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Estate Planning & Tax Glossary

It's been some time since we did an estate planning and tax glossary. Much of what we said last time has been affected by the Tax Cuts and Jobs Act (TCJA), which was enacted in late 2017, and made numerous changes to the tax law. Although most of the changes affecting individuals are temporary and only last through 2025, an update still seems in order. On that theory, here is a current glossary of selected estate planning, income tax and retirement plan terms.

Adjusted Gross Income (AGI) – AGI equals gross income minus "above-the-line" deductions, such as those for alimony and one-half of the self-employment tax. (Under TCJA, for separation agreements entered into after December 31, 2018, alimony is no longer deductible for payor spouses and no longer taxable to payee spouses – a permanent change.)

Adjusted Taxable Gift – a lifetime gift that uses up part of the donor's applicable exclusion amount (see below) and that is part of the donor's estate tax computation. Annual exclusion gifts (see below) and direct payments of tuition and medical expenses (including health insurance premiums) are not adjusted taxable gifts and do not erode the donor's applicable exclusion amount.

After-tax Dollars – dollars on which income tax has already been paid. Roth IRAs and 529 plans (see below), for example, are funded with after-tax dollars.

Alternative Minimum Tax (AMT) – the AMT is a parallel tax system designed to ensure that taxpayers pay "enough" income tax. Although the AMT originally targeted a relative handful of wealthy taxpayers, its scope has significantly expanded over time. Yet because of various (temporary) changes under TCJA, far fewer taxpayers are likely to be subject to AMT through 2025; AMT is owed to the extent it exceeds the taxpayer's "regular" tax.

Annual Exclusion Gifts – refers to the inflation-indexed amount that donors can give, gift tax-free, to as many people as they wish, every year. In 2019, this amount is $15,000 per donee ($155,000 if the donee is a spouse who's not a U.S. citizen). If one spouse makes a gift, and the other spouse consents, the gift can be $30,000 per year (a "split gift"). Annual exclusion gifts do not erode the donor's applicable exclusion amount (see below).

Annuity – a fixed amount that is typically payable for a period of years, the annuitant's lifetime, or a combination of the two. While an annuity offers the certainty of a steady payment, it is not considered a hedge against inflation.

Applicable Credit Amount – once known as the "unified credit." The credit applies against federal estate and gift tax, and in 2019, is $4,505,800 (i.e., the estate tax on $11.4 million, the 2019 basic exclusion amount (see below)).

Applicable Exclusion Amount – the amount of property that can be sheltered from gift and estate tax. It consists of the inflation-adjusted $10 million "basic exclusion amount" (see below) and for surviving spouses, if applicable, the "deceased spousal unused exclusion amount" (DSUE – see below). If there is no DSUE, the applicable exclusion and basic exclusion amounts are the same. (Through 2025, TCJA doubled the $5 million basic exclusion amount, indexed for inflation, to $10 million, indexed for inflation.)

Ascertainable Standard – a clearly discernible standard by which a trustee is allowed to pay income or principal to a trust beneficiary. A typical ascertainable standard permits distributions for a beneficiary's "health, education, maintenance and support" (what's known as the "HEMS" standard). When a trustee has a "beneficial interest" in the trust – i.e., is eligible for principal or income distributions – such standards prevent the trust property from being includible in the trustee/beneficiary's taxable estate, *and* from being a taxable gift when the trustee/beneficiary makes discretionary distributions to other beneficiaries.

Basic Exclusion Amount (BEA) – through 2025, TCJA doubled the $5 million inflation-indexed BEA to $10 million, indexed for inflation. The 2019 BEA is $11.4 million (it was $11.18 million in 2018). The BEA is part of the applicable exclusion amount (see above) and helps protect property from gift and estate tax.

Charitable Deduction – the deduction against income, gift and estate taxes for gifts to charity. The charitable income tax deduction is limited, but the gift or estate tax deduction is unlimited.

Charitable Gift Annuity – an annuity paid by a charity in exchange for a gift to that charity. With cash gifts, the annuity payments are treated as part ordinary income and part return of the investment. With gifts of appreciated property, the transfer is a "bargain sale," and the annuity payments are treated as part ordinary income, part long-term capital gain (if the asset was owned for more than a year) and part return of the investment. If the annuitant outlives her life expectancy (determined at the gift's inception), her continuing payments will be treated as ordinary income; when the gift is made, the present value of charity's remainder interest is eligible for a current income tax deduction. Typically, a charitable gift annuity pays less than a commercial one, and is generally based on recommendations from the American Council on Charitable Gift Annuities. A charitable gift annuity can be a good way to benefit charity *and* retain an income stream. Distributions from a charitable gift annuity (other than a return of capital) are subject to the 3.8% tax on net investment income (see below).

