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Gifts in 2010 as a Strategy to Reduce Your Estate

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One of the lesser known components of the 2010 estate tax repeal is that the gift tax rate in 2010 is 35%, as opposed to the 45% gift and estate tax rate that was in place in 2009. This presents a planning opportunity for a taxpayer to reduce his taxable estate and save a significant amount of taxes if the taxpayer believes that his estate will be subject to an estate tax in the future.

Absent new legislation, the 2010 estate tax repeal will sunset in 2011, with the estate tax reinstituted at rates as high as 55% and an exclusion amount equal to $1 million (adjusted for inflation). Gifts in excess of $1 million also will be subject to gift tax at rates as high as 55%. Thus, gifting assets in 2010 at a lower rate will ultimately transfer significantly more wealth to a taxpayer's beneficiaries.

Assume that a taxpayer desires to gift $10 million to his children and has used his lifetime gift exclusion. In 2010, the gift tax on this gift, payable at a 35% rate, would be $3.5 million. Taxpayer would pay the gift tax so the total outlay for the taxpayer to get $10 million to his beneficiaries would be equal to $13.5 million. Assuming that the taxpayer survives three years from the date of the gift, the amount of the gift tax paid will not be included in taxpayer's estate.

Now assume that the same taxpayer does not make the gift in 2010, and dies with $13.5 million in his estate in a year where the maximum estate tax rate is 55% (and said taxpayer also has used his full exclusion amount). The amount of estate tax due on the $13.5 million included in the taxpayer's estate would be approximately $7.5 million, leaving approximately $6 million to pass to the taxpayer's beneficiaries. On these facts, the 2010 gift of $10 million increases the net amount passing to taxpayer's beneficiaries by almost $4 million.

The lower gift tax rate combined with the fact that the gift tax paid is not subject to estate tax (assuming taxpayer survives three years from the date of the gift) can produce dramatic savings for taxpayers inclined to make gifts in 2010 and pay gift tax.

Even more dramatic savings can be achieved in 2010 if the taxpayer's beneficiaries are grandchildren. Due to the fact that the generation-skipping transfer ("GST") tax is repealed in 2010, a gift in 2010 to grandchildren will not trigger a GST tax. If the same taxpayer dies in future years leaving these assets to grandchildren, the assets will be subject to both estate tax and a significant GST tax (up to 55%), further diminishing the amount ultimately passing to grandchildren.

There are less than three months remaining (assuming no retroactive application of new gift and estate tax laws) to implement this planning.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North
25 Main Street
Hackensack, NJ 07601
Phone: (201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone: (212) 752-8000

500 Delaware Avenue
Suite 1410

Wilmington, DE 19801
Phone: (302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone: (410) 230-0660

301 Commerce Street
Suite 1700
Fort Worth, TX 76102
Phone: (817) 810-5250