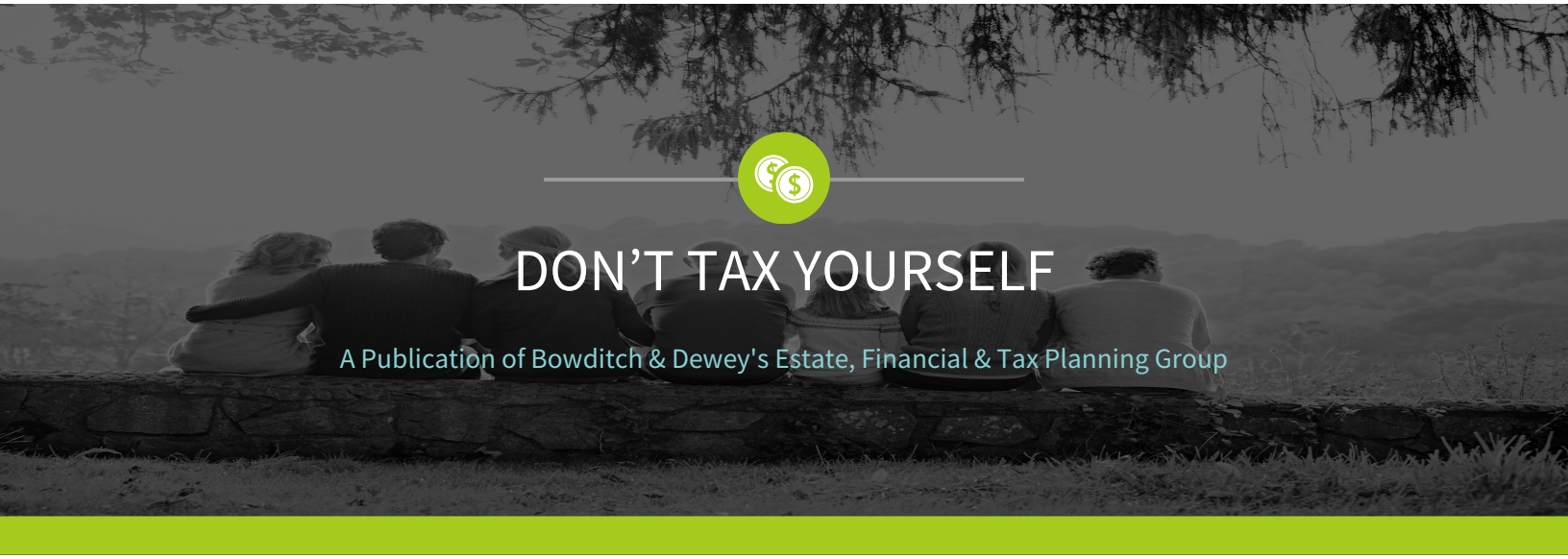


DON'T TAX YOURSELF

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Leveraging Gifts in a Down Market

BY BOWDITCH & DEWEY • MAY 4, 2020

Down markets are a prime opportunity for tax planning for high net worth families. In the few years following the 2008 recession, wealthy families took advantage of gifting options to transfer wealth and reduce taxes. Once again, in 2020, we have a down market, and if you have a taxable estate, you should consider taking advantage of this opportunity to transfer wealth by leveraging the down market, so your loved ones will pay less estate taxes upon your death.

The historical numbers:

- In 2000, the federal lifetime estate tax exemption amount was $675,000.
- In 2005, it was $1,000,000.
- In 2009, it was $3,500,000.
- In 2011, it was $5,000,000.
- Today, in 2020, it is $11,580,000.

The current law is set to sunset in 2025, which means that in 2026, it will revert back to the law that was in place when it was enacted, $5.6 million, with a slight increase for inflation. At this time, Generation Skipping Transfer tax (GST) equals the same amounts as the lifetime exemption amount. If your estate exceeds the exemption amount, the federal estate tax rate is a 40% tax on the excess, and if you gift to a skip person, then the GST is another 40% tax. In addition, many states have their own estate taxes that must be paid. Massachusetts taxes all estates in excess of $1,000,000, with graduated rate not exceeding 16%. If your total gross estate is less than the exemption amount, no taxes are due.

The lifetime exemption amount may be gifted during lifetime or transferred at death, or you could gift a portion during your life with the remainder of your exemption available at your death. When you file the gift tax return, if you gift to a skip person or to a trust, you may allocate a portion of your available GST exemption to the gift. The IRS has told us that if you gift now, while the exemption is high, it will not count against you when the exemption decreases later. By gifting

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a portion of your exemption amount during your lifetime, the asset and any appreciation on the asset (from the time of the gift until your death) would not be in your countable estate for estate tax purposes because it would be owned by the person receiving the gift.

You can generally make two types of gifts to leverage the transfer of wealth in a down market:

- **Making Annual Gifts of the Gift Tax Exemption Amount** ($15,000 per person in 2020) by gifting marketable securities, instead of gifting cash to loved ones.
- **Making Lifetime Gifts that Utilize All or a Portion of your Lifetime Estate Tax Exemption Amount**, by gifting marketable securities, real estate holdings, and/or business interests, instead of cash, to your loved ones directly, or even better, to an irrevocable trust where you may allocate your GST, to be held for the benefit of your loved ones, in generations.For example, assuming your estate is greater than the federal estate tax exemption amount, and you own stock, real estate, or a business with a value in January 2020 of $10,000,000 and the market value decreased by 30%, the current market value is $7,000,000. You could gift that stock or real estate to an irrevocable trust for the benefit of your descendants. If you have a family limited liability company, with that irrevocable trust as a member of the LLC, using a business appraisal, you may qualify for a discount on the gift for a minority interest and/or lack of control, which may reduce the currently valued gift of $7,000,000 another 30%, which means that the gift is valued at $4,900,000 for the gift tax return. Thus, in this down market, you may be able to transfer assets worth approximately $10,000,000 (assuming the value of the transferred assets will increase again over time) to your descendants by utilizing only $4,900,000 of your lifetime estate tax exemption amount and allocating your GST exemption amount to the gift, which could be a tax savings of approximately $2,040,000 (which is the 40% estate tax that you would otherwise have paid on the transfer of the $5,100,000 value not counted in this gift). In addition, if that gift was made to skip person, then you may save an additional 40% GST, totaling $4,080,000 in estate and GST tax savings on the value not counted in this gift.

A word of caution regarding gifting: the general rule is that a person who receives the gift will receive your cost basis in it (carryover basis). This means that if you bought a stock for $1, it was valued at $50 at the time of your gift, and valued at $100 at the time of your death, then the person receiving the gift decides to sell it after your death, the sale is $100 – $1 carryover basis = $99 x the capital gain rate due for income taxes. You would count the gift as valued at $50 against your lifetime estate tax exemption amount.

Alternatively, if you held that same stock until your death, the person inheriting stock would generally receive the stock with a step-up in basis equal to the fair market value on the date of your death, so if the same person sells it after your death for $100 – $100 step up basis = $0 capital gain means 0 income tax due. However, depending on the size of your gross estate and your remaining lifetime estate tax exemption amount, the stock may incur an estate tax due at your death.

This is why we usually look for assets that have a high cost basis when making a gift, and a low cost basis when keeping assets in your estate. You should discuss gifting in further detail with your attorney or accountant because there are some exceptions to the general carryover basis rule, which are a bit more complicated.

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