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FALL 2012 NEWSLETTER

2012 GIFTING STRATEGIES

This Newsletter discusses several issues about gifting, but it focuses on the opportunity to make large gifts before December 31, 2012.

Unless Congress passes new legislation acceptable to the President, on December 31, 2012, the current "Unified Credit", which is equivalent to a $5,120,000 lifetime exclusion from gift, estate and generation-skipping transfer tax, will sunset. In its place will be a Unified Credit equivalent to a $1,000,000 exclusion from gift and estate taxes and a slightly higher generation-skipping tax exclusion based on an inflation adjustment. Tax rates over the exclusion equivalent will increase from the present 35% rate to a graduated rate between 41% and 55% at the $2,500,000 gross estate/gift level. These exclusions take into account all prior lifetime gifts over the annual exclusion amount in the year of the gift. This exclusion limitation does not apply to the unlimited marital deduction for gifts to a spouse or to charitable gifts. Historically, over the last 75 years the excluded amount has not gone down. It is possible that sometime in 2013 Congress could pass legislation retroactive to January 1, 2013, but there is no assurance that will happen.

With that uncertainty, until this December 31st the opportunity exists to make large gifts up to the exclusion amount (taking into account prior gifts over the annual exclusion) without paying transfer (gift or estate) taxes. Even if the exclusion amounts are restored or estate taxes are eliminated completely, now is still a good time to gift the for the following reasons: (a) The value of may assets may now be the lowest it will ever be again, allowing the maximum transfer of these assets within the exclusion amount. (b) Income tax rates for capital gains and investment income will increase in 2013 unless all of the "Bush Tax Cuts" are reinstated for 2013 and later and the new 3.8% investment income tax (to fund the health care act) is repealed. Therefore shifting assets to lower income tax bracket family members will result in saving taxes on the family unit level. Donors need to be aware, however, that the donee's income tax basis for all gifts received is the lower of the donor's income tax basis or fair market value, so there is no depreciation increase or capital gain elimination through gifting. Gifts over the annual exclusion are also added back to the taxable estate, but it is understood that those gifts will receive credit for gift taxes that would have otherwise been paid (eliminating the "clawback" concept).

Through appropriate structuring, gifts can be set up earlier in 2012 but not completed until the end of 2012 and in some instances in 2013 or not at all if the donor wants additional time to make a decision or possibly revoke the gift entirely. The end of the year delayed gift or ability to revoke a gift is accomplished through amending what is initially established as a revocable trust and making it irrevocable before December 31, 2012 or revoking the trust entirely. The deferral into 2013 is for gifts to a spouse using the Qualified Terminable Interest Property election when filing a gift tax return (with extension October 15, 2013) for a gift made to a spouse that would convert the gift from use of the gift tax exclusion to a marital deduction not using that exclusion with the QTIP election.

Gifting with borrowed funds is possible to keep other assets available either because needed as a resource or to preserve the step up in income tax basis on death of the property owner. Use of gifted funds is appropriate if the funds are available and it is expected that interest costs will be covered by income generation from other sources.

The current annual exclusion for which a gift tax return is not required is a gift of not more than $13,000 to any person during the calendar year 2012. For 2014 this amount is increased to $14,000. To qualify for the annual exclusion, the gift amount must be of a "present" gift as opposed to a "future" gift that does not qualify for the annual exclusion. For a "present" gift the donee must have access to the benefits provided by the gift. Therefore, a gift in trust, must give the donee a power to claim part of the principal of the trust (this is called a "Crummey" power which means the done must be entitled to receive the greater of 5% of the amount of the trust principal or $5,000).

If year-end gifting of any amount is desirable for you, then you need to act soon. All donors need to consider the time it takes to transfer the assets and if appropriate draft legal documents associated with the gift.

Internal Revenue Service Circular 230 requires that I inform you as follows: Any U.S. federal tax advice contained in this communication (including any attachments) is not intended to be used and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or tax-related matter(s).