

Money Matters

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Skloff Financial Group Question of the Month

By Aaron Skloff, AIF, CFA, MBA

Q: We are considering gifting assets to our children and parents? What are the tax benefits and detriments of gifting assets?

The Problem – How a Gift Can Be a Tax Dream or a Tax Nightmare

Many people gift assets to their children and parents with the best intentions. Those gifts may generate tax benefits to those making the gifts, the children, the parents, or all parties – **a tax dream**. On the other hand, those gifts may generate tax detriments to those making the gifts, the children, the parents, or all parties – **a tax nightmare**.

The Solution – Understanding the Tax Benefits and Tax Detriments of Gifts

For 2024, you (“donor”) can gift up to \$18,000 (\$36,000 cumulatively for a couple) to as many people (“donee”) as you want without the donor or donee having to document the gift or pay taxes. These amounts are known as the “annual exclusion”. Gifts in excess of those amounts require you to file IRS Form 709 - United States Gift (and Generation-Skipping Transfer) Tax Return.

Filing IRS Form 709 does not mean you have to pay a gift tax. In addition to the annual exclusion, you have a lifetime gift and estate tax exemption. For 2024, you have a cumulative lifetime gift tax and estate tax exemption of \$13.61 million (\$27.22 million cumulatively for a couple). A surviving spouse can use the unused portion of their deceased spouse’s lifetime exemption. This process is called portability. According to the IRS, “In order to elect portability of the decedent's unused exclusion amount (deceased spousal unused exclusion (DSUE) amount) for the benefit of the surviving spouse, the estate's representative must file an estate tax return (Form 706) and the return must be filed timely.” Gifting can help others as it reduces your income taxes, capital gains taxes and taxable estate.

Translation: you can gift \$13.61 million (\$27.22 million cumulatively for a couple) during your lifetime and neither you nor the recipients have to pay gift taxes. Gifts and estates in excess of these amounts are subject to taxes of up to **40%**. According to the IRS, the following gifts are **not** taxable gifts: 1. Gifts that are not more than the annual exclusion for the calendar year. 2. Tuition or medical expenses you pay for someone (the educational and medical exclusions). 3. Gifts to your spouse. 4. Gifts to a political organization for its use. In addition to this, gifts to qualifying charities are deductible from the value of the gift(s) made.”

Does This Sound Too Good to Be True?

When examining the tax code, if it sounds too good to be true, it probably is too good to be true. Many of the tax benefits from the Tax Cuts and Jobs Act (TCJA) that took effect on January 1, 2018, are set to expire on December 31, 2025. The top tax bracket for individuals, estates and trust income will increase from 37% to 39.6%. The following tax brackets will increase: 12% to 15%, 22% to 25% and 24% to 28%. The cumulative lifetime gift tax and estate tax exemption will collapse to approximately \$6.8 million (\$13.6 million cumulatively for a couple).

Gifts made in advance of the exemption collapse are grandfathered. Let’s look at an example. You gift \$13.61 million (\$27.22 million cumulatively for a couple) in 2024. The exemption collapses to \$6.8 million (\$13.6 million cumulatively for a couple) in 2026. You are not responsible for taxes on the difference between the 2024 and 2026 exemptions.

Gifts That Generate Tax Benefits to Those Making the Gifts, Children, Parents or All Parties – A Tax Dream

To simplify the following examples, all parties are not subject to tax on a child’s investment and other unearned income (Kiddie Tax). If you gift \$18,000 of cash (\$36,000 cumulatively for a couple) to each of your **two** children, neither you nor they have to pay **any** taxes, despite gifting a total of \$36,000 (\$72,000 cumulatively for a couple) – **a tax dream**.

In addition to your children, if you gift \$18,000 of cash (\$36,000 cumulatively for a couple) to **each** of your parents, neither you nor they have to pay **any** taxes, despite gifting a total of \$36,000 (\$72,000 cumulatively for a couple) – **a tax dream**.

Instead, if you gift \$1 million of cash (\$2 million cumulatively for a couple) to each of your **two** children or parents, neither you nor they have to pay **any** taxes, despite gifting a total of \$2 million (\$4 million cumulatively for a couple) - **a tax dream**.

Your children or parents do not have to file Form 709, but you do. The amount in excess of your annual exclusion, \$1.964 million (\$3,928,000 cumulatively for a couple), can be applied toward your lifetime gift tax or estate tax exemption – **a tax dream**.

Instead, if you gift a \$18,000 mutual fund for which you originally paid (“cost basis”) \$5,000 to one of your children and/or your parent, neither you nor they have to pay a **gift tax** – **a tax dream**.

If your child and/or parent immediately sells the \$18,000 mutual fund, they may be subject to a capital gains tax on the \$13,000 gain based on how long **you** owned the mutual fund and **their** income level. The capital gains tax rate is **their** income tax rate for short term capital gains if **you** owned the mutual fund for one year or less. Based on **their** income, **their** income tax rate could be **0%**. If it is a long term capital gain because **you** owned the mutual fund for over one year, **their** capital gains tax rate, based on **their** income, could be **0%** - **a tax dream**.

Action Steps

Work closely with your Registered Investment Adviser (RIA) to reduce your taxes, and grow and preserve your wealth.

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