

ASK THE EXPERT

Strategies to avoid triggering estate taxes

The problem: The “lifetime exemption” is the tax-free gift of up to \$1 million that a person can make during his lifetime. If a father gifts his “lifetime exemption” to his children and dies within three years, is the transfer permanent?

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The rules: After death, estates up to \$1.5 million are exempt from estate tax. However, any gifts made during the donor’s lifetime reduce that \$1.5 million. So if your father gave you \$1 million now and his estate is worth \$500,000 or less when he dies, the estate tax will not apply. The estate exemption is set to increase gradually to \$3.5 million by 2009.

How it works: Cash gifts made anytime before death are permanent. When an asset like a home or business is gifted and the donor

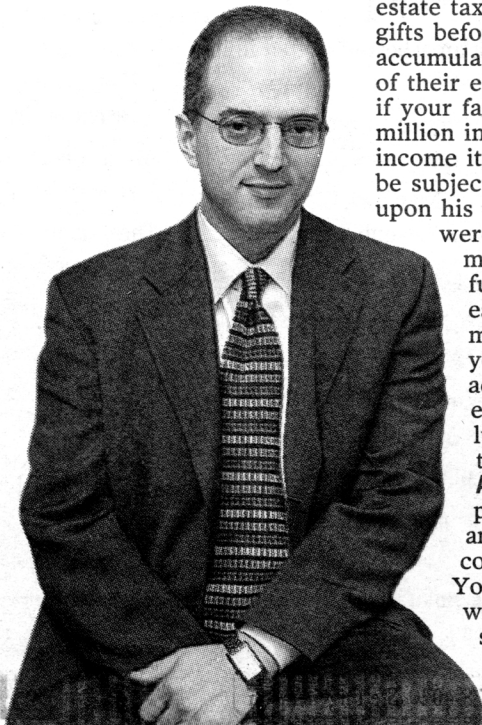
dies within three years, the IRS looks at who had control of the asset. For example, for Medicaid-planning purposes, elderly people sometimes “gift” their homes or companies to their children, but retain

income from the property or management control over the company. In these cases, the asset or part of the asset may revert back to the donor’s taxable estate.

The strategy: Donors can sometimes avoid or reduce estate taxes if they make gifts before death and move accumulating interest out of their estate. For instance, if your father keeps the \$1 million in his estate, the income it earns could also be subject to estate tax upon his death. But if he

were to gift that money now, the future interest earned on the money would go to you rather than accumulating in his estate and potentially triggering estate taxes.

A caution: Estate planning is complex and fraught with competing interests. Your father should work with a professional to ensure that generational transfers are tax-effective.



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