# 2022 Estate and Gift Tax Planning

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**This article discusses tax planning from a federal estate and gift tax perspective. Below we discuss making gifts to children and grandchildren during 2022 while incurring little or no gift tax.[1] Many of these techniques could also reduce your overall income tax burden. Although the Tax Cuts and Jobs Act of 2017 (the "Act") made significant changes to our tax code, the transfer tax system remained relatively unchanged. The most notable change in the Act was the doubling of the estate and gift tax exclusion amount and the generation-skipping transfer ("GST") tax exemption amount. The Act also made numerous changes that may impact certain family businesses and private foundations. If you have concerns regarding how these changes could affect certain estate and gift planning transactions in which you intend to engage or have previously engaged, please contact your tax advisor and estate planning attorney to further discuss your estate and gift planning inquiries.**

[1] The ability of a taxpayer to make tax-free transfers is subject to a variety of limitations depending on the donor's specific tax situation. Consult your tax advisor for more information.

# Use of Applicable Exclusion Amount to Reduce Estate and Gift Tax

For 2022, the estate and gift tax exclusion amount — the amount a taxpayer may transfer without incurring estate or gift taxes — is inflation-adjusted to $12,060,000.[2] The increased estate and gift tax exclusion amount is only available for decedents dying and gifts made after 2017 and before 2026; thereafter, the estate and gift tax exclusion amount returns to $5,000,000 (adjusted for inflation). The value of a person's estate and/or lifetime gifts exceeding the exclusion amount is subject to a 40% estate and gift tax rate. Further, through a so-called "portability" provision, if a spouse dies after 2010 without exhausting his or her estate and gift tax exclusion amount, the surviving spouse may be able to use the deceased spouse's remaining exclusion amount against his or her transfers during lifetime or at death.

Aside from being free from gift taxes, lifetime gifts of up to $12,060,000 could save estate taxes because they remove post-gift appreciation on, and possibly income from, the gifted assets from the donor's estate. However, if an asset is given during lifetime, the donee takes the donor's tax basis (cost). If an asset is acquired from a decedent, the basis is generally the value at the date of death. Therefore, there is a trade-off between removing potential future appreciation from an estate and forgoing the income tax step-up at death.

The IRS has clarified that if you use your lifetime exclusion before 2026, and then die when the exclusion has reverted to pre-2018 levels, the benefit of the increased exclusion is not recaptured. This is an incentive to use the increased exclusion for lifetime gifting by 2026, although that should never be the only consideration in an estate plan.

Note also that, for transfers that are deemed to "skip" a generation, such as gifts to your grandchildren, the GST tax exemption for 2022 is also inflation-adjusted to $12,060,000. Like the estate and gift tax exclusion amount, the increased GST tax exemption amount is only available for transfers made after 2017 and before 2026. However, the unused GST tax exemption amount may not be used by a surviving spouse (in other words, the portability provision does not apply for GST tax purposes). Like the estate and gift tax rates, the rate used for calculating the GST tax is 40%. The GST tax applies in addition to the gift or estate tax.

As explained below, certain types of lifetime gifts do not reduce a taxpayer's applicable exclusion amount and are not subject to gift tax.

[2] Some states also have gift and/or estate taxes. This discussion is limited to the federal gift and estate taxes.

# Annual Gift Tax Exclusion

The most used method for tax-free giving is the annual gift tax exclusion, which, for 2022, allows a person to give up to $16,000 directly to each donee without reducing the giver's estate and lifetime gift tax exclusion amount. A person is not limited as to the number of donees to whom he or she may make such gifts. Further, because the annual exclusion is applied on a per-donee basis, a person can leverage the exclusion by making gifts to multiple donors (family and non-family). Thus, if an individual makes $16,000 gifts to 10 donees, he or she may exclude $160,000 from tax. In addition, because spouses may elect to apply their exemptions to a single gift from either spouse ("gift-splitting"), married givers may effectively double the amount of the exclusion to $32,000 per donee. A person may not carry over his or her annual gift tax exclusion amount to the next calendar year.

The annual gift tax exclusion applies to gifts of any kind of property, as long as the gift is of a present, rather than a future, interest. Gifts of appreciated property also could result in income tax savings to the giver, because the recipient would pay the capital gains tax on any sale. Therefore, before giving away appreciated property that is likely to be sold, it is important to consider the income tax cost to the recipient.

