

'Tis the Season for Giving



Regardless of the actions Congress will take, 2011 will usher in significant changes to the estate and gift taxation. The estate tax reform passed in 2001 (under George H. W. Bush) is set to expire on December 31, 2010. At this time, lawmakers have not agreed on any estate tax reform. This uncertainty would suggest that the following tips should be considered for prudent planning and gifting during the holiday season:



Background:

There is, in 2010, a maximum gift tax rate of 35 percent and an exemption of \$1 million for gift tax purposes and there is no estate tax or generation skipping transfer (GST) tax. Therefore, your estate is not subject to estate tax if you die in 2010. Your estate will, however, be subject to the new “modified carryover basis” rules that will have an impact on the gain your heirs must recognize when they eventually sell property from your estate. You are not subject to GST tax, if you give property in 2010 to your grandchild or great-grandchild (a “skip person”), but you will be subject to the gift tax rules.

Estate Tax Rules in 2011 and the “Grinch”:



If Congress fails to act, the estate tax and GST tax will be restored to the same onerous rules we had in 2000. The maximum gift, estate and GST tax rates return to 55 percent with a minimal exemption of only \$1 million. However, the tax basis of any property your heirs receive from your estate will be the fair market value on the date of your death which should minimize their taxable gain (the old “step-up” in basis rules).



Congressional Action and “T’was the night before Christmas”:

Although Congress continues to express their intent to enact estate tax reform legislation before the expiration of the 2001 reform; its Members are unable to agree on the extent of the reform. A failure to act may result in no “holiday present” to the People before the end of 2010 and a reversion to the pre-Bush rules. If Congress does act,

they could return to a modified version of the gift, estate and GST tax rules that were applicable in 2009. If so, the top rate might be between 35 and 45 percent with an exemption amount between \$3.5 million and \$5 million (although it is likely the gift tax exemption might remain at \$1 million). Early in 2010, Congress seemed to consider making any reform retroactive to January 1, 2010; however, given their failure to get reform passed quickly and the subsequent deaths of many taxpayers in 2010 (who were not subject to the estate tax), this now seems unlikely. Members of Congress have expressed their intent to allow the estates of persons who died in 2010 to elect either to apply the current 2010 law or any newly enacted estate tax legislation. Congress has not been clear as to whether they might try to make any GST tax reform totally or partially retroactive.



Maximize Gift Tax Exclusions and “wrapping up those presents”:

The historic strategy of reducing your estate through annual gifting to your children and grandchildren (and even great-grandchildren) remains a basic and powerful estate planning tool regardless of any pending estate tax reform. Generally, gifts of up to \$13,000 per donee (\$26,000 for married couples), with no limit on the number of donees, are excluded from gift tax in 2010 and those dollars will be removed from your estate. Additionally, payment of tuition (directly to an educational institution) for the benefit of your children or grandchildren is excluded from gift tax and is not limited to \$13,000.



Maximize Gifts to the Grandchildren:

2010 transfers directly to grandchildren (or great-grandchildren), in addition to taking advantage of the low gift tax rate, are currently not subject to GST tax this year. But be cautious, GST tax reform in the future may include these transfers retroactively.

Take Advantage of Gift Tax Exemption Amount and “the gift that keeps on giving”:



By gifting appreciating property to your heirs, you are able to take advantage of the \$1 million gift tax exemption now using today’s value. The value on the date you give it away is used to determine your estate tax when you die regardless of how much the property may appreciate after you give it away.



Consider Making Taxable Gifts and “the really big presents”:

The gift tax rate is 35 percent currently – probably the lowest we will see in our lifetimes, regardless of any anticipated tax reform. Once you have taken advantage of the \$1 million gift tax exemption, contemplate whether you might want to make additional taxable gifts. Paying tax now may preserve more of your family wealth compared to paying gift or estate tax at probable future rates.

Another tax minimization strategy is taking advantage of low interest rates and depressed property values. When both of these conditions exist, it is almost always beneficial to make transfers of property, even if you do incur gift tax. There are other estate planning techniques that can be utilized to further enhance these opportunities such as family limited partnerships, charitable lead trusts, grantor retained annuity trusts and sales to family trusts. Consult your wealth transfer professionals.

Consider Making Transfers from Trusts That Would Have Been Subject to GST Tax but “be careful of the Grinch”:



Some distributions from some trusts, prior to 2010, were subject to GST tax because these distributions were made to a grandchild of the donor (a skip person) and referred to as taxable distributions. The beneficiary who received the distribution was required to pay GST tax. Currently, distributions to skip persons made in 2010 are not subject to GST tax. One must keep in mind that GST tax reform may include these transfers.

Be careful when making transfers to Trusts. Because it is almost certain that there will be a GST tax in 2011 and beyond, one should give careful consideration prior to making any transfers to trusts that may have GST tax consequences in the future (such as transfers to trusts in which grandchildren or remote heirs are current or potential beneficiaries). Given that there is no GST tax in 2010 and thus no current GST exemption, there is also no shield to prevent future GST tax consequences.

