST tax is a 40% tax on certain transfers to individuals who are two or more generations younger than the transferor. The GST tax applies in addition to the gift or estate tax, although it also can apply in situations in which neither tax applies. For example, an individual who gives $100,000 to a grandchild, whose parents are living, would have made a gift that's subject to both the gift tax and the GST tax. We'll explore the mechanics of the GST tax below, but the individual would owe gift taxes on that gift if they had already fully used their lifetime exemption, and they would owe GST tax if they had already fully used their GST tax exemption. This simple example, however, belies the complexity of the GST tax.

The GST tax applies to three types of transfers:

- direct skips,
- taxable distributions, and
- taxable terminations.[675]

The GST tax, however, doesn't apply to certain pre-1986 trusts.[676]

Direct skips

A direct skip generally is a transfer to a skip person if the transfer is subject to the gift tax or estate tax.[677] A skip person generally is:

- an individual who is two or more generations younger than the transferor or
- a trust of which the beneficiaries generally are only individuals who are two or more generations younger than the transferor.[678]

For example, a gift into trust of which only the settlor's grandchildren and more remote descendants are beneficiaries usually is a direct skip.

In the case of a direct skip, the GST tax generally is 40% of the amount by which the direct skip exceeds the transferor's unused GST tax exemption.[679] In 2024, the GST tax exemption is $13.61 million.[680] This amount adjusts annually for inflation.[681]

Taxable distributions

A taxable distribution generally is a distribution from an irrevocable trust to a skip person.[682] In the case of a taxable distribution, the GST tax generally is 40% of the taxable distribution, unless the trust is GST tax-exempt.[683] A trust generally is GST tax-exempt if:

- by reason of an automatic allocation or a timely affirmative allocation, GST exemption was allocated to each contribution to the trust, or
- by reason of a late allocation, GST exemption was allocated to the trust in an amount equal to the GST non-exempt portion of the trust at the time of the late allocation.[684]

As the name implies, an automatic allocation occurs automatically. Under certain conditions, a contribution to a trust qualifies for the automatic allocation of the transferor's GST tax exemption, unless the transferor elects out of the automatic allocation rules. An affirmative allocation occurs when an allocation is made on a gift or estate tax return.

In the case of a direct skip, the transferor is liable for the GST tax.[685]

Taxable termination

A taxable termination generally is the termination of an interest in a trust if, after the termination, only skip persons are beneficiaries of the trust or have interest in the property that was distributed from the trust.[686] In the case of a taxable termination, the GST tax generally is 40% of the trust property, unless the trust is GST tax-exempt.[687] In the case of a taxable termination, the trustee is liable for the GST tax.[688]

[675] IRC §§ 2601 and 2611(a).
[676] Treas. Reg. § 26.2601-1(b)(1)(i).
[677] IRC § 2612(c). See Treas. Reg. § 26.2612-1(a).
[678] IRC § 2613(a). See Treas. Reg. § 26.2612-1(d).
[679] IRC §§ 2602, 2623, 2631(a), 2641(a), and 2642.
[680] IRC § 2631(c). See IRC § 2010(c) and Rev. Proc. 2023-34.
[681] IRC § 2010(c)(3)(B).
[682] IRC § 2612(b). In some cases, however, a distribution from a trust is a direct skip or taxable termination.
[683] IRC §§ 2602, 2621, 2631(a), 2641(a), and 2642.
[684] IRC § 2642.
[685] IRC § 2603(a)(3).
[686] IRC § 2612(a).
[687] IRC §§ 2602, 2622, 2631(a), 2641(a), and 2642.
[688] IRC § 2603(a)(1).

Pre-1986 trusts

Certain pre-1986 trusts are GST tax-exempt. A trust that was irrevocable on September 25, 1985, generally is exempt from the GST tax, except to the extent of any contributions to the trust made after that date.[689] For GST tax purposes, a lapse or release of a general power of appointment potentially is a constructive addition to a trust.[690] A trust that was irrevocable on September 25, 1985, may lose its GST tax-exemption if there's a substantive modification of the terms of the trust.[691] A modification of an administrative provision generally won't affect the trust's GST tax-exempt status, but a modification of a dispositive provision that shifts the beneficial interests or extends the vesting of an interest in the trust may cause a loss of the trust's GST tax-exempt status.[692]

Making non-taxable gifts

A non-taxable gift transfers wealth out of an individual's estate without using any of the individual's lifetime exemption or causing the individual to be subject to any gift tax. Non-taxable gifts include:

- Annual exclusion gifts
- Tuition exclusion gifts
- Medical expense exclusion gifts
- Spousal gifts
- Charitable gifts
- Contributions to 501(c)(4), 501(c)(5), 501(c)(6), and 527 organizations

Annual exclusion gifts

An individual who wishes to reduce their estate for estate tax purposes might consider making non-taxable gifts to family members and others. Under the annual exclusion, the first $18,000 of gifts made by an individual to a donee during 2024 are non-taxable.[693] This amount adjusts annually for inflation.[694] Table 15 shows the annual exclusion from 2000 to 2024. In addition to removing the money or other property from the individual's estate for estate tax purposes, the gift removes any future appreciation with respect to that money or property from the individual's estate. To the extent a gift is non-taxable, it doesn't consume any of the individual's lifetime exemption (i.e., gift and estate tax exemption).

Table 15

Annual exclusion in 2000 to 2024.

2000	$10,000	2005	$11,000	2010	$13,000	2015	$14,000	2020	$15,000
2001	$10,000	2006	$12,000	2011	$13,000	2016	$14,000	2021	$15,000
2002	$11,000	2007	$12,000	2012	$13,000	2017	$14,000	2022	$16,000
2003	$11,000	2008	$12,000	2013	$14,000	2018	$15,000	2023	$17,000
2004	$11,000	2009	$13,000	2014	$14,000	2019	$15,000	2024	$18,000

Sources: Rev. Proc. 99-42; Rev. Proc. 2001-13; Notice 2001-12; Rev. Proc. 2001-59; Rev. Proc. 2002-70; Rev. Proc. 2003-85; Rev. Proc. 2004-71; Rev. Proc. 2005-70; Rev. Proc. 2006-53; Rev. Proc. 2007-66; Rev. Proc. 2008-66; Rev. Proc. 2009-50; Rev. Proc. 2010-40; Rev. Proc. 2011-52; Rev. Proc. 2012-41; Rev. Proc. 2013-35; Rev. Proc. 2014-61; Rev. Proc. 2015-53; Rev. Proc. 2016-55; Rev. Proc. 2017-58; Rev. Proc. 2018-57; Rev. Proc. 2019-44; Rev. Proc. 2020-45; Rev. Proc. 2021-45; Rev. Proc. 2022-38; and Rev. Proc. 2023-34.

[689] Treas. Reg. § 26.2601-1(b)(1)(i). See also Pub. L. 99-514, § 1433(b)(2)(A), as amended by Pub. L. 100-647, § 1014(h).
[690] Treas. Reg. § 26.2601-1(b)(1)(v)(A).
[691] Treas. Reg. § 26.2601-1(b)(4)(i)(D).
[692] Id.
[693] IRC § 2503(b)(1) and Rev. Proc. 2023-34.
[694] IRC § 2503(b)(2).

A gift qualifies for the annual exclusion only if it's a gift of a present interest.[695] A gift of a present interest is a gift in which the donee has an unrestricted right to the immediate use, possession, or enjoyment of the transferred property or the income from the transferred property.[696] For example, a gift of cash or shares of a company's stock directly to another individual is a gift of a present interest (so long as there aren't any strings attached to the gift).

Gift splitting

Gift splitting is an arrangement in which an individual's spouse is treated as making one-half of the gifts that the individual makes to third-party donees during the calendar year. While a gift of community property is treated as made one-half by each spouse, a gift of any other type of property by an individual to a third-party donee generally isn't treated as made one-half by each spouse.[697] Gift splitting offers a way to achieve this treatment. The individual who makes the gifts must file a gift tax return for purposes of splitting gifts.[698] The consenting spouse generally must also file a gift tax return.[699]

For a more in-depth discussion of gift splitting, the reporting requirements, and potential tax implications, see Todd D. Mayo, *Reporting Requirements for Gifts and Other Transfers* (a publication of the UBS Advanced Planning Group).

