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Additional Analysis To Be Made When Gifting in 2011 and 2012

Posted at 9:09 AM on February 14, 2011 by Samuel Weiner

Under the Tax Relief Act of 2010, an individual has a lifetime exemption equal to \$5 million for 2011 and 2012. This exemption can be used to not pay estate and gift taxes or both. In 2013, this exemption is scheduled to go back to \$1 million unless there is further legislation enacted to have the exemption be different. There is a legitimate concern that it will be important to utilize this exemption over the next 2 years to avoid the potential risk that it may go down to a lesser amount in the future. There needs to be careful analysis as to whether one should gift. A key concern is the income tax basis that the recipient will receive. If one inherits an asset, the basis is the date of death value. Alternatively, if one receives a gift, the basis is the lesser of the grantor's basis and the fair market value of the property at the time of gift. This can have a great impact on a subsequent sale of the asset and/or depreciation deductions available for a depreciable asset. For example, assume that dad bought a rental property for \$100,000 and it is now worth \$5 million. Dad wants to transfer the property to his child. If dad gifts the property, then the child's basis will be \$100,000. If the child then sells the property for \$5 million, he/she will have a capital gain of \$4.9 million which at an approximate combined federal and state income tax rate of 25% would result in taxes of \$1,225,000. Alternatively, if Dad died owning the property, the child's basis would be \$5 million and a subsequent sale would result in no capital gain. If the child did not sell the inherited property, he/she would be able to take much higher depreciation deductions based on the substantially increased basis to

reduce taxable rent payments thereby substantially reducing income taxes. Therefore, any gift plan analysis must take into account the benefits to be derived by gifting such as federal and New Jersey/New York estate tax savings versus any potential lost income tax benefits.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North
25 Main Street
Hackensack, NJ 07601
Phone: (201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone: (212) 752-8000

500 Delaware Avenue
Suite 1410
Wilmington, DE 19801
Phone: (302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone: (410) 230-0660

301 Commerce Street
Suite 1700
Fort Worth, TX 76102
Phone: (817) 810-5250