Updates in Estate Planning

Caroline Q. Robbins, Esq.
Proskauer Rose LLP
crobbins@proskauer.com

Andrew M. Katzenstein
Estate Whisperer
andy@theestatewhisperer.net

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2026 EXEMPTIONS

- The applicable exclusion amount is increased from $13,990,000 to $15,000,000 for 2026 (per the One Big Beautiful Bill Act "OBBBA").
- The GST exemption is similarly increased from $13,990,000 to $15,000,000 for 2026 per OBBBA.
- The annual gift tax exclusion remains at $19,000 for 2026.
- The annual exclusion for gifts to non-citizen spouses is increased from $190,000 to $194,000 for 2026.

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OBBBA Changes: SALT Deduction

- Tax Cuts and Jobs Act of 2017 limited state and local tax ("SALT") deduction to $10,000 per taxpayer through 2025
- OBBBA increased SALT deduction to up to $40,000, subject to phaseout (down to $10,000) for taxpayers making more than $500,000
- Reverts back to $10,000 limit in 2030
- Non-grantor trusts receive their own SALT deduction, subject to same income phaseout
  - "Stacking" non-grantor trusts may be possible
  - But subject to IRS scrutiny, and non-grantor trusts have downsides

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OBBBA Changes: Trump Accounts

- Tax-deferred savings account for minors, can be funded starting in July 2026
- One-time deposit of $1,000 from federal government for children born in 2025 through 2028
- Private contributions allowed of up to $5,000 in total (from all sources) per child per year (indexed for inflation) through year in which child turns 17
  - No tax deduction for contributions
  - Employers can contribute up to $2,500 of the $5,000, which will not be considered taxable income
- Must be invested in “eligible investments” (e.g., mutual fund or ETF tracking a U.S. stock index)
- After child turns 18, distributions may be taken, and the account will be treated like a traditional IRA
  - Ability to withdraw money, subject to ordinary income tax, for qualifying expenses (e.g., college tuition or a first-time home)
  - Withdrawals before age 59.5 are subject to the 10% early penalty if not spent on a qualified expense
- Withdrawals are taxed as ordinary income, but child has a tax basis equal to value of contributions made by individuals

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OBBBA Changes: 529 Accounts

- Additional expenses, beyond tuition, treated as qualified higher education expenses in connection with enrollment in or attendance at elementary or secondary school
  - curriculum and curricular materials
  - books or other instructional materials
  - online educational materials
  - tuition for certain tutoring
  - dual enrollment fees
  - certain testing fees
  - certain educational therapies for students with disabilities
- $10,000 annual limit for K-12 expenses increases to $20,000 starting in 2026

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OBBBA Changes: Charitable Deduction

- Tax Cuts and Jobs Act of 2017 temporarily increased from 50% to 60% the AGI limitation for cash contributions to qualifying public charities – the OBBBA has made that increase made permanent
- Non-itemizers can get deduction for charitable contributions up to $1,000 ($2,000 for joint filers) (not applicable for contributions to DAFs or supporting organizations)
- For itemizing taxpayers:
  - 0.5% floor on charitable contributions – deduction only allowed to extent that total contributions exceed 0.5% of AGI
  - Cap on itemized deductions for high-income taxpayers, reducing effective value of charitable deductions in the top 37% bracket (deduction treats those taxpayers as being in 35% tax bracket)
- These changes are effective 2026

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OBBBA Changes: QSBS

Shares issued before July 4, 2025	Shares issued after July 4, 2025
Must hold stock for more than 5 years for gain from sale of qualified small business stock (QSBS) to be 100% excluded	Tiered gain exclusion for QSBS issued post-OBBBA: - 50% for QSBS held for 3 years - 75% for QSBS held for 4 years - 100% for QSBS held for 5+ years
Exclusion capped at $10 million per issuer, subject to greater exclusion based on 10 times the taxpayer's basis in the QSBS	Exclusion capped at $15 million per issuer (indexed for inflation), subject to greater exclusion based on 10 times the taxpayer's basis in the QSBS
No exclusion if at time of issuance corporation's gross assets exceed $50 million	No exclusion if at time of issuance corporation's gross assets exceed $75 million (indexed for inflation)

