

LEGAL ALERT

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Annual Exclusion Can Reduce Federal Estate Taxes

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A common and simple estate planning technique designed to reduce the size of an estate to minimize federal estate taxes is to make lifetime gifts to family members. A person can make gifts totalling \$10,000 per person per year. The \$10,000 amount is known as the "**annual exclusion**". If the gifts in any year to a person do not exceed the annual exclusion amount, then no gift tax is incurred, no gift tax return needs to be prepared, and the value of the gift is forever removed from the donor's estate when computing the federal estate tax liability of the donor's estate. The Tax Payer Relief Act of 1997 modified the annual exclusion amount so that in 1999, and subsequent years, the \$10,000 will be increased based on an inflation adjustment.

It is not uncommon for people to make year-end gifts or for someone holding a durable power of attorney to make "death bed" gifts shortly before a person dies. These gifts are

often made by check. Under the "relation-back" doctrine, checks mailed to charitable donees prior to the donor's death but not paid until after the donee's death relate back to the date of delivery.

In 1994, the Tax Court applied the "relation-back" doctrine to year-end annual exclusion gifts made to non-charitable donees. In that case, although the checks were drawn on December 14th and deposited on December 31st, the checks did not clear the bank until January 2nd. The Tax Court applied the "relation-back" doctrine because the taxpayer was able to establish: (1) the donor intended to make a gift; (2) the check was delivered unconditionally; and (3) the check was presented for payment within the year for which the favorable gift tax treatment was sought. If, however, a parent gave a child a check for \$10,000 on December 31, 1998 and the child does not present the check for payment until January 2, 1999 the gift will not qualify for the annual

exclusion treatment for 1998. The check **must** be presented for payment in the year in which the gift is made.

Recently the Tax Court addressed "death bed" gifts made by checks to non-charitable beneficiaries concluding that the gifts were not completed prior to the donor's death. The checks were written on behalf of the donor using a durable power of attorney before the donor died, but the checks were not presented for payment until after the donor died. All of the checks were within the \$10,000 annual exclusion limit. The Tax Court held that the checks not drawn on the decedent's bank account prior to the decedent's death were included in the decedent's estate for calculating the federal estate tax liability. In order for the gift to be "**complete**" the donor must part with "**dominion and control of the asset so as to leave the donor no power to change its disposition.**" Because the power of attorney

holder was also on the account, a stop payment could have been ordered. The Tax Court distinguished its decision from the earlier decision (in which the annual exclusion gift was permitted) by observing that in the 1994 case the donor was still alive when the checks were paid.

The delivery of a check to a non-charitable donee will be complete for estate tax purposes when the donor parts with "dominion and control" under state law, or the date on which the donee deposits the check (or cashes it), if the following are met: (1) the check was paid by

the bank when it was first presented for payment; (2) the donor was alive when the check was paid by the bank; (3) the donor intended to make a gift; (4) delivery of the check was unconditional; and (5) the check was deposited or cashed in the calendar year for which the gift tax treatment is sought.

Those who plan to make annual exclusion gifts, for whatever reason, should make them well in advance of the end of the year in order to allow sufficient time for the donee to deposit or cash the check. For "death-bed" gifts

made by a power of attorney holder intended to reduce federal estate taxes, certified checks should be used and the durable power of attorney should expressly authorize the power holder to make gifts on behalf of the principal. If a regular check is used, then the donee should be instructed to present the check for payment as soon as possible.

*If you would like further information regarding this topic, please contact **Jeffrey R. Wonacott**, or any member of our Business & Property Law Department listed below.*

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