Gifts to a UGMA or UTMA account

A contribution to a Uniform Gifts to Minors Act (UGMA) account or a Uniform Transfers to Minors Act (UTMA) account is a gift of a present interest to the beneficiary of the account.[700] Accordingly, a contribution to a UGMA or UTMA account can qualify for the annual exclusion. To the extent that, during a calendar year, an individual's contributions to a UGMA or UTMA account and other gifts to the beneficiary of the account exceed the annual exclusion, the gifts would be taxable gifts, which would consume the individual's lifetime exemption or, if the individual has fully used their lifetime exemption, would be subject to gift tax.

A UGMA or UTMA account is a relatively simple way of facilitating gifts to minors. A UGMA or UTMA account, however, terminates upon the beneficiary attaining the age specified in the laws governing the account (usually 21 years of age). Upon termination, the custodian must transfer the assets in the account to the beneficiary.

For more information about UGMA and UTMA accounts, see Carrie J. Larson, *Avoiding UTMA Regret* (a publication of the UBS Advanced Planning Group).

Gifts to a 529 plan

A 529 plan is a tax-advantaged investment plan that is designed to pay the beneficiary's qualifying educational expenses.[701] When an individual contributes to a 529 plan, they are treated as making a gift to the beneficiary of the plan.[702] The gift counts against the individual's annual exclusions to the beneficiary.[703]

An individual can elect to treat a gift to a 529 plan as made ratably over five years.[704] An individual thus can front-load a 529 plan with five years' worth of annual exclusion gifts. For purposes of making the election, the individual must file a gift tax return for the year in which the individual actually makes the gift to the 529 plan.[705] Let's say that, in 2024, Dylan gives $90,000 to a 529 plan for the benefit of Dylan's child Ezra and elects to treat the gift as made ratably over five years. By doing so, Dylan is treated as making a $18,000 gift to Ezra in 2024 and each of the four following years. So long as Dylan doesn't make any other gifts to Ezra in 2024 through 2028, each of those gifts would be nontaxable (under the gift tax annual exclusion) and wouldn't use up any of Dylan's lifetime exemption.

If an individual makes this special election for a gift to a 529 plan and dies before the end of the fourth year after the year in which the gift was made,

[695] IRC § 2503(b)(1) and Treas. Reg. § 25.2503-3(b).
[696] Id.
[697] See Instructions for Form 709.
[698] IRC § 2513(b)(1) and Treas. Reg. § 25.2513-2(a)(1).
[699] Treas. Reg. § 25.2513-1(c).
[700] Rev. Rul. 59-357.
[701] IRC § 529(a).
[702] IRC § 529(c)(2).
[703] Id.
[704] IRC § 529(c)(2)(B).
[705] IRC §§ 529(c)(2)(B) and 6019.

then the individual's estate includes the portion of the gift attributable to the years after the individual's death.[706] Let's again say that, in 2024, Dylan gives $90,000 to a 529 plan for the benefit of Dylan's child Ezra and elects to treat the gift as made ratably over five years. What happens if Dylan dies in 2027? For estate tax purposes, Dylan's estate will include $36,000, which is the portion of the gift that Dylan would've been treated as making in 2028 and 2029 if Dylan hadn't died.

To the extent that, during a calendar year, an individual's gift to a 529 plan (after taking into account any election to treat the gift as made ratably over five years) and other gifts to the beneficiary of the 529 plan exceed the annual exclusion, the gifts would be taxable gifts, which would consume the individual's lifetime exemption or, if the individual has fully used their lifetime exemption, would be subject to gift tax.

For some individuals, a 529 plan is an attractive way to provide for a child's, grandchild's, or another individual's educational expenses, because it is tax-advantaged and relatively easy to establish and maintain. For other individuals (often those with significant wealth), an irrevocable trust for the benefit of one or more children, grandchildren, or other individuals is more appealing, because the trust can be more flexible and can help to achieve broader planning objectives.

For more information about 529 plans, see Jessica Mazzaro Friedhoff, *Funding Education: 529 Accounts and Annual Giving Trusts* (a publication of the UBS Advanced Planning Group).

Contributing to a traditional IRA or Roth IRA

Instead of making an outright gift, an individual might make a contribution to a traditional IRA or Roth IRA on the other individual's behalf. Contributing to a traditional IRA or Roth IRA on another individual's behalf is a gift to the other individual. For 2024, the total contributions an individual may make (or someone could make on their behalf) to traditional IRAs and Roth IRAs can't exceed the lesser of:

- $7,000 ($8,000 if the individual has attained 50 years of age), or
- the individual's taxable compensation for the year.[707]

Tax-deductible contributions to traditional IRAs may be limited if the individual or their spouse is participates in a workplace retirement plan and their income exceeds certain levels.[708] Contributions to Roth IRAs may be limited if their income exceeds certain levels.[709] (We discuss these limits above.)

For purposes of the IRA contribution rules, an individual generally can contribute to a traditional IRA or Roth IRA on or before the due date for the individual's income tax return (ignoring any extension) and can treat the contribution as if made in the prior year.[710] For gift tax purposes, however, an individual who contributes to a traditional IRA or Roth IRA on behalf of another individual makes a gift upon making the contribution, regardless of whether the contribution is treated as having been made in the current year or the prior year for purposes of the IRA contribution rules.[711]

Tuition exclusion

Under the tuition exclusion, the payment of another individual's tuition is non-taxable if it's made directly to the school or other educational provider.[712] This exclusion applies only to the payment of tuition and doesn't apply to the payment of room, board, books, or other educational expenses.[713] Under state law, a parent may have a legal obligation to pay a minor child's tuition (and sometimes an adult child's tuition), in which case the payment of the child's tuition isn't a gift and the tuition exclusion is irrelevant.

To the extent the exclusion applies, the payment of the tuition is a non-taxable gift and doesn't consume any of the individual's annual exclusion or lifetime exemption.[714] Let's say that, in 2024, Florian pays $40,000 of tuition on behalf of Garnet, who is one of Florian's grandchildren. Florian makes the payment directly to the university that Garnet is attending. In addition, Florian gives $18,000 to Garnet. Both gifts are nontaxable. Florian's payment of the Garnet's tuition is nontaxable under

[706] IRC § 529(c)(4)(C).
[707] IRC §§ 219(b)(5) and 408A(c)(2). See Notice 2023-75.
[708] IRC § 219(c).
[709] IRC § 408A(c)(3).
[710] IRC § 219(f)(3).
[711] Treas. Reg. § 25.2503-1.
[712] IRC § 2503(e)(2)(A).
[713] Treas. Reg. § 25.2503-6(b)(2).
[714] IRC § 2503(e)(1).

the exclusion for tuition payment, and Florian's other gift is nontaxable under the gift tax annual exclusion. Neither gift uses up any of Florian's lifetime exemption.

Medical expense exclusion

Under the medical expense exclusion, the payment of another individual's medical expenses is non-taxable if it's made directly to the healthcare service provider.[715] Premiums for healthcare insurance generally are treated as a medical expense.[716] To the extent the exclusion applies, the payment of the medical expenses is a non-taxable gift and doesn't consume any of the individual's annual exclusion or lifetime exemption.[717] Under state law, a parent ordinarily has a legal obligation to pay a minor child's medical expenses, in which case the payment of the child's medical expenses isn't a gift and the medical expense exclusion is irrelevant.

Spousal gifts

A gift to a spouse potentially is non-taxable. A gift to a spouse doesn't transfer wealth to another younger generation, which often is the objective in advanced planning. It may provide the donee spouse with sufficient assets to use their lifetime exemption. Importantly, it also may help the donee spouse to achieve non-tax objectives, such as addressing the donee spouse's own financial needs or possibly protecting assets from the donor spouse's future creditors. The gift and estate tax treatment of gifts to a spouse differs, depending on whether or not the spouse is a US citizen.

Gifts to a spouse who's a US citizen

An outright gift to a spouse who's a US citizen generally qualifies for the marital deduction.[718] A gift in trust for the benefit of a spouse can qualify for the marital deduction if certain conditions are met.[719] For example, an individual could make gifts to a lifetime QTIP trust. During the spouse's life, the trust must generally distribute its net income to the spouse and cannot distribute any property to someone other than the spouse.[720] On the gift tax return, the donor spouse must make a QTIP election.[721] The trust property is includable in the spouse's estate for estate tax purposes.[722] The marital deduction is unlimited.[723]

Gifts to a non-citizen spouse

A gift to a non-citizen spouse doesn't qualify for the marital deduction.[724] Under a special annual exclusion, the first $185,000 of gifts made by an individual to a non-citizen spouse during 2024 are non-taxable.[725] This amount adjusts annually for inflation.[726] Table 16 shows the annual exclusion for gifts to a non-citizen spouse from 2000 to 2024. A gift qualifies for this annual exclusion only if it's a gift of a present interest.[727]

Table 16

Annual exclusion for gifts to a non-citizen spouse in 2000 to 2024.

