Estate Planning Review - The Journal, 2012 Gift Planning Isn't Only for the Super Wealthy, (Aug. 21, 2012)

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Many, perhaps most, clients whose net worth falls below the $5 to $10 million level are ignoring the exhortations of their professional advisers to address gift planning in 2012 and take advantage of what may be a fleeting $5.12 million lifetime gift tax exclusion. These clients feel that they are not in the wealth strata where planning is relevant. However, that could be a costly and erroneous misconception. There are many individuals with estates well below the $5 to $10 million range who should give serious consideration to gift planning before year end. The following is a listing of relevant clients, planning ideas, and tips that could prove quite valuable to taxpayers who are wealthy, but not "super-wealthy."

Equalization of Prior Gifts

Using the 2012 inflation-adjusted gift tax exclusion to equalize prior gifts among children, grandchildren or more remote descendants should be considered. For most of the history of the estate tax, especially when the exclusion was a mere $600,000, the most common estate planning tool was the tax-free annual gift, originally $10,000 per done (adjusted for inflation to $13,000 currently). It was common for parents and others to simply make annual gifts in cash, or perhaps interests in a closely held family business, to each child and grandchild, and in some cases even to spouses of descendants, in order to maximize these tax-free annual gifts and thereby reduce the donor's taxable estate. This type of gift planning has continued for some clients because it is appreciated by the heirs. It's simple, and requires no legal involvement, so long as the gifts are made simply by writing checks. However, a common issue with annual gift planning is the disparity in gifts between family lines. For instance, if one child never married and never had children, while another child married and had five children, each of whom also married and had equal or larger families, the disparity of gift transfers over a few years by family line could easily run to the many hundreds of thousands of dollars or more. Moreover, annual gifts made over many years to older grandchildren tend to accumulate to much larger sums than those made to those more recently born (i.e., the younger grandchildren).

Clients often wish to correct this type of disparity in gifting among their grandchildren. These clients, even if below the $5 million plus radar screen, should consider consummating "equalizing" gifts in 2012. If, in 2013, the gift tax exclusion declines to only $1 million this type of equalization may become impossible without a tax cost. Thus, meeting the personal objective of many clients in equalizing wealth transfers by a child's family line or among individual grandchildren should be addressed now. In the event equalizing gifts are made, practitioners should be certain that any "make up" provision in the donor's will (i.e., gift equalization provision) is updated to reflect the new reality.

Same Sex and Other Non-Married Partners

For many non-married couples (e.g., domestic partners), the lack of any gift tax marital deduction has often impeded desired personal planning. Something as simple as putting a long-time partner's name on the deed to a primary residence or vacation home for personal reasons could not be accomplished because of the potentially confiscatory gift tax. Now, equalizing ownership of certain assets that carry a significant emotional value, or equalizing the estates of non-married partners who do not otherwise qualify for the gift tax marital deduction might be quite simple with a $5.12 million gift tax exclusion. A decline in the gift tax exclusion to $1 million, even if the estate tax exclusion remains much higher, would certainly put a damper on these types of transfers.

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Non-Citizen Spouses

The same kind of thinking would apply for married couples with a spouse who is not a U.S. citizen because there is no gift tax marital deduction available and annual tax-free gifts to a non-citizen spouse are limited to $100,000 (adjusted for inflation to $139,000 for gifts in 2012). The lack of an unlimited gift tax marital deduction has often impeded desired personal planning. Similar to the situation for same-sex or unmarried couples, equalizing ownership of certain assets that carry a significant emotional value or equalizing the estates of a client with a non-citizen spouse would seem to be relatively simple with a $5.12 million exclusion. And, a decline in the gift tax exclusion to $1 million, even if the estate tax exclusion remains much higher, would also present an obstacle to these types of transfers.

Audit Threshold

Many clients are very audit-averse. The fear of an IRS audit often impedes desirable planning. If a client might benefit from making a significant lifetime transfer, making that transfer when the gift tax exclusion is $5.12 million may just put the gift so far below the gift tax audit radar that "audit-phobic" clients may be far more comfortable proceeding with a gift program now rather than in later years.

Asset Protection

With all the hype in the press and from professional firms to their clients about the estate tax planning benefits of making large gifts in 2012, the benefits of establishing irrevocable asset protection trusts (e.g., spousal lifetime access trusts or "SLATs" for a spouse or completed gift domestic asset protection trusts or "DAPTs") as asset protection vehicles have often been overlooked by clients who do not view themselves as likely to face a federal estate tax. Nevertheless, funding these types of trusts while the gift tax exclusion is so large makes these types of wealth transfers incomparably simpler and less costly than if the client were to make the same transfer in a future year if the gift tax exclusion were to decline to a mere $1 million. In that scenario, the client who might otherwise be able to make a simple wire transfer of a brokerage account of perhaps $2 million in 2012 would have to form a family limited partnership or family limited liability company, contribute appropriate assets to the entity, wait some meaningful period of time, have a discount entity appraisal completed, and then engage in a seed gift of other assets, such as marketable securities without a discount, and then complete an intra-family sale of interests in the entity. Further, even that type of planning may become impossible if valuation discounts for intra-family transfers and grantor trust status are repealed.

Insurance Plans

Clients can use the current high gift tax exclusion to shore-up problematic Trust Owned Life Insurance, or "TOLI," policies. For example, if a life insurance policy remains viable, but the underlying economics of the policy have changed as a result of market or interest rate performance, a large cash gift to the trust might suffice to correct the performance issue. Making this transfer as a simple gift check while the exclusion is high, might be far simpler than the machinations that might otherwise be required if a substantially lower gift tax exclusion becomes law in future years. Another possible insurance related transaction for clients who are not necessarily ultra-high net worth is to use the current high gift tax exclusion to facilitate an exit strategy from an existing split-dollar insurance arrangement that is no longer desired, needed, or optimal. This might be accomplished by simply making a large cash gift to a life insurance trust and having the trust use the funds to pay back the client, other family member, or trust that has advanced funds under the split-dollar arrangement.

Family Loans

Many parents and other benefactors have loaned money to their children or other heirs, perhaps to allow the heir to purchase a home or provