Upstream Gifting and Capital Gains

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Most people know about gifting appreciated stock to their children, as a way to reduce their (potentially) taxable estate and save on estate taxes—or, for most of us, a way to transfer the capital gains tax liability to a person in a lower tax bracket. But some tax experts are now recommending that their clients gift appreciated assets and securities to their *parents*.

It's not as crazy as it sounds. Consider a couple with some assets that are worth $1 million and almost all of it is taxable upon sale. Under the enormous lifetime exemption from estate and gift taxes, they can gift these assets to an elderly parent—with the proviso that the elderly parent will leave those same assets to the couple in his/her will.

In the likely event that the elderly parent pre-deceases the gifting couple, the assets would come back to them with what is called a step-up in cost basis—stepped up to the value at the time the asset returns. Since capital gains taxes are calculated on the difference between the cost basis and the current value when sold, this means that the $1 million long-term capital gains tax obligation is finessed away. So too are any additional (otherwise taxable) gains that may have occurred while the elderly parent owned the assets.

The strategy can be used for stocks, bonds and shares of a company.

Of course, there are issues to consider. One of them is the fact that, once the gift is made, the parent has full legal control over the assets, so there would need to be some conversation about how they will be handled while in the parent's possession. If the assets happen to be real estate, art or collectibles, the family might want to also gift funds that can be used to take care of the assets.

Also, one has to be mindful that the gift/estate tax exemption is not unlimited; $15 million for individuals and $30 million for couples—indexed to inflation. And it's not unheard of for the arrangement to include the couple's kids; that is, instead of the people who gifted the stock to the parent receiving it back, it could be transferred to their kids instead. This would give all the advantages of upstream gifting plus the more traditional advantages of gifting to heirs.

Sources:

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https://www.merceradvisors.com/trust-estate/upstream-planning-and-generational-wealth-mercer-advisors/

If you have any questions about this article or want to discuss your family finances, investment portfolio, or financial planning advice, please call on me anytime at my number (215) 325-1595 or you can click here to schedule a meeting.

Please feel free to forward this article and offer to anyone you know who might have financial questions or need some unbiased advice. Most financial advice is sales advice. In stark contrast, we are fee-only (non-commissioned) fiduciary advisors. We just provide truthful, unbiased advice to our clients.

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