

Federal gift tax: liability based on lifetime gifts

Dear Reader:

You recently asked how the federal gift tax liability is determined. Unlike the income tax which is based on taxable income for each year, the gift tax rate is based on the cumulative amounts of taxable gifts you make over the course of your life. Thus, as you make more and more taxable gifts, your gift tax bracket increases.

First, because of the annual exclusion, only gifts in excess of \$13,000 to each donee are "taxable" in 2009.

Next, the gift tax on the first \$1 million of taxable gifts you make during your life is covered by a gift tax credit. This credit wipes out the first \$345,800 of gift tax liability. This is the liability that would arise from \$1 million of taxable gifts. Accordingly, only after the taxable gifts you make during your life reach \$1 million will any gift tax apply. The tax on gifts made in the current year is the tax on total lifetime gifts minus the tax on gifts made before the current year.

Example. The taxpayer made no taxable gifts before 2001. In 2001, the taxpayer made \$750,000 in potentially taxable gifts. The gift tax on this amount, calculated under the gift tax rate schedule, was \$248,300, but the credit of \$220,550 that was in effect in 2001 (exempting the first \$675,000 of gifts) reduced the actual tax bill to \$27,750.

In 2009, the taxpayer makes an additional \$250,000 in potentially taxable gifts. This brings lifetime gifts up to \$1 million. Before application of the gift tax credit, the gift tax on \$1 million of gifts would be \$345,800: a \$248,300 gift tax liability on the 2001 gifts, plus \$97,500 on the 2009 gift of \$250,000, taxed at a marginal bracket of 39%. The actual 2009 gift tax bill is zero, because the gift tax credit of \$345,800 that applies in 2009 effectively exempts \$1 million of gifts. Because the taxpayer has used up his lifetime gift exemption, any otherwise taxable gifts he makes in later years will not be exempted from tax by the gift tax credit.

I should also note that under federal tax legislation enacted in 2001, the estate tax is scheduled to be repealed, effective 2010. However, the gift tax was not repealed, presumably to discourage taxpayers from making transfers to related taxpayers in lower income brackets. Therefore, the gift tax promises to remain a powerful consideration in the structuring of lifetime dispositions and in estate planning.

If you would like to discuss the role lifetime gifts can play in your overall estate plan or have any additional questions, please call.

