

United States Wealth Transfer Taxation: An Overview and Comparative Law Analysis

The U.S. taxes the gratuitous transfer of wealth by U.S. citizens or residents under two distinct regimes: (1) an integrated gift and estate tax system; and (2) a tax on generation-skipping transfers. These regimes will be considered in turn. It should be noted that various bilateral treaties between the U.S. and various countries can change the taxation scheme where nonresidents or foreign nationals are involved.

Gift and Estate Taxes

The U.S. gift tax and estate tax are separate taxes, with gift taxes chargeable during life and estate taxes at death, but in application they are integrated into one system.

The Gift Tax

The gift tax is a charge on the donor of the gratuitous transfer. Certain gifts, however, are excluded from taxation. There is an annual limitation on such excluded gifts equal to \$18,000 (USD) per donee. The value above \$18,000 per donee is taxable. The donees are typically related to the donor (children, grandchildren, nieces, nephews), but they need not be related. The \$18,000 figure is adjusted annually for inflation in increments of \$1,000.¹

Similar to excluded gifts, other gifts are deducted for purposes of determining the tax base. These deductible gifts include ones to spouse and to certain charities. Regarding a spouse, the entire amount of the gift is deductible if the spouse is a U.S. citizen (which does not include a person who is a U.S. resident but not a citizen). If the spouse is not a citizen, then only the first \$185,000 of the value of the gift is excluded each year.² This exclusion replaces the \$18,000 exclusion applicable to a donee who is not a spouse. The \$185,000 exclusion, like the \$18,000 exclusion, is indexed annually for inflation in increments of \$1,000.

The deduction for gifts to charities is unlimited in amount. The types of charitable foundations and other charitable recipients are broadly defined to include those operating for exclusively religious, charitable, scientific, literary, or educational purposes, among others. The recipient organization need not operate within the U.S., but it must meet U.S. criteria.

After applying exclusions and deductions, the amount of taxable gifts is determined. During the lifetime of a donor who is a U.S. citizen or resident, he or she may make use of an exemption of taxable gifts in the amount of \$13,610,000. This exemption applies to all taxable gifts made by the donor during the donor's lifetime, and the balance of the exemption is available at death to reduce the estate tax.³ The exemption does not apply at the level of the donee as under some inheritance tax regimes. As such, there are no exemption amounts depending on the degree of relationship of the donee to the donor. The exemption amount does not replenish itself after

¹ \$18,000 is the amount of annual exclusion for gifts made in the year 2024.

² \$185,000 is the amount of annual exclusion for gifts to a noncitizen spouse made in the year 2024.

³ \$13,610,000 is the gift/estate exclusion amount for the year 2024.

certain intervals of time as under some foreign regimes. Instead, it is one gross exemption, which can be used during life against gifts or at death against the person's remaining estate.

Once the exemption is exceeded, gifts are taxed at 40%. There are no rate categories as under some foreign inheritance tax regimes for different recipients of the gifts, based on their relationship to the donor.

The donor is responsible for filing the tax reports ('returns') with the Internal Revenue Service (IRS) and paying the gift tax, if any.

For income tax purposes, the donee of a gift takes the donor's tax basis in each asset received. Upon sale of the asset, the donee will report gain or loss in relation to such 'carry-over' basis.

A nonresident of the U.S. who is not a citizen is subject to gift tax on gratuitous transfers of only U.S.-sited immovables and tangible movables, as well as on paper currency or coins. The same annual exclusion of \$18,000 per donee and \$185,000 to a non-U.S. citizen spouse applies. A nonresident-noncitizen does not enjoy an exemption from the gift tax.

The only state of the U.S. that imposes a gift tax is Connecticut.

The Estate Tax

The sister tax to the gift tax is the estate tax. At the death of a U.S. citizen or resident, the executor of the decedent's estate must list and value all property interests of the decedent of any kind, regardless of situs. This figure is known as the "gross estate". From the gross estate there is deducted certain bequests to the surviving spouse, funeral expenses, the expenses of estate administration, debts of the decedent, estate and inheritance taxes payable to states of the United States, and bequests to charitable foundations and other charitable recipients. If the surviving spouse is not a citizen of the U.S., then the marital bequest must be to a certain trust known as a Qualified Domestic Trust ('QDOT').⁴

After reducing the gross estate by the amount of the permissible deductions, the result is the taxable estate. To this figure the lifetime taxable gifts are added, and the tax is calculated, and the \$13,610,000 exemption, expressed as a credit, is applied against the tax. The effect of this mechanism is to apply the unused \$13,610,000 exemption against the taxable estate. The rate of tax is 40%, as under the gift tax. A whole or partial credit is available for foreign estate and inheritance taxes. The gift and estate exemption amount is indexed annually for inflation in increments of \$10,000.

The executor of the decedent's estate is responsible for filing the tax returns with the IRS and paying the tax.

A nonresident of the U.S. who is not a citizen is subject to estate tax on U.S.-sited immovables and tangible movables, paper currency and coins, shares of U.S. corporations, and certain obligations of U.S. companies and persons. It is notable that bank deposits, marketable debt

⁴ Bilateral treaties can serve to broaden the types of marital bequests that are deductible. The treaties with Germany, France and Canada provide such relief.

obligations (such as bonds), and proceeds of life insurance policies are not includible in the tax base. After allowing for certain deductions, the balance of the estate is taxable above an exemption amount of \$60,000.⁵ The rate of tax is 40%.

Unlike in some countries that do not have a stand-alone estate tax system, the U.S. does not impose a capital gains tax on a decedent's unrealized gains. Instead, from an income tax perspective, the U.S. provides for a new basis at death that is equal to the date-of-death fair market value of each asset. Of course, as set forth above, the entire value of the asset is includible in the tax base for estate tax purposes.

The following states of the U.S. have an estate or inheritance tax: Connecticut, Hawaii, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, and Washington. The District of Columbia (Washington, D.C.) also has an estate tax.

The Generation-Skipping Transfer Tax

The generation-skipping transfer (GST) tax is a wealth transfer taxation scheme that is separate and distinct from the estate and gift tax. For the GST tax to apply, there must be a gratuitous transfer of wealth from a person during life, or from his estate at death, to a transferee who is two or more generations below the transferor. Such a transfer is known as a "skip". In the typical case, the transferee is a lineal descendant, and therefore it is apparent whether the descendant is a grandson or granddaughter or someone more remote. If there is no familial connection, then the substitute rule is that the transferee is thirty-seven and one-half years younger than the transferor.

Each taxpayer, whether or not a citizen or resident of the U.S. enjoys a \$13,610,000 lifetime exemption from GST transfers, meaning that skips aggregating up to that amount do not incur tax.⁶ After that threshold, transfers are taxed at a flat rate of 40%. The GST exemption is separate from the integrated gift and estate exemption of the same amount. It is also indexed annually for inflation in increments of \$10,000.

No states of the U.S. currently impose a GST tax.

⁵ Bilateral treaties can serve to narrow the tax base and increase the exemption amount.

⁶ \$13,610,000 is the GST exemption amount for the year 2024.