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The Time Is Now: Gift Planning Opportunities Will Expire at Year End

BY ALISON I. GLOVER, SUSAN M. KEALY, PETER M. MILLER, KURT R. STEINKRAUSS, REENA I. THADHANI, SARA A. WELLS, AND ALLISON M. WHITMORE

As we enter the second half of 2012, it is important to consider certain time-sensitive estate and gift planning opportunities. The gift and GST tax exemptions were increased to $5,120,000 for 2012 – the highest exemptions in history. With just five months left until the exemptions are scheduled to revert back to $1 million as a part of the expiration of the extended Bush tax cuts (absent further legislation), time is running out to use your full gift and GST exemptions if you are interested in doing so.

$5 Million Gift and Generation Skipping Transfer (“GST”) Tax Exemptions

The gift and estate tax exemptions are unified under current law. This means that if you use your $5,120,000 exemption today, your exemption remaining at your death will be $0. That said, there are several benefits to using your gift and GST tax exemptions to make a large lifetime gift now, rather than waiting until death:

- Possibility that the exemptions will decrease in the future;
- Any post-transfer appreciation is removed from your taxable estate;
- Current depressed asset values may provide opportunities for substantial post-gift appreciation; and
- Lifetime gifts are especially useful in saving state estate taxes, particularly if you live in a jurisdiction that imposes an estate tax but not a gift tax (such as Massachusetts or New York).

However, there are also some drawbacks:

- You may not want to gift low-basis property (donees receiving gifted property take the donor’s “carryover basis,” whereas, under current law, the basis of an asset received at death is “stepped up” to the asset’s fair market value);
- Gifted asset values may decrease, resulting in a waste of a portion of your exemption; and, most importantly,
- You may need the money at some point in the future.

When making a large gift, you should consider the use of a trust. Making a gift in trust allows you to separate the timing of the gift (which is often driven by tax motivations) from the timing of the distributions (driven by family and financial factors). In addition, using a trust can provide income and GST tax benefits, and you can structure the trust so that it gives your beneficiaries significant (although not total) control.

Sell/Loan Assets to Trusts While Interest Rates Are Low

If giving away a significant amount of wealth makes you uneasy, but you still wish to take advantage of current gifting opportunities, you may consider *selling* property or *loaning* funds to a trust for the benefit of your family members. As long as the transferred asset appreciates more than the interest rate you charge, you will have removed the future appreciation from your taxable estate while maintaining the current value of the asset for yourself. For this reason, this approach is often called an “estate freeze” technique.

These techniques are especially attractive given today’s interest rates. The IRS just announced the following minimum rates for August 2012: 0.25% for short term loans of less than three years; 0.88% for mid-term loans between three and nine years; and 2.23% for loan terms exceeding nine years.

Under this approach, you would sell assets to a trust (or lend money to the trust) and take back a note at a minimal interest rate. The trust could be structured in such a way that a sale of assets does not trigger any income taxes as a result of the sale. At the end of the loan term, any appreciation in excess of the interest rate remains in the trust for the benefit of your family members.

If you have already utilized the sale technique described above, you may also want to consider refinancing the outstanding note to take advantage of the current interest rates. Also, in the event that you would now like to make a gift to utilize your gift and estate tax exemption, you should consider forgiving the note (which would be considered a gift to the borrower).

GRAT Interest Rate Lowest in History

Like the sale technique discussed above, the GRAT (Grantor Retained Annuity Trust) is another gift tax–efficient mechanism to shift future wealth to your heirs. Under this strategy, you would create a trust under which you would retain the right to receive annual annuity payments for a fixed period (usually two to five years). After the annuity payment period expires, your interest in the trust would terminate, and your family members (or a trust for their benefit) would receive the balance free of gift tax.

The August interest rate used for GRATs is at an all-time low of 1.0%, making it easier than ever before to transfer wealth through the use of this mechanism. For example, if you transfer a $1 million asset to a three-year GRAT, and that asset appreciates 15% annually over the three year period, your heirs will receive approximately $355,000, free of any gift tax, and you will have received approximately $1,021,000 back in distributions.

There are several downsides to a GRAT, including the inability to allocate your GST exemption to the gift (meaning that distributions to your grandchildren from the resulting trust could incur a tax), and that you must survive the term in order to realize any tax benefits. In addition, several bills severely limiting the effectiveness of GRATs have been proposed in Congress.

Under the right circumstances, however, the GRAT can be an ideal way to transfer significant wealth to your heirs with very little downside risk.

Time to Act

The confluence of increased tax exemptions, low asset values, and low interest rates make this the ideal time to consider gifting strategies. The increased estate, gift, and GST tax exemptions are scheduled to sunset at the end of this year and legislation may soon limit the effectiveness of GRATs. With the uncertainty in Washington, the future of the tax system is anyone’s guess. What we do know for certain, however, is that these opportunities are available now.

The process of setting up these gifting strategies may take several months, so it is important to act soon. Please feel free to call us to discuss how these and other techniques may help you and your family achieve your estate planning objectives.

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