Friday, June 10, 2011

THE DAILY RECORD

WESTERN NEW YORK'S SOURCE FOR LAW, REAL ESTATE, FINANCE AND GENERAL INTELLIGENCE SINCE 1908

EstatePLANNING

Gifting: More than a new tie for Father's Day

For most of us, a discussion on the topic of gifting does not include words such as taxes, exclusions or limitations. Rather, when the word "gift" is mentioned, it is done so with a connotation of birthday presents, like that new Ohio State University sweater vest or those always useful sub shop gift cards.

By JASON P. TORRES
Daily Record Columnist

But as you might expect, a gift can go well beyond the simplicity of an exchange of gifts at the holidays. In the world of estate planning, clients solicit advice about how to make a gift to another individual in the most advantageous manner.

The proposed gift could be in many forms, including cash, securities, real estate or even baseball cards. Unfortunately, the "how" is often far more complicated than the "what" in the transaction, as the parties involved (including the advising attorney) must be aware of the limitations and consequences of gifting as set forth in the Internal Revenue Code.

I have outlined below several different strategies for making gifts, from the most basic to the more complex. This is by no means an exhaustive list, but rather one that includes less frequently considered gifting methods.

Gifting can take many different forms in addition to those listed below, including the use of trusts, planning with Uniform Transfers to Minors Act, Uniform Gift to Minors Act and 529 accounts, gifting of interests in Family Limited Partnership and Limited Liability Companies and the purchase of life insurance. Whether any of the gifting alternatives mentioned above or outlined below are advisable will depend entirely on the circumstances presented and the objectives of the client. A proper education of the options available to the client will assist him or her in making an appropriate gifting decision.

Annual exclusion gifting – IRS Code §2503(b)

Layman's terms — An individual can make gifts of up to $13,000 (in the aggregate) to another individual without the gifts having to be reported to the IRS. The $13,000 is often referred to as the annual exclusion amount. As such, a federal gift tax return, or Form 709, would not be required to be filed. The amount of the annual exclusion is indexed for inflation in increments of $1,000; therefore, its next scheduled increase will be to $14,000.

What to watch out for — (1) All gifts count, including birthday presents and those given at the holidays. For example, if grandma makes an annual exclusion gift of $13,000 to her grandson in June and then gives him a $100 gift at Christmas, she is technically over the filing threshold and must file a Form 709 by April 15 of the following year; and (2) the $13,000 annual exclusion only applies to present interests in property. If the use and/or enjoyment of the gift will not be realized until some future date or time, the gift would not qualify as an annual exclusion gift under the code.

Qualified transfer for tuition - IRS Code § 2503(e)(2)(A)

Layman's terms — Grandma and grandpa can pay for their granddaughter's college tuition and the code does not consider the transfer of funds as a gift. Grandma and grandpa can even pre pay all four years of college without having to file a gift tax return, as long as the tuition payments to the educational institution are non-refundable.

What to watch out for — (1) Grandma and grandpa must make the tuition payments directly to the educational institution, and not to the granddaughter, her parents or anyone else; (2) the educational institution must be one that is described in §170(b)(1)(A)(ii) of the code which lists several requirements for the institution; and (3) the exclusion under §2503(e)(2)(A) only applies to tuition payments and not to other related college expenses such as books or room and board.

Qualified transfer for medical expenses – IRS Code §2503(e)(2)(B)

Layman's terms — Granddaughter can pay for her grandmother's medical care and the code does not consider the

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transfer of funds by granddaughter as a gift. Medical care is defined under §213(d) of the code. For purposes of this exception, qualifying medical expenses include dental expenses, hospital services, medicines, nursing services and ambulance services.

What to watch out for — (1) Similar to the qualified transfer for tuition, granddaughter must make the medical expense payment directly to the health care provider; and (2) one of the primary difficulties with this form of gifting is that payment is often expected at the time of service versus having the health care provider send an invoice. With the former often the case, granddaughter will need to be present when payment is requested so that the transfer of funds can be made directly to the provider.

Below market intra-family loan – IRS Code §7872

Layman's terms — Money is lent from one family member to another, with the interest due to the "lender" at below market rates. "Market" is considered the interest rate published by the U.S. Treasury to calculate imputed interest charges, and referred to as the Applicable Federal Rate (AFR). For a demand loan, or a loan that is payable in full upon the demand of the lender, the lender is treated as having made a gift in the amount of the difference between the AFR and the below market amount. With a term loan, defined as any loan that is not a demand loan, the lender has made a gift equal to the excess of the amount loaned over the present value of all payments required to be made under the terms of the loan.

What to watch out for — There is a *de minimis* exception to the below market loan rules outlined in §7872(c)(2) of the code. With respect to a gift loan between individuals, no gift is imputed where the aggregate outstanding amount of loans between the lender and borrower does not exceed $10,000. However, this de minimis exception does not apply to below market loans directly attributable to the purchase or carrying of income producing assets. IRC § 7872(c)(2)(B).

Gift of joint tenancy interest – Treasury Regulation §25-2511-1(h)

Layman's terms — During mother's lifetime, she adds her son as a joint account owner for all of her bank accounts and adds his name to the title of the house. Mother's intentions are to have her son retain ownership of the bank accounts and real property upon her death.

What to watch out for — With respect to mother adding her son to the bank account, the treasury regulation section referenced above provides that the gift does not occur until the son draws upon the account for his own benefit and without obligation to account for part of the proceeds to his mother. In other words, the gift does not occur until her son actually withdraws money from her account. The treasury regulations treat the timing of the gift of the real property interest differently. When mother adds her son to the title of her house, there is an immediate gift to her son, the non-contributing title holder, of one half the value of the property.

The concept of gifting, while simple at its core, can become quite complex upon an examination of the many different options available. Accordingly, if it appears that a client intends to make gifts that are more substantial than the aforementioned sweater vest, gift card or other keepsake, then it is worthwhile to have a more detailed conversation about the applicable laws.

More importantly, for clients who are looking to transfer wealth to family, friends or charity in a tax advantaged fashion, an attorney must be familiar with the tax rules which allow for significant opportunities — and pitfalls.

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