2000	$103,000	2005	$117,000	2010	$134,000	2015	$147,000	2020	$157,000
2001	$106,000	2006	$120,000	2011	$136,000	2016	$148,000	2021	$159,000
2002	$110,000	2007	$125,000	2012	$139,000	2017	$149,000	2022	$164,000
2003	$112,000	2008	$128,000	2013	$143,000	2018	$152,000	2023	$175,000
2004	$114,000	2009	$133,000	2014	$145,000	2019	$155,000	2024	$185,000

Sources: Rev. Proc. 99-42; Rev. Proc. 2001-13; Notice 2001-12; Rev. Proc. 2001-59; Rev. Proc. 2002-70; Rev. Proc. 2003-85; Rev. Proc. 2004-71; Rev. Proc. 2005-70; Rev. Proc. 2006-53; Rev. Proc. 2007-66; Rev. Proc. 2008-66; Rev. Proc. 2009-50; Rev. Proc. 2010-40; Rev. Proc. 2011-52; Rev. Proc. 2012-41; Rev. Proc. 2013-35; Rev. Proc. 2014-61; Rev. Proc. 2015-53; Rev. Proc. 2016-55; Rev. Proc. 2017-58; Rev. Proc. 2018-57; Rev. Proc. 2019-44; Rev. Proc. 2020-45; Rev. Proc. 2021-45; Rev. Proc. 2022-38; and Rev. Proc. 2023-34.

[715] IRC § 2503(e)(2)(B).
[716] Treas. Reg. § 25.2503-6(b)(3).
[717] IRC § 2503(e)(1).
[718] IRC § 2523(i)(1).
[719] IRC §§ 2056(b)(5), (b)(7), and (b)(8).
[720] IRC § 2056(b)(7)(B)(ii).
[721] IRC § 2056(b)(7)(B)(v).
[722] IRC § 2044.
[723] See IRC § 2056(a).
[724] IRC § 2523(i)(1).
[725] IRC §§ 2503(b)(1) and 2523(i)(2). See Rev. Proc. 2023-34.
[726] IRC §§ 2503(b)(2) and 2523(i)(2).
[727] IRC §§ 2503(b)(1) and 2523(i)(2) and Treas. Reg. § 25.2503-3(b).

An individual must file a gift tax return if, during the calendar year, the total amount of gifts of a present interest (excluding any gifts that qualify for the tuition exclusion or medical expense exclusion) to a non-citizen spouse exceeds the annual exclusion for gifts to a non-citizen spouse.[728]

Charitable gifts
A gift to a charitable organization generally qualifies for the gift tax charitable deduction.[729] To the extent it qualifies for the gift tax charitable deduction, a gift is non-taxable. The gift tax charitable deduction is unlimited.[730]

A gift of a partial interest in property generally doesn't qualify for the gift tax charitable deduction.[731] There are exceptions. Subject to certain conditions, a gift of a partial interest can qualify if it is:

- a contribution of a remainder interest in a personal residence or farm,[732]
- a contribution of a undivided portion of the individual's entire interest in the property,[733]
- a contribution to a charitable remainder trust,[734]
- a contribution to a charitable lead trust,[735] or
- a qualified conservation contribution (e.g., a conservation easement).[736]

In the case of a contribution of a undivided portion of the individual's entire interest in the tangible personal property (such as artwork), the contribution generally isn't deductible unless the individual owned all of the interests in the property immediately before the contribution or the individual and the charitable donee owned all of the interests in the property immediately before the contribution.[737]

Contributions to 501(c)(4), 501(c)(5), 501(c)(6), and 527 organizations
Contributions to certain types of organizations aren't gifts for gift tax purposes. These organizations are:

- 501(c)(4) organizations (also known as social welfare organizations),[738]
- 501(c)(5) organizations (agricultural and horticultural organizations),[739]
- 501(c)(6) organizations (business leagues, professional associations, and similar organizations),[740] and
- 527 organizations (also known as political organizations).[741]

A contribution to any of those organizations is ignored for gift tax purposes.

Using the lifetime exemption

An individual who wishes to reduce their estate for estate tax purposes might consider making gifts that use their lifetime exemption (i.e., gift and estate tax exemption). These are gifts that don't qualify for the gift tax annual exclusion, tuition exclusion, medical expense exclusion, marital deduction, or charitable deduction. In tax parlance, these are called taxable gifts, even though an individual doesn't pay any gift tax on them until the total amount of taxable gifts that an individual makes during their life exceeds their lifetime exemption.[742]

In 2024, an individual's lifetime exemption is $13.61 million.[743] This amount adjusts annually for inflation and currently includes a temporary increase.[744] This increase expires after 2025, at which time the lifetime exemption will be cut roughly in half.[745] To the extent an individual didn't use

[728] IRC §§ 2523(i)(2) and 6019(1). For purposes of this guide, a non-citizen spouse is a spouse who isn't a citizen of the United States.
[729] IRC § 2522(a).
[730] See IRC § 2522(a). Compare IRC § 170(b).
[731] IRC § 2522(c)(2).
[732] IRC § 2522(c)(2). See IRC § 170(f)(3)(B)(i).
[733] IRC § 2522(c)(2). See IRC § 170(f)(3)(B)(ii).
[734] IRC § 2522(c)(2)(A).
[735] IRC § 2522(c)(2)(B).
[736] IRC § 2522(c)(2). See IRC § 170(f)(3)(B)(iii).
[737] IRC § 2522(e)(1).
[738] IRC § 2501(a)(6).
[739] Id.
[740] Id.
[741] IRC § 2501(a)(4).
[742] Treas. Reg. § 25.2505-1(a).
[743] IRC §§ 2010(c) and 2502(a). See Rev. Proc. 2023-34. This assumes the individual is a US person for gift and estate tax purposes.
[744] IRC §§ 2010(c)(3)(B) and (C).
[745] IRC § 2010(c)(3)(C).

Table 17

Lifetime exemption in 2000 to 2024.

2000	$675,000	2005	$1.50 million	2010*	$5.00 million	2015	$5.43 million	2020	$11.58 million
2001	$675,000	2006	$2.00 million	2011	$5.00 million	2016	$5.45 million	2021	$11.70 million
2002	$1.00 million	2007	$2.00 million	2012	$5.12 million	2017	$5.49 million	2022	$12.06 million
2003	$1.00 million	2008	$2.00 million	2013	$5.25 million	2018	$11.18 million	2023	$12.92 million
2004	$1.50 million	2009	$3.50 million	2014	$5.34 million	2019	$11.40 million	2024	$13.61 million

** In 2010, the gift tax exemption was $1 million, and the estate tax exemption was $5 million (for estates electing to be subject to the estate tax).*
Sources: IRC § 2010(c); Pub. L. 107-16, § 521(a); Pub. L. 111-312, § 302(a); Rev. Proc. 2011-52; Rev. Proc. 2013-15; Rev. Proc. 2013-35; Rev. Proc. 2014-61; Rev. Proc. 2015-53; Rev. Proc. 2016-55; Rev. Proc. 2017-58; Rev. Proc. 2018-57; Rev. Proc. 2019-44; Rev. Proc. 2020-45; Rev. Proc. 2021-45; Rev. Proc. 2022-38; and Rev. Proc. 2023-34.

their lifetime exemption during life, they effectively can use it upon their death. Table 17 shows the lifetime exemption from 2000 to 2024.

By making gifts that use their lifetime exemption, the individual potentially removes from the individual's estate any future appreciation with respect to the money or property that the individual gives away. In addition, by making those gifts before the lifetime exemption decreases after 2025, the individual potentially can take advantage of the higher exemption.[746] Let's assume that an individual has made $12 million of taxable gifts by the end of 2025 and, as a result of the scheduled decrease, the lifetime exemption is $7 million in 2026. The individual generally won't be subject to gift or estate taxes on the $5 million of taxable gifts that they made while the higher exemption was in effect.[747]

When making gifts that use their lifetime exemption, an individual might make gifts into an irrevocable trust for the benefit of their spouse and descendants or an irrevocable trust for the benefit of their descendants.[748] Using a trust may offer important advantages. A trust can potentially insulate trust property from the claims of a beneficiary's creditors (including a spouse or former spouse), and it can potentially keep the trust property out of a beneficiary's estate for estate tax purposes. A trust, however, requires proper administration, which involves some time and expense.

