Making lifetime gifts continues to be a smart estate planning strategy

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With the federal gift and estate tax exemption now at a record high $11.58 million for 2020, most estates aren't taxable. But that doesn't mean making lifetime gifts isn't without significant benefits — even if your estate isn't taxable under the current rules. Let's examine reasons why gifting remains an important part of estate planning.

Lifetime gifts reduce estate taxes

If your estate exceeds the exemption amount — or you believe it will in the future — regular lifetime gifts can substantially reduce your estate tax bill. The annual gift tax exclusion allows you to give up to $15,000 per recipient annually tax-free without using up any of your gift and estate tax exemption. In addition, direct payments of tuition or medical expenses on behalf of your loved ones are excluded from gift tax.

Taxable gifts — meaning gifts beyond the annual exclusion amount and not eligible for the tuition and medical expense exclusion — can also reduce estate tax liability by removing future appreciation from your taxable estate. Taxable gifts first reduce your exemption amount without payment of gift tax; once your exemption amount is reduced to zero through lifetime taxable gifts, all taxable gifts made thereafter are subject to gift tax. Still, you may be better off paying gift tax on an asset's current value rather than estate tax on its appreciated value down the road.

When gifting appreciable assets, however, be sure to consider the potential income tax implications. Property transferred at death receives a "stepped-up basis" equal to its date-of-death fair market value, which means the recipient can turn around and sell the property free of capital gains taxes. Property transferred during life retains *your* tax basis, so it's important to weigh the estate tax savings against the potential income tax costs.

Tax laws aren't permanent

Even if your estate is within the exemption amount now, it pays to make regular gifts. Why? Because even though the Tax Cuts and Jobs Act doubled the exemption amount, and that amount will be adjusted annually for inflation, the doubling expires after 2025. Without further legislation, the exemption will return to an inflation-adjusted $5 million in 2026. But if the Democrats win the presidency, capture control of the US Senate and retain control of the US House of Representatives in the upcoming 2020 election, it is very likely that the exemption amount will be reduced from its current level through legislation earlier (perhaps effective as early as January 1, 2021). So it's better to use your exemption amount through gifting this year (with it's high $11.58 million level per person; $23.16 million for a married couple), than to lose the opportunity to do so if the exemption amount gets reduced next year to an inflation-adjusted $5 million or perhaps even to $3.5 million.

The good news is that the IRS issued final regulations in late 2019 that should provide comfort to taxpayers interested in making large gifts under the current gift and estate tax regime. The concern was that a taxpayer would make gifts during his or her lifetime based on the higher exemption, only to have their credit calculated based on the amount in effect at the time of death.

To address this fear, the final regulations provide a special rule for such circumstances that allows the estate to compute its estate tax credit using the higher of the exemption amount applicable to gifts made during life or the amount applicable on the date of death.

Gifts provide nontax benefits

Tax planning aside, there are other reasons to make lifetime gifts. For example, perhaps you wish to use gifting to shape your family members' behavior — such as by providing gifts to those who attend college.

Regardless of the amount of your wealth, consider a program of regular lifetime giving. We can help you devise and incorporate a gifting program as part of your estate plan.

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