Estate Tax Concepts

GIFT TAX ANNUAL EXCLUSION

Presented for

Valued Client

Presented by

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GIFT TAX ANNUAL EXCLUSION

The Concept…

- Those who regularly use the gift tax annual exclusion can reduce the size of their taxable estate and transfer wealth at a lower cost.
- Every year, an individual can give up to the annual exclusion amount (set at $14,000 in 2017) to as many people as desired without making a taxable gift.
- For example, Lionel has two children who are married and two nephews who recently graduated from college. He gives $14,000 to each child, the spouse of each child and each nephew—six gifts of $14,000 that total $84,000. Lionel reduces his estate, transfers wealth to family, and avoids gift tax on the transfers.
- Since these gifts can be made year after year using the annual gift tax exclusion, it can be an effective means of progressively transferring wealth to family members over time.

The Procedure…

A transfer of property is considered a gift only when it is:

- **Gratuitous,** which means the transfer can't provide the donor with any fair value in return. This would be considered a sale, not a gift. For example, if the donor sells an antique auto worth $60,000 to his niece for $35,000, the donor is considered to have made a $25,000 gift and a $35,000 sale.
- **Complete,** which means the donor can't retain any control over the property, possession of the property or any power to revoke the gift.
- **Voluntary,** which means the transfer of property isn't the result of any legal requirement. For example, a trust required for a child by a divorce court as part of the marriage dissolution isn't a gift because it was required, not voluntary.

Here are some additional requirements:

- To secure the annual exclusion, gifts must be of a "present interest." This means that the person receiving the gift must have an unrestricted right to the immediate use, possession or enjoyment of the property after the gift is made.
- The exclusion isn't allowed if there are any conditions that delay use of the property or require the recipient to get someone else's agreement to use the property.

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- The present interest rule doesn't disqualify a gift made to a Section 2503(c) trust for a minor child from the annual exclusion. Even though this technically represents a "future interest," the annual exclusion is allowed.
- If the gift exceeds the annual exclusion amount, donors may draw on their lifetime gift tax credit to shelter the excess amount from the federal gift tax.
- The lifetime gift tax exclusion and the estate tax applicable exclusion are unified. In 2017, the unified credit will shelter up to $5.49 million in taxable lifetime gifts and taxable estate transfers.

Gift-Splitting

- An even greater annual exclusion benefit can be realized with gift-splitting.
- Only married couples can take advantage of gift-splitting.
- When only one spouse owns the property, both spouses can join in making the gift for federal gift tax purposes, which effectively doubles the available gift tax annual exclusion.
- To properly split a gift, one spouse must consent on that year's federal gift tax return.
- For example, Lionel and Marjorie want to give the maximum amount to their son Nigel and his wife, Olivia, without incurring gift tax. In 2017, the couple jointly gives $28,000 in stock to both Nigel and Olivia. Neither gift is taxable because Lionel and Marjorie agree to split the gifts—which is possible even though Lionel is the sole owner of the gifted stock.

The Bottom Line…

The federal gift tax annual exclusion provides individuals and married couples a tax-advantaged way to transfer property during their lifetimes to people who may likely be the ultimate recipients anyway. It lets recipients enjoy property sooner, and provides "givers" a way to both reduce future estate taxes and have the satisfaction of making lifetime gifts.

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SUMMARY

What Is It?

The gift tax annual exclusion is a planning tool that individuals can use to reduce the size of their gross estates by making gifts during their lifetime. The amount an individual may give free of gift tax to any one person is subject to a limit that is indexed annually for inflation. However, there's no limit on the number of people who may receive such gifts.

How Does It Work?

Every year, individuals may give up to the annual exclusion—$14,000 in 2017—to as many people as they want. The gross estate is then reduced by the total amount of these gifts. For example, a man giving $14,000 to one person in 2017 reduces his estate by $14,000. A woman who gives $14,000 each to five different people reduces her estate by $70,000 using the annual exclusion.

If the gift exceeds the annual exclusion amount, the donor can use the unified credit to shelter up to $5.49 million of taxable lifetime gifts or taxable estate transfers (in 2017).

