

# ESTATE AND GIFT TAX SAVINGS THROUGH NET GIFTS

*Real or an Illusion?* BY GARY ALTMAN, ESQ. AND MICHAEL WOLSH, ESQ.

As estate and tax planning attorneys, we get excited about ways to help reduce our clients' estate and gift taxes. We diligently read the cases, statutes, regulations, revenue rulings, and other materials the IRS disseminates, as well as listening to other estate planning attorneys and reading various tax publications. One strategy I often hear some of my colleagues in other firms heralding for its tax savings is a *Net Gift*.

In simple terms, a Net Gift is a Gift the donor makes to the donee in which the Gift Tax on the Gift will not be paid by the donor, but instead will be paid by the donee out of the proceeds of the Gift he or she receives. For example, Mary gives Bill a gift of \$10 million, which is subject to gift tax, which Bill is obligated to pay. Mary pays no gift tax and Bill pays approximately \$2.6 million in gift tax while receiving the other \$7.4 free of any tax. (Currently the gift tax rate is 35%. Assuming that Mary has already used her 5.12 million lifetime gift tax exemption, then a gift of \$7.4 million generates a gift tax of approximately \$2.6 million). Now, if Mary gave a \$10 million gift to Bill, but chose to pay the gift tax herself, Mary would pay 3.5 million in gift taxes.

The example above leads many estate planners to say Net Gifts result in less tax. (In the example above, \$900,000 less gift tax). But are these savings real, or an illusion? I have always believed the savings are an illusion and I will show why below.

***From the Example Above***

(Numbers are approximate.):

| Type of Gift      | Net Gift                       | Gift on Which the Donor Pays the Tax |
|-------------------|--------------------------------|--------------------------------------|
| Gift Amount:      | \$10,000,000                   | \$10,000,000                         |
| Total Tax:        | \$2,600,000<br>(paid by donee) | \$3,500,000<br>(paid by donor)       |
| Total to Donee:   | \$7,400,000                    | \$10,000,000                         |
| Total from Donor: | \$10,000,000                   | \$13,500,000                         |

the tax in one case being \$900,000 less than the other. But, as you can see, the donor in one case is actually paying out a combined \$13.5 million (gift plus the tax the donor pays) to get the donee \$10 million. On the other hand, a \$10 million Net Gift only gives the donee \$7.4 million. Thus, it is an illusion to simply focus on less gift taxes from the \$10 million Net Gift versus the \$10 million gift on which the donor pays the tax. The better way to compare the two is below.

| Type of Gift      | Net Gift                       | Gift on Which the Donor Pays the Tax |
|-------------------|--------------------------------|--------------------------------------|
| Gift Amount:      | \$10,000,000                   | \$10,000,000                         |
| Total Tax:        | \$2,600,000<br>(paid by donee) | \$3,500,000<br>(paid by donor)       |
| Total to Donee:   | \$7,400,000                    | \$10,000,000                         |
| Total from Donor: | \$10,000,000                   | \$13,500,000                         |

As you can see, the better way to compare a Net Gift with a gift on which the donor pays the tax is to consider the Total Amount to Donee and the Total From the Donor. If those amounts equal each other, there is no gift tax difference between a Net Gift and a gift on which the donor pays the tax.

Having said the above, there may still be some tax or non-tax reasons for a client to do a Net Gift. But the basic gift or estate tax savings on a Net Gift are mostly, if not at all, an illusion. Hence, when we advise our clients on ways to reduce or eliminate their gift or estate taxes, our goal is to create a plan or strategy that will actually produce real significant gift and estate tax savings, and not just a smoke and mirrors plan that appears to reduce gift and estate taxes, but is actually an illusion.

*For the latest information on Net Gifts, follow our estate planning blog, Altman Speaks.*

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***"I have always believed [Net Gift] savings are an illusion..."***

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Based on the calculations above, I think some estate planners get distracted by the gift in both cases being \$10,000,000 and