

# Capturing an Annual Exclusion Gift to Spouse

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People with potential taxable estates should consider maximum utilization of the Annual Exclusion. The Annual Exclusion is an amount a person (the Donor) can give to another person (the Donee) without any gift tax consequences. The current Annual Exclusion amount is \$13,000 per Donee. So you could give 10 people \$13,000 each, every year, without incurring any gift tax and not using your Lifetime Exemption (which allows up to \$1,000,000 in additional gifting before tax is actually incurred). When the estate tax returns in 2011 with rates up to 55%, a person facing estate tax saves \$7,150 per Annual Exclusion gift made. All future appreciation on the gift escapes the tax as well.

Most gifting programs, even the ones that include children, grandchildren and in-laws miss a very valuable Donee. If you are married, a gift can be made to your spouse that is structured to qualify for the Annual Exclusion. An outright gift to a spouse won't work, because it will automatically qualify for the Marital Deduction. A marital deduction merely postpones the estate tax until both spouses have deceased.

However, a gift in trust to your spouse does not automatically qualify for the Marital Deduction.

A gift in trust to your spouse only qualifies for the Marital Deduction if:

1. The Trust is drafted to qualify for the Marital Deduction, and
2. Marital Deduction treatment is elected on a Gift Tax Return (Form 709)

So if you make a gift in trust to your spouse, and the gift does not qualify for the Marital Deduction, then how is the gift treated under the tax code?

By default, all gifts qualifying for the Annual Exclusion must use the Annual Exclusion prior to dipping into the \$1,000,000 Lifetime Exemption. So you can make an Annual Exclusion gift to your spouse, by making the gift to your spouse in a trust that does not qualify for the Marital Deduction. There is a limit on the Annual Exclusion available to the spouse however. That limit is the amount of the Annual Exclusion is limited to either \$5,000 or 5% of the value of the assets in the trust (with, of course, the Annual Exclusion amount being the maximum).

## **Advantages of a Gift in Trust to Your Spouse:**

- It can qualify for the Annual Exclusion, providing potential estate tax savings of \$7,150 for each year a gift is made, plus estate tax avoidance on all future appreciation in value.

- Indirect access to the gift through trust distributions to your spouse during his or her lifetime.
- Each spouse can set up a trust, thereby doubling the estate tax benefits.
- The trust assets are protected from creditors.
- The trust (for income tax purposes) is a Grantor Trust, which means the appreciation in the trust is not burdened by income tax. The income tax on taxable income in the trust is paid by the Donor's other unprotected assets (the ones that will be subject to estate tax in the future, which means there is potential for additional estate tax savings).

The Annual Exclusion Gift in Trust to Spouse is an important tax loophole that can help preserve family wealth. The trust requires specialized drafting, and this planning should not be attempted without competent legal counsel.