Real Estate

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Gifting Real Property Now

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Want to reduce potential estate taxes? Those of you with estates worth more than $5,000,000 (especially including real property) should take advantage of certain laws that may end in 2012.

For 2011-12, the lifetime gift tax exemption is "unified" with the estate tax exemption. You can either gift up to $5,000,000 during your lifetime without paying gift tax (at 35 percent), or if you die in 2011-12, you can leave the first $5,000,000 to your heirs without paying estate tax (also at 35 percent).

Currently the exemptions are scheduled to decrease to $1,000,000 in 2013.

Why and What Should I Gift?

Now's a great time to gift real property, since values are lower than ever. By transferring real property out of your estate now, you freeze the value of the asset at today's lowered amounts.

Also, any increase in property value will accrue to the benefit of your beneficiaries, not to the government. You'll have to pay capital gains on a subsequent sale, but that rate is significantly less than the estate tax rate.

Gifts of Partial Interests

Property owners can maximize their gift tax exclusion by passing partial real property interests and taking a fractional-interest discount. Generally, the value of a fractional interest is less than the corresponding percentage of the total value of the property because the property owner cannot dispose of such property as easily.

Thus, by passing such an interest, you use up less of your gift tax exclusion (reduced by the fractional interest value, not the percentage value). The fractional interests themselves must be valued by a special appraiser.

A similar principle applies if the property is owned by a business entity. Instead of gifting a fractional property interest, you gift a minority business interest in the entity holding the property.

Thus, you can control the entity by keeping the majority interest, but still make gifts at a discounted rate. You may be able to remove an asset valued at $100,000 for a gift tax value of $60,000, after the relevant discounts. Minority interests must be valued also by a special appraiser.

You can still control gifted property by employing a specialized irrevocable trust instrument, such as a Qualified Personal Residence Trust, to remove your residence from your estate. This fixes the gift's value for tax purposes, but still enables you to use or control the asset for a specified time.

The present value of these transfers for the gift tax is the present value of the beneficiaries' remainder interests (per IRS tables). The greater the instrument term, the greater the potential transfer of wealth tax-free (assuming a rising market). However, a longer term carries additional risk – if you do not survive the term, the assets may be returned to your taxable estate.

Property Taxes?

Each parent can transfer a residence and up to $1,000,000 of assessed value in other real property to children without triggering a Property Tax Reassessment.

If you own property purchased for $40,000 presently valued at $800,000, your children would keep your property tax base if the asset qualified under the above rules.

This is a great way to transfer an asset you don't want to manage (like rental property), because (i) you won't pay capital gains on the property if sold, (ii) you remove the asset growth from your taxable estate, and (iii) your children will benefit from the income now, and can manage and maintain the property for you.

When Making Gifts, Always Use Caution

Strategic gifting requires some planning. Ask yourself:

1. Can I afford to make the gift?
2. What proportion of my estate consists of the interests I plan on gifting?
3. Where are property values headed?
4. What is the likelihood of tax rates changing, and will a transfer constitute a "change of ownership" triggering a reassessment for property taxes?

Some of these questions have no solid answers, but should at least be considered in some fashion. Other issues may also apply.

However, given the low property values and high gift/estate tax exclusion, it's an extremely favorable time to make gifts.

Meet with your Estate Planning Attorney and your Certified Public Accountant to discuss whether gifting is right for you.

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