- Per taxpayer exclusion, so potential to use non-grantor trusts to stack QSBS deductions
  - Separate trusts should be respected if they have different primary beneficiaries and a significant non-tax purpose

OBBBA Changes: Opportunity Zones

- Originally created as part of the TCJA, Opportunity Zones provide tax incentives to taxpayers who invest in economically distressed areas
- Under the TCJA rules, taxpayers could roll capital gain into Qualified Opportunity Funds (QOFs), defer the gain until the end of 2026, receive a partial basis step-up, and permanently exclude appreciation after 10 years.
- New rules: for investments made on or after January 1, 2027, there's a five-year rolling period of deferral, a 10% basis step-up after five years for regular OZs and 30% basis step-up for rural OZs, and eliminates QOF gain after 10 years.
- The Opportunity Zone program is now permanent.

OBBBA Changes: Increased Exemption

- Tax Cuts and Jobs Act of 2017 increased estate and GST tax exemption, but was then scheduled to sunset (and essentially get cut half) on December 31, 2025
- That sunset has been eliminated by OBBBA
- 2025 exemption of $13,990,000 is unchanged
- Exemption increases to $15,000,000 on January 1, 2026, with annual increases thereafter indexed for inflation
- This change is permanent – no sunsetting

How to Use Increased Exemption

- If you can, use your increased exemption in January by gifting in trust
  - The earlier the gift, the more time the trust has to appreciate, increasing the total value of assets not subject to estate tax at death
  - While the exemption increase is "permanent," laws can change
- If exemption is used up, consider "freeze" transaction, after taking current interest rates into account
- The Reluctant Giver
  - You know the gift should be made but are you willing to do it?
  - "Painless" giving

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How to Use Increased Exemption

- Supercharging the Use of the Exemption
  - Gifts to grantor trusts
  - Avoid taxes for multiple generations by allocating more generation-skipping transfer (GST) tax exemption
  - Trusts can be created in jurisdictions that permit perpetual trusts
  - Use discounting techniques to enhance savings. For example, with a 30% discount, an asset worth $42,857,143 can be gifted without tax using parents' combined $30,000,000 exemptions.
  - Leverage exemption with sales to grantor trusts
  - Be sensitive to basis issues and consequences of losing a step-up in basis
  - Buy gifted assets back from grantor trusts (not QPRTs) just before death to accomplish basis step-up

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How to Use Increased Exemption

- "Freeze" Transactions – Interest Rates
- Applicable Federal Rates:

	Jan 2025	Jan 2026
Short-Term (3 years or less)	4.33%	3.63%
Mid-Term (3 to 9 years)	4.24%	3.81%
Long-Term (over 9 years)	4.53%	4.63%
7520 Rate (for GRATs)	5.20%	4.60%

- These are the minimum rates that must be applied for a transfer to be a loan rather than a gift
- These rates change monthly, based on the average yields of U.S. Treasuries

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GIFTS AND SALES TO IDITS

- An IDIT is an "intentionally defective irrevocable trust". This is just a fancy name for an irrevocable grantor trust. The "defect" is the provision in the trust that makes the trust a grantor trust (e.g., the power of the grantor to substitute assets of equal value, or the power of the grantor to borrow without adequate interest or security).
- If a trust is a grantor trust, for income tax purposes all items of income, deduction and credit are reported on the grantor's return.
- IDITs are used in the estate planning context because the settlor of the IDIT pays the income tax on IDIT income. In effect, that is a reduction in the value of the settlor's estate, and an increase in the value of the IDIT (because it doesn't get depleted by having to pay the tax).
- That looks very much like a gift by the settlor to the IDIT…

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GIFTS AND SALES TO IDITS

- …BUT because when a person pays his or her own tax that isn't a gift, this effective transfer from the settlor to the IDIT avoids treatment as a taxable gift.
- For that reason, most estate planning trusts start out as IDITs.
- In the future, if the settlor of the IDIT doesn't want to pay the income tax on trust income, there are two options:
  - The power(s) (such as the power to substitute assets of equal value or the power to borrow without interest or security) that make the IDIT a grantor trust can be release, "turning off" the grantor power.
  - The IDIT, *upon creation of the IDIT*, can include a provision that allows an independent trustee to reimburse the grantor for tax paid on trust income. (CCM 202352018 suggests draconian results if clause is added later by trust modification.)

