Gift Tax Annual Exclusion

The Concept…

- Individuals who regularly use the gift tax annual exclusion can reduce the size of their taxable estate and transfer wealth to family and friends at a lower cost.
- Every year, individuals can give up to the annual exclusion amount (set at $15,000 in 2019) to as many people as they choose without making a taxable gift.
- For example, Lionel has two children who are married and two nephews who recently graduated from college. He gives $15,000 to each child, the spouse of each child, and each nephew—six gifts of $15,000 that total $90,000. Lionel reduces his estate, transfers wealth to his family, and avoids gift tax on the transfers.
- These annual exclusion gifts can be made year after year. The gift tax annual exclusion can be a useful part of progressive wealth transfer to family members.

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The Procedure…

- ❖ A transfer of property is considered a gift only when it has the three following characteristics:
  1. It must be 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. 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. The remaining $35,000 is a sale, not a gift.
  2. It must be complete, meaning the donor can't retain any control over the property, possession of the property, or any power to revoke the gift.
  3. It must be voluntary, meaning 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.
- ❖ To secure the annual exclusion, the 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 delaying use of the property to some time in the future, or requiring the recipient to get someone else's agreement in order to use the property.
- ❖ 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.
- ❖ For gifts that exceed 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 2019, the unified credit will shelter up to $11.4 million in taxable lifetime gifts and taxable estate transfers (total).

Gift-Splitting…

- An even greater benefit from using the gift tax annual exclusion can be accomplished through gift-splitting.
- Gift-splitting can only be done by married couples.
- Regardless of who owns the property, both spouses join in making the gift for federal gift tax purposes. As a result, a couple effectively doubles the available gift tax annual exclusion.
- In order 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 2019, the couple jointly gives $30,000 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 gives individuals and married couples a tax-advantaged way to transfer property during their lifetimes to people who are intended as the ultimate recipients anyway. It lets the recipients enjoy the property sooner while providing the givers a way to reduce federal estate taxes in the future.

How a 2503(c) Trust For Minor Works

1. The donor transfers property to a 2503(c) trust for the benefit of a minor beneficiary. Gifts to the trust qualify for the federal gift tax annual exclusion.

2. At the trustee's discretion, property and income from the trust are used for the beneficiary's benefit until the beneficiary reaches age 21.

3. The property and any accumulated income remaining in the trust are distributed outright to the beneficiary at age 21.

How Gift Splitting Works

1. Husband and wife make a gift—in this example, $60,000—splitting their gift so that each is deemed to give $30,000, even if the property comes entirely from one spouse.

2. They apply their respective gift tax annual exclusion amount—$15,000 each in 2019, indexed to inflation for later years—reducing the taxable gift to $15,000 for each spouse.

3. Both spouses can draw upon their own unified credit to offset the gift tax otherwise due on their taxable gifts.

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