



Estate Planning Considerations for Ohio Families

Section 6

Gift Taxes, Ohio and Federal

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One of the most commonly used tools to reduce the size of an estate is “gifts.” A long-term plan to make gifts can result in substantially reduced estates. Gifts to charity, during life, have the additional benefit of qualifying for an income deduction. Property that is left to a charity, in the will or trust, is not subject to Ohio or federal estate tax. Some people with large estates leave any property subject to federal estate tax to a favored church or charity rather than have half of it go to various government agencies and the attorney.

Ohio Gift Taxes

There is no Ohio tax on gifts made during life. However, for annual gifts in excess of \$10,000 to a person within three years prior to death, the amount over \$10,000 will be included in the Ohio taxable estate. Note, the \$10,000 amount may be changed to conform to the new \$11,000 federal gift tax annual exclusion discussed next.

Federal Gift Tax

Property transferred by gift during the owner’s life may be subject to gift tax. Lifetime taxable transfers are taxed at the same rate as death transfers, once the cumulative taxable gifts exceed the amount exempted by the Applicable Exclusion Amount (AEA, see Ohio and Federal Estate Taxes). However, in 2010 gifts that exceed the AEA for federal gift tax purposes will be taxed at 35%.

The federal gift tax annual exclusion is \$11,000 for 2002. The tax law since 1997 makes provision for the annual gift exclusion to be adjusted for inflation, but only in \$1,000 increments. The first year the annual exclusion made the \$1,000 jump was 2002. Thus, each person can give, tax free, \$11,000 annually (indexed by inflation after 1998 and went up by \$1,000 in 2002) to as many different individuals as he or she desires. A husband and wife together could give \$22,000 annually to each beneficiary. For example, the husband could give child A \$11,000 and child B \$11,000, and the wife could give each child \$11,000. Hence the parents could gift property valued at \$44,000 to the two children each year, if the parents can afford it.

Larger gifts can also be made. But gifts that are not excluded under the \$11,000 per person rules are considered taxable gifts and must be reported on a gift tax return in the year made and become part of the gross estate at death. For example, a widow could give a child \$110,000, yet not owe any gift tax in that year. Of this \$110,000 gift, the first \$11,000 would be tax free and \$99,000 would be a taxable gift. If she has not used her \$1,000,000 applicable exclusion amount (AEA, see Ohio and Federal Estate Taxes), no gift tax will be owed on the gift tax return, but her AEA will be reduced by \$99,000.

In 2002 or 2003, the AEA will shelter \$1,000,000 from federal estate tax. If the widow passed away later in one of those years she could pass an additional \$901,000 through the estate free of federal estate tax. For lifetime gifts, once the cumulative total of taxable gifts exceeds the amount exempted by the AEA for gift tax purposes, the donor begins to pay tax on the taxable gifts. The AEA for federal estate tax purposes increases over time to a 2009 figure of \$3,500,000, however, the applicable exclusion amount for federal gift tax purposes remains at \$1,000,000, even after repeal of the federal estate tax in 2010. So after 2003 a donor might have used his or her entire \$1,000,000 AEA for gift tax purposes, but have additional AEA for estate tax purposes. However, under current law the AEA for both federal gift and estate tax purposes will be \$1,000,000 in 2011.

Gift Tax Marital Deduction

Donor spouses can give unlimited amounts to their spouse, who is a U.S. citizen, during the donor spouse's lifetime, without gift tax. If the donee spouse is not a U.S. citizen, gifts of up to \$112,000 may be made per year to the non-citizen spouse, with this amount being indexed for inflation. If the donor spouse makes gifts in excess of this amount to the non-citizen spouse, the donor spouse will use a part of the AEA for gift tax purposes, if available, or to the extent it is unavailable, may incur some gift tax.

Basis of Property Gifted

Property given during life retains the basis it had in the hands of the donor. However, most property passed through an estate receives a new basis equal to its value in the estate. In 2010 when the federal estate tax repeal is in effect, some estates in excess of \$1,300,000 may not receive a full step-up in basis in the estate.

Income Tax

The person who receives a gift does not pay tax because of receiving the gift. If they receive cash it is theirs to do with as they please without any tax consideration. However, if they receive something other than cash, which they later sell, they will have taxable income, if the sales price is greater than the basis of the item they received. Also, a person may not claim a gift to another person as a charitable contribution.

Gift Tax Returns

An annual gift tax return, IRS Form 709, is required for any year in which over \$11,000 is given to any one donee by any one donor. The tax return is due by April 15 on the year after the gift was made. No tax is due unless the \$1,000,000 AEA for gift tax purposes has been fully utilized by the donor. In addition, the spouse of the donor of the gift may sign the tax return to elect to have one-half of the gifts treated as having been made by the spouse. In this manner, the taxpayer may make use of the spouse's annual exclusion. Finally, if you make a larger gift to a 529 plan for college expenses, such as Ohio's College Advantage Program, you may make an election on the gift tax return to treat the gift as being made over a five-year period. For example, if you made a \$55,000 transfer and made the election, you will be treated as making an \$11,000 annual exclusion gift for a five-year period, and you will not need to use any portion of the \$1,000,000 AEA for gift tax purposes.

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