until April 1 of the following year. This means that two distributions must be taken in the second year—one by April 1 and the second RMD by December 31.

☐ For qualified retirement plans (but not IRAs), distributions can be postponed until retirement if the plan allows it. However, this option does not apply to those who own more than 5% of the business.

☐ There are no RMDs from Roth IRAs for account *owners*, but *beneficiaries* must take RMDs even though such withdrawals are not taxable.

other age-related breaks

•Health savings accounts (HSAs). Those who attain age 55 by the end of the year can contribute an additional amount to an HSA if they are eligible to make contributions. This means that the person must be covered by a high-deductible health insurance plan—in 2007, this is a policy with a minimum deductible for self-only coverage of $1,100, or $2,200 for family coverage. The additional contribution is limited to $800 in 2007 ($900 in 2008 and $1,000 starting in 2009).

•Long-term-care insurance. Those who pay premiums for this coverage can claim a portion of the cost as an added itemized medical expense (subject to the 7.5% of AGI floor). This amount depends on age. For 2007, those age 40 or younger can add $290 to their other itemized medical expenses...those over 40 but not over 50 can add $550...over 50 but not over 60, $1,110...over 60 but not over 70, $2,950, and those over age 70, $3,680.

•Additional standard deduction. When seniors turn age 65, they can claim an added standard deduction each year. For 2007, the additional amount is $1,300 for those who are unmarried or $1,050 per married person. Of course, those who itemize deductions in lieu of claiming the standard deduction do not receive any benefit in this case.

Note: Those who attain this age on January 1, 2008, are treated as being age 65 on the last day of 2007 and can claim the additional standard deduction on a 2007 return. TH

ESTATE PLANNING HOTLINE

How Gift Splitting Can Help Married Couples Save Lots on Taxes

Gideon Rothschild, Esq., CPA
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After last November's election, the prospects for near-term estate tax repeal are even more uncertain. Therefore, it makes sense for affluent taxpayers to plan to reduce their taxable estates. Anyone with an estate of more than $2 million, including a house and life insurance policies—or married couples with estates of more than $4 million—is vulnerable.

The core strategy is to use the annual gift tax exclusion and possibly the lifetime estate tax exemption. You'll move assets (and any future appreciation) out of your estate without paying tax.

But married couples have double exclusions and exemptions. So a couple can elect to split gifts, effectively doubling the amount of tax shelter.

You can give away up to $12,000 per year to each of any number of recipients, tax free, under the annual gift tax exclusion. In the future, this exemption will periodically go to $13,000, $14,000, etc., depending on the pace of inflation.

Example: Beth Parker has two children. She can give them a total of $24,000 in 2007 ($12,000 to each), in addition to any payments she makes directly to providers of service for medical bills or school tuition, which are themselves specifically exempt from gift tax. Such $12,000 gifts won't incur gift tax. In fact, Beth won't even have to file a gift tax return.

Doubling up: Beth's husband, Dan, also can give a total of $24,000 to their two children this year. This doubles the speed of their estate tax reduction.

Catch: In this example, Dan does not have assets to give to their children but Beth does. How can they maximize their use of the gift tax exclusion?

Tactic 1: Beth can give assets to Dan or move them into a joint account. Transfers between US citizen spouses are tax free (gifts to noncitizen spouses are only tax free up to $125,000 per year). Dan can then give those assets to their children. Again, no gift tax returns need be filed.

Tactic 2: Beth may not want to transfer assets to Dan. She might find it too complicated (some assets are harder to transfer), or she simply might not want to go through all the paperwork. Instead, she can give each child up to $24,000 this year. Then Dan can elect to join in the gift.

This procedure is known as gift splitting. *How it works...*

splitting for heirs

When a married couple splits gifts, a gift tax return must be filed. Both spouses must consent to a 50-50 split.