Charitable Lead Trust (CLT) – a "split-interest" trust that is the inverse of a charitable remainder trust (CRT – see below). With a CLT, charity gets the "up-front" income interest, generally for a period of years, and the donor's heirs get the "remainder interest," or what's left after the income interest ends. Although the trust is usually not structured to generate an income tax deduction for the charitable interest, that interest generates a gift or an estate tax deduction that helps offset the gift of the remainder interest. As with a CRT, the CLT's income interest must be either an annuity (a fixed amount that never varies) or a unitrust interest (a variable amount that reflects increases (or decreases) in the trust's value). Unlike a CRT, a CLT has no required minimum payout. A CLAT is a charitable lead annuity trust and a CLUT is a charitable lead unitrust. CLTs are subject to the 3.8% tax on net investment income (see below), and are not tax-exempt.

Charitable Remainder Trust (CRT) – a "split-interest" trust that is the inverse of a charitable lead trust (see above). With a CRT, an individual gets the "up-front" income interest for a period of years (no more than 20) or life, and charity gets the "remainder interest" (what's left after the income interest ends). The charity's interest is not subject to estate or gift tax, and is eligible for an income tax deduction (subject to limitations) if the donor creates the CRT during life. Lifetime CRTs are typically used to diversify low-basis assets and defer capital gains tax. Although the trust itself is tax-exempt, its payout is taxable to the up-front beneficiary; if the trust is invested for growth, however, the payout will generally be subject to favorable capital gains tax rates (distributions of post-2012 income are treated as "net investment income" (NII) for purposes of the 3.8% tax on NII – see below).

With a **charitable remainder annuity trust (CRAT)**, the payout must equal at least 5% (but no more than 50%) of the trust's *initial* value, and there can't be greater than a 5% probability that the trust's principal will be exhausted before the up-front interest ends. With a **charitable remainder unitrust (CRUT)**, the payout must equal at least 5% (but no more than 50%) of the trust's *annual* value. For any CRT, the charity's remainder interest must equal at least 10% of the trust's initial value. The **"FLIP-CRUT"** is a variation on the CRUT, and can effectively serve as an additional retirement vehicle: the trust initially pays the lesser of its income or at least 5% of its annual value, and turns into a regular CRUT on the happening of a specified non-discretionary event (such as the birth of a grandchild) or on a specified date (such as anticipated retirement).

Community Property – the property ownership system that applies in nine states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. (Alaska has an elective community property system.) Community property applies to married couples, with each spouse deemed to own one-half of the property. When the first spouse dies, the cost basis of all community property, not just one-half, is adjusted to its fair market value. Assuming the property has appreciated, this basis "step-up" wipes out *all* of the property's built-in capital gains. This treatment is more favorable than that of jointly held spousal property in the rest of the United States: in general, when the first spouse dies in these states, only one-half of the jointly held property gets a basis adjustment, so that only one-half of the built-in capital gains disappear.

Credit Shelter Trust – a trust that is typically created under someone's will and is funded with the amount that can be protected from estate tax (see Applicable Exclusion Amount). A credit shelter trust usually provides for the surviving spouse and children, and can pass tax-free to children at the spouse's death; it shelters property from estate tax in both spouses' estates. Because "portability" is now available (see below), however, there is less need for such a trust, which may also be undesirable in light of the large basic exclusion amount (see above) that can protect taxable transfers. Furthermore, because the credit shelter trust is not includible in the surviving spouse's estate, there is no opportunity for a basis step-up, which will eliminate any built-in capital gains on the trust property (see Stepped-up Basis, below).

Crummey Power – a power designed to ensure that a donor's gift to a trust is a "present interest" and therefore qualifies for the annual exclusion (see above). A Crummey power permits the trust beneficiary to withdraw the gift for a limited period of time (say, 30 days). If the trust has no Crummey powers, lifetime gifts from the donor typically will be ineligible for the annual exclusion and will erode the donor's applicable exclusion amount (see Adjusted Taxable Gift) unless the trust qualifies as a Minor's Trust (see below). Crummey powers are typically used in irrevocable life insurance trusts (see below). "Crummey" was the name of the taxpayer who litigated this issue.

Decanting – refers to when a trustee "pours over" – or decants – an existing trust into a new trust. Although not every jurisdiction permits decanting (for which the rules vary), decanting can still be permitted by the trust terms. In general, decanting is done to enhance the trust's administration.

Decoupling – refers to what a number of states (about 13) have done to preserve *state* estate tax dollars: by untying themselves from the federal system, decoupled states can still collect state estate tax dollars. State exclusion amounts vary widely – e.g., Massachusetts has a frozen $1 million exclusion and in 2019, New York has an inflation-indexed exclusion of $5.74 million – as do how the states calculate their estate tax. The key point is that even if individuals are no longer subject to federal estate tax, they still may be subject to *state* estate tax if they reside in a decoupled state or own property there but reside elsewhere.

