

TAX E-NEWS - GIFTING AS A TAX STRATEGY

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WHY YOU SHOULD TALK TO YOUR CLIENTS ABOUT GIVING IT AWAY

As you know, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Tax Relief Act") was signed into law on December 17, 2010. In addition to extending certain income tax cuts, the federal gift tax and federal estate tax exemptions were once again unified with a \$5 million exemption amount and a maximum rate of 35% through December 31, 2012. This change to the tax law provides some unique gifting opportunities for your clients.

Where the gift tax provisions of the Tax Relief Act are quite generous, the concern is that they are also short lived. In fact, if no further changes to the law occur, then the gift tax exemption amount will return to \$1 million with a maximum tax rate of 55%. Clients are likely to have a discussion about gifting as part of their overall estate plan with their estate planning attorneys, however, many clients may not meet with their estate planning attorneys for several years and these clients may miss the chance to take advantage of current laws and make significant gifts. In addition, some clients may have already used their \$1 million gift tax exemption and may not consider making additional gifts to maximize the existing gift tax exemption in 2011 and 2012.

Clients tend to meet with their tax advisors at least once a year, however, therefore, you have an excellent opportunity to raise gifting as a strategy for your clients to consider as part of your annual tax planning conversation. To facilitate that discussion, below are some general concepts to consider when you meet with your clients.

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Any discussion concerning lifetime gifting should identify the types of assets the client has that may be available to gift. You, the tax advisor, have an ideal view of the client's current overall financial picture, including cost basis information, and can identify what assets may be appropriate to give away during the client's lifetime. For example, assets that have potential for appreciation are traditionally some of the best assets to consider as part of a lifetime gifting plan. By gifting the asset during their lifetime, the client has effectively removed the future appreciation of the asset from his or her gross estate at death and result in significant savings.

Assets that generate income may also be appropriate to transfer as gifts. A client can transfer income tax liability incurred on an asset to the gift recipient, who may be in a lower income tax bracket. By transferring an income generating asset to a grantor trust, the client can remove the asset from his or her estate, but still be responsible for the income tax incurred on the asset, thereby further decreasing his or her estate by the amount of income taxes due.

The Tax Relief Act also extended the IRA charitable rollover rules through the end of 2011. Any client who is over the age of 70½ and has excess assets in his or her IRA may transfer up to \$100,000 to a public charity without treating the transfer as a taxable withdrawal from the IRA. The transfer can be counted toward the required minimum distribution, but not included in the client's taxable income.

Any lifetime gifting discussion should take the recipient of the gift into consideration. Gifts can be made directly to individuals. In some cases, however, a gift to a trust for the benefit of an individual or group of individuals is more appropriate. Recipients may be too young or may not be responsible enough to manage large financial gifts. A properly structured trust can protect such beneficiaries and ensure that the gifts are used in a manner that the client intends. In addition, the generation skipping transfer tax exemption is \$5 million for the next two years, making gifts to trust for the benefit of grandchildren and future generations extremely attractive for clients who have substantial wealth and a desire to provide for future generations.

As mentioned above, gifts to a grantor trust remain possible under the Tax Relief Act. For income tax purposes, a grantor trust is treated as owned by the grantor in whole or in part. The trust asset appreciates tax-free. The grantor pays any income taxes due on the assets held in the grantor trust, which further reduces the client's overall estate over time.

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A client with a largely illiquid estate may also benefit from making lifetime gifts. By transferring illiquid assets during his or her lifetime, a client may remove assets from the estate that could present problems for the family after the client's death. Illiquid estates that are required to pay administrative estate expenses, liabilities of the decedent and income and estate taxes may be forced to sell assets in hostile conditions or under unfavorable terms. Such a transfer would not only remove these assets from the estate, but would also reduce the value of the client's overall estate to minimize or eliminate total federal estate taxes due.

Lifetime gifting is also an effective way to transfer control of a business. Many business owners utilize the annual exclusion amount to transfer portions of their business interests to successor owners each year. By making such transfers, the existing owner retains control over the business while slowly transferring value and control to the successors. Over the next two years, a business owner may transfer larger portions of their business at once, if desired.

