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*"We make a living by what we get,
we make a life by what we give"*

- Winston Churchill

2006 GIFT TAX EXCLUSION \$12,000



Tax experts are reporting that the annual gift tax exclusion, which has been \$11,000 per person per year since 2002, is expected to

increase to \$12,000 effective January 1, 2006. The gift tax exclusion is the amount the Internal Revenue Service allows a taxpayer to gift (with no strings attached) to another individual without incurring gift tax. The tax code permits the gift tax exclusion to rise with inflation. This year's inflation figures are anticipated to reach the next threshold. The IRS is expected to make an official announcement of the change by December. The increase means that more can

be gifted each year for estate tax planning purposes.

Although the permitted annual \$11,000 exclusion (or less if you so choose) may not seem significant by itself, do not underestimate the cumulative value of this type of gifting program, for instance, to each of your children and grandchildren: the resulting asset shift, when combined with post-gift appreciation and earnings build-up, may be significant!

A STEP AHEAD

A FOCUS ON GIFTING

With the end of the year approaching, we thought that it would be a good time to focus the articles in this newsletter on gifting and on particular gifting strategies. Apart from the fact that giving gifts benefits our loved ones and enhances their mental and physical well-being, gift giving provides a mechanism for reducing the size of our estate. Not only is the value of the gift itself removed from the estate but any growth in the value of the asset, or appreciation, together with all earnings on the gifted amount are also removed from the estate.

The annual gift tax exclusion permits each of us to gift the sum of \$11,000 per person this year without incurring a gift tax. Husband and wife may each transfer \$11,000 to any number of recipients. However, this is not cumulative. We are

GIFTING WITH A 529 PLAN

Section 529 of the Internal Revenue Code provides an excellent mechanism for saving for the costs of higher education for our children and grandchildren. Funds put away when a child is young are likely to grow significantly especially as the income generated escapes federal income tax and many states, including New York, allow deductions for contributions to a 529 Plan. 529 Plans are offered in all fifty (50)

not permitted to save this year's exclusion and apply it to a larger gift in a subsequent year. It is a "use it or lose it" opportunity. A gift that exceeds the exclusion amount is taxable to the donor and not the recipient of the gift. From the time the gift is made, the recipient reports all future income earned on the gifted amount. This results in a shift of inter-family income to lower income brackets and enhances overall family net worth.

It is always important to coordinate gifting with other asset protection strategies. If you are already engaging in Medicaid asset protection planning, for instance, it is important to inquire, before making gifts that were not considered in the strategy, what effect the annual exclusion gifts will have on your planning.

states and there is no residency requirement for the establishment of a 529 Plan. Investment minimums are usually very low and must be made in cash. Contributions in excess of the amount that is reasonably necessary to provide for the higher education expenses of the beneficiary are prohibited. Because state plans vary so widely, it is important to shop for the best plan for your family.

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Berwitz & DiTata LLP

PLANNING WITH A QPRT



The Qualified Personal Residence Trust ("QPRT") is an excellent estate planning device which permits the transfer of qualified real property, at a discounted rate, to designated beneficiaries. Created by Congress in 1990, it is one of the few statutory estate planning tools available to taxpayers. Provided that the QPRT conforms with the statutory requirements, it will reduce the taxable estate of the taxpayer.

The QPRT is so advantageous because it permits the donor of the gift to delay its ultimate transfer to the beneficiary for a term of years while utilizing a fraction of the current property value to calculate the tax consequences of the gift. For example, if you were to gift your home to your children today the value of that gift would equal the current value of the house. What is the gift's value if you *promise* to give the house to your children in *10 years* instead of today? Because your children do not derive any benefit from the gift for 10 years, the value of the gift is considerably less than the actual fair market value of the house. Thus, a qualified home

worth \$1,000,000 transferred to a QPRT with a 10 year term in November 2005 will have a gift tax *value* of only \$486,790.

