

LEGAL EASE



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Gift taxes confusing to many taxpayers

Tax season is in full swing, and gift tax requirements continue to confuse many tax payers. Many people are under the misconception that gifting of assets is prohibited beyond the annual exclusion. A recent issue of Elder Law Answers (www.elderlawanswers.com) speaks to the “nuts and bolts” of gift tax.

Gifting of excess assets is a good estate planning strategy. In conjunction with the advice of an estate planning attorney, many people can give gifts to family members during life, which will reduce the tax obligations of their estate at their deaths, and simultaneously, enable them to enjoy the results of their bounty while they are still living. A regular, documented gifting strategy may be acceptable to the Department of Welfare if and when the person who made the gifts unexpectedly requires long term nursing home care and Medicaid (this has not yet been tested).

The annual gift tax **exclusion** for 2006 was \$12,000. This means that each taxpayer (donor) is entitled to give away \$12,000 to any one individual (donee), other than their spouse, and need not report this gift to the IRS. The donor can give \$12,000 each to any number of donees. A husband and wife can give \$24,000 to each donee without the reporting requirement. However, if a taxpayer gives more than \$12,000 to one person in a year, a gift tax return (Form 709) must be filed.

The fact that Form 709 must be filed does not necessarily mean that any tax is owed. The giver, or donor, is the person who is assessed the gift tax. However, the IRS permits each donor to give away \$1 million during his or her lifetime in excess of the annual exclusion. So, if a taxpayer did not give away more than \$1 million in the past, Form 709 is merely for informational purposes. However, if the taxpayer reports tax on Form 709, this counts against the overall federal estate tax exclusion, which is \$2 million this year. For many people, gifting during their lifetime is a good way to avoid having a federal estate tax obligation at all.

Some consideration needs to be given to the timing of the gifts. If the donor survives the gift by one year, i.e. lives one year past the date of the gift, then no Pennsylvania inheritance tax is owed on that money. Otherwise, that gift is “pulled back” into the estate for purposes of PA inheritance tax. Also, the Deficit Reduction Act of 2005 (DRA) makes the timing of gifts critical when someone is applying for Medical Assistance. It is important to consult with an elder law attorney before making any gifts when nursing home care is anticipated.

It is possible to give away more than \$1 million over a lifetime without owing taxes. Form 709 is only required when someone gives away more than the annual exclusion amount to one person. A married couple with a married child can give \$48,000 in one year and still be within the exclusion amounts. Paying for someone else’s medical care or tuition is exempted from reporting requirements. The money must be paid directly to the educational institution or health care provider. You can give away property other than cash, such as stock. And tax deductible gifts made to charities need not be reported, unless the donor retains an interest.