2012 Gifting Opportunity Bigger Than Ever

By Baird's Financial and Estate Planning Team

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The outcome of the recent election has sparked a renewed interest in the opportunity to make tax-free gifts before year-end. Under gift tax rules that are scheduled to expire at the end of this year, individuals can currently make tax-free gifts of up to $5,120,000 (married couples can gift twice that amount). Unless new legislation is enacted in the remaining weeks of 2012, the exemption amount will plunge to $1,000,000 for 2013 and beyond. Taking advantage of this unique gifting opportunity before the end of the year could save donors a tremendous amount in future estate taxes.

Three Possible Scenarios

Most observers believe one of the following three scenarios is likely to occur next year.

- **$1,000,000 exemption.** If continued gridlock prevents the two parties from reaching a compromise on a deficit-reduction plan, the country will go over the so-called "fiscal cliff" on January 1, 2013. Across-the-board tax increases totaling more than $500 billion would be triggered, along with automatic spending cuts for most federal programs. The gift and estate exclusion amount would decrease to $1,000,000, and the top tax rate would increase to 55%.
- **$3,500,000 exemption.** One possible compromise position would return federal estate and gift tax rules to 2009 levels. In 2009, the estate tax exemption was $3,500,000, but only $1,000,000 of the exemption could be used to make lifetime gifts. The top estate and gift tax rate was capped at 45%.

- **$5,000,000 exemption.** Despite President Obama's pledge to raise taxes on top earners, it still may be possible to extend the current estate and gift tax rules as part of a grand bargain. Under this scenario, the exemption would continue at the current level of $5,000,000 (inflation-indexed to $5,120,000 for 2012). The full exemption amount would be available to make lifetime gifts, or to make transfers at death. The tax rate on transfers above the exemption amount would remain at 35%.

Use It or Lose It

The uncertainty swirling around these tax rules has prompted some affluent families to consider making large gifts before December 31, 2012, as a strategy to save future estate taxes. Taking advantage of the existing rules to make a tax-free gift of $5,120,000 this year could save as much as $2,200,000 in future estate taxes. Future appreciation on gifted property also escapes taxation in the donor's estate.

Caution Urged

Large gifts should only be made after careful consideration. A lifetime gift is a *permanent and irrevocable* transfer of property, and donors should never give away what they cannot afford to be without. Every situation should be evaluated on a case-by-case basis before deciding whether to make large gifts in 2012.

Basic Gifting Strategies

If, after careful evaluation, you decide to make a substantial gift in 2012, there are many gifting strategies to consider.

- **Outright gifts.** You can make an outright gift of cash, securities, real or personal property, art objects and collectibles, etc. Outright gifts must be complete and unconditional. Transferring assets with the potential for appreciation may result in even greater estate tax savings. Although no gift tax will be incurred unless the cumulative value of all your gifts exceeds the current $5,120,000 exclusion amount, all gifts exceeding the $13,000 annual gift exclusion threshold must be reported on a U.S. Gift Tax Return.
- **Gifting a business interest.** There is an added advantage to making gifts of an interest in a closely-held business. Typically, the gift tax value of a business interest may be reduced by one or more valuation discounts. Consult with a tax professional and qualified business valuation expert before reporting such gifts on a U.S. Gift Tax Return.
- **Gifts in trust.** If you are making gifts to younger beneficiaries, you might consider creating a gift trust. You can restrict access to the trust property for the beneficiary's health, education, maintenance

and support. You may further exempt property from estate taxes in successive generations by allocating Generation-Skipping Tax Exemption to lifetime gifts.

- **Insurance trusts.** An effective way to leverage a transfer of wealth may be to make a gift to an Irrevocable Life Insurance Trust. If the trustee purchases life insurance on the insured donor, the insurance proceeds payable will be excluded from the donor's estate for federal estate tax purposes. Existing life insurance policies can also be gifted.
- **Loan forgiveness.** If you have previously made a loan to a child or other beneficiary, forgiveness of the loan amount may be treated as a gift.
- **Charitable Remainder Trusts.** A CRT can be structured to provide income to a non-charitable beneficiary for a specified period, followed by a gift of the remaining trust property to one or more qualified charitable organizations. The donor receives a current charitable income tax deduction equal to the actuarial value of the trust remainder.
- **More advanced gifting strategies include:** Grantor Retained Annuity Trusts, Qualified Personal Residence Trusts and Family Limited Partnerships.

If you are unsure whether this unique gifting opportunity is something you should take advantage of, or to learn more about these and other gifting strategies, contact your Baird Financial Advisor for additional information.

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