

Gift Planning Dos and Don'ts

Rules can make financial planning easier. "Buy low, sell high," is one. "Go first class or your children will," is another. When it comes to selecting assets to give to your children or grandchildren as part of a gifting program, following a number of mini-rules may help.

Choosing Assets To Give Away

To some extent, the choice of what assets to transfer depends on whether the gift will be taxable or nontaxable as part of the annual exclusion or lifetime exemption equivalent. The following Dos and Don'ts offer some guidance in choosing assets to give away.

Asset Choice Dos

In some estate plans, gifting has become an art as plans are arranged to shift the most growth and control tax consequences.

Do give property that should appreciate. Assets likely to have significant growth often make the best gifts. The nature of the property and current market conditions are important. These assets may include interests in a closely held business (especially one that might go public or be subject to an attractive buy-out), life insurance policies, real estate, publicly traded securities, high-quality artwork and collectibles.

Do give discountable property. Property that can be discounted from full market value is ideal for a gift program. Types of discounts include minority interest, lack of marketability, blockage and restricted use or a combination of these types. Property qualifying for these discounts includes interests in family investment partnerships, interests in family closely held corporations or business partnerships, fractional undivided interests in real estate or works of art, out-of-the-money options, and restricted stock in a publicly traded company.

Do give high income producing assets. Gifts of high-yield stocks and bonds, S corporation stock and some partnership interests can shift income to lower-bracket taxpayers.

Do consider tax basis. Gifts of low tax basis property will shift the capital gain to the donee. Is this desired? Will the property be sold in the near future? If the donor kept the property, there would be a step-up in basis at death. How important is this?

Do give to help your estate qualify for special tax treatment. This is a chance to structure your estate so that it can qualify for deferred payment of estate taxes, special use valuation or special treatment on redemption of closely held stock. By gifting nonfarm and nonbusiness interests, you can increase the ratio of farm and business type assets held by your estate so it qualifies for the special tax breaks.

Do keep track of nontaxable gifts. There is no limit on gifts made directly for medical and educational expenses. (If the gift is for a grandchild, be careful not to discharge your child's legal obligation of support.) Annual gifts of up to \$10,000 per donee (\$20,000 if husband and wife split the gift) are excluded from gift tax. For gift tax purposes, there is an unlimited charitable gift deduction and an unlimited marital deduction.

Asset Gifting Don'ts

From a pure tax planning viewpoint, let's consider some types of gifts you want to avoid or consider carefully.

Don't give away your estate's liquidity. Generally, your estate will need assets such as cash and marketable securities to pay obligations, expenses and taxes.

Don't lose favorable tax benefits for your estate. Your estate can receive special tax treatment for:

- Nondividend treatment on redemption of closely held stock,
- Deferred payment of estate taxes on closely held business interests, and
- Special-use valuation on farm and business real estate.

However, these business and farm interests need to comprise a certain percentage of your estate, so you can't make gifts of these interests that will bring your estate below the required level of ownership.

Don't keep strings. If you retain rights or powers over gifted property, it may be brought back into your estate. Avoid keeping the power to alter, amend, revoke or terminate. Avoid having the gift revert back to you if something happens. Avoid keeping a lifetime right to use or right to income.

Don't convert capital gain into ordinary income. Some assets would generate capital gain to you if you sold them but become ordinary income items to the donee, such as property that would be inventory in the donee's hands.

Don't gift income tax favored property. Generally it is better to retain assets that have tax advantages, such as tax-free bonds, depreciable real estate, and oil and gas interests.

Don't lose sight of your tax objectives. A gift of a future interest may be valued at \$10,000, but it doesn't qualify for the gift tax annual exclusion. Rights of withdrawal gifts (Crummey gifts) may not qualify for the generation-skipping transfer tax annual exclusion.

Nontax Considerations

Never give away more than you should. You'll want to make sure you retain sufficient assets to maintain your desired lifestyle. Consider your income, expenses, probable future needs and that "something extra" in reserve.

Give assets now that could create problems for your executor later. Certain assets can be difficult to administer after you're gone. Now might be the time to make a gift of that vacant parcel of land you own in another state, or maybe divide up your coin or stamp collection or items of jewelry that you no longer use. Interests in closely held businesses also may fall into this category.

Remember who is receiving the gift. Do not make gifts that the recipient cannot handle. Consider the age and experience of the donee in selecting the gift and determine whether a trust arrangement might be advisable. On the other hand, a gift of a stock portfolio can give a child experience in the stock market

and a gift of an interest in the family business may serve as a good training ground for the greater amount to be inherited.