Retirement Weekly

5 reasons you should gift to your children now

Published: June 4, 2021 at 2:05 p.m. ET

By Danielle Justo

COLUMBIA TRISTAR/COURTESY EVERETT COLLECTION

Listen to Article
6 minutes

In 2020, some family business owners held off on preparing gifting programs that would transfer assets from them to their children to see which way the presidential election and then the Senate race turned out. Now that we are well into 2021, Congress is focused on grappling with the new tax plan.

Whether it is real estate limited liability company interest, shares in the family business, or stock on the NYSE, these families who delayed their programs, should consider gifting to their children in 2021.

Here's why.

1. **The COVID-19 effect.** Valuations in some businesses, retail and restaurant chains, certain office buildings, etc. may be at an all-time low due to COVID causing shutdowns and restricted openings. Consult your appraiser or valuation expert sooner than later; if you have a history with your CPA firm, this may be a good place to start. For instance, say you own your business 50/50 with your son or daughter. It was worth $1 million, but today is worth $500,000, you should gift now. Even if you gift half of your share, when your enterprise reopens fully, and your value is restored, you've already transferred out at the low value, thereby getting 50% more value of your ownership share out of your estate — giving away what would have been the 50% for the value of 25%. Why is this important? Because when you pass away, there will be fewer assets subject to estate tax liability and therefore fewer dollars spent on paying estate taxes.

2. **The end of the stepped-up basis?** Biden's tax plan calls for realization of capital gains at death. Generally, the longer you hold an asset, the better off you are from a cap-gains standpoint. After a year, you are taxed at the long term versus the higher short-term rate. If you own a building, for example, and you pass away, the building value flows through your estate and your children inherit it at the current value, namely, they enjoy a step up in basis. So, if you purchased the building for $100,000 in 1980, and it is now worth $1 million, when you sold it or gifted it you would be taxed on the difference (subject to other improvements, etc.) but if it passed through your estate, your children inherited it at the $1 million basis, thereby selling it the next day for $1 million and enjoying the benefit of no capital-gains tax. If this change in the law passes, your children forego this benefit. What this means is that there will be no capital gains reason to hold on to it instead of gifting it.

3. **Increases in capital-gains tax and the elimination of the 1031 tax deferred exchange?** Another point in Biden's proposed plan is to increase the capital-gains rates to income-tax rates on those making over $1 million. The top level will be restored to 39.6%. This increase, coupled with the end of the stepped-basis, are a double whammy for assets that increased in value substantially. In particular, it will nearly double the long-term rate at the highest bracket.

And that's not all. It's been proposed a few times since its inception into the tax code in 1954: the elimination of the 1031 exchange. This time it is proposed (along with many of the tax increases) only for those with incomes over $400,000. Why is this important? Section 1031 of the code allows for tax deferral of capital gains for exchanges of like-kind real property. It formerly covered various types of property, but was limited with the Tax Cuts and Jobs Act of 2017 to real estate. With the increases in capital-gains rates and realization of capital gains on death discussed above, the elimination of this commercial real estate economic incentive will cause an even more significant tax effect on transactions if passed.

1. **Federal estate tax to rise and exemptions to lower?** The proposed plan addresses an increase in the rate of estate tax from 40% to 45%. Each spouse in the family can gift $11.7 million each, exempt of federal estate tax. Biden's plan reduces this exempt amount to a prior $3.5 million level for each spouse. Even if only one of these tax proposals gets approved, since the exemption is scheduled to expire at the end of 2025 regardless, why wait?

2. **Goodbye portability?** Though the proposed plan does not remove it, a compromise position to the exemption increases may be to eliminate portability. Portability allows a surviving spouse to use some of a husband (or a wife)'s unused federal exemption. So, for instance, if you gave away $1.7 million, but didn't get around to giving away the other $10 million you could and should have before you passed, your spouse could elect portability on your estate tax return and pass on your unused portion of $10 million to be used in the surviving spouse's estate, for a total of $21.7 million, free of federal estate tax. The removal of this election would put more federal estate tax dollars back into the coffers of the federal government to pay for many of the 2020 and beyond economic programs.

Many people ask why they should move forward in the first half of 2021 with their planning. The real question is: will any of these changes be retroactive? It's hard to tell, but a year ago, the IRS cited that