

UPDATE: Three things to remember when giving money to your kids

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By Elizabeth O'Brien, MarketWatch

This Mother's Day, Mom may be thinking beyond the flowers or chocolates she may get to the gifts she plans to give. More folks are opting to give financial gifts to their heirs during their lifetimes, advisers say, but before Mom springs the good news over Mother's Day brunch she should make sure her generosity won't jeopardize her retirement security.

An estimated 17% of wealth transfers occur during the giver's lifetime, according to a report last year by the Center on Wealth and Philanthropy at Boston College. People enjoy seeing loved ones benefit from their gifts, said Greg Popera, a private wealth adviser with Merrill Lynch in Tysons Corner, Va., noting that the number of his clients giving away money during their lifetimes has grown over the past decade. People realize that, if they wait until they die to give a full inheritance, their heirs could be approaching or even in retirement themselves, with major purchases such as the family home and college tuitions already behind them.

Even so, all but the very wealthy must weigh whether lifetime gifts will compromise their own retirement security. They also must distinguish between a gift to a financially independent adult child versus support for one who isn't fully self-sufficient. Some 17% of boomer households, or nearly 8 million, still support adult children, and this assistance can seriously compromise parents' ability to retire, according to a study this spring by Hearts & Wallets, a financial research firm.

There's plenty of educated guesswork involved in deciding whether a gift makes financial sense, given all the unknowns. One of the biggest question marks surrounds potential long-term care needs. An estimated 7 in 10 people turning age 65 will eventually need assistance with basic activities of daily living, such as bathing, dressing and eating. Medicare doesn't cover these expenses, which can quickly add up for families. "Aging is very expensive," said Catherine Anne Seal, an elder law attorney in Colorado Springs, Colo. and vice president of the National Academy of Elder Law Attorneys.

One reason people give gifts is to lower the value of their estate for tax purposes. The federal estate tax is levied on the portion of an estate that exceeds \$5.43 million for an individual and \$10.86 million for a couple (some states have estate taxes with lower thresholds). This is a tax on the transfer of assets between non-spouses. It's known as the gift tax when the giver is alive and the estate tax, or "death tax," after the giver passes away; both kinds of transfer count toward the taxpayer's total exemption.

Generally, people worried about paying the federal estate tax are going to be able to gift money during their lifetimes without any impact on their ability to fund extended long-term care costs, planners and attorneys say. They note though that sometimes people with large estates have big spending habits to match, so this isn't necessarily a given.

People holding a long-term care insurance policy also will be less concerned about funding future care needs. But most people don't carry this type of coverage, which has become both pricier and less comprehensive in recent years.

For everybody else, we've rounded up some considerations to make before giving heirs an early inheritance.

Plan conservatively

The average stay in a nursing home is between two and three years, yet those averages mean nothing to the man who seems fine one day and dies of a heart attack the next, or the woman with Alzheimer's who needs intensive care for a decade.

No one wants to think about going into a nursing home, but sometimes a person's needs exceed what even the most dedicated family members can provide at home. "There's a tremendous amount of denial," Seal said. "Nursing homes are filled with people who were never going to go there."

The national median cost of a private room in a nursing home is about \$7,600 a month, according to the Genworth 2015 Cost of Care Survey, although in some higher-cost parts of the country it tops \$10,000. Those who can remain at home, with assistance, pay a national median hourly rate of \$20 for a home health aide, according to Genworth. And those numbers are in today's dollars -- people retiring now will have to pay more when they eventually need care.

Medicaid funds the long-term care costs of people who have depleted most of their assets and meet certain income and other criteria. And yet, "you can't give in contemplation of going on Medicaid," Seal said. Those applying for Medicaid face a five-year look-back period during which all gifts are scrutinized, and asset transfers can result in a penalty in the form of months of exclusion from Medicaid coverage.

For this reason, people should conservatively budget for five years' worth of nursing home costs before they give money away to heirs, said Shirley B. Whitenack, a partner with Schenck, Price, Smith & King in Florham Park, N.J. and president-elect of the National Academy of Elder Law Attorneys.

While people can't purposefully deplete their assets for the purpose of going on Medicaid, unforeseen circumstances arise. "You may be healthy now, but tomorrow you have a stroke," Whitenack said.

Let's say a healthy couple in their 70s worth \$2 million wants to give their adult child \$500,000 to help him launch a business. They might be able to do this and still live quite comfortably, but before they do they should make sure to set aside five years' worth of nursing home expenses--between \$500,000 and \$600,000-- just in case, Whitenack said.

That's because, if one of them has that stroke soon after giving away the \$500,000, the couple will need to ride out an entire look-back period, funding five years' worth of nursing home costs before becoming eligible for Medicaid.

During that five years, the couple must not give away another cent in cash or other assets. While tax law allows individuals to gift \$14,000 per recipient, per year exempt of the gift/estate tax, "IRS rules have nothing to do with Medicaid rules," Seal said.

Employing this strategy doesn't guarantee the spouse in the nursing home will qualify for Medicaid at the end of the five years, but it at least keeps alive the possibility. Medicaid is administered at the state level, and certain rules and eligibility criteria vary by state. Those contemplating asset transfers should consult an elder law attorney beforehand to understand how the gift will affect potential Medicaid eligibility in the future.

People should also consult accountants to understand the tax implications of their potential gift. Some assets, such as highly appreciated stock, might be best transferred after the owner's death, when the tax treatment is more favorable for the recipient, said Bill Engel, a financial adviser with Fort Pitt Capital Group in Pittsburgh.

Don't count on getting it back

Some parents who give their adult children money think the children will give the money back if they end up needing it, financial planners say. But it's wrong to give a gift with any kind of expectation of a payback, even if a true need arises, they warn.

For one, the recipient might have used the money for an illiquid purchase, such as a house. Secondly, even if the child has every intention of returning the money, his or her spouse could disagree.

What's more, if the adult child has gotten divorced, the money might already have been split up as part of the marital assets. And if the child has filed for bankruptcy, creditors might have gotten their hands on the cash.

Those who want to retain the possibility of using gifted funds in the face of hardship could open up a 529 college-savings account for a grandchild, advisers say. Grandparents who retain ownership of the account can tap the funds if needed, even though they'll have to pay taxes on the gains plus a penalty for withdrawing the money for non-educational purposes.

Get creative with gifts

People who aren't sure they can afford to give an early inheritance can think of other ways to provide for their heirs during their lifetime. "Maybe gifting isn't just an exchange of finances," said Rand Spero, president of Street Smart Financial, a fee-only financial planning firm in Lexington, Mass.

Spero had one client who gave her daughter the family piano, a meaningful gift since both of them enjoyed playing. Grandparents can watch their grandchildren while the parents go on vacation. Those who own a vacation home could allow their family members to stay for free.

It's best to err on the side of caution, experts say. After all, people who ultimately run out of money and become financially dependent on their heirs may regret their earlier generosity.

Seal and her law partner often talk clients out of making financial gifts they might not be able to afford. Parents' impulse to help their children runs deep -- and doesn't necessarily diminish with the passage of time -- but it's sometimes best to hold back. "You raised them, you educated them, and you gave them their start in the world," Seal tells her clients. "That's all you owe them."

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