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## 2011 Is a Good Year to Think About Tax-Free Gifting Strategies

We all know that it is better to give than receive, but if possible, it can be even more advantageous to give and be tax savvy about it too! It is that special feeling in your heart from giving that makes it all worth it, but at the same time, there is nothing wrong with looking at tax smart ways to give as well. Even if you are not a famous philanthropist like Bill Gates, or members of the Rockefeller family, gifting money to your children and grandchildren can be a goal of yours.



In today's confusing world there are several common strategies that you can use that allow you to gift some of the assets you have accumulated in your estate which in turn could possibly reduce the tax debts on your heirs when you pass. With proper gift planning it is possible to be generous and tax efficient at the same time.

### Estate and Gift Taxes

Once your net worth exceeds a certain amount, your estate may be subject to estate taxes. Currently, an individual can gift up to \$5,000,000 federally tax-free during their life or when they pass to a non-spouse beneficiary. If you are married, you can gift up to twice this amount, or \$10,000,000. That is the federal amount that can transfer federal tax-free to non-spouse beneficiaries. This number is called the basic exclusion amount. (There is no limitation for a spouse to gift to their spouse as long as their spouse is a U.S. citizen.)

While exchanging or gifting large amounts of money to your spouse is considered tax free, this is not always a best solution to reducing your taxable estate. Unfortunately, this transfer could potentially increase the amount of tax you can potentially impose on your spouse's estate. Gifting assets to your children, or grandchildren and other

non-spouse beneficiaries is treated differently; however, there are still various ways you can provide some tax-free gifts for these special beneficiaries.

Unfortunately, today's generous exclusions only apply for two calendar years. In 2013, unless Congress changes the current law, the federally tax-free amount will revert back to \$1,000,000 per person, and the federal tax rate for many estates can go up to 55% (compared to the current maximum rate of 35%).

Many people are surprised when they learn that the gift tax is paid by the giver and not the receiver! It is sometimes hard to believe that the person making the gift is also the one that has to pay out of pocket any of these additional gift taxes. Talk about being generous!

In addition to all these federal taxes, you should investigate whether the state in which you reside might also tax your estate. Currently 16 states and the District of Columbia have an estate tax.

Even if a \$5,000,000 tax-free amount (\$10,000,000 if you are married) sounds like more than enough to cover what you ever expect to have, it is always a good idea to think and plan ahead. We do not know what Congress will do next. If Congress does nothing, that limit will revert back to \$1 million in 2013. It can be helpful to plan for your financial future. Most estate plans anticipate reasonable possibilities.

If taxes are potentially an issue, there are several strategies available to reduce or eliminate the Government's share. One of the best ways to reduce estate taxes is to gift away assets while you are alive, which in turn leaves less for the government to tax after you are gone. If there were no limits to these lifetime gifts, it would be very easy to avoid

estate taxes. That is why the government established “gift tax” rules, which are a backstop to the estate tax.

Current law imposes a gift tax of up to 35% once you have gifted past a certain amount. You can gift up to \$13,000 to as many recipients as you would like without incurring a gift tax. Spouses can combine this annual exclusion to jointly give \$26,000 to as many people as they want gift and estate tax-free.

If you exceed this limit, the difference can count against your \$5,000,000 lifetime gift and estate tax exclusion. After you have given away more than that, the gift tax of up to 35% applies.

The simplest and most tax-efficient way to pass your wealth to others is by using the annual exclusion, which allows you to give \$13,000 of assets each year to as many individuals as you want without having to worry about gift tax. Remember – there is no limit to the number of recipients. For example, a married couple with a child who is married and has 2 children could make a joint gift of \$26,000 to the adult child, the child’s spouse and each grandchild – a total of 4 people – providing the family \$104,000 a year.

There are many additional strategies for subsidizing relatives, friends, or others without having to pay unnecessary taxes:

### **Create a Gifting Strategy**

It is always a good idea to sit down and work on your strategy for gift giving. Think about how you can possibly set up a plan for making gifts to your children and their children that will maximize your usage of the \$13,000 per person per year rules and if necessary, if it is tax efficient, reduce your estate while making these gifts during your living years. For larger estates, your gifting strategy can be a very important piece of your overall estate plan.

Another important area to address is what type of asset is best to gift. This can be very complicated and it requires the knowledge of various tax laws and the “step-up in basis” rules. There are different pros and cons to the various investments that are possible. Please consult with a qualified estate tax professional before your decision is made.

