

PUBLICATION

Gifting: A Temporary Window of Opportunity

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The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Act), provides a short-term fix and relief for estate, gift and generation-skipping transfer (GST) taxes. The estate, gift and GST tax provisions of the Act are scheduled to expire at the end of 2012. During 2011 and 2012, all three taxes have a rate of 35 percent and an exemption amount of \$5 million, indexed for inflation. Beginning January 1, 2013, the much harsher statutory mandates which existed in 2001 are scheduled to return, including a reduction in the estate tax exemption from \$5 million to \$1 million and an increase in the estate tax rate from 35 percent to 55 percent. Our [Tax Alert](#) issued on December 22, 2010 explains these changes in greater detail.

Substantial Tax-Free Gifts

The \$5 million exemption from gift tax and GST tax that applies during 2011 and 2012 affords an unparalleled opportunity to make sizeable tax-free gifts. For example, a married couple can give away \$10 million in combined assets and pay no gift or GST tax.

The size of these tax-free gifts can be increased further based on the type of asset being gifted. For example, a 10 percent interest in \$10 million in cash is worth \$1 million. A 10 percent interest in a parcel of real estate valued at \$10 million may be worth something less than \$1 million due to the hassles of co-ownership. On the other hand, a 10 percent member interest in a limited liability company (LLC) or corporation which owns a \$10 million parcel of real estate, may well be worth less than \$1 million -- particularly if the entity restricts transfer of its ownership interests or stock and assuming that a minority interest in such an entity would have little or no say in management decisions. A qualified valuation expert would value the interest or stock being gifted, and in doing so would take into account restrictions against transfer and the limitations inherent in a minority interest.

The obvious benefit is that the gift transferred, whether individual assets or ownership interests in an entity that in turn owns assets, is removed from the couples' taxable estates immediately with no federal gift tax due. Further, if the couple transferred the gift to a properly structured trust for the benefit of their children and grandchildren, then the original gift and all of the income and growth on the gift could, in appropriate situations, be used for the benefit of the children for their lifetimes and pass at their deaths to the couple's grandchildren free of any federal estate and GST taxes.

Timing and Techniques

Gifts do not have to be made at one time, and a series of gifts can be made as long as all gifts are completed before 2013. In addition, techniques other than outright gifts can be appealing in the current climate of low interest rates and depressed real estate values.

There are gift techniques whose estate, gift and GST tax consequences depend in part on interest rates set by the Internal Revenue Service on a monthly basis. These Applicable Federal Rates (AFR) are rates of return assumed by the IRS for various purposes and are generally lower than commercial interest rates. For the past several years, AFRs have been at historical lows. Certain techniques provide clients with the opportunity to

leverage gifts to successive generations by taking advantage of the difference between the AFRs and actual rates of return realized on the gifted assets.

One such technique is known as a grantor retained annuity trust (GRAT). A GRAT is a trust to which a person makes a gift, retaining the right to a return for a stated term of years at a specified interest rate. If the person who made the gift outlives the trust's term, and if the assets appreciate and provide a rate of return in excess of the retained rate, then that excess amount can pass to the remaining beneficiaries completely free of estate, gift and GST taxes.

Potential Downsides

Is there a downside to making substantial gifts in 2011 and 2012 if the exemption from the estate tax, gift tax and GST tax is reduced in 2013 and the effective tax rates are increased? The short answer given by many tax commentators is generally no, at least in regard to federal tax considerations. For instance, the Act provides that in determining the amount of any estate tax due, the gift tax rate and the exemption in effect at the time of a decedent's death, rather than those in effect at the time of the gift, are used to determine the amount of any estate tax due. While no gift tax may have been due when gifts were made in 2011 and 2012, it appears that any estate tax due in 2013 will be calculated as if a gift tax was actually paid in 2011 or 2012 using the rates in effect in 2013, thereby reducing the amount of estate tax due in 2013. Of course, subsequent legislation or IRS interpretations could alter that outcome.

Some tax commentators are concerned that if the available exemption in 2013 is less than the current \$5 million exemption, the IRS will try to "claw back" the gift tax that would have been paid on the difference between the current \$5 million exemption and the \$1 million exemption scheduled to begin in 2013. However, other commentators believe that there is no authorization for such a "claw-back", and that the tax savings in utilizing the \$4 million in additional exemption (\$5 million exemption less assumed 2013 \$1 million exemption) would be preserved. At a minimum, any appreciation on the gifted assets arguably will escape any estate taxation in the couple's estates.

Conclusion

The Act, with its generous exemptions, presents a brief window to make sizeable gifts which, if structured correctly, have the potential for dramatic gift tax savings and even greater estate tax savings for children of donating parents. State tax implications, as well as a multitude of non-tax issues, must also be considered. For further information, please contact one of the attorneys in the Firm's Tax Department.