

OUTLOOK

Gift Now or Pay Later?

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The good news is that the opportunity for tax-free transfers of wealth to future generations has never been better during our lifetimes. The bad news is that the window on this opportunity is closing in four months.

For the remainder of 2012, the Federal gift, estate and generation-skipping transfer tax exemptions are all \$5,120,000 and the maximum tax rate is 35%. Barring new legislation from Congress, this \$5.0 million-plus exemption is scheduled to drop to \$1.0 million on January 1, 2013, with the maximum estate and gift tax rate increasing to 55%. The Federal estate and gift tax “exemption” refers to the amount that can be transferred by a U.S. citizen during his or her lifetime or at death without Federal estate or gift tax. It is important to note that the exemption is a per person amount, so that a married couple can effectively double the available exemption with proper planning.

Depending upon your state of residence, state gift tax rules may need to be considered before implementing any gifting strategy. Some states do not have a gift tax, while others either follow the Federal system or have their own independent rules.

If you plan to take advantage of this unique gifting opportunity, we encourage you to act soon. Attorneys, accountants, and valuation professionals are seeing unprecedented levels of gifting transactions, all of which need to be completed by year end.

There are a myriad of gifting options available, ranging from an outright gift of assets to an individual to complex trust structures intended to benefit future generations. Effective and efficient planning requires a collaborative effort between you and your advisors to accomplish your personal goals (for example, how much and which assets you wish to transfer, for the benefit of whom and when), in a structure that provides you maximum leverage and flexibility.

A typical response that we hear from clients is that they understand this unique gifting opportunity, but they are either not yet ready to relinquish control of the assets or are not totally comfortable that they will not need the assets

in the future. Fortunately, there are some creative gifting strategies that can address these concerns while still locking in these very favorable gift tax exemptions.

For example, a husband and wife are able to set up trusts for the benefit of each other and their descendants. Each spouse can make gifts into the trust for the benefit of the other spouse up to the maximum lifetime exemption amount. As the trustee of the trust established and funded for their benefit, each spouse has the ability to access funds in his or her trust for living needs. However, if other assets are sufficient to maintain their lifestyle, the assets transferred to the spousal trusts will continue to appreciate and eventually transfer to future generation(s) free of any transfer tax. While these spousal trusts are just one example of gifting opportunities available, they have been extremely popular with people not yet quite ready to give up total control over and access to the assets.

In addition to the limited opportunity to take advantage of the current exemption amounts, there are a couple of additional factors that make now an opportune time to make gifts. The first is the current low interest rate environment. Many of our estate planning techniques involve interest rate arbitrage or leveraging the interest rates the IRS requires us to apply to any transfer involving the time value of money. The historically low interest rates have magnified the effects that can be achieved through some of these techniques. The other factor that compliments gifting strategies today is the relatively depressed value of real estate, and in some cases businesses, that owners may want to transfer, in whole or in part, to future generations. Transferring property at a depressed value not only removes that value from your estate, but also any future appreciation of the property.

It is also worth noting that certain estate planning techniques, principally grantor retained annuity trusts (“GRATs”) and intentionally defective grantor trusts (“IDGTs”), are frequently mentioned as targets of any new tax reform. The concepts are being targeted because of the potentially large estate and tax savings they can provide. These techniques are particularly well suited to facilitate the transfer of a business or supercharge the benefits of other gifting concepts, and their potential future abolishment is a good reason to review your current planning options.

Without new legislation from Congress, in 2013 we return to a 55% maximum Federal estate tax with a very low \$1 million exemption per person. While we are all hoping that new legislation will provide more favorable estate and gift tax opportunities in the future, you should give serious consideration to what steps you can take today to hedge against the scheduled reduction in the exemption and increase in the Federal estate and gift tax rate.

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