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Give to others, not the IRS

Blog

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- The season of giving is an important time for us to give thanks and revisit our priorities—especially after a life-changing couple of years—and make an important year-end decision: "How much am I planning to give to the IRS, and how much to my family and to charities?"
- In this report, we review considerations that may help you to make the most of the giving season, managing your tax liabilities and making a difference for the people and causes that matter the most to you.

Your hard-earned wealth is so much more than just numbers on a screen, and success is defined by more than simply growing that number. The giving season is an opportunity to focus on the people and causes that mean the most to you and your family, and a time to make sure that your gifts are able to create the most positive impact possible.

Here are a few strategies that you may want to discuss with your financial advisor and your tax advisor. Please also refer to UBS Wealth Way: 2023 Tax fact sheet for more information.

1. Give to your future self

Before giving to others, make sure that you are on track for meeting all of your own savings goals. Please check out our Savings waterfall worksheet to make the most of your savings dollars, and to make sure that you and your spouse are taking full advantage of all of your contribution options (and any match that your employer may offer).

2. Put stocks in stockings

Giving investments to your family can be a great way to help introduce children to investing, providing a concrete example of the power of compounding growth that can help encourage them to adopt a long-term growth mindset.

Giving appreciated stocks also allows you to give more than you could after realizing capital gains taxes, and may also give you a way to trim concentrated positions and reduce your unrealized capital gains taxes. In most cases, young children will have an opportunity to realize those capital gains at a lower tax rate—possibly a 0% tax rate, if their taxable income falls into that bracket when they sell—increasing your family's overall after-tax wealth.

If you want to gift appreciated securities *without* also passing along the tax obligation, you may prefer to use a grantor trust. In this case, you will remain responsible for the trust's income taxes. When structured correctly, either strategy can allow you to reduce your future estate tax liability. You and your spouse can each take advantage of your "annual exclusion" to gift up to USD 17,000 per recipient in 2023 (which will increase to USD 18,000 in 2024) before tapping into your lifetime gift and estate tax exemption limit.

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3. The gift of education

529 college savings plans have a special feature—known as accelerated gifting, or "front-loading"—that allows a family to contribute more than the annual exclusion amount by filing a gift tax return and electing to have the contribution treated as being made over a five-year period. Front-loading can help to remove the dollars—along with their future growth—out of the contributor's taxable estate and into the beneficiary's account, where growth will be tax deferred (and tax-free, as long as the funds are used for qualified educational costs or converted to a Roth IRA).[1]

In 2023, a married couple filing jointly can use front-loading to contribute up to USD 170,000 (5 years of annual USD 17,000 exclusions for each spouse) to the 529 account of any beneficiary without incurring a federal gift tax. This can be done for multiple 529 plans, assuming that each has a different beneficiary and other gifts haven't already been made for this tax year. For more information on 529 giving, including the new SECURE 2.0 Act provision that allows for a potential 529-to-Roth conversion, please see How to get the most out of your 529 plan.

4. "Brady bunch" your donations

The 2023 standard deduction is USD 13,850 for single filers and USD 27,700 for married couples filing jointly, and many itemized deductions were eliminated in the 2017 Tax Cuts and Jobs Act, which helps to explain why roughly 9 out of 10 taxpayers file using the standard deduction. With this in mind, you may want to "Brady bunch" several years of charitable gifts into a single year to make itemizing your taxes worthwhile and retain the tax benefits of charitable gifting.

If you'd like to make a very large donation this year in order to reduce your taxes, but you would like to stretch your charitable donations over more years rather than make a big one-time gift, you may want to consider using a Donor Advised Fund (DAF) or a private foundation. These vehicles can allow your family to make a charitable contribution —including appreciated securities—and keep these funds growing before they are eventually granted or donated.

As you consider itemizing your charitable donations, bear in mind that cash contributions have a higher limit on deductions than donations of appreciated stocks or funds. In the former instance, you may be able to get credit card points, and in the latter instance you can benefit from avoiding capital gains taxes. Please see Charitable giving: the rules of the road, an excellent guide to effective charitable giving strategies written by our esteemed colleagues in the UBS Advanced Planning Group, Family Office Solutions, and Family Advisory and Philanthropy Services teams.

