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GIFTS IN ESTATE PLANNING

Cecil D. Maynard
Extension Economist

The purpose of this current report is to briefly outline some of the gift tax strategies and ideas for different economic levels. Although gift giving is not as advantageous as it was prior to the 76 Tax Reform Act it still can play a vital role in estate planning for many people.

Some of the conditions, rules and regulations concerning gift taxes will be listed. The first $3,000 of gifts made to any one person during any calendar year is excluded in determining the total amount of gifts for the calendar year. For a gift in trust each beneficiary of the trust is treated as a separate person for purposes of the $3,000 exclusion. The $3,000 exclusion is not available for gifts of future interest such as a remainder interest in a trust. A unified credit against estate and gift taxes is allowed for gifts made after January 1, 1977. Unified gift credits are listed in Table 1.

All gifts in excess of the $3,000 annual exclusion will be included in the donors estate for estate tax purposes. The points mentioned above assumes the donor lives three years after the date of the gift.

If the donor does not live three years after the date of gift and the gift is more than $3,000 two things will happen: (1) the full value of the gift at date of death will be included in the donor's estate and (2) any gift taxes paid on the gift will also be included.

Marital Deductions

The first $100,000 marital gift is tax free. Fifty percent of the transfers in excess of $200,000 are taxable. The estate tax marital deduction must be reduced by the amount of the gift tax marital deduction allowed for lifetime transfers in excess of 50% of the value of the transfer. This would apply to marital deduction gifts that are less than $200,000. The general rule is that if a gift is under $100,000 the available marital deduction is reduced by 50% of the gift. If the marital deduction is between $100,000 and $200,000 the estate marital deduction is reduced by 1/2 the amount of the gifts subtracted from $100,000.

TABLE 1

For gifts made:	The credit is:
After December 31, 1976, and before July 1, 1977	$6,000
After June 30, 1977, and before January 1, 1978	$30,000
After December 31, 1977, and before January 1, 1979	$34,000
After December 31, 1978, and before January 1, 1980	$38,000
After December 31, 1969, and before January 1, 1981	$42,500
In 1981 and thereafter	$47,000

Gift Splitting by Husband and Wife to a Third Party

Spouses may elect to split the gift made to a third party and thereby get a benefit of using a lower gift tax rate bracket. By splitting the gift the annual exclusion and the unified credit could be doubled.

To split the gift the spouses must be legally married to each other at the time of the gift. They both must signify on their separate gift tax returns their consent to have all gifts made in that calendar quarter split between them. In Oklahoma the gift taxes do not apply to gifts between spouses since September 6, 1975. There is a procedure similar to the Federal Law on splitting gifts in Oklahoma.

Computation of Gifts

Gifts made before 1977 are taken in account to determine the rate at which the gifts, including those made after 1976, are taxed.

The gift tax is determined as follows:

1. Compute a tentative tax on the total taxable gifts made by the donor, including
   a. The taxable gifts made before 1977,
   b. The taxable gifts made after 1976, and
   c. The taxable gifts made in the present quarter;
2. Compute a tentative tax on the sum of all taxable gifts made by the donor, excluding the taxable gifts made in the present quarter;
3. Subtract the tax computed in (2) from the tax computed in (1). This result is the gift tax before the available unified credit. The resulting gift tax is reduced by the amount of the unified credit available in the present quarter.

An example of how gift taxes are computed is as follows:

Example: Bill Smith had made the following gifts:

In 1975, $53,000 to his son
In 1978, $153,000 to his daughter
In 1980, $43,000 to his son

The computation of the gift tax for 1980 is as follows:

Total taxable gifts for 1980	$43,000
Less: Annual exclusion	3,000
Taxable gifts	$40,000
Plus: Prior taxable gifts (20,000 1975) (150,000 1978)	$170,000
Total taxable gifts	$210,000
Tentative tax on total taxable gifts	$ 58,000
Less: Tentative tax on prior taxable gifts	45,200
Gross gift tax	$ 12,800
Less: Available unified credit ($42,500 - $34,000)	8,500
Net gift tax	$ 4,300

Marital Gift Strategies

Generally speaking, in estates in excess of $500,000 in which the majority of the property is in the husbands name it is advantageous for the husband to make a gift to the spouse of $100,000 regardless of which spouse dies first. Profitability of making gifts in excess of $100,000 will depend on which spouse dies first. An important reason for marital gifts is to provide a spouse with limited assets a large enough estate to utilize the allowable credit for federal estate taxes in the event the spouse with limited assets dies first, otherwise the unified credit for estate taxes is lost forever. The law provides that certain joint tenancy properties created by the husband and wife after 1976 may be treated as belonging one-half to each spouse for estate tax purposes. The test for qualified joint interests must be met. The joint tenancy must have been created by the decedent or the decedents

spouse and the creation of the joint tenancy interest must constitute a gift to qualify. A serious question has been raised as to wisdom of using the first $100,000 free marital gift to create joint tenancy after January 1977. The readers should cautiously weigh the advantages and disadvantages in such a transaction for two reasons. One, all the joint tenancy property will be subject to tax in the surviving joint tenants estate, and two, the estate marital deduction will be reduced when a marital gift is made. If large marital gifts are made to a spouse, property ownership as tenants-in-common or outright sole ownership should be considered. The primary advantage of using joint tenancy arrangements after January 1, 1977 appears to be for a couple making a down payment on a purchase. If the down payment is $6,000 or less the husband or wife could make a $3,000 tax free gift to his or her spouse. By filing a gift tax return only one-half of the value would be included in estate of the first spouse to die. Additional payments or improvements in excess of $6,000 would result in another gift tax return having to be filed. See section on gifts of life insurance as a strategy for married couples.

