

Summary of Key Topics for Gifting assets to Children.

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- **Annual Exclusion Amount:** The Internal Revenue Code ("IRC") allows each US citizen an annual exemption from gift tax, which we call the Annual Exclusion Amount. The Annual Exclusion Amount is currently \$16,000. Each person can currently gift a total of \$16,000 to everyone/anyone *every year without* having to file a *gift tax return*. The Annual Exclusion Amount does not count against a person's lifetime Gift Tax Exemption amount.
 - This exclusion is used heavily by high-net-worth families to move assets to the next generation (and below) over time.
- **Lifetime Gift Tax Exemption** The IRC gives each US citizen a lifetime exemption, which we call the Gift Tax Exemption. The Gift Tax Exemption is currently \$12.06m. Each person can currently gift a total of \$12.06m in assets to anyone, during his/her lifetime without *paying*
 - When we use our lifetime gift tax exemption we file a gift tax return but pay no tax. It's a tally system to tell the government what we have used and what we have left at death. When we run out of lifetime gift tax exemption and continue to make gifts which exceed the annual exclusion amount of \$16k, then we start paying gift tax at approximately 40% of the gift.
 - For example, if I gifted \$500k to my sister this year (and that was my *only taxable gift ever*), my gift tax return would say: I started with my full lifetime gift tax exemption of \$12.06m and just used up \$500k, so now I have \$11,560,000 in lifetime gift tax exemption left to use during my lifetime.
- **Estate Tax Exemption:** The IRC also gives each US citizen an exemption at death, which we call the Estate Tax Exemption. The Estate Tax Exemption is also currently \$12.06m. If a person does not use all of his/her Gift Tax Exemption during life, he/she can use it at death to avoid paying estate taxes on the assets that pass to beneficiaries at death.
 - You don't get both. You can either use your gift tax exemption during life or at death as an estate tax exemption.
 - In my above example, if I did no additional gifting and I died while the estate tax exemption was still \$12.06m, I would be able to leave \$11,560,000 in assets to my heirs without incurring estate tax.
- **Amount of Gift / Estate Tax Exemption.** The amount of the Estate/Gift Tax exemptions has varied over time. They are currently adjusted for inflation each year. In addition, the current exemptions are higher than they have been historically - they went from \$5m adjusted for inflation to \$10m adjusted for inflation in 2018. However, those high numbers will automatically *sunset* without anyone having to do anything in 2026 back to the \$5m adjusted for inflation. We don't know what that number will be but for general planning / estimating purposes a \$6m number is often used. We'll call the 2026 Exemption amount \$6m for purposes of this overview.
- **Timing of a Gift:** Timing of a gift is important. We need to balance the benefit of a potential step-up in basis with getting the future appreciation of assets out of our estate.
 - Currently, if one dies with an asset and then passes that asset to his/her heirs, there is a step-up in basis for that asset to the date of death value; which in essence, erases any capital gains for the heirs. If they immediately sold the asset, only gain after the date of death would be subject to capital gains tax. For a highly appreciated asset this step-up can save a great deal of

capital gains. There has been talk in Congress that the step-up in basis may change but no progress has been made on that front.

- Often later in life, people will hold on to assets or not sell highly appreciated assets hoping *to die* while owning them to get the step-up in basis for their heirs.
- If one gifts an asset during life, it uses up lifetime exemption amount, but the future *appreciation* of that asset is removed from the estate permanently. However, any appreciation, in the asset at the date of gift will be taxable to the beneficiary if the beneficiary decides to sell it. There is no basis step up on assets gifted. The beneficiary generally assumes the donor's basis.
 - So if a person has an asset that is expected to appreciate substantially during life, it may be more advantageous to get the appreciation out of one's estate rather than to *wait* on the step-up in basis; especially, if the asset may be sold during lifetime anyway.
- **Reasons to Make the Gift.** There are all sorts of reasons to make a gift during life. Here are just some of them:
 - Use up the currently high estate tax exemption before it is scheduled to decrease in 2026.
 - Get the appreciation expected on an asset out of one's estate.
 - To get the next generations involved in a family business.
 - Because gifting is fun and it shouldn't all be about taxes.
- **Structure of Gift.** If the decision to make the gift has been made, the decision should be made as to whether the gift will be outright or in trust.
 - Outright gives the beneficiary more direct control over the asset.
 - However, outright gifts will be subject to creditors, may be subject to claims from ex-spouses (depending upon what state someone lives in) and will be includable in that beneficiary's estate at his/her death; meaning it could be *taxed twice*.
 - Gifts in trust allow the donor more control of the gift even after death...
 - A third-party-trust (a trust made by someone else – you) is *not owned* by the beneficiary, so it is often not subject to the creditors of the beneficiary (i.e. car accident, bad business deal, and in some cases ex-spouses).
 - You can control how flexible the trust is (how big the spigot for distributions is) you can make it very flexible or very restrictive depending.
 - Dictate Future Beneficiaries. You can also control who gets the assets after the death of the primary beneficiary (child) – you can ensure it goes to the grandchildren and not a spouse. (remember you cannot disinherit your spouse in NC. He/she has a right to up to 50% of your total assets at death).
 - Potential Estate Tax Savings for the Grandchildren and beyond. Trust assets (limited to the decedent's estate tax/generation skipping tax exemption) can avoid estate tax when the trust beneficiary dies and assets pass to the next generation because they are not included in the beneficiary's estate.
 - Roles: Whether the gift into trust is during life or at death, you'll need a trustee and it can't be you; either because you are dead or because you can't have any involvement in a gift after death without it being includable back in your estate at death (i.e. *taxed*). Choice of a competent, trusted individual or corporate trustee is important.

For more information, please contact Erin Bailey atebailey@tuggleduggins.com or 336-271-5264.

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