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## NF96-296 Gifting as an Estate Planning Tool

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# NebFact



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## Gifting as an Estate Planning Tool

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This is one in a series of **NebFacts** providing information on the use of estate planning "tools" — mechanisms that can be used in attaining desired estate planning outcomes. Titles in the series are listed following the last narrative section of each document. Reading the documents in this series will improve your understanding of estate planning tools and alternatives, and make it easier to communicate with your attorney, accountant, and other helpers when your estate plan is prepared.

**Your need for legal and tax advice:** While the information contained in this document is thought to be accurate, it should not be used as a substitute for legal advice on matters related to business organization, taxation, estate planning, gifting of assets, life insurance, or other business and financial management matters. Consult with your legal and tax advisers before making decisions.

### How is gifting used in estate planning?

In implementing an estate plan, assets can be transferred from donors (usually members of the older generation) to recipients who may be younger-generation family members, contemporaries of the donors, unrelated persons, or a charitable or philanthropic organization. The Internal Revenue Service (IRS) recognizes as gifts only the transfer of a **present interest** in property. If IRS is to recognize a transfer of property as a gift, the donor(s) must unconditionally transfer all title and control of the property to the recipient(s) at the time the gift is given. If restrictions or limitations are placed on use of the property, or if part or all of title and control is to be transferred at a later date, the donor(s) retain a remainder interest and the transfer of property is not a gift in the meaning used in this discussion. (For a discussion of gifts of a remainder interest, see NF 96-298, *Charitable Remainder Trusts and Charitable Annuities as Estate Planning Tools*.)

If gifts are made in cash or fixed-value securities, the worth of a gift is its dollar value at the time of the gift. If the gift is anything other than cash or fixed-value securities, the worth of the gift is its fair market value (sale price) at the time of the gift. Unless the gift is subject to gift tax and the tax is paid, the recipient's tax basis for a gift is the same as the donor's basis prior to the gift. (See NF 93-144, *Determining Property Basis*, for information about the tax basis of property.) A gift can be any type of

tangible property (land, buildings, fixtures and equipment, vehicles, jewelry, coin collections, etc.) or intangible property (securities, shares of stock, etc.).

Under current law, every person is entitled to give up to \$10,000 per year to each of as many recipients as desired without incurring a gift tax liability for the donor or an income tax liability for the recipient. If they wish to do so, a married couple can give up to \$20,000 per year per recipient with the same exemptions from taxes. This exemption applies, only when the transfer of title and control of the subject property is complete and unconditional with the donor(s) retaining no present interest in the property.

The \$10,000 or \$20,000 amounts are absolute limits for tax-free gifts to any one recipient during a tax year. A gift of \$10,000 (one donor) or \$20,000 (married couple making a joint gift) to any one recipient is not subject to gift tax. However, if the gift is followed by a birthday, Christmas, or incidental gift with measurable value, the tax year total would exceed the tax-free limit and a gift tax liability would be incurred on the excess above \$10,000 (one donor) or \$20,000 (married couple making a joint gift). Alternatively, by making principal gifts totaling less than the tax-free amount of \$10,000 (\$20,000 for a married couple giving a joint gift) the donor(s) can also give special occasion gifts without incurring a gift tax liability as long as the yearly total to any one person does not exceed \$10,000 or \$20,000.

For each recipient of gifts totaling to more than \$10,000, a gift tax return must be filed by the donor(s) even when there is no gift tax liability. If there is a gift tax liability, it is calculated on the amount in excess of \$10,000 or \$20,000 (as applicable). While the donor(s) can elect to pay the gift tax with the return, the usual approach is to reduce the donor's (donors') unified estate and gift tax credit balance by the amount of the calculated gift tax liability. (The lifetime unified estate and gift tax credit is \$192,800 and shelters from taxation a total of up to \$600,000 of taxable estate assets and taxable gifts.) Using a portion of the credit defers payment of the gift tax, but reduces the balance of the unified tax credit that's available for use at the time the donors' estate is probated.

Gifts to charities, philanthropies, educational and religious institutions, and the numerous organizations and institutions with nonprofit status (501.c.3 corporations) also is used by many persons. These gifts do not incur gift tax or estate tax liability, usually are partly or completely deductible from the donor's (donors') current taxable income, and are an important source of support for the recipient units. (For additional information, see NF 93-114, *Charitable Giving in Estate and Retirement Planning*.)

