If You Have a Large Estate, Consider Gifting

Gifting is a valuable part of most estate plans, but when financial advisors think of gifting they usually just think in terms of the annual exclusion gift that can be made each year. The annual exclusion gift increased in 2023 to $17,000 per person, so for a couple, $34,000 can be given to a single individual. A client can make annual exclusion gifts to any number of individuals during a calendar year, and the recipient of the gift does not need to be related.

So, if a client wants to make a $17,000 gift to a child and another $17,000 gift to a good friend, both will qualify as annual exclusion gifts. The annual exclusion gift is a simple transaction where a gift tax return does not need to be filed – which may account for its popularity. As indicated by the chart at right, over a period of time a single small annual exclusion gift can remove a considerable amount from an individual's estate.

Illustrates gift of $17,000 each year for 20 years at 5% and 7% growth assumptions.

Why gift as part of an estate plan?

- The gift and the growth on the gifted assets are outside of your clients' estate.
- Result: More passes to the people your clients want, and they pay less in federal or state estate taxes.

What happens if the gift exceeds the annual exclusion amount?

Once your clients gift to an individual during a calendar year exceeds the $17,000 annual exclusion amount the excess amount begins to eat into their lifetime gift and estate tax exemption. Also, the client will need to report it on a form 709 gift tax return. So, if your client makes a gift of $50,000 to an individual the $33,000 excess over the $17,000 annual exclusion will use the lifetime exemption. The $33,000 excess will not be subject to gift tax as long as the client's cumulative lifetime gifts (in excess of the annual exclusion) is not more than the gift tax exemption amount.

With the passage of the Tax Cuts and Jobs Act in 2017 (the Act) the gift and estate tax exemption increased significantly from $5,490,000 per person to $11, 180,000. The chart shows further significant increases in the exemption amount over the past six years. Since the exemption amount in 2023 is $12,920,000 if a client has never made a gift in excess of the annual exclusion amount s/he could make a gift of $12,937,000 to one individual ($17,000 qualifying for annual exclusion with the balance using the exemption) and not be subject to gift tax.

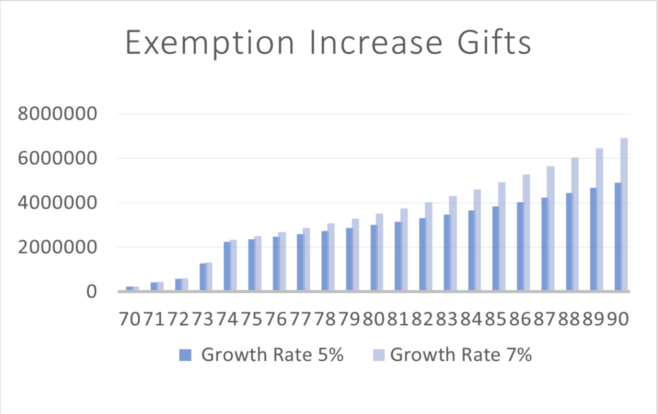
Gift & Estate Exemption Amount		
2018	$11,180,000	Increases
2019	$11,400,000	220,000
2020	$11,580,000	180,000
2021	$11,700,000	120,000
2022	$12,060,000	640,000
2023	$12,920,000	860,000

There is one big caveat to be aware of – the large exemption amount is temporary – it only applies to tax years up to 2025. Unless Congress makes the increased exemption permanent, starting January 1, 2026, the exemption reverts back, or sunsets, to $5,000,000 indexed for inflation. Legislation has been introduced more than once in the past few years to reduce the exemption before the current sunset date. Because the large exemption is set to sunset many legal advisors have recommended that their high-net worth clients lock-in to the exemption today by making large exemption gifts. For example, a one-time gift of the 2018 exemption of $11,180,000 at an after-tax growth rate of 5% in 20-years would remove $29,663,868 from an individual's estate.

However, talking a client into making such a significant gift is easier said than done. There are some down sides to gifting. First, a gift requires that your client relinquish control over the asset. One concern clients often have when it comes to giving away assets is the fear that they may need the funds in the future. To address this fear financial advisors will typically need to perform a cash flow analysis showing that a client has sufficient liquid assets to meet after-tax income needs.

For your young or moderately well-to-do clients with net worth in excess of the current exemption amount, a gift of the exemption amount may not be feasible.

However, these clients might consider a gift equal to the annual cost of living increase in the exemption amount. As indicated by the chart this strategy can remove a significant amount from an individual's estate.

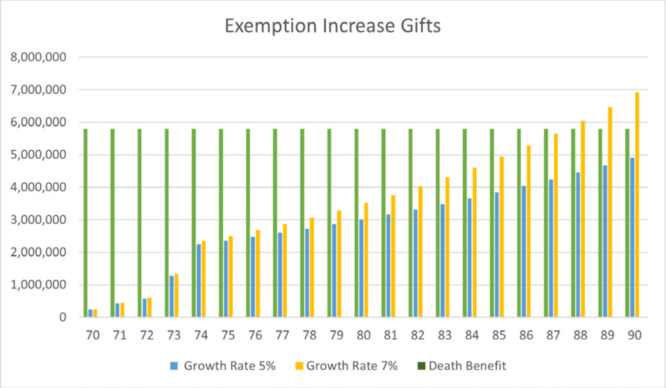


Illustrates gift of annual increase in the exemption amount from 2018-2023 with 5% and 7% assumed growth.

Large lifetime gifts can create another concern for your clients. Specifically, the recipient of the gifted asset acquires the same income tax basis as the person who made the gift. In other words, for purposes of calculating taxable gain the basis is carried-over. So, if the gifted asset appreciates in value the recipient incurs a taxable gain when selling the asset. In contrast, assets held by an individual until his/her passing receive a new basis equal to date of death value, step-up in basis, avoiding taxable gain.

In a nutshell, the financial professional needs to help his/her clients to carefully select assets to gift to minimize the impact of income taxes. There is one asset that can avoid income tax even when gifted – life insurance. Life insurance can provide both income and estate tax-free proceeds, but how does it compare to simply investing the amount. The green bars on chart illustrates the purchase of a survivorship life insurance policy with a face amount of $5,799,616 on a 70-year-old couple (standard health risk) using the annual increase in the exemption amount from 2018 to 2023.

It demonstrates that it takes 18-years before an asset with an assumed after-tax growth rate of 7% exceeds the life insurance death benefit. Depending on a client's tax bracket this could require a client to achieve a before tax return approaching 11%.



*The policy featured is John Hancock Life Insurance Company's Protection Survivorship Universal Life Form:22PSIUL assuming a standard non-smoker rating with Bronze status vitality credits.**

Conclusion

Gifting is a valuable part of most estate plans, and there are many options when it comes to gifting, more than just the annual exclusion gift that can be made each year. Depending on the client's situation, with a carefully thought-out plan, that process can provide many benefits.

** Life insurance policies contain exclusions, limitations, reductions in benefits, and terms for keeping them in force. A licensed insurance professional can provide further details, as well as additional information on policy costs and features. Insurance policies and/or associated riders and features may not be available in all states.*

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