Should I Make A Gift During Life or Wait Until My Death?

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Related Categories: Gift Tax, Estate Planning

There are two main considerations when deciding when to make a gift of property. The first is estate tax, and the second is property basis.

Generally, estates of a decedent are taxed on ALL property that was owned by that person at the time of death. It makes sense to try and move property out of your estate to avoid this type of taxation. However, this really depends on the size of your estate. For most taxpayers this will not be an issue since this type of taxation does not apply to estates valued under $5,340,000 ($5,430,000 for 2015). Just because your estate exceeds this amount does not automatically mean that you should start giving away assets to avoid estate tax.

It is important to keep in mind that an estate is only taxed on the amount that exceeds the exclusion amount. For example, if at the time of death, your estate was worth $5,500,000 the amount taxed would be limited to the difference between the estate's value and the lifetime exclusion amount. For this example, that number would be $160,000. At a tax rate of 39.6%, the estate tax burden would be $63,360. This amount may still be dwarfed by the advantages afforded to your beneficiaries if the property is transferred at death.

The following sections may help you decide when to make a gift of property.

Gifts Made During Your Lifetime

There are some advantages to making a gift or property during your lifetime. If your estate is valued well over the lifetime exclusion amount, gifting during your lifetime may offer a great way to lower the tax burden on your estate. There are also non-tax reasons for gifting during your lifetime. Receiving gratitude or seeing the beneficiary make good use of the property may be enough to outweigh any tax benefits. Gifts made during life may also avoid conflict between beneficiaries that may fight over the true meaning of gifts made after life.

However, gifts made during your lifetime may have some unintended tax consequences. A person receiving the gift will keep the same tax basis you had in the property immediately before making the gift (basis is generally the price you paid for the property). For example, if you gifted a rental home you had purchased in 1990 for $100,000 and it is now worth $500,000, the recipient of the home would keep the $100,000 basis. When the recipient wants to sell the home they will have to recognize $400,000 in gain ($500,000 - $100,000). Additionally, the recipient would be limited to the $100,000 basis in the property for depreciation purposes. For people with property that has a higher basis, this may not be a concern. However, due to appreciation of the property or a lowered basis due to depreciation used by the giftor, most property will tend to have a lower basis. This can make gifting property before death a bad idea for tax purposes.

Gifts Made After Death

As discussed above, waiting until after your death to gift property can create problems between beneficiaries. Also, you may not experience the gratitude or joy of seeing the beneficiary utilizing the property. However, the beneficiary may be grateful when they sit down to do their own taxes.

When property is allowed to pass at death, the property is subject to what is called a "step-up" or "step-down" in basis. A step-up occurs if the decedent dies owning property with a basis that is lower than the current fair market value. Instead of taking the same basis (like was saw in lifetime gifts), the recipient now receives a stepped up basis equal to the fair market value of the property on the date of your death. Using the rental house example above, where the giftor had purchased a rental home for $100,000, the recipient will now take a basis of $500,000 instead of the purchase price of $100,000. The beneficiary could now sell the rental home for the fair market price of $500,000 with no capital gain. Assuming your beneficiary is in the highest tax bracket that is a tax savings of around $80,000. Additionally, the recipient will now have $500,000 available for depreciation (if applicable).

Alternatively, a step-down occurs if a decedent dies owning property that has a basis lower than the fair market value. Instead of increasing the basis, it is "stepped down" to the date of death value. For example, imagine you had purchased a home for $500,000 in 1990 and due to a terrible housing market, the fair market value of the home at the time of your death was only $300,000. When the house passed to the beneficiary at your death, he would take a basis of $300,000 instead of the $500,000 you paid for the home. It would seem logical to gift this type of property before death to preserve the larger basis. However, current rules deny this strategy. Gifting a property with a higher basis than the fair market value has an identical effect on the basis of the property as waiting until death. The best idea for property that has declined in value, therefore, is to sell it before death to avoid losing the tax benefits of the loss.

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Each estate is different and the goals of the owners of that estate can vary wildly. Sitting down with an attorney that is familiar with the laws can help you form a strategy to create a plan that will be the most advantageous for your situation.

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