

THE BIG ESTATE PLANNING QUESTION OF 2012

Should you exploit the \$5.12 million lifetime gift exemption?

Presented by Ellen Dorle, CFP

An unprecedented gift. In late 2010, Congress gave wealthy taxpayers a remarkable short-term opportunity to shift assets out of their estates tax-free during their lifetimes. This opportunity is available through the end of 2012 - and it could vanish after that.¹

Two important things happened at the end of 2010:

- Congress reunified the estate tax, gift tax and generation-skipping tax (GST), giving each top rates of 35% with **\$5 million lifetime individual exemptions**. (In 2012, these exemptions are actually set at \$5.12 million, as they are indexed for inflation.)
- In addition, **the estate and gift tax exemptions became portable** between married couples. So currently, an executor of an estate can elect to transfer any unused portion of a deceased spouse's \$5 million individual exemption to a surviving spouse.^{1,2,7}

With these changes, a whole new horizon emerged in terms of estate planning - one that may sunset in 2013.

The big news: the \$5 million lifetime gift tax exemption. For married couples, the lifetime gift tax exemption is actually \$10.24 million at the moment thanks to the portability factor. Back in 2010, the lifetime gift tax exemption was at \$1 million and it wasn't portable.^{3,4,7}

If you used up the prior \$1 million lifetime gift tax exemption before 2011, you now have the opportunity to gift up to \$4.12 million more before 2013 given the new \$5.12 million limit.^{2,7}

So considering all this, the big question is: should you gift as much as you can to your children before 2013 with the intent of reducing inheritance taxes down the road?

After all, lifetime gifts reduce your taxable estate. Additionally, if you give your children appreciated securities, the long-term capital gains of those securities will be taxed at their capital gains rates rather than yours. If your children's income puts them in the 10% or 15% tax bracket, their capital gains tax rate is 0% through 2012.^{1,4,5}

Portability means great flexibility - provided you play by the rules. Let's illustrate how this works. Dad doesn't gift up to \$5.12 million during his lifetime - he only ends up gifting \$3 million. Well, Mom can subsequently gift up to \$7.24 million after he passes thanks to the portability rules, as there would still be \$7.24 million to go toward the present \$10.24 million lifetime gift tax exemption for a married couple.

There is an important rule you must follow to realize this portability: when the first spouse passes away, the executor of his or her estate must file an estate tax return even if no estate tax is owed. That estate tax return formally notifies the IRS that you are transferring the unused or partially used gift tax exemption.^{4,6}

Incidentally, this estate tax return is due nine months after the death of said spouse, with a six-month extension permissible.⁶

Is there still a need for bypass trusts? We can't say goodbye to them, because 15 states still levy their own estate taxes with exemptions commonly at \$1 million or under. Moreover, what if portable exemptions aren't retained in the future?⁶

The potential for savings could be great. When you look at this remarkably generous lifetime gift tax exemption allowance in light of certain estate planning techniques that might leverage it - such as the grantor-retained annuity trust and the family limited partnership - the potential is intriguing. Parents can potentially forgive millions of dollars of low-interest, intra-family loans and possibly arbitrage state tax rates if their children live in different states.

The problem: we don't yet know what 2013 will bring. Congress could elect to retain the increased lifetime individual exemption (and portability) for 2013 and beyond, but the massive federal deficit would seem to render this a longshot.

If Congress lets the 2010 law governing gift and estate taxes sunset, it will be 2001 all over again - the individual lifetime gift tax exemption will reset from \$5.12 million to \$1 million (with no portability) and estate taxes will top out at 55% instead of 35%.⁷

Once more, estate and tax planning professionals must again weigh the degrees of opportunity and ambiguity presented by our shifting estate tax laws.

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Citations.

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