Estate, Succession Planning & Probate Administration Practice Group **October 25, 2012**

IT'S NOT TOO LATE!

SOME YEAR END ESTATE PLANNING STRATEGIES TO CONSIDER

Unless Congress acts before the end of the year, there will be significant increases to estate and gift taxes that will come into effect on January 1, 2013. There is a brief window left before the end of this year to make major gifts up to $5,120,000 per person or $10,240,000 per couple. The federal gift tax lifetime exemption which had, prior to 2011, never been greater than $1.0 million since the present gift tax was enacted in the 1930's, was increased for 2011 and 2012 to $5.0 million (adjusted for inflation) under the 2010 Tax Act signed on December 17, 2010. This $5,120,000 exemption also applies to the federal estate tax and federal generation skipping tax ("GST") for 2012.

On January 1, 2013, absent any action by Congress between now and the end of the year, the combined exemption for all three taxes - estate, gift, and GST - will return to $1.0 million as it was under 2001 law. Not only will the exemptions drop but the estate and gift tax highest marginal rate will increase from the current 35% rate to 55% effective for transfers beginning next year. What does this mean for your family? For those families with taxable estates under $1.0 million, not much. However, for a single person whose estate is $3.0 million, the scheduled estate tax changes could result in a $945,000 federal estate tax charge if the individual dies in 2013 without any changes made to the tax laws versus a zero federal estate tax liability if death occurs in 2012.

This presents a unique opportunity to act quickly, especially for those who have used all or a large portion of their previous $1.0 million gift tax exemption or for those who wish to make gifts to grandchildren or that will pass over several generations without federal estate, gift, or GST tax. Gifts can be made outright or into an irrevocable trust that will allow the donor to control the purposes for which distributions will be made as well as the timing. Through the use of a dynasty trust and the client's GST exemption, financial benefits can be provided to multiple generations without having to pay gift or GST tax if those exemptions have not yet been fully utilized by the taxpayer.

What assets are best to gift during this brief window? The best types of assets to gift in this climate fall into three categories: those that are unneeded during the grantor's lifetime, assets that will likely appreciate in value between now and the grantor's death, and assets that beneficiaries are unlikely to sell or liquidate. Some examples are assets that do not generate needed income such as depressed real estate, business interests, and high value life insurance policies.

Business interests are particularly attractive gifting assets. Due to the economy, the value of the interest may be lower than what it was a few years ago, allowing an even greater gift. Also, for the time being, valuation discounts for things such as lack of marketability and lack of control are still permissible,

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but beware that there have been proposals for changing the gift/estate/GST regime over the last couple years which will prohibit such discounts. For high net worth individuals, estate planning strategies which utilize a grantor retained annuity trust or an intentionally defective grantor trust are very effective tools in this ultra-low interest rate environment. The use of operating agreements, buy-sell agreements, redemption agreements, compensation or consulting agreements, and/or trusts can help make gifts of business interests more palatable to those who are somewhat uncertain about transferring ownership to the next generation.

If you have a vacation home that you would like to pass on to your children, consider using some of your $5,120,000 gift tax exemption now to establish a qualified personal residence trust ("QPRT"). A QPRT allows you to place a residence in a trust while retaining the right to use and live in the house for a specified term of years. At the end of the term, assuming you are still living, the ownership of the residence transfers to your heirs without any additional estate or gift tax consequences. You will be making a taxable gift at the time of the initial transfer into the trust which will count against your lifetime gift tax exemption of $5,120,000. The value of your gift will be equal to the value of the remainder interest that passes to your children at the end of the trust's term. If you think that your vacation home will appreciate significantly in the years to come, this is a particularly attractive tool to consider at this time, given the current depressed real estate market.

What assets don't make the best gifts? As has always been the case, low cost basis assets that are likely to be sold by the beneficiaries are the most challenging to gift. An example would be a large concentration of well-performing publicly traded stock purchased decades ago. By gifting a low basis asset, the beneficiary will receive the donor's low basis in the asset. When sold, the difference between the low basis and present value will be subject to capital gains tax. While for this year the capital gains tax rate is only at 15%, if Congress does not act, beginning in 2013 the long term capital gains rate will increase to 20% (18% for assets acquired after 12/31/2000 and held for more than 5 years). Under present law, if the same low basis asset is received at the donor's death by inheritance instead of by gift, the beneficiary receives a "step up" in basis to the date of death value which largely eliminates capital gains tax if sold soon thereafter. As such, a thorough evaluation of the comparison in tax liabilities should be made before deciding to gift low cost basis assets.

If you are considering a major gift before year end, the time to start the process is now so a thoughtful, timely, and well documented plan can be implemented before these exemptions expire. Please contact one of our members of the Estate, Succession Planning, Probate Practice Group attorneys for further information and assistance with your estate and gift plan. Our members include the following attorneys:

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