

CHAPTER SEVEN – Gift Strategies

Reasons for and against making lifetime gifts:

Pro: Tax savings (federal income, gift and estate taxes); possible state income tax savings (in other jurisdictions than Texas)?

Shifting wealth to younger generation(s).

Con: Loss of control over the funds or property; possibly “inadequate” (?) resources to enable the donor to pay expenses in later life (e.g., expenses of one’s “last illness”); & concern about the potential behavior of donee.

Choosing the Gift Property

p.2

Strategies in picking the potential gift property:

1) High tax basis property (including cash).

2) High appreciation potential property
(including when property to be transferred is
currently depreciated in value).

3) Discount/reduced valuation possibilities –

Note (at p.3) the Pierre case (2009) – *next slide*.

Pierre case

p.3

Pierre case (2009) where:

- 1) a single member LLC was created and funded with cash & marketable securities.
 - 2) LLC interests were transferred (by gifts & sales) to trusts for child & grandchild.
 - 3) Discounted values (30%) were claimed on the gifts of LLC interests for gift tax purposes; seeking beneficial use of the “LLC wrapper.”
- Subsequently: “Step transaction doctrine” applies & only 8% “lack of control” discount.

Income Tax Basis Considerations

p.4

Code §1015 specifies a transferred income tax basis for gifts, except for loss property (in certain situations). Why?

How choose loss property for making gifts?

What tax treatment results if the property appreciates significantly after the gift transfer?

Note Code §1015(d)(6) adjustment for (any) gift tax attributable to the appreciation portion.

What order for gifts? Cash first (if § 1015(d)(6) is applicable)? No tax basis increase for cash.

Identifying a “Gift” for Gift Tax Purposes

p.5

See Reg. §25.2511-1(a) & (c)(1) re gratuitous transfers of wealth & gift tax exposure.

Reg. §25.2511-1(g) re no donative intent is necessary to complete a gift. Cf., objective facts.

Determining gift amount re a formula – permissible? See Wandry case, note 7, p. 5.

Cf., “gift” concept for income tax & *Duberstein*.

Identifying a “Gift” for Gift Tax Purposes

p.5

Rev. Rul. 77-372, p. 5 – transfer was made to equalize estate distributions (i.e., “hotchpot”); gift treatment when equalization contribution made (i.e., in excess of state law requirement).

Excess was not recoverable (as determined under applicable state law).

Cf., advancement vs. debt obligation (e.g., gift with obligation for refunding).

Identifying a “Gift” for Gift Tax, cont. P.8-9

Family settlement arrangement?

Lender’s cancellation of relative’s debt.

Payment of another’s liability, including on a life insurance policy or a home mortgage debt.

Interest free loan - §7872 - low/no interest debt.

Excessive salary to child-employee.

Gift by a closely-held corporation?

Payment for a child’s wedding?

Excessive trustee’s fees paid to children?

Contributions to §501(c)(4) organization? P.9

Gift Completion Considerations

p.10

Non-trust transfers, e.g., a check or negotiable instrument – when is the transfer complete?

Rev. Rul. 67-396, p. 10; Rev. Rul. 84-25, p.11.

Gift of a U.S. Treasury bond? See Regs.

Joint checking or savings account?

Gift of corporate stock or mutual fund shares?

Is a record transfer necessary to complete gift?

Does a gift occur when one spouse pays all the FIT liability for a particular year? P.12

Gift of a promissory note (whose note)?

Gifts made Under Durable Power of Attorney p.12

Can a gift be made on behalf of a principal by an “attorney in fact” for that principal?

How document the capacity to make a gift?

What federal estate tax effect results if no legal capacity exists to make the gift? Code §2038.

Responsibility of the executor to retrieve?

See Texas Estates Code §1162.001 (p.15) re possible Texas court authorization for a guardian to make gifts for federal gift tax and estate tax planning purposes.

Transfers into a Trust & Gift Completion Issues

Rev. Rul. 77-378, p. 16 – completed gift occurs even where the independent trustee can distribute P&I to the grantor in the trustee's discretion; cf., Rev. Rul. 62-13 (p.18).

See Reg. §25.2511-2(c) (p.18) - an incomplete gift results when the donor has power to change interests among the beneficiaries in the trust.

Cf., Reg. §25.2511-2(d) where donor's retention of only a right to determine time when a specific beneficiary is to receive from trust. Cf., Lober.

Transfers into a Trust & Gift Completion Issues

PLR 201628010 (p.18) - Distribution Committee

(1) Written consent of Grantor is necessary to distribute to the grantor, but (2) no consent is essential to distribute to others, and (3) distribution of principal subject to standard as grantor directs. Holding: (1) No §§ 671-674, etc., inclusion; (2) No ruling re §675 (fact question); (3) Gift is incomplete by Grantor for gift tax purposes; (4) A trust distribution is not a gift by Committee members but by Grantor.

