Consider Gifting Options Now

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Karen L. Kayes

As discussed elsewhere in this newsletter, the federal estate and generation-skipping transfer (GST) taxes are scheduled to reappear in 2011, absent Congressional action. The estate and GST taxes will be at higher rates (increasing from the 45% rate in 2009 to 55% in 2011), with a significantly lower tax exemption (decreasing from $3.5 million in 2009 to $1 million in 2011).

Although the estate and generation skipping taxes were repealed for 2010, the gift tax was not. Taxable gifts, in excess of those allowed as tax-free and after use of the $1 million exclusion, are taxed in 2010 at a flat 35%. In 2011, the gift tax will increase to a maximum of 55%.

Tax-free Gifts

These significant increases in the taxation of wealth transfer means individuals who may be subject to estate taxation will want to consider some of the simpler gifting strategies available. They include:

- Gifts of $13,000 to an unlimited number of donees. Especially in 2010, gifts to grandchildren and other younger generation individuals may be desirable.
- Direct payment of tuition expenses to qualified educational organizations on behalf of an individual.
- Direct payment of medical expenses, including health insurance premiums, on behalf of an individual.

Since there is no limit to the number of annual exclusion gifts that a donor may make to different donees, this method of gifting is an extremely useful technique to transfer wealth without reducing a donor's gift and estate tax exemption. The payment of qualified tuition and medical expenses is in addition to the annual exclusion gifts and could thereby significantly reduce a taxable estate.

Taxable Gifts

Taxable gifts should also be considered in 2010. If the $1 million exclusion is fully utilized, a donor will pay gift tax. However, in 2010, the gift tax rate is 35%. If the gift is made in 2011, the rate will increase to a maximum of 55%. Similarly, if the asset is left in the donor’s estate, at death the value will be taxed at up to 55%.

To illustrate the savings, let’s assume John has an estate of $2 million. He has 3 children and 6 grandchildren. In 2011, without having made any gifts, the estate tax owing will be $560,250. If, during 2010, John makes annual exclusion gifts to each of his children and grandchildren, he will have reduced his taxable estate to $1,883,000, and reduced the federal estate tax to $507,600, a savings of $52,650. If, instead, John gifts $1 million among his children and grandchildren, he will pay $268,100 in gift tax. If he lives 3 years beyond the payment of the gift tax, the amount of the tax paid will also be excluded from his estate, resulting in zero estate tax liability.

Review Your Options

It is impossible to know for certain what the estate and gift tax system will ultimately look like for 2011, let alone for future years. In fact, Congress may attempt to alter the 2010 system retroactively. Regardless, for those likely to be subject to estate tax, consultation with a Warner Norcross & Judd estate planning attorney is recommended to determine if any of these strategies will work for you.