Gifts and Gifting

Essentials 2018

Gifts are a major tool in estate planning and can result in significant income and estate tax savings. There are also many non-tax reasons for making gifts. The broad definition of a gift is any transfer, sale, or exchange of property from one person to another without full and adequate consideration in money or money's worth. By making a gift, the donor removes all future appreciation on the property from his or her estate. This can substantially reduce the donor's estate. Additionally, someone else's educational or medical expenses can be paid without being subject to gift taxes.

Present Interest vs. Future Interest Gifts

Gifts of present interest qualify for the annual exclusion from the Federal gift tax. A present interest gift is one for which the client has the right to currently use, enjoy, or possess the property. The client's right must begin at the time the gift is made, not at some future date. Everyone can gift an amount up to the annual exclusion each year to any number of people without any gift tax, if the gift is a present interest. Annual exclusion gifts are an extremely valuable, tax-efficient means of gifting property and can reduce the size of the client's taxable estate. Gift qualifying for the annual exclusion are often used to pay life insurance premiums.

A future interest gift occurs when the recipient's use, possession, or enjoyment of the property starts at a future date. For example, a gift in trust is a gift of future interest unless the beneficiary is given a right to immediately require the distribution from the trust of his/her proportionate share of the gift. A future interest gift does not qualify for the annual exclusion. The IRS requires the trustee give the beneficiary notice of their right to withdraw the gifted funds for a period of time (usually 30 days) using a "Crummey Notice." Once the period for withdrawal has lapsed, the trustee can use the funds to pay premiums or use for other purposes.

Split Gifts

A married couple can, in effect, combine their gifts to provide an additional level of gift tax leverage. It doesn't matter which spouse owns the property if they both elect to treat the transfer as a split gift. If the couple elects gift splitting, it applies to all gifts either one makes during a year, other than to each other. The Internal Revenue Service requires that the couple file a gift tax return when split gifts are made even though no gift tax is owed. The gift tax return (Form 709) must be filed on or before April 15th of the year following the year the gift is made.

Considerations

- Outright gifts to a spouse qualify for the gift tax marital deduction. Gifts to a trust for a spouse must meet certain requirements to qualify for the marital deduction.
- In addition to gifts qualifying for the gift tax annual exclusion, marital deduction or charitable deduction, a donor may make additional gifts up to the amount of the lifetime exemption (this is known as the applicable exclusion amount (or unified credit)). Any unused lifetime exemption is available at death.
- Outright gifts to a charity qualify for the gift tax charitable donation. Gifts to a trust for a charity must meet certain requirements to qualify for the charitable deduction.

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- Gifting and life insurance can be a powerful combination. If life insurance is owned by an Irrevocable Life Insurance Trust (ILIT), the trust will generally receive the policy death benefit free of estate and income tax. Clients can use their annual exclusion amounts to gift money to an ILIT, and then the trustee can use those gift dollars to purchase life insurance. The death benefit would be substantially compared to the original gift.
- When the recipient sells the property received as a gift, any gain is based on the donor's basis, not the property's value at the time of the gift. Inherited property is valued at the value at the date of death. This can result in high income taxes for gifted property than inherited property.
- If the premium is larger than the available annual exclusions, or if the annual exclusions are being used with other planning, then the client should consider implementing a premium sharing arrangement (endorsement split-dollar, employer loans, private loans) or a premium financing arrangement. Premium sharing arrangements are essentially a process of "renting" the death benefit (endorsement arrangements) or borrowing to pay premiums (loan arrangements). The effect is to reduce the annual gift tax cost from the entire premium cost for the year to either: (1) the "economic benefit" (endorsement arrangement) or (2) the "interest" (loan arrangement) cost of the arrangement. It is important to have an exit strategy for any premium sharing arrangement. Such strategies can include: using policy values, Grantor Retained Annuity Trust, sale to grantor trust, charitable remainder trust, etc.

Essentially

Gifts are an effective estate tax planning tool. Gifts qualifying for the annual exclusion are totally removed from the donor's estate. The appreciation on property gifted is excluded from the donor's estate. They should be considered in any estate plan designed to minimize estate taxes.

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