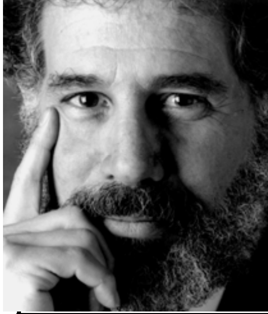

Leimberg's Think About It

Think About It is written by Stephan R. Leimberg, JD, CLU

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WHAT EVERY PLANNER NEEDS TO KNOW ABOUT THE GIFT TAX ANNUAL EXCLUSION

Congress originally enacted the annual exclusion in 1932. It's purpose was

> "to obviate the necessity of keeping account of, and reporting numerous small gifts..." and to "fix the amount sufficiently large to cover most cases, wedding and Christmas gifts and occasionally gifts of small amounts."

Today, the annual gift tax exclusion is one of the most simple, yet powerful, of all the tools available to the sophisticated estate planner.

WHY THE ANNUAL EXCLUSION IS SO VERY IMPORTANT

The privilege of totally excluding gifts from taxation is an extremely valuable one. Gift tax rates are equal to estate tax rates – and those rates are – once the gift becomes taxable – high. The right to totally exclude a gift from such rates can be very advantageous.

Second, an incredible amount of wealth can be shifted, gift tax free, through the use of the (currently) $12,000 exclusion.

1. The annual exclusion can be taken each year – for each gift – to each donee – with the number of potential donees virtually unlimited!

   A 70 year old widower with four children and six married grandchildren (16 donees) could divest himself of $192,000 ($12,000 x 4) plus ($12,000 x 12) – each and every year for the rest of his life. Assuming a 50% combined state and federal estate tax bracket, each year's gifts save $96,000! In 10 years the donor will have given away $1,920,000 – saving $960,000! Remember, (a) no out of pocket tax cost has been incurred and (b) no exhaustion of his unified credit was necessary.

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But the **NumberCruncher Software** illustration below shows that if the donor makes gifts for the remaining 16 years of his life expectancy, the amount of total gifts amounts to $3,072,000 with a potential estate tax savings of $1,536,000. But of course, that's not the whole story. If the donees invest the annual gifts at merely 4% after tax, the total value of the gifts at that time will be $4,190,310 – resulting in a potential estate tax savings of $2,095,155! And consider how much more there would be if all or a substantial portion of each year's gift was used by each donee to purchase life insurance on their parent's life.

2. A married couple could double the amount of annually excludable gifts made to third persons such as children – from $12,000 to $24,000 – each – by "splitting" the gift. In other words, if the non-donor spouse consents to the gift, it may be treated as if each spouse made one-half of the gift. This enables the spouse owning most of the property to take advantage of the other spouse's annual exclusion. In the example above, a married couple could – over a 16 year period (the 70 year old—older donor's life expectancy) give away $6,144,000 with a potential estate tax savings of $3,072,000! The projected value of those gifts – if the donees enjoy a 4% after tax return on the gifts – would be $8,380,620 – resulting in a potential estate tax savings of $4,190,000! (A 50 year old donor with 10 donees making $12,000 annual gifts who splits the gifts with her husband and makes those gifts in a planned program for life (expectancy 33.1 years) would give away $8,160,000 with a potential estate tax savings of $4,080,000. But if the donees invest at 4% net after-tax, the money will grow to $16,765,898 over the 50 year old donor's life expectancy – resulting in potential estate tax savings assuming a 50% combined state and federal rate – of $8,382,949! Again, if all or a significant portion was invested in life insurance on either or both parent's lives, an astounding amount of financial security could be provided – estate tax free – to future generations.

3. Annual exclusion gifts can be made even on the donor's deathbed – and if made in the form of cash, securities, real estate, or even art or collectibles, will not be brought back into the donor's gross estate. Such gifts will not be brought back into the donor's estate – regardless of how close to death they were made – or the reasons motivating the gift.

