

An Overview of Asset Transfer Strategies



by Elaine Floyd, CFP®

You may need to transfer assets for all sorts of reasons. A working knowledge of various transfer techniques can help you determine when it's appropriate to move money around, and how to minimize the tax and legal implications of the process.

Asset transfers are an important part of financial planning. As you move through life, you are constantly acquiring and disposing of assets until that final transfer takes place—the one you're not around to see.

Some asset transfers are initiated as a result of a life event or other major decision. Others are suggested by attorneys or financial advisors as a way to better arrange your affairs. Some asset transfers are as easy as handing a tangible item over to another individual. Others are fraught with legalities and should not be attempted without counsel.

Here is an overview of asset transfers—the tip of the iceberg, if you will. Many of the regulations governing asset transfers are state laws, so your best bet is to check with your financial advisor and a good attorney—several of them, actually, in different specialties—who can guide you through the transfer process.

Why assets move

There are lots of reasons why people transfer assets. Here are some of them.

- **Marriage or cohabitation.** You want to put a new spouse or partner's name on the title.
- **Divorce.** A couple wants to divide joint property between the two spouses and retitle it in separate names.
- **Buyout (or sale to) co-owner.** One of two co-owners wants to own full rights to the asset.
- **Anticipation of incapacity or death.** An elderly person wants to put a son or daughter on the title for ease of transfer.
- **Establishment of a trust.** There are many reasons for forming a trust; assets must be retitled in order to be transferred into the trust.

- **Establishment of a private annuity.** You need income and want to keep assets in the family; assets are sold to family members in exchange for regular payments.
- **Reduction of estate taxes.** You may want to remove assets from your estate in order to reduce the amount subject to estate tax.
- **Reduction of income taxes.** You may want to transfer assets to a low-bracket family member so investment earnings will be taxed at a lower rate.
- **Medicaid eligibility.** You may want to reduce the amount of "countable assets" so that Medicaid will pay for nursing home care.
- **Bankruptcy.** You may need to meet the state's asset requirement laws in order to discharge debts or other obligations.
- **Anticipation of lawsuits.** You might need to protect assets from judgments (applicable to people in high-risk occupations, such as surgeons).
- **Gifting.** You may want to gift securities or other property to an individual or to charity.
- **Cash or asset exchange.** You may want to sell an asset for cash and/or buy a different asset.

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You should be aware of gift tax rules

Tax and legal considerations

It would seem that if an individual wants to get rid of an asset or if two individuals want to enter into a private transaction, they ought to be able to do it without tripping over a bunch of laws. For smaller transactions, they can. For instance, gift giving at birthdays and holidays would normally be exempt from asset-transfer laws.

In some transfer situations, however, there's opportunity for tax evasion, taking advantage of people, or exploiting laws that are designed to help the needy. In those cases, certain procedures must be followed. And to make sure they are, the transfer process itself—the physical transfer of title to another person—may be extremely complex and not possible to complete without the help of an attorney, escrow officer, transfer agent, or other intermediary.

Even so, the intermediary arranging for the transfer may not be obligated to warn clients of the various tax and legal ramifications—in some cases he or she may simply be following instructions to transfer title—so it is up to you to know the law—or obtain legal counsel.

Here are a few of the common considerations involved in asset transfers:

Gift tax

If you are thinking about transferring assets to family members to save income or estate taxes or to facilitate transfer later on, then you should be aware of gift tax rules. In 2016, any gift to an individual that exceeds \$14,000 for the year (\$28,000 for joint gifts by married couples) applies against the lifetime gift tax exclusion and requires the filing of Form 709 for the year in which the gift was made. The gift tax does not need to be paid at the time Form 709 is filed, unless the client has exceeded the lifetime gift tax exclusion of \$5.45 million in 2016 (adjusted annually for inflation).

The annual gift tax exclusion—the amount that may be given away without eating into the lifetime exclusion—is adjusted for inflation in \$1,000 increments. Transfers to spouses who are U.S. citizens and to charitable organizations are exempt from gift tax. Payments made directly to an educational or health care institution are also exempt from gift tax. Property exchanged for equivalent value (as in a sale to another party) is not subject to gift tax. However, low-interest loans to family members may be subject to gift tax. Complicated transactions like these require the advice of an attorney or tax advisor.

Kiddie tax

The practice of transferring assets to children to avoid income tax on investment earnings is less popular now, because for 2016 investment income exceeding \$2,100 earned by qualified children is taxed at the parents' rate. The first \$1,050 is tax free, the next \$1,050 is taxed at the child's rate, and the remaining income is taxable to the parents. The kiddie tax is also subject to inflation adjustments in \$50 increments. It's certainly possible to get around the kiddie tax by investing in assets that don't pay current income—but then what's the point of transferring assets to children, especially when parents must think about funding college.

Financial aid

The formula that determines need-based aid factors is a much higher percentage of assets when they belong to children (20%) as opposed to parents (5.64%). So the classic financial aid strategy is to keep assets away from children and stash parents' assets in retirement plans, home equity, and other exempt assets.

What if a child already has significant assets—say, in an UGMA or UTMA account? Is there any way to get them out of the child's name? Probably not (check with an attorney to be sure), at least not until the child turns 18 or 21 and has the legal authority to transfer property. But by then it may be too late for financial aid, since schools look at the family's financial picture as early as the student's junior year of high school. Any parent who wants to maintain maximum financial aid flexibility (and this includes need-based scholarships, not just loans) should think twice before transferring assets to children.

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Asset transfers may not be as straightforward as you think

Medicaid

Medicaid is designed for people with few assets who can't afford to pay for custodial care. In the past, people had to "spend down" to such small amounts that often the healthy spouse was left nearly destitute. This led to rampant asset transfers and big business in "Medicaid planning."

However, the laws have been liberalized in recent years to better protect the healthy spouse, so asset-transfer gimmicks have waned somewhat. In any case, clients contemplating asset transfers in anticipation of applying for Medicaid need to be aware of "look back" laws—60 months for transfers to individuals (with some exceptions if the transfer is to a child under 21 or a child of any age who is blind or disabled) and trusts.

Bankruptcy

Each state has its own laws relating to how much property a client can keep and still discharge debts in bankruptcy. These laws also address property transfers in which it appears that the debtor is trying to pull a fast one.

Popular asset-transfer strategies

The main point to understand is that asset transfers may not be as straightforward as you think, and some transfers may have unintended consequences. At the same time, strategies you may not have considered could provide the perfect financial planning tools. Popular alternatives include:

- **Annual gifting.** Every year, give cash or property equal to that year's gift tax exclusion to each child, grandchild, or any prospective heir to remove assets from the estate.
- **Transferring assets to parents.** If you are supporting elderly parents you may want to transfer assets to low-bracket parents who would pay taxes on the income being used for their support.
- **Writing checks directly to educational institutions.** Grandparents who are paying for their grandchildren's education should pay the school directly; during the accumulation phase they should contribute to a 529 plan rather than an UGMA.
- **Trusts and other advanced strategies.** There's no substitute for consulting with an estate planning attorney and tax advisor for individual advice regarding asset transfers that can accomplish specific objectives.

As Director of Retirement and Life Planning for Horseshmouth, Elaine Floyd helps advisors better serve their clients by understanding the practical and technical aspects of retirement income.

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