2012 Gift Tax Exemption: Use it or Lose it!

By Robert M. Buckel

The big news in last year's Tax Relief Act of 2010 legislation was not the $5,000,000 estate tax exemption, but rather the $5,000,000 gift tax exemption. Technically referred to as an applicable exclusion amount, each person is given an amount that can be used to transfer assets tax free to someone either at death or during lifetime. In the recent past, the amount that could be passed tax free at death far exceeded the amount that could be passed tax-free during lifetime. The Tax Relief Act changed this so we are currently in the final year of a two-year period in which the entire $5,000,000 applicable exclusion amount can be given away either during lifetime or at death. Thus for the remainder of this year even those who have utilized their prior $1,000,000 gift tax exemption, can now give away an additional $4,000,000 (or $8,000,000 for a couple). Unfortunately, this generous tax regime is scheduled to expire on December 31, 2012. If Congress and the President fail to agree, the applicable exclusion amount will return to $1,000,000 (as existed in 2001). Given Congress's deadlock on tax and budget issues many tax advisors believe after this year, the amount that can be given away during life will be less than the current $5,000,000.

Gifting Options

There are a number of ways that one can utilize the gift tax exemption before year-end. The most obvious is a gift of cash, securities or real estate. If the gift will be made with something other than cash, then making a gift of an asset with a high cost basis is best since a donee will take the donor's income basis in the gifted asset.

If there are family loans in existence, then this may also be a good time to consider forgiving the loan. The forgiveness of the loan will be treated as a "gift" and utilize a portion of the donor's gift tax exemption. Forgiveness of a loan needs to be structured properly to deal with potential adverse income tax consequences of the loan forgiveness.

A Gift with a Return

Many people wish to use their gift tax exemption but cannot afford to part with the income generated from the $5,000,000. There are options available to meet this concern. For example, a parent could make a transfer utilizing one or more planning vehicles which provide the donor with an annuity or installment payment for a certain term of years. Examples of such arrangements are "grantor retained annuity trust" (GRAT) or a sale to a grantor trust similar to the one described below. Care must be taken in structuring such arrangements as there are several variables therefore it is advisable to consult your attorney.

Family Gift Trust

Estate planners have also come up with a technique that allows a couple to utilize their combined $10,000,000 exemptions, but still retain the use or benefit of the property. The technique is the creation of a "Family Gift Trust" (FGT).

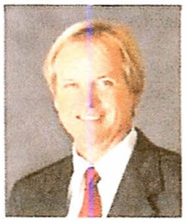
A Family Gift Trust is an irrevocable trust set up by one spouse, let's say the husband, into which the husband transfers property which is worth $5,000,000. The beneficiaries of the FGT typically include the grantor's spouse and descendants. Although the husband has gifted away property to the FGT, if his wife is the primary beneficiary of the FGT, then she still has access to the use and benefits of the property. If structured properly the wife can also be the trustee or co-trustee of the FGT. In instances where it is more appropriate to use an independent or corporate trustee, one or more of the family members can be given the power to remove and replace the trustee.

In this example, the initial transfer of assets into the FGT by the husband constitutes a taxable gift and thus utilizes the husband's $5,000,000 gift tax exemption in 2012. The benefit of the FGT is that the husband has utilized his $5,000,000 gift tax exemption but the marital unit maintains access to the property in the FGT. With careful drafting and planning, the wife can set up a similar (but not reciprocal or identical) FGT for the benefit of her husband and their descendants which utilizes her $5,000,000 gift tax exemption.

Finally, it is possible that a FGT can be structured for income tax purposes to be a "grantor trust" so its income is taxable to the grantor allowing the trust assets to grow free of income taxes similar to those in an IRA.

The remainder of 2012 is a window of opportunity to utilize your $5,000,000 gift tax exemption – use it wisely or be prepared to lose it.

The comments expressed herein are intended for general informational purposes only and should not be relied upon as legal advice. Please consult legal counsel to obtain specific advice for your situation.



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