



PRESTIGE WEALTH MANAGEMENT GROUP  
*Retirement Planning & Distribution Specialists*

## Special Report

# 2011 Is a Good Year to Think About Tax-Free Gifting Strategies

**W**e all know that it is better to give than to receive, but if possible, it can be even more advantageous to give and be tax savvy about it too!

In today's confusing world, there are several common strategies you can use that will allow you to gift some of the assets that you have accumulated in your estate, which in turn could possibly reduce the tax debts incurred by your heirs when you pass. With proper gift planning it is possible to be generous and tax efficient at the same time.

### Estate and Gift Taxes

Once your net worth exceeds a certain amount, your estate may be subject to estate taxes. Currently, you can gift up to \$5,000,000 federally tax-free during your life, or, when you pass, to a non-spouse beneficiary. If you are married, you can gift up to twice this amount, or \$10,000,000. That is the federal amount that can transfer federally tax-free to non-spouse beneficiaries. This number is called the basic exclusion amount. (There is no limitation for a spouse to gift to his or her spouse as long as the spouse is a U.S. citizen.)



While exchanging or gifting large amounts of money to your spouse is considered tax free, this is not always the best solution to reducing your taxable estate. Unfortunately, this transfer could possibly increase the amount of tax that you can potentially impose on your spouse's estate. Gifting assets to your children, grandchildren and other non-spouse beneficiaries is treated differently; however, there are still various ways that you can provide some tax-free gifts for these special beneficiaries.

Unfortunately, today's generous exclusions only apply for two calendar years. In 2013, unless Congress changes the current law, the federally tax-free amount will revert back to \$1,000,000 per person, and the federal tax rate for many estates can go up to 55% (compared to the current maximum rate of 35%).

Many people are surprised when they learn that the gift tax is paid by the giver and not the receiver! It is sometimes hard to believe that the person making the gift is also the one that has to pay out of pocket any of these additional gift taxes.

In addition to all of these federal taxes, you should investigate whether the state in which you reside might also tax your estate. Currently 16 states and the District of Columbia have an estate tax, including New Jersey, New York and Pennsylvania.

Even if a \$5,000,000 tax-free amount (\$10,000,000 if you are married) sounds like more than enough to cover what you would ever expect to have, it is always a good idea to think and plan ahead. We do not know what Congress will do next. If Congress does nothing, the limit will revert back to \$1 million in 2013.

If taxes are potentially an issue, there are several strategies available to reduce or eliminate the government's share. One of the best ways to reduce estate taxes is to gift away assets while you are alive, which in turn leaves less for the government to tax after you are gone. If there were no limits to these lifetime gifts, it would be very easy to avoid estate taxes. That is why the government established "gift tax" rules, which are a backstop to the estate tax.

Current law imposes a gift tax of up to 35% once you have gifted passed a certain amount. You can gift up to \$13,000 to as many recipients as you would like without incurring a gift tax. Spouses can combine this annual exclusion to jointly give \$26,000 to as many people as they want gift and estate tax-free.

If you exceed this limit, the difference can count against your \$5,000,000 lifetime gift and estate tax exclusion. After you have given away more that, the gift tax of up to 35% applies.

The simplest and most tax-efficient way to pass your wealth along to others is by using the annual exclusion, which allows you to give \$13,000 of assets each year to as many individuals as you want without having to worry about the gift tax. Remember – there is no limit to the number of recipients. For example, a married couple with a child who is married and has 2 children could make a joint gift of \$26,000 to the adult child, the

child's spouse and each grandchild – a total of 4 people – providing the family \$104,000 a year.

There are many additional strategies for subsidizing relatives, friends or others without having to pay unnecessary taxes.

## Create a gifting strategy

It is always a good idea to sit down and work on your strategy for gift giving. Think about how you can possibly set up a plan for making gifts to your children and their children that will maximize your usage of the \$13,000 per person per year rules, and, if necessary and if it is tax efficient, reduce your estate while making these gifts during your living years. For larger estates, your gifting strategy can be a very important piece of your overall estate plan.

Another important area to address is what type of asset is best to gift. This can be very complicated, and it requires the knowledge of various tax laws and the "step-up in basis" rules. There are different pros and cons to the various investments that are possible. Please consult with us before you make your decision.

As with other financial strategies, we can help you determine which of these strategies is best for you and your specific situation. However, for the purposes of education, here are some strategies that you can consider.

## Make a gift in 2011

For 2011, you may generally give up to \$13,000 per person without being subject to gift tax rules. This means that a couple can typically gift \$13,000 each (a total of \$26,000) to a child or grandchild without incurring any tax impacts.

## Fund college savings plans

Many people are interested in providing tuition assistance to their children or grandchildren who plan on going to college. One great way to do this is by



establishing a Section 529 education savings plan, which allows the earnings to grow tax-free as long as the money is used for higher education.

