More Give in the Gift Tax

The Tax Cuts and Jobs Act of 2017 increased the federal estate tax exemption to $11.18 million for 2018. That's per person, so the combined exemption for a married couple can be as much as $22,360,000 worth of assets this year.

The same ceilings apply to the federal gift tax, which offsets the estate tax.

Example 1: Mona McAfee plans to give $20,000 to her son Luke this year. Does that mean that Mona's estate tax exemption would be reduced to $11,160,000?

Probably not. In addition to the lifetime exemption numbers now in effect, there is also an annual gift tax exclusion. Due to an ongoing process of inflation adjustment, that exemption increased to $15,000 in 2018. Therefore, in 2018, each person can give up to $15,000 to any number of recipients without incurring gift tax consequences. That's up from an annual $14,000 exclusion, which was in effect the previous five years.

Here, Mona's $20,000 would be partially covered by the $15,000 exclusion, so only $5,000 will have gift tax consequences. Mona would have to report a $5,000 taxable gift on IRS Form 709. That $5,000 taxable gift will reduce her current federal estate and gift tax exemption amount to $11,175,000, assuming no other taxable gifts have been made.

As the recipient of the gift, Luke will pay no taxes.

Real World Relevance

Most people won't have estates close to $11 million, so this exercise might seem academic. Still, the $15,000 annual gift tax exclusion can have practical effects in many situations. It's also worth noting that paying someone else's medical or education bills directly won't be included in the $15,000 allowance.

Example 2: Rhonda Cole wants to provide financial support for her son Mark's two children, Ken and Julie. To do so, Rhonda pays tuition bills for Ken and Julie directly to their colleges. The total is $50,000. In addition, Rhonda gives them each $15,000 in 2018 and no other gifts.

Rhonda also decides to give Mark $15,000 this year and pays $5,000 worth of bills from Mark's medical procedures directly to the health care providers. In total, Rhonda has given $100,000 to her loved ones, reducing her taxable estate by that amount. However, she hasn't gone over the $15,000 exclusion for any recipient in 2018, so Rhonda hasn't made any taxable gifts and will not have to file a gift tax return.

Note that the $15,000 limit presents a handy ceiling for making family gifts each year without the bother and expense of filing a gift tax return. This strategy won't work as well if Rhonda gives Mark $50,000 so Mark can pay his children's college bills. Then, Rhonda will have made a taxable gift of this amount and will be required to file Form 709.

Paired Planning

Other possibilities exist if a married couple holds assets jointly, perhaps in a bank or brokerage account. A gift from such an account, or a gift of other property, by one spouse can be considered to be divided equally between the two spouses, so the annual gift tax allowance effectively increases to $30,000. There are two ways to do this. The easy way would be for each spouse to write a separate check for $15,000. If this is not practical, the spouses can get the benefit of a $30,000 annual exclusion by electing "gift splitting" on Form 709.

Trusted Advice

Gift Tax Notes

- The gift tax lifetime exemption ceiling of $11.18 million for 2018 will increase with inflation, but much lower limits are scheduled after 2025. There is some uncertainty about how this reduction, if it takes effect as scheduled, will affect large taxable gifts.

- Any future reduction in the lifetime gift tax exemption is unlikely to affect gifts that conform to annual gift tax exclusion rules.