Some estate planners like the alternative of each spouse owning 1/2 of the total estate. Our experience in Oklahoma is that it is fine if the couple has acquired assets in each one name over time during the marriage. If however, all of it is in the husbands name it can be an expensive alternative for the husband to make a gift of 1/2 of a large estate to the wife. The profitability of making gifts in excess of 100,000 in Oklahoma depends on which spouse dies first.

A gift to a spouse is not subject to Oklahoma gift taxes.

Strategy for Surviving Spouse

In large estates it may be advisable to make large taxable gifts under the following conditions: real property that is likely to appreciate in value. For example, when property is given as a gift after 1977 it will be thrown back into the estate for estate tax purposes, however it will be added back into the estate at the value at which it was approved for gift tax purposes, not at market value upon death of donor. For example, a gift of $100,000 farm today might be worth $200,000 in ten years, however, at the decedents death the value of $100,000 would be added back in the estate rather than $200,000. Again, it is assumed the donor lives in excess of three years after the date of the gift. It is wise to make gifts of royalty prior to the time that oil production has started. If a transfer of oil producing royalty is made the transferee loses the depletional allowance. This can become very costly for income tax purposes. If oil is discovered, the parents usually have large income taxes to pay and regret not having made gifts of royalty to their children.

One should not overlook the value of making $3,000 annual gifts, for example, a parent can give his son $3,000 and his daughter-in-law $3,000 per year for a total of $6,000. If there are grandchildren gifts can be made to them. Thus, usually it is possible for a surviving spouse to give considerable wealth over a period of years by making maximum use of the $3,000 annual exclusion.

Gifts of Land

When gifts of farm land are made, and it is desired to make use of the $3,000 annual exclusion several alternatives are available. For example, one could give an undivided 1/10 or other fractional interest in a given piece of property. This would increase abstract costs. Another example might be to break the land into smaller parcels such as 40 acres and use the $3,000 annual exclusion plus a portion of the unified credit each year.

Gifts of Life Insurance

It is common to make gifts of life insurance. Normally the donor is one

who has significant assets in his estate and desires to reduce it by making a gift of his insurance policy. No gift tax is due on term life insurance. On other policies the value for gift tax purposes is the interpolated reserve at the time of the gift plus a part of the last premium paid. The life insurance company will provide the form and the value of the gift. A policy transferred within three years of death will be included in the estate even if the value of the policy is less than $3,000. The big advantage of gifts of life insurance is that the value for gift tax purposes is small compared to face value of the policy if included in the donors estate.

When gifts of life insurance policies are given as gifts the donor should not retain incidents of ownership, which are any rights under the policy. Retaining rights of ownership will cause the value of the policy to be included in the estate of the donor.

Gifts of Raised Farm Produce

Gifts of raised grain or livestock are not included in the income tax return of the donor (person making gift). Inventories have to be adjusted for those on the accrual basis making such a gift. The cost of producing the items must be deducted from the donor's production costs on his tax return. When the donee (receiver of the gift) sells the farm produce, he must report the income on his return. The basis of the gift in the hands of the donee is the same as the donor's. By using the $3,000 annual exclusion a saving in both gift and income tax is possible by giving gifts of raised farm produce.

Crop shares received as rent must be included in the gross income of the donor, even though they are given as a gift. Warehouse receipts of such crop shares would be treated the same.

Grain received as rent is treated differently than raised grain when given as a gift.

Gifts to Minors

Gifts of stock, securities or money are eligible for transfer to minors under the "Gifts to Minors Act". Gifts of land, livestock and machinery are not eligible under this act. For large gifts, a trust should be considered for minors.

Disadvantage of Gifts

The income tax basis of the donor carries over to the donee when a gift is made. Gift property does not receive a new basis for the donee. Thus if the property is to be sold by the donee it is usually better to inherit the property rather than receive it as a gift if minimizing income taxes is the objective.

Gifts in Trust

There are a number of ways gifts can be given by trust. Both irrevocable and revocable trusts may be considered. The marital deduction trust and trusts for minors and incompetents play an important role. Irrevocable trusts and Clifford trusts are subject to gift taxes.

Date of Return

A gift tax return must be filed within 6 weeks of the quarter in which accumulated gifts reach $25,000. If the gift is less than $25,000 it is due April 15 of the following year.

Summary

Always consider the objectives and motives of the individual or family in making life time gifts. Generally, making gifts should be a part of estate planning. Sound planning will reduce income taxes, gift taxes and estate taxes.

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