You are allowed to make up to 5 year's worth of these contributions in one year (up to \$65,000 per child or up to \$130,000 per child for a married couple) without being subject to gift taxes. If you do give these large amounts of money to a person, you cannot gift to this person again within the next 5 years or this will eat into your lifetime maximum amount of tax-free gifts.

### **Pay college tuitions directly**

Direct payments for college, graduate school or private school tuition (excluding room and board) are excluded from the \$13,000 annual gift tax limitation. This rule applies to anyone making tuition payments, and is one that is often utilized by grandparents who want to give extra money to grandchildren without being restricted by the gift tax limitations. Helping grandchildren or children pay for their education can provide an incredibly rewarding feeling. In today's world, college tuitions are very expensive and this strategy can help you significantly reduce your overall estate, while providing a meaningful reward.

### **See if you qualify to get credit for tuition payments**

The American Opportunity Credit is currently available to reduce your tax bill by up to \$2,500 per student if you are paying tuition for the first four years of college. To qualify for this credit, the student must be your dependent, and you must fund at least \$4,000 in tuition and qualified expenses (including books and other course-related materials). Additionally, your modified adjusted gross income needs to be below \$160,000 if married and filing jointly or \$80,000 if you are single. After that point, there is a phase out that finalizes after a couple earns more than \$180,000 or \$90,000 if you are single. Like with all other strategies, please consult with us on the details of this before considering this option.

### **Pay the medical expenses of loved ones directly**

Medical bills have escalated over the past decade. You can pay directly for medical or dental expenses without using your annual exclusion. These payments are exempt from gift taxes, no matter how much money you spend. Please note that you must make the payments directly to the providers of these services – you can't just reimburse the person you want to benefit.

### **Consider opening a custodial account for your children or grandchildren**

Many parents and grandparents utilize this technique as a learning experience for their children or grandchildren. They open an account that can help teach their children or grandchildren about investing. This can accomplish two goals. It can teach children about investing, as well as help you move dollars into their name. By opening a custodial account, you can make sure that the money is managed by you until they reach the age of majority (21 for most states, a few states are 18) and then, at that point, hopefully they are mature enough to take over that account. Please keep in mind that custodial accounts for children or grandchildren younger than 19 (and sometimes younger than 24) are generally taxed by the current kiddie income tax rules. This means that the first \$950 of the child's investment income will be tax free. The next \$950 will be taxed at that child's rate, but anything over \$1,900 for the year 2011 is scheduled to be taxed at the parent's higher rate. Please keep this in mind when making your decision as to where to invest this money. Also, remember that gifting to set up this type of account is limited to the \$13,000 tax-free per person rules. Consider using a custodial account as a learning vehicle for children or grandchildren as well as a way to gift money in a tax smart fashion. We can help give you more information on how this would work.

## Consider setting up an irrevocable trust fund for minor children

While this strategy should also be discussed with a lawyer, one of the reasons to consider this trust is that it allows you to make a gift to minor children each year without handing them an actual check. The minor children will then receive all of this money tax-free when they reach the age of majority set forth by the trust. Keep in mind that this is subject to the \$13,000 limitation, but it is a great way to give money and still maintain some control of it.

## Consider helping a child or grandchild contribute to a Roth IRA

Although this is once again subject to the \$13,000 per year limitation, children of any age who have earned income from a job, even if it is just baby sitting or lawn mowing, may contribute up to the amount they have earned, with a \$5,000 maximum for 2011, to a Roth IRA. Provided they do not earn over the amount that makes them ineligible to contribute to a Roth IRA (\$120,000 modified adjusted gross income if single; \$176,000 if married couple), you can give them the money to make the contribution. Even though your children or grandchildren might use your gift to fund their Roth IRA, there is no tax break for this gift and it will be counted toward the \$13,000. On a positive note, your children or grandchildren to whom you gift this money to can reap many benefits in the future thanks to your generosity. After the age of 59 ½, they will be eligible to withdraw all of the money including the earnings from this Roth IRA, tax free. If they choose to, they can also contribute more to it along the way.

## Conclusion

There are many other gifting strategies to utilize to reduce your estate, including charitable donations to be made to the charity of your choice upon your death, which can reduce your estate's overall taxable assets. These are all important decisions with which we can help you.

*We have found that most people make a living by what they get but they can make a lifetime by what they give.*

When reviewing your estate plan and options it is helpful to remember what was said by Percy Ross, a great American self-made multi-millionaire who is best known

*“He who gives while he lives gets to know where it goes.”*

We look forward to helping you with putting together a strategic plan for your specific situation.

Part of our responsibilities as an independent wealth advisor is to help and direct clients form their strategies for their estate plans. If you have any questions about yours, please contact our office to make a complimentary appointment.

As part of our Personal CFO Services, we review and coordinate your investment strategies and how these strategies affect and interact with your tax and estate planning needs and concerns. See our Personal CFO Services for our full list of services.

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