Example: Beth gives $24,000 to each of her two children this year. She

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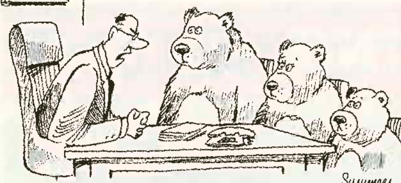

"Frankly, your tax return was *not* 'just right.' "

Ms. X, Esq.

Inside the IRS

What to do if the IRS sends you a check to which you are not entitled... Based on the most recent study conducted by the Treasury Inspector General for Tax Administration (TIGTA), the IRS issues millions of dollars of incorrect refund checks each year. Many times, the IRS will credit one person's account with someone else's money or issue a duplicate refund to the same person. *Do not* keep the money if the IRS mistakenly sends you a check or electronically sends money to your account. Eventually, the IRS will realize that it has made an error and ask for the money back—with interest. *Better approach:* If you receive money from the IRS and suspect that it was sent mistakenly, or you don't understand why the IRS gave it to you, send it back with a letter requesting that the IRS confirm that the payment is accurate. If the IRS sends a new check, with an explanation, you can then cash the check—unless you know that the IRS still has not corrected its mistake.

If it sounds too good to be true... Promoters of tax schemes continue to make compelling arguments to gullible individuals that income they earn is not subject to US income tax based on Internal Revenue Code Section 861. Under the promoters' theory of this section of the code, US citizens are subject to income tax only from foreign-based activities. This position has been shown to be without merit, false, and a misapplication of the law and the regulations. *Fallen star:* Actor Wesley Snipes has been indicted for tax evasion because he submitted amended tax returns claiming refunds of millions of dollars based on the Section 861 argument. The indictment also alleges that Snipes did not listen to his tax adviser, who advised against participating in the scheme. Snipes, who was arrested on December 11, 2006, pleaded not guilty, was released on a $1 million bond and returned to Namibia, where he was filming a movie. At a news conference, one of his lawyers said, "Mr. Snipes was a victim of his tax advisers." It's tax season—don't be duped.

When the IRS asks you to extend the statute of limitations... Generally, the IRS must make an assessment of additional tax within three years from the date a tax return was filed. If the tax return is being examined, the IRS may ask you to extend the statute of limitations for a period of one year or longer until it completes the examination. *If you refuse:* The IRS will make an assessment based on what it thinks you owe and you will then have the right to file a petition with the US Tax Court. *Strategy:* If the IRS has failed to identify a significant tax issue (such as your failure to report a large chunk of income), it may be a good idea to refuse to extend the statute of limitations. Giving the IRS more time to pursue the tax audit could mean that it will use the extra time to develop additional tax issues that could cost you a lot of money or even involve defending yourself against criminal charges. Consult your attorney, of course.

Ms. X, Esq., is a former IRS agent and still well connected.

files a gift tax return on which Dan consents to the use of his annual exclusions.

Therefore, Dan effectively gives $12,000 to each child this year. He uses up his annual exclusion and can make no further tax-free gifts to either child in 2007.

Required: To qualify for gift splitting...

•Both spouses must be US citizens.

•Neither spouse can remarry during the year.

•If one gift is split, all gifts made by either spouse to any recipient during the same year must be split.

eating into the exemption

In some cases, gifts will be larger than $12,000 per recipient in a given year. Another set of tax rules will come into play, and gift splitting can be advantageously used again.

How it works: Gifts that don't qualify for the annual gift tax exclusion may be sheltered by a lifetime $1 million gift tax exemption.

Example: Beth's and Dan's older child, Carla, wants to buy a condo, so Beth gives her $200,000. If Beth decides against gift splitting, she can use her $12,000 exclusion and wind up over the limit by $188,000.

Assuming Beth has made no other taxable gifts, she will owe no gift tax. However, her $1 million lifetime gift tax exemption will be reduced by $188,000, so the remaining exemption will fall to $812,000.

Estate tax effect: That $188,000 gift also reduces Beth's estate tax exemption.

Example: Assume that Beth makes no other taxable gifts and dies when the estate tax exemption is $2 million, as it is now. Because of this $188,000 gift, Beth's estate tax exemption will be reduced to $1,812,000.

