March 2010

The Truth About Gift Tax

By Gina M. Barry, Esq.

One of the most common areas of confusion with respect to estate planning is gift tax. Gifts are made for a myriad of purposes, including celebrating occasions, helping a child or other family member, protecting assets from potential nursing home costs or even reducing an estate for estate tax purposes. Gifts are often made without the realization that certain gifts must be reported to the government via a gift tax return. When taxable gifts have been made, the gift tax return must be filed by April 15th of the following year – i.e. along with your income tax returns.

Massachusetts does not impose a gift tax regardless of the amount that has been given away. For Massachusetts residents, tax is imposed only by the federal government. That being said, most people believe that they can gift $10,000 per year without reporting it. In fact, the annual exclusion amount is based upon the Consumer Price Index, and the exclusion has increased gradually from $10,000 in 1997 to $13,000 in 2009. Recently, the Internal Revenue Service announced that the 2010 gift tax annual exclusion will remain at $13,000. This means that an individual can give up to $13,000 to as many people as desired in 2010, and there is no requirement to file a gift tax return reporting the gifts. A married couple can gift $26,000 to as many individuals as desired, as each spouse receives their own exclusion. If no gift tax return is required, then obviously no gift tax will have to be paid.

Although the gift tax annual exclusion is not limited to gifts to family members, gifting to family members can provide a great opportunity to transfer wealth and reduce potential estate taxes. For example, a married couple with three children and three grandchildren can gift $26,000 ($13,000 each) to each child and grandchild in 2010 without reporting the gifts. This would reduce their estate by $104,000. Even assuming that the annual gift tax exclusion never increased, if they repeat the same gifts each year, after 10 years, they would have removed over $1,000,000 from their gross estate, which would likely translate into estate tax savings as well.

Removing value from an estate is most important when the estate's value exceeds the estate tax threshold. In 2010, the Massachusetts estate tax threshold is $1 million. As of the time of the writing of this article, the federal estate tax has been repealed for 2010 and is set to return to $1 million in 2011. Most commentators now agree that it should be anticipated that a law will be enacted that will return the federal estate tax threshold to $3.5 million for 2010 and future years. By systematically gifting, what would have been a taxable estate can be reduced significantly, which would reduce, or even possibly eliminate, estate taxes.

In addition to gifting using the annual exclusion amount, there is a $1,000,000 lifetime exemption from gift tax. This means that even if a taxpayer gives more than $13,000 to a single recipient in a given year, the gift amount above $13,000 will not be subject to tax unless the taxpayer has already given a total of $1,000,000 in taxable gifts in their lifetime. When a gift tax return is filed, the amount of the gift will use some of the donor's unified credit, which is the credit that allows an individual to pass assets to their heirs at the time of their death without paying estate tax. In some situations, it makes sense to use some of the unified credit. If the donor owns assets that are expected to appreciate substantially in value, gifting those assets before the appreciation occurs can lock the appreciation out of their estate for estate tax purposes and allow the recipient to reap the benefit of the appreciation. Of course, the appreciated value will be included in the estate of the recipient, but the recipient may then consider systematic annual exclusion gifting to reduce their total estate. Also, if the donor's total estate is less than $1 million, gifts in excess of the annual exclusion amount will have no impact.

Finally, it is important to note that when a gift is given, it is not taxable to the recipient. Many people believe that if you give a gift in excess of the annual exclusion amount, the recipient will have to pay income tax on the excess amount. This is simply not true. Likewise, the giver of a gift does not receive a tax deduction for having made a gift, unless the gift was made to a qualified charity.

Gina M. Barry is a Partner with the law firm of Bacon Wilson, P.C., Attorneys at Law. She is a member of the National Association of Elder Law Attorneys, the Estate Planning Council, and the Western Massachusetts Elder Care Professionals Association. She concentrates her practice in the areas of Estate and Asset Protection Planning, Probate Administration and Litigation, Guardianships, Conservator-ships and Residential Real Estate. Gina may be reached at (413) 781-0560 or GBarry@BaconWilson.com.