

Gifts: An Estate Transfer Tool

Not all estate planning has to wait until your death to be effective. Some people desire to transfer property before their death, when they can see the benefits and receive the enjoyment of the outcome. This can be accomplished through an estate planning tool called gifting.

Gifts are an expression of love and affection, but can also serve other purposes. Gifts can give children an opportunity to participate in the management of a family business, pay medical expenses, assist with the purchase a home, and much more. Gifts can transfer income-producing property from one family member to another, perhaps to someone in a lower tax bracket. Gifts can reduce the size of the estate that must pass through court administration and even reduce federal estate taxes.

Federal Gift Law.

Giving away your property sounds simple, but one needs to be aware of the Federal Gift Tax and its rules. The federal government levies a gift tax upon transfers of real and/or personal property made during the transferor's lifetime, where the transferor does not receive full and adequate consideration. The person making the gift must part with the property and control over it (or part of it) before it is considered a gift.

The monetary value of the gift is the fair market value of the property on the date the gift was made, less the fair market value of any property received in return. Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under compulsion to buy or sell.

Annual Exclusion

Federal law permits an annual exclusion of up to \$12,000 on transfers to family members or other persons without payment of the Federal Gift Tax. The annual exclusion is indexed for inflation and by regulation adjusts in \$1,000 increments.

For gifts amounts lower than the annual exclusion (\$12,000) a Federal Gift Tax return does not need to be filed with the IRS. The annual exclusion is not cumulative and does not carry over from one year to the next.

For gifts greater than the annual, there still may be benefits to gifting property and paying the gift tax, rather than waiting to transfer the property through your estate. Federal law allows for the deduction an applicable credit of \$345,800 during the years 2006 – 2009. The credit is used to offset gift taxes on transfers made during life. This means a person can transfer during life, in addition to the annual exclusion of \$12,000, up to \$1,000,000 in assets with no Federal gift tax. There are numerous rules relating to gifts in excess of the annual exclusion and you should consult with a professional if you are considering such gifts.

Gifts by Married Couples

Each spouse can give up to \$12,000 per person per year, for a total of \$24,000 by a married couple.

Example: A father and a mother can give each of their two children up to \$24,000 annually reducing their taxable estate by \$48,000 per year. The children will not have to pay gift taxes on the \$24,000 each received, but will have to pay any state and federal income taxes on any income earned on the property following the date of the gift.

Gifts made by married couples from jointly held assets, such as real estate, joint bank accounts or joint investment accounts are treated as being made equally by each spouse. If the asset is held in the name of only one spouse, an election can be made so that the gift is treated as being made equally by both spouses.

Marital Exemption

Married people can make gifts of any amount to one another; not gift tax is due and no gift tax return is required to be filed provided the spouse is a U.S. citizen.

Educational – Medical Exemption

Any amounts paid directly to a qualified educational organization for tuition or to a health care provided for medical services are excluded from the gift tax.

Example – A grandparent can pay the cost of law school tuition and fees (\$75,000) for their grand daughter to attend law school. The amount is not subject to federal gift tax because they fall under the educational exemption. In addition, the grandparent could gift the grand daughter \$12,000 directly under the annual exclusion.

Example – A parent or grandparent could pay the medical expenses directly to the hospital to cover the cost of services not covered by medical insurance and not file a gift tax return.

Charitable Deductions.

Gifts made to qualified charitable, religious, education, governmental agency and qualifying organization with tax-exempt status (501(c)(3)) are not subject to the federal gift tax.

Gifts for your situation

Gift giving is usually combined with other estate planning tools. Before you sell the family farm or cottage and pay capital gains taxes, consider making a gift. If you are likely to incur estate taxes at death it may be advisable to give away more while you can enjoy the benefits. There are numerous exceptions and rules which must be considered when planning gifts and avoiding Federal estate gift taxes.

This article is not a substitute for legal advice; it is designed to help persons to be better informed of the basic provisions of the Federal gift tax law. There are numerous exceptions and conditions to some of the concepts discussed. In addition, there are regular changes in the tax laws.