Defined Value Clause – a clause designed to mitigate adverse gift tax consequences when the donor gives away hard-to-value property. With such a clause, the gift's value typically equals a fixed dollar amount: if the IRS argues that the property is undervalued, the clause reallocates the donor's "excess" gift to another party (such as charity); if charity is not involved, the formula can effectively reallocate the excess to the donor – an approach the IRS opposes.

Donor-Advised Fund – a charitable fund that is typically run by a community trust or a financial institution. The donor's contribution goes into a separate account, and is eligible for a current income tax deduction (the donor advises the fund on subsequent charitable gifts). Because the fund is treated as a public charity, the donor is entitled to a larger income tax deduction than for gifts to a private foundation (see below).

DSUE (Deceased Spousal Unused Exclusion Amount) – the DSUE represents the amount of unused applicable exclusion amount of the predeceased spouse that carries over to the surviving spouse (see "Portability"). It can't be any larger than the basic exclusion amount in effect at the predeceased spouse's death.

Dynasty Trust – a trust that is created in a jurisdiction that has abolished the "rule against perpetuities" (see below). A dynasty trust can theoretically last "forever" and need not terminate when the law usually requires trusts to terminate – generally about 100 years after they are created. Such trusts are typically set up in Delaware, South Dakota or Alaska.

Estate Tax – a tax on the transfer of property at death. Generally, if a decedent's taxable estate exceeds her available applicable exclusion amount (see above), her estate will be subject to estate tax, for which the top rate is 40%. Because TCJA temporarily doubled (through 2025) the inflation-indexed $5 million basic exclusion amount (see above) to $10 million, indexed for inflation, even fewer individuals are affected by the federal estate tax. (The 2019 basic exclusion amount is $11.4 million.)

Executor – the individual, bank or trust company named in someone's will to administer that person's estate when she dies, and to ensure that the will's terms are carried out (a bank or trust company in that role is called a "corporate" executor). The executor's duties include figuring out what the decedent owned, gathering the decedent's assets, determining her debts and liabilities, and filing any necessary federal or state estate tax returns and final gift and income tax returns. The executor also must make a number of post-mortem tax planning decisions and preserve the estate's assets before they are distributed. This can mean managing those assets, and appropriately insuring them. (In many jurisdictions, the executor is instead called the "personal representative.")

Family Limited Partnership (FLP) – a pass-through entity that can garner gift and estate tax valuation discounts, since limited partnership interests are worth less than the underlying partnership property ("pass-through" means that income passes through to the partners, and is not separately taxed to the partnership). Discounts arise because of restrictions on the rights and powers of limited partners: for example, limited partners cannot freely transfer their respective interests, control distributions, participate in the partnership's management, or easily withdraw from the partnership. FLPs (along with limited liability companies – see below) invite scrutiny from the IRS; they are generally looked upon more favorably if they have "legitimate non-tax purposes," and are funded with some kind of working business, rather than just marketable securities or cash.

Fiduciary – one who stands in a relationship of trust to others, and often holds people's assets. Executors and trustees, for example, are fiduciaries. A bank or trust company is a "corporate" fiduciary. As then-Judge Benjamin Cardozo described the fiduciary's standard of behavior in a 1928 New York Court of Appeals case (*Meinhard v. Salmon*), it requires "[n]ot honesty alone, but the punctilio of an honor the most sensitive."

529 Plan – a tax-preferred account that allows parents, for example, to save for their children's higher education. Like a Roth IRA, a 529 plan is funded with after-tax dollars (see above); as long as withdrawals are used for "qualified higher education expenses," such as college tuition and room and board, the earnings portion of the withdrawal is not subject to income tax. All 50 states offer these plans. TCJA now permanently allows up to a $10,000 annual withdrawal to help pay for K – 12 tuition expenses (such a withdrawal may not be "qualified," however, in certain states (e.g., New York) and could trigger adverse state income tax consequences).

Generation-Skipping Transfer Tax (GST) – a transfer tax that is *in addition* to the estate or gift tax; it typically applies to transfers, whether outright or in trust, to people such as grandchildren. The GST exemption (or amount that can be protected from GST) equals the basic exclusion amount (see above); in 2019, it is $11.4 million. Unlike the applicable exclusion amount (see above), the GST exemption is not "portable," and requires careful planning for married couples to take full advantage of their respective GST exemptions. The tax rate is 40%.

Gift Tax – a tax on lifetime transfers of property. The basic exclusion amount (see above), which equals $11.4 million in 2019, protects lifetime transfers from gift tax. The top gift tax rate is 40%.

