



GIFTING OFTEN WORTH MORE WHILE YOU'RE ALIVE

People with potential estate taxes must wrestle with a tricky question: should I give away some of my estate now or wait until my death to pass it on to my heirs? In many cases, the answer is to make gifts while you are alive, sometimes for a reason you may not realize.

Certified Financial Planner practitioners caution that before giving away assets while you are alive, you want to make sure you have enough assets to support yourself. But assuming you can afford to give assets away during your lifetime, what are the tax benefits and trade-offs? (This discussion doesn't cover charitable gifts, which also offer significant tax benefits.)

Most people know they can give away up to \$10,000 a year per donee free of gift tax, or up to \$20,000 if a married couple makes the gift (the \$10,000 is now indexed for inflation). In addition, a person dying in 1999 can pass on another \$650,000 in property free of federal gift and estate taxes thanks to a lifetime tax credit. (Technically, a person receives a tax credit of \$202,050, which is the amount that would be assessed on the \$650,000.)

Under our unified gift and estate tax credit system, the excluded \$650,000 can be either in the form of taxable gifts made during lifetime, bequests made at death or a combination. For example, if you have made lifetime taxable gifts of \$300,000, another \$350,000 in estate property would be excluded. (The gift and estate exclusion amount is scheduled to climb to \$1 million by 2006.)

Once you've used up the annual gift-tax exemption and the unified credit, any gifts or estate property is taxed at the same rate, starting at 37 percent and climbing to 55 percent once the total reaches \$3 million. Since gifts and estate property are taxed at the same rate, what difference does it make whether you gift during lifetime or not?

One answer is probably familiar to you. Future appreciation on property you give away stays out of your estate unless you make the gift within three years of your death. If you give away stock worth \$400,000, you'll owe gift taxes on that \$400,000. If the stock appreciates in value to \$1 million by the time you die, your estate won't pay estate taxes on the \$600,000 gain.

A second reason for gifting property during your lifetime may be less obvious, but it can save taxes even if the property doesn't go up in value between the time of the gift and your death. That's because under the unified gift and estate tax system gift taxes are "exclusive" while estate taxes are "inclusive."

Say you have a piece of property worth \$1 million. Let's also assume you are in the 55 percent gift-and-estate tax bracket and you've exceeded the \$650,000 exclusion. If you give the property away at least three years before your death, the total cost of your gift will be \$1,550,000—the value of the property itself plus the \$550,000 you must pay in gift taxes on the property. However, if you wait until your death, the total cost of passing on that same property will be \$2,220,000!

Why the \$670,000 difference? Because by gifting during lifetime, you remove not only the \$1 million piece of property from your estate, you remove the \$550,000 you use to pay the gift tax. If you wait until death, you pay tax not only on the \$1 million property, but also on the \$550,000 needed to pay the taxes on that property. In addition, you'll owe taxes on the money in your estate needed to pay the taxes on the \$550,000, and so on and so on. In short, you pay taxes on the money you use to pay the taxes.

Gifting during lifetime has disadvantages, such as losing the step-up in basis, which will mean higher capital gains taxes for the heirs, and the opportunity cost on the money used to pay the gift tax. You'll want your financial advisor to run the numbers. However, for people in a high marginal gift-and-estate tax bracket with a high expected appreciation of the property, gifting during lifetime is often the best choice.

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