4. Annual exclusion gifts do not form part of the base used to compute the rate of tax when calculating federal estate taxes, i.e., they are not considered "adjusted taxable gifts." So, unlike taxable gifts, annual exclusion gifts are not added back to push up the rate the remaining estate is taxed. So annual exclusion gifts have no adverse impact on estate tax costs.

WHY MAKE GIFTS IN TRUST?

There are many reasons why planners often suggest clients make gifts in trust as opposed to outright. (See The New Book of Trusts http://www.leimberg.com/products/books/newBookOfTrusts.asp). The tax advantages are obvious, but there are also many "people oriented" goals. I generally break these down into three main categories: (1) management, (2) conservation, and (3) dispositive.

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Quite often, a client will feel that the beneficiary is unwilling or unable to invest, manage, or handle the responsibility of an outright gift. Obviously, gifts to minors fall into this category. But the use of trusts should also be considered for persons who are legal adults but who lack the emotional or intellectual maturity, physical capacity, or technical training to handle large sums of money or assets which require constant and high level decision-making capacity. A trust is often used to postpone full ownership until the donees are in a position to handle the property properly.

Many donors want to achieve the income and estate tax advantages of gifts, but are reluctant to place all the ownership rights in the hands of the donee. Many donors utilize trusts as the solution to the ambivalent position of wanting to institute a program of gifting but fearing the possible results of an outright "no-strings attached" transfer which lessens the donee's dependence on them.

A further impetus for the use of a trust is where the proposed gift property does not lend itself to fragmentation – but the donor desires to spread beneficial ownership among a number of people. For instance, a large life insurance policy (and ultimately the proceeds it generates when the insured dies) is almost always better held by a single trustee than jointly by several individuals. Another common example is real estate; often land will be more valuable if it is not divided. A ten acre tract of land may be worth substantially more than ten one acre tracts. Using a trust as the receptacle for the gift, ten beneficiaries could share in the growth and income from the land without necessitating an actual division of the property itself. At a specified point in time or on the occurrence or nonoccurrence of a given event, the trustee could sell the property and divide the proceeds or split up the property itself among the trust's beneficiaries.

Donors should consider irrevocable trusts in lieu of outright gifts where conservation of assets and particular dispositive plans are important, i.e. where control is essential. For instance, a donor will often want to limit the class of beneficiaries and prevent the donee from disposing of property to persons "outside the family." The trust provides a means of preventing the donee's spouse or children from acquiring statutory or common law rights such as dower or courtesy. A gift in trust for the donor's daughter's benefit alone (or even for the benefit of herself and her husband as long as they are married) provides protection against the unsuccessful marriage. A closely-held business is often the major (or only practical) asset an individual can use to make meaningful and significant gifts. A trust provides a vehicle for a donor to make gifts of stock with minimal loss of control.

The Uniform Gifts/Transfers to Minors Act appears to provide many of the desired characteristics described above – and is simple, relatively easy to implement, and inexpensive. But it lacks the flexibility of a trust and subjects the property to probate expenses, federal and state death taxes at the child's death. Although most donors will not want substantial amounts of property to fall into the absolute control of a child at age eighteen (or 21 depending on state law) that is precisely what such Acts require.

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A trust, therefore, is one of the best ways a donor can give property and at the same time achieve flexibility to meet future contingencies and attain his or her personal objectives.

THE PROBLEM OF OBTAINING AN ANNUAL EXCLUSION FOR GIFTS TO TRUST

Commentary above shows that the annual exclusion is an extremely useful and profitable estate planning tool and that gifts in trust are often indicated for a multiplicity of reasons. But a problem arises when the donor seeks to obtain an annual exclusion for gifts in trust. That problem is triggered by the dichotomy between the objectives of Congress as stated in the wording of the Internal Revenue Code Section 2503(b) and the objectives of the donor as manifested in the trust instrument.

The Code provides that the annual exclusion applies only to gifts of

"other than gifts of future interests in property."

The Regulations then specifically state that

"no part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar quarter."

The Regulations define the term "future interest" as a legal term which

"includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time...."