An irrevocable trust of which the settlor's spouse is a beneficiary (and contributions to which don't qualify for the marital deduction) is sometimes called a spousal lifetime access trust. For more information on spousal lifetime access trusts, see Catherine McDermott, *Spousal Lifetime Access Trusts* (a publication of the UBS Advanced Planning Group).

For more information on trust administration, see Casey C. Verst, *Duties of a Trustee* (a publication of the UBS Advanced Planning Group).

To the extent that, at the end of a calendar year, an individual's taxable gifts made during their lifetime exceeds their lifetime exemption, the individual generally will owe gift taxes.[749] The top marginal gift tax rate is 40 percent.[750] Accordingly, the gift tax on gifts made by an individual during a calendar year is approximately 40 percent of the amount by which the individual's taxable gifts made during their lifetime exceeds their lifetime exemption.[751]

If an individual owes gift tax, the tax usually is due on April 15 of the year following the calendar year in which the gifts are made, but the initial due date is extended if April 15 is a Saturday, Sunday, or holiday.[752] Accordingly, an individual's 2024

[746] Treas. Regs. §§ 20.2010-1(c)(1) and (c)(2).
[747] Id.
[748] Treas. Reg. § 25.2503-2(a) (a gift in trust is generally treated as a gift to the beneficiaries of the trust).
[749] IRC § 2502(a).
[750] IRC §§ 2001(c) and 2502(a).
[751] Id.
[752] IRC § 6151(a). See IRC § 6075(b). See also Treas. Reg. § 25.6075-1(d).

gift taxes generally are due April 15, 2025.[753] A late payment is subject to interest and penalties.[754]

The lifetime exemption is available only to an individual who is a US person for gift and estate tax purposes.[755] An individual generally is a US person for gift and estate tax purposes if they are a US citizen or are domiciled in the United States.[756] Special gift and estate tax rules apply to an individual who isn't a US person for gift and estate tax purposes.[757]

Shifting future appreciation out of the estate

An individual who has used as much of their lifetime exemption as they are comfortable using but isn't looking to accumulate more wealth might consider implementing one or more strategies that freeze the value of their estate (or a portion of it) for estate tax purposes. These strategies effectively shift future appreciation out of an individual's estate without using any of the individual's lifetime exemption or causing the individual to incur any gift or estate taxes.

Selling assets to a grantor trust
If an individual hasn't previously created a grantor trust, then the individual would make a gift to an irrevocable trust that's designed to be a grantor trust with respect to that individual.[758] This gift may be a seed gift – possibly, about 10 percent or 11 percent of the value of the assets that the individual intends to sell to the trust – or it may be more substantial.[759] The individual subsequently would sell assets to the trust in exchange for a promissory note. Since the trust is a grantor trust with respect to the individual, the sale is ignored for income tax purposes.[760] Thus, the individual doesn't recognize any gain upon the sale. The transaction, however, is respected for gift and estate tax purposes.[761]

The promissory note may be designed so that the trust pays only interest until maturity and a lump-sum (balloon) payment at maturity, or it may be designed so that it's amortized. For purposes of avoiding potential gift tax issues, the interest must not be less than the applicable federal rate. To the extent that, over the term of the promissory note, the trust property appreciates more than the applicable federal rate, the sale to the grantor trust potentially would shift wealth to the trust and out of the individual's estate without any gift or estate tax costs.

For a more in-depth discussion of sales to grantor trusts, see Casey C. Verst, *Sales to Grantor Trusts* (a publication of the UBS Advanced Planning Group).

Grantor retained annuity trust
A grantor retained annuity trust (GRAT) is an irrevocable trust that distributes an annuity to the settlor for a term of years, after which the remaining assets are distributed to one or more individuals (typically, the settlor's children) or a trust for their benefit. A zeroed-out GRAT is a GRAT that's designed so there isn't any taxable gift upon its creation and, to the extent its assets appreciate at a rate that exceeds the 7520 rate in effect when the trust was funded, the excess appreciation passes to the remainder beneficiaries without incurring any gift or estate taxes.[762]

For a more in-depth discussion of GRATs, see Jennifer Lan, *Grantor Retained Annuity Trusts* (a publication of the UBS Advanced Planning Group).

Charitable lead annuity trust
An individual who is charitably inclined and wishes to potentially shift wealth on a gift and estate tax free basis to children (or others) might consider creating a charitable lead annuity trust. A charitable lead annuity trust pays an annuity to one or more charities (possibly the individual's donor advised fund or private foundation) for a term of years, after which the remaining property is distributed (either outright or in trust) to one or more non-charitable beneficiaries (typically, the donor's children). The trust often

[753] Id.
[754] IRC §§ 6601(a) and 6651(a)(2).
[755] See IRC § 2001(a). Compare IRC § 2101(a). For purposes of this guide, "US person" means United States person, and a "US citizen" means a United States citizen.
[756] Treas. Reg. § 20.0-1(b).
[757] See, e.g., IRC §§ 2101 to 2108.
[758] A grantor trust is generally disregarded for income tax purposes, and the settlor (or, in some cases, the beneficiary) reports the trust's income, deductions, and credits on their personal income tax return. IRC §§ 671 to 679.
[759] The purpose of this seed gift is to provide the trust with sufficient financial capacity so that the trust isn't financing the entire purchase price, which would not usually occur in an arm's length transaction. The gift also provides the trust with some liquidity so that it has funds to service the interest payments on the promissory note.
[760] Rev. Rul. 85-13.
[761] See IRC § 2511(a).
[762] For an explanation of the section 7520 rate, see note 568.

is designed so that there isn't any taxable gift upon its creation and, to the extent its assets appreciate at a rate that exceeds the 7520 rate that applied when the trust was funded, the excess appreciation passes to the non-charitable beneficiaries without incurring any gift or estate taxes.[763] In addition, the donor potentially may be entitled to an income tax charitable deduction upon funding the trust. (We discuss charitable lead annuity trusts in more depth above.)

Qualified personal residence trust
A qualified personal residence trust (sometimes called a *QPRT*) is an irrevocable trust to which the settlor contributes their personal residence while retaining the right to use the residence for a term of years.[764] Upon the expiration of that term, the residence usually remains in trust for the benefit of one or more individuals (typically, the settlor's children). If the settlor wishes to continue using the residence, they must pay fair market rent to the trust.[765] The settlor makes a taxable gift when they contribute the residence to the trust. Since the settlor retains the right to use the personal residence for a term of years, the amount of the gift is a fraction of the total value of the property contributed to the trust.[766]

With an important caveat, a qualified personal residence trust can be an effective way of shifting future appreciation out of the settlor's gross estate. The settlor must survive the initial term to achieve the estate tax benefits; if the settlor dies during the initial term, their gross estate includes the trust property.[767] To the extent the settlor has other assets that are more likely to appreciate faster than their personal residence, however, other wealth transfer planning strategies may be more tax-efficient. A qualified personal residence trust isn't as flexible as other types of grantor trusts. For example, the settlor can't retain the power to swap (substitute) property for trust property.[768] Also, the rules governing qualified personal residence trust can be restrictive and sometimes annoying to follow.

Most critically, a qualified personal residence trust might not currently be a viable planning strategy. Under proposed regulations issued by the IRS in 2022, there may be adverse tax consequences if a settlor creates a qualified personal residence before 2026 (i.e., before the scheduled decrease in the lifetime exemption) and dies after 2025 but before the initial term expires. Upon their death, the settlor's gross estate includes the trust property. Under the proposed regulations, the settlor potentially could be worse off than they would've been if they hadn't created the qualified personal residence trust.

This result may be unintended. The proposed regulations would establish an anti-abuse exception to the anti-clawback rule, so the anti-clawback rule would generally apply only where the individual does not retain possession and enjoyment of the transferred asset.[769] Under the anti-clawback rule, an individual who makes gifts that use the temporary increase in the lifetime exemption before its expiration at the end of 2025 generally doesn't have those gifts clawed back into their gross estate if they die after the temporary increase expires.[770] Nonetheless, the proposed anti-abuse rule would apply to qualified personal trusts, excluding them from the protections of the anti-clawback rule.

