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REAL ESTATE GIFTS AND POTENTIAL TAX PITFALLS

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Families are taking advantage of favorable tax laws for 2011 and 2012 by making real estate gifts part of their financial planning. However, tax payers who have recently made, or are contemplating making a gift of real estate to a family member, may unwittingly expose themselves to taxes, penalties, and the misery of an audit if they fail to report these gifts to the IRS.

The Internal Revenue Code[1] allows an individual to make annual gifts of up to $13,000 per recipient ($26,000 from a married couple) without any reporting obligation. In addition to these annual gifts, current tax laws allow taxpayers to transfer up to $5 million during years 2011 and 2012 before triggering any federal gift or estate tax to the donor. This cap on tax-free gifts includes both lifetime transfers and transfers at death. Because the cap will end after 2012, financially savvy taxpayers are making transfers now to avoid potential estate taxes later on.

The Problem

While taking advantage of the tax-free transfer cap is a legitimate method of avoiding taxes, families should be aware of gift reporting requirements, as failing to report could put them at risk for heavy penalties and back taxes. A recent Wall Street Journal article[2] explained that the IRS is screening state real property records for unreported transfers among family members in an effort to identify taxpayers who have exceeded the $5 million cap. If the IRS determines that a tax payer failed to report such gifts and they exceeded the tax-free cap over their lifetime, gift taxes and penalties may be incurred.

Real estate gifts are measured by the fair market value of the property: the amount negotiated between a willing buyer and willing seller. The costly mistake that taxpayers make when gifting property to family members is failing to obtain an accurate appraisal of the property. Instead, they rely on a less-than-accurate figure, often to avoid exceeding the tax-free transfer cap. The painful result is twofold: (1) penalties incurred for failing to report a taxable gift in excess of the tax-free transfer cap and (2) extending the time the IRS has to audit the taxpayer.

The Solution

Taxpayers can capitalize on favorable gift tax laws for 2011 and 2012 without exposing themselves to penalties by taking the following steps:

File. File gift returns for any gift exceeding $13,000. Reporting enables the IRS to assess whether an individual's total gifts at death exceed the $5 million cap and may also discourage future IRS audits.

Appraise. Get an accurate appraisal of any real estate gift so you know exactly how much you are gifting and whether you need to report it.

Report immediately. The IRS has a limited window to audit gift tax returns. Filing the return starts the clock on the time period during which the IRS may review the return and challenge real property valuations.

Track. Track the number and amount of gifts you transferred over your lifetime to ensure you do not exceed the $5 million cap.

GHR has both business and estate planning attorneys with experience in reducing estate tax liability for clients making gifts to any individual or entity. If you would like to discuss how gifting may be utilized as part of your estate or business succession plan, contact Eric Jamieson at ejamieson@ghrlawyers.com .

[1] 26 U.S.C. 2523.

[2] Dale Arden, *IRS Scrutinizes Gifts of Real Estate,* The Wall Street Journal (May 26, 2011).