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Carefully Planned Gifting Programs Worth Considering

The uncertainty regarding the future of the federal estate tax requires flexibility in your estate planning. Giving property away during your life remains one of the simplest ways to reduce federal estate taxes. For large gifts, this technique is limited to the amount of the lifetime gift tax exclusion, which is presently $1 million. However, the recent increase in the annual exclusion amount warrants review of the benefits of making small gifts as part of a carefully planned gifting program.

Annual Exclusion

The annual exclusion from gift tax is rather simple. In 2006, you can make an unlimited number of $12,000 gifts (up from $11,000 in 2005) of cash or property to each donee without incurring any gift tax liability. Married couples can combine each of their exclusions and give away $24,000 per year to each donee. Even when the property is owned by only one of them, a married couple can still give away $24,000 to each donee by electing to split gifts. This election allows them to treat a particular gift made by one of them as if each spouse donated half the gift.

Present Interests

The annual exclusion is only available for gifts of "present interests." Gifts are present interests when the person receiving the gift has immediate and unrestricted use, possession or enjoyment of the gift when it is made. The gift also must have an ascertainable value. Although the present interest requirement does not apply to outright gifts, those made in trust are sometimes treated as future interests, which do not qualify for the annual exclusion unless they meet certain statutory and/or documentary exceptions.

Using Annual Exclusions

The simplest use of the annual exclusion involves outright lifetime gifts. However, in many situations, individuals can utilize the annual exclusion and maintain some control of what is done with the money without the Internal Revenue Service treating the gift as a future interest. Some common examples include:

Trusts that allow a right to withdraw the money within 30-60 days after contribution. These withdrawal rights are known as "Crummey Powers." Any money that is not withdrawn is used as the grantor dictates in the Agreement of Trust.

Qualified Tuition Programs (§529) and Education Savings Accounts (§530). Funds contributed to these programs grow tax-free and are used to pay for higher education expenses.

Certain statutory §2503(c) trusts and statutory gifts to minors. If the statutory requirements are satisfied, these gifts qualify for the annual exclusion, even though the minor does not receive the money until age 21.

Educational and Medical Exclusions

In addition to the annual exclusion, any amount paid on behalf of an individual as tuition directly to an educational organization or as payment for medical care directly to the provider is eligible for exclusion from the gift tax. The exclusion is even available for the payment of another individual's medical insurance premiums directly to the carrier.

Conclusion

Whether and when to implement an aggressive gifting program as part of an overall estate plan depends on the nature and value of your assets, the characteristics of your beneficiaries, and the objectives of your estate plan. However, if implemented properly, a gifting program that takes advantage of some or all of these exclusions can transfer a significant amount of value to the next generation tax-free. ★

Why It's Better to Give

The following example illustrates the effectiveness of using the annual exclusion to reduce federal estate tax liability.

A married couple in their mid-70s has two married children and four grandchildren. The couple's combined taxable estate is in excess of $5 million. By either direct or split gifting, in 2006 the couple can give $24,000 per year to each of the eight individuals (two children, their spouses and four grandchildren), which totals $192,000 per year. After 15 years, the couple will have given away over $2.8 million tax-free.

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