Where the donee's enjoyment is immediate, complete, and without restriction – such as where cash or other property is received outright or through custodianship or guardianship – it will be considered a present rather than a future interest. But probably the donor's central reason in the establishment of a trust as a receptacle for gifts was to overcome such immediate, complete, and unrestricted rights in the donee, exactly the opposite of what the Code and Regs. demand for an interest to be "present."

EACH GIFT TO TRUST IS ACTUALLY TWO GIFTS

When a client, seeking to accomplish conservation, disposition, management, income, or estate tax savings objectives through a gift in trust, provides for a deferral of the payment of principal, for federal gift tax purposes, he is making two gratuitous transfers; one transfer creates an interest in the income while a second transfer creates an interest in the principal. Either or both may qualify as present interests or either or both may be considered "future" and therefore non-qualifying interests.

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WHAT STANDS BETWEEN THE CLIENT AND THE ANNUAL EXCLUSION?

The IRS has many weapons it uses in its attempts to strike down the taxpayer's use of the annual exclusion. The IRS will claim the transfer is one of a future interest while the taxpayer, your client, will claim the gift is of a present interest – while at the same time trying to achieve the personal management, conservation, dispository, and control objectives through the terms of the trust.

I will examine below techniques for accomplishing both of your client's objectives and focus on trusts which have "demand" (Crummey) type withdrawal provisions and Section 2503(b) "income" trusts which qualify for an annual exclusion – but only to the extent of the actuarial value (which can be computed through software such as **NumberCruncher**) of the beneficiary's right to income – to the extent that right has ascertainable value.

Simultaneous with the grant of the exclusion in 1932 came the denial in the case of gifts of future interests. The purpose for that denial was because of the "apprehended difficulty, in many instances, of determining the number of eventual donees and the values of their respective gifts."

This limitation of the annual exclusion to present interest gifts has generated many cases which focus on the meaning of a "present" as opposed to a "future" interest.

WHO IS THE DONEE?

A Gift in Trust is a Gift to the Beneficiaries Rather Than to the Trustee

Does the term "person" include a gift to a trustee or executor? If so, by creating multiple trusts, you could create multiple annual exclusions. But the courts have held that, although the term "person" does include a trust or estate, a gift to a trust is treated as a gift to its beneficiaries, those persons to whom the gift was made (just as a gift to a business entity is deemed to be a gift to its owners in proportion to their interests in the business). So a gift to a trust is treated as a gift to the trust's beneficiaries. That means a single transfer to a trust can qualify for multiple annual exclusions! The number of exclusions depends on the number of beneficiary-donees, the ascertainable amount each donee is to receive, and qualification of the interest as present rather than future.

WHAT IS A "FUTURE INTEREST" GIFT? WHAT IS A "PRESENT INTEREST" GIFT?

A future interest gift is one in which the donee's use, possession, and enjoyment was postponed until the occurrence (or non-occurrence) of a future uncertain event. The beneficiaries of a

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future interest gift have no right to the present enjoyment of the corpus (or of the income) from the gift.

The nature of the gift is determined as of the date of the gift (and not by what the trustee may subsequently choose to do in his/it's discretion). So if beneficiaries must wait until the occurrence of a future event to enjoy trust income, it makes no difference if the trustee has the discretionary power to make advancements to them, even if payments of income are actually made. Even an unqualified right to income will be considered a future interest if the enjoyment can or will be postponed. Keep in mind that a gift of an immediate life interest in income is a present interest – even if possession of the corpus (principal) is withheld or postponed. So if a gift is made to a trustee to pay income to the donor's spouse for life and at her death to deliver the property to the two daughters, the discounted value of the wife's income interest is a present one – but the daughters' interest is future.

A present interest gift is one where the donee obtains the immediate, unfettered, and ascertainable right to use, possess, or enjoy the gifted property. Any restriction which postpones these legal rights – even for a second –makes the property transferred a future rather than present interest. Any barrier to the donee's immediate and absolute enjoyment is fatal to the exclusion. **Note**: It's not when the donee's title to the property vests that counts – it's when enjoyment starts.

