

STRATEGIC

LAW GROUP PC

Strategic Integrated Planning

Estate and Income Tax Planning - Gift Tax Exclusions

If you're like most people, you don't like to think about planning your estate. But it's an important part of ensuring the financial security of your loved ones. One of the most common tools used in estate planning - and one that everyone should at least give careful consideration to - is a program of giving gifts. A carefully planned gift-giving program can reduce the amount of your estate that is subject to tax while still passing on wealth.

Estate planning. Estate planning is always complicated but it takes on additional complexity in 2010 because of important changes in federal tax law. Technically, the federal estate tax is abolished for decedents dying after December 31, 2009 and before January 1, 2011. However, Congress is expected to revive the federal estate tax sometime in 2010 (patterned after the 2009 estate tax) and make the estate tax retroactive to January 1, 2010.

Let's take a brief look at how the traditional estate tax rules operated in 2009 and may apply again in the future. For decedents dying before January 1, 2010, their estate was entitled to an exclusion that exempts a portion of the property from the federal estate tax. In 2009, the amount excluded was \$3.5 million. That means that an estate of \$3.5 million or less was free from federal tax.

The rules are significantly different for 2010. For decedents dying on or after January 1, 2010 and on or before December 31, 2010, the federal estate tax is abolished. In its place, are carryover basis at death rules. The income tax basis of property acquired from a decedent's estate generally must be carried over from the decedent. Executors are allowed to partially increase the basis of property by up to \$1.3 million (\$3 million in the case of property passing to a surviving spouse); further appreciation will be subject to tax when the asset is sold.

An example will help illustrate how carryover basis works: In 1997, Adam buys stock worth \$150,000. Adam dies in 2010 and leaves the stock to his son, Paul. The value of the stock on the day of Adam's death is \$180,000. Under the carryover basis rules, if Paul sells the stock, he might pay tax on all the gain since 1997. In contrast, under the stepped-up basis rules, Paul can immediately sell the stock and not recognize any taxable gain because his basis in the stock "steps-up" to his father's basis as of the date of Adam's death.

It is unclear at this time when Congress will revive the traditional stepped-up basis rules for 2010. Indeed, Congress could do nothing, which will leave the carryover basis rules in effect for all of 2010. After 2010, the stepped-up basis rules will return but at less generous tax treatment than in 2009. Please contact our office if you have any questions. Our office will keep you posted of developments.

Gifts. Gifts are an important component of estate planning. While large gifts are subject to gift taxation, you can give away up to \$13,000 in 2010 per recipient per year free of gift tax. In addition to the annual gift tax exclusion of \$13,000, you get a lifetime gift tax exclusion of \$1

million. Under current law, the \$1 million exclusion is permanent. Additionally, lifetime transfers between spouses are free from gift tax.

There is a great deal of flexibility in the types of property that can be transferred. Gifts that qualify for the \$13,000 annual exclusion can be made in money, property such as stocks or bonds, or even a life insurance policy, as long as the recipient gets the present right to possess or use the property. The gift may be in trust if the terms of the trust give the recipient the immediate right to the property or income from the property.

You can give up to \$26,000 in 2010 per recipient per year if you're married and your spouse consents to "split" your gifts. This is useful for spouses who do not own an equal amount of property. The spouse with less property can consent to gifts made by the wealthier spouse, thereby effectively doubling the amount that the wealthier spouse can give away tax free. To take advantage of "gift splitting," both spouses must be U.S. citizens or residents. The consent must be given on a gift tax return, so a return must be filed even if no gift tax is due. However, a short form gift tax return is available.

One important thing to remember when you make a gift is that the recipient must take your basis in the property. Unlike the carryover basis rules for distributions from a 2010 estate that exempt \$1.3 million in appreciated assets from carryover basis, carryover basis for lifetime gifts of property does not carry any exemption amount. What's more, even the amount of a gift qualifying for the annual gift tax exclusion (\$13,000 or \$26,000 for split gifts) is not exempt from carryover basis. This means that if the recipient sells the property, any gain on the sale will be measured using what you paid for the property, not what the property was worth when he or she received it. Consequently, choosing the right property to achieve your goals is an important aspect of any gift-giving program.

Another way to further the financial security of others without incurring gift tax is by payment of medical and educational expenses. You can pay an unlimited amount for these expenses tax free as long as the payments are made directly to the medical services provider or educational institution. The person you benefit does not need to qualify as a dependent for tax purposes. Any medical expenses, however, must not be reimbursed by insurance, to either you or to the beneficiary.

If used properly, a program of gift-giving can benefit everyone involved and achieve tax savings in your estate planning. If you have any questions about the best way of using gifts as part of your overall financial plan, please call us. 1-866-657-0246 or jwaage@strategiclawgroup.com