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The Effect of Timing of Property Transfers on Tax Savings for Estate Planning

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on Tax Savings for Estate Planning

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Abstract

This paper presents a summary of the tax effects of making lifetime property transfers under conditions of uncertainty. Since the time of death is only an estimate, the risk involved when a transfer is made at suboptimal times was analyzed.

Simulation was used to generate 24 random samples in which the time of the property transfer was varied. Sensitivity analysis was performed with respect to the type of property transferred, size of the estate and percentage ownership of the property by each spouse.

In general, the findings were that lifetime transfers result in tax savings regardless of the time the transfer is made. The major exception is the case in which the property is owned solely by the first spouse to die and is transferred shortly before his death.

The Effect of Timing of Property Transfers
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This paper presents a summary of the tax effects of making lifetime property transfers under conditions of uncertainty. Since the time of death is only an estimate, the risk involved when a transfer is made at suboptimal times was analyzed in the following manner.

Case #1

Eight samples consisting of 100 simulations in each sample were obtained for the case in which both spouses own 50% of the property under consideration. The tax savings factor computed in each simulation represents the percent of the gift property value which may be saved (or paid) in taxes by making a lifetime as opposed to an at-death transfer. Sensitivity analysis was performed by varying the time the transfer is made from one sample to the other.

The following hypothesis was tested for each sample:

Ho_1: Under the current stepped-up basis provisions, there are no tax savings from making lifetime transfers.

Ha_1: Under the current stepped-up basis provisions, there are tax savings from making lifetime transfers.

A one-sided nonparametric sign test was applied to the data. The level of significance at which the null hypothesis is rejected is presented in Table 1. The median tax savings factor (or tax increase) is also shown.

In each sample, the null hypothesis is strongly rejected. In other words, a lifetime as opposed to an at-death transfer should be made to save taxes regardless of the time the property is gifted. A comparison

No. of Years Property Is Transferred Before Death of First Spouse	Median Tax Savings Factor (or Tax Increase) from Making Lifetime as Opposed to At-Death Transfer	Level of Significance at which Null Hypothesis Is Rejected
3 (Sample 1)	10.25%*	< .0002
10 (Sample 2)	10.23%	< .0002
20 (Sample 3)	13.01%	< .0002
30 (Sample 4)	11.51%	< .0002
40 (Sample 5)	9.38%	< .0002
50 (Sample 6)	8.61%	< .0002
60 (Sample 7)	9.97%	< .0002
70 (Sample 8)	9.19%	< .0002

Table 1

<u>Property is Owned 50% by Each Spouse</u>

*Stated in terms of percentage of value of gift property.

of the median tax savings factors reveals a slight decrease in tax savings when property is given away early in life (40 or more years before death). However, the difference between the smallest and largest median tax savings factors is only 4.4% (13.01% - 8.61%) of the value of the transferred property.

Case #2

Eight more random samples consisting of 100 simulated values in each were obtained for the case in which the property under consideration is fully owned by the first spouse to die. In three of the samples, a median increase in taxes occurs when a lifetime transfer is made. See Table 2. The null hypothesis is strongly rejected in two samples: (1) the time of transfer is 50 years before death and (2) the time of transfer is 70 years before death. The median tax savings are 2.69% and 2.63% of the property's value, respectively. Considering the magnitude of savings, the highly improbable transfer times and the risk of having to pay additional taxes, it is not advisable to make lifetime transfers when the property is fully owned by the first spouse to die. The property should be transferred to the children through the decedent's estate.

Case #3

Once again, eight random samples of 100 each were obtained for the case in which the property is fully owned by the surviving spouse. The results are shown in Table 3. In each sample, the null hypothesis is strongly rejected and lifetime transfers should be made sometime during

No. of Years Property Is Transferred Before Death of First Spouse	Median Tax Savings Factor (or Tax Increase) from Making Lifetime as Opposed to At-Death Transfer	Level of Significance at which Null Hypothesis Is Rejected
3 (Sample 1)	(6.57%)*	> .9998
10 (Sample 2)	(3.14%)	< .5026
20 (Sample 3)	0.73%	< .3446
30 (Sample 4)	2.07%	< .1587
40 (Sample 5)	(0.11%)	< .5228
50 (Sample 6)	2.69%	< .0007
60 (Sample 7)	1.09%	< .3446
70 (Sample 8)	2.63%	< .0228

Table 2

<u>Property is Owned Solely by First Spouse to Die</u>

*Stated in terms of percentage of value of gift property.

No. of Years Property Is Transferred Before Death of First Spouse	Median Tax Savings Factor (or Tax Increase) from Making Lifetime as Opposed to At-Death Transfer	Level of Significance at which Null Hypothesis Is Rejected
3 (Sample 1)	26.22%*	< .0002
10 (Sample 2)	24.82%	< .0002
20 (Sample 3)	21.84%	< .0002
30 (Sample 4)	19.40%	< .0002
40 (Sample 5)	16.60%	< .0002
50 (Sample 6)	15.13%	< .0002
60 (Sample 7)	14.01%	< .0002
70 (Sample 8)	12.25%	< .0002

Table 3

Property is Owned Solely by Surviving Spouse

*Stated in terms of percentage of value of gift property.

life. Upon examination of the median tax savings factors, it appears that the closer the gift is made to the time of death, the greater the potential tax savings.

In summary, the greatest tax savings result when property is given during life which is fully owned by the surviving spouse. At the time of the gift, however, it is not known with certainty which spouse will die first. If the property which is gifted is fully owned by the first spouse to die, the potential tax savings are minimal and the risk of having to pay more taxes is substantial. The risk/return decision should be evaluated for cases in which the property to be transferred is owned solely by one spouse.

On the other hand, for the case in which property is owned 50% by each spouse, lifetime transfers should be made. Although the potential tax savings are less than in the situation where the property is owned solely by the surviving spouse, the risk of paying additional taxes is negligible regardless of the time of transfer or which spouse dies first.

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