RS RYAN SWANSON
Lawyers since 1897

Ryan, Swanson & Cleveland, PLLC
1201 Third Avenue, Suite 3400
Seattle, WA 98101-3034

www.ryanswansonlaw.com

Dos and Don’ts of Selecting Assets to Give as Gifts

In selecting property to give as a gift, the following general rules apply; however, you should consult with your estate or tax attorney before making a significant gift as your situation may require.

Don'ts

1. Do not give property with a basis higher than its current fair market value if the donee is someone other than your spouse. Instead, you should sell the property, realize the loss (for income tax purposes), and make a gift of the proceeds. If the property is given away, the donee's basis in the property for determining loss is its fair market value at the time of the gift. If the donee is your spouse, you should make an inter vivos marital deduction gift to the spouse in order to preserve the potential tax benefits. Your spouse will receive your adjusted basis for purposes of determining loss.
2. Do not give property with a positive tax attribute, such as property that generates tax-exempt income or is expected to produce an income tax loss or that shelters other income.
3. Do not give property that is encumbered and that has a basis less than the present balance of the encumbrance. The assumption of the indebtedness by the donee will cause you to realize gain to the extent the debt exceeds the basis of the property.
4. Do not give property that you will continue to use or need, such as your residence, unless the gift is to a Qualified Personal Residence Trust.
5. Do not give your principal residence if you qualify for the $250,000 exclusion of gain under Section 121 ($500,000 for married couples). You might want to first sell the residence, realize the gain, apply the Section 121 exclusion, and then give away the net proceeds. You also might want to contribute the residence to a Qualified Personal Residence Trust with an appropriate term.
6. Do not give property that is a "wasting" asset or is expected to decline in value. Appreciating assets make good gifts because of the transfer of appreciation to the donee.
7. Do not give property that is necessary for qualification under Section 303, 2032A, or 6166.
8. Do not give Section 306 stock. Although the gift does not trigger any adverse income tax consequences to you, the stock continues to retain its Section 306 taint in the hands of the done, which may be a disadvantage to the donee. On the other hand, if the Section 306 stock is retained by you until death, the Section 306 taint will be removed as a result of the new basis the stock acquires at death.
9. Do not give a partnership interest if the transfer of the interest would cause a termination of the partnership under Section 708(b)(1)(B).
10. Do not give S corporation stock if the transfer would cause a termination of the S election.
11. Do not give life insurance you own if death is imminent. A gift of the incidents of ownership in a life insurance policy within three years of death will not remove the policy proceeds from your estate because of the three-year recapture rule of Section 2035(d)(2).
12. Do not give an encumbered life insurance policy if, as a result of the encumbrances, you will be deemed to retain an incident of ownership in the policy.

13. Do not give property that will result in an adverse income tax consequence to you. For example, the gift of an installment obligation constitutes a disposition under Section 453B, which requires you to realize gain or loss measured by the difference between the basis of the obligation and its fair market value at the time of the gift. Another example: A gift of a U.S. savings bond triggers your recognition of income as to the bond's accrued interest (*i.e.*, increase in redemption value) that has not been previously reported by you. Such gifts may be appropriate, however, if you need income to offset unused losses.
14. Do be aware that the donee of gifted property takes a “carryover” basis (*i.e.*, the same cost basis the donor had). In contrast, inherited property receives a “step-up” in basis to its value as of the date of death. Therefore, some clients prefer to make gifts of higher basis assets rather than low-basis assets, because if the low basis assets are sold, they may result in large capital gains taxes being owed. One needs to balance the potential capital gains taxes against the potential estate tax savings available through gifting.
15. Do not give high income-producing property to children under age 18. [Age limit may be different based on circumstances.] Under the "kiddie tax" rules of Section 1(g), if the child's total unearned income exceeds $1,900 per year (for 2012), the excess is taxed at the parents' marginal income tax rate.
16. Do not make gifts that require valuation under actuarial tables. The IRS takes the position that the actuarial tables in the Regulations cannot be used for gift tax purposes if you have an incurable disease in such an advanced stage that death is clearly imminent. In those circumstances, your actual life expectancy must be used in valuation.

Dos

1. Do make gifts of property that reduce the value of the assets retained by you. Gifts of closely held business interests or real estate may permit the remaining interest owned by you to be eligible for a minority discount upon your death. On the other hand, if you want to preserve the benefits of Sections 303, 2032A and 6166, gifts of such interests may not be appropriate.
2. Do make gifts of cash.
3. Do make gifts of assets that are expected to appreciate.
4. Do make gifts of property that would otherwise prevent qualification under Sections 303, 2032A and 6166, keeping in mind that certain gifts within three years of death are taken into account in determining qualification under these sections.
5. Do consider depressed values and low interest rates in evaluating your current gifting options.
6. Do use your annual gift tax exclusion, which is $13,000 per donor per donee in 2012.

All references to Section numbers are references to sections of the Internal Revenue Code of 1986, as amended from time to time.

For more information, please contact Kari Brotherton (206.654.2227/brotherton@ryanlaw.com) or Nancy Kennedy (206.654.2233/kennedy@ryanlaw.com).