



2012 gift tax planning - a golden opportunity

MSK Client Alert

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Seemingly not a day goes by without reports of tax reform, making specific planning difficult. Despite the uncertainty, two things are clear. First, the federal gift tax, estate tax and generation-skipping transfer tax rates are the lowest, and the related exemption amounts are the highest, in recent memory. Second, unless Congress takes action, these tax rates will increase, and all exemptions will decrease, dramatically, beginning January 1, 2013, as follows:

2012 2013 ⁽¹⁾

Gift Tax

Lifetime Exemption \$5,120,000 \$1,000,000

Annual Exclusion \$13,000 \$13,000

Highest Marginal Rate 35% 55%

Estate Tax

Exemption \$5,120,000 \$1,000,000

Highest Marginal Rate 35% 55% ⁽²⁾

GST Tax

Exemption \$5,120,000 \$1,360,000

Highest Marginal Rate 35% 55%

Taking action in 2012, an individual could remove up to \$5.12 million (\$10.24 million for a married couple) of assets otherwise subject to the estate tax upon death ⁽³⁾. Gifts need not be that large to benefit from the 2012 rules. Individuals making gifts of more than \$1 million, and individuals who already have used up their gift tax exemption, also may benefit. If the gift is properly structured, the appreciation in value and income from the gifted assets also may be sheltered.

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The 2012 rules are a particular boon to members of same-sex and other unmarried (in the eyes of federal law) couples wanting to transfer assets to each other.

There is some speculation that future legislation may recoup part of the benefit of large 2012 gifts. For example, if a person makes a \$5 million gift in 2012 and the estate and gift tax exemptions decrease to \$3.5 million when he dies, there is a question as to whether there will be additional estate tax on the excess gifted amount. Much of what we hear suggests there will not be this "claw back." Even if there is, we believe making a gift now should exclude future appreciation and income from estate tax.

Making a gift can be as simple as writing a check or deeding an interest in real estate. In the appropriate circumstances, more creative techniques can leverage the exemptions and pass greater wealth free of tax. These can involve, among other things, family limited partnerships or limited liability companies, grantor retained annuity trusts (GRATs) and other special types of trusts, and intrafamily sales and other bona fide transactions.

This year may be a particularly favorable time for advanced planning. While it is impossible to predict what Congress may do, legislation introduced in the past few years has proposed the elimination of common aspects of advanced planning, such as valuation discounts for lack of marketability and control, certain GRAT terms and aspects of so-called defective grantor trusts.

A gift does not necessarily require parting with significant additional assets. Past planning should be revisited to see if the current rules can be put to good use. For example, if a parent previously made a loan to her son, now could be a good time for her to forgive the loan tax free. As another example, if a parent and his daughter are co-owners of the daughter's residence, he might transfer his interest to her.

In selecting specific assets to gift during lifetime, the estate tax savings should be evaluated together with the income tax consequences. A key factor to take into account is an asset's income tax basis. If an individual gives an asset during his lifetime, his income tax basis will carry over, becoming the beneficiary's basis in the asset. In contrast, if an asset is subject to estate tax, the beneficiary's income tax basis would be equal to the asset's fair market value. Depending on the asset, the difference in these rules can significantly affect the income tax consequences to a beneficiary who later sells the asset.

For those who have been considering making a gift, 2012 is a great time to do so. For those who have been on the fence, the advantages of gifting this year might make the difference. Either way, we recommend this year's gift planning be started as soon as possible.

*(1) Certain amounts may be subject to further inflation adjustment.

*(2) An additional 5% surtax applies to taxable estates between \$10 million and roughly \$17 million. This "bubble," popularized as a 60% tax rate, recoups the benefit of the estate tax exemption and lower marginal tax rates applicable to estates of lesser value, so that large estates are taxed at a flat 55% tax rate.

*(3) The actual lifetime exemption available in any particular situation is generally the maximum exemption reduced by any portion of the exemption used for gifts in prior years.



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Please contact any member of our Trusts & Estates practice group if you would like to discuss the way these rules might apply to your specific situation.