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## **Estate and Gift Tax Planning Techniques** **January 16, 2009**

Dear Client:

This letter will discuss several tax planning techniques for estate and gift purposes. Many of these techniques will also reduce your overall income tax burden.

### **Use of Gift Tax Exemptions to Reduce Estate and Gift Tax**

The current federal estate tax exemption is \$3,500,000, although this amount will be reduced to \$1,000,000 million in 2011 unless Congress decides otherwise. An important method of ensuring that your estate will not be subject to estate tax is to make sufficient gifts during your lifetime so that at your death your estate is smaller than 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. While many wait until year-end to make such tax-free gifts, any time during the year is a good time to do so, and the sooner the better.

### **Annual Gift Tax Exclusion**

The most commonly used method for tax-free giving is the annual gift tax exclusion, which allows you to make a gift of up to \$13,000 (the limit was increased effective January 1, 2009) on an annual basis 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 gifts to 10 donees, you can exclude up to \$130,000 of these gifts 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.

Your annual gift tax exclusion expires at the end of each year, so the sooner in the year you take advantage of this type of gifting, the better. 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 one year (before December 31) and the second early in the next year (after January 1). For example, if you are married, you can make a total tax-free gift of \$52,000 to any individual by making a gift of \$26,000 in December and another \$26,000 in January.

As noted above, the annual exclusion is applied on a per donor, per donee, per year, 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 his daughter, for a total of \$39,000 in tax-free gifts. This amount can be doubled to \$78,000 if your spouse joins in the gifts.

### **Tuition Payment Exclusion**

In addition to the annual gift tax exclusion, you are also 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 must be for the purpose of education or training. Because there is no limit on the amount of the gift, the 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 leave you the option of making an annual exclusion gift later in the year.

### **Section 529 College Savings Plans**

Contributions to a Section 529 College Savings Plan ("529 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 qualify you for a state income tax deduction, *but only if the plan is sponsored by your state.*

Distributions from a 529 Plan can be used for a wide range of educational expenses, including tuition, fees, books, supplies, and room and board. An added advantage of a gift to a 529 Plan is that the income earned on the contribution is tax-free, as long as the contribution is eventually used for educational purposes. 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 Plan. You can fund a savings plan with up to \$65,000 and then file an election with the IRS to spread this gift over five years for gift tax purposes. By using five \$13,000 annual exclusions, the entire gift is tax-free.

### **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 that would qualify for an income tax deduction. You cannot claim an income tax deduction for the payment unless the payment is made for your spouse or dependent.

The exclusion for medical payments includes the payment of medical insurance. 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 and grandchildren, due to the 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 sufficient control over the gift that it is considered a 'present' interest rather than a future interest. Although this presents a risk of the beneficiary withdrawing the gift from the trust, the potential loss of your making 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 is done.

### **Charitable Gifts**

You should review your charitable giving to ensure that it is being done in the most tax-efficient manner. Charitable giving is an important form of estate planning. Gifts to charity will never be subject to estate or gift tax. If you are planning to make a large gift, we should review its impact on your over-all 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 that will require an appraisal (usually 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.

This year *may* present a planning opportunity if you are at least age 70-1/2 and wish to make a charitable gift from your IRA. In late 2007 and again in late 2008, Congress passed legislation that allowed you to make a gift of up to \$100,000 to charity directly from your IRA. Unfortunately, in each prior case, Congress failed to pass such legislation until very late in the year. Again in 2009 we have no assurance that such charitable gifts from IRA will be permitted and we will need to "wait and see" what Congress does. However, assuming that Congress does pass such legislation in 2009, a charitable gift from your IRA may be made in lieu of, or in addition to, your annual minimum required distribution. Because the gift passes directly to charity, it has the benefit of not increasing your adjusted gross income and is not subject to the cutback on itemized deductions. If you are interested in making such a gift, you should defer taking your 2009 minimum required distribution until your tax advisors have the opportunity to demonstrate the tax benefits of such a gift.

In conclusion, we hope that the information in this letter is useful in your 2009 Estate and Gift planning. If you wish to discuss any of the planning techniques that we have described, please feel free to call.

R. Leonard Davis, III