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GIFTS AND SALES TO IDITS

- Taxpayers make gifts so that their heirs can avoid transfer tax on the future appreciation of the gifted asset.
- There are two types of appreciation that can effectively be transferred by gifting:
  - Real Life Appreciation: what is given away actually appreciates in value.
  - Man-Made Appreciation: structuring the asset that will be given in a manner that discounts apply can reduce the value of the gifted asset for gift tax purposes (e.g., gifts of non-voting and/or non-marketable interests in partnerships or LLCs).
- Beginning on 1/1/26 (ignoring the annual gift tax exclusion), each person can give away $15,000,000 without having to pay gift tax. A married couple can give away twice that amount, or $30,000,000. Gifts in excess of that amount will incur gift tax at a 40% rate.

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GIFTS AND SALES TO IDITS

- If a taxpayer wants to transfer appreciation on assets worth more than $30,000,000, without paying gift tax, he or she may instead decide to sell those assets to children or to trusts for their benefit.
- Sales of appreciated assets result in capital gains tax. However, because a sale to an IDIT is treated as a sale *from* the taxpayer *to* the taxpayer, there is no capital gain recognized. The purchaser IDIT receives the asset with the seller's carryover basis.
- This is another significant advantage of using IDITs as part of an estate plan.
- If the settlor can buy the assets back from the IDIT at their appreciated value for cash pre-death, those assets can be included in the settlor's estate and receive a basis step-up.

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WHY PEOPLE SELL ASSETS TO IDITS

- Typically, a settlor does not contribute cash to an IDIT and then simply have the IDIT buy the asset the settlor expects to appreciate. And even if this is what a settlor wanted to do, the limit on how much he or she could sell to the IDIT would be $15,000,000 or $30,000,000 for a married couple (because more cash than that couldn't be given without incurring gift tax). The settlor could simply gift the asset expected to appreciate without needing to employ the additional complications of a sale.
- BUT: if the settlor wants to transfer the appreciation on assets worth more than $30,000,000, it must be done by sale to avoid gift tax.

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WHY PEOPLE SELL ASSETS TO IDITS

- Note: gift tax is typically paid with cash that isn't subject to gift tax, while estate tax is typically paid with cash that is subject to the estate tax. Effectively, that makes the gift tax about 16% "cheaper" than the estate tax.
- Therefore, paying gift tax (more than 3 years before death) actually reduces transfer taxes. And there is no "time value" issue when dealing with transfer taxes like there is in the income tax realm. Deferring income tax makes sense because the amount of income that is taxed is an amount certain; but as transfer taxes are imposed on the value of an asset owned by a decedent at death, if assets appreciate over time, then deferring the transfer tax just means that the tax is on a larger amount.
- Yet, people hate writing big checks to IRS and therefore use sales to transfer appreciation in excess of their lifetime exemptions.

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STRUCTURING SALES TO IDITS

- Step 1: create the IDIT.
- Step 2: make a gift to the IDIT of an amount equal to 10% of the value of the asset that will be sold to the IDIT.
  - A sale to an empty IDIT might result in the inclusion in the settlor's estate of the IDIT settlor under IRC Section 2036(b)(1). That section causes estate tax inclusion of an asset transferred in which the transferor keeps the "…right to possess or enjoy the property or the income therefrom…"
  - Why? Because if the only asset out of which a note taken back in a sale to an IDIT can be paid is the asset that was sold to the IDIT, IRS will treat the asset as having been transferred but the transferor as keeping the right to possess or enjoy the property on the income therefrom.
  - Arising from a debt/equity case, urban legend has arisen that at 10% gift to the IDIT is enough to break that "2036 string" that exists if the sale is to an empty IDIT.

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STRUCTURING SALES TO IDITS

  - Whether urban legend or not, most practitioners follow this 10% rule, and attorneys don't report that IRS challenges that convention.
- Step 3: sell the asset to the IDIT in exchange for a promissory note (though a sale for an annuity payment is another option that is discussed below).
  - The note should bear interest at the applicable federal rate ("AFR"), to avoid gift tax on the interest that would otherwise not be paid.
  - The term of the note is typically 9 years – so that the mid-term AFR can be used. Also, because assets sold are often expected to see a "pop" in value shortly after the sale, a 9-year term will fit.
  - Typically, the note permits prepayment. If the asset "pops" to as high a value as the settlor believes it would reach, prepayment of the note at that time locks in the largest amount of appreciation that can be transferred to the IDIT for the benefit of its beneficiaries.

