



GELT & GRASSGREEN P.C.

Theodore Z. Gelt
Randi M. Grassgreen
Kristen L. Sweat

Attorneys and Counselors at Law
303 E. 17th Avenue, Suite 910, Denver CO 80203
303.830.1200 *telephone* 303.830.9400 *fax*
866.670.9316 *toll-free*
gg@gelttaxlaw.com

Of Counsel:
Jeffrey M. Nobel
Mark A. Vogel

Louis E. Gelt (1908-1997)

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RE: Guide to the Gift Tax Annual Exclusion

For gifts up to \$12,000 for tax year 2007 (the “Annual Exclusion Amount”), the IRS allows taxpayers to gift assets to others (i) without incurring any gift tax; (ii) without utilizing any portion of the taxpayer’s \$1,000,000 lifetime gift tax credit; and (iii) without having to file a gift tax return. (Please note the Annual Exclusion Amount is indexed for inflation and so it will increase in future years). The Annual Exclusion Amount is determined on a per donee basis, so the taxpayer may make gifts of \$12,000 to several different donees in a single tax year. Additionally, if a husband and wife decide to treat the gift as if made by both of them, then \$24,000 may be gifted to each donee. This gifting provision is an effective tool to decrease the size of one’s taxable estate and transfer assets to family members without incurring the gift tax.

Gifts of cash, securities, tangible personal property and real property to a donee qualify for the Annual Exclusion Amount, provided that the donee has a present interest in the gift, meaning the donee’s enjoyment or use of the gifted property is not limited to some future date. If the property to be gifted exceeds the Annual Exclusion Amount, the taxpayer may gift a fractional interest in the property and may continue to do so over a number of years until the entire property has been gifted to the donee.

A taxpayer may make outright gifts directly to an individual, most commonly to family members, or gifts to a trust for the benefit of family members. In making gifts to a trust, it is important to ensure that the trust provides the beneficiary current withdrawal rights for contributions made to the trust. These withdrawal rights provide the trust beneficiary with a sufficient present interest in the gift for the gift to qualify for the Annual Exclusion Amount. This current withdrawal right is commonly referred to as the “Crummey Power,” named after a court case which held that an immediate right to withdraw property contributed to a trust gives the trust beneficiary a present interest in the gifted property.

One common use of a gift to a trust concerns life insurance policies. A taxpayer may gift a life insurance policy to a trust created for the benefit of the taxpayer’s family when the policy has little or no value. By gifting the life insurance policy to an irrevocable trust with Crummey Powers, the taxpayer is able to remove the value of the life insurance proceeds from his or her estate, thereby decreasing any estate tax the taxpayer may owe. There are additional restrictions when gifting a life insurance policy to a trust, so a financial adviser should be consulted. A trust itself may acquire insurance policies if the taxpayer believes the additional restrictions cannot be met.

Outright gifts and gifts in trust are not the only methods of utilizing the Annual Exclusion Amount. Taxpayers may create UGMA (Uniform Gift to Minors Act) or UTMA (Uniform Transfer to Minors Act) Accounts for their children or grandchildren and gift the Annual Exclusion Amount to such accounts. Additionally, taxpayers may gift to a 529 Higher Education Savings Plan for their children or grandchildren.

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It is important to note that any amount that taxpayers pay directly to qualified educational institutions on behalf of a donee for tuition will not be considered a gift for tax purposes. Therefore, such amounts paid to qualified educational institutions on behalf of a donee will not affect a taxpayer's Annual Exclusion Amount with respect to that donee. The same rule applies to amounts paid directly to any person providing medical care to a donee. Please note there is no limitation on the amounts that may be paid on behalf of a donee to a qualified educational institution for tuition or amounts paid to someone providing medical care to a donee.

Gifts of assets under the Annual Exclusion Amount is an effective way to transfer assets to family members in a non-taxable transaction, which will also reduce potential estate tax. Taxpayers who commence annual gifting early on will have the opportunity to transfer considerable assets. There are different estate planning tools taxpayers may consider to accomplish an effective gifting plan, as outright gifts to children may not be the most beneficial. Therefore, taxpayers should consider consulting an estate planning attorney to tailor a gifting plan to their needs.

We hope that you found this information helpful. Please contact us if you have any questions on the annual gift tax exclusion or on any other matters.

Very truly yours,

GELT & GRASSGREEN P.C.



Kristen L. Sweat, Esq.

This newsletter has been prepared by Gelt & Grassgreen P.C. to provide information on recent legal developments of interest to our readers. It is not intended to provide legal advice for a specific situation. We would be pleased to provide such legal assistance as you require on this and other subjects.

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