Gift-splitting permits married couples to elect to split a gift that is made from the separate property of only one spouse. This allows the couple to double the annual exclusion available for the gift. For example, if Oliver wants to give his son stock worth $28,000 in 2017, he and his wife Hannah could elect to split the gift, with each of them using their $14,000 annual exclusion, even though Oliver is the sole owner of the stock. Oliver and Hannah could choose to repeat this scenario in future years.

What Constitutes a Gift?

To qualify for the gift tax annual exclusion, the property being transferred must be considered a completed gift. This means that it must be:

1. **Gratuitous.** The donor can't receive something in return or it would be considered a sale, not a gift.
2. **Complete.** The donor may not retain any control over the property (such as retaining actual possession) or any power to revoke the gift.
3. **Voluntary.** The donor must choose to make the gift—a transfer required by a court of law or other legal authority is not considered a gift.

In addition, qualifying gifts must be of a "present interest." This means that the person receiving the gift must have the right to enjoy the property immediately after the gift is made. The donor cannot use the gift tax annual exclusion if the recipient's enjoyment of the gift is delayed until some future time or if the recipient is required to get someone else's agreement in order to exercise rights of ownership. There is, however, an important exception to the present interest requirement: Gifts to a 2503(c) trust for a minor qualify for the annual exclusion even though the minor beneficiary has a future interest.

What Are the Benefits?

The federal gift tax annual exclusion gives individuals and couples a tax-advantaged way to transfer property during their lifetimes to people who would likely be the ultimate recipients anyway. Donors can reduce the size of their gross estates, thereby reducing the federal estate tax and other estate administration costs. The recipients can enjoy the property before the donor’s death, with immediate use of the gift.

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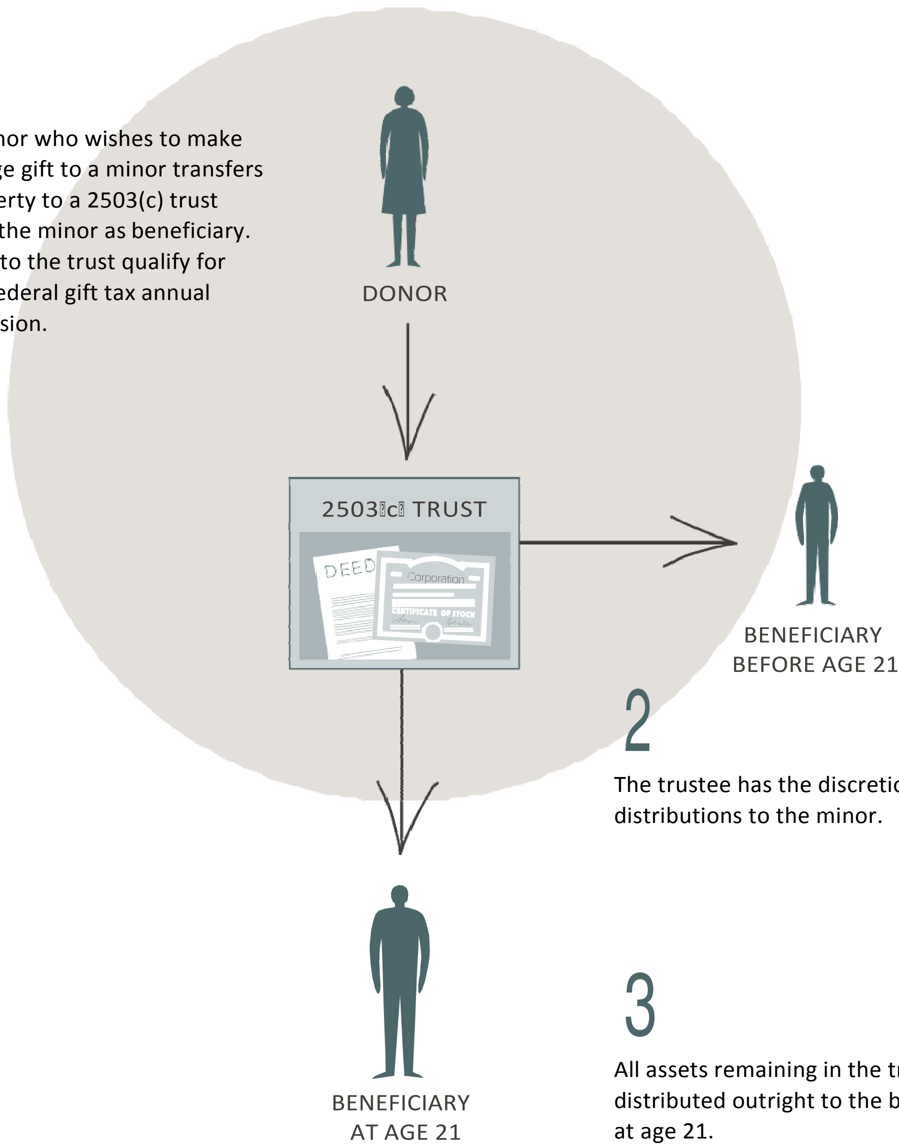
How a 2503(c) Trust for Minors Works