Grantor – the person who creates a trust is called a grantor. Another term for this is "settlor" or "trustor."

Grantor Retained Annuity Trust (GRAT) – a trust that is used to transfer future appreciation to the grantor's children at little or no gift-tax cost. The grantor funds a GRAT with property that is likely to appreciate significantly or is a "cash cow"; the trust pays the grantor an annuity, typically for two to three years. At the end of that period, whatever is left in the GRAT (the "remainder interest") passes either outright or in further trust to the grantor's children. The GRAT is generally structured so that the present value of the grantor's annuity equals virtually 100% of what the grantor put into the trust, thereby eliminating the gift to heirs (a "zeroed-out GRAT"). Assuming the GRAT outperforms the interest rate used to value the annuity (see 7520 Rate), that "excess" will pass tax-free to children.

Grantor Trust – a trust the grantor creates while she's alive, and that she owns, for income tax purposes (such as a revocable trust – see below). In other words, because the trust is not treated as a separate taxpayer, its income, losses, deductions and credits are reported on the grantor's income tax return. A **"defective" grantor trust** is structured so that it is taxable to the grantor for income tax purposes but will not be includible in her estate. With such a trust, the grantor's payments of the trust's income taxes are effectively tax-free gifts to the trust and its beneficiaries, who are relieved of the tax liability; also, transactions between the grantor and the trust (such as a sale of appreciated assets) are not taxable.

Gross Estate – refers to everything a decedent owns at death, including individually owned property, her share of jointly held property, pension plans, insurance benefits, etc. Determining the size of a decedent's gross estate is the first step in determining her potential estate tax liability.

Health Care Proxy – the document in which an individual names someone else to be her "health care agent" or "health care surrogate." The agent will make health care decisions for the individual when she no longer can. The rules regarding health care proxies vary from state to state. See Living Will, below.

HIPAA – refers to the Health Insurance Portability and Accountability Act, which has rules regarding patient privacy. Health care providers cannot share information regarding an individual's medical treatment or conditions with, say, family members unless the patient consents to such sharing or, if the patient is not able to consent, the provider feels it's in the patient's "best interests."

Incentive Trust – a trust that is typically created under someone's will, and that is designed to reward beneficiaries for certain types of behavior, such as achieving high grades or finding gainful employment. Incentive trusts, for example, may authorize principal distributions equal to a beneficiary's earned income: although well-meaning, such "carrots" could inadvertently penalize a beneficiary who chooses a low-paying profession or stays at home to raise a family or take care of a disabled relative – probably not what the trust's creator intended!

Income Beneficiary – the individual or entity currently eligible to receive income from a trust.

Inherited IRA – typically refers to an IRA that a non-spouse beneficiary receives after the IRA owner's death. For example, if deceased Dad names Daughter as his IRA beneficiary, Daughter has an Inherited IRA.

Inheritance Tax – a tax that some states impose at death. Unlike the estate tax, which is imposed on *property* passing at someone's death, an inheritance tax is imposed on the *recipient* of the property, based on the recipient's relationship to the decedent: in general, the closer the degree of kinship, the lower the tax.

***In Terrorem* Clause –** a clause in a will (or revocable trust) that threatens to disinherit anyone challenging the document. Courts are generally reluctant to enforce "no-contest" clauses and construe statutes authorizing them very narrowly. In some jurisdictions, such as Florida, these clauses are unenforceable.

Intestate – when an individual dies without a will disposing of her probate estate (see below) at death, this property passes by "intestate succession" under local law, which sets forth who the individual's heirs are and how much they will take (first in line are typically the surviving spouse and children).

Itemized Deductions – these deductions are reported on Schedule A of Form 1040, and reduce the taxpayer's taxable income. They include deductions for state and local income taxes ("SALT"), mortgage interest and charitable contributions. Because TCJA (temporarily) limited or eliminated many itemized deductions – e.g., it imposed a $10,000 cap on the SALT deduction – more taxpayers are likely to now take the much higher **standard deduction**, which TCJA basically doubled through 2025 (in 2019, the standard deduction for single filers is $12,200 and for married joint filers is $24,400).

Irrevocable Life Insurance Trust (ILIT) – an irrevocable trust designed to own insurance on an individual's life, and remove the insurance from that person's taxable estate. Typically, the insured's surviving spouse and children are the trust beneficiaries; when both spouses are gone, the trust passes estate tax-free to children. Insurance trusts usually have Crummey powers (see above) so that gifts to the trust (generally used to pay insurance premiums) qualify for the annual exclusion (see above). If an existing policy is transferred to the trust, the insured must live for three years to keep the insurance out of his estate; if the insured's trustee buys the policy, the three-year rule does not apply.

