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How to Max Out the Gift Tax Exclusion

When possible, limit your lifetime gift-giving to amounts covered by the annual gift tax exclusion.

Ken Berry • Dec. 27, 2022

Do you want to pass wealth to beneficiaries without any dire tax consequences? The easiest method is to give cash or property to your loved ones that qualifies for the annual gift tax exclusion. In most cases, you don't even have to file a gift tax return!

These gifts can be used to systematically reduce the size of your taxable estate, while enabling your family to realize income tax savings on future income. But there's a downside: You must relinquish complete control over the assets you give away.

Basic premise: Under the annual gift tax exclusion, you can give gifts of cash or property to a recipient up to a specified amount without paying any federal gift tax. The annual exclusion, which is indexed for inflation in increments of $1,000, is increasing to $17,000 per recipient in 2023 from $16,000 in 2022.

In other words, you can gift the maximum amount to a sibling, child or grandchild, or several of these, in the same tax year with no gift tax problems. Furthermore, the annual exclusion is doubled for "split gifts" made by a married couple. (However, a gift tax return must be filed for split gifts.)

By using the exclusion astutely from year to year, a married couple can easily transfer amounts valued well into six figures, all on a tax-free basis.

Example: Mork and Mindy have three adult children and seven grandchildren. Each spouse gives a holiday gift of $16,000 to each child and grandchild in December of 2022. Then they turn right around in January of 2023 and give each relative $17,000. Result: In a period spanning a matter of weeks, Mork and Mindy have reduced their joint estate by a grand total of $660,000 ($320,000 in 2022 and $340,000 in 2023).

If you're giving away stock instead of cash, various other tax rules come into play. For instance, if the stock is later sold at a gain, it will be taxed at the tax rate of the holder, presumably at a lower rate than if you had sold it yourself. For this reason, you may want to give away low-basis stock and keep high-basis stock that can provide a valuable tax loss. Factor this wrinkle into the equation.

Furthermore, be aware that a gift made directly to a financial institution to pay for tuition or to a health care provider to pay for medical expenses doesn't count towards the gift tax exclusion. So you can pay a grandchild's college tuition bill next semester besides giving the same grandchild $16,000 in 2022 and another $17,000 in January—all of it without owing any gift tax.

Finally, there's one more gift tax trick up your sleeve. The unified estate and gift tax exemption. This exemption, which is $12.92 million million for 2023 (up from $12.06 million in 2022), is available for lifetime gifts after you've exceeded the annual gift tax exclusion. However, using the exemption erodes the remaining estate tax shelter.

Practical idea: When possible, limit your lifetime gift-giving to amounts covered by the annual gift tax exclusion.

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