Planning considerations for certain types of property

For some individuals, their wealth includes equity interests in a family business or other closely held business. For some, their wealth includes incentive stock options (ISOs), nonqualified stock options (NSOs), or restricted stock units (RSUs). The rules governing these types of equity compensation present special issues for wealth transfer planning. And for some, their wealth includes carried interests. We'll briefly explore some planning issues involving these types of property.

[763] Id.
[764] Treas. Reg. § 25.2702-5(c)(1). More broadly, a settlor might create either a personal residence trust or a qualified personal residence trust, but a qualified personal residence trust generally is more favorable, because it's more flexible. See Treas. Reg. § 25.2702-5(b)(1). Compare Treas. Reg. § 25.2702-5(c)(1).
[765] If the settlor doesn't pay fair market rent, the settlor's gross estate potentially would include the trust property. See IRC § 2036(a)(1).
[766] Treas. Reg. § 25.2512-5(d)(2)(iii).
[767] IRC § 2036(a)(1).
[768] Treas. Reg. § 25.2702-5(c)(9).
[769] Prop. Reg. § 20.2010-1(c)(3).
[770] Treas. Reg. § 20.2010-1(c).

Closely held businesses
An individual who owns an interest in a family business or other closely held business potentially faces a host of planning issues. While there's an array of potential tax issues, some of the hardest issues to resolve sometimes are the non-tax issues. Motivating key family members or other owners to engage in planning can be one of the most challenging obstacles to effective planning. Likewise navigating family and personal dynamics can present another set of challenges.

> Motivating key family members or other owners to engage in planning can be one of the most challenging obstacles to effective planning.

For an in-depth discussion of the planning considerations with interests in closely held businesses, see David Leibell and Jacqueline Denton, *Business Succession Planning* (a publication of the UBS Advanced Planning Group), David Leibell, *Family Dynamics Play an Important Role in the Success or Failure of the Family Business* (a publication of the UBS Advanced Planning Group), David Leibell, *Planning for the Sale of a Closely Held Business* (a publication of the UBS Advanced Planning Group and UBS Family Office Solutions), and Jacqueline Denton, *Buy-Sell Agreements* (a publication of the UBS Advanced Planning Group).

S corporations
An S corporation is an entity that's classified as a corporation for federal tax purposes and elects to be taxable as an S corporation.[771] An entity that's a corporation for state-law purposes is a classified as a corporation for federal tax purposes.[772] An entity that's a limited liability company for state-law purposes may elect to be classified as a corporation for federal tax purposes.[773] An S corporation is (mostly) treated as a pass-through entity, and income, deductions, and credits flow through to its shareholders in proportion to their ownership interests.[774] An S corporation is subject to a myriad of rules governing its qualification and operation. For example, an S corporation can't have more than 100 shareholders, it can't have more than one class of stock, and only certain trusts can qualify as shareholders.[775] These rules are complex, and violations can have adverse tax consequences, so planning with shares of an S corporation can be challenging.

For an in-depth discussion of the planning considerations with shares of an S corporation, see Jennifer Lan, *Transfers of S Corporation Stock* (a publication of the UBS Advanced Planning Group).

ISOs
ISOs are generally nontransferable, so wealth transfer planning opportunities are limited.[776] Nonetheless, an individual's estate plan should take account of any ISOs that the individual owns. During life, an individual potentially can transfer ISOs into a revocable trust, so that the ISOs will avoid probate.[777] The IRS privately ruled that such a transfer doesn't cause the ISOs to lose their preferential status,[778] but the ruling isn't something on which people (other than the taxpayer who requested it) can rely and plan documents governing ISOs often don't allow such a transfer. In their will, an individual can direct how ISOs must be transferred upon death.[779]

For a more in-depth discussion of ISOs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

Shares acquired by exercising ISOs
After exercising ISOs, an individual can engage in wealth transfer planning with the shares acquired by exercising the options. When gifting or otherwise

[771] IRC § 1361(a).
[772] Treas. Reg. § 301.7701-2(b).
[773] Treas. Reg. § 301.7701-3(a).
[774] IRC § 1366(a).
[775] See IRC §§ 1361(b) and 1361(c)(2).
[776] IRC § 422(b)(5). Despite the apparent prohibition against transfer, ISOs might be transferrable but convert into NSOs upon a transfer. See Treas. Reg. § 1.421-1(b)(2) and Rev. Rul. 2002-22. If so, an individual who is willing to forgo the tax advantages of ISOs potentially can engage in wealth transfer planning with those options.
[777] Treas. Reg. § 1.421-1(b)(2).
[778] PLR 9309027 (December 4, 1992).
[779] IRC § 422(b)(5).

transferring shares acquired by exercising ISOs, an individual generally should use only shares that the individual has held for more than two years after the grant of the ISOs and more than one year after the exercise of the ISOs. A gift or other transfer of shares that haven't been held for the both the one- and two-year time periods generally is a taxable event for income tax purposes, and the individual generally must include in ordinary income an amount equal to what the spread was when the individual exercised the ISOs (i.e., the stock's fair market value on the date of exercise minus the strike price).[780]

For a more in-depth discussion of shares acquired by exercising ISOs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

NSOs

The transferability of NSOs determines whether an individual can use them in wealth transfer planning. Some NSOs are transferable; others are not. Some NSOs are transferable only to certain persons, such as family members or trusts for their benefit. The plan documents governing the NSOs dictate the degree to which the NSOs are transferable. Even if the plan documents generally prohibit the transfer of NSOs, companies sometimes are receptive to amending the documents to eliminate the prohibition or otherwise allowing the transfers.

For an individual who owns transferable NSOs, the immediate efficacy of wealth transfer strategies depends on how many of the NSOs are vested. Contributing unvested NSOs to an irrevocable trust or otherwise gifting those options would accomplish little from a wealth transfer tax perspective. For gift tax purposes, a gift of unvested NSOs is not complete until the options vest.[781] In contrast, a gift of vested NSOs is a completed gift.[782] The individual could give those options outright to a child or other individual, could contribute those options to a SLAT, GRAT, or other irrevocable trust, or could sell those options to an irrevocable grantor trust. Gifting vested NSOs generally becomes more attractive when the share value is depressed, because the drop in the share value decreases the NSOs' value for gift tax purposes. Of course, it wouldn't make sense to make gifts using vested NSOs if the individual believes that the value of the shares will continue to fall.

After giving NSOs to another individual or a nongrantor trust, the transferor will continue to be liable for the income taxes arising from the NSOs' exercise. Transferring NSOs does not shift the income tax liability. For example, if an individual gives 1,000 NSOs to their child, they will recognize income when their child's exercises the NSOs (assuming that, upon the options' exercise, the child receives shares that are fully vested and fully transferable).

For a more in-depth discussion of NSOs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

Shares acquired by exercising NSOs

After exercising NSOs, an individual can engage in wealth transfer planning with the shares acquired by exercising the options. The individual could contribute the shares to an irrevocable trust, such as a SLAT or a GRAT, or sell those shares to an irrevocable grantor trust. Here again, those strategies can be more attractive when the shares' value are expected to appreciate substantially in the future. If the shares qualify as QSB stock, the individual might also consider strategies for stacking.

For a more in-depth discussion of shares acquired by exercising NSOs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

RSUs

Wealth transfer planning with RSUs is limited. RSUs are non-transferable, so it isn't possible to gift them. In addition, the individual who received them must include in income the amount of cash and the fair market value of unrestricted stock received when the RSUs vest.

For a more in-depth discussion of RSUs, see Todd D. Mayo, *Equity Compensation* (a publication of the UBS Advanced Planning Group).

Carried interests

A carried interest presents some special planning issues. Since it may potentially generate significant wealth, it's often an attractive asset to gift, so

[780] IRC § 83(a) and Treas. Reg. § 1.421-2(b)(1)(i).
[781] Rev. Rul. 98-21.
[782] Id.

that any future wealth isn't includable in the gross estate of the individual to whom it was granted. A gift of a carried interest, however, may be impractical, because it may be subject to transfer restrictions. If a carried interest is transferrable, a gift of the interest may be subject to special valuation rules if the transferor also owns a senior preferred interest (e.g., a capital interest in an underlying or related fund).[783] When this rule applies, the value of transferor's gift includes the value of the carried interest *and* the retained capital interest.[784] This is an unattractive – and even potentially disastrous – result.