"Kiddie Tax" – an income tax rule designed to ensure that a child's "unearned income" doesn't benefit from what would likely be the child's lower income tax rates. (Unearned income refers to investment income such as interest, dividends and capital gains.) The tax applies to: a) children under age 18, and b) children who don't earn more than half of their own support and are: i) age 19 or ii) full-time students, ages 19-23. Prior to TCJA, unearned income in excess of $2,100 (the 2017 threshold) was effectively taxed at the parent's highest rate; under TCJA (through 2025), the child's unearned income is basically taxed at the same compressed rate brackets that apply to trusts and estates.

Life Expectancy – the length of time someone is expected to live according to a given mortality table. For example, according to the mortality table used to determine "required minimum distributions" (see below) for an "inherited IRA" (see above), the life expectancy of a 40 year-old is 43.6 years.

Limited Liability Company (LLC) – like the family limited partnership (FLP – see above), LLCs are often used for planning purposes, and typically contain various restrictions on the LLC interests, including their transferability, which can help garner valuation discounts for the members' interests. The LLC is a pass-through entity, meaning that its income passes through to its members. LLCs (along with FLPs) are under scrutiny from the IRS; they are generally looked upon more favorably if they have "legitimate non-tax purposes," and are funded with some kind of working business, rather than just marketable securities or cash.

Living Will – a document that sets forth someone's health care wishes when she no longer can. Because the law generally presumes that individuals would want everything done to keep them alive, living wills typically (but not always) rebut that presumption and direct that the individual not be kept in a "persistent vegetative state." Most states recognize living wills, which are often coupled with a "health care proxy" (see above).

Marital Deduction – the deduction against gift or estate tax for gifts made by one spouse to the other, either outright or in trust. The deduction effectively postpones tax until the surviving spouse dies, and is unlimited if that spouse is a U.S. citizen; if not, there is no marital deduction for lifetime gifts to non-U.S. citizen spouses, and it is only available for transfers at death to non-U.S. citizen spouses IF the property passes to a "qualified domestic trust"– see Annual Exclusion Gifts, above, and QDOT, below.

Minor's Trust – a trust that holds property for a minor child, and is sometimes referred to as a "2503(c) trust." Gifts to the trust qualify for the annual gift tax exclusion even though the trust beneficiary does not have a Crummey power (see above). The trust must be solely for the child, and can be used for the child's benefit before he reaches age 21, when the property must be turned over to him. The trust may, however, give the child, say, 30 days to terminate it at age 21; if the child does not, the trust will continue.

Net Investment Income (NII) – as of 2013, a 3.8% tax applies to "net investment income." NII includes interest, dividends, annuities, royalties, rents and capital gains (i.e., passive income), but not distributions from retirement accounts such as IRAs and 401(k)s, self-employment income, excluded gain (as from the sale of a principal residence) and municipal bond income. (See 3.8% Tax on Net Investment Income.)

Pease Limitation – refers to the limitation on most itemized deductions (see above) if a taxpayer's adjusted gross income (AGI – see above) exceeds a threshold amount. Under

TCJA, the Pease limitation is suspended through 2025. ("Pease" is the name of the lawmaker who introduced this provision nearly 30 years ago.)

PEP – refers to the "personal exemption phase-out," or how personal exemptions (say, for the taxpayer and the taxpayer's family) disappear if taxpayers have "too much" adjusted gross income (AGI – see above). Under TCJA, PEP is suspended through 2025.

Per Capita – "by the head." Trust documents occasionally provide that when the current beneficiary dies, the remaining trust property will pass to the individual's "surviving issue, *per capita* and not *per stirpes*." This means that all of the beneficiary's surviving descendants take an equal share of what's left of the trust. To illustrate, assume that Parent is the current beneficiary, and has three children, each of whom has two children. At Parent's death, the property passes to her surviving issue, *per capita* and not *per stirpes*. Because Parent has nine surviving descendants (three children and six grandchildren), each one receives 1/9 of the trust remainder. The more usual distribution, however, is *per stirpes* (see below).

Per Stirpes – "by the stocks" or "by the roots." Trust documents often provide that when the current beneficiary dies, the remaining trust property will pass to the individual's "surviving issue, *per stirpes*." This means, for example, that grandchildren split whatever share their deceased parent would have received. To illustrate, assume that Parent is the current beneficiary, and has three children, each of whom has two children. Parent's son predeceases her. At Parent's death, the property passes to her surviving issue, *per stirpes*. Parent's two living children each take 1/3, and her predeceased son's two children split their father's 1/3 share, each taking 1/6. Contrast this disposition with "*per capita*" (see above).

