



Advantages and Disadvantages of Gifting

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DEFINITIONS

It is always best to start the discussion of any topic by first defining the terms to be discussed.

What is a gift?

A gift is the transfer of any asset from one person to another for less than adequate compensation. A gift contemplates the surrender of the original owner's control of the asset to another person or entity.



TAXES

Who pays the tax caused by a gift?

The person making the gift is referred to as the Donor of the gift. The person receiving the gift is referred to as the Donee of the gift. Gifts are never taxed as income to the Donee. If there is a gift tax generated by the making of a gift, generally it is paid by the person making the gift, the Donor.

Are all gifts taxable?

No, there are several exceptions.

ANNUAL GIFT EXCLUSION

The first exception is often referred to as the annual gift exclusion amount. The federal gift tax rules currently provide that you may give an amount not exceeding \$12,000 in 2008 (\$13,000 in 2009) to any other person once each year. Gifts of this amount or less are excluded from the payment of any federal gift tax. There is no limit as to the number of persons to whom you make annual exclusion gifts in any one year.

If you are married, you may give twice the annual exclusion amount (\$24,000 in 2008, and \$26,000 in 2009) to a donee using your and your spouse's annual gift

exclusion amount even though all the assets comprising the gift may be made from one spouse. However, in no event can you and your spouse give an amount in excess of \$24,000 (in 2008) to any one individual in any one year and use their annual gift exclusion amount as an exception to shield the gift from gift tax.

In order to qualify for the annual exclusion, your gift must be made with absolutely no restrictions. If there is a restriction made on the gift, such as, "Here is \$12,000, son. You can do whatever you want with the money, but you can't buy a car with it," then your gift does not qualify for the annual exclusion. The transfer is still a gift, but unless the transfer is covered by another exception, the transfer may be taxable to the Donor.

Gifts to minors (persons under legal age or the age as set by state statute for this particular exception) under the Uniform Gift to Minors Act may be subject to restrictions still qualify for the annual gift exclusion. When the minor reaches the age of majority, these restrictions are removed and the Donee of the gift is thereafter free to do whatever he or she desires with the gift.

If a gift is made of \$12,000 or less to any one person in 2008 is the Donor required to file a gift tax return?

No. There is no requirement that a gift tax return be filed by the Donor for gifts of \$12,000 or less to any one person in 2008 (\$13,000 in 2009).

LIFETIME GIFT EXEMPTION

Are there other exceptions to the gift tax in addition to the annual exclusion amount just discussed?

In addition to your ability to make any number of annual gift exclusion gifts to Donees each year, a Donor may, over the course of his or her lifetime, make up to \$1 million in gifts.

Gifts utilizing the Donor's \$1 million lifetime exemption must be reported on a federal gift tax return (Federal Gift Tax Form 709) on or before April 15th of the year succeeding the year in which the gift was made.

ESTATE TAX INCLUSION

In 2008, you can die leaving an estate of not more than \$2 million before you are required to pay federal estate tax. Is this \$1 million lifetime gift tax exemption in addition to your \$2 million federal estate tax exemption, or a part of it?

The \$1 million gift tax exemption for lifetime gifts is part of the \$2 million estate tax exemption available at death. Accordingly if you have used your \$1 million lifetime exemption for gifts during your lifetime, your estate tax exemption is reduced accordingly, so you only have \$1 million of your federal estate tax exemption remaining. The estate tax exemption increases to \$3.5 million in 2009. However, the lifetime gift tax exemption will remain at \$1 million.

The federal government changes the rules regarding gift and estate tax exemptions and exclusion amounts. Prior to undertaking any estate or gift tax planning strategies, you should consult an attorney to review the current rules and regulations and the probable tax effects of gifting.

INCOME TAX CONSEQUENCES

Are there income tax consequences of gifting in addition to the potential gift tax consequences?

Generally the Donee of a gift takes over the basis and holding period of the Donor. Consequently, when the Donee sells the property, the Donee may recognize gain that occurred while the Donor held the property.

EXAMPLE. You own ten acres of land you purchased for \$1,000 per acre. In 2008, each of these acres is now worth \$12,000. You wish to use your \$12,000 annual exclusion to gift one acre to your son. Your gift tax consequences are determined by the current value of the asset on the date of the gift. Accordingly, you can give your son one acre and avoid the payment of any gift tax.

The receipt of the acre as a gift is not income taxable to your son, as gifts are not income taxed to Donees.

However, if your son thereafter elects to sell this acre for \$13,000, he will not use the value of the asset on the day he received it (\$12,000) as his basis in calculating his taxable gain realized by the sale. Because your son received the acre as a gift, he will instead use your basis in the property as his basis for purposes of calculating his taxable gain on the sale. If the sale price is \$13,000, the basis of the son in the acre is your original basis of \$1,000 and the taxable gain is \$12,000.

For this reason, when a gift of an appreciated asset is made to a Donee, the Donor and the Donee should pay close attention to the Donor's basis and holding period in the gifted asset. In contrast, assets passing by reason of death under current estate tax laws are stepped up (or down) to fair market value on the date of death and automatically receive long-term capital gain or loss treatment. You should contemplate in advance the income tax consequences to the donee or heir upon a subsequent sale.

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