VALUE OF INCOME INTEREST IN TRUST QUALIFIES FOR EXCLUSION – IF INCOME IS REQUIRED TO BE DISTRIBUTED CURRENTLY

As I just noted, if a trust instrument mandates current distribution of income, the present interest does not have to be in the corpus and the income interest can – by itself – qualify for the annual exclusion. The exclusion will not be disallowed merely because the income beneficiary does not also have a present interest in the corpus. This "steady and ascertainable flow of income" concept is the central force for the 2503(b) Trust described below.

NECESSITY FOR JOINT DESCISIONS KILLS EXCLUSION

If the only way a donee can obtain the use, possession, or enjoyment (including the exercise of rights under) of the property is through the joint consent/approval of others, the transfer will be considered a future interest gift. This is one reason why I recommend strongly against gifts of life insurance that will be jointly owned by siblings (or others). If the donees of a life insurance policy must act jointly, the gift will not qualify for the annual exclusion. It is far better planning to split up the policy and give each person his/her own discrete policy – or to place the policy in trust – and use Crummey Powers to assure the exclusion.

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IMPACT OF THE NATURE OF PROPERTY GIFTED

The present or future value question will be decided based on the particular facts of each situation. The nature of the property placed in trust will not, per se, generally be determinative. For instance, suppose the donor gives non-interest bearing notes. Even though, by their terms, the notes are not payable for some period of time, the beneficiaries could be given present rights to the proceeds of the notes without postponement until a future event. In such case, the annual exclusion will be allowed. Likewise, with a gift of life insurance or a bond or a fractional interest in property. A gift of all the incidents of ownership in a life insurance contract will be considered a present interest gift even if the policy is term insurance, has no cash value, or will lapse if no future premiums are paid. (Of course, if the donee's right to dispose of the policy are restricted, that probably will transform the gift to one of a future interest.)

But **beware:** the IRS may argue that where a trust beneficiary is given the right to income from property which, at the date of the gift is non-income producing, the right is at best dependant on the trustee's discretion to sell and make the proceeds income producing. Or it may argue that the exclusion must be denied because the interest is too uncertain to be valued. Alternatively, the Service could insist that the amount excludable should be limited to the actual income produced.

One potential problem concerns the Section 7520 Treasury Regulations: They provide that the valuation of an income interest in a trust that holds only non-income producing property — may not be based on standard valuation principles — unless the beneficiary has a power to demand that the trustee sell or otherwise make the underlying assets income producing.

Recently, in a case called Hackl, (see http://www.leimbergservices.com) the 7th Circuit Court of Appeals denied an annual exclusion for gifts of interests in an LLC. The bottom line of the case is that, merely making an outright transfer of a donor's entire interest in property does not, per se, assure the annual exclusion — if restrictions in the operating documents of the LLC or FLP are so broad that they render the transferred interests "essentially without immediate value to the donees." Form will not, proved this court, triumph over substance. To obtain an annual exclusion, your client must be able to demonstrate that the donee can in fact derive substantial current economic value from the gift.

So, if the annual exclusion is important, LLCs or FLPs should not create absolute restrictions on a donee's right to transferring (and thus realize immediate meaningful value from) their interest. (In Hackl, no transfer was permissible without the consent of the manager, Mr. Hackl). An alternative is to give the donee of the LLC or FLP interest a "put" right to force a buy-out at fair market value or a Crummey-like power for a reasonable period of time.

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FUTURE INTEREST IF ENJOYMENT CONTINGENT ON TRUSTEE'S DISCRETION

Where the amount of income and principal to be distributed depends on the discretion of a trustee or only when the trustee deems distributions necessary, it is clear that the mere possibility of postponement of the donees' enjoyment will be fatal. The one central criterion of a future interest is the possibility of future enjoyment. The power of a trustee to accumulate income — even for a very short period of time — makes that interest "future." There can be no delays, even if the delay or possibility of delay in enjoyment is caused by a discretionary power in the hands of a third party other than a trustee.

