The Politics of Gifting

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If you are fortunate enough to have the financial capacity to gift, your generosity may not always be received in the manner in which it was intended. In the paragraphs that follow, I will discuss some of the intricacies of gifting and the challenges that may arise.

The decision to gift may be prompted by a desire to help another individual; it may be about asset protection or part of an overall estate planning strategy. If you are inclined to gift, it's often more satisfying to do it while you are still alive rather than through your estate so that you can witness the benefit, but the struggle of whether or not one has enough money to see themselves through retirement prevents many from considering a lifetime gifting strategy. I find it interesting, that regardless of net worth, almost everyone worries about whether their money will hold out. We are just wired that way.

Regardless of the motivation here are a few things to consider:

Suggestion #1 – *Take care of yourself first*

I refer to this as the "Oxygen Mask Rule". When we fly, we are advised that in the event of a sudden loss of cabin pressure an oxygen mask will drop from the ceiling. We are instructed to put our own mask on first before we assist others otherwise we too could become a potential victim. This logic applies to finance. Take care of yourself first before you help others lest you to become financially dependent upon someone else later in life. It's not selfish, it's sound financial planning.

Suggestion #2 - *How much?*

Current tax law allows for an annual gift per person, per recipient of $14,000 per year. A couple may gift up to $28,000 (2 x $14,000) to an individual. There is no tax to the recipient, no write off for the donor and no need to file a gift tax return. Any amount in excess of this amount requires the filing of the gift tax report which does not result in any immediate tax impact but will lower the lifetime Federal estate tax exemption, currently $5.4 million per person by the amount in excess of $14,000. Keep in mind that these scenarios may or may not apply to your personal tax situation. Wells Fargo Advisors is not a tax or legal advisor, so we strongly recommend evaluating the information throughout this letter with your chosen tax or legal professional.

Suggestion #3 - *Multigenerational gifting*

I'm often asked how best to treat children and grandchildren. Do we consider the first generation equal recipients and leave it up to their discretion to gift to the grandchildren from their own pool of money or do we look at each individual, regardless of generation as an entity without regard to the number of children that each of the next generation has? This question is a bit more difficult answer. Gifting to a grandchild for education purposes for instance could alternatively be considered a gift to the parent as it reduces their financial obligation, allowing them to save more for themselves but an outright gift to a grandchild is a gift to that individual. The answer is unique to each family situation but I tend to lean towards treating each person regardless of generation as an individual.

Suggestion #4 - *Gifting to a 529 plan*

A 529 or college funding plan allows money to potentially grow tax-free if used for college or postgraduate work (not prep school). There is however a unique feature to a 529 plan; the donor (owner) retains the right to reclaim the funds if his or her situation changes. While the owner would be obligated to pay taxes on any gains as well as a 10% penalty, they still control the funds until they are distributed. This is the only type of account which allows an individual to move assets outside of his or her estate and still retain control. 529 plans are not only a great way to help with college expenses but are also a unique estate planning tool for those inclined to fund future generational education expenses in an account where beneficiaries can be modified.

Suggestion #5 - *Setting up a Donor Advised Fund*

Donor Advised Funds (DAFs) have become extremely popular in the last 10 to 15 years. You might think about them as a "charitable savings account." A DAF is a philanthropic vehicle established as a public charity. When you donate cash or other assets to your DAF, you make an irrevocable gift, and you get an immediate charitable tax deduction. Donors can contribute to the fund as frequently as they like and then recommend grants to their favorite charities when they are ready. There are limits, of course, on the amount you can deduct depending on the amount of the gift. Generally, however, you can deduct up to 50% of your adjusted gross income each year when you donate cash, and up to 30% of your AGI for assets that have gone up in value since you acquired them. It may be a wonderful way for you or your donor advisors (children or even grandchildren) to contribute to your favorite charities while taking advantage of the tax benefits associated with them.

Suggestion #6 - *Gifting to young children*

It is with the best intentions that parents and grandparents set aside money for their children's future. There may be modest tax benefits if held in a Uniform Gift or Unified Trust account but there are also drawbacks. It's what I refer to as "financial immaturity". I'm trying to suggest, in the most delicate way, that it's not always best to drop a pile of money in the hands of an 18 to 21 year old, the age of majority, when all assets gifted over a lifetime become the property of the young adult. Of course there are those children that can handle it and for those who can, the guardian of the funds has the right to release assets early or spend the funds on the child's behalf. It's important to remember that money gifted to a child is an irrevocable gift and can only be used for the benefit of the child. Once they reach the age of majority the money reverts to the child's control. I've seen many a new car or truck appear in the driveway when college was the ultimate parental objective!

Suggestion #7 - *What if my child is a spendthrift?*

No one wants to see their gift spent irresponsibly. Setting up a trust with restrictive covenants may be the answer. If the amount in question is significant, it's often wise to release funds as the beneficiary attains a certain age with the hope that age will bring increased levels of responsibility. (I've also found the threat of no additional gifts is a pretty effective means of getting a message across!) Setting up a joint account with the recipient so that the donor can keep an eye on it is not a good decision as the donor retains the ability to take back funds and the IRS may not consider this a real gift. Assets held in a joint account at death may be considered only partially gifted.

I've saved the most difficult one for last and thus the title "Politics of Gifting".

Suggestion #8 - *Do you gift equally to everyone or gift more to those in need?*

The answer to this question is also circumstantial. First, I believe that gifting equally, regardless of need, is always preferential. Unequal gifting can set up unintended family rifts. One child may have worked diligently, sacrificed and saved while another may have squandered his or her earnings or never have had the drive to become financially independent. In this instance rewarding the one most in need might send the wrong message. Wall Street has a term for this and it's called "moral hazard". In the case of unforeseen circumstances such as a medical emergency, job loss or death of a spouse the situation is altogether different. In these situations I encourage my clients to have an open and honest dialogue with all family members with the objective of a collective "buy-in". These discussions draw families together and make it feel as though the gift is from everyone, offering support to those in need during difficult times.

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