

LIFETIME GIFTS VERSUS TRANSFERS AT DEATH

Lifetime gifts are transfers of wealth that occur during one's lifetime. These gifts can result in fewer taxes than transfers at death. The savings result from differences in the way estate and gift taxes are paid.

Because funds used to pay the estate tax are themselves subject to the tax, estate tax is paid on the entire value of the estate, including assets that will ultimately pass to the federal government in the form of estate taxes.

In contrast, funds used to pay gift taxes are neither subject to gift nor estate taxes. The gift tax is calculated based on the value received by the recipient of the gift. In other words, gift tax is paid with funds left over after a gift is made, and the amount of gift tax paid to the federal government further reduces the value of the estate. We will use an example to illustrate:

In the examples that follow, both Steve and Bob have used their total lifetime unified credit/exclusion amount, and the estate and gift tax rate is 35%. Steve has \$1,000,000 in cash he wants to leave to his in his estate when he dies. Bob has \$1,000,000 in cash he wants to give to his son today.

	Steve (Transfer at Death)	Bob (Lifetime Gift)
Total Transfer	\$1,000,000	\$1,000,000
Transfer Tax Due	\$350,000	\$259,259
Beneficiary Receives	\$650,000	\$740,741

Steve: Steve dies, leaving \$1,000,000 in cash to his son. Steve's estate includes the entire \$1,000,000, and his son will pay 35% of that value in estate tax, or \$350,000. Steve's son will receive \$650,000.

Bob: Bob transfers \$1,000,000 to his son today. Since we calculate gift tax on the value of the gift Bob's son actually receives, we need to know how much of the \$1,000,000 Bob will give to his son today. The taxable gift will equal the amount of the transfer divided by 1 plus the tax rate ($\$1,000,000 / (1 + .35)$). Based on this calculation, the final amount Bob will give to his son today is \$740,741. The gift tax amount will be 35% of this amount ($\$740,741 \times .35$), or \$259,259.

Based on the above examples, Steve's son will receive \$90,741 less than Bob's.

Don't dismiss the viability of making a lifetime gift because you have used all of your lifetime exclusion! It could save your family significant tax dollars.