

2009 Year-End Estate and Gift Tax Planning

Use of Gift Tax Exemptions to Reduce Estate and Gift Tax

The federal estate tax exemption in 2009 is \$3.5 million. Any estate exceeding that amount is subject to a 45% tax on the excess amount. Although the exemption amount and tax rates in future years are uncertain, there is no doubt that the estate tax will be with us. Therefore, you should consider making sufficient gifts during your lifetime so that your estate will not exceed the then-current exemption amount.

Your lifetime gifts are, however, subject to a gift tax that is imposed at the same rate as the estate tax. This “unified” system is intended to eliminate any tax advantage to making gifts. But certain types of lifetime transfers are not subject to gift tax, and the end of the year is a good time to make these tax-free gifts.

Annual Gift Tax Exclusion

The most commonly-used method for tax-free giving is the annual gift tax exclusion, which allows you to annually make a gift of up to \$13,000 to each donee with no gift tax. There is no limit on the number of donees to whom you can make such gifts — if you make identical gifts to 10 donees, you can exclude up to \$130,000 from tax. In addition, if you are married you can double the amount of the exclusion to \$26,000 per donee, because you and your spouse can combine your exemptions in a single gift from either of you. This amount is indexed for inflation, but it is not expected to increase in 2010. The exclusion applies to gifts of any kind of property, although certain types of property may require an appraisal.

Your annual gift tax exclusion expires at the end of each year, so the year end is the appropriate time to use it. If you want to make a gift that exceeds the amount of the exclusion, you can effectively double the exclusion by making one gift in December and the second in January. For example, if you are married, you can make a tax-free gift of \$52,000 to any individual by making a gift of \$26,000 in December 2009 and another \$26,000 gift in January 2010.

The annual exclusion is applied on a per-donee basis. As a result, you can leverage the exclusion by making gifts to multiple members of the same family. For example, you could make \$13,000 gifts to each of your son, his wife and their daughter, for a total of \$39,000 in tax-free gifts. This tax-free amount can be doubled to \$78,000 if your spouse joins in the gifts.

If you have any questions, please do not hesitate to call. We would be happy to meet with you at your convenience to discuss the strategies outlined above. There is still time to implement these strategies to minimize your 2009 tax liability.

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Tuition Payment Exclusion

In addition to the annual gift tax exclusion, you are allowed to make tax-free tuition payments for any individual. There is no limit on the amount that can be excluded, except that the payment must be to a tax-exempt school and for the purpose of education or training. The exclusion applies only to tuition — payments for room and board, books, computers, or related expenses are not eligible. Because there is no limit on the amount of the gift, its timing is less important than it is with the annual exclusion. Nevertheless, if you have the choice of making either a tuition payment or an annual exclusion gift for a particular beneficiary, it will usually be better to make the tuition payment, because that will give you the option of making an annual exclusion gift later in the year.

If the tuition payment is made on behalf of a dependent, and if your adjusted gross income is \$160,000 or less (for a joint return), then you may also be entitled to an income tax deduction for the payment. Let us know if you think that you may qualify. This deduction is scheduled to terminate at the end of 2009, so it is important to take advantage of it before the end of the year.

Section 529 College Savings Plans

Contributions to a section 529 college savings plan do not qualify for the exclusion for tuition payments, but can take advantage of the \$13,000 annual gift tax exclusion. The contribution to the plan may also entitle you to a state income tax deduction.

Distributions from a 529 plan can be used for a wide range of educational expenses, including tuition, fees, books, supplies, computers, and room and board. An added advantage of a gift to a 529 plan is that the income earned on the plan contributions is tax-free, as long as it is eventually used for educational purposes. Thus, you can reduce your own income taxes by funding a 529 plan with savings that would have been used for college anyway. And because you can name yourself as the custodian of the account, you ensure that your beneficiary uses the account for educational purposes.

A special rule allows you to use up to five annual gift tax exclusions when funding a 529 college savings plan. You can fund a savings plan with up to \$65,000 (5 x \$13,000) this year and then file an election with the IRS to spread this gift over five years (2009 - 2013) for gift tax purposes. By using five annual exclusions, the entire gift becomes gift-tax-free, although you will have to wait until 2014 to make another tax-free contribution.

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Medical Payment Exclusion

The payment of a beneficiary's medical expenses is also excluded from the gift tax, with no limitation on the amount excluded. To qualify for this exclusion, the payment must be made directly to the provider, and it must be for medical expenses of the type that would qualify for an income tax deduction. You can claim an income tax deduction for the payment if it is made for your spouse or dependent.

The exclusion for medical payments includes the payment of medical insurance premiums. If you have a child or grandchild who is paying for his or her own insurance, payment of their insurance premiums is an efficient means of making a tax-free gift that does not consume the \$13,000 annual exclusion.

Gifts in Trust

Despite the tax savings, you may be uneasy about making outright gifts to your children or grandchildren, due to your loss of control over how they use the gift. This concern can be addressed by making the gifts in trust, which will allow you to determine when they receive the money and how it is to be used.

There are special requirements for ensuring that a gift in trust qualifies for the \$13,000 annual exclusion. Usually, the trust is drafted to provide the beneficiary with temporary withdrawal rights over the gift (usually for 30 days), such that it is considered a present interest rather than one that vests in the future. Although this presents a risk of the beneficiary withdrawing the gift from the trust, the probability of your terminating any further gifts to the trust is usually sufficient to prevent this. If you are interested in making a gift in trust, we will be glad to explain how this can be done.

Charitable Gifts

The year end is a good time to review your charitable giving to ensure that it is being done in the most tax-efficient manner. Charitable giving is a form of estate planning, because a gift to charity will never be subject to estate or gift tax. If you are planning to make a large gift before January 1, we should review its impact on your 2009 income tax liability and whether it may make sense to defer all or a portion of the gift to 2010. If the gift is of property and will require an appraisal (usually required for gifts of property with a value in excess of \$5,000, other than publicly traded stock), we should start the process as soon as possible so that the appraisal is available before year end.

In conclusion, we hope that the information in this letter is useful in your year-end gift planning. If you wish to take advantage of any of the planning techniques that we have described, please feel free to call.

Sincerely yours,

Pursuant to Circular 230 promulgated by the Internal Revenue Service, if this letter, or any attachment hereto, contains advice concerning any federal tax issue or submission, please be advised that it is not intended or written to be used, and that it cannot be used, for the purpose of avoiding federal tax penalties unless otherwise expressly indicated.

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