As with all other financial strategies, it is best to work with a financial planner, and in this case even

consider consulting with your lawyer or accountant to determine which of these strategies are best for you and your specific situation. However, for the purposes of education, here are some strategies that you can consider.

### **Make a gift in 2011**

For 2011, you may generally give up to \$13,000 per person without being subject to gift tax rules. This means that a couple can typically gift \$13,000 each (a total of \$26,000) to a child or grandchild without incurring any tax impacts.

### **Fund College Savings Plans**

Many people are interested in assisting their children or grandchildren going to college or a university after they graduate from high school in the future. One of the great ways to do this is through establishing a Section 529 education savings plan, which allows the earnings to grow tax-free as long as the money is used for higher education.

You are allowed to make up to 5 year’s worth of these contributions in one year (up to \$65,000 per child or up to \$130,000 per child for a married couple) without being subject to gift taxes. If you do give these large amounts of money to a person, you cannot gift to this person again within the next 5 years or this will eat into your lifetime maximum amount of tax-free gifts.

### **Pay college tuitions directly.**

Direct payments for college, graduate school or private school tuition (excluding room and board) are excluded from the \$13,000 annual gift tax limitation. This rule applies to anyone making tuition payments and is one which is often



utilized by grandparents who want to give extra money to grandchildren without being restricted by the gift tax limitations. Helping grandchildren or children pay for their education can provide an incredibly rewarding feeling. In today’s world, college tuitions are very expensive and this strategy can help you significantly reduce your overall estate, while providing a meaningful reward.

## See if you qualify to get credit for tuition payments.

The American Opportunity Credit is currently available to reduce your tax bill by up to \$2,500 per student if you are paying tuition for the first four years of college. To qualify for this credit, the student must be your dependant and you must fund at least \$4,000 in tuition and qualified expenses (including books and other course-related materials). Additionally, your modified adjusted gross income needs to be below \$160,000 if married and filing jointly or \$80,000 if you are single. After that point there is a phase out that finalizes after a couple earns more than \$180,000 or \$90,000 if you are single. Like with all other strategies, please check on the details of this before considering this one.

## Pay the medical expenses of loved ones directly.



Medical bills have escalated over the past decade. You can pay directly for medical or dental and tuition expenses without using your annual exclusion. These payments are exempt from gift taxes, no matter how much money you spend.

Please note that you must make the payments directly to the providers of these services – you can't just reimburse the person you want to benefit.

## Consider opening a custodial account for your children or grandchildren.

Many grandparents and parents utilize this technique as a learning experience for their children or grandchildren. They open an account that can help teach their grandchildren or children about investing. This can accomplish two goals. It can teach a child about investing as well as help you move dollars into that child's name. By opening a custodial account, you can make sure that the money is managed by you until they reach the age of majority (21 for most states, a few states are 18) and then at that point hopefully they are mature enough to take over that account. Please keep in mind that custodial accounts for children or grandchildren younger than 19 (and sometimes younger than 24) are generally taxed by the current kiddie income tax rules. This means that the first

\$950 of the child's investment income will be tax free. The next \$950 will be taxed at that child's rate, but anything over \$1,900 for the year 2011 is scheduled to be taxed at the parent's higher rate. Please keep this in mind when making the decision as to where to invest this money. Also remember that gifting to set up this type of account is limited to the \$13,000 tax-free per person rules. Consider using a custodial account as a learning vehicle for children or grandchildren as well as a way to gift money in a tax smart fashion. We can help give you more information on how this would work.

## Consider setting up an irrevocable trust fund for minor children.

While this strategy should be discussed with a lawyer first, one of the reasons to consider this trust is that it allows you to make a gift to a minor child each year without handing them an actual check. The minor child will then receive all of this money



tax-free when they reach the age of majority set forth by the trust. Keep in mind that this is subject to the \$13,000 limitation but a way to give money and still maintain some control of it.

## Consider helping a child or grandchild contribute to a Roth IRA.

Although this is once again subject to the \$13,000 per year limitation, children of any age who have earned income from a job, even if it is just baby sitting or lawn mowing, may contribute up to the amount they have earned, with a \$5,000 maximum for 2011, to a Roth IRA. Provided they do not earn over the amount that makes them ineligible to contribute to a Roth IRA (\$120,000 modified adjusted gross income if single; \$176,000 if married couple), you can give them the money to make the contribution. Even though your child or grandchild might use your gift to fund their Roth IRA, there is no tax break for this gift and it will be counted toward the \$13,000. On a positive note, your child or grandchild that you gift this money to can reap many benefits in the future thanks to your generosity. After the age of 59 ½ they will be eligible to withdraw all of the money including the earnings from this Roth IRA tax free. They can also contribute more to it along the way

and at some point years from now they will hopefully look back to the gift you gave them with a big smile and much gratitude.

