

Wills, Trusts,
and Estates

Class 4

Some Types of Taxes

- Income (state and federal):
 - Applicable to almost all income except gifts.
 - Graduated scale, based on income level.
- Capital Gains (federal)
 - Figured out by taking the sale price and subtracting the “basis” (the basis is the price paid originally for the object that is being sold).

Some Types of Taxes (cont.)

- Sales (state)
 - Taxed as a percentage of the sale price for goods and/or services.
- Property (county) [sometimes known as school tax]
 - Each year, property owners pay a percentage of the property's value.

Types of Taxes Most Relevant to our Course (the “transfer” taxes)

- Gift Tax (federal)
 - May be imposed on the donor for lifetime gifts that exceed the Unified Credit amount.
- Estate Tax (federal and some states)
 - May be imposed on the decedent's estate that exceeds the Unified Credit amount.

Types of Taxes Most Relevant to our Course (the “transfer” taxes) (cont.)

- Inheritance Tax (some states) [alternative or in addition to the estate tax]
 - May be imposed on the beneficiary(ies) of a decedent’s estate.
- Generation Skipping Transfer Tax (federal)
 - Extra tax on gifts that “skip” a generation (e.g. grandfather to granddaughter) to prevent people from avoiding transfer taxes by “skipping” a generation.

Gift Tax

- Taxed only on *gratuitous* transfers
 - If there is a sale for less than the market value, it's a part gift- part sale; so gift tax is only on the gift part.
- ***Graduated*** scale based on amount of the gift
- Tax is measured ***exclusively*** of the gift
 - [The percentage is based on the gift without the tax component.]

Cost Basis

- *Important for measuring the gain realized or loss sustained when a person sells an item.*
- For items that are **bought** for fair market value, the buyer's purchase price becomes the buyer's basis.
- For items **received as a gift**, the basis of the donor carries over to the donee ("carryover" basis).

Cost Basis (cont.)

- For **part gift, part sale** transactions, the basis is a combination:
 - For the gift part, the basis carries over.
 - For the sale part, the basis becomes the sale price.
- For items **received from a decedent** via inheritance or Will, the basis becomes the fair market value as of the date of death (“step up” in basis).

Quiz Time!

Example for Basis in a Part Gift Part Sale Transaction

- Mary buys a house for \$100,000 in 1980. In 2003, the house is worth \$500,000. She “sells” the house to her son, Robert, for \$200,000.
- What is Robert’s cost basis?

Example for Basis in a Part Gift Part Sale Transaction (cont.)

- This is a part gift part sale transaction.
 - The sale is for \$200,000 of the house.
 - The gift is of \$300,000 worth of the house.
- Basis:
 - The sale price becomes part of the basis (\$200,000).
 - The remaining \$300,000 corresponds to 60% of the gift, so 60% of Mary's basis transfers to Robert. Since Mary's basis was \$100,000, \$60,000 gets added to Robert's basis.
 - Robert's new basis is \$260,000.
 - (If Robert sells the house for \$500,000, he will have to pay capital gains tax on \$240,000)

Exemptions for the Gift Tax

- Annual Exclusion
 - Currently \$19,000 per year per beneficiary (indexed for inflation).
- Gift Tax Unified credit
 - Each person gets \$15,000,000 (as of 2026, indexed for inflation) of tax-free gifts (not including the other exemptions) over the course of a lifetime.

<https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax>

Exemptions for the Gift Tax (cont.)

- Marital deduction
 - Gifts between spouses who are U.S. citizens are completely tax free.
 - If one spouse is not a U.S. citizen, the deduction is (currently) \$194,000 as of 2026 (indexed for inflation).
 - Reason: The government is afraid that wealthy people will give all their appreciated property to a foreign spouse and thus avoid ever having to pay capital gains tax on that property.
- Charitable deduction
 - No limit

Estate Tax

- Measured **inclusively**
- \$15,000,000 (as of 2026, indexed for inflation)
- Estate expenses (debts, executor's fees, attorney fees etc.) are exempt.
- Marital and Charitable deductions apply as well.
- State Death tax deduction