

Historic Opportunity To Make Large, Tax-Free Gifts Expires on December 31, 2012

The federal gift tax exemption for 2012 is at an all-time high of \$5.12 million. Individuals may transfer up to \$5.12 million to children, grandchildren, or any other beneficiary, without paying gift tax. This opportunity is unprecedented in our history, but there is a catch. Unless Congress acts before the end of the year, the exemption will decrease significantly on January 1, 2013. There may be only a few months left to take advantage of this opportunity to make large, tax-free gifts.

On December 17, 2010, President Obama signed into law the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010." We will refer to this law as the "2010 Tax Act." The 2010 Tax Act made several changes to the estate and gift tax. The most significant change was increasing both the gift tax and estate tax exemptions to \$5 million and indexing both exemptions for inflation. Before the 2010 Tax Act, the gift tax exemption was only \$1 million.

The increase in the exemptions is only temporary, however. If Congress and the President do not act by the end of this year, the gift tax and estate tax exemptions will both revert to their 2001 level--\$1 million.

The gift tax exemption will remain at \$5.12 million for the rest of 2012. That means an individual may transfer up to \$5.12 million to his or her children, grandchildren, or other beneficiaries tax-free. Moreover, a married couple can combine their gifts and transfer up to \$10.24 million without paying any gift tax. Gifts are not taxable income to the recipient.

In addition to the reduction in the exemption, the tax rates are scheduled to increase significantly in 2013. Currently, the tax rates for the gift, estate, and generation-skipping transfer ("GST") tax are a flat 35%. In 2013, the lowest tax rate will be 39% and the maximum rate increases to 55%.

Because of the rate increase, individuals who have already used their \$5.12 million exemption may wish to consider making additional gifts this year to take advantage of the relatively low 35% rate in effect for 2012.

Why make a lifetime gift? Lifetime gifts reduce the value of a taxpayer's estate and will, therefore, result in less estate tax liability at death. Lifetime gifts also have two advantages over gifts made at death.

First, any future appreciation in property that a client gives away during life will not be part of the client's taxable estate at death.

Second, it is better to pay gift tax than estate tax. The reason it is better to pay gift tax is because of the way the two taxes are calculated. The gift tax is "tax-exclusive," while the estate tax is "tax-inclusive." The gift tax is tax-exclusive because it is computed on the value of the property being transferred. The estate tax is tax-inclusive because the tax is computed on the amount of the property a taxpayer owns at the time of his or her death, including that portion of the estate that will have to be used to pay the tax.

The simplest way to make a gift is an outright transfer of ownership of an asset to the beneficiary. But the use of a trust as the vehicle for making the gift is often more appropriate than an outright transfer of ownership.

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For example, giving a significant asset to a minor or young adult may not be a good idea. Alternatively, making the gift to an irrevocable trust can protect the asset in the event the beneficiary is not equipped to manage or invest the asset, may spend the gift unwisely, has creditor problems, or if divorce is a concern.

There are many different methods for making a gift, and the best technique will depend on a variety of factors such as: (1) the client's goals and objectives; (2) the age and other characteristics of the beneficiaries; and (3) the type of assets that will be given (e.g., real estate, marketable securities, closely held business interests, artwork, collectibles, etc.).

Time is running out. If you would like to take advantage of this gifting opportunity or would like additional information, please contact a member of our Trust and Estates Practice group at (585) 232-6500 to schedule a meeting. ■

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