Better to Give Than Receive: Three Ways to Save on Estate Taxes

When planning an estate tax strategy, we advise clients to maximize their estate and gift tax exclusion. During 2013, you can make many gifts to children and grandchildren while incurring little or no gift tax. These gifts may also reduce your overall income tax burden. Here are three options:

Estate and Gift Tax Exclusion

The amount a taxpayer may transfer without incurring estate or gift taxes in 2013 is $5,250,000. The amount of the estate and/or lifetime gifts that exceed that amount is subject to a 40% estate and gift tax rate. However, if a spouse dies after 2010 without exhausting his or her estate and gift tax exclusion amount, the surviving spouse may be able to use the deceased spouse's remaining exclusion amount, called a portability provision.

Lifetime gifts of up to $5,250,000 also may save estate taxes because they remove post-gift appreciation on, and possibly income from, the gifted assets from the transferor's estate.

Gifts or transfers of assets to grandchildren in essence 'skip' a generation, and are subject to the same exemption amount ($5,250,000 in 2013). However, the generation-skipping transfer (GST) tax exemption may not be used by a surviving spouse. Like the estate and gift tax rates, the rate used for calculating the GST tax is 40%.

While still living, certain types of lifetime gifts preserve a taxpayer's applicable exclusion amount and are not subject to gift tax.

Annual Gift Tax Exclusion

The most commonly used method for tax-free giving is the annual gift tax exclusion, which, for 2013, allows a person to give up to $14,000 to each donee without reducing the giver's estate and lifetime gift tax exclusion amount. A person is not limited as to the number of donees (family or non-family) to whom he or she may make such gifts. So, if an individual makes $14,000 gifts to 10 donees, he or she may exclude $140,000 from tax or from reducing their lifetime gifts. Spouses may combine their exemptions in a single gift from either spouse, doubling the amount of the exclusion to $28,000 per donee. Amounts are per year, and if not used, may not be carried over to the next calendar year.

The annual gift tax exclusion applies to gifts of any kind of property, as long as the gift is of a present, rather than a future, interest, although certain types of property may require an appraisal. Gifts of appreciated property also could result in income tax savings to the giver, because the recipient would pay the capital gains tax on any sale.

Tuition Payment Exclusion
A taxpayer may also make tuition payments for any individual without incurring gift tax. Though the amount that may be excluded is not limited, all payments must be made directly to a qualifying educational institution for education or training purposes. The exclusion applies only to tuition. Room and board, books, required equipment, or related expenses are not excludible. Because there is no limit on the gift amount, its timing is less important than with the annual gift tax exclusion.

Medical Payment Exclusion
Subject to limitations, a person may exclude from gift taxes all payments he or she makes directly to medical providers on behalf of another individual. The exclusion for medical payments also includes the payment of medical insurance premiums. Thus, paying a child or grandchild's insurance premiums is an efficient means of making a tax-free gift that does not consume either the annual gift tax or the estate and lifetime gift tax exclusions. Further, the payor may claim an income tax deduction for a payment made for his or her spouse or dependent.

Gifts in Trust
A person may not wish to make outright gifts to children or grandchildren, due to the loss of control over how they use the gift. Gifts in trust allow the trust creator to determine when the beneficiaries receive the money and how it is used.

By observing special requirements, a trust creator can ensure that a gift in trust qualifies for the annual gift tax exclusion. Generally, the trust is drafted to provide the beneficiary with temporary withdrawal rights over the gift (usually for 30 days), such that the gift is considered a present interest rather than one vesting in the future. Although this arrangement presents a risk that the beneficiary could withdraw the gift from the trust for purposes not to the creator's liking, the likelihood of the trust creator terminating any further gifts to the trust is usually sufficient to prevent such withdrawals. If you are interested in making a gift in trust, we can explore this option more thoroughly.

Charitable Gifts
Now is an excellent time to review charitable giving to ensure it is accomplished in the most tax-efficient manner. Charitable giving is a form of estate planning because a gift to charity never will be subject to estate or gift tax, and provides the giver with an immediate income tax deduction. If a person wishes to make a large gift, his or her circumstances must be reviewed to determine the gift's impact on this tax year's income tax liability and whether all or a portion of the gift should be deferred to a later tax year. If the gift is property and requires an appraisal (usually for gifts of property with a value in excess of $5,000, other than publicly traded stock), the process should be started as soon as possible to ensure a successful transfer.

In conclusion, we hope that the information in this letter is useful in your estate and gift planning for 2013 – 2014. If you wish to take advantage of any of the planning techniques that we have described, please feel free to contact us.