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STRUCTURING SALES TO IDITS

  - Some practitioners secure the note to make the sale to the IDIT look more like a "real sale" that would happen between unrelated parties, to avoid the IRS ignoring the sale and treating the transaction as a gift. *Not* securing the note, however, will provide for a bigger discount on that note if it remains unpaid at the settlor-seller's death. So long as interest is paid when due pursuant to the terms of the note, and all sale documents and changes to the governing instruments of assets sold properly reflect the sale, the fact that there is no security doesn't seem to raise a significant risk that IRS will just ignore the sale.
- Step 4: execute all sale documents. If entities are sold, amend governing instruments to admit the IDIT as the owner, or issue a share certificate of a corporation in the name of the IDIT.
- Step 5: administer the purchased asset and note in accordance with the terms of the sale.

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STRUCTURING SALES TO IDITS

- K-1s should be issued to the IDIT (even though the settlor will pay the tax).
- Interest payments should be made when due in accordance with the terms of the note.
- If principal is repaid prior to maturity, it should be done periodically. Don't use all the income of the transferred asset to make payments each year, or that gives IRS the chance to assert that the settlor did nothing but transfer the asset and keep for his or her lifetime the "right to possess the income therefrom" and that the value of the asset in the IDIT should be included in the settlor's estate under IRC Section 2036(b)(1).

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STRUCTURING SALES TO IDITS

- Interest on the note can be paid with cash flow from the asset sold to the IDIT. If the IDIT is a Crummey trust, annual exclusion gifts can be made if cash flow from the asset sold is not sufficient.
- The note can be paid off using the appreciated value of the asset it purchased when due, or cash if that appreciated asset has been sold as part of a liquidity transaction. If the asset was wrapped in an LLC to create a discount at the time of sale, consider taking enough of the asset out of the LLC before the IDIT pays off the note so that the discount doesn't work against the plan when the payment is being made.
- If the AFR falls over the term of the note, the note can be re-negotiated. Perhaps consider some consideration for the refinance (e.g., a little principal is prepaid, or the term of the note is made shorter), though probably not required to avoid transfer tax consequence.
- Similarly, if the asset hasn't yet appreciated when the note is due, the note can be extended (but at the then AFR) and paid at a later date.

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STRUCTURING SALES TO IDITS

- Step 6: file a gift tax return reporting the gift to the IDIT. Be sure to allocate GST exemption to the trust so that it has a zero inclusion ratio. Most people adequately disclose the sale on the gift tax return as well.
- Step 7: if the grantor dies before the note is paid in full, the IDIT is no longer a grantor trust. Interest payments thereafter are taxable to the grantor's estate (or heirs). There is no step-up in basis for the IDIT's assets. Though there is some confusion as to whether or not principal payments on the note post-death result in capital gain to the grantor's estate (or heirs), the general consensus is that because the note isn't IRD there is no capital gain recognized. As a result, the IDIT's basis in the asset remains unchanged (i.e., there is no "credit" towards basis for payments made post-death).

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SALES TO IDITS

Illustration

- At an exemption amount of $30,000,000 per couple, assets worth $330,000,000 can be transferred to a grantor trust via combination of gift and sale. If assets appreciate 30% in value between transfer and death, $99,000,000 passes without transfer tax to trust for children and grandchildren. At a 40% rate, estate tax savings is $39,600,000.