## Conclusion

There are many other gifting strategies to utilize to reduce your estate, including charitable donations to be made to the charity of your choice upon your death which can reduce your estate's overall taxable assets. These are all important decisions that need to be discussed at length with your financial advisor and your attorney.

*We have found that most people make a living by what they get but they can make a lifetime by what they give.*

When reviewing your estate plan and options it is helpful to remember what was said by Percy Ross, a great American self-made multi-millionaire who is best known for his philanthropy. He said,:

*“He who gives while he lives gets to know where it goes.”*

As a qualified financial professional, we are capable of helping you with putting together a strategic plan for your specific situation.

As we always like to remind you, part of our responsibilities as a financial planner is to help and direct clients form their strategies for their estate plans. If you have any questions about yours, please contact our office to make an appointment.

As with all other financial strategies, it is best to work with a financial planner, and especially in this case, consider consulting with your lawyer or accountant, to determine which of these strategies are best for you and your specific situation.

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*We believe that investors deserve more and should receive more!*



That's why, as part of our **Client Services**, we offer the ability to review and coordinate not only our client's investments strategies, but how they affect and interact with their tax and estate planning needs and concerns.

**If you have any friends or loved ones whose current financial professional is not providing this service then call us at (847) 913-5594 to schedule a complimentary private Financial Physical.**

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## *About Dean R. Hedeker*



Dean Hedeker has over 30 years of experience assisting clients in all aspects of financial planning, and is committed to prudently preserving and growing his clients' wealth. Dean is directly involved with investment management and financial planning for our clients and manages the wealth of more than 100 hard-working families. Dean is also an experienced attorney in the fields of estate planning, business law and tax law. Dean earned both his undergraduate and Juris Doctor degrees with highest honors. He also became a Certified Public Accountant in 1977. He was admitted to the Bar of Supreme Court of Illinois in 1981, the United States District Courts and the United States Tax Court. Practicing the triple role of attorney, certified public accountant and registered financial consultant gives Dean unique qualifications. Dean is a sought-after speaker, he has been invited to speak for many various organizations.. Hedeker Wealth clients directly benefit from this experience

by being invited to workshops each year, which cover the latest news and valuable advice for tax planning, estate planning and investment management.

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**Dean R. Hedeker is a Financial Planner with Hedeker Wealth Management Group, LLC – An SEC Registered Investment Advisor**

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There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.

This optimism about the future does not minimize the fact that we have gone through one of the worst economic periods in market history. Remember that equity markets are volatile and an investor may lose money and there is no guarantee that securities will appreciate. This material contains forward looking statements and projections. There are no guarantees that these results will be achieved.

The price of commodities is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities is widely unregulated and concentrated investing may lead to higher price volatility.

In general, the bond market is volatile, bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. The investor should note that investments in lower-rated debt securities (commonly referred to as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default.

Investments in real estate have various risks including possible lack of liquidity and devaluation based on adverse economic and regulatory changes.

Sources: Wall Street Journal (10/25/10, 11/4/10, 11/13-14/10, 11/16/10, 11/20-21/10, 11/18/10, 11/29/10, 12/10/10, 12/14/10, 12/17/10, 12/23/10, 12/29/10, 12/30/10, 12/31/10, 1/3/11, 1/6/11, 1/7/11, 1/8-9/11, 1/10/11, 1/13/11), Barron's (11/8/10, 1/3/11), Money Magazine (Jan/Feb 2011), Bloomberg Business Week (10/18-24/10, 11/18-14/10, 1/3-9/11, 1/10-16/11), Kiplinger's Personal Finance (1/2011), By The Numbers (1/8/10), Fortune Magazine (12/27/10), Investment News (11/10, 11/15/10), The Economist (9/4/10, 10/30/10, 12/18/10, 1/1/11), Forbes (12/20/10), Nick Murray Interactive (January 2011), Financial Planning Magazine (September 2010, January 2011), Time Magazine (1/10/11), American Funds Newsline (3/31/11)

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