"Portability" – this refers to a surviving spouse's ability to effectively "inherit" the deceased spouse's unused applicable exclusion amount – or DSUE (see above). For this to happen, the executor must file a timely estate tax return for the deceased spouse, even if an estate tax return is not otherwise required because the deceased spouse's estate is under the filing threshold ($11.4 million in 2019); merely filing the return is deemed to elect portability. The surviving spouse can use this leftover exclusion for gift OR estate tax purposes. The deceased spouse's unused generation-skipping transfer tax exemption (see above) is NOT portable, however, nor is that spouse's unused *state* estate tax exclusion (except, apparently, in Hawaii and Maryland).

Power of Appointment – a trust beneficiary's right to direct who takes trust property, either during the beneficiary's life or at death. With a "general power of appointment" (GPA), the beneficiary can give the property to herself, her estate, her creditors or the creditors of her estate – in addition to giving it to other people. GPA property is includible in the beneficiary's estate for estate tax purposes. With a "limited power of appointment" (LPA), the beneficiary cannot give the property to herself, her estate, her creditors or the creditors of her estate – even though, depending on how broadly the power is written, she conceivably could give it to anyone else. LPA property is *not* includible in the beneficiary's estate for estate tax purposes.

Power of Attorney – a document wherein an individual (the "principal") names someone else to act as her "attorney-in-fact" and transact business on her behalf. Note that the attorney-in-fact is not authorized, for example, to make annual exclusion gifts (see above) unless the document so states. A "*durable*" power of attorney is effective when executed and remains so if the principal becomes incompetent. A "*springing*" power of attorney does not become effective until a stated event occurs, such as the principal's incompetence. Any power of attorney ends at the principal's death.

Present Value – what a future dollar (or revenue stream) is worth in today's dollars. For example, with a GRAT (see above), the present value of the grantor's annuity is subtracted from the fair market value of the trust property to determine the present value of the grantor's remainder gift to heirs (they get what's left after the annuity ends). So if, for instance, the present value of the grantor's annuity is 100%, the present value of the remainder gift is zero. The 7520 rate (see below) is the interest rate used to make this computation.

Pre-tax Dollars – dollars on which income tax has not yet been paid. Many retirement accounts (such as 401(k)s) are funded with pre-tax dollars – meaning that future distributions from the account are generally subject to income tax.

Private Foundation – a charitable entity that can be created either as a trust or a corporation, and that can last in perpetuity. It gives the founder maximum control over his charitable giving, and lets him direct how the foundation uses its contributions. Private foundations have a number of rules that must be scrupulously followed, such as minimum amounts that must be paid out annually and prohibitions on self-dealing. Gifts to private foundations are eligible for a limited income tax deduction, and an unlimited gift or estate tax deduction.

Probate Estate – assets that a decedent owns in his own name that are governed by his will, and not by contract or state law. The probate estate includes individually owned real estate, bank and brokerage accounts and tangible personal property, but not, for example, jointly owned property, and life insurance, qualified plan benefits and IRAs that name someone other than the decedent's estate as the beneficiary.

Prohibited Transaction – any of six proscribed direct or indirect transactions between a "disqualified person" and the person's retirement plan, including, for example, a loan between an IRA owner and her IRA. If, say, the IRA owner runs afoul of the prohibited transaction rules, the IRA loses its tax exemption and is treated as fully distributed to the IRA owner and therefore potentially subject to income tax.

Qualified Business Income (QBI) – under TCJA, through 2025, if a taxpayer has QBI, that income is eligible for a 20% deduction. This deduction is subject to many rules and exclusions and offers much complexity for higher income taxpayers.

Qualified Opportunity Zones – TCJA offers taxpayers with realized capital gains the opportunity to reinvest those gains in "qualified opportunity funds" that in turn invest in "qualified opportunity zones," low-income census tracts that were previously approved by the Treasury Department. Tax benefits for investors potentially include income tax deferral (and partial elimination) of the reinvested capital gains, as well as elimination of post-contribution gains, provided the investment is held for at least 10 years.

QDOT – a "qualified domestic trust." This trust qualifies for the marital deduction (see above) and postpones estate tax when the surviving spouse is not a U.S. citizen. It can be structured as 1) a QTIP trust (see below); 2) a "general power of appointment" trust, where the surviving spouse receives all of the trust's income *and* can direct what happens to the property at death, including appointing it to herself or her estate; 3) a charitable remainder trust (see above) IF the surviving spouse is the only income beneficiary; or 4) an "estate trust," where trust income accumulates and the trust pours into the surviving spouse's estate at death. Unless principal distributions to the surviving spouse are "hardship"-related, they will trigger the estate tax that would have been payable if this property had been taxable at the first spouse's death. The QDOT is thus "pay as you go," whereas the QTIP trust is "pay once you're gone"; it reflects the concern that the surviving spouse may not be a U.S. resident at death, thereby making it difficult to collect the deferred estate tax.

