



TAXATION & WEALTH PLANNING

# ALERT

## \$5.12 MILLION GIFT GIVING WINDOW OF OPPORTUNITY: 6 MONTHS AND COUNTING!

In prior alerts, we informed you of short-term planning opportunities involving family gifting. The Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2011 (2010 Tax Act) increased the lifetime gift tax exemption to \$5 million in the year 2011, and, with an inflationary adjustment, to \$5.12 million in 2012. By its terms, the 2010 Tax Act will sunset after Dec. 31, 2012, and under current law, the gift tax exemption is scheduled to revert to \$1 million on Jan. 1, 2013. Thus, spouses who have not previously made substantial gifts have the ability to transfer up to \$10.24 million to friends and family or to trusts for them if the gift is made before Jan. 1, 2013, with maximum rate schedules at 35 percent.

This alert is a reminder of the opportunities that continue to be available through the remainder of this year. It is impossible to predict whether Congress will act to prevent the scheduled exemption reduction to \$1 million in 2013, so the amount of the gift tax exemption after Dec. 31, 2012, remains unclear. Due to the uncertainty, it may be prudent to consider certain planning vehicles to effectively utilize the benefits of the current exemption of \$5.12 million while it remains in the law for the next 6 months, even if total assets are currently below the \$5.12 million and \$10.24 million thresholds.

Some of the benefits and opportunities of a gifting program utilizing all or a part of the lifetime exemption are as follows:

1. **Reduction in Estate Tax:** If the exemption is reduced in future years, a current lifetime gift can substantially reduce the estate tax burden to a family on the death of the donor. In many cases, a current gift of \$5 million can reduce the estate tax burden by 40 percent of the gifted amount, or \$2 million, thereby increasing by that amount assets ultimately available to the family, all assuming the exemption is reduced to \$1

million as scheduled. Gifts can also reduce the state estate tax burden that exists in many states.

2. **Removal of Future Appreciation From Tax:** A current gift removes any appreciation on the gifted asset from the estate. Thus, if \$5 million is given today of an asset likely to appreciate (say real estate or traded stock interest) and the gifted asset increases to \$10 million, the \$5 million of appreciation is not includible in the donor's taxable estate.
3. **Retention of Control and Income From Gifted Assets:** Some donors are concerned over the loss of control and loss of the income of gifted assets. It is possible to design a gift-giving program between spouses so both spouses continue to retain significant control over the gifted assets and simultaneously retain the economic benefits of the gifted assets. For instance, spouses may establish trusts for each other for their joint lives, and thereafter for family members, utilizing their available gift tax exemptions, ultimately permitting up to \$10.24 million plus appreciation to pass to family members without estate tax consequences. The design of such trusts must carefully conform with case law and IRS rulings to achieve the intended result.
4. **Retention of Control and Annuity Stream for Designated Period:** Gifts can also be made to Grantor Retained Annuity Trusts (GRATs) in which the grantor retains control over the gifted asset and retains an annuity stream for a designated period of time, which may be many years or as short as two years. At the end of the designated period, the asset may pass to family members without gift or estate tax consequences, depending upon the duration of the trust and the amount of the annuity stream passing to

the grantor. To be successful, the grantor must survive the trust term.

5. **Leveraging Gifts With Personal Residence:** In the case of a personal residence, a gift tax can be leveraged so that more than the reduced gift tax value can be removed from the estate. This can be accomplished through an approved technique known as a Qualified Personal Residence Trust (QPRT) in which the residence is placed in trust for a designated period of years. During the designated period, the donor reserves the right to continue to live in the residence. As trustee, the donor may determine when and if to sell the residence and reinvest into a smaller residence or retain the proceeds in the trust. At the end of the trust term, the residence or the proceeds of sale can pass, without gift or estate tax consequences, to family members. As in the case of the GRAT, the grantor must survive the trust period to be successful. For example, a residence worth \$1 million could be gifted to a QPRT and the value of the gift might be only \$300,000, depending upon the donor's age and duration of the trust, thereby removing \$700,000 from the estate, plus all future appreciation.
6. **Protection From Creditors and Spousal Claims:** Gifts can be directed to pass to trusts for family members in a manner that protects the assets from the potential creditors of the donees and from matrimonial claims of spouses of donees.
7. **Charitably Minded Gifts:** Charitably minded donors can benefit by making gifts to Charitable Lead Trusts, which accomplish the following:
  - a. Providing an annual stream of payments to favored charities,
  - b. Assuring the underlying principal of the trust will eventually pass to family members,
  - c. Avoiding gift and estate tax consequences associated with the gift, and

- d. Creating current or future income tax benefit to the grantor by reason of the gift.

For more specifics, see our [alert on charitable giving opportunities under the Tax Relief Act of 2010](#).

8. **Grantor Trusts – Tax-Free Gift of Income Tax to Donee:** Trusts can be designed to benefit both children and grandchildren, all without gift or estate tax consequences or income tax consequences to the donee. The grantor of the trust incurs the income tax generated by the transferred assets, thereby creating an additional tax-free gift to the trust. If the grantor sells assets to the trust, the grantor could retain a stream of payments, income tax free, while heirs enjoy the gift and estate tax benefits. This type of trust is a grantor trust.
9. **Life Insurance and Leverage:** Life insurance is a method to leverage your gift tax exemption. If single premium life insurance policy is purchased for (say) \$5 million, depending upon the age and health of the insured, multiples of \$5 million (in the form of insurance proceeds) can pass to trusts for children and grandchildren by utilizing the \$5 million lifetime exemption and avoiding estate and generation-skipping transfer (GST) tax on the enhanced insurance proceeds.

While these techniques do not represent an exhaustive list, they present areas of opportunity that should be reviewed with an estate planning attorney in order to coordinate the appropriate planning vehicle or vehicles with the objectives of the donor and his family. This window of opportunity may only last for less than 6 months and should not be overlooked.

Please call us with your questions. We encourage you to contact your relationship attorney at Fox Rothschild or a member of the firm's [Taxation & Wealth Planning Department](#) in the state in which you maintain your permanent residence to discuss the 2012 window of opportunity for your estate tax program and to determine whether appropriate changes should be made.

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