Alternative plan: If Beth and Dan split the $200,000 gift, $24,000 will be covered by the annual exclusion. The excess $176,000 will reduce their lifetime gift tax exemptions (and their eventual estate tax exemptions) by $88,000 apiece.

Result: Using gift splitting, a married couple can give away up to $2 million ($1 million per spouse)

in addition to amounts sheltered by the annual exclusion. No gift tax will be due.

That $2 million worth of assets given away might grow to $3 million, $4 million, or more during the couple's lifetime and thus deliver a substantial amount of estate tax shelter.

Vital: Whether or not you split gifts, be sure not to give away assets you might need for support during a long retirement.

trust traps

Gift splitting often makes sense because it doubles the amount of assets you can transfer to younger generations without owing gift tax, for instance, in cases where one spouse owns the bulk of a couple's assets or only one spouse wants to make gifts. However, transfers to certain types of trusts shouldn't involve gift splitting.

Examples: Qualified personal residence trusts (QPRTs), grantor-retained annuity trusts (GRATs), and grantor-retained unitrusts (GRUTs).

Why this can backfire: If the grantor dies during the trust term, the trust assets are counted in the decedent's taxable estate.

Result: In this situation, the donor gets gift tax relief but not the consenting spouse.

Example: Ed Thomas creates a GRAT and transfers assets into it. Based on interest rates in effect at that time and the trust term, the value of the transfer is placed at $500,000.

Ed and his wife, Jean, split the gift to the GRAT, effectively using up $250,000 apiece of their gift tax exemptions. When Ed dies before the trust term, the trust assets go back into his estate and the $250,000 worth of gift tax exemption that he used is restored. *Trap:* Jean doesn't get any refund or any tax relief. Thus, she has used up $250,000 worth of gift and estate tax exemption and received no benefit.

Strategy: For transfers to QPRTs, GRATs, or GRUTs, don't split gifts. Funding should come from only one donor, who will be responsible for all the gift tax. Consult a qualified adviser about your specific situation. TH

DEPRECIATION HOTLINE

The Very Powerful Refund Strategy That Many Businesses Overlook

Martin S. Kaplan, CPA

Many businesses that use real estate in their operations, from restaurants and offices to factories and warehouses, have accidentally overlooked depreciation deductions they could have claimed in past years—often in large amounts.

Opportunity: Recent IRS rule changes let businesses claim these overlooked deductions now, going back any number of years, without filing amended tax returns.

depreciation keys

The cost of business assets is deductible through depreciation, with different items depreciated at different rates...

- Nonresidential real estate (such as a commercial building) is depreciable over 39.5 years.
- Improvements to real estate (such as landscaping and grading) are depreciable over 15 years.
- Certain restaurant and leasehold improvements made through 2007 are depreciable over 15 years.
- Business equipment and other movable "personal property" is depreciable over shorter periods, typically five or seven years.

The shorter the depreciation period, the larger the annual depreciation deduction—until the item's full cost is deducted.

Example: Using straight-line depreciation, a $100,000 expenditure on...

- Five-year equipment will provide $20,000 of deductions annually.
- Improvement to real estate provides about $6,667 of deductions annually.
- A commercial building provides only about $2,500 of deductions annually.

Mistake: Many business owners assign items to the wrong depreciation categories.

In particular, they very often treat items that *appear* to be part of a building as part of it for depreciation purposes—even though the items in fact qualify for depreciation at a much faster rate as equipment or personal property. The result is that they fail to claim large available depreciation deductions year after year.

Example: Floor coverings (such as carpeting or vinyl) installed in commercial real estate are depreciable over five years. But a business owner who acquires a new building with them installed is likely to fail to depreciate them as a separate item, and instead may mistakenly treat them as part of the building.

Result: Instead of deducting 100% of the floor coverings' cost over five years, less than 15% might be deducted. If they cost $100,000, more than $85,000 of deductions might be

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