The statutory exclusion amount ($10,000) is adjusted for inflation annually, using 1997 as the base year. The amount of the exclusion for 2008 is $12,000. These illustrations assume that the amount of the gift tax annual exclusion is $12,000.

The exclusion covers gifts an individual makes *to each donee each year.* Thus, a taxpayer with three children can transfer a total of $36,000 to them every year free of federal gift taxes. If the only gifts made during a year are excluded in this fashion, there is no need to file a federal gift tax return. If annual gifts exceed $12,000, the exclusion covers the first $12,000 and only the excess is taxable. Further, even taxable gifts may result in no gift tax liability thanks to the unified credit (discussed below). (Note, this discussion is not relevant to gifts made by a donor to his spouse because these gifts are gift tax-free under separate marital deduction rules.)

Gift-splitting by married taxpayers. If the donor of the gift is married, gifts to donees made during a year can be treated as split between the husband and wife, even if the cash or gift property is actually given to a donee by only one of them. By gift-splitting, therefore, up to $24,000 a year can be transferred to each donee by a married couple because their two annual exclusions are available. Thus, for example, a married couple with three married children can transfer a total of $144,000 each year to their children and the children's spouses ($24,000 for each of six donees).

Where gift-splitting is involved, both spouses must consent to it. Consent should be indicated on the gift tax return (or returns) the spouses file. IRS prefers that both spouses indicate their consent on each return filed. (Because more than $12,000 is being transferred by a spouse, a gift tax return (or returns) will have to be filed, even if the $24,000 exclusion covers total gifts.

The “present interest” requirement. For a gift to qualify for the annual exclusion, it must be a gift of a “present interest.” That is, the donee's enjoyment of the gift can't be postponed into the future. For example, if you put cash into a trust and provide that donee A is to receive the income from it while he's alive and donee B is to receive the principal at A's death, B's interest is a “future interest.” Special valuation tables are consulted to determine the value of the separate interests you set up for each donee. The gift of the income interest qualifies for the annual exclusion because enjoyment of it is not deferred, so the first $12,000 of its total value will not be taxed. However, the gift of the other interest (called a “remainder” interest) is a taxable gift in its entirety.

Exception to present interest rule. If the donee of a gift is a minor and the terms of the trust provide that the income and property may be spent by or for the minor before he reaches age 21, and that any amount left is to go to the minor at age 21, then the annual exclusion is available (that is, the present interest rule will not apply). These arrangements (called Code Sec. 2503(c) trusts because of the section in the Internal Revenue Code that permits them) allow parents to set assets aside for future distribution to their children while taking advantage of the annual exclusion in the year the trust is set up.

“Unified” credit for taxable gifts. Even gifts that are not covered by the exclusion, and that are thus taxable, may not result in a tax liability. This is so because a tax credit wipes out the federal gift tax liability on the first taxable gifts that you make in your lifetime, up to $1 million. However, to the extent you use this credit against a gift tax liability, it reduces (or eliminates) the credit available for use against the federal estate tax at your death.