Gifting and Taxes

An Estate Planning Attorney's Perspective

For Immanuel Lutheran Foundation, Inc. Webinar

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Disclaimer: This information is intended for educational purposes only, is not intended to be legal advice for any one person or situation, and is not a substitute for such advice. Estate Planning and Taxation are governed by both state and federal laws which change periodically. Always consult with your attorney and tax professional for the most up-to-date advice relevant to your particular situation.

Four Main Reasons You May Choose to Make Gifts

1. *Avoid Tax*

   - Estate Tax – 40% on value of estate over Exemption
   - Income Tax – as high as 37% (diff. brackets) – want to reduce your Taxable Income
   - Capital Gains Tax – 20% on long-term capital gain ($250K excluded for principal residence)

2. *Philanthropically Inclined*

   - You have charities/causes you care about and want to support them

3. *Family Member in Need of Support*

   - e.g., adult disabled child, child with economic hardship, child needs housing, college funds for grandchildren, etc……

4. *You are Facing significant long-term care costs/Medicaid Eligibility*

   - Medicaid eligibility requires spend-down of assets to mere $2,000 (with limited exemptions for spouse), and lien recovery.

5. Combination of the above

**** Decision to make a Gift depends on these factors:**

Who to?

What amount?

What is my reason—what's most important to me?

Weighing the tax consequences of the particular asset– benefits or detriments to you, your heirs

Why the Frenzy to Consider Gifting in 2021???

Be Aware of Likely Changes to Tax Policy

- Reasons: politics; trillion dollar deficit, global competition, infrastructure, etc.

Law as of 2021 – Tax Cuts and Jobs Act

- Estate Tax Exemption = $11.7M per person, $23.4M couple
- Many Grantor Trusts allowed to shield excess from tax
- Income Tax brackets lowered = top bracket is 37%

Proposed Law for 2022 – Build Back Better Act

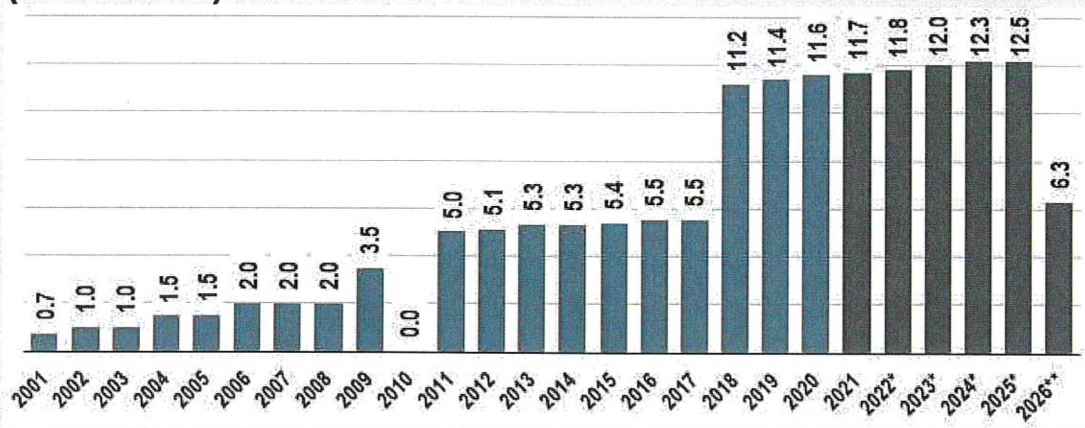
- Estate Tax Exemption = lowered to Pre-TCJA levels: <u>$5M per person, $10M couple</u>. Accelerated sunset from 2026 to 2022
- Many Grantor Trusts typically used to shield excess from tax now <u>disallowed</u> (No more GRAT, GRUT, IDGT, ILIT, SLAT, etc.)
- <u>Income Tax brackets raised</u> to Pre-TCJA levels: = top bracket returns to 39.5%

Betting on Congress: Will they or won't they?...........

Each Person must consult their advisors and assess their risk and what it means for them.

