TAKE ADVANTAGE OF TRANSFER TAX BENEFITS NOW
By Kevin Lanigan, Carlson Estate Planning

The Tax Relief Act of 2010 fundamentally altered wealth transfer planning by substantially increasing the gift tax and generation-skipping transfer (GST) tax exemptions, which are now $5,120,000. This means a married couple can make lifetime tax-free gifts in excess of $10 million to their descendants or others. Prior tax law would have limited the couple's gift tax-free lifetime transfers to $2 million. The tax law changes, however, are set to expire at the close of 2012.

Without Congressional action, transfer tax rates will increase, and exemptions will decrease in 2013. The gift and estate tax rate will increase to 55 percent and the gift tax exemption will be reduced to just $1 million. Many taxpayers are avoiding transfer tax law uncertainty by taking advantage of wealth transfer opportunities before the end of the year. However, because important choices have to be made prior to implementing a wealth transfer plan-including a) identifying the property to be transferred, b) selecting the gift recipients, and c) determining the manner in which the recipients receive the gifts, it is advisable to start the process as soon as possible.

<u>Importance of Using Gift Tax Exemption</u>

The recent increase in the gift tax exemption has created an important wealth transfer opportunity. A lifetime gift removes all future income from and appreciation on the transferred property from a donor's taxable estate, which could result in substantial estate tax savings. In addition, lifetime gifts may also provide significant state transfer tax savings because many states continue to impose separate estate and GST taxes, while few states impose a gift tax. A failure to take advantage of temporary tax law benefits could result in the unnecessary payment of estate taxes at a rate as high as 55 percent on assets in excess of $1 million.

<u>Trust and Generation-Skipping Planning</u>

A taxpayer could also use the increased exemption to give assets gift tax-free to his or her children. An outright gift to a family member, however, may yield only short-term benefits as the recipient may be faced with future transfer tax obligations. Instead, making a gift to a trust for family members and allocating GST exemption to those transfers can provide long-term benefits to a family. This type of GST exempt trust is often referred to as a "Dynasty Trust." Under current law, Dynasty Trusts offer continued protection from estate and GST taxes as long as the assets remain in the trust. Allocating GST exemption to a trust, however, does not mean that grandchildren have to be the initial beneficiaries of the trust. A spouse or child can be a beneficiary if desirable, and the trust can be structured to avoid taxation for multiple generations while permitting each generation of beneficiaries to alter the terms of the trust for future generations.

The laws of many states allow Dynasty Trusts to last for multiple generations. Some states even permit Dynasty Trusts to operate in "perpetuity." For these reasons, it is important to carefully consider the provisions of the Dynasty Trust and in tax law changes or changes in family circumstances. This planning flexibility can also alleviate family concerns that long-term trusts could create a sense of entitlement in young beneficiaries.

Selection of Assets to Give

The best assets to transfer are those with significant potential for long-term appreciation and with a high income tax basis (because lifetime transfers generally do not result in a "set up" in income tax basis as do transfers at death). Interests in closely held entities are also attractive because current law may support the use of valuation discounts when determining the value of such interests for gift tax purposes. Gift tax exemption also can be used to forgive existing intrafamily loans.

2013 Budget Proposals

The Obama administration recently issued its 2013 revenue proposals. Some of the proposals concerning estate planning have been carried over from prior years, others are new. The budget may provide some indication of possible future transfer tax changes. The following budget items are noted, although it is difficult to predict whether Congress will act on any of them:

- Reduce the estate and GST exemptions to $3.5 million and the gift tax to $1 million, and provide a top rate of 45 percent for those taxes

- Modify the treatment of "grantor trusts" to provide, among other changes, that a grantor trust will be included in the donor's estate

- Eliminate a trust's GST exemption on the trust's 90th anniversary

- Eliminate valuation discounts on family-controlled entities

- Require a minimum 10-year term for grantor retained annuity trusts