## **How is gifting used in estate planning?**

Gifts usually is combined with other estate planning tools as individuals and families develop and implement their estate plans. Gifts can be made directly by the donor(s) or through distributions from a trust or other type of intermediary.

If you or you and your family own an incorporated business, you may want to consider making annual gifts of stock to your descendants. This can be a very effective means of making incremental shifts in ownership and control. However, if the number of intended heirs is large, gifts of stock also can result in fractionated ownership of the corporation — a situation where each of many owners has a small ownership interest. Management of a family corporation with fractionated ownership can become very difficult if disagreements among stockholders emerge and are sustained over an extended period of time.

In another use, cash gifts to intended heirs are used to pay the premium costs of life insurance on the donor. The policy is owned by the gift recipient(s). Upon the death of the donor the life insurance proceeds are used to pay estate and inheritance taxes, to implement a buy-sell agreement, to pay the

remaining balance of a sale contract for the family business or other property purchased from the donor, or for other similar uses. These arrangements work well only if deaths occur in the expected order. The untimely death of a gift recipient can greatly reduce or negate the usefulness of gifting to pay life insurance premiums. For more information on the use of life insurance in estate planning, see NF 96-297, *Life Insurance As An Estate Planning Tool*.

In some instances, members of the older generation give many or most assets to their descendants in exchange for promises that the donors' needs will be provided for throughout the remainder of their lives. When this is done, and the donors' savings are used to pay the resulting gift tax liability, the donors may be left with relatively few assets and a low level of current income. These arrangements can be satisfactory, but the risks of unsatisfactory outcomes is high. Care and caution are advised.

## **Is gifting an adequate means of implementing my estate planning?**

Persons who have an estate and have no one (descendants or other persons) to whom they want to leave the estate sometimes use gifting to a charity of their choice as their principal means of estate planning. When the value of an estate is predicted to be large enough to result in substantial estate tax liabilities, the owner(s) often elect to use gifting as a means of reducing the size of the estate and the associated tax liabilities. This can be accomplished by transferring assets to descendants, other persons, or organizations prior to the death of the donor. Gifting can be an important means of implementing some parts of your estate planning.

Whether gifting is your principal estate planning tool or a minor aspect of your estate planning, you also will want to have a valid and up-to-date will. A well-written and up-to-date will provides guidance as your personal representative settles your affairs, and ensures that assets other than those you've transferred as gifts do not default (escheat) to the state.

## **Glossary**

### **Escheat**

Assignment of property to the state because there is no verifiable legal owner — typically when there is no heir to property.

### **Fair Market Value**

The market price for an asset that would be agreed to by a willing buyer and a willing seller.

### **Gift**

A voluntary transfer of property for which nothing of value is received in return. If Internal Revenue Service is to recognize a transfer as a gift, the donor(s) must unconditionally transfer all title and control of the property to the recipient(s) at the time the gift is given.

### **Intangible property**

Property that only represents real value such as bonds, stock certificates, promissory notes, certificates of deposit, bank accounts, contracts, leases, and other similar items.

### **Tangible property**

Property that is capable of being perceived by the senses — generally, tangible property is real estate, personal property, or moveable property that has value of its own and is not merely a representation of real value. Land, machinery, buildings, business equipment, inventories, homes and furnishings are examples of tangible property.

### **Tax Basis**

The owner's cost of an asset for income and estate tax purposes as determined under the Internal Revenue Code and IRS regulations (see *NF 93-144, Determining Property Basis*).

## Documents in This Series:

- NF 95-236, *Nebraska Inheritance and Estate Taxes*
- NF 96-291, *Intestate Succession As An Estate Planning Tool*
- NF 96-292, *A Will As An Estate Planning Tool*
- NF 96-293, *Joint Tenancy As An Estate Planning Tool*
- NF 96-294, *Tenants In Common Ownership As An Estate Planning Tool*
- NF 96-295, *A Trust As An Estate Planning Tool*
- NF 96-297, *Life Insurance As An Estate Planning Tool*
- NF 96-298, *Charitable Remainder Trusts and Charitable Annuities As Estate Planning Tools*
- NF 96-299, *Estate Planning Glossary*

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***File NF296 under: HOME MANAGEMENT***

***B-8f, Estate Planning***

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