Likewise, if a trustee has the power under trust documents to allocate receipts to income or principal or to change expenses to income or principal or credit income with capital gains or charge income with capital losses, or to allocate trust income among several beneficiaries, any one of those powers will convert the income stream to a future interest. Even if the trustee's power is for "a good cause" (e.g. the power to withhold income distributions to an income beneficiary who has become a drug or drinking addict or who has become suicidal) will cause the income stream to be a future interest due to the contingency.

So a future interest will be found if there is any element of uncertainty with respect to the happening of a future event. The mere fact that distribution of corpus can or will be postponed will be enough to make the gift of corpus one of a future interest. The same applies to the income stream. **Note**: A power in the trustee to distribute corpus to the beneficiary will not kill the exclusion – even if the end impact is to reduce the trust's income payments to that same donee.

IMPORTANCE OF ABILITY TO VALUE THE INTEREST

If there is any possibility that the beneficiary's right to income will be cut off, the annual exclusion will be denied. The exclusion will be denied if the interest in question has no determinable value, i.e., if for any reason it is impossible to value the interest. That could happen, for example, if someone else could invade the trust principal making the value of gifts of income from that corpus impossible to determine. (This could be countered by showing that the invasion power was limited by an ascertainable standard and that the chance of invasion was negligible or showing that the trustee's discretion was more administrative than substantive.)

BURDEN OF PROOF ON CLIENT

Unfortunately, the law clearly requires the taxpayer — rather than the IRS — be able to prove that a given gift is one of a present interest. So the burden of proof is on your client.

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CRUMMEY POWERS: THE UNDERLYING CONCEPT

If a donee is given a power to take the property in trust in a manner so complete and absolute that his right becomes tantamount to outright ownership, the interest will be considered "present." This demand or withdrawal right has come to be called a Crummey Power from a case by that name.

It is now clear that

> "it is the right of the donee to the income –
> rather than the accident of whether there is income at any given time,
> that is the criterion of a present interest."

A spendthrift clause will not be, per se, fatal to the exclusion if the donee has the right at any time to demand payment of corpus and income.

A provision giving trustees the right to use payments of principal or income "directly for the benefit of such beneficiary" will not give a trustee discretion to withhold payment or create a future power where the beneficiaries have a demand right. So payments can be made directly to the beneficiary – or to a parent for the child's benefit – or to some other person who will use it for the beneficiary's benefit.

The age of the beneficiary is irrelevant. A withdrawal power can be given to a mere baby – since the legal right to use, possess, or enjoy - rather than physical capacity - is the determining factor. So a Crummey withdrawal power can be effectively used even if (a) the beneficiary is a minor or (b) if no guardian for that minor has actually been appointed or even if it's probable a guardian never will be appointed, or (c) if it is highly unlikely that a demand will ever be made., or (d) no demand is ever made, or (e) contributions are made toward the end of the year so that the time to make withdrawals is limited (as long as it's long enough for the beneficiary to have a "reasonable time" and "reasonable warning" of the withdrawal power).

It is my strong suggestion that each beneficiary (or parent or guardian on the beneficiary's behalf) be informed formally, by annual registered letter (return receipt requested or alternatively, requiring the donee to initial and return a copy of the letter) of the time and conditions of the right – made in ample time to effectively exercise that right (a month from the date of the registered mailing) should be enough. A consistent failure to give timely notice will be viewed by the IRS and the courts as an illusory power of withdrawal.

I also feel it's very important that the trustee should maintain, during the withdrawal period, sufficient cash on hand (or readily marketable and easily transferable securities) to meet any demand(s) that might be made.

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Through these Crummey powers, it became possible to use an instrument which achieves a gift tax exclusion without allowing beneficiaries carte blanche and without subjecting beneficiaries to needless income and estate taxation on trust income and corpus.

