Now or later: When's the right time to transfer your wealth?

Published on February 9, 2021

To gift or not to gift? It's a deceptively complex question. The temporary doubling of the federal gift and estate tax exemption — to an inflation-adjusted $11.7 million in 2021 — is viewed by some people as a "use it or lose it" proposition. In other words, you should make gifts now to take advantage of the exemption before it sunsets at the end of 2025 (or sooner if lawmakers decide to reduce it earlier).

But giving away wealth now isn't right for everyone. Depending on your circumstances, there may be tax advantages to keeping assets in your estate. Here are some of the factors to consider.

Lifetime gifts vs. bequests at death

The primary advantage of making lifetime gifts is that, by removing assets from your estate, you shield future appreciation from estate taxes. But there's a tradeoff: The recipient receives a "carryover" tax basis — that is, he or she assumes *your* basis in the asset. If a gifted asset has a low basis relative to its fair market value ("FMV"), then a sale will trigger capital gains taxes on the difference.

An asset transferred at death, however, currently receives a "stepped-up basis" equal to its date-of-death FMV. That means the recipient can sell it with little or no capital gains tax liability. So, the question becomes, which strategy has the lower tax cost: transferring an asset by gift (now) or by bequest (later)?

The answer depends on several factors, including the asset's basis-to-FMV ratio, the likelihood that its value will continue appreciating, your current or potential future exposure to gift and estate taxes, and the recipient's time horizon — that is, how long you expect the recipient to hold the asset after receiving it.

Also, be aware that President Biden proposed eliminating the stepped-up basis benefit during his campaign.

Hedging your bets

Determining the right time to transfer wealth can be difficult, because so much depends on what happens to the gift and estate tax regime in the future. It may be possible to reduce the impact of this uncertainty with carefully designed trusts.

Let's say you believe the gift and estate tax exemption will be reduced dramatically in the near future. To take advantage of the current exemption, you transfer appreciated assets to an irrevocable trust, avoiding gift tax and shielding future appreciation from estate tax. Your beneficiaries receive a carryover basis in the assets, so they'll be subject to capital gains taxes when they sell them.

Now suppose that, when you die, the exemption amount hasn't dropped, but instead has stayed the same or increased. To hedge against this possibility, the trust gives the trustee certain powers that, if exercised, cause the assets to be included in your estate. Your beneficiaries enjoy a stepped-up basis and the higher exemption shields all or most of the asset's appreciation from estate taxes.

Please work with us to monitor legislative developments and adjust your estate plan accordingly.

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