Making the Most of the New Gift Tax

By Kevin Lanigan, Carlson Estate Planning

Under the Tax Act of 2010, which became effective last December, individuals can give away up to $5 million in gifts during their lifetime without triggering gift taxes ($10 million for married couples). The previous gift tax exemption was $1 million.

This change presents a great estate tax reduction opportunity. Making sizable gifts to heirs is typically an integral part of any tax-reducing wealth transfer strategy. Wealthy families now have far more flexibility in making transfers of wealth without incurring huge tax liabilities.

While this is great opportunity, it's important that you discuss the consequences with your tax advisor soon, since the current tax law expires December 31, 2012 and the current exemptions may then decrease. That outcome will be determined by Congressional action.

Understanding Gift Tax

Making gifts to heirs while you are alive reduces the size of your estate, thereby reducing the amount that may someday be subject to estate taxes. Any appreciation of those gifted assets will occur outside of one's estate, which means that the appreciated value will also not be subject to estate tax.

Beginning this year, the gift tax exemption is unified with the $5 million estate tax exemption. If you use up, say, $4 million of your gift tax exemption making gifts during your lifetime; only $1 million of your estate will be exempt from estate tax when you die.

That said, you can also give away significant amounts of your estate each year without eating into your exemptions. In 2011, you can give gifts of up to $13,000- and couples can give $26,000- per recipient, to an unlimited number of recipients, without those gifts counting against your gift or estate tax exemption. If you and your spouse gave $26,000 to each of three children and seven grandchildren every year, you could reduce your taxable estate by $260,000 a year, tax free, and without reducing your gift tax or estate tax exemption. Over five years you could pass $1.3 million out of your estate with no transfer tax implications.

Taking Action

The new gift tax exemption rules offer plenty of opportunities for estate planning. Make sure your existing estate plan is set up to take full advantage of them. Meet with your estate planning or financial advisor to review your estate plan and determine whether anything needs to be changed in light of the enhanced gift and estate tax regulations.

For example, the new law also introduces significant changes to the generation-skipping transfer tax, or GST. Transferring wealth directly to grandchildren or later generations can help sidestep unnecessary taxes. For example, say a couple passed assets to their children, who then left those assets to their children: The inheritance could potentially face two separate estate tax bills. Skipping generations can ensure that the assets are taxed only once. The new tax rules include a $5 million generation-skipping tax exemption that is unified with the gift and estate tax exemptions.

The unclear future of estate and gift taxes makes the current opportunity for gift giving all the more attractive, before the current laws expire in 2012. It’s wise to begin the process as early as possible.

Talk to Your Advisor About:

- Revising your estate plan given the new transfer tax rates
- Gifting noncash assets, such as shares in a family business
- Gifting-vehicles to make gifts to young heirs while still retaining some control over how the funds are used