# Estate Planning: Gifting

Systematic gifting is a simple way to transfer assets to your heirs, reduce your estate, and mitigate your potential estate taxes. It also provides an opportunity to see beneficiaries enjoy what has been provided and observe how they respond in managing the assets they have been given.

Gifting Limits

The simplest way to avoid estate taxes at death is to give assets away during your lifetime. In order to prevent people from giving away entire estates and thereby avoiding estate tax completely, gift taxes were added to the tax code creating restrictions on amounts that can be gifted each year without tax consequences.

The "Annual Exclusion" allows you to give up to $17,000 per year to any number of recipients without being considered "taxable" gifts (spouses can receive an unlimited value of gifts if they are a citizen while this amount is limited to $175,000 for a non-citizen). Married couples can "split" gifts up to $34,000 per year to any number of recipients (each are then considered to have given $17,000 even if it came from just one of them). Any gifts above these amounts to any one person in any year are "taxable" to the donor. When gifts become "taxable" they will begin to reduce the $12.92 million total lifetime gift tax and $12.92 million generation skipping transfer tax (GSTT) exclusion, indexed for inflation, available to each individual. The dollar amounts noted are for 2023 and will be indexed annually for inflation, though they are scheduled to decrease and revert to prior law after 2025 with an estimated indexed exemption of $7.54 million in 2026. The amount of exclusion used for each gift is dependent on who (spouse, child, grandchild, trust, etc.) actually receives the gift. Actual tax payments are not owed until the total "taxable" gifts exceed these exclusion amounts. Additionally, you may make unlimited payments directly to medical providers or educational institutions on behalf of others without being subject to gift tax.

Charitable giving, on the other hand, allows you to remove an appreciated asset from your estate, while also benefiting from an income tax deduction. In general, you can deduct the full amount (up to 50% of your adjusted gross income) of cash donations given directly to public charity and up to 30% of your adjusted gross income for gifts of appreciated securities; contributions to private foundations are limited to 30% of your adjusted gross income for cash donations and 20% for gifts of appreciated securities. Charitable contributions above these limits can be deducted in each of the following 5 years until it is used up; after 5 years the amount is lost. You may also be able to avoid capital gains taxes on charitable gifts of appreciated securities.

Considerations

- *Income Tax*: At death the assets included in your estate receive a tax basis adjustment making it equal to value on the date of death. This can provide a significant tax savings to your heirs if you own assets with low or no tax basis (it should be noted that if assets are intentionally received prior to death in order to receive a basis step up but are transferred back to the donor as an inheritance within 1 year of the transfer the beneficiary would not receive the basis step up). When assets are gifted, the tax basis will carry over, and the beneficiary will be responsible for paying the tax on any gains when the asset is sold. This tax liability may be the same, lower or greater than what otherwise may have been paid by the donor depending on their tax situation. It is important to assess the level of basis prior to gifting assets and determine if the tax liability can be mitigated by recognizing gain pre-gift versus post-gift, or if having the value taxed in the estate while receiving a basis step up may be more advantageous. Proper planning may result in a sale by the original owner who will pay income taxes on the gain then gift cash proceeds, or it may be advantageous for a beneficiary in a low or no capital gain tax bracket to sell the appreciated property themselves.

- *Skip Persons & GSTT Exemption*: A "skip" person would be any family member who is at least two generations below the person making a gift or 37½ years younger if they are not a family member. When gifts to an individual exceed the annual exclusion, it will begin to use your Basic exemption amount. If the individual is a skip person, it will use both the Basic exemption amount and the GSTT exemption amount. Special exemption rules exist when making gifts to trusts which at any point may benefit a skip person.
- *Gift Taxes*: To the extent that your exemptions are fully used, you will begin to pay out of pocket gift taxes on amounts in excess of these limits. These taxes are payable at a rate of 40%, which is the same rate applicable to assets included in the estate. While cutting a check to the IRS for gift taxes may not be desirable, there is a benefit since gift taxes are tax exclusive while estate taxes are tax inclusive. Put another way, when you die you will pay estate tax on the amount you pay to the IRS, while this is not the case with gift tax (to transfer $100,000 during your life would cost $140,000 ($40,000 in tax + $100,000 gift) while transferring $100,000 at death would cost $166,667 ($100,000 gift + $66,667 in tax). It should be noted that in order for the IRS to guard against death bed transfers to recognize this savings, the amount of gift taxes paid are still included in the estate if you do not live 3 years past the date of the transfer. There are also special rules that provide a basis increase on gift taxes paid on unrealized capital gain.
- *Complexities*: There are very few straight forward answers when it comes to Federal and State laws, and it is important to recognize that for each situation there may be specific exceptions, qualifications, and additional considerations applicable depending on the specific circumstances of each gift.

*Financial Independence*: Gifting programs decrease the amount of estate tax that you may ultimately have to pay; however, it is important to assess the effect this may have on your personal financial independence. To properly assess the impact of gifting on your own independence, we recommend working through a more comprehensive plan. As part of our planning process we can discuss your specific estate planning priorities and determine which gifting tools, if needed, are best suited to help you accomplish your goals.