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Annual Exclusion Gifts

Annual exclusion gifts are a powerful and relatively simple way to transfer wealth. Annual exclusion gifts do not generate gift tax or use up any of the lifetime gift and estate exemption, can be made to an unlimited number of recipients each year and can be made as frequently (or as sporadically) as the donor wishes.

In 2006, the annual exclusion gift limit is \$12,000 per recipient. In addition, if you are married, your spouse can make separate additional gifts to the same recipients, or if you and your spouse prefer, one spouse can make gifts for both spouses. So, two spouses can actually give up to \$24,000 per year per recipient.

The benefits of making annual exclusion gifts are illustrated by the following example. Consider a husband and wife, each 50 years old, who together have two children and four grandchildren. If either husband or wife makes only \$12,000 of annual gifts to the couple's children and grandchildren (totaling \$72,000 per year) at the beginning of each year for the next 10 years and if the after-tax rate of return on the transferred assets is 5%, the couple will have transferred about \$1,000,000 tax-free to their children and grandchildren over that time period. After 20 years of gifting, the gifts would total about \$2,000,000; and after 30 years would be about \$5,000,000. If the combined state and federal estate tax rate in effect is 45%, this gift plan will save \$450,000; \$1,125,000 or \$2,250,000, respectively, in estate taxes.

Virtually any property can be used to make annual exclusion gifts. Cash, marketable securities and interests in family partnerships and LLCs are among those most commonly used, but fractional interests in real estate, art and other valuable personal property also can be used. Cash has several advantages: (i) it is easy to transfer; (ii) easy to value; and (iii) has a cost basis exactly equal to its fair market value (which means that the recipient receives the gift without any unrealized appreciation or capital gains tax exposure). On the other hand, while fractional interests in real estate and minority interests in closely held companies are more complicated to value and transfer than cash or marketable securities, they offer the advantage of qualifying for valuation discounts and allow the donor to retain more control over the management of the transferred assets.

Annual exclusion gifts to children or young adults can be made to custodial accounts under a variety of trust arrangements.

If we can be of assistance to you in considering these points further, please let us know.

Presented as information to our clients and friends, and not to be construed as or take the place of legal or other professional advice or opinion.

IRS Required "Circular 230" Notice: Pursuant to recently enacted federal regulations imposed on attorneys who give tax advice ("Circular 230"), we are required to include a notice in most of our written communications that any tax advice contained in the communication is not intended or written to be used, and may not be used: (i) by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by any governmental taxing authority; or (ii) by any person to recommend or support the promotion or marketing of any federal tax transaction addressed in the communication.