5. Use QCDs to donate efficiently

Qualified charitable distributions (QCDs) are another way that you can give to charities on a tax-efficient basis. If you need to make a Required Minimum Distribution from your IRA (generally limited to traditional and inherited traditional IRAs) and you are at least age 70½, you and your spouse may each donate up to USD 100,000 from your respective IRAs to one or more charitable organizations. QCDs will count toward your RMD, and it won't be subject to federal income tax, but this gift must be made directly from an IRA to the charitable organization, and it must be completed by year-end.[2]

6. Give while you live

In 2023, an individual may also make transfers of up to USD 12.92 million (USD 25.84 per married couple), either during their lifetime or at death, without incurring any gift or estate tax on those transfers. For the 2024 tax year, this lifetime exemption is set to increase to approximately USD 13.6 million per individual (USD 27.2 million per married couple) due to inflation.[3] It will likely also see one further inflation adjustment for the 2025 tax year, but then—unless Congress takes action (which seems unlikely)—the lifetime exemption will revert to 2011's original USD 5 million base amount (adjusted for inflation) on 1 January 2026.

We therefore estimate that the lifetime exemption for the 2026 tax year will be approximately USD 6.2 million per individual (USD 12.4 million per married couple)—roughly half the current level—significantly increasing the number of families that are affected by the estate tax. If there is a chance that your family will be subject to the estate tax, there are three reasons to consider making lifetime gifting a priority:

1. There is a window of opportunity to take advantage of currently favorable gift and estate tax provisions.

2. Most portfolios are still struggling to recover their losses from the 2022 bear market. Making a lifetime gift with depreciated assets may enhance the effectiveness of gift and estate planning strategies, because future growth of gifted assets will occur outside your taxable estate.

3. If you have already exceeded your lifetime gift and estate tax exemption, then making lifetime gifts can be far more tax-efficient than end-of-life gifts. Although the top marginal federal tax rate for estate and gift taxes are both 40%, there is one key difference between the two: The gift

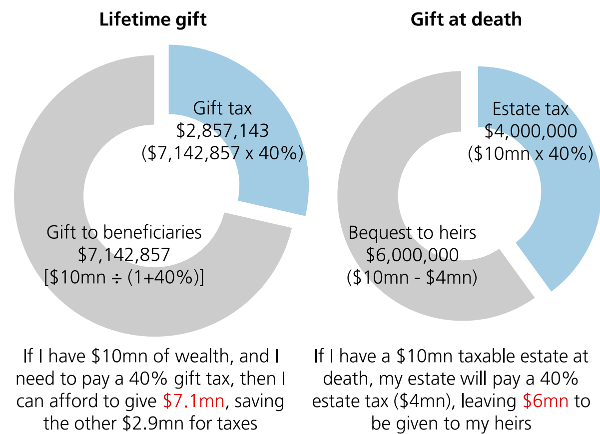
tax is "tax-exclusive"—applied only to the value of the asset being transferred, while the estate tax is "tax-inclusive," based on the entire estate (including assets that are used to pay the estate tax).

This means that—when you make a gift to anyone other than a spouse or charity in excess of your lifetime and annual exemptions—you will need to pay taxes based on the amount of the taxable gift. By contrast, estate taxes are paid based on the value of your entire taxable estate. This sounds like a weird technicality, but it can have a meaningful impact on the value that you are able to give your family.

If you want to give USD 1 million during your lifetime, you need to set aside USD 400,000 for taxes (USD 1 million x 40%), so the total cost of that gift is USD 1.4 million. If you want your heirs to receive USD 1 million from your estate, on the other hand, you need to leave at least USD 1.66 million (the estate tax is USD 1.66 million x 40% = USD 0.66 million, leaving USD 1 million for your heirs).

Figure 1 - Taxes on lifetime gifts are based on the size of the gift. Estate taxes apply to the entire taxable estate.

Hypothetical example of USD 10 million of assets, assuming lifetime gift and estate tax exemption amounts have been exhausted



If I have $10mn of wealth, and I need to pay a 40% gift tax, then I can afford to give $7.1mn, saving the other $2.9mn for taxes

If I have a $10mn taxable estate at death, my estate will pay a 40% estate tax ($4mn), leaving $6mn to be given to my heirs

Source: UBS. For illustration purposes.

[1] IRC § 529(c)(2)(B). It is necessary to file a gift tax return to claim this treatment. The accelerated gifting election is made on IRS Form 709, and filed with your federal tax return, in the first year the accelerated gift is given. You cannot use the annual exclusion for gifts to this individual before the end of five calendar years, but subsequent rounds (i.e., every five years) of accelerated gifting are permitted. If a donor elects to have a 529 contribution treated as made over a five-year period, and then dies during that five-year period, a portion of the gift will be subject to the estate tax. IRC § 529(c)(4)(C).

[2] It's important to note that you cannot make a QCD to a donor advised fund or a private foundation. For more information on QCDs, please see Beyond RMDs: 3 Strategies to improve your after-tax wealth potential.

[3] This is an estimate; the final figure will depend on forthcoming inflation data.

Appendix

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