1

A donor who wishes to make a large gift to a minor transfers property to a 2503(c) trust with the minor as beneficiary. Gifts to the trust qualify for the federal gift tax annual exclusion.



2

The trustee has the discretion to make distributions to the minor.

3

All assets remaining in the trust are distributed outright to the beneficiary at age 21.

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How Gift-Splitting Works

1

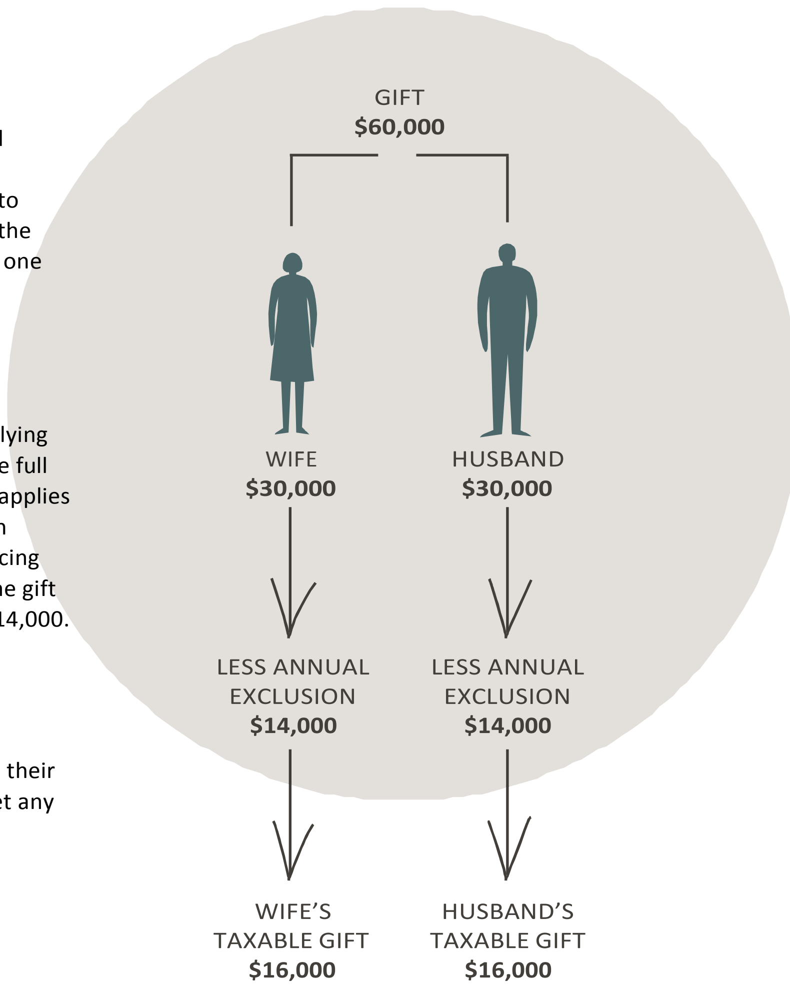
To reduce taxes, a married couple makes a large gift together. Each is deemed to make half the gift, even if the property only comes from one spouse.

2

Instead of one spouse applying the gift tax exclusion to the full gift amount, each spouse applies their own gift tax exclusion amount, significantly reducing the taxable gift. In 2017, the gift tax exclusion amount is $14,000.

3

Both spouses can draw on their own unified credit to offset any gift tax due.



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