# Filing Gift Tax Returns

If you make gifts in excess of the annual exclusion amount to any individual, you will need to file a gift tax return. If either spouse makes a gift, the other spouse may elect to treat the gift as made half by him or her, thus doubling the amount of the gift sheltered by the annual exclusion. That election requires filing a return. If you make gifts of hard-to-value assets such as closely held stock, family partnership units, or real estate, you may want to obtain an appraisal of the asset being gifted and include the appraisal with the gift tax return. If the full details of the valuation and the gift are disclosed in your gift tax return, the statute of limitations for the IRS to challenge an appraisal and claim that a gift tax is owed will begin to run. Generally, the statute is three years from the due date of the return, or actual filing date if later. If a gift tax return is not filed, a gift tax can be assessed at any time, which could be a problem for you or your family decades hence. (If you do fall into this category, please seek the advice of your tax adivsor.) These provisions apply even if the value of the gift was believed to be below the annual exclusion amount at the time. If any gift transfers are made in trust (i.e., a life insurance trust), and grandchildren are current or potential future beneficiaries of the trust, it may be necessary to file a gift tax return to allocate your GST tax exemption. This may be required even if the transfers are less than the gift tax annual exclusion and therefore otherwise would not require filing a return.

# Tuition Payment Exclusion

In addition to the annual gift tax exclusion, a person may make tuition payments for any individual without incurring gift tax. Though the amount that may be excluded is not limited, all payments must be made directly to a qualifying educational institution for education or training purposes. The exclusion applies only to tuition (prepaying multiple years' tuition in advance is permissible). Thus, payments for room and board, books, required equipment, or related expenses are not excludible. Because there is no limit on the amount of tuition payments, its timing is less important than with the annual exclusion. Nevertheless, if a person has the choice of making either a tuition payment or an annual exclusion gift for a particular beneficiary, it usually is preferable to make the tuition payment, because he or she still could make an annual exclusion gift later in the year.

No gift tax reporting is required for tuition payments.

# Section 529 College Savings Plans

Contributions to a college savings plan established according to section 529 of the Internal Revenue Code (a "529 plan") do not qualify for the exclusion for tuition payments but are covered by the annual gift tax exclusion. A contribution to the plan also may entitle the contributor to a state income tax deduction. Thus, a contributor can reduce his or her own income taxes by funding 529 plans for children, grandchildren, etc., with funds that would have been used for college anyway.

Qualified distributions from a 529 plan may be used for a wide range of educational expenses, including tuition, fees, books, supplies, required equipment, and room and board, but not transportation costs. Qualified 529 plan expenses also include up to $10,000 per year per beneficiary for K-12 expenses. An added advantage of a gift to a 529 plan is that, generally, the income earned by plan contributions is tax-free, so long as it is used for educational purposes. Also, because the contributor may be the plan's custodian, he or she can ensure that the beneficiary uses the account for educational purposes. If the initial beneficiary does not need the full amount in his or her 529 plan, the custodian may move the funds to another individual's plan.

A special rule allows a contributor to utilize up to five annual gift tax exclusions simultaneously when funding a 529 plan. Thus, for 2022, he or she may fund the plan with up to $80,000 (5 × $16,000), then elect on his or her gift tax return to spread this gift over five years (2022 through 2026) for gift tax purposes. By using five annual exclusions, the entire gift becomes gift-tax-free. However, the contributor must wait until 2027 to make another tax-free contribution to this plan, or any annual exclusion gifts to that child or grandchild.

For 2022, by combining the 5-year election with gift-splitting with your spouse, you could fund as much as $160,000 into a 529 plan for a child or grandchild.

If the gifts to the 529 plan do not exceed the annual exclusion (including the 5-year election), funding a 529 plan for a grandchild will not use up your GST tax exemption.

# Medical Payment Exclusion

Subject to limitations, a person may exclude from gift taxes all payments he or she makes directly to medical providers on behalf of another individual. The exclusion for medical payments also includes the payment of medical insurance premiums. Thus, paying a child's or grandchild's insurance premiums is an efficient means of making a tax-free gift that does not consume either the annual gift tax or the estate and lifetime gift tax exclusions. No gift tax reporting is required for this type of gift. Further, the payor may claim an income tax deduction for a medical payment made for his or her spouse or dependent.

Like the 529 plans, contributions to a qualified ABLE account may be made for the benefit of certain disabled beneficiaries.[3] Generally, the contribution limit for a qualified ABLE account is the annual gift tax exemption amount ($16,000); however, Congress enacted a temporary increase to the overall limitation for tax years after 2017 and before 2026.[4] Otherwise, the ABLE program is like a 529 qualified tuition program, except that the range of expenses that may be paid from an ABLE account are much broader than a 529 plan.

# Gifts in Trust

A person may not wish to make outright gifts to children or grandchildren, due to the loss of control over how they use the gift. Gifts in trust allow the trust creator to determine when the beneficiaries receive the money and how it is used. Depending on the terms of the trust, it may be possible for a trust creator to be the trustee, although usually an alternative trustee is recommended to avoid estate inclusion issues. "Alternative trustee" can include your spouse or other relatives, as well as unrelated individuals, professional advisors (financial advisors, attorneys and accountants) and corporate trustees.

