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Worth It Episode 4: Pain Free Gifting – Using Your Lifetime Gift Tax Exemption With Residences and Outstanding Loans?

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In this episode of Worth It, associate Daniel W. Hatten, and senior counsel Vanessa Maczko discuss options for clients who are seeking to use their remaining federal lifetime gift tax exemption without the **“**pain**”** generally associated with giving up assets. To that end, we will talk about options for gifting personal residences and ways to use outstanding loans to make gifts. Tune in as Dan and Vanessa explain in more detail some options for "pain-free" gifting.

Dan Hatten: Hello, and welcome to Worth It, a podcast brought to you by Proskauer’s Private Client Services Group. Covering a wide range of topics concerning estate planning, wealth transfers, and important legal developments and other issues our clients frequently face when organizing their estates. My name is Dan Hatten, Associate in Proskauer’s New York office. And this episode will be discussing options for clients who are seeking to use their remaining federal lifetime gift tax exemption without the pain generally associated with actually giving up those assets. To that end, we’ll talk about options for gifting principal residences and ways to use outstanding loans to make gifts. Joining me for this episode is Vanessa Maczko, Senior counsel at Proskauer’s New York office. Welcome, Vanessa.

Vanessa Maczko: Hi, Dan, thank you for having me here today.

Dan Hatten: Thanks for coming. As we discuss ways for clients to gift pain-free. As a little bit of background, can you explain what it actually means to make a gift for federal transfer tax purposes?

Vanessa Maczko: Sure, no problem, Dan. In order to make a gift for federal gift tax purposes, client must give up, "dominion and control" of the asset. What this really means is that a client cannot retain certain rights in the asset that the IRS will deem to be control. Generally, this includes the right to enjoy the income from the asset or the ability to decide who enjoys the property. Sometimes, really, it is that stark reality that makes gift giving difficult for clients. They may fear running out of assets by giving too much away, but they'll still want to utilize their $11,580,000 dollar federal lifetime gift tax exemption, while it's still available.

Dan Hatten: Got it. When you've seen clients in this situation, what kind of options do you recommend where the client can make a taxable gift for transfer tax purposes, but not necessarily lose access to an asset that, you know, is in their bank account or that they're using on a daily basis.

Vanessa Maczko: There's one option that works for clients who have previously loaned money or property to trust or to their children. Over the last few years, interest rates have been historically low. Clients in that situation have made loans to benefit the younger generation, with the hope that the assets would be invested and appreciation above the interest rate would wholly benefit the younger generation. The client would still have an entitlement to be repaid those assets, but that may be a long time in the future. So in this type of situation, the clients could consider forgiving the outstanding loans. The amount that's forgiven would be the taxable gift, and that would use up some or more or all of his or her remaining exemption. But at the end of the day, the client does not feel like they have to give anything up, because they're not parting with any assets.

Dan Hatten: Are there any risks to this type of a loan forgiveness?

Vanessa Maczko: There aren't really any tax risks. Individuals are free to forgive loans at any time, so long as they are aware of the tax consequences. So the two big points that clients need to understand when deciding whether to forgive a loan, is that one, they will never have that loan repaid, which is the point of forgiveness. So they're not going to get that money back. And two, the loan forgiveness may not have the biggest upside when compared to making a new gift of assets that are expected to appreciate.

Dan Hatten: Sounds pretty straightforward. When clients don't have outstanding loans, what kind of other assets should they consider gifting while keeping their standard of living the same?

Vanessa Maczko: So this option has been really common, especially this year, when clients are moving to give away most of their exemption. The option is to give away residences. It could be their primary residence. It could be a vacation home. And generally, they give it away to a trust, either a trust for the benefit of their descendants or a trust for the benefit of their spouse and their descendants. And using a primary residence is helpful in these situations, because there may be ways for clients to continue to use the property like nothing changed, while still transferring the property and its future appreciation out of their estate.

Dan Hatten: If a client doesn't want to use a spousal lifetime access trust or they're not married, does using a residence for a gift still work?

Vanessa Maczko: Yeah, even if the client is single or doesn't want to use a spousal lifetime access trust or SLAT, gifting a residence can still be effective. However, the gift may not be quite as pain-free for those clients. And this is because when you're giving away a residence, and you're not a beneficiary of the trust that receives the residence, then you have to pay rent in order to continue to use the property. Paying rent is an estate planner's dream because you're paying the trust money, and there's no income tax consequences if the trust that you're paying is a grantor trust. And there's no gift tax consequence because you're paying rent, not just making a gratuitous transfer. So we love when clients want to do this, but a lot of clients don't actually want to pay rent for the rest of their lives, as long as the property's in the trust. The clients need to really understand that when you're giving away the entire property and with no interest in any way shape or form that you have to be comfortable with paying rent for the foreseeable future. In addition, for other clients, there are various issues that they should at least be aware of. These are not prohibitive consequences. Real estate or condos are generally pretty simple to transfer. There's going to be a deed. But recently, co-ops, in New York City at least, are allowing trusts to own the proprietary lease and stock certificate. Anytime you're dealing with a co-op, you are dealing with the co-op board and that will always take extra time with the paperwork and various lawyers involved.. Also, something to remember is that if a residence has a low cost basis, the client may forego the opportunity to step up the basis at the client's death. That's because assets owned by the trust are not included in the client's estate and thus are not eligible for the step up in basis. Now, we do have some ways to fix this, but basis planning can be an entire podcast itself, so I won't go into that here.

Dan Hatten: Thank you Vanessa for joining me today and explaining some options for pain free gifting. Sounds like clients can consider forgiving any outstanding loans they may have made previously to other trusts or to their descendants directly. Alternatively, clients can consider planning with their primary residence or vacation home where the asset can be transferred, but the client can retain the use of the property either as a beneficiary of a trust created by their spouse or by renting the property back. Either of these alternatives allow the client to use a portion of his or her remaining lifetime gift tax exemption without the client feeling like he or she actually gave up much of the assets that they're using to live. So thanks again for joining today.

Vanessa Maczko: Thank you for having me.

Dan Hatten: With that, we'll wrap up this episode of Worth It. We hope you enjoyed this podcast and please join us for future episodes. If you would like to receive notifications when new episodes are available, please visit our website at Proskauer.com and click the subscribe to our publications link at the bottom of any page. Thank you for listening.