An individual potentially can avoid the special valuation rule by taking advantage of the vertical slice rule.[785] Under this rule, the special valuation rule generally doesn't apply if the individual gifts a proportionate amount of all of their ownership interests in the fund.[786] Alternatively, an individual potentially can avoid the special valuation rule – and any transfer restrictions – through the use of a private derivative. In somewhat overly simplistic terms, the individual sells the right to some or all of the future appreciation to a trust that's a grantor trust with respect to the individual. The derivative usually is designed so that the sale price equals the fair market value of the future appreciation, so that the transaction isn't a gift. This strategy generally is successful if the actual appreciation exceeds the anticipated appreciation.

For a more in-depth discussion of carried interest, see Ann Bjerke, *Planning with Carried Interest* (a publication of the UBS Advanced Planning Group). For a general discussion of the use of private derivatives in wealth transfer planning, see Todd D. Mayo, "Derive Time," *STEP Journal*, August 2023, pp. 49-51. (Todd is a Senior Wealth Strategist in the UBS Advanced Planning Group.)

Reviewing the estate plan

An individual should periodically review their estate plan to ensure that their plans reflect their current wishes and objectives. This includes both tax and non-tax objectives. This review may be especially important if there has been a significant life event – such as a marriage, divorce, birth, or death – or a significant change in financial circumstances.

Reviewing dispositive terms
An individual may wish to review the dispositive terms of their estate plans. Those are the provisions that spell out who gets what and when. As circumstances change and an individual's thinking evolves, an individual may wish to update or change those dispositive terms.

Reviewing fiduciaries
An individual may wish to review whom they've named to serve in different roles in their estate plan. These persons include:

- Agents under a healthcare proxy or similar document
- Agents under a power of attorney for financial and legal matters
- Guardians for the individual (sometimes called conservators)
- Guardians for the individual's minor children
- Personal representatives (under the will)
- Trustees
- Trust protectors
- Trust advisors, distribution directors, investment directors, and similar roles under the terms of a trust

Sometimes, these persons colloquially are called "fiduciaries." (In some cases, a trust protector, trust advisor, distribution director, or a person serving in a similar role might not be subject to a fiduciary duty and thus might not be a fiduciary in a more literal sense.)

Reviewing family limited partnerships and similar structures
An individual who owns an interest in a family limited partnership or similar structure might consider reviewing the governing documents such as the partnership agreement and the entity's administration to ensure that it achieves the desired tax and non-tax objectives. If the family limited partnership or similar structure isn't properly structured and administered, it may not achieve those objectives. The consequences can be severe. For example, in one case, the IRS successfully argued that all of the assets in a family limited partnership were includible in an individual's estate

[783] See IRC § 2701.
[784] Id.
[785] Treas. Reg. § 25.2701-1(c)(4).
[786] Id.

for estate tax purposes, because the individual had created the partnership and was also entitled to vote on whether to dissolve the partnership.[787]

For a more information about the use of limited liability companies and other entities in estate planning, see Casey C. Verst, *Family Business Entities* (a publication of the UBS Advanced Planning Group).

Reviewing healthcare wishes
An individual should review living wills or other documents containing their healthcare wishes and instructions for purposes of verifying that they are comfortable with the healthcare and end-of-life-related instructions that they previously made.

Refreshing the advanced directives
An individual who signed their financial power of attorney or healthcare power of attorney more than two or three years ago might consider signing new ones, even if nothing has changed.

Organizing documents and information
As a part of reviewing the estate plan, an individual should consider taking the time to confirm that their estate planning documents and information are well organized and accessible by the persons who will need to access them upon the individual's incapacity or death.

Further reading
For a more information about estate planning, see Joanna Morrison, *Estate Planning: An Overview* (a publication of the UBS Advanced Planning Group).

Reviewing ownership of assets

An individual should review how they own their assets for purposes of making sure that the way in which they own them aligns with their estate plan. They should confirm the titling of the assets, so that they can ensure those assets will be distributed according to their goals and objectives. In some cases, that may involve titling non-retirement assets in the name of the individual's revocable trust.

An individual should maintain a personal balance sheet. While it is beneficial to have a complete list of assets and liabilities, the need for a regularly updated, comprehensive personal balance sheet has grown increasingly important as society enters the modern digital age. As we move away from receiving paper statements and instead rely on information provided electronically, there may no longer be a file cabinet full of paper statements that people can reference in order to determine what someone owns and what they owe if they are unable to manage their own financial affairs.

Reviewing beneficiary designations
An individual should periodically review the beneficiary designations for purposes of ensuring that they reflect the individual's current wishes and objectives. Assets that have beneficiary designations include:
- IRAs, qualified plans, and 403(b) plans
- annuities
- life insurance
- pay on death (POD) accounts
- transfer on death (TOD) accounts

For example, an individual who is divorced may still have their former spouse named as a beneficiary on certain assets.

Reviewing jointly owned property
An individual who owns an account or property jointly (whether with their spouse or someone else) should evaluate whether that's the best way to own the account or property. There may be tax and asset protection reasons why a different form of ownership may be better.

Funding revocable trusts
An individual who has created a revocable trust should periodically review which assets are held in trust and which assets aren't. Since one of the advantages of a revocable trust is probate avoidance, an individual might consider transferring into the trust any assets that aren't already held in trust (being mindful of assets that may require special attention, such as copyrights, QOFs, ISOs, IRAs and other retirement accounts, and certain non-retirement assets having beneficiary designations).

Managing digital accounts and assets
An individual should maintain a list of usernames and passwords for their digital accounts and assets. Upon incapacity or death, the persons who are responsible for managing the individual's affairs will need to access their online accounts, such as online

[787] *Estate of Powell v. Commissioner*, 148 T.C. 392 (May 18, 2017).

bank and brokerage accounts, credit card accounts, and frequent flyer and other loyalty programs. In some cases, it may be worthwhile to enable them to access email and social media accounts. Of course, it's important to safeguard this information in a secure but accessible manner. An individual's estate planning documents should address how their digital accounts and assets will be handled upon their incapacity or death.

Further reading
For a more information about asset titling, see Catherine McDermott, *Asset Titling* (a publication of the UBS Advanced Planning Group). For a more information about planning after a divorce, see Laura M. Chooljian, *Planning after a Divorce* (a publication of the UBS Advanced Planning Group).

Reviewing life insurance coverage and policies

An individual should review their life insurance policies annually. Is the coverage still adequate given the purpose for which the individual has the policy? For example, if an individual maintains a policy to replace the income that their family would lose upon their death, is the amount of coverage in line with their current level of income? Do they have the right kind of policy given their age, circumstances, and goals?

Checking beneficiary designations on your life insurance policies
An individual should periodically review the beneficiary designations on their life insurance policies. They should make sure that those designations reflect their current wishes and circumstances. A significant life event – such as a marriage, divorce, birth, or death – may affect an individual's choices concerning beneficiaries.

Reviewing irrevocable life insurance trusts
If an individual created an irrevocable trust to own one or more insurance policies, they should consider reviewing the trust and its administration for purposes of ensuring that the trust continues to fulfill their goals and is being administered properly. For example, is the individual making gifts to the trust using their gift tax annual exclusion, so that the trustee can pay the premiums on the life insurance policies? If so, is the trustee sending notices (sometimes called Crummey letters) to the beneficiaries who have a right to withdraw some or all of the contributions to the trust?

Further reading
For a more in-depth discussion of life insurance, see Jennifer Lan, Premini Scandurra, and Hunter Peek, *Life Insurance* (a publication of the UBS Advanced Planning Group).

Planning for liquidity

Depending on their age and financial circumstances, an individual may wish to evaluate whether their family is likely to have sufficient liquidity after their death. What funds will be available to pay debts, expenses, and taxes? What funds will be available to support a surviving spouse or other family members? Will there be sufficient liquid assets with which to pay any estate taxes (which generally are due nine months after an individual's death)? For a married couple, some of these issues – such as the payment of estate taxes – may be a concern only when the surviving spouse dies.

For more information, see Rebecca M. Sterling, *Planning for Estate Liquidity* (a publication of the UBS Advanced Planning Group).

An individual should review their life insurance policies annually. Is the coverage still adequate given the purpose for which the individual has the policy?

State tax planning

Overview

In addition to considering any federal tax consequences, an individual should also consider any actions that would impact their state income tax liability. This is especially true for those individuals who reside in states with high state and local income taxes.