In addition, valuation discounts remain in effect under the current tax law. Therefore, an individual may leverage his or her exemption and gift an even greater amount of value from his or her estate. This may be particularly attractive to clients who own closely held businesses, limited partnerships or other assets that qualify for discounts in marketability or control. A client could use the \$5 million exemption to transfer an asset with a market value that exceeds the exemption amount, if the asset qualifies for discount. Any discount valuation must be properly prepared by a qualified professional and must be defensible before the IRS.

Of course, prior to engaging in any lifetime gifting plan, your client should be advised of the disadvantages of making gifts. Your client must be prepared to give up control of the asset to be transferred. Your client should also meet with his or her financial advisor to review and carefully consider the impact of such gifts on the client's financial plan. Depending upon the assets transferred, a client may be giving up liquidity and should ensure that any change in their estate will still allow them to live comfortably. The client and his or her financial advisor should also consider whether such gifts can be made without impacting the client's future financial goals.

There has been some discussion and commentary about whether tax-exempt gifts made in 2011 and 2012 will be subject to additional estate tax (the "claw back") for those who die after 2012 if the federal estate tax exemption amount is less than \$5 million. This

could potentially result in having an exemption for lifetime gifts that is higher than the exemption for estate tax purposes, potentially causing previously exempt gifts to be subject to additional estate tax after 2013. The general consensus among practitioners appears to be that Congress did not intend to subject such gifts to additional estate tax under the Taxpayer Relief Act, however, a legislative or technical correction may be necessary to clarify this. In the event that a client does choose to make a gift of \$5 million in 2011 or 2012, such a gift will be included in the client's estate at death and subject to the then applicable estate tax rate and exemptions, but the client should not be subject to any additional tax had they not made such a gift. The client will still have removed the appreciation on the asset from his or her estate.

Any gifting strategy should be consistent with your client's existing financial and estate plans. Additionally, if your client does not have a financial and estate plan, or if your client states that he or she has not recently reviewed his or her financial and estate plans, then you, as the tax advisor, have the opportunity to enhance your relationship with your client at the annual tax planning meeting by reminding your clients that their tax planning, financial planning and estate planning can and should work together, but this can only occur if the plans are cohesive and the advisors are in communication with each other.

The client's financial plan will ensure that the client has sufficient assets under his or her control to continue to maintain his or her lifestyle and meet his or her financial goals both during your client's lifetime but possibly for future generations. The client's estate plan not only sets forth the client's wishes as to the disposition of his or her property at death while minimizing any estate taxes, but also ensures that the appropriate individuals are named to handle any financial or medical affairs in the event of incapacity. An estate plan is also an excellent tool to protect beneficiaries from themselves or others. In some cases, beneficiaries are too young to be able to inherit a significant amount of wealth and may end up squandering the family's wealth quickly. Other beneficiaries have a history of behavior that could be further enabled upon receipt of a significant sum of funds, particularly if the parent is no longer alive to provide guidance. Further, some beneficiaries have unique needs that can be addressed in a properly drafted estate plan.

Each client's situation is unique and any strategy should be carefully reviewed and analyzed with the client and his or her professional advisors. By taking advantage of the unique tax

environment that will be in place at least through the end of 2012, you are able to begin this conversation with your clients during your tax planning meetings beginning at the end of 2011. If your client is interested in engaging in any lifetime gifting, then he or she should consider meeting with you, the tax advisor, as well as his or her financial and legal advisors to begin establishing such a plan.

The members of Devine Millimet's Trusts & Estates Group provide estate planning, trust and probate administration and estate, gift and fiduciary tax services to clients of all wealth levels, of all ages, and from all types of businesses, professions and occupations. We strive to find creative solutions to complex issues in a manner which meets family objectives while minimizing estate taxes and probate and other administrative expenses. We work with the family advisors, including CPAs, insurance professionals, financial advisors and corporate counsel, to insure an integrated approach to the family plan.

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