



2010: the year of the taxable gift

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Congress's inaction has made 2010 the year of the taxable gift. While the payment of gift taxes has always provided an advantage over the payment of estate taxes, the current federal gift tax rate of 35% (its lowest since 1934), coupled with the current repeal of the generation-skipping transfer tax (GSTT) and a depressed economic environment, makes the gift tax advantage greater than ever.

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("Act") made significant changes to the estate tax, gift tax, and GSTT. The Act lowered tax rates and increased exemption amounts, with the end result being the elimination of the estate tax and GSTT for 2010. The Act sunsets on December 31, 2010, and on January 1, 2011, the transfer tax laws revert back to the law as it existed in 2001.

2009	2010	2011	Exemption from GSTT	\$3,500,000	Unlimited	\$1,340,000
			\$1,100,000 indexed for inflation from 2004	GSTT Rate	45%	None 55%
			Gift Tax Exemption	\$1,000,000	\$1,000,000	\$1,000,000
			Maximum Gift Tax Rate	45%	35%	55%
			Additional 5% on gifts between \$10,000,000 and \$17,184,000	Estate Tax Exemption	\$3,500,000	Unlimited
					\$1,000,000	Maximum Estate Tax Rate
					45%	None 55%
					Additional 5% on estates between \$10,000,000 and \$17,184,000	

Gift Tax:

There have always been three tax benefits to making lifetime gifts. First, the income and appreciation on the gifted assets are removed from the donor's estate. Second, assuming the donor lives for at least three years from the date of the gift, the amount of gift tax paid is removed from the donor's estate. Third, the gifted property may receive a discounted value that it would not have otherwise received if included in the donor's estate (e.g., minority interest discount).



2010: the year of the taxable gift

However, in 2010 there is a fourth benefit to making lifetime gifts. Specifically, the gift tax rate for this year is currently 35%, which is 20% less than 2011's slated maximum gift tax rate of 55%, and 10% less than 2009's maximum gift tax rate of 45%. Although historically gift tax rates and estate tax rates have always been the same, there is no estate tax in 2010. As discussed above, if Congress does not pass any new estate tax legislation, the estate tax is automatically reimposed on January 1, 2011, at a maximum 55% rate. With the potential future estate tax rate being greater than 35%, there is a benefit to "lock in" the current rate.

Let's take an example. Assume that we start with \$5,400,000 of assets that the donor is able and willing to gift. Next, assume that in the year of death the estate tax is 55% (i.e., the highest rate it is slated to return to in 2011). Finally, assume that, between the year 2010 and the year of death, the combined after-tax earnings and appreciation on these assets is equal to 50% of the 2010 value. Under Plan A no gift is made. Under Plan B the donor gifts \$4,000,000 and uses the other \$1,400,000 to pay the gift tax. The result of these two plans is as follows (assuming the donor lives for at least three years from the date of the gifts):

Plan A	Plan B	Start	\$5,400,000	\$5,400,000	Gift Tax	0	(1,400,000)	Subtotal	\$5,400,000	4,000,000	Earnings/ Appreciation	2,700,000	2,000,000	Subtotal	8,100,000	6,000,000	Estate Tax	(4,455,000)	0	Net to Beneficiaries	\$3,645,000	\$6,000,000
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Accordingly, in this example the donor's beneficiaries receive \$2,355,000 more under Plan B than they would under Plan A.

GSTT:

Every transfer to a grandchild (or non relative who is at least 37-1/2 years younger than the donor) in excess of the GSTT exemption amount is subject to GSTT unless it is excluded under the annual gift tax exclusion (currently \$13,000) or used directly to fund education or health care. However, since the GSTT is repealed for 2010, for gifts to grandchildren in 2010, donors will pay only the 35% gift tax, while in 2011, donors will pay the flat 55% GSTT plus gift tax at a rate as high as 55%.

The return of the GSTT in 2011 brings uncertainty. While it is clear that outright generation-skipping transfers (e.g., writing a check to a grandchild) are not taxable in 2010, it is unclear how 2010 generation-skipping transfers made to trusts for the benefit of grandchildren will be treated when the GSTT returns.

For example, the IRS has not clarified whether generation-skipping transfers made to trusts in 2010 will be excluded from GSTT when distributions are made to grandchildren post-2010 (because the trust was created in 2010 when the GSTT was repealed) or whether such distributions post-2010 will be subject to GSTT unless sheltered post-2010 by the then-applicable GSTT exemption.

Due to this uncertainty, gifts to grandchildren in 2010 should be made outright or into trusts created for the sole purpose of paying education and medical expenses. If a donor wishes to limit the control of the donee over the gifted asset, but does not want the restrictions of a trust solely for education or health purposes, the use of outright gifts of family limited partnerships, limited liability companies, and non-voting stock should be considered.



Short Term GRAT:

A particularly effective gifting vehicle, especially in the current economic environment where asset values and interest rates are low, is the "short-term GRAT." Unfortunately, the short-term GRAT may soon be banned by Congress. While Congress does not seem to want to enact legislation regarding transfer taxes, it appears all too eager to end the heyday of the short-term GRAT. Several tax bills currently being debated in Congress would prohibit short-term GRATs from being created as of the date the President signs the legislation. None of these bills has yet passed both houses of Congress, but some or all of them may be voted on now that Congress has returned from its summer recess. Thus, for interested clients, time is of the essence.

Planning:

Generally, the making of a gift is not a one-day process. Often appraisals must be obtained, business entities formed, trust instruments drafted, and transfer documents prepared. In addition, the cash needed to pay the gift taxes should start being accumulated since the amount that can be accumulated may determine how much can be gifted. Therefore, it is best to start planning as soon as possible to ensure that the gift is made in 2010, before this ideal gifting environment comes to an end.

Timing:

While the gift-planning process should be started, as a precautionary measure, it may be wise to wait until the last part of the year to implement the gift (excluding gifts to short-term GRATs) because:

1. Congress may adopt legislation changing the transfer tax rules before the end of 2010 that may either disrupt a gifting plan or create new planning and gifting opportunities; and
2. The donor could die before the end of 2010; if so, the gift will have created an unnecessary transfer tax.

Conclusion:

2010 is the year of the taxable gift - the year of opportunity (at least for the time being). If you are an individual with an estate over \$1,000,000, or a couple with an estate over \$2,000,000, and you can part with some of your wealth, now is the time to act.