Glad Tidings for Year-end Gifts

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Due to recent tax law changes; you may want to give generous gifts to family members this holiday season. The gifts can reduce the size of your taxable estate. Here is a brief overview of the basic tax rules.

Annual gift-tax exclusion: Under the annual gift-tax exclusion, you can give away a specified amount each year to a recipient without paying any federal gift tax. The exclusion, which is indexed for inflation, is $13,000 for 2012. (It is being increased to $14,000 for 2013.) For example, you might give up to $13,000 to each of your two children and three grandchildren—a total of $65,000 in gifts—without triggering any gift tax.

Furthermore, the annual gift-tax exclusion is doubled to $26,000 if your spouse joins in the gifts. In other words, you might give away $26,000 to each of the five family members, free of gift tax. That totals $130,000 in tax-free gifts. By giving the same amount for five years in a row, you can reduce your taxable estate by $650,000.

Cumulative gifts: The amount of any gifts made above the annual gift-tax exclusion may be sheltered by the lifetime gift-tax exemption (although this reduces the available tax shelter for your estate). Prior to the 2010 Tax Relief Act, the estate- and gift-tax systems were severed, with the lifetime gift-tax exemption remaining locked at $1 million. But a 2010 act reunified the two systems, with a maximum exclusion amount of $5 million per person for 2011 and 2012 (indexed to $5.12 million for 2012).

Educational and medical gifts: You can pay qualified expenses directly to a medical provider or educational institution on behalf of others without incurring any gift-tax liability. For instance, if your child or grandchild attends college, pay the youngster's tuition directly to the school. These gifts do not count against the amounts sheltered from gift tax by the annual gift-tax exclusion.

Your family may also save income tax when you give gifts to other family members. Typically, the income subsequently earned from the gifts is taxed to a family member in a lower tax bracket than you are. For instance, you might decide to transfer income-producing property to a minor child. However, don't overlook the impact of the "kiddie tax." If a child younger than 19 or a full-time student younger than 24 receives more than $1,900 in unearned income in 2012, the excess is generally taxed at the income tax rate of the child's parents—regardless of the source of the gifts.

With the end of the year fast approaching, you can set up a gift-giving program to maximize the tax benefits. The estate-tax laws are scheduled to "sunset" after 2012, so be sure that your plan can accommodate changes.

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