To Gift or Not To Gift

Estate planning often includes gifting to decrease one's estate in the hopes of saving estate tax. Understanding the legislative landscape is necessary to explain the tax benefits of gifting but, in the most basic terms, if one gives property away, one has less property that may be subject to estate tax. Both the gifted property and all future appreciation on the gifted property escape estate tax in the donor's estate. Although the federal estate tax is scheduled to be eliminated for decedents who die in 2010 and the exemption from estate tax will increase from $1.5 million to $3.5 million from now until that time, after 2010 the estate tax exemption goes back down to $1.0 million.

There are limitations on the amount of property that can be gifted annually. If the annual limitation is exceeded, one is said to have made a "taxable" gift. Each person has a lifetime gift tax exemption that is applied to "taxable gifts"; thus, no gift tax is actually paid until such lifetime exemption has been exhausted.

Gift Tax Exemption

The annual exclusion from gift tax is $11,000 per donee per calendar year and only applies to present interest gifts. Often when a transfer is made to trust, the trust grants a power of withdrawal that converts the future interest gift into a present interest gift to enable the gift to qualify for the annual exclusion. (For a detailed discussion of powers of withdrawal, please refer to the article in June's *Perspective* on this subject.)

The lifetime gift tax exemption is frozen at $1.0 million even as the estate tax exemption increases. Transfers in excess of the annual exclusion, after the donor's lifetime exemption is exhausted, generate gift tax. Actually paying gift tax is almost always poor planning in light of the elimination of the estate tax in 2010.

To remove property from one's estate, one must make a complete gift which requires relinquishing all dominion and control over the property gifted. A gift where one retains the right to use the property is ineffective in removing the property from the donor's estate. The donor must no longer benefit from the property or control the property.

A gifting program that uses annual exclusion gifts and, in limited circumstances, a portion or all of a donor's $1.0 million exclusion can transfer a substantial amount of wealth over a number of years. Annual exclusion gifts by parents of $22,000 plus the appreciation on the same add up quickly. The removal of the gifted sums decreases the donors' estates and will likely save estate tax.

Gifting Threshold

Even if there is a substantial projected estate tax saving from a gifting program, there are many issues that should be considered before making gifts. The first and foremost issue that must be considered is the amount of property one should have before making gifts. I call this a gifting threshold. From an estate tax planning perspective, the

threshold should logically be the current estate tax exemption amount; however, I suggest that this should not be the determining factor.

A potential donor should have property that he/she is virtually certain that he/she will not need at any point in the remainder of his/her life before commencing a gifting program because, once a gift is made, the donor can no longer benefit from the property. Moreover, the donor should not rely on the donee "giving" the property back if the donor needs it because the property, if gifted outright to the donee, is subject to the claims of creditors of the donee.

Each potential donor should determine his/her own gifting threshold and gifting thresholds vary dramatically. A young person is likely to have a higher threshold while an older person may have a much lower gifting threshold. Gifting thresholds rely on subjective data too. A conservative donor is more likely to believe that he/she needs a greater amount of property for the remainder of his/her life which results in a higher gifting threshold. The financial condition of the donee also often impacts a donor's gifting threshold. The greater the need of the donee, the more likely the donor is to gift.

Prior to making any gifts, I suggest that donors consider their own personal and financial circumstances to define their gifting threshold. Consider age, income, assets, and life expectancy based on health and family history. After one decides on his/her threshold, one must determine an appropriate gift amount. Again, this is a personal decision that should consider all of the same factors as determining a gifting threshold. Obviously, the gift should not be of an amount that brings one's property below their gifting threshold. Finally, one needs to decide what to gift.

To evaluate the issue of what to gift, a donor must first look at what the donor owns and what of those items he/she can live without. This usually eliminates the donor's home and often leaves cash, securities, and rental real estate. Next, the donor must consider the implications of the gift. For example, a gift of rental real estate not only transfers the property to the donee, but it also transfers the future rental income to the donee.

Next the donor must consider the income and estate tax implications of gifting each particular item of property. A gift generally removes property from the donor's estate for estate tax purposes and a donee generally receives the donor's basis in gifted property for income tax purposes, but, as with many tax rules, there are many exceptions especially when the donor and the donee are related, as they usually are.

Whether to make a gift, how much to give and what to give are all complicated issues. These issues must be determined by consideration of more than just the potential estate tax savings. As with any other sophisticated estate planning technique, I recommend that you consult and attorney or Certified Public Accountant who practices in these areas prior to commencing a gifting program.

The author of this article, Joseph G. Imbriani, Esq., CPA/PFS, practices in the areas of taxation and estate planning and is a partner of the Boston law firm of Taylor, Ganson & Perrin, LLP.