Even better, while the house will continue to appreciate during all of the 10 year period, the increase in value is out of your estate as well. Assuming a 5% annual growth rate, the house worth \$1,000,000 today will be worth \$1,700,000 at the end of 10 years. Considering that the maximum federal estate tax rate in 10 years will be 55%, this would result in a net federal estate tax savings of at least \$667,000.

There are additional benefits as well. After the 10 year term expires, when the beneficiaries own the property, the taxpayer can further reduce his or her taxable estate by paying the fair market rent to the new owners. Such payments are not considered gifts and do not reduce the annual exclusion available to the taxpayer (currently \$11,000 and increasing to \$12,000 on January 1, 2006). Also, the interest in the real estate that is transferred to the QPRT, the remainder, is not subject to the claims of creditors of the taxpayer (provided the transfer was not a fraudulent conveyance).

Notwithstanding the estate planning benefits of creating a QPRT, there are some consequences that might be considered disadvantages. Chief among them are that the full value of the property is includible in the taxpayer's estate if the taxpayer dies before the completion of the selected term of years. For this reason the term should be a period the taxpayer is likely to survive. Other considerations are that the taxpayer will lose control over the asset at the end of the term, the step-up in basis that would occur if the property had remained in the taxpayer's estate for capital gains tax purposes will no longer be available, and the rental payments made by the taxpayer after the expiration of the term, less expenses relating to the property, will be included in the beneficiary's "taxable income" for annual income tax purposes.

A QPRT is a reliable estate tax planning device that can result in significant savings for your family. Do not hesitate to ask us whether this effective wealth preservation strategy fits in with your overall estate planning goals.

B&D WELCOMES PHIL

We are pleased to welcome attorney Philip A. Martone Jr. to the firm. Phil joins us as Of Counsel and brings a broad background of twenty plus years in administration and business development with the trust departments, personal and corporate, of one

of the money center banks. He is a graduate of Washington & Jefferson College, magna cum laude, and Syracuse University College of Law. He will be participating in various seminars and speaking engagements. Phil welcomes your telephone calls, will

be happy to answer your questions or assist you with the resolution of your concerns and looks forward to meeting you.



Gifts with a 529 plan (continued from page 1)

Often, clients are concerned that they may save money for a particular child who later does not, for whatever reason, continue with his or her schooling, or that money will remain in the account after the beneficiary completes his or her education. 529 Plans are very flexible. The beneficiary can be changed at any time and for any reason as long as the new beneficiary is a "member of the family" of the current beneficiary, a term which is very broadly defined and includes: the mother or stepmother, father or stepfather, grandparents, son, daughter, stepchildren, siblings or step-siblings, nieces or nephews, spouse or spouses of any of the above!

The money in the 529 Plan may be withdrawn at any time. However, if the withdrawal is not used for a "qualified higher education expense," the earnings are taxed as ordinary income to the distributee,

either the account owner or the beneficiary, and a ten percent (10%) penalty is imposed on the amount withdrawn. This penalty is waived if the withdrawal follows the death or disability of the beneficiary. "Qualified higher education expenses" include tuition for college or vocational training, fees, books, supplies and equipment. If the beneficiary is an "eligible student," one who carries at least half of the normal full-time work load, room and board may also constitute a qualified expense.

From an estate planning standpoint, the funds contributed to a 529 Plan are generally not includible in the estate of either the donor or the beneficiary for federal estate tax purposes. Moreover, contributions qualify for the annual \$11,000 gift tax exclusion and, to maximize the potential growth of the account, the donor can "pre-fund" the

529 Plan by making a gift of up to \$55,000 in any one year provided that no further gift is made to the beneficiary during the next four years. It is very important to coordinate gifts to a 529 Plan with other annual gifting.

For Medicaid planning purposes, the funds that are contributed to a 529 account are considered available resources of the donor because the donor has the continuing ability to withdraw funds, albeit with a penalty. Even funds contributed many years before a nursing home placement may not be protected and may cause an applicant to be disqualified for Medicaid benefits. Instead, a 529 Trust can be created as part of the planning strategy. By its terms, a 529 Trust prohibits the contributor from withdrawing the contribution. This can make the assets unavailable for Medicaid purposes.