Estate Planning in 2012

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The past several months have seen a torrent of articles, newsletters and bulletins summarizing the present situation concerning estate planning. It is time to step back, simplify (to the extent possible) and clearly analyze the present and future estate planning situation.

There are basically three primary goals that are at the heart of estate planning:

1. Reduction of estate and gift taxes;

2. Deferral of the tax burden; and

3. Providing liquidity for ultimate payment of taxes.

At present, we are in an extremely volatile time concerning estate planning. The present rules are only effective for the remainder of this year. What the future (2013 and onward) rules will be is dependent on what Congress does (or fails to do) in 2012 and early 2013.

For 2012, Congress increased the estate gift and generation-skipping transfer (GST) tax exemptions to $5,120,000 and lowered the estate, gift and generation-skipping transfer tax rates to 35%. However, these increased exemptions and lower rates are scheduled to vanish at the end of 2012. Unless Congress acts, the year 2013 will see much lower tax exemptions and much higher transfer tax rates.
Accordingly, some clients may be well served by making transfers in 2012, in order to take advantage of a confluence of factors which favor the making of gifts:

1. Lower tax rates;

2. High exemptions;

3. Low interest rates; and

4. Possible low asset values.

The Current 2012 Transfer Tax System

Rates are historically low

In 2012, the estate, gift and GST tax rate is 35%.

In 2013, unless Congress acts, these rates will return to a graduated tax system, with the highest rate being 55%.

Exemptions are high

In 2012, the estate, gift and GST tax exemption is $5,120,000 (minus the amount of exemption used in prior years).

In 2013, unless Congress acts, the estate and gift tax exemption will be reduced to $1,000,000 and the GST tax exemption will be reduced to $1,360,000.

As an added complexity, it is quite likely that income tax rates will be higher and deductions curtailed in 2013. In such a case, one might want to consider accelerating income into 2012 and analyze when it would be most advantageous to utilize deductions.

State Estate Tax Considerations

An added complication in tax planning is that several states have estate tax systems with exemptions different from the federal system. For example, New Jersey only has a $675,000 estate tax exemption. New York has a $1,000,000 exemption. Florida has no estate tax. However, it is important to remember that none of these states has a gift tax. Accordingly, the making of gifts can result in state estate tax savings.

Making Gifts

It is important to note that for federal transfer tax purposes, because of the unified nature of the gift tax and estate tax, the making of lifetime gifts does not result, in and of itself, in reduced estate tax. The major benefit of making lifetime gifts is that currently, it presents opportunities to plan for asset discounts that might not otherwise be available in one’s estate and all subsequent appreciation in the value of the asset transferred is ultimately removed from the taxable estate. However, making gifts now may also present an opportunity to clean up or simplify prior planning. This can be done through such things as gifting away intra-family loans or making gifts to insurance trusts by utilizing assets that may be a source to fund future premium payments.

Gifting Techniques

General Rules

Gift assets that you expect will appreciate.

Gift assets to a trust, rather than outright.

1. Creditor protection.

2. Can be removed from beneficiary's estate.

3. If trust is a "grantor trust," donor can make subsequent tax free additions to trust by paying the trust's income tax liability each year.

4. Dynasty trust for long term estate tax exclusion.

Grantor Retained Annuity Trusts ("GRATs") can still be used to great advantage.

GRATs provide for the future passage of assets to beneficiaries at a current discount in value, sometimes to near zero, for gift tax purposes. However, their use may be restricted by Congress in the near future.

Family Limited Partnerships can still be used.

They are especially attractive because of availability of valuation discounts. Again, Congress may restrict their use in the near future.

Conclusion

Clients should carefully review their planning and decide whether to make substantial gifts in 2012, as this year may be the last year to take advantage of current low rates, high exemptions and available gifting techniques.

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