Financial Planning Newsletter

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Gifting

Hello!

This month's newsletter highlights the strategy of gifting, the amount one can give to another without being subject to gift tax. For this year, the annual gift exclusion is $13,000 ($26,000 if married) and there is no limit on the number of gifts a person can make to different individuals.

There is also a lifetime gifting exemption which allows for larger gifts to be made now and this is tied directly to the federal estate tax exemption. Any amount of one's lifetime gifting exemption used would then be deducted from one's estate tax exemption after death. For 2012, this amount is $5,120,000 per person ($10,240,000 for married couples). Just two years ago, in 2010, this figure was $1,000,000 per person. This significant increase in the lifetime gifting exemption was part of the Tax Relief Act of 2010 signed into law by President Obama and was applicable for years 2011 and 2012. For 2011, it was $5 million and due to an inflation adjustment, the federal lifetime gifting exemption increased to $5.12 million per person. This provides an opportunity for individuals to transfer a large amount of wealth to others this year without incurring any gift tax liability. This amount is scheduled to revert back to $1 million effective January 1, 2013 if Congress does not amend or extend current law.

Purpose of Lifetime Gifting

The primary advantage of making lifetime gifts is to remove from one's estate all the income from, and any future appreciation in the value of, the gifted assets. For example, if an individual had $10 million of assets and did not take advantage of the lifetime gifting exemption this year, and the estate doubled to $20 million in ten years, that amount minus the estate tax exemption would be subject to federal estate taxes. Alternatively, if that individual gifted $5 million this year, no matter how the gift is eventually treated for estate tax purposes, any future gains on the $5 million would be excluded from his or her estate. Depending on the amount and the type of asset that is gifted, this future income and appreciation can be significant.

The higher gift exemption has other advantages too. For those that are business owners and/or investment property owners, this also presents a greater opportunity to protect more of their assets by using asset protection trusts.

For individuals who had utilized their $1 million lifetime gift tax exemption in previous years, they can now make additional gifts of $4.12 million to reduce their overall estate. Spouses who had exhausted their combined $2 million exemption can now gift an additional $8.24 million.

Gifts made during one's lifetime reduce their taxable estate. However, those gifts in excess of the annual exclusion will also reduce their estate tax exemption.

How to Make Lifetime Gifts

There are various ways to make gifts:

- Transferring items such as cash, securities, real estate, and vehicles (either outright or in a trust)
- Funding a Charitable Remainder Trust (CRT) or a Charitable Lead Trust (CLT)
- Setting up a Family Limited Partnership (FLP) or Family Limited Liability Company (FLLC)

Generation Skipping Transfers

For assets passed down to grandchildren and great-grandchildren, the exclusion for the "generation skipping" tax is also at $5.12 million for 2012. This gives an individual a greater planning opportunity to make taxable gifts by the end of this year.

Non-Taxable Gifts

In addition to the annual exclusion amounts, one can also make unlimited gifts to the following without any gift tax or estate tax consequences and without having to file a gift tax return:

- Spouse (as long as he or she is a U.S. citizen) – gifts to a non-U.S. citizen spouse are exempt up to the first $139,000 in 2012.
- Educational expenses – as long as payments are made directly to the educational institution for tuition only. Books, supplies, and living expenses are not included but can be paid for using the annual gift exclusion.
- Medical expenses – these include fees by the hospital and physicians as well as insurance expenses. These payments have to be made directly to the medical facility or healthcare provider.
- Charitable organizations (ones approved and recognized by the IRS).
- Political organizations for its use.

Gift Tax

In the event that one makes a gift higher than the annual exclusion amount and either does not choose to use their lifetime gifting exemption amount or have exceeded the amount, the person who made the gift, not the recipient, would be subject to a gift tax liability. For 2011 and 2012, the rate is 35% (reduced from 45% in 2010). In 2013, the gift tax rate is scheduled to increase to 55%.

Tax Reporting

If an individual makes a taxable gift in excess of the annual exclusion amount, he or she must file IRS Form 709: United States Gift (and Generation-Skipping Transfer) Tax Return, which is required even if there is no gift tax liability due to the $5.12 million lifetime exemption. For those that are married, a joint gift tax return cannot be filed. Each spouse must file a separate return if he or she makes any taxable gifts but there is an option to split gifts with a spouse. This allows one spouse to take advantage of his or her annual gift exclusion plus their spouse's exclusion for a gift that is made entirely by one spouse.

The gift tax return is due the same time as regular tax returns and if an extension is filed, it is due on October 15th.

Estate Planning Attorney

It is recommended that one's current estate plan be reviewed if one wants to take advantage of this higher lifetime gifting exemption which is scheduled to end this year. It is important that an estate planning attorney be consulted to help in developing a customized strategy as each person's situation is different.

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