

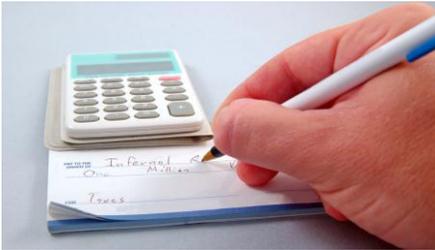


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## Make Large Gifts Now, Pay More Tax Later?

February 16, 2011 by Deirdre Wheatley-Liss



If you make big gifts in 2011-2012, what happens when you die in 2013 and beyond?

Right now, and continuing through 2012, there is a gift tax/estate tax/GST exemption amount of \$5,000,000 per person. We have discussed before what a fantastic opportunity this can be for wealthy families to do transfers at little or no transfer tax.

However, for every action, there is also a reaction. One thing that is not being talked about, and that families need to be aware of, is: What are the consequences of making a large gift utilizing the \$5,000,000 exemption amount, in the event that the estate tax exemption amount upon your death is lower (such as \$1,000,000) and what impact this might have on your New Jersey estate taxes. This problem is sometime referred to as the "Clawback" (no, I did not make that up).

All of this stems from the little known or understood fact that "prior taxable gifts" are added to a person's taxable estate to determine their federal estate tax liability. Since New Jersey relies on the Federal estate tax liability scheme as it existed in 2001 to determine its estate taxes, the Clawback issue is particularly dear to New Jersey residents.

When making a gift using your gift tax exemption, it is generally explained that you use it now or you use it later. For example, if you make a gift of \$2,000,000 during your lifetime, and the estate tax exemption amount was \$5,000,000 on your death, you would effectively have \$3,000,000 of your exemption left. However, the way that is calculated is you have \$6,000,000, you gave away \$2,000,000 (leaving a \$4,000,000 estate, which is less than the \$5,000,000 exemption amount) and you die. Your prior \$2,000,000 gift is added back to your taxable estate of \$4,000,000, creating the same \$6,000,000 taxable estate, the \$5,000,000 is applied to the estate, and in my example, you have \$1,000,000 upon which the estate tax may be levied.

The problem? What happens if the estate tax exemption amount is less upon your death. Going back to the example above, you had a \$6,000,000, you gave away \$2,000,000 so that you have a \$4,000,000 estate upon your death. You add back in the \$2,000,000 to create a \$6,000,000 taxable estate, but you only have a \$1,000,000 exemption amount. In this situation, your taxes are being levied on a \$5,000,000 taxable estate (\$6 million less \$1 million exemption), but in reality, there are only \$4,000,000 of assets actually in your estate, because you had added back this theoretical \$2,000,000 that you had already given away.

For New Jersey purposes, this situation can be even worse. That is because New Jersey has such a low estate tax threshold of \$675,000. Theoretically, you could have had \$5,100,000, and given away \$5,000,000. For New Jersey estate tax purposes, the \$5,000,000 "prior taxable gift" is added back in to your taxable estate, and the New Jersey estate tax is calculated on the combined amount.



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The New Jersey estate tax is somewhere in the vicinity of \$350,000, but the only assets that you actually have are \$100,000.

So when considering gifting to take advantage of the 2011/2012 transfer tax sale, thought must be given to what happens after the sale is over – will so much of your estate be potentially subject to taxes if there is a lower estate tax rate (or if you are in New Jersey) that making a gift now precludes you from making other distributions upon your death?

Thanks to Steven A. Loeb, Esq. for his insights for this article.

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