It is possible to provide that:

- no demand right occurs until and unless a transfer is made to the trust and a notice is given (i.e., predicate the withdrawal power on notification),
- no more than the amount placed in the trust can be demanded each time the right arises, and
- (assuming demand rights are noncumulative) to the extent withdrawal rights are not exercised by the end of the calendar year, they will lapse forever and the beneficiary will be unable to make demands with respect to transfers made to the trust during a prior calendar year. So withdrawals can be limited to only new contributions to the trust.
- If the person given a withdrawal right predeceases the insured grantor, the grantor attains a power to substitute a new person to have the withdrawal right, i.e., an "alternate withdrawer."
- The power to demand lapses as to any beneficiary who becomes subject to a bankruptcy (or divorce proceeding). This would prevent the bankruptcy trustee from exercising the withdrawal right.

If a trust instrument provides that no demand right exists unless a Crummey notice is provided to a donee, other gifts (for which no annual exclusion is needed) could be made. This technique would not only provide the donor with extensive control in the case of a donee who used the demand power unwisely or too often but also protect the trusts' assets to some degree from the beneficiary's creditors. The donor could continue to make annual gifts but, by not notifying the beneficiary, could void the demand right as to future gifts.

When there are multiple Crummey beneficiaries, each beneficiary must be individually named. Each named withdrawal power owner must be given a clear pro rata right to make withdrawals from the trust so that the IRS can't argue that the amount subject to withdrawal is uncertain or not ascertainable.

WHY USE LIFE INSURANCE AS A GIFT TO THE TRUST?

Life insurance is one of the most highly effective of all lifetime gifts. First, at minimal gift tax cost, the entire face value (death benefit) of the policy can be removed from the grantor-insured's gross estate. For instance, millions of dollars of death benefits can be shifted at the cost of only the interpolated terminal reserve plus unearned premiums as of the date of the transfer.

Second, a gift of life insurance doesn't reduce the client's spendable income.

Third, the client's personal security is diminished only by the transferred cash surrender value – and even this can be minimized by a pre-transfer loan immediately prior to the transfer. [**BEWARE:** The loan (together with any prior outstanding loans) must **NOT** be in excess of the policy-owner's basis or dire income tax results may occur. The disposition of the policy would

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be deemed a constructive sale triggering immediately taxable ordinary income gain.] An alternative would be for the trustee to make an arms' length fully secured loan to the insured.

ANNUAL EXCLUSION PROBLEMS WHEN LIFE INSURANCE IS PLACED INSIDE A TRUST – AND SOLUTIONS

There is no question that the gratuitous transfer of a policy – and/or cash to pay policy premiums – whether outright or to an irrevocable trust – is a gift. If the transfer of the policy (or cash to pay premiums) is outright, the gift will be one of a present interest.

But when a policy or the premiums to keep a policy in force is transferred to the typical irrevocable trust, absent effective Crummey power provisions, the gift will be one of a future interest because the beneficiaries' enjoyment is delayed. Note that if the original transfer of the policy itself is considered a future interest, the premiums paid by the grantor to keep that policy in force will also be considered future interest gifts.

Of course, an unlimited demand right (i.e. giving a beneficiary unlimited an unrestricted power to demand that the trustee give her, at her request, any portion or all of the principal of the trust for her benefit) would solve the problem and obtain an annual exclusion – but at the cost of the loss of control the grantor wanted, i.e. the grantor typically does not want beneficiaries to be able to obtain trust assets at will. Most clients will not want to widen the withdrawal power to any amount greater than absolutely necessary to obtain that year's maximum annual exclusion. (Such a broad and unlimited power would also cause assets in the trust to be exposed to federal estate tax in the estate of the holder of the power.) Again, the Crummey technique balances the client's nontax objectives with the desire to obtain an annual exclusion.

SECTION 2503(b) INCOME TRUST

There is yet another way to delay the payment of the principal of a trust beyond the legal majority of a child and at the same time provide income and financial security, exclude the trust's corpus from that child's estate, protect the corpus from the claims of the child's creditors, and obtain an annual exclusion. These advantages can all be obtained through a Section 2503(b) income trust.

