



## WHY WOULD A DONOR EVER ELECT TO PAY GIFT TAXES?

The average donor has such an aversion to voluntarily paying taxes of any kind that it is frequently much more effective to illustrate the tax-efficiency of intentionally paying gift taxes using simple numbers before describing the underlying concept. Assume the following fact pattern: A client with \$7 million of cash, who has used up all of her lifetime exemption from the Federal gift tax, decides that she would like to make a gift of \$5 million to her children during her life. She makes the gift, resulting in a gift tax payment of \$2 million. Suppose the same client instead decided to retain all of the same \$7 million until her death, providing in her Will that it will pass to her children. The inclusion of the \$7 million in her estate would generate an estate tax of \$2.8 million so that the children would receive \$4.2 million. This means that the children would receive \$800,000 less as a result of the client's decision to retain these funds in her estate rather than giving them to the children during her life.

The \$800,000 swing/lost benefit in this example results from the different manner in which estate and gift taxes are calculated. Estate tax calculations are tax inclusive, meaning that the estate is also paying taxes on the dollars that are used to pay the tax. Gift tax calculations are tax exclusive, meaning that the donor is not paying tax on the dollars that are used to pay the tax. The IRS is fully aware of this planning opportunity, which is why tax payments made within 3 years of death are included in a decedent's estate. However, for the donor who is inclined to make a gift and likely to survive that gift by 3 years, electing to pay gift taxes can result in a meaningful benefit for the donor's beneficiaries.