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Gifts That Keep on Giving

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***With the summer almost in the rearview, gift-giving may not feel like a top priority. From a tax planning perspective, however, it might be the perfect season to consider making substantial gifts to benefit your family*.**

Gift Tax Facts

The federal gift and estate tax exemption is historically high. It is tied to a $10 million per person base amount indexed for inflation. This year and each year following that historically high exemption will continue to increase based on inflation until 2026 when the exemption is scheduled to sunset to the previous $5 million per person base amount. While inflation carries with it many negative impacts, recent high inflation has led to a significant opportunity for tax-efficient gifting in 2023 and beyond.

In 2022, each person could have transferred $12,060,000 during their lifetime or at death without incurring federal gift or estate taxes. The inflation adjustment in 2023 has raised that amount to $12,920,000 per person (or $25,840,000 for a married couple). This means that even if an individual *fully* utilized their exemption in 2022 by making lifetime gifts, they could make additional tax-free gifts of up to $860,000 in 2023 (or $1.72 million for a married couple).

The annual gift tax exclusion also increased in 2023. It went from $16,000 in 2022 to $17,000 per person, per recipient in 2023. This means that a parent with three children could make additional gifts valued at $51,000 in 2023 free from gift tax consequences ($17,000 to each child), regardless of their available lifetime exemption. If both parents do this, they can gift a total of $34,000 to each child and move $102,000 out of their taxable estate in 2023.

These threshold increases, taken together, can provide significant tax benefits. Once assets are gifted to beneficiaries (either outright or properly in trust), they are no longer included in the donor's taxable estate. The gifted assets and, perhaps most importantly, all of the *income and appreciation* accrued over time will continue to pass free from tax. The earlier these gifts are made, the more income and appreciation potentially can be removed from a taxable estate.

Is Gifting an Option for Me?

There is no "one-size-fits-all" in estate or tax planning. Every individual and family will have different factors to consider: personal relationships, asset values, gross estate composition, and overall planning goals. There are also many non-tax factors to consider when making gifts to family. But gifts are certainly some of the most tax-efficient tools to consider for transferring wealth in this tax environment.

And these benefits are not limited to the ultra-wealthy. Certainly, those with estates far exceeding the current exemption are more likely to be feeling the urgency to "use it or lose it," but others with more modest estates can also benefit from these historically high tax thresholds. Parents can make increased annual gifts to their children and remove incrementally more from their taxable estates than in years past. Larger lifetime gifts can be made during the lifetime of a donor, allowing the donor to see the fruits of their generosity. These proactive gifts could have a significant effect in the future when the estate tax may impact far more families than it does today.

Methods for Gifting

Annual gifts of $17,000 per donor per recipient can be made outright or in trust free from gift tax (provided that gifts in trust must satisfy certain parameters). By gifting assets in trust, donors can provide additional asset protection benefits to their recipients. While an incremental increase for one recipient may not seem significant, anyone making gifts to multiple individuals (such as children, grandchildren, nieces, or nephews) will quickly see the compounding effect of this increased annual exclusion. When these gifts are made year after year, significant value can be transferred for the benefit of these recipients.

For those looking to make larger lifetime transfers, gifts can be made in trust for a spouse or children and can strategically "lock-in" the value of assets that are likely to appreciate, further compounding the tax benefits of a present transfer.

If gifts for grandchildren or younger generations are properly structured to incorporate use of the generation-skipping transfer tax exemption (which currently is tied to the same metrics as the estate tax exemption), these gifted assets can benefit generation after generation without becoming subject to estate taxes in those subsequent generations.

The Numbers

The tax savings are significant. A married couple's use in 2023 of *only* the new "inflationary increase" exemption amount of $1.72 million would result in estate tax savings of at least $688,000 in the event the exemption decreases in the future, either because Congress actively reduces it or passively allows it to sunset in 2026. Those savings could increase over time. If we assume an investment growth rate of 5% for five years, those gifts could be worth almost $2.2 million in the hands of the gift recipients. If the married couple instead had retained that extra $1.72 million in their taxable estates, the appreciated value in just five years would generate approximately $880,000 in estate taxes due at their passing. As you can see, these annual increases can provide significant leverage against estate taxes over time.

Of course, these gifting strategies must fit into a broader thoughtful estate plan. Prior to making any gifts, it is important to review prior gifting history, analyze support needs, and properly frame these opportunities within your broader retirement, lifestyle, and family planning goals. This season may prove fruitful if these gifting opportunities align with your overall plan.

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