The Trend of Increasing the Estate Tax Exemption May Be Coming to an End

Federal Estate Tax Exemption Amount for Individuals ($ million)



Source: Internal Revenue Service

*Projections based on adjustments for inflation

**Current sunset and reversion to pre-2018 levels in 2026

*** Proposed Build Back Better Act would accelerate this reversion to 2022 with a proposed $5M exemption (indexed for inflation to $6.2M)

Assume: Exemption = $5M person; $10M married couple

Husband & Wife's Estate

VALUE: $10M

*Each Spouse has a personal FGET exemption

--------------Husband's Passing--------------

B Trust **Gifts** **A Trust**

$5M Exemption

Husband's Estate

Irrev. Bypass or Disclaimer Trust (B)

$4M

All $4M protected from federal estate tax (with $1M of room for appreciation)

This exemption is locked in at Husband's death.

OUT OF ESTATE = $2M

1. Gifts to Irrevocable Trusts:

A. Charitable Remainder Trusts

B. Other Irrevocable Trusts

(QPRT, GRAT, GRUT, ILIT, IDGT, etc. may be gone except for those that are grandfathered]

2. Outright Gifts to family or charities.

$5M Exemption

Wife's Estate

$4M and Growing

Gifts

Rev. Trust (A)

$2.0M

Non-Trust Assets

$2.0M

(IRA's, 401k, and??)

All $5M total value of surviving Wife's Estate is protected from federal estate tax (with $1M room for appreciation.....***watch that appreciation and make gifts as needed)

ALWAYS MONITORING:

1. Will Congress lower the Exemption?
2. How quickly are my assets appreciating and approaching the exemption amount?

[... Continued from A-B Trust Plan Chart: See Chart attached separately]

OUT OF ESTATE

1. Gifts to Irrevocable Trusts:

    A. Charitable Remainder Trusts (Make gift to CRT, Take tax deduction over number of years, income to beneficiaries for lifetime, upon death principal to charity)

    B. Other Irrevocable (non-charitable) Trusts

    (Per Build Back Better, the QPRT, GRAT, GRUT, ILIT, IDGT, etc. will be gone except for those that are grandfathered]

2. Outright Gifts to family or charities.

BIG QUESTION: Which of my assets should I gift? Is there a preferred order or strategy?

ANSWER: Yes! But it all depends on your particular circumstances and types of assets......

CONSIDER:

1. Do you have enough liquid funds (or insurance) to pay for long term/elder care expenses for both spouses?

2. Do you have an additional, perhaps more important, reason for making a gift other than estate tax savings? (i.e., adult disabled child; child having trouble buying a home, child with economic hardship, college accounts for grandchildren, precious family lake property, etc.)

3. Are there charitable causes you wish to support and are you philanthropically inclined?

4. What are the Tax Consequences of making the particular gift?

    a. Securities & real property: Lost Step Up in basis for donee = carryover basis may cause donee to pay significant Capital Gains Tax upon donee's future sale?

    b. IRA: Can't gift IRA outright, must take a distribution first, but then any large gift distribution may push you into a higher personal income tax bracket and increase your taxable income?

    c. But, But, But!!! Tax mitigation .....

i. ANNUAL GIFT TAX EXCLUSION - Each person is allowed to gift $15,000 to each selected recipient per year, with no limit on the number of recipients. This is the annual Gift Tax Exclusion and is <u>not reported</u> to the IRS for Gift and Estate Tax purposes. Gift away without consequence. Example: 10 gifts x $15k pp = $150K total/year

ii. QUALIFIED CHARITABLE DISTRIBUTION (QCD) FROM IRA: up to $100,000 income tax free

ii. OTHER CHARITABLE GIFTS = A TAX DEDUCTION – You can structure charitable gifts in various ways to maximize and even carryover the tax deduction to reduce your taxable income and taxable estate in one or more years.

<u>GENERAL GIFTING GUIDELINES</u>:

1. First, gift CASH. Cash has no basis.
2. Next, IF gifting to family or friends, gift high basis/ low gain assets, BUT, if gifting to a charity, gift lower basis / higher gain assets. CHARITY DOES NOT PAY CAP GAINS TAX ON THE GIFT.
3. Analyze and choose the lesser of two evils (tax). Example: Choosing to make the gift to avoid the heftiest estate tax at 40% and being okay with the lesser income tax or cap gains tax consequences.
4. Consult and use your TEAM OF ADVISORS: CPA, Attorney, Wealth Advisors

THANK YOU!