ESTATE PLANNING &
ELDER LAW CENTER

BRIAN T. TREACY

Plan for Tomorrow, Today

Gifting and Taxes

There has always been a great deal of confusion about one ability to make gifts from an estate and the implications on gift and estate taxes.

Most clients do not have estates large enough (over $5 million) to have estate tax or gift taxes imposed but they have been told that they can only give a certain amount (currently $13,000) per individual each year without having to pay gift taxes. The vast majority of people need not be concerned with gifting more than $13,000 per year, especially under the current estate tax laws.

Many view this as a harsh tax law. I agree.

What is the Annual Exclusion anyway? It is an amount that the IRS allows you to give away without the amount being subject to gift tax or requiring the filing of a gift tax return. The annual exclusion is currently $13,000 but is indexed for inflation in $1,000 increments.

As a planning tool, the annual exclusion allows wealthy clients to reduce the value of their taxable estate. Every $13,000 that is gifted under the annual exclusion is $13,000 less that will be subject to estate tax at the client's death. But most clients can ignore the Annual Exclusion Amount. Say that Joe, an unmarried man, has an estate worth $1 million. In 2012, Joel decides to give his $100,000 vacation home to his daughter Sally. This gift clearly exceeds Joel's $13,000 annual exclusion. Does that mean that Joel or Sally will need to pay taxes on the transfer?

The answer is "no." Each person has a certain amount (the applicable exclusion amount) that he or she can give away during their lifetime and at death without being subject to estate or gift taxes. That amount is currently $5 million. That means that Joe can give an aggregate of $5 million away during his lifetime or at his death without worrying about estate taxes. Since Joe's estate is only worth $1 million he doesn't need to worry about being subject to estate or gift tax on any lifetime transfers. The gift of the vacation home to Sally will not be subject to gift taxes.

Gifts in excess of the annual exclusion only reduce the overall applicable exclusion amount. Each gift in excess of $13,000 will chip away at the $5 million that a person could otherwise transfer free of estate and gift taxes.

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GIFTING AND TAXES (cont'd)

If Joe gave away $87,000 more than the annual exclusion amount ($100,000 value of home less $13,000 annual exclusion amount). This $87,000 reduces his applicable exclusion amount of $5 million to $4,913,000. Since Joel's estate is only worth $1 million, his remaining $4,913,000 exemption will easily cover the value of his estate at death. No estate or gift taxes will be paid on the transfer of the home to Sally.

Because the value of most people's estates doesn't exceed the applicable exclusion amount (currently $5 million per person, $10 million per married couple), most people don't need to worry about paying gift taxes for gifts in excess of the annual exclusion amount (currently $13,000).

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