Gift Transfers to a Grantor Trust (IDGT) p.25

Gift completion for gift tax but not for income tax. Three options re Grantor's income tax:

(1) No reimbursement; (2) Required reimburse; (3) Discretionary reimbursement by Trustee. Rev. Rul. 2004-64 (p.26) – (1) holding payment of income tax by the grantor is not a gift to the trust. (2) inclusion in the gross estate (under Code §2036(a)) if grantor retains the right to be reimbursed by the trust (Situation 2 in ruling). (3) no gift by donor & no §2036 in **Situation 3.**

Notice 2010-19

p.30

IRC §2511(c) provides that a transfer in trust is treated as a gift transfer unless the trust is treated as wholly owned by donor under Subpart E.

What does §2511(c) and this IRS Notice accomplish?

Annual Donee Gift Tax

Exclusion

p.30

Code §2503(b) – annual donee exclusion in amount of \$15,000 (for 2019, i.e., the \$10,000 amount, as indexed for inflation).

Limited to gifts of a “present interest.” Must be a right to a substantial present economic benefit. What about a gift of a growth stock paying no current ordinary dividends? P. 31.

See Rev. Rul. 76-360, p. 31, re effect of a “restrictive agreement” after a “statutory merger.” Note the possibility of an annual donee exclusion for only the “income interest” component (p.33).

Other Possible “Present Interest” Limitations

- 1) Older shareholders forgive debt owing to them from a closely held corporation – thereby enhancing the value of all shares, including those owned by younger minority shareholders. Stinson case, p. 33. No annual donee exclusion.**
- 2) Gift of limited liability company (LLC) or LP interests to younger generation donees (where restrictions apply on transfer of ownership interest). P.33 (Hackl). No exclusion.**

Rev. Rul. 77-358

p.34

Transfers to irrevocable trusts where the trustee could:

- 1) Apportion receipts and disbursements;
- 2) Allocate gains and losses to income;
- 3) Invest in current income assets.

Gift of income interest only; reversion to the grantor.

Problem with the potential diversion of income to the corpus with the loss allocation power. The income right was not ascertainable & no “present interest.”

Use of a “Crummey” Withdrawal Power **p.35**

Does a right of withdrawal, even though not exercised, facilitate “present interest” status upon a property transfer?

How can a donor “leverage” the annual donee exclusion? Are contingent interests OK for the exclusion? See the Cristofani case, p. 36.

See Mikel case, p. 40. In terrorem clause as limiting withdrawal rights?

Note the “reciprocal gift” limitation, p. 36, (Sather case).

Use of a “Crummey” Power, cont.

What is the appropriate treatment for enabling annual donee exclusions?

See the JCT “Options” paper (2005), p. 36, with choices re restricting Crummey power.

Obama budget proposal for FY 2017.

Maximum \$50,000 in annual donee exclusion gifts.

No revision proposal with change in Presidential Administration.

Gift Splitting Between Spouses

p.41

Code §2513 authorizes gifts made by one spouse to be treated as made $\frac{1}{2}$ by each spouse.

How stagger gifts to other beneficiaries when one spouse has more assets than the other?

Is Code §2513 even relevant in a community property jurisdiction (e.g., Texas) when making gifts to non-spouses?

If so, under what circumstances?

Gift Tax Marital Deduction

p.41

Code §2523 provides for an unlimited marital deduction for gifts to a spouse.

Code §2523(b) provides that deduction is not available when a (nondeductible) “terminable interest” is transferred to the spouse. Why?

Exception for transfer to QTIP trust. §2523(f).

See Code §2523(i) (p. 42) re \$100,000 limit (indexed) on marital deduction gift to non-U.S. citizen spouse. Why this \$ limit? Why not an unlimited deduction in this situation?

Gifts within Three Years of Death

p.42

Code §2035(a)(2) inclusion in gross estate is required where termination (within 3 years of death) of a “retained power” occurs (see §§2036-2038 & 2042).

What about transfers from a “revocable trust” made within 3 years of death? See PLR 9343003, p. 42. Characterized as withdrawals for this rule? See treatment under §2035(e).

continued

Gifts within Three Years of Death, cont. p.42

Further: inclusion of the gift tax amount in the gross estate is required – Code §2035(b). P. 46.

Consider the possibility of making a “net net gift,” i.e., the gift tax value is reduced by:

- (1) the gift tax amount, plus**
- (2) the actuarial value of the possible estate tax attributable to inclusion in the gross estate under §2035(b).**