

IRS: Gifts to Irrevocable Grantor Trust Will Not Receive Basis Step-Up At Death

Key Takeaways

- The IRS has confirmed its view that when assets are gifted to an irrevocable grantor trust and not included in the grantor's estate, the trust assets will not receive a step-up in basis at the death of the grantor.
- Clients should review their trusts for planning opportunities, such as the ability to use "swapping powers" and are encouraged to develop a strategy around income taxation of trust assets.

Lifetime gifts to irrevocable grantor trusts have long been a staple in the estate planning playbook for clients with large estates. By gifting assets to an irrevocable trust during their lifetime, taxpayers are able to remove the gifted assets from their taxable estate at their passing. A portion of the taxpayer's lifetime estate and gift tax exemption would typically be used by making the gift¹; however, any appreciation in the assets after the date of the gift would not be subject to estate tax upon the death of the grantor.²

Structuring the irrevocable trust as a "grantor trust" allows the grantor to continue to be responsible for the income taxes generated by the trust during their lifetime. In essence, this allows the grantor to continue to make "tax-free" gifts by paying the tax liabilities of the trust without using further gift tax exemption. The IRS recently addressed one outstanding question relating to completed gifts to irrevocable grantor trusts: do the trust assets receive a basis step-up at the passing of the grantor?

Internal Revenue Code § 1014 generally provides that a decedent's assets will receive a step-up in basis at death, meaning that the basis in the property will be equal to the fair market value at death (eliminating capital gains on appreciation during the decedent's lifetime). In Revenue Ruling 2023-2³, the IRS made clear its position that completed gifts to an irrevocable grantor trust will not receive a step-up in basis at the death of the grantor under IRC § 1014. Because the assets are not included in the taxable estate of the grantor, the IRS takes the position that this is not an asset of the grantor's that would receive a step-up in basis at death.

This Revenue Ruling largely confirms what many practitioners had already believed to be the case – assets gifted to an irrevocable grantor trust that are excluded from the grantor's estate will not receive a basis step up at the grantor's passing. Note that life insurance proceeds are generally income tax-free under IRC § 7702 – as such, life insurance proceeds that pay out to an irrevocable grantor trust will not be impacted by this Revenue Ruling and will not be income taxable.

Individuals with assets in grantor trusts are encouraged to consider the income tax treatment of the trust assets during their lifetime. For example, many trusts include “swapping powers,” whereby the grantor may swap low basis trust assets for higher basis personal assets of equal value during their lifetime. This allows the lower basis assets to receive a basis step-up by being included in the estate of the grantor, while the assets with little to no gain remain in trust. Contact your Summit Advisor to learn more about this Revenue Ruling, or to discuss its application to your own circumstances.

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¹ In 2023, the US estate and gift tax exemption is \$12,920,000 per individual. Gifts above this amount are subject to a 40% federal estate tax. Many states also impose a separate estate tax.

² Note that gifts made within three years of the date of death may be pulled back into the estate for federal or state estate tax purposes.

³ Revenue Ruling 2023-2, *available at* <https://www.irs.gov/pub/irs-drop/rr-23-02.pdf> (last accessed April 17, 2023).