EXPERT CONTRIBUTOR

WAS THAT A GIFT, A LOAN, OR AN ADVANCEMENT?

CLASSIFICATION MATTERS

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SOMETIMES OUR LOVED ONES NEED FINANCIAL SUPPORT, and most of us offer it when we can, but when we offer our money or property to them, are we giving them a “gift” a “loan” or an “advancement” on a future inheritance?

Gifts

The IRS doesn’t care whether you intend to make a gift, loan, or advancement to your loved one. It categorically defines a “gift” as “the transfer of property by one individual to another while receiving nothing, or less than full value, in return.”

In the eyes of the IRS, whether you meant to or not, you gave a gift if you transferred cash, real estate, or any type of tangible or intangible property to another person without expecting to receive something of at least equal value in return. Also, you gave a gift if you sold property for less than full value or provided someone with an interest-free or reduced-interest loan.

Loans

If there is a mutual understanding that the money or property you transferred to a loved one is to be returned, this is considered a loan (even if it’s not put on paper).

Advancements

If, during your lifetime, you transfer money or property to a loved one who is also a beneficiary of your estate plan, you could consider the transfer an advancement on their inheritance. An advancement simply means they are receiving some or all of their inheritance ahead of time, and the beneficiary’s share of the estate will be reduced by the amount of the advancement when you die.

Why does classification matter?

Gifts can be taxed.
Gifts of a certain value, or many gifts to the same person (other than your spouse) having a certain cumulative value, are subject to federal “gift taxes.” In 2024, that certain value is $18,000 and $36,000. If you alone gifted someone more than $18,000 worth of gifts, or you and your spouse jointly gifted someone more than $36,000 worth of gifts, all in 2024, the overage of those limits will be taxed to you as the gift-giver. There’s more to it than that, but federal gift taxes are a hefty subject too big for this article.

Some gifts have rules.
The IRS does not tax gifts given as payment of tuition when paid directly to the institute of education, or gifts given as

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payment of medical bills when paid directly to the healthcare provider or medical insurance company. You (and your estate) can give as much as you want for these purposes if you give on behalf of your loved one—not to your loved one.

Gifts can upset your estate plan.
When you're thinking of giving a gift to a loved one who is a beneficiary of your estate plan, it's important to consider the impact on your overall plan. If your estate plan's ultimate goal is to give equal gifts to your beneficiaries, then giving a gift to one of them during your lifetime and then their full inheritance when you die will upset this balance. Ultimately, they will receive more from you than the others. Careful planning can prevent this, which may mean amending your estate plan documents.

Loans don't die.
If your loved one doesn't pay back the entire loan before you die, they will owe the remaining balance to your estate.

You should draft a written loan document so both parties—the lender and the borrower—are aware the transfer is a loan and will remain an outstanding obligation until it's returned in full, even if you die beforehand.

Loan forgiveness (or not) and advancements must be built into your estate plan before you die.

If your loved one's debt is still outstanding when you die, and you want to forgive the debt at that point, particular provisions must first be drafted into your Will and/or Revocable Living Trust to permit that to occur.

If your loved one's debt is still outstanding when you die, and you don't want to forgive the debt, it can carry on as a loan owed to your estate or it can be treated as an advancement. The loan will naturally become owed to your estate, but if you want to treat the balance owed as an advancement, particular provisions must first be drafted into your Will and/or Revocable Living Trust to permit that to occur.

Advancements require record keeping.
For an advancement to count as an advancement, you must keep accurate records regarding the transfer of funds, particularly if multiple advancements are made. Otherwise, when you die, your loved ones could contest the advancements ever occurred.

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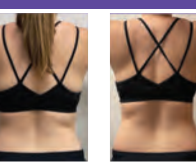
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