THE COST OF GIVING

IT'S CALLED THE GIFT TAX, AND IT MEANS YOUR GENEROSITY CAN PUT A BIGGER DENT IN YOUR BANK ACCOUNT THAN EXPECTED

By Amiel Z. Weinstock

When Donald Trump married Melania Knauss last year, good friend Shaquille O'Neal bought them a white Phantom Rolls-Royce reportedly worth at least $325,000. A nice gesture, but one that likely cost O'Neal almost 50 percent more than the sticker price—in gift taxes.

Although most are familiar with the income tax regime, its little-known cousin is often overlooked. For mere mortals the gift tax is not usually an issue, as it is triggered only when a gift exceeds the so-called "annual exclusion amount," which increased to $12,000 in 2006. However, for "The Big Aristotle" (and many others with high incomes and significant net wealth), gifts of that value are more commonplace.

The annual exclusion amount applies to every non-charitable gift you make during the year, including gifts of cash and tangible items (cars, jewelry, houses, etc.). You may make as many exclusion gifts as you want in any given year, as long as each recipient is different. If you are married, you may use your spouse's annual exclusion amount to double up on those gifts, effectively allowing you to give $24,000 to each recipient in 2006.

This tax rule applies to everyone, no matter what their relationship, with one very important exception: the spouse. If your spouse is a citizen of the United States, you may make unlimited gifts to him or her without incurring any tax. (The rules for spouses who are not citizens are more restrictive.) Remember when Kobe Bryant bought his wife, Vanessa, that infamous $4-million diamond ring? The gift tax didn't apply there.

In 2006, the gift tax rate is 46 percent of what the transferred property is worth, and is the gift-giver's responsibility. Last year it was 47 percent, meaning that for a present worth approximately $350,000, O'Neal presumably had to pay an additional $144,000 in gift taxes ($350,000 less $44,000 of annual exclusion gifts—at $11,000 per person per recipient—times 47 percent).

In addition to the annual exclusion gifts that are tax-free, everyone is allowed a $1,000,000 lifetime maximum before gift taxes are imposed. Based upon what we know about O'Neal and his magnanimity, however, it's safe to assume that the Rolls was not the first large gift he's ever given, and that he has long passed the $1,000,000 threshold.

Keep in mind that **any gifts exceeding the yearly exclusion amount will have an impact on your estate taxes (whether you've gone past the $1,000,000 lifetime threshold or not).** That's not to say you shouldn't make these gifts and take advantage of the $1,000,000 limit, which is often a very good strategy for a variety of reasons. Keep in mind, however, that a gifting program is only effective as part of your overall estate-planning strategy.

If you are considering making gifts to friends or family, ask your tax advisor about alternative strategies that can reduce your exposure to the gift tax. For example, cash gifts can straddle the end and beginning of two calendar years (i.e., instead of giving someone $20,000 as a Christmas gift on Dec. 25th, give them $12,000 on Christmas and the rest on Jan. 1). Larger gifts can be made through a low-interest loan to the recipient; as you receive payments on the loan you can decide if you will forgive some or all of the payments (perhaps in an amount up to the annual exclusion for that year).

More sophisticated wealth-transfer planning (which is better suited to family transactions) involves creating tax-efficient vehicles like limited partnerships and limited liability companies. These allow you to transfer greater amounts of value for lower tax cost over an extended period of time.

Finally, if you really want to buy mom and dad that dream house, consider that you may achieve a greater tax result if you own the house and let them live there. Shaquille O'Neal's present to Mr. and Mrs. Trump is likely to have little impact on his financial security, but for many athletes with big hearts and even bigger "families," making these types of gifts can be costly.

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