The Gift Tax

In order to maximize the amount you're able to give to others, it's important to know when those gifts may be taxed. This white paper provides an overview of the gift tax laws to help you minimize taxes and maximize the benefits you're able to provide.

Gift Tax Basics

The IRS considers a gift to be any type of transfer you make, directly or indirectly, where you have not received full reimbursement in return. While most people tend to think about cash, gifts can include tangible property as well such as cars, real estate, or even a business.

Under current law, you may give up to $15,000 to an individual in 2021 without incurring taxes on that gift. This is called the annual exclusion amount. There is no limit on the number of individuals you can give to, and as long as you don't exceed the annual exclusion amount, there are no reports you must file.

If you are married, you and your spouse may gift up to $15,000 each for a combined total of $30,000 annually to a single individual; however, even though the amount is under the annual exclusion amount, you will need to file Form 709 which is the United States Gift and Generation-Skipping Transfer Tax Return.

So what happens if you exceed the $15,000 annual exclusion for one or more individuals? First, you do need to report any gifts that exceed the annual exclusion amount on the IRS Form 709. Then, the excess amount will be applied to your lifetime gift tax exemption until it is exhausted. Under the law, each person has a lifetime gift tax exemption to help cover gifts in excess of the annual exclusion plus assets given to their heirs. For 2021, lifetime gift tax exemption is $11.7 million per person and $23.4 million per couple, and those amounts do increase each year with inflation.

So let's say you give an individual $20,000 in 2021. The first $15,000 is exempt due to the annual exclusion. The remaining $5,000 would go against your lifetime gift tax exemption, which you would need to report on the IRS Form 709.

If an individual exhausts their lifetime gift tax exemption, then they must pay taxes on gifts in excess of the lifetime gift tax exemption amount. The tax rates are progressive, ranging from 18% to 40% depending on the taxable amount.

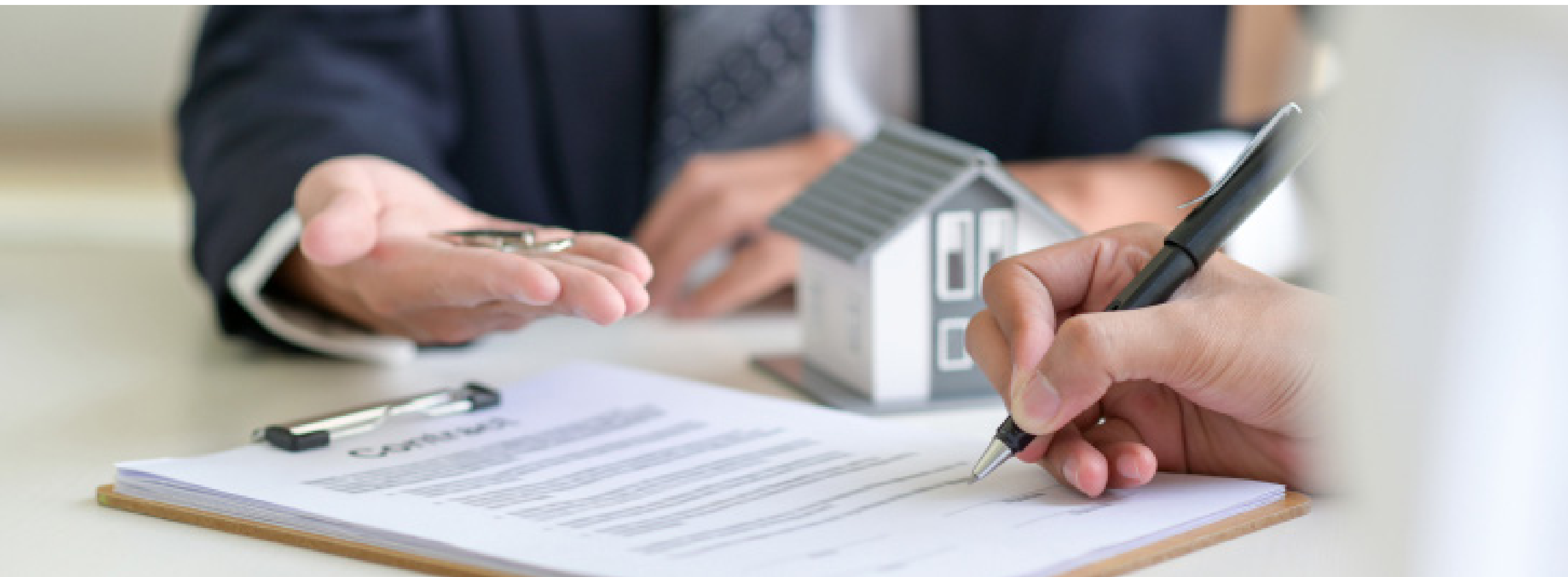
Gifts That Are Exempt

There are certain types of gifts that do not count against your annual or lifetime exclusion. These gifts include gifts to a spouse who is a U.S. citizen, gifts to charitable organizations, gifts for tuition and qualified educational expenses that you make directly to the educational institution, and gifts to cover medical expenses for someone else when you pay the provider of the medical service directly. This is why paying for education is an excellent way to transfer wealth tax free from one generation to another.

Basis Step-up

As we discuss gifting, it's also important to explain how "basis" works in estate planning. An individual may own certain assets that appreciate over time, and if sold during their lifetime might be subject to capital gains taxes on the profit from the sale. However, under current law, certain assets such as stocks, mutual funds, bonds, businesses, equipment and real estate, may receive a step-up in basis upon the death of the owner. From a tax point of view, it's essentially a readjustment in what the asset originally cost. This enables heirs to avoid paying taxes on the appreciated value of the asset.

Let's say Joe had purchased a piece of property for $100,000 several years ago. Joe passes away and leaves the property, now valued at $200,000, to his daughter. The daughter holds the property for six months and sells it one day for $250,000. In this case, Joe's daughter will owe taxes on only $50,000, which is the appreciated value since the time of Joe's death.



Legislation

In 2017, the Tax Cuts and Jobs Act significantly increased the gift tax exemption and lifetime exclusion limits, which we benefit from today. While these increases are not scheduled to sunset until December 31, 2025, many taxpayers are questioning whether the current legislature will reduce these limits prematurely. There is also concern that the legislature may increase the estate tax rates and eliminate the basis adjustments for inherited assets. Perhaps an even bigger concern is whether potential changes in the law would be made retroactive to January 1,2021.

Next Steps

There are estate planning strategies that can help mitigate the risk of changes to the laws and the possibility of retroactivity. Every situation is unique and now would be a great time to evaluate your gifting and estate plan. If you have any questions or would like to discuss your plan, please contact our office.

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