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Other “Freeze” Techniques

- Loans to family members or trusts
- Qualified Personal Residence Trusts (“QPRTs”) – If interest rates are high at QPRT formation, the gift value of the residence transferred to the QPRT is lower
- Charitable lead annuity trusts (“CLATs”) – If interest rates are high at CLAT formation, a greater annual percentage goes to charity each year
- Grantor retained annuity trusts (“GRATs”) – if interest rates are high at GRAT formation, a larger annuity needs to be paid to Settlor
  - GRATs have a 4.6% “hurdle rate” if created in January 2026 (unchanged since October 2025)

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Proposed California Billionaire Tax

- **Proposal:** A proposed ballot initiative was submitted to the California attorney general that would impose a one-time, 5% tax on each California resident with $1 billion or more of “net worth”
- **Qualifying for the Ballot:** In California, ballot initiatives need to receive a certain number of valid signatures to qualify for the ballot. In this case, the initiative needs 874,641 valid signatures. The initiative has significant financial backing and is expected to clear that hurdle.
- **Simple Majority to Pass:** If the initiative qualifies for the November 2026 ballot, it will need only a simple majority of votes to pass.

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Proposed California Billionaire Tax

- **Definition of "Net Worth":** The initiative defines "net worth" as assets minus liabilities, subject to numerous exceptions. Real estate and tangible personal property (like gold bullion or fancy cars) held outside California are excluded from the definition of net worth. Certain retirement plans, pension plans, and deferred compensation are also excluded. Taxpayers can exclude a total of $5 million of hard-to-value assets like art, collectibles, non-publicly traded financial instruments, intellectual property rights, debts, and personal property. On the other hand, an individual's net worth is deemed to include assets held in grantor trusts, charitable remainder trusts, and non-grantor trusts that the individual funded. The tax also applies to beneficiaries of non-grantor trusts that were set up by people who are now dead, provided that a beneficiary's interests in his or her trusts (together with the beneficiary's personal assets) exceed $1 billion. "Net worth" appears to includes gifts in excess of $1 million made after October 15, 2025.

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Proposed California Billionaire Tax

- **Individuals Subject to Tax:** The tax would be levied on billionaires living in the state on January 1, 2026.
- **Valuation Date:** The tax would be based on asset values on December 31, 2026.
- **Claw-back:** For individuals with more than $1.1 billion of net worth, the tax would apply to their entire net worth, not just the amount over the $1 billion threshold. The tax would phase in for individuals with between $1 billion and $1.1 billion of net worth.
- **Marriage Penalty:** Married couples would be considered a single "individual" for purposes of calculating whether a taxpayer is subject to tax.

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Proposed California Billionaire Tax

- **Valuations:** Publicly traded assets would be valued based on their publicly traded values. Illiquid assets that are not publicly traded would be presumed to have fair market values equal to the sum of (a) the book value and (b) 7.5x book profits, but taxpayers would be able to engage third-party appraisers to produce appraisals reflecting lower values if those lower values were more accurate.
- **Payment of Tax:** The tax would be due on April 15, 2027. Taxpayers could pay the tax upfront or in five equal installments over five years, though there'd be a 7.5% annual interest charge on deferred amounts. Some taxpayers with illiquid assets may qualify for additional deferral.

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Proposed California Billionaire Tax

- **Potential Avoidance Strategies:**
  - Exception for directly held real estate
  - Exception for out-of-state tangible personal property
  - Gifts of less than $1 million
  - Moving out of state before the end of 2025
  - Distribute assets from irrevocable trusts

- **But:** (1) Transactions must have economic substance and substantial non-tax reasons; (2) statutory language is full of undefined terms and vague language, making planning difficult.

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Elcan v. Commissioner (Tax Court Docket No. 3405-25)

- Grantor created GRATs and subsequently exercised substitution powers to exchange assets in the GRATs for promissory notes (a common GRAT "freeze" technique when dealing with either a "winning" GRAT or a "losing" GRAT)
- Annuity payments to Grantor were satisfied using the receivables (the promissory notes)
- IRS issued notice of deficiency stating initial gifts to GRATs were taxable in entirety because the grantor's retained annuity interests were not qualified interests under IRC 2702 and the transfer of the notes to the GRATs in the substitutions were subsequent taxable gifts.
- To be determined…

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Estate of Kalikow v. Commissioner, 2025 WL 686037(2nd Cir. 2025)

- Issue: Whether value of QTIP trust's settlement payment to surviving spouse was a liability that was deductible against the included value of the QTIP trust in surviving spouse's estate
- Husband established a QTIP trust for wife that paid to their children upon her death. Wife's residuary estate went to charity.
- After wife's death, a dispute arose as to whether all of the income of the QTIP trust was distributed to wife and parties settled with the QTIP trust agreeing to make a lump sum payment to wife's estate.
- Wife's estate tried to include QTIP trust at a value net of the settlement payment.
- Deduction was disallowed as settlement did not affect the value of the underlying assets of the QTIP trust—further, there was no issue with double taxation as wife's estate passed to charity.