QTIP Trust – a "qualified terminable interest property" trust; it qualifies for the marital deduction (see above) and typically postpones estate tax until both spouses have died. The surviving spouse must receive all of the trust's income at least annually, and may receive principal distributions at the trustee's discretion, if the trust permits this. When the surviving spouse dies, the trust is taxable in his estate. After taxes, the property passes according to the trust's terms – as set forth by the predeceased spouse. QTIP trusts are especially useful in second marriages, where the predeceased spouse wants to provide for her surviving spouse, but ensure that the children from her first marriage receive any remaining trust property when the surviving spouse dies.

Qualified Personal Residence Trust (QPRT) – a trust to which the grantor transfers a "personal residence" (i.e., a principal residence or a vacation home) and retains the right to use the residence for a term of years. At the end of the trust term, the residence passes to the grantor's heirs. Although the grantor's transfer of the residence to the trust is a gift, that gift is reduced by the present value of the grantor's right to use the residence and direct what happens to it if he dies during the trust term. For the QPRT to be successful, the grantor must outlive the trust term; "successful" QPRTs also pass along built-in capital gains to the heirs.

Qualified Plan – refers to various retirement vehicles, including pension, profit sharing and 401(k) plans; it also loosely refers to IRAs (individual retirement accounts).

Remainderman – the individual or entity (such as a trust) that takes the "remainder" of a trust, or what's left when the current beneficiary's interest ends.

Required Minimum Distribution (RMD) – refers to the annual distribution an account owner must start taking from a qualified plan, such as a 401(k) or a pension or profit sharing plan, at the later of retirement or reaching age 70½. With IRAs, RMDs must start at age 70½, even if the IRA owner is still working. Non-spouse beneficiaries of "inherited IRAs" (see above) must start taking RMDs the year after the owner's death.

Revocable Trust – a trust that the grantor can revoke or amend at any time. Also known as a "living trust," a revocable trust offers no transfer tax savings, but serves as an asset management vehicle during the grantor's life, and can help provide for the grantor upon his disability or incompetence. As long as the grantor is alive, the trust is a grantor trust (see above), with its income reportable on the grantor's return. At the grantor's death, the trust becomes irrevocable and a separate taxpayer; it typically serves as a will substitute, and governs the disposition of assets the grantor transferred to it during life and at death (usually through a "pour-over" will).

Right of Election – refers to the surviving spouse's right to "elect against" the predeceased spouse's will and take a share of that spouse's estate, as determined under state law. The elective share is in lieu of whatever the surviving spouse would have received under the predeceased spouse's will.

Rollover IRA – an IRA funded with "rollover" dollars from an employer-sponsored retirement account – as in, Worker changes jobs or retires, and moves her 401(k) from former employer into a "rollover" IRA. Also refers to when a surviving spouse is named as the beneficiary of her deceased spouse's IRA and rolls it into an IRA in her own name, thereby allowing her to name her own beneficiaries and subjecting her to the same "required minimum distribution" rules (see above) that would apply if she had been the original IRA owner.

Roth IRA – an individual retirement account that is funded with after-tax dollars (see above). Roth IRAs differ in some important ways from "traditional" IRAs (see below), including the following: 1) the account's earnings are income-tax free when distributed provided the owner doesn't take out more than what was contributed in the first five years of the account's creation; 2) the owner can still contribute to the account even after reaching age 70½; and 3) the owner has no "required minimum distributions" (see above).

Rule against Perpetuities – the general rule that a trust must terminate within "lives in being" plus 21 years. In other words, unless the jurisdiction governing the trust has abolished its rule against perpetuities (see Dynasty Trust), the trust must terminate no later than 21 years after the death of a designated individual who was alive when the trust was created (the theory is that property should not be tied up forever). A trust that lasts for the perpetuities period often runs for about 100 years.

Sale to a Defective Grantor Trust – like the GRAT (see above), this technique is a way to transfer appreciation gift-tax efficiently. The grantor sells an asset to a "defective grantor trust" (see Grantor Trust) in exchange for a note that is usually interest-only (i.e., a balloon note). Because the grantor owns the trust for income tax purposes, neither gain from the sale nor interest on the note is taxable to the grantor. Appreciation in excess of the note's interest rate remains in the trust for the grantor's heirs, gift-tax free. If the grantor dies while the note is outstanding, the income tax consequences regarding the transaction are uncertain; there could also be gift and generation-skipping transfer tax consequences if, on audit, the IRS increases the value of the asset sold.

Second-to-die/Survivorship Life Insurance – a cost-effective insurance policy on two people's lives that does not pay out until both have died. Married couples frequently use second-to-die insurance to replenish the wealth lost to estate taxes at the surviving spouse's death, and provide cash for what could be an otherwise illiquid estate. Typically, second-to-die insurance policies on married couples are held in irrevocable life insurance trusts (see above) to ensure that the policies will not be includible in either spouse's estate.

