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MAXIMIZE YOUR NEXT GENERATION GIFTING

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Leverage High Gift & Estate Tax Exemptions Before They Sunset

An important goal for many individuals is to leave a legacy for the next generation. With the federal gift and estate tax exemption currently at an all-time high ($13.61M for individuals or $27.22M for a married couple) and scheduled to be reduced at the end of 2025, gifting to children and grandchildren now can be a great way to take advantage of these tax exemptions while seeing the impact of the gift during your lifetime.

The federal estate tax rates max out at 40% on the value of the estate that exceed the amounts above. By making gifts during your lifetime, you reduce your taxable estate by the amount of the gift and remove the appreciation on the amounts gifted from your taxable estate. There is also a generation-skipping transfer (GST) tax applied to gifts that skip a generation (i.e., a gift to a grandchild).

Estates are taxed at a rate of 40% on amounts that exceed the federal estate tax exemption. This does not include the state-level estate tax, if applicable. So, an individual can (a) make a gift to a trust for children and grandchildren up to the available federal estate tax exemption and (b) allocate GST tax exemption to the gift to avoid having the trust pay a GST tax when distributions are made to grandchildren.

In addition, the trust will inherit the donor's income tax basis for capital gains purposes. This makes cash gifts an attractive option. If securities or other assets are gifted, the donor of the gift should consult their attorney and accountant to ensure the lifetime gift achieves the maximum tax savings rather than the recipient inheriting the assets upon the donor's death.

Deciding How Much to Give

Before deciding how much to give, an individual should understand what they need to retain to fund their own personal goals and any unexpected needs they may have in the future. Working with your advisors, you can create a wealth plan that can stress-test your asset base and determine an amount you can comfortably give while still meeting all your personal financial goals. Once you have determined the recipient and amount of the gift, the next consideration is how you want the recipient to use the gift.

Data as of September 2024.

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Annual Exclusion Gifts and Direct Payments

If the intent is for the recipient to have full control and use of his/her gift, an outright gift can be a simple, straightforward option. An individual can make an annual exclusion gift of $18K ($36K if married and splitting gifts) to any individual without it being subject to gift tax. Annual exclusion gifts to children, their spouses, and grandchildren can be a great way for a couple to meaningfully reduce their taxable estate each year without using their lifetime gift and estate tax exemption.

An individual can give gifts worth more than the annual exclusion amount but will have to file a gift tax return and use some of their available gift and estate tax exemption.

If the gift is intended to cover medical expenses or tuition for a student, a payment directly to the qualifying educational institution or medical provider can be a great option without any gift tax consequences.

529 Plans

If you want to give a gift to cover current or future education expenses for a child or grandchild, a gift to a 529 plan can be a good option. A donor can give up to five years' worth of annual exclusion gifts (which is $90K per individual or $180K for a married couple) to a 529 plan in a lump sum.

The account will grow tax free and can be withdrawn tax-free if the funds are used for qualified educational expenses, such as tuition and room and board. In addition, $10K per year can be withdrawn to cover tuition for students in grades K-12. Any withdrawals that are not "qualified" will be subject to income tax and a 10% penalty.

529 plans are not considered an asset of the student/beneficiary for financial aid purposes. Remaining assets in a 529 plan can be transferred to a beneficiary who is a member of the original beneficiary's family (such as a sibling or child of the beneficiary.)

Any additional gifts during the five-year period by the donor to the beneficiary of the 529 plan will result in the filing of a gift tax return and use of a portion of the donor's lifetime exemption.

UTMA Accounts

A Uniform Transfer to Minors Act (UTMA) account is a traditional option to hold gifts for minor grandchildren. The account is owned by a custodian for the benefit of the minor, and the funds can be spent on behalf of the minor as the custodian sees fit. The downside is that the assets in the account become the personal property of the minor when they attain the age of majority. Depending on the state where the account is opened, this can mean the minor has full ownership of the assets at age 18 or 21. UTMA accounts are usually considered an asset of the child for financial aid purposes.

An UTMA account can receive gifts from more than one individual and can grow significantly. Parents are often scrambling as the minor approaches the age of majority to avoid the assets landing in the minor's hands. Some parents encourage their children to create a revocable trust, which appoints the parent as trustee. The UTMA assets are deposited into the revocable trust and the parent has some control over how much the child can take from the trust. This is not always an ideal option, as it requires the child to be amenable to creating a trust that names the parent as trustee.

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Creating a Trust

If you want to make a large gift or if your goal is to have funds available for the future use of multiple generations, creating a trust can be a good option. The individual creating the trust can tailor the terms of the trust so that distributions are made to beneficiaries to accomplish certain goals. The trust can continue in perpetuity (depending on what state law governs the terms of the trust), so that it benefits future generations.

A trust provides protection from the beneficiary's creditors, but it may be considered an available asset for financial aid purposes.

The individual creating the trust will make a gift of assets (either cash or an in-kind distribution) to the trust. This is a completed gift for gift tax purposes, so the donor of the gift will lose control and use of the assets, and the gift is also excluded from the donor's estate for estate tax purposes.

The trust will pay the income tax on the income earned and gains recognized in the trust unless the individual creating the trust opts for grantor trust status. This means the individual creating the trust (the grantor) will be deemed the owner for income tax purposes and pay the income tax and capital gains. This is a good way to maximize trust growth (since it is not paying the tax) without making an additional taxable gift for gift tax purposes. The pros and cons should be discussed with your accountant and attorney to avoid any unintended consequences.

Here to Help

If you are contemplating a gift, we suggest you contact your attorney to see what option works best for you and your family. If you need assistance with creating a wealth plan to determine what you can comfortably give, please contact your First Manhattan Wealth Management team to discuss how we can help.

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