By observing special requirements, a trust creator can ensure that a gift in trust qualifies for the annual gift tax exclusion. Generally, the trust is drafted to provide the beneficiary with temporary withdrawal rights over the gift (usually for 30 days), such that the gift is considered a present interest rather than one vesting in the future. Although this arrangement presents a risk that the beneficiary could withdraw the gift from the trust for purposes not to the creator's liking, the likelihood of the trust creator terminating any further gifts to the trust is usually sufficient to prevent such withdrawals. If you are interested in making a gift in trust, you should explore this option more thoroughly with your estate planning attorney. If such a trust includes grandchildren as current or future beneficiaries, you may need to file a gift tax return to allocate the GST tax exemption to the trust even if no gift tax exemption is used.

[3] ABLE accounts are tax-advantaged savings accounts for individuals with disabilities and their families, also known as 529A accounts.

[4] A designated beneficiary who works may also contribute his or her compensation up to the poverty line amount for a one-person household, unless the employer makes a contribution to the designated beneficiary's retirement plan.

# Advanced Planning

In addition to the straightforward gifting techniques discussed above, there are additional strategies that should be considered. These include interfamily loans (no-interest or interest bearing), sales of closely held assets for a note, sales to trusts, and planning with closely held businesses or family partnerships. Given the recently increased exemption amounts, this is a good time to consult your tax advisor and estate planning attorney to learn more about these strategies.

The IRS has also issued guidance regarding transfers of life insurance policies. Under certain circumstances, the tax-free nature of the policy proceeds can be lost if a policy is transferred. If you are considering transferring any life insurance policy, you should consult your attorney or tax advisor.

# Charitable Gifts

Now is an excellent time to review charitable giving to ensure it is accomplished in the most tax-efficient manner. Charitable giving is a form of estate planning, because a gift to charity never will be subject to estate or gift tax and provides the giver with an immediate income tax deduction. By giving appreciated property to charity, the gain inherent in the property is never taxed. If you are considering a large gift, you should have your tax advisors prepare a tax projection to determine the gift's impact on this tax year's income tax liability and whether all or a portion of the gift should be deferred to a later tax year (although gifts in excess of one year's limitation can be carried forward for five years). Additionally, you may want to take advantage of the increased charitable contribution deduction limitation for cash contributions made after 2017 and before 2026.[5] For these years, cash contributions can be deducted up to 60% of your adjusted gross income, versus 50% outside that window. Note that certain legislative acts allowed a temporary increase of the percentage limitation up to 100% of your adjusted gross income for cash contributions in 2020 and 2021. Additionally, taxpayers are entitled to a $300 deduction for charitable contributions in 2020 and a $300 deduction for non-joint filers or $600 for joint filers in 2021.

If the gift is property and requires an appraisal (usually for gifts of property with a value in excess of $5,000, other than publicly traded securities), the process should be started as soon as possible to ensure a successful transfer. If you are considering making year-end charitable gifts of mutual funds, then consult with both the charitable organization and your financial advisor as mutual fund companies typically need a few weeks lead time to complete the gift and the donation will need to be coordinated with the charity.

If your gifting plans include individual donees who might benefit from a stable source of income, it is possible to combine an immediate charitable deduction for you with a lifetime source of income for them. Depending on the amounts involved, a charitable gift annuity or a charitable remainder trust may be appropriate.

[5] In order to deduct more than $300 for charitable contributions, a taxpayer must itemize their deductions on their tax return.

# Asset Titles and Beneficiary Designations

For an estate plan to work properly, it is not just necessary to have good documents; your assets must be titled appropriately or the plan will not be effective. For example, if you have an account that is titled "Pay on Death," then the person named will receive that account, even if your will or living trust leaves all your assets to another person. The same rule applies to beneficiary designations (i.e., life insurance, pensions, IRAs). The named beneficiary will receive that property, notwithstanding any provisions in your will or living trust. Beneficiary designations are as important as your will or trust, and a copy should be kept with your other estate planning documents. Please contact your tax advisor or estate planning attorney if you need assistance in completing this important step in your planning.

# Digital Assets and Passwords

Any estate plan or disability plan should consider digital assets. As part of your estate planning, you should consider who should have access to your social media accounts and electronic financial records, and how that access can be granted. If this is a concern for you, please discuss developing and documenting a plan with your estate planning attorney.

In conclusion, this article summarizes the many different aspects of estate and gift planning for 2022. If you wish to learn more about the planning techniques that we have described, please contact your tax advisor, estate planning attorney or financial advisor.

**Important Disclosures**

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