

'TIS BETTER TO GIVE...ESPECIALLY NOW!

LEGAL ARTICLE

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BY JULIE Y. WANN

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The financial headlines lately have been depressing. Interest rates are going up, and the stock market is going down. Inflation is driving up the costs of everyday goods and services. The Bay Area real estate market, which had been skyrocketing, even appears to be softening. Those counting on cashing out their stocks for retirement are thinking twice.

Looking on the bright side of the doom and gloom, this is a great time to make gifts.

The Basics of Gift and Estate Taxes

When an individual (the donor) makes a gift, the donor is subject to gift tax based on the amount of the gift. However, every individual has a basic exclusion amount (BEA) from gift and estate tax.¹ The BEA for 2022 is \$12,060,000, and includes both gift and estate tax. Gifts made by the donor during

their lifetime reduce the exemption available at death for estate tax purposes. This means that an individual who has not made any gifts previously would be able to gift assets worth up to \$12,060,000 without having to pay any gift tax. Similarly, an individual who passes away in 2022 and has not made any taxable gifts during their lifetime would have a taxable estate worth \$12,060,000 and not be subject to estate tax.

Just five years ago, the BEA was only approximately \$5 million. The Tax Cuts and Jobs Act (TCJA), the tax reform legislation enacted in December 2017, doubled the BEA for tax-years 2018 through 2025. In 2026, the BEA is due to revert to its pre-2018 level of \$5 million, adjusted for inflation. The IRS issued regulations to clarify that people taking advantage of the increased BEA by making gifts during the period from 2018 to 2025 will not be penalized after 2025 when this amount is scheduled to drop. People who make large gifts between 2018 and 2025 can do so without being concerned that they will lose the tax benefit of the higher exclusion level once it decreases.²

In addition to the BEA, every person has an annual exclusion for gifts. The exclusion is indexed for inflation, and the annual exclusion is \$16,000 in 2022. This is no limit on how many people to which the exclusion can be applied. As an example, if an individual has three children and six grandchildren, they can gift \$16,000 cash to each child and grandchild, and not incur any gift tax and not use any of their BEA.

Why Gift When Value of Assets are Low?

Since each person has a fixed amount of BEA for their lifetime, an individual with a taxable estate should carefully consider how to efficiently utilize the exemption amount to minimize estate tax. For assets whose value is decreased (e.g. securities), this may be a good time to gift the assets, particularly if the value of the gift exceeds the annual exclusion. Gifting an asset when its value is low minimizes how much BEA would be used. The stock market is cyclical, and solid investments should rebound and regain their value. Waiting to gift the securities until after it has regained its value would mean using more BEA to gift those securities.

In addition, if an individual wants to minimize their taxable estate, it would be good to gift assets that would appreciate exponentially, to avoid the appreciation that would accumulate and contribute to a larger taxable estate over time.

Lastly, with the anticipated decrease in BEA only a few years away, now is a good time to tally your assets and assess whether you want to use your exemption. It's "use it or lose it" for the increased BEA that may be eliminated in 2026. An individual whose potential taxable estate is well in excess of \$12 million should consider using his/her BEA before 2026.

Tax Basis of Assets Gifted

When an asset is gifted, the donor's tax basis is transferred to the person receiving the gift (the donee). But if the donor retains the asset and holds onto it until their death, such that the asset is included in their taxable estate, then the asset's tax basis will be increased ("stepped up") to its fair market value as of the date of death. Having a stepped up tax basis is beneficial to the donee, but it could cost the donor's estate additional estate tax if the donor retains the asset and the donor's taxable estate exceeds the BEA. Since the federal estate tax rate is higher than the federal capital

gains tax rate, it may be a better overall tax result if the donor gifts the asset now while the asset's value is low, using the increased BEA which could be lost if not used.

How to Structure the Gift

There are different ways for a donor to gift assets. The gift can be outright, or an irrevocable trust may be a more desirable vehicle. Setting up an irrevocable trust allows the donor to dictate when and how the donee receives the assets, and the trust can provide protection from the donee's creditors. The estate planning attorneys at Hoge Fenton can work with you to strategize how best to structure your gift and evaluate the pros and cons of various options.

¹ Gift and estate tax laws are different for non-U.S. persons. Exclusion amounts mentioned in this article apply to U.S. citizens and permanent legal residents.

² <https://www.irs.gov/newsroom/estate-and-gift-tax-faqs>

About the Author



Julie Y. Wann is a member of Hoge Fenton's Corporate, Tax, and Estates & Trusts groups. Julie advises individuals in estate and tax planning, wealth transfer, and estate and trust administration. She represents limited liability companies, partnerships, corporations, and nonprofits, on entity formation, governance and operational matters. Julie also focuses on individual, partnership, and corporate taxation, and structures real property transfers that preserve the real property tax basis

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