7520 Rate – an interest rate that the IRS publishes monthly, and that is defined in

Section 7520 of the Internal Revenue Code. The 7520 rate is an assumed rate of return, and is used to determine the present value of items such as annuities (e.g., a GRAT – see above), life estates, and income and remainder interests. The more the transferred property outperforms the 7520 rate, the better the result – as in, more appreciation is removed tax-free from the grantor's estate.

Stepped-up Basis – the upward adjustment in basis that occurs when someone dies owning appreciated assets (if the assets have depreciated, there is a "step-down" in basis). That is, at death, an individual's assets are effectively "marked to market," so that any built-in capital gains *and* losses disappear.

"Stretch" IRA – refers to the protracted payout that the beneficiary of an "inherited IRA" (see above) can receive for his "required minimum distributions" (see above). For example, if 55 year-old son inherits deceased Dad's IRA, Son can receive RMDs over his 28.7 year life expectancy (see above).

Taxable Estate – a decedent has a "taxable estate" when his gross estate (minus deductions, such as for administration expenses and charitable and marital bequests) PLUS adjusted taxable gifts (see above) exceed the basic exclusion amount in effect the year the decedent dies (it's $11.4 million in 2019). In other words, someone could die with a $100 million estate, but it still won't be taxable if it all passes to charity – whereas someone who dies with a $12 million estate that he leaves to his children will have a taxable estate.

Taxable Income – this refers to income, minus all deductions; it is the amount on which a taxpayer's regular income tax is figured. In 2019, if a taxpayer's taxable income exceeds $612,350 for married couples filing jointly, and $510,300 for single taxpayers, that excess will be subject to the top rate of 37%; note that qualified dividends and most long-term capital gains will be subject to a top rate of 20%, along with the 3.8% tax on "net investment income" (see below)).

3.8% Tax on Net Investment Income (NII) – as of 2013, there is a 3.8% tax on "net investment income" (see above). The tax applies to both individuals AND trusts and estates. For individuals, the tax is 3.8% times the *lesser of* the individual's NII (see above) OR adjusted gross income (plus foreign earned income) minus a threshold amount that is *not* indexed for inflation: $250,000 (married couples filing jointly), $200,000 (single taxpayers), and $125,000 (married filing separately). For trusts and estates, the tax is 3.8% times the *lesser of* the entity's undistributed NII OR the entity's adjusted gross income minus the amount at which the entity hits the highest tax bracket (for 2019, this number is $12,750).

"Traditional" IRA – also known as an "ordinary" or a "regular" IRA, this type of individual retirement account is any IRA that is not a Roth IRA or a SIMPLE IRA. Depending on the IRA owner's "modified adjusted gross income," contributions to the account may or may not be deductible (deductible contributions are "pre-tax" (see above) and non-deductible contributions are "after-tax" (see above)).

Transfer Tax – a tax on the transfer of property. Estate, gift and generation-skipping transfer taxes are all transfer taxes.

Trust – an entity where the trustee holds legal title to the assets, and the beneficiaries (the people who benefit from the trust) hold beneficial title to the assets. A trust can help save people from themselves, potentially insulate assets from creditors and offer tax savings.

Trustee – the individual or bank or trust company named to administer a trust's assets. The trustee's duties include managing the trust's assets, making appropriate distributions to beneficiaries and filing tax returns for the trust. When a bank or trust company fills that role, it is called a "corporate" trustee.

Unrelated Business Taxable Income (UBTI) – refers to taxable income that is unrelated to a tax-exempt entity's purpose and will trigger excise tax. For example, if an IRA generates income through a margin account, that "debt-financed income" is a subset of UBTI, and will generate excise tax.

UTMA/UGMA Accounts – refers to "custodial" accounts under the Uniform Transfer to Minors Act and the Uniform Gifts to Minors Act (UTMA has generally replaced UGMA). Both Acts provide a simple framework for transferring property to minors: in general, UTMA permits donors to give a broader class of assets than UGMA and holds those assets until the minor reaches age 21 (unless the donor selects age 18 at the account's creation); UGMA usually requires the minor to receive the property at age 18, unless the donor selects age 21. The "kiddie tax" (see above) applies to both types of accounts.

Will – the document by which an individual disposes of her probate estate (see above) at death.

April 7520 rate

The April 2019 7520 rate is 3.0%, a drop of 0.20% (20 basis points) from March's 3.2% 7520 rate. The April mid-term applicable federal rates (AFRs) are also down slightly: 2.55% (annual), 2.53% (semi-annual) and 2.52% (quarterly and monthly). The March mid-term AFRs were: 2.59% (annual), 2.57% (semi-annual) and 2.56% (quarterly and monthly).

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