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2014 Estate, Gift and GST Tax Exclusions: New Amounts Create New Opportunities

By Deborah Cohn

The IRS updated the inflation-adjusted tax figures for 2014, increasing several federal gift tax annual exclusion amounts and the lifetime gift, estate and generation skipping tax exemption totals. Here are the specifics for each:

The lifetime exclusion from federal gift or estate taxes increases in 2014 from $5,250,000 to $5,340,000 per donor or decedent. The exclusion amount measures the value of assets an individual may give during his or her lifetime and upon death *without* giving rise to an out-of-pocket gift or estate tax liability. This is a lifetime exemption, so use of any portion of this exclusion amount during one's life reduces the total available for gifting by the individual at death.

The 2014 annual exclusion from federal gift tax remains $14,000 per recipient. The annual exclusion is the amount an individual may give to a recipient *without* incurring a federal gift tax liability or using a portion of his or her lifetime exemption from federal gift and estate tax. The donor may make annual exclusion gifts of up to $14,000 per recipient to as many recipients as the donor chooses as long as the recipient has the immediate right to access the gifted funds. Gifts to trusts need to satisfy special requirements to qualify for the annual exclusion.

The exemption from the generation skipping transfer tax (the GST exemption) also increases to $5,340,000 per individual. The GST tax is a separate tax on amounts passing to beneficiaries at least two generations below the donor. In 2014 the GST exemption can be used to protect up to $5,340,000 of assets from GST taxes.

A simple gift from a grandparent to a grandchild is one example of a GST transfer. A gift *by a grandparent to a trust* for the benefit of several beneficiaries including at least one grandchild or later generation beneficiary can also generate GST taxes. For example, in a trust for the benefit of a spouse, children and grandchildren, taxes could be imposed during the lifetime of the spouse or child as distributions are made from the trust to a grandchild; the exact amount of the tax would be based on the value of that distribution. The GST tax could be levied on the value of all of the remaining trust assets when the spouse and child have died and all of the remaining beneficiaries are grandchildren or later generation beneficiaries. The GST exemption can be allocated when the trust is initially funded to protect all of the assets (up to the grandparent's then-available GST exemption) from GST taxes as future taxable events arise. (NOTE: GST planning is inherently complicated. This blog only addresses some basic considerations.)

The expanded annual exclusion for gifts to a non-citizen spouse increases from $143,000 to $145,000. The *unlimited* marital deduction protects from federal gift tax transfers by one spouse to a U.S. citizen spouse. When the recipient spouse is not a U.S. citizen, however, the unlimited marital deduction does not apply. Instead, only amounts up to an expanded annual exclusion are protected from gift tax. The donor spouse can also protect the transfer from taxes using the inflation adjusted $5,000,000 exclusion ($5,340,000 in 2014) *if the donor is a U.S. citizen or permanent resident.* If he or she is a non-citizen who is not domiciled in the U.S. for transfer tax purposes, the larger lifetime exclusion amount cannot be applied and the transfer can result in an immediate gift tax on the amount of the gift exceeding the expanded annual exclusion. The non-resident non-citizen donor has no margin for error and must take particular care when making transfers of difficult-to-value assets such as real estate.

These rules often create a trap for the unwary, particularly for those with G-4 visas. G-4 visa holders may, depending upon their particular situation, be deemed as either domiciled in the U.S. or as non-resident, non-citizens. The problem frequently arises when a non-resident, non-citizen divides jointly-owned property between the joint owners. The transfer may be found to constitute a gift from one joint owner to

another, depending upon their relative contributions to the cost of the jointly-owned property and their relative interests in the asset after termination of joint ownership. If the value of the gift exceeds the applicable annual exclusion, the donor cannot rely on the inflation adjusted $5,000,000 gift tax exclusion ($5,340,000 in 2014) to protect the transfer from immediate gift taxes.

Division of jointly-owned assets between spouses, where at least one is *not* a U.S. citizen, should be carefully planned under the guidance of a tax or estate planning professional in order to avoid unpleasant tax surprises.

U.S. citizens, permanent residents and certain entities (including domestic corporations, partnerships, estates and trusts) receiving aggregate annual gifts or bequests from foreign persons in excess of a certain threshold, must report these large amounts to IRS on Form 3520. The threshold aggregate amount for taxable years starting in 2014 will increase to $15,358.