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Estate of Spizzirri v. Commissioner, No. 23-14049 (11th Cir. 2025)

- Issue: Whether payments to decedent's stepchildren at decedent's death, which were required under a prenuptial agreement, were deductible as claims against the estate
- Decedent entered into a prenuptial agreement with his fourth wife. At the time of the agreement, decedent had significant net worth and four children from a prior marriage. Wife had minimal net worth and three children from a prior marriage.
- Prenuptial agreement was modified multiple times over lengthy marriage. Initial agreement included certain provisions for wife at decedent's death (in lieu of statutory rights), including a marital trust, residency rights and a percentage of home sale proceeds. This was later modified to provide a lump sum payment to wife and lump sum payments to each of wife's adult children at decedent's death.

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Estate of Spizzirri v. Commissioner, No. 23-14049 (11th Cir. 2025)

- Decedent never updated his will to reflect prenuptial agreement requirements.
- Upon decedent's death, stepchildren filed creditor's claims, and estate paid each stepchild his or her lump sum amount.
- IRS disallowed deduction.
- IRC § 2053(c)(1)(A) provides that in order to qualify as a deductible claim against an estate, a claim must be "contracted bona fide and for an adequate and full consideration in money or money's worth."

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Estate of Spizzirri v. Commissioner, No. 23-14049 (11th Cir. 2025)

- Intrafamilial transfers, which include transfers to the lineal descendants of a decedent's spouse, are viewed with heightened scrutiny.
- The Treasury Regulations list five factors to consider when evaluating whether intrafamilial claims involving a decedent are bona fide:
  - The transaction underlying the claim or expense occurs in the ordinary course of business, is negotiated at arm's length, and is free from donative intent.
  - The nature of the claim or expense is not related to an expectation or claim of inheritance.
  - The claim or expense originates pursuant to an agreement between the decedent and the family member, related entity, or beneficiary, and the agreement is substantiated with contemporaneous evidence.
  - Performance by the claimant is pursuant to the terms of an agreement between the decedent and the family member, related entity, or beneficiary and the performance and the agreement can be substantiated.
  - All amounts paid in satisfaction or settlement of a claim or expense are reported by each party for federal income and employment tax purposes, to the extent appropriate, in a manner that is consistent with the reported nature of the claim or expense.

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Estate of Spizzirri v. Commissioner, No. 23-14049 (11th Cir. 2025)

- Tax Court held decedent's estate failed to prove it was entitled to a deduction because the estate failed to provide the claims were "contracted bona fide" and "for an adequate and full consideration in money or money's worth."
- 11th Circuit affirmed based on following:
  - Not arm's length as the agreement was made to keep wife happy (and decedent had history of making gifts to one of the stepchildren)
  - Payments were related to wife's expectation or claim of inheritance
  - Claims did not originate from any transaction between stepchildren and decedent
  - Stepchildren were not obligated to perform under the agreement
  - Estate failed to introduce evidence the stepchildren reported payments as income

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Estate of Rowland v. Commissioner TCM 2025-76

- Issue: Whether at surviving spouse's death, surviving spouse's estate could use first to die's deceased spousal unused exclusion (DSUE)
- In 2018, first spouse's estate filed Form 706 late and sought to rely on "safe harbor" under Rev. Proc. 2017-34, which allows certain late filed returns to be deemed timely if "complete and properly prepared."
- First spouse's return estimated values and omitted specific valuations of assets, so the IRS determined the return was incomplete under Treas. Reg. 20.2010-2(a)(7), which invalidated the DSUE election.

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Estate of Rowland v. Commissioner TCM 2025-76

- Holding: First spouse's return was both untimely and not "complete and properly prepared" as required by the safe harbor. The court emphasized that the special rule permitting estimated reporting applies only to marital or charitable deduction property that does not affect the value of other bequests. Because there were non-marital and non-charitable bequests, the return's blanket use of estimated values violated the reporting rules, precluding the portability election.

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