



2012 GIFTING OPPORTUNITIES

For the 2012 calendar year, an individual has the ability to give away up to \$5,120,000 of an individual's property without adverse federal gift tax liability (the "*federal gift tax exemption*"). The federal gift tax exemption is in addition to an individual's ability to annually give away up to \$13,000, per donee, to an unlimited amount of individual donees (the "*annual gift tax exclusion*"). Unique gifting opportunities are available in 2012 as more specifically described below:

➤ **Recent History of the Federal Gift Tax.** On December 17, 2010, President Obama signed into law the **Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010** (the "*TRA*") which made temporary changes to the federal transfer tax laws for the 2011-2012 years. However, the TRA, like its predecessor, the **Economic Growth and Tax Relief Reconciliation Act of 2001** (the "*EGTRRA*"), which set forth the prior transfer tax laws, contains a sunset provision that will cause the federal transfer tax changes of the TRA to lapse as of December 31, 2012, and on January 1, 2013 reinstate the federal transfer tax laws that existed in 2001.

NOTE: The TRA federal gift tax exemption of \$5,120,000 for 2012 represents a significant increase from the maximum federal gift tax exemption of \$1,000,000 set forth under the EGTRRA. Also, the TRA rate of tax of 35% for gifts in excess of the federal gift tax exemption represents a decrease from the rate of 45% that was in place under the EGTRRA.

➤ **A Unique Gifting Opportunity.** At the end of 2012, absent new legislation, the TRA will expire. Should the TRA expire, in 2013, the federal gift tax exemption will return to \$1,000,000 and the rate of tax on gifts in excess of \$1,000,000 will increase to 55%.

NOTE: It is uncertain whether the favorable TRA federal gift tax exemption and rate of tax will remain after 2012. Enactment of new legislation is entirely possible before the end of 2012. Also, there is the possibility that new legislation could be enacted during 2013 and made retroactive to the beginning of 2013. New legislation could provide the same favorable federal gift tax exemption and rate of tax as provided under the TRA. However, the only certainty is that the favorable TRA exemption and rate of tax remains in place for 2012.

➤ **Why Gift?** Perhaps the primary reason to consider gifting during 2012 is to minimize paying federal transfer tax at the donor's generation and defer the payment of transfer tax to a subsequent generation. The TRA "unified" the federal gift tax and federal estate tax rules. Therefore, an individual's exemption from federal estate tax at the individual's death is also \$5.12 million for 2012 and uncertain for 2013 and beyond (an individual only has one exemption that can

be used during life or at death, or the combination of the two – an individual does not get to use two separate exemptions). However, a transfer made during 2012 would “freeze” the value of that gift for federal transfer tax purposes and avoid federal transfer tax liability on the appreciation of the gifted asset. For example, a gift of a \$5.12 million asset made in 2012 that later appreciated to \$10 million would pass free from transfer tax at the donor’s death, whereas if the gift was not made, the full \$10 million would be subject to federal estate tax at the donor’s death, with any amount in excess of \$5,120,000 left subject to federal transfer tax.

NOTE: With respect to certain assets with an expectation of appreciation, the TRA presents unique opportunities for “freezing” the value of the gifted asset and allowing the gifted asset to appreciate free from federal transfer tax.

➤ **Entity Valuation Discount Planning Opportunities.** The TRA continues favorable treatment of obtaining valuation discounts with respect to assigning a value to transfers of minority interests in certain entities including closely held businesses, limited liability companies (LLCs) and family limited partnerships (FLPs). Legislation that alters the TRA may curtail the availability of favorable valuation discounts.

NOTE: This year’s budget proposal by the President contains recommendations that valuation discounts be dramatically limited for transfers of a minority interest in a family-controlled entity to a member of that family. Although a budget proposal is not binding legislation, the appearance of these restrictions in a budget proposal signifies there may be some intent to reduce the ability of taxpayers to obtain favorable valuation discounts.

➤ **Irrevocable Spendthrift Trust Creditor Protection.** Intra-family gifting is often achieved through irrevocable trust planning; examples of these types of trusts include “Dynasty Trusts” and “Generation-Skipping Trusts.” Gifts made in trust, rather than outright, allow the donor to restrict unfettered access to gifted property and establish safeguards to prevent the donee from exhausting the gifted property too quickly. Also, transferring assets to an irrevocable trust helps protect the donee from creditors, including a subsequent unanticipated divorce between the donee and his/her spouse. Further, proper planning may provide lifetime benefits to the donee without adverse federal estate tax consequence to the donee at the donee’s subsequent death.

NOTE: If gifting to future generations is not desired, there are gifting opportunities available between spouses. A donor spouse can create an irrevocable trust for the donee spouse *and* descendants. The donee spouse can be the trustee with full control over the trust assets to make distributions to the donee spouse and descendants without those assets being subject to federal transfer tax liability in either spouse’s estate. Opportunities are also available for both spouses to establish such a trust.

➤ **Cushion Gifting.** Giving away property valued at or close to \$5.12 million federal gift tax exemption may not be possible or preferred. However, 2012 affords the opportunity to make gifts of a portion of the TRA federal gift tax exemption. Many donors reached the \$1.0 million EGTRRA federal gift exemption and stopped gifting. The TRA 2012 federal gift tax exemption permits an individual to modestly increase prior gifting without gift tax liability.

NOTE: Further, the TRA offers the opportunity to give “hard-to-value” assets with less fear of incurring gift tax liability. Certain interests in entities are often difficult to value. A gift made of an interest in an entity with a wide range of potential value that is well within the cushion of the 2012 \$5.12 federal gift tax exemption may be less likely to trigger scrutiny by the IRS if made in 2012 and reported on a 2012 federal gift tax return.

➤ **Low Interest Rates.** The current low interest rate environment presents unique wealth transfer opportunities. Interest rate cuts have affected two important interest rates, the “applicable Federal rates” (the “*AFR rates*”) and the “7520” rate, (the “*7520 rate*”). The AFR rates represent the minimum rates of interest that must be charged to debt instruments to avoid imputed interest for Federal gift and income tax purposes. The 7520 rate represents the interest rate used to calculate the present value of certain lifetime and remainder interests.

NOTE: With the 7520 rate and AFR rates at historic lows, while rates remain low in 2012, there is opportunity to take advantage of gifting techniques including intra-family loans, grantor retained annuity trusts (“*GRAT*”) and sales of assets to an intentionally defective grantor trust (“*IDGT*”), as well as the use of trusts in connection with charitable giving.

➤ **Formula Federal Estate Tax Exemption/Marital Deduction Planning Review.** Many estate plans are structured to make full use of an individual’s exemption from federal estate tax and the unlimited marital deduction against federal estate tax available only available between spouses. The objective is the deferral of the payment of federal estate tax until the latest date possible. This formula exemption/deduction planning entails funding a “bypass trust” with an individual’s federal estate tax exemption and funding a “marital trust” with the remainder of an individual’s assets. In prior years, when the EGTRRA federal estate tax exemption was lower than the current \$5.12 million federal estate tax exemption, certain estate plans named non-spouse primary beneficiaries of the “bypass trust” with the objective that the majority of the individual’s assets would be used to fund the “marital trust” for the primary benefit of the surviving spouse. Applying that same formula in 2012, however, would fund the “bypass trust” with an increased \$5.12 million federal estate tax exemption for the benefit of non-spouse beneficiaries.

NOTE: The applicability of the increased 2012 \$5.12 million federal estate tax exemption in connection with the formula exemption/deduction planning currently set forth in many estate plans may produce an unintended result if non-spouse beneficiaries are the primary beneficiary of the “bypass trust.”

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