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Elder Law: *Inter Vivos* or Testamentary Gift: Which is Best?

Giving a gift during one's lifetime is termed an *inter vivos* gift. A gift made after the death of the giver is a testamentary gift.

How does one make a gift after death, you may ask. Simply, it is done through a Will or other testamentary instrument, including a Trust. The more common question, however, is which type of giving is best?

There are several factors to consider before deciding which manner of gift giving is best for you. First, consider whether the property you intend to give is needed for your care or enjoyment. This is true whether such property is real property (*i.e.*, "real estate") or personal property (all other tangible and intangible property).

Second, consider the tax implications. If your estate is now greater than about $700,000 if single, or $1.4 Million if married, your estate will likely be subject to estate taxes after paying all of your medical, funeral, burial, and other expenses. Since the maximum federal estate tax rate is 55%, it may make sense to begin giving *inter vivos* gifts to avoid such taxes.

However, in considering such federal estate tax savings, you must also be mindful of other tax implications of an *inter vivos* gift. That is, an *inter vivos* gift carries with it your tax basis. The consequence of this fact is that all appreciation or gain in value of the gift will become taxable when sold by the donee.

Such capital gains tax can be significant when the gift is a home that was purchased decades ago. For example, suppose that you purchased your home in the early 1960s for $25,000. If you make an *inter vivos* gift of your home to your child or your children, their tax basis will be $25,000.

Further suppose that you are still living in the home and they wait until your death before selling it. At that time the home could have a fair market value of $200,000. When sold, your children would have a capital gain of $175,000. Assuming a 28% capital gain tax rate, your children would have to pay $42,000 in capital gain taxes.

If the home you give to your children becomes their residence and they live in the home for at least two years, then they would avoid the capital gain taxes under current tax laws. Also, depending on the size of your estate, the federal estate taxes on such a home, if kept in your estate until your death, could be substantially greater than the 28% capital gain tax rate.

Of course, tax laws and rates are always subject to change. For instance, Congress is currently considering a total repeal of the federal estate taxes (the Republican Party), or in the alternative,

substantially increasing the lifetime exclusion from such taxes to $4-5 Million (the Democratic Party). Therefore, whatever plans you make now, you need to periodically review them for changes in federal and state tax laws.

Most of the time, however, an *inter vivos* gift of a home is not for the purpose of avoiding federal estate taxes or having your child or children live in the home. It is often motivated by a fear that somehow the home may be taken by Medicaid, if you have to move to a long-term care facility. This issue was discussed in my February 2000 column. You may want to review that column for more information.

The alternative to an *inter vivos* gift is a testamentary gift. That is, the property is given after your death through a will or a trust. The advantages of giving in this manner are (1) the tax basis is stepped up to the fair market value on the date of death; (2) you have full ownership and control of such property during your lifetime; and (3) your intent to make such a gift is revocable, allowing you to change your mind or to make changes in response to changes in the tax laws.

If your estate is not large enough to be subject to estate taxes, you should seriously consider the avoidance of capital gain taxes through a testamentary gift, rather than through an *inter vivos* gift. And remember, adding a child's name to your deed is equivalent to giving that child an *inter vivos* gift of ½ of your home. That ½ ownership in your home will subject your child to the capital gain tax discussed above.

It is best to consult with an Elder Law Attorney to assist you in analyzing your options and your particular situation before deciding on which method of giving is best for you and your children or other donees.