Managing residency

An individual who spends time in multiple states might wish to assess whether they could be treated as a resident in more than one of those states. States have different standards for determining whether someone is a resident, and the standard for income tax purposes sometimes differs from the standard for estate tax purposes. In some cases, an individual's domicile (where they intend to live indefinitely) is more relevant than their residency (generally where they are physically present). For income tax purposes, residency sometimes is based strictly on physical presence (i.e., a day-count test). Other times, other factors are relevant (e.g., whether the individual rents or owns an apartment, house, or other dwelling in the state). By managing residency, an individual potentially can avoid unexpected taxes.

Changing residency

An individual who resides in a state with high taxes might consider changing residency to a state with lower taxes. Again, states have different standards for determining whether someone is a resident or domiciliary, and the standard for income tax purposes sometimes differs from the standard for estate tax purposes. Establishing ties with a new state – and, often more importantly, breaking ties with the old state – can take time and effort. Of course, changing residency affects a lot more than taxes. It affects an individual's personal, social, and business connections and may affect quality of life. In addition, beyond income and estate taxes, there are other taxes and costs to consider (e.g., property taxes, automobile registration fees, and auto and homeowners' insurance premiums).

For a more in-depth discussion of changing residency, see Catherine McDermott, *Changing State of Residence* (a publication of the UBS Advanced Planning Group).

Shifting income and gains out of state

An individual who lives in a state that imposes an income tax might consider creating a nongrantor trust in a state that doesn't impose an income tax on trusts. To the extent that the individual contributes assets to such a trust, the individual can potentially shift income and gains out of the individual's home state and thus potentially avoid state income taxes on the trust's income and gains. States that don't impose income taxes on trusts include Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, and Wyoming. Delaware doesn't impose income taxes on trusts that don't have any Delaware-resident beneficiaries.[788]

A business owner who is looking to sell their business in the next few years might find it appealing to contribute some shares of their business to a nongrantor trust established in one of the trust-friendly states. When they ultimately sell the business, the gain on the shares held by the trust potentially wouldn't be subject to any state income tax.[789] A business owner who previously created a nongrantor trust that holds shares of the business and isn't already in a trust-friendly state might consider moving it to one.[790] Similarly, a business owner who previously created a grantor trust that holds shares of the business might consider converting the trust to a nongrantor trust and, if it isn't already in a trust-friendly state, moving it to one.[791] Again, when in either of these situations they ultimately sell the business, the gain on the shares held by the trust potentially wouldn't be subject to any state income tax.[792]

In California and New York, residents are taxed on distributions from nongrantor trusts in a manner that aims to erase the economic benefit of the trusts having avoided state

[788] 30 Del. C. §§ 1632, 1635(a), 1636, and 1639. A trust that is a Delaware-resident trust must file a Delaware fiduciary income tax return even if the trust doesn't have any resident beneficiaries.

[789] In some states, it may not be possible to avoid state income taxes on the sale if the business is taxable as a partnership or S corporation for federal income tax purposes. See, e.g., *Burton v. New York State Department of Taxation and Finance*, 43 Misc. 3d 316 (N.Y. Sup. Ct. 2014).

[790] More precisely, the business owner would seek to eliminate any connections (nexus) that the trust has to the business owner's home state (or any other state that might impose an income tax on the trust).

[791] Converting a grantor trust to a nongrantor trust – a process that's often described as toggling off grantor trust status – has other potential implications. These include possibly recognizing certain gains, losing potential gift and estate tax advantages, and losing flexibility in the administration of the trust.

[792] See note 789.

income taxes in the years before the distribution.[793] (These states impose a throwback tax, which is what erases that economic benefit.) Despite this, using a nongrantor trust in a trust-friendly state may still be advantageous if the beneficiaries are likely to change their residency before the trust makes any distributions to them.

States take different approaches to determining whether a trust has sufficient connections (in tax parlance, nexus) with the state to be taxable in the state. A trust may be subject to tax based on:

- A settlor's residence
- A beneficiary's residence
- A trustee's residence
- The trust's place of administration
- The location of assets

In some cases, courts have held that a state's taxation of a trust based solely on the settlor's residency at the time that the trust became irrevocable is unconstitutional.[794] In addition, the United States Supreme Court has held that a state's taxation of a trust based solely on the trust having a beneficiary who's a resident of that state is unconstitutional.[795]

> Even if a state doesn't tax a trust on all of its income, a state will tax a trust on source income (that is, income that traces back to the state).

Even if a state doesn't tax a trust on all of its income, a state will tax a trust on source income (that is, income that traces back to the state). For example, a state typically would tax rents that a nongrantor trust receives from any real property located within the state.

When using a nongrantor trust for purposes of reducing state income taxes, an individual needs to consider whether the trust will be a completed gift trust or an incomplete nongrantor (ING) trust. In the case of a completed gift trust, contributions to the trust are completed gifts for gift tax purposes, and (so long as the trust is properly designed and administered) the trust property isn't includible in the settlor's estate for estate tax purposes. In the case of an ING trust, contributions to the trust are incomplete gifts for gift tax purposes, and the trust property is includible in the settlor's estate for estate tax purposes. A completed gift, nongrantor trust thus incorporates income and estate tax planning. In contrast, an ING trust incorporates income tax planning (but not estate tax planning).[796]

For New York income tax purposes, an ING trust generally is treated as a grantor trust with respect to the settlor to the extent it's funded while the settlor is a New York resident.[797] Accordingly, while the settlor is a New York resident, the settlor must report the trust's income, deductions, and credits on their personal New York income tax return.[798] In 2023, California enacted similar legislation. Under the California law, the grantor of an ING trust generally must report the trust's income, deductions, and credits on their California income tax return.[799] This law is effective for taxable years beginning on or after January 1, 2023.[800]

[793] N.Y. Tax Law § 612(b)(40) and Cal. Rev. & Tax Code § 17745(b).
[794] See, e.g., *Fielding v. Commissioner*, 916 N.W.2d 323 (Minn. 2018), aff'g No. 8911-R, 2017 BL 194423 (Minn. Tax Ct. May 31, 2017), *Linn v. Department of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013), *Residuary Trust A v. Director, Division of Taxation*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013), aff'd on other grounds, 28 N.J. Tax 541 (N.J. Super. Ct. App. Div. 2015) (New Jersey), and *McNeil v. Commonwealth*, 67 A.3d 185 (Pa. Commw. Ct. 2013).
[795] *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, 588 US ___, 139 S.Ct. 2213 (2019).
[796] For a more in-depth discussion of ING trusts, see Ann Bjerke and Todd D. Mayo, *ING Trusts* (a publication of the UBS Advanced Planning Group) and Todd D. Mayo, *ING Trusts: Key Decision Points for Settlors* (a publication of the UBS Advanced Planning Group).
[797] NY Tax Law § 612(b)(41).
[798] NY Tax Law §§ 611(a) and 612(a). See also Instructions to 2022 N.Y. Form IT-205, p. 5.
[799] Cal. Rev. & Tax. Code § 17082(a).
[800] Id.

Trust planning and administration

Overview

Trusts require ongoing attention. Lapses in the proper administration of a trust may thwart the trust's objectives, may have adverse tax consequences, and may create liability for those responsible for the trust's governance. Accordingly, an individual may wish to regularly review the administration of any trusts of which they are a settlor, beneficiary, or trustee.

Sending Crummey notices

In some cases, an individual may design an irrevocable trust so that one or more of the beneficiaries has the power to withdraw some or all of each contribution made to the trust. To the extent that a beneficiary can withdraw a contribution to a trust, the contribution is a gift to the beneficiary and qualifies for the gift tax annual exclusion.[801] When an individual makes a contribution to a trust, the trust agreement may require the trustee to provide notices to the beneficiaries who can withdraw some or all of the contribution. Even if the trust agreement doesn't require the trustee to send those notices, it may be advantageous to do so to ensure that the contribution qualifies for the gift tax annual exclusion (to the extent of the withdrawal powers).

Considering the income tax implications of a grantor trust

In the case of a grantor trust, the settlor (or sometimes a beneficiary) must report the trust's income, deductions, and credits on their personal income tax return. The trust itself is generally disregarded for income tax purposes. While it's often advantageous for a trust to be a grantor trust – by paying the tax, the settlor (or beneficiary) allows the trust property to accumulate without any diminution due to those taxes – the tax bite sometimes becomes unpalatable.