It works like this:

- An irrevocable trust is created for a minor.
- The terms of the trust provide that the trust make immediate and mandatory distribution of all income. (Income can be paid by the trustee to a savings or custodial account in the minor's name).
- The trust will last for a specified term of years – or for the lifetime of the trust's beneficiary.
- The beneficiary could be given – through a special (limited) power of appointment - broad powers to appoint the trust property - to others.

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- Liberal invasions of principal are allowed – in the discretion of an independent trustee.

Note that three things are necessary for a gift of an income interest in a trust to qualify for the annual exclusion: First, the trust must receive income. Second, some portion of that income must "flow steadily" to the income beneficiary. Third, the portion of the income flowing steadily to the income beneficiary must be actuarially ascertainable.

For gift tax purposes, the entire amount placed into the 2503(b) trust is a gift. The gift would be divided into two portions: (1) an income portion and (2) a remainder (principal) portion. Of course, the present value of the remainder interest would not qualify for the annual exclusion – because by definition – it is a gift of a future interest. But the actuarial value of the income interest would be a present interest.

The younger the beneficiary, the longer the income stream is expected to last (i.e. it has a higher actuarial value) and the greater this portion of the gift will be. In many cases the value of the income interest will represent a major portion of the entire gift – even though that beneficiary's right to the trust's corpus are limited (or even non-existent).

DOWNSIDES OF A 2503(b) TRUST

No tool or technique of estate planning is without its cost or downsides. Since each gift made to a 2503(b) trust is at least partially a future interest gift, each time a transfer is made to such a trust a gift tax return must be filed. (A solution to avoiding the necessity of filing a gift tax return might be to give the income beneficiary Crummey Powers, a right to withdraw, on a non-cumulative basis, a portion of the future interest gift - limited to the difference between the annual exclusion and any exclusion allowable for other present interest gifts from the same donor).

Perhaps the single biggest downside to a 2503(b) trust is that the trust may hold only income producing property and the trustee must be specifically forbidden from investing in non-income producing property. The solution is to hold at all times enough income producing property to maximize the use of the annual exclusion.

ANNUAL EXCLUSION PLANNING WHERE DONEE SPOUSE IS NOT A U.S. CITIZEN – BUT A "SUPER ANNUAL EXCLUSION" MAY BE AVAILABLE

No annual exclusion is allowed when the donee is the donor's spouse and is not a U.S. citizen.

But a little known Code Section2523(i)(2) provides what may be considered a **Super Annual Exclusion**. This exclusion is available only if all the requirements for an annual exclusion are met – but the normal exclusion is blocked solely because the recipient spouse is not a U.S. citizen.

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This super exclusion for gifts to non-citizen spouses is currently a whopping $125,000 (indexed) – a year! To qualify for it:

- The gift must qualify for the gift tax marital deduction (but for the fact that the recipient spouse is not a U.S. citizen). So it must be an outright gift or one that is tantamount to outright.
- The gift must be a present interest gift.

So if the wealthier spouse is willing to, he/she can make cash gifts (a gift in trust for a non-citizen spouse will work only if it provides a qualifying income interest for life and couples that with a testamentary general power of appointment – and even then – only to the extent of the actuarial value of the recipient spouse's income interest) to the non-citizen spouse of up to $125,000 – each and every year!

Now consider if that super annual exclusion amount is used by the recipient to purchase life insurance on the donor spouse's life – how much leverage is possible – and how much wealth can be shifted!

SUMMARY

The annual exclusion is a highly useful and significant estate planning tool that can be used to minimize or eliminate the cost of shifting an estate from one generation to another. Through careful planning, it is possible to obtain an annual exclusion – even for gifts in trust – and to leverage the overall advantage if the beneficiaries or a trustee on their behalf uses all or a significant portion of each year's annual exclusion gifts to purchase life insurance on the life of either (or both) the grantor and/or the grantor's spouse.

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