

Gifts to Your Spouse -- A Must for Your Estate Plan

The marital deduction allows you to transfer an unlimited amount of property to your spouse without gift or estate tax consequences as long as your spouse is a U.S. citizen. This deduction provides married couples with a variety of estate planning opportunities.

Maximize Use Of the Lifetime Exclusion

A common use of the marital deduction is the lifetime transfer of assets to a less wealthy spouse so that he or she can shelter assets through the use of the applicable lifetime gift and estate tax exclusion amount (currently \$650,000, gradually increasing until it reaches \$1 million in the year 2006). If you and your spouse each have at least \$650,000 of assets in your own name, then you can protect a full \$1.3 million from estate tax. However, if you don't make a transfer and one of you dies with less than \$650,000, then your family will not be able to fully utilize the applicable exclusion amount and will have to pay a tax that could have otherwise been avoided.

Take Advantage of a Lower Estate Tax Bracket

The federal estate tax imposed on assets owned by an individual gradually increases from 37% to 60%. As the wealthier spouse, you may have more assets taxed in the higher estate tax brackets than your spouse. If you gift assets to your spouse to equalize your assets, you can lower your estate tax bill.

If you are not comfortable transferring a substantial amount of assets to the control of your spouse during your life, consider creating a trust. A lifetime qualified terminal interest trust is an underutilized estate planning technique that can result in significant tax savings.

Even if you die first, equalizing estates after your death may be possible by providing in your estate plan for a special qualified terminable interest property (QTIP) marital deduction trust. Through the QTIP trust, the executor or trustee may elect to equalize the taxable estates of you and your spouse by determining which portion of your assets will qualify for the marital deduction and be taxed in your spouse's estate and which portion will be included in your estate and taxed on your death.

Facilitate a Step-Up in Basis

You may also use gifts to your spouse to obtain income tax advantages by manipulating the step-up in basis of the property that occurs at death. The basis of property that you owned is stepped up to its fair market value at your date of death. If you and your spouse hold property jointly, the basis of one-half of the property is stepped up (unless the property is community property). Transferring appreciated property to an older or ailing spouse also may be advantageous. The surviving spouse will receive a stepped-up basis provided that he or she survives for more than a year after the transfer.

Enjoy Other Advantages

One advantage of gifting assets to a spouse is asset protection. Each person is generally liable only for his or her own debts, though there are some exceptions. For example, a spouse may be liable for debts of his or her spouse incurred for the support of the family or medical care. However, a transfer of assets to a spouse, as long as it is not in fraud of creditors, may protect the assets from the transferor's creditors.

The transfer must be a transfer in all respects, with no understanding that the property will be returned to the transferor at a later date. When considering gifts to your spouse, remember that he or she is free to dispose of the property without your consent.

Transfers can also be used to ease estate administration in the event one spouse becomes seriously ill. One example of such planning is transferring S corporation stock or partnership interests to the spouse who is most likely to live longer so that he or she may use existing losses. In determining whether to make such gifts, consider the loss of the step-up in basis that would otherwise be available at death.

If you wish to make a gift to charity on the death of the first to die, a transfer or bequest to the spouse most likely to survive can create flexibility and save taxes. The surviving spouse will be able to take charitable tax deductions for both income tax and gift tax purposes.

Finally, making gifts to your spouse can provide him or her with experience managing assets.

Consider the Possibilities

For help in sorting through the sometimes confusing issues involved in gifting assets, please feel free to contact us. We are here to help you with any questions you may have about these or other ways to minimize taxes on your estate.

Case Study: Equalizing Tax Brackets

Mrs. Brown has \$650,000 in assets and Mr. Brown has \$3.6 million in assets, for a total of \$4.25 million. If Mrs. Brown (the less wealthy spouse) dies first, there will be no federal estate tax because of the applicable exclusion amount. On Mr. Brown's death, the federal estate tax will be about \$1.4 million (reflecting a 55% tax bracket not including the state death tax credit and assuming a \$650,000 applicable exclusion amount). If, however, the Browns' estates are equalized through lifetime gifts so that each has \$2.125 million, the top estate bracket will just dip into the 49% layer. The total estate tax payable by both estates would be about \$1.26 million. This equalization results in a tax savings of about \$140,000.