

The Estate Planning Advisor

Gifting Strategies – and Pitfalls

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The IRS recently announced that beginning January 1, 2009, the annual gift tax exemption will increase from \$12,000 to \$13,000. That is, every individual may make annual gifts to any other individual in an amount not to exceed \$13,000 per year (known as the “Annual Exclusion”) without having to file a Federal gift tax return or utilize any portion of their \$1,000,000 lifetime gift tax exemption.

There are many different ways to make gifts, and different implications for each method. The simplest form of gifting is an outright gift of cash. Cash gifts are an easy way to make a tax-free transfer of wealth. Contrary to a popular misconception, neither the donor nor recipient has to pay any tax for gifts at or below the Annual Exclusion amount. For individuals or married couples whose estates exceed the current New York estate tax exemption – which is still fixed at \$1 million per person – use of annual gifting can go a long way towards reducing or eliminating a potential New York estate tax liability.

For example, assume “Joan,” an 83-year old widow, has total assets of \$1.2 million consisting of a home valued at \$400,000, an IRA of \$300,000, and \$500,000 in a money market account. If Joan were to die in August 2009, her estate would be well below the \$3.5 million Federal estate tax threshold. However, based upon a \$1.2 million taxable estate, Joan’s estate would be subject to a New York State estate tax liability in the sum of \$45,200.

But assume instead that in January 2009 Joan makes \$13,000 gifts from the money market account to each of her five children and eleven grandchildren, for total gifts of \$208,000. If Joan were to die later that year, her estate assets would be below the New York estate tax threshold, resulting in an estate tax savings of \$45,200.

The situation is a bit trickier if gifts are made of appreciated assets such as stocks or real estate. Gifts of appreciated assets are subject to a “carryover basis,” whereby the recipient of the asset acquires the asset at the donor’s cost basis. For example, assume that Joan owns stock in ABC Widget Corp. that she bought for \$10.00 a share, and which is now worth \$100.00 a share. Joan gives 130 shares of stock to her son Skip. The \$13,000 gift qualifies for the Annual Exclusion. However, if Skip thereafter sells the stock for \$100.00 a share, he will recognize a taxable gain of \$11,700. With combined Federal and New York capital gains tax rates of approximately 21%, Skip will pay capital gains taxes of approximately \$2,450.

Had Skip instead inherited the same stock from Joan upon her death, under current law he would have received the stock at a “stepped-up” cost basis valued at the date of Joan’s death. If the date of death value were \$100.00 a share and Skip sold it for that same amount, he would pay no capital gains tax.

Be aware that while gifting may be an attractive strategy for estate tax reduction, gifts can adversely impact the donor’s subsequent eligibility for Nursing Home Medicaid coverage. For any gifts made during the “look back period” (currently three years, but eventually expanding to five years), there is a statutory presumption that all gifts are

made for the purpose of qualifying for Medicaid, and will thus result in a Medicaid period of ineligibility. The duration of this “penalty” is based on the amount of all gifts made during the look back period. This rule makes no exception for the Annual Exclusion gifts, or even for charitable gifts. The presumption can be rebutted by evidence that the gifts were made for a purpose other than to qualify for Medicaid, but that would require prevailing at an administrative “Fair Hearing” which is available upon a Medicaid denial.

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