

Debunking Eight Gift Tax Myths

BY STEPHEN H. GARIEPY

Everyone makes gifts, whether it's a birthday present motivated by love and affection or stock in the family business motivated by tax planning goals. The gift tax, when it applies, is a flat rate of 40%. But few know the ins and outs of the gift tax rules. Eight prevalent myths deserve debunking.

Myth #1: The recipient of a gift must pay income tax on the gift. Generally, not true. There's a specific exclusion of gifts from income tax. And it makes no difference whether the gift is in the form of real estate, an automobile,

jewelry, stock or cash. However, a gift by an employer to an employee is taxable income unless made entirely for personal reasons not related to past or future services.

Myth #2: The donor pays gift tax if annual gifts to a recipient exceed \$14,000. Almost never the case. Although a donor is limited to an annual gift exclusion of \$14,000 per recipient per year (\$15,000 in 2018), a donor is also entitled to a large lifetime gift exemption of \$5,490,000 (\$5,600,000 in 2018). For example, if a donor makes a \$100,000 gift in 2017, the donor uses the \$14,000 annual exclusion and \$86,000 of the lifetime exemption. Further,

the annual exclusion and lifetime exemption can be doubled for married donors if both spouses take the required steps to "split" their gifts. Certain payments for tuition, medical care and health insurance do not count as gifts at all. There's also an unlimited gift tax deduction for qualifying gifts to a spouse. This gift tax marital deduction means there's never an excuse for skimping on a wedding anniversary present.

Myth #3: The lifetime gift exemption is a hard ceiling. The ceiling can be punctured. There are sophisticated estate planning strategies that can leverage the gift tax exemption many

Choosing just the right souvenir gift requires as much strategic planning as dealing with the gift tax laws.
St. Petersburg, Russia
Photograph by Steve Gariepy, 2017



times over. For example, a \$5,000,000 gift can cover a \$50,000,000 transfer, totally free of gift tax. There are even devices that can zero-out the gift tax on the future appreciation on large holdings. Just ask Sheldon Adelson (Las Vegas Sands), Mark Zuckerberg (Facebook), Lloyd Blankfein (Goldman Sachs), and Charles Ergin (Dish Network), who have transferred millions, even billions, free of gift tax.

Myth #4: A gift always saves estate taxes. Not with an estate exemption that matches the lifetime gift exemption of \$5,490,000 (\$5,600,000 in 2018). Only one-tenth of one percent of estates are subject to estate tax in the first place. Moreover, if a donor dips into the lifetime exemption it's a wash because it reduces the estate exemption dollar-for-dollar. Ways a donor can come out ahead include leveraging the exemption, paying gift tax (the same 40% rate as the estate tax but it's tax-exclusive), taking advantage of valuation discounts for lack of marketability and control, shifting ownership but not income tax responsibility, and gifting assets that appreciate in value between the date of the gift and the date of death.

Myth #5: There's no tax disadvantage to making a gift. A trap for the unwary. In the case of a gift of an appreciated asset, such as stock, the recipient takes over the donor's low cost basis and the recipient pays capital gain tax on a later sale. On the other hand, if there is no gift and the asset passes on the donor's death to the recipient, the recipient takes a stepped-up basis equal to the asset's then market value and all pre-death appreciation escapes capital gain tax. Always compare the projected estate tax savings to the income tax cost.

Myth #6. If the estate tax is repealed, the gift tax would be too. The estate tax was repealed once before, but the gift tax wasn't. And for good reason. The gift tax is a backstop not only to the estate tax but also to the income tax. Repealing the gift tax would open the floodgates to transferring appreciated assets subject to capital gains tax to family members in lower income tax brackets. Retention of the gift tax would be all the more important if, as often proposed, repeal of the estate tax is coupled with either a repeal of the step-up in basis to fair market value at death or levying a capital gains tax triggered at death.

Myth #7. If the estate tax is repealed, making use of the gift tax exemption to save estate taxes becomes irrelevant. That assumes any repeal would be permanent. In 2010 the estate tax was repealed, but just one year later, in 2011, was reinstated. Countering the calls for repeal of the "death tax" in the 2016 presidential election were proposals to increase the tax. Those proposals included reducing the estate exemption to \$3,500,000, reducing the generation-skipping-transfer (GST) exemption to \$3,500,000, reducing the gift exemption to \$1,000,000, and increasing the top gift, GST and estate tax rates to 70%. The estate tax laws will continue to be subject to change with the shifting political winds.

Why continue to make use of the gift tax exemption, even if repeal of the estate tax is on the horizon or in fact enacted? We are living in the golden age of estate planning. We enjoy the most generous-ever exemptions. The most advanced estate planning strategies, though on the IRS radar screen, have not yet been curtailed by Congress.

Making use now of the gift tax exemption can lock in the gift tax and GST tax exemptions at their current historic highs, leverage the exemptions to cover significantly larger transfers, divert future appreciation from the taxable estate, and take advantage of valuation discounts. Estate planning transactions entered into prior to or during any estate tax repeal are likely to be grandfathered from estate tax if the tax is reinstated. If any repeal of the estate tax turns out to be only temporary, doing nothing during the lull may result in missed opportunities to get significantly ahead before asset valuations increase, exemptions decrease, valuation discounts disappear, and estate planning strategies are legislatively closed. In cases where potential estate taxes are at stake, estate planning should continue on a proactive course.

Myth #8: The most important gifts are material. Not if we step back to look at the big picture. The most valuable gifts — family, friendship, health, the wonders of nature, peace — are all priceless — and tax-free.



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