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GIFT LOW BASIS ASSETS OR HOLD UNTIL DEATH

Do You Gift Low Basis Assets Now or Hold until Death for Step-Up in Basis?

When pondering this question, high net worth individuals must compare estate tax benefits of gifting low basis assets during their lifetime against the future income tax benefits to their heirs of holding those assets until death to receive a stepped-up basis.

The question is particularly relevant for those who own Publicly Traded Stock, Real Estate, Closely Held Businesses, Intellectual Property and other appreciated assets. Considerations include:

- Assets gifted during life retain the cost basis of the transferor
- Conversely, assets held and transferred at death receive a Stepped-Up Basis equal to then current Fair Market Value
- Benefits of Stepped-Up Basis Include:
  - Reduces Capital Gains Tax on a post-death sale of assets
  - Resets value for depreciation deductions which can offset income for rental real estate
  - Increases amount that can be withdrawn tax-free from a closely held business

The costs and benefits weighed involve different tax systems (Estate, Gift and Income), and time frames.[1] As such, assumptions for life expectancy, asset growth rates, and future tax rates must be considered. In addition, tax benefits occurring in the future must be analyzed in present value terms.

Sample Fact Pattern:

- 75 year-old in average health owns 100% of a commercial real estate property worth $10 Mil.
- Cost basis is assumed to be $0 due to depreciation deductions and prior refinancing
- Property generates $450,000/year of rental income with 2.5% rental increases every 5 years
- Property has a high-grade tenant with a long-term lease
- Family intends to hold property long-term, such that the primary benefit of a basis step-up following death would be depreciation deductions
- Client no longer needs income and is considering moving the property by gift to a Generational Trust in the current year
- The Client has his/her full Unified Credit intact

[1] **Realty Transfer Tax transaction costs, if any, are not factored into this model**

- **Step – 1 Projected Estate Tax Savings**

Year of Gift / Year of Death	**2019**	**2024**	**2029**	**2034**
Property Value	10,000,000	11,314,082	12,800,845	14,482,982
Rental Income Invested @ 6%	76,500	2,473,425	4,930,273	7,466,083
Estate Tax Value of Real Estate + Inv. Cash	10,076,500	13,787,507	17,731,119	21,949,064
Gift Value of 99% of R.E. (40% Discount)	5,985,441	8,189,779	10,532,284	13,037,744
Estate Taxes on R.E. & Invested Cash	4,030,600	5,515,003	7,092,447	8,779,626
Tax Savings From Gift (Discount @ 40%)	1,596,118			
Net Present Value (NPV) of Estate Tax Savings [2]	**$1,596,118**	**$1,596,118**	**$1,596,118**	**$1,596,118**

Step – 2 Measure the Value of Stepped-Up Basis

Year of Step-Up (Death)	**2019**	**2024**	**2029**	**2034**
Stepped-Up Value	10,000,000	11,314,082	12,800,845	14,845,056
Annual Income Tax Savings[3]	102,564	116,042	131,291	152,257
Consecutive Years of Savings	39	39	39	39
NPV of Future Income Tax Savings @ 6%	**$1,533,238**	**$1,296,283**	**$1,095,947**	**$949,737**

Step – 3 Compare Estate Tax Savings with Income Tax Benefits of Basis Step-Up

	2019[4]	**2024**	**2029**	**2034**
NPV of Estate Tax Savings @ 6%	**1,596,118**	**1,596,118**	**1,596,118**	**1,596,118**
NPV of Future Income Tax Savings @ 6%	1,533,238	1,296,283	1,095,947	949,737
Benefit of Gifting Today	**$62,880**	**$299,835**	**$500,171**	**$646,381**

Conclusions From This Model:

- Gifting now, is financially preferable to holding for Stepped-Up Basis.
- The current unified Estate and Gift Tax Credit of $11.4 Mil. is scheduled to revert to $5.49 Mil. (indexed) after 2025, enhancing the benefits of gifting in 2019.
- A Financial Analysis projecting and comparing options is a key **first step** in Estate Planning.

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[2] **Tax savings based on Discount applied to Gift. NPV benefit is constant as Growth Rate is assumed to equal Discount Rate.**
[3] **Assumes property transferred qualifies for 39 year depreciation.**
[4] **Three year lookback for lifetime gifts not considered for this model.**