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# ESTATE PLANNING WITH TAX-FREE GIFTING

In general, whenever you give cash or property to another person, you are potentially subject to the federal gift tax. If you make "taxable gifts," you are required to file a federal gift tax return (Form 709) and use some of your lifetime exclusion from gift tax ($11.4 million in 2019). Filing a return is required even if it is unlikely that any gift tax will ever be owed from gifting during lifetime and at death.

Some gifts are not taxable and do not affect your lifetime exclusion. By making nontaxable gifts, you may reduce estate taxes by removing property from your taxable estate, including any future appreciation in the property's value. But, there can be unexpected gift, estate, generation-skipping transfer, and income tax consequences. Practically speaking, very few people will be subject to gift, estate, or generation-skipping transfer taxes, and it may be important to consider the long-term care benefit eligibility ramifications of gifting. Also, keep in mind that gifts, once made, are irrevocable.

## Marital Deduction Gifts

The marital deduction permits unlimited outright gifts to your spouse without gift tax if your spouse is a U.S. citizen. For gifts to a spouse who is not a U.S. citizen, there is an annual exclusion amount of $155,000 in 2019.

## Annual Exclusion Gifts

You may gift up to the annual exclusion amount—$15,000 in 2019—before a federal gift tax return must be filed. The exclusion amount includes all gifts during the year, such as holiday gifts and birthday gifts. The exclusion amount applies to each donor and each donee. For example, spouses with two children can give their children a total of $60,000 ($15,000 x 4) each year with no need to file a gift tax return. If the property is owned by one spouse, both spouses' exclusions can be used if they elect to "split" their gifts by signing an election on a gift tax return.

## Gifts of Tuition and Medical Expenses

In addition to the annual exclusion, there is an unlimited exclusion from gift tax for payments you make for another person's tuition or medical expenses. Your payment must be made directly to the educational institution, medical care provider, or insurance company. The exclusion is not available if you reimburse someone else for these expenses. The education exclusion applies only to tuition, not to room and board, books, or other supplies. The medical exclusion does not apply to amounts that are reimbursed by insurance.

Section 529 of the Internal Revenue Code provides favorable income tax treatment for state-sponsored college savings accounts. So-called 529 plans are established to pay "qualified higher education expenses" for a designated beneficiary. Unlike trusts and custodial accounts, 529 plans allow the donor to maintain control of the account and even transfer the account to another beneficiary. Contributions to these accounts qualify for the $15,000 annual gift tax exclusion and the amount is not included in the donor's estate. The donor also has the option to make an accelerated transfer to a 529 plan of up to $75,000 ($150,000 for married couples) with these same benefits. For the transfer not to be included in the donor's estate and chip away at the lifetime gift tax exclusion, the donor must report the transfer as a series of five equal annual transfers on federal gift tax returns. A financial advisor can help choose among the many available 529 plans and investment options.

Similar to 529 college savings plans, section 529A of the Internal Revenue Code provides for savings accounts for individuals with disabilities. Contributions to these accounts qualify for the $15,000 annual gift tax exclusion, and the amount is not included in the donor's estate. As a benefit to the individual with disabilities, the money can be withdrawn from the account tax-free when paying for qualified expenses.

**Gifts to Minors**

It is generally not desirable to make large outright gifts to minors (in Maine, persons under age 18). Therefore, gifts to minors usually involve transfers to a responsible adult or a financial institution that will act in a fiduciary capacity to hold and manage the property until the minor reaches the age of majority or older. In general, to avoid estate or income tax complications, the custodian or trustee for gifts to minors should not be the donor or the donor's spouse and should not be the minor's parent. Before establishing a trust or other account for a minor, you should consult your financial advisor or accountant regarding the income tax consequences and the impact on the minor's eligibility for college financial aid.

There are two common methods for making gifts to minors that will qualify for the annual gift tax exclusion:

1. **Custodianship.** The Uniform Transfers to Minors Act ("UTMA") allows a donor to create a custodianship by designating an adult or a qualified financial institution as custodian to manage the minor's account. Under Maine law, the donor may specify that the property is to be held by the custodian until the minor reaches age 21; otherwise the minor is automatically entitled to the property at age 18. For income tax purposes, the property belongs to the minor and any taxable income from it must be reported on the minor's income tax return. The custodian must provide an accounting to the minor and the Maine Probate Court when the custodianship ends.

2. **2503(c) Trust**. A trust is more flexible than a custodial account and can continue beyond age 21. The trust is established by a written agreement between the donor/grantor and the trustee. To qualify for the annual exclusion, the trust must strictly comply with certain statutory requirements, including allowing the beneficiary to terminate the trust and withdraw the trust property at age 21. However, the trust may provide that if the beneficiary does not exercise this right within a limited period (for example, 30 days) after reaching age 21, the trust can continue.

**Gifts to a Trust**

Gifts made to a trust—other than a 2503(c) trust—are generally subject to the annual gift tax exclusion rules unless special requirements are met, regardless of who the beneficiary is. "Crummey" trusts are an exception to this rule and may be used for gifts to beneficiaries of any age. Unlike the 2503(c) trusts, Crummey trusts do not require that the beneficiary have the right to distribution at age 21. The distinguishing feature of the

Crummey trust is that the beneficiary (or a minor beneficiary's parent or guardian) must have the right (usually for a limited period such as 30 days) to withdraw every contribution the donor makes to the trust. If the withdrawal right is not exercised, then the property stays in the trust and the trust continues for as long as specified in the trust document. A Crummey trust offers more flexibility than a 2503(c) trust, but it is more complicated to create and maintain.

### Income Tax Considerations

A donor is not entitled to any income tax deduction for a gift to or for the benefit of an individual. A donee does not receive any taxable income when receiving a gift and need not report the gift on his or her income tax return. When a donee receives a lifetime gift (versus upon the donor's death through a Will, the law for when people have no Wills, or a properly created trust), the donee assumes the donor's income tax basis when the property is not cash. Therefore, if a gift is property that has appreciated in value, the donee may have to report capital gains upon a later sale of that property.

### Important Long-Term Care Planning Implications

Even if a gift need not be reported to the IRS for gift tax purposes, the gift may still be penalized by the Department of Health and Human Services (DHHS) if an application is filed for MaineCare long-term care benefits. Under the MaineCare rules, a penalty may be imposed on an applicant for all gifts that exceed $500 per calendar quarter. While certain gifts are not penalized, including spouse-to-spouse transfers or transfers to a child with a disability, a gift for tax purposes is not an exempt transfer.

Before gifting significant sums of money or other property, it is important to talk to an attorney to determine if the gift should be made at all, how to minimize effects on benefit eligibility, and what strategies are available to preserve assets from any future long-term care costs.

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