



STRATEGIC ESTATE PLANNING: MAKING GIFTS IN 2012

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High Gift Tax Exemptions = A Chance to Avoid Transfer Taxes

2012 provides an excellent opportunity for well-off individuals to gift money or other assets to family or friends, thereby reducing the size of the well-off donors' estates and increasing the amounts they can transfer tax free. This is due to the \$5 million federal gift tax exemption currently available to individuals for their lifetimes.

It is uncertain at what levels the federal gift tax and estate tax exemptions (also currently \$5 million) will be on January 1, 2013. These exemptions are scheduled to drop to \$1 million each next year, if Congress does nothing to change the law. It is unclear whether Congress will act to preserve those exemptions, whether it will let them expire, or whether it will re-set the exemptions at some other level, such as \$3.5 million each. Most estate planners predict that these exemption levels will likely be re-set by Congress at or above \$3.5 million, which was the figure used in President Obama's budget. If Mr. Romney wins the White House, likely the exemption levels will stay at \$5 million each.

Given this uncertainty, gifting to reduce the size of an estate over \$3.5 million (or \$7 million for married couples¹), which may well be taxable in 2013, provides a hedge against a possible reduction in both the federal estate tax and the federal gift tax exemption levels. By strategically gifting assets in 2012, wealthy individuals can transfer assets tax free to family members and/or friends. Those same assets, if given to the same recipients (either by gift in the donor's lifetime or by will or trust at the donor's death) in a subsequent year with lower estate tax and gift tax exemptions, could be significantly reduced by federal taxes. In the past, the federal estate tax rate has been as high as 55%.

How Does that Work?

Here is an example, to illustrate the point:

¹ Opposite-sex married couples only. Same sex couples married under New Hampshire or other state law may not use spousal "portability" of excess gift or estate tax exemptions due to the federal "Defense of Marriage Act."

80 year old Matriarch, with an estate of \$5 million (mostly stock, a small house, and an IRA left by her husband), decides to gift to her children, Steven and Deborah, \$1 million each in stock, thereby reducing Matriarch's estate to \$3 million. Matriarch files a federal gift tax return, but no tax is due because of the \$5 million lifetime exemption. Congress does nothing, and the estate and gift tax exemptions drop to \$1 million each. After living 10 more years, gradually spending her money and making additional annual gifts of \$13,000, tax free, to Deborah, Steven and to her two grandchildren, Matriarch passes away in 2022, with an estate worth \$1 million, all of which passes tax free to Matriarch's children and grand children. By strategic giving, she passed \$4 million, tax free, to her family: \$2 million in gifts this year, \$1.04 million through annual gifts over 10 years (\$13,000 x 4 people x 10 years) and \$1 million when she dies in 2022.

What if Matriarch did not make that gift in 2012? If all the other facts remained the same, and if the federal tax on estates (over \$1 million) is 55% in 2022, then she could only pass \$1 million when she dies tax free to her family. The remaining \$2 million in her estate would be taxed at 55%, with \$1.1 million going to Uncle Sam, and only \$.9 million going to her family. Which would you prefer?

What About a "Claw Back?"

It is possible that Congress will lower the federal gift tax exemption to under \$5 million – say \$2 million – and also enact a "claw back" provision, essentially pulling back any gifts made in 2012, which exceed the new exemptions, \$1 million in this example. If that were to happen to Matriarch, she would owe tax on \$1 million of her \$2 million gift to Steven and Deborah. Although that would not be her preference, in the end, even with the "claw back," she is no worse off after making her \$2 million gift in 2012 than if she had given the \$2 million in 2013, with half subject to tax, provided she gifted high basis assets. In fact, she will have removed any appreciation in the assets from her estate, transfer tax free.

Conclusion: 2012 Is a Good Year to Give If You Do It Right

As with all estate planning choices, individuals planning to gift away significant amounts, over the annual exclusion amounts (\$13,000.00 per person per recipient) are well advised to consult an attorney skilled in estate planning and a financial planner, to make sure there are no unintended legal, financial or tax consequences.²

² Disclaimer: This article is intended for general informational purposes only and is not intended as legal, financial or tax advice. In accordance with IRS Circular 230, the information in this article is not intended or written to be used, and cannot be used, by any recipient for the avoidance of penalties under Federal tax laws.