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'Tis the Season for Gifting

by Mark Doyle, J.D., L.L.M. Taxation



As the end of 2011 approaches, there is no better time to take advantage of historically high gift tax exemptions and low tax rates to transfer assets to family members.

The Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 set the estate, gift and generation-skipping transfer tax exemption amount at \$5 million per person and the top rate of tax at 35 percent for 2011. As a result, a married couple is currently allowed to transfer up to \$10 million of wealth without incurring a federal gift or estate tax.

The increased gift tax exemption of \$5 million per person will not be around much longer, as the government is scheduled to decrease the exemption to \$1 million per person beginning in 2013. Rumors of an even earlier end to the \$5 million exemption are resulting from potential proposals by the Congressional Super Committee to the full Congress on how to reduce the deficit by at least \$1.5 trillion over the next decade. Some proposals include rolling back the lifetime gift tax exemption from \$5 million to \$1 million, while other reports recommend a reduction from \$5 million to \$3.5 million (which was the exemption in effect in 2009) to be instituted as early as January 1, 2012.

Now is the time to make use of the current \$5 million lifetime gift tax exemption. This can be done by establishing a family limited partnership or family limited liability company, using a Qualified Personal Residence Trust or implementing many other year-end tax-saving strategies. The following estate-planning advice provides a guide for gift-giving during this holiday season.

Irrevocable Trust

One way to utilize a substantial portion of the \$5 million tax exemption is by making a gift to an irrevocable trust for the benefit of family members. This method would subtract the value of the gifted asset, plus future appreciation, from your estate. Assets that have declined in value, but are expected to rebound, are ideal to transfer as gifts because the gift amount has been reduced and the increase in value would occur inside the trust, where it would not be subject to estate tax. Making gifts to irrevocable life insurance trusts to fund premiums on insurance policies takes advantage of the increased lifetime exemption. This could provide an opportunity to leverage the gift tax exemption into a larger tax-free death benefit for an estate.

Family Limited Partnerships

Family Limited Partnerships are another way to maximize gifts to family members. Funding investment properties or a closely held business into an LLC or Limited Partnership provides asset protection, management and control mechanisms. In addition, gifts to children or key employees receive the benefit of a substantial discount in value due to lack of marketability and control for a minority interest. For example, a gift by a parent of a partnership interest may have a face value of \$40,000, but with an applicable valuation discounts it will fall below the annual exclusion limit of \$26,000 per couple.

Annual Exclusion Gifts

Annually, each person is able to make tax-free gifts of up to \$13,000 (\$26,000 for a married couple) to any number of individuals. This annual exclusion will end on Dec. 31, and taking advantage of this exemption may result in a tremendous holiday gift for the recipient.

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Furthermore, taxpayers may want to consider funding 529 plans (an education savings plan) by Dec. 31 to apply 2011 gift tax exclusion to the contributions. Individuals can even "front-load" these plans by making five years' worth of annual exclusion gifts. As a result, up to \$65,000 (\$130,000 for a married couple) could be transferred to a 529 plan in 2011 without generating a gift tax.

Charitable and Retirement Planning

In order to obtain an income tax charitable deduction for 2011, gifts must be made by Dec. 31. Individuals over the age of 70 1/2 are able to transfer up to \$100,000 directly from an IRA to a public charity – this distribution would be free from income tax and would count toward required

minimum distribution.

With just weeks remaining in 2011, individuals who have not yet begun the appraisal process should keep in mind that it may take several weeks for a transfer of stock via stock certificate or stock power to be complete. Additionally, gifts of property with a value in excess of \$5,000 (other than publicly traded stock) require an appraisal. Contributions to Roth or traditional Individual Retirement Accounts (IRAs) for the current year must be made by April 15, 2012.

Grantor Retained Annuity Trusts

Entering into intra-family loans or establishing Grantor Retained Annuity Trusts (GRATs) can allow individuals to take advantage of the historically low interest rates. GRATs are irrevocable trusts designed to transfer the appreciation in an asset to beneficiaries at a nominal gift tax cost. As of last month, the hurdle rate is at an all-time low of 1.4 percent. Consequently, assets inside the trust need only to grow in excess of 1.4 percent in order to succeed in transferring wealth without incurring estate and gift taxes. Immediate action is advised, as Congress has proposed restricting the ability to use certain short-term GRATs in the near future.

Review Estate Planning Documents

With the recent changes in the estate tax law, there has been a significant increase in estate or generation-skipping transfer tax exemptions. A review of all estate-planning documents is highly recommended to ensure that all existing formulas are still applicable.

In addition, for those who live outside of California in a state with an independent state death tax, a review of formula allocations in estate-planning documents is also recommended, as the federal estate tax exemption is now significantly greater than most state death tax exemptions.

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