What if the tax bite is unpalatable? The individual may be able to borrow from the trust for purposes of paying the taxes. By borrowing from the trust, the individual gets the liquidity to pay the taxes but doesn't increase the individual's estate for estate tax purposes. In the case of a self-settled trust, the trustee may have the power to distribute trust property to the settlor. In the case of a spousal lifetime access trust, the trustee may have the power to distribute trust property to the settlor's spouse. In the case of a trust that's a grantor trust with respect to the settlor, the trustee (or possibly another person) may have the power to reimburse the settlor for the income taxes attributable to the trust. An individual might wish to avoid a pattern of distributions or reimbursement payments, because the individual may be seen as having retained an interest that would cause the trust property to be includible in the individual's estate for estate tax purposes.

An individual who created a trust that is a grantor trust with respect to them might consider whether they should toggle off grantor trust status. This individual usually can cause a trust to become a nongrantor trust – and thus its own taxpayer – by releasing certain powers that the individual has under the terms of the trust. For example, the individual may have the power to swap or substitute assets, or the individual may have the power to borrow from the trust. By releasing those powers, the individual might be able to toggle off grantor trust status, so that they will no longer be taxable on the trust's income. In some cases, the process for converting a trust from a grantor trust to a nongrantor trust is more involved. Of course, it's important to think through all of the ramifications of toggling off grantor trust status. For example, converting a trust from a grantor trust to a nongrantor is an inclusion event with respect to any qualified opportunity fund, causing the immediate recognition of any deferred gains. A conversion also might trigger certain gains.

[801] *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).

Making year-end distributions from nongrantor trusts

As year-end approaches, a settlor or beneficiary of a nongrantor trust might ask the trustee to consider distributing the trust's income (and, depending on the terms of the trust, the trust's capital gains) to the beneficiaries who are taxed at lower rates than the trust. This may be more tax efficient, because trusts are subject to compressed income tax brackets and a lower threshold for the 3.8% net investment income tax. Under the 65 day rule, the trustee may make a distribution within the first 65 days of 2024 and, for tax purposes, treat it as being made on December 31, 2023.[802] This gives the trustee some extra time to evaluate whether to make a distribution. Of course, the trustee should consider the tax status, goals, and objectives of the trust and beneficiaries before making any tax-motivated distributions to any of the beneficiaries.

> If an individual created a trust that owns an interest in a family-controlled limited partnership or limited liability company, they might consider reviewing the structure to ensure that it achieves their tax and other objectives.

Reviewing trust structures

If an individual created a trust that owns an interest in a family-controlled limited partnership or limited liability company, they might consider reviewing the structure to ensure that it achieves their tax and other objectives. If the structure isn't properly designed and administered, it may not achieve those objectives. For example, if an individual created the trust and is the manager of a trust-owned limited liability company, it may be best to have an independent manager who makes decisions about distributions from the limited liability company to the trust. For a more information about the use of limited liability companies and other entities in estate planning, see Casey C. Verst, *Family Business Entities* (a publication of the UBS Advanced Planning Group).

[802] IRC § 663(b).

About the Advanced Planning Group

The Advanced Planning Group consists of former practicing estate planning and tax attorneys with extensive private practice experience and diverse areas of specialization, including estate planning strategies, income and transfer tax planning, family office structuring, business succession planning, charitable planning and family governance.

The Advanced Planning Group provides comprehensive planning and sophisticated advice and education to ultra high net worth (UHNW) clients of the firm. The Advanced Planning Group also serves as a think tank for the firm, providing thought leadership and creating a robust intellectual capital library on estate planning, tax and related topics of interest to UHNW families.

Purpose of this document.
This report is provided for informational and educational purposes only. It should be used solely for the purposes of discussion with your UBS Financial Advisor and your independent consideration. UBS does not intend this to be fiduciary or best interest investment advice or a recommendation that you take a particular course of action. The information is current as of the date indicated and is subject to change without notice.

Personalized recommendations or advice.
If you would like more details about any of the information provided, or personalized recommendations or advice, please contact your UBS Financial Advisor.

Conflicts of interest.
UBS Financial Services Inc. is in the business of establishing and maintaining investment accounts (including retirement accounts) and we will receive compensation from you in connection with investments that you make, as well as additional compensation from third parties whose investments we distribute. This presents a conflict of interest when we recommend that you move your assets to UBS from another financial institution or employer retirement plan, and also when we make investment recommendations for assets you hold at, or purchase through, UBS. For more information on how we are compensated by clients and third parties, conflicts of interest and investments available at UBS please refer to the 'Your relationship with UBS' booklet provided at ubs.com/relationshipwithubs, or ask your UBS Financial Advisor for a copy.

No tax or legal advice.
UBS Financial Services Inc., its affiliates and its employees do not provide tax or legal advice. You should consult with your personal tax and/or legal advisors regarding your particular situation.

Important additional information applicable to retirement plan assets (including assets eligible for potential rollover, distribution or conversion).
This information is provided for educational and discussion purposes only and are not intended to be fiduciary or best interest investment advice or a recommendation that you take a particular course of action (including to roll out, distribute or transfer retirement plan assets to UBS). UBS does not intend (or agree) to act in a fiduciary capacity under ERISA or the Code when providing this educational information. Moreover, a UBS recommendation as to the advisability of rolling assets out of a retirement plan is only valid when made in a written UBS Rollover Recommendation Letter to you provided by your UBS Financial Advisor after a review of detailed information that you provide about your plan and that includes the reasons the rollover is in your best interest. UBS and your UBS Financial Advisor do not provide rollover recommendations verbally.

With respect to plan assets eligible to be rolled over or distributed, you should review the IRA Rollover Guide UBS provides at ubs.com/irainformation which outlines the many factors you should consider (including the management of fees and costs of your retirement plan investments) before making a decision to roll out of a retirement plan. Your UBS Financial Advisor will provide a copy upon request.

Important information about brokerage and advisory services.
As a firm providing wealth management services to clients, UBS Financial Services Inc. offers investment advisory services in its capacity as an SEC-registered investment adviser and brokerage services in its capacity as an SEC-registered broker-dealer. Investment advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate arrangements. It is important that you understand the ways in which we conduct business, and that you carefully read the agreements and disclosures that we provide to you about the products or services we offer. For more information, please review client relationship summary provided at ubs.com/relationshipsummary, or ask your UBS Financial Advisor for a copy.

Borrowing using securities as collateral involves special risks, is not suitable for everyone and may not be appropriate for your needs. All loans are subject to credit approval, margin requirements, and margin call and other risks; credit lines may be subject to breakage fees. For a full discussion of the risks associated with borrowing using securities as collateral, review the Loan Disclosure Statement included in your application package/account opening package. **UBS Financial Services Inc. (UBS-FS) and its Financial Advisors have a financial incentive to recommend the use of securities backed loans, rather than the sale of securities to meet cash needs because we receive compensation related to the loan as well as the investments used to secure the loan.** We benefit if you draw down on your loan to meet liquidity needs rather than sell securities or other investments, and have a financial incentive to recommend products or manage an account in order to maximize the amount of the loan. UBS-FS and its Financial Advisors and employees offer banking and lending products to clients through our affiliates and third-party banks in our capacity as a broker-dealer and not as an investment adviser.

UBS-FS, their employees and affiliates do not provide legal or tax advice. You should contact your personal tax and/or legal advisors regarding their particular situations, including the legal and tax implications of borrowing using securities as collateral for a loan.

This information is not provided based on your particular financial situations or needs and does not take into account individual investors' circumstances. You should not consider this information to be a "recommendation" by UBS or your UBS Financial Advisor.

General economic risks of investing in opportunity zones.
Qualified opportunity zones include low income urban, suburban or rural communities that were nominated for that designation by each state and possession based on 2010 US Census data, and which were certified by the secretary of the United States Treasury via his delegation authority to the Internal Revenue Service ("IRS"). The purpose of the legislation is to encourage economic growth and investment in these distressed communities by providing federal income tax benefits to taxpayers who invest within these zones. Investors should understand that an investment in these distressed economic areas is subject to the risk that the anticipated economic growth may not materialize and could result in a loss of some or all of their investment.

Original Publication Date:
Approval Code: IS2400385
Expiration Date: 1/31/2025

© UBS 2024. All rights reserved. The key symbol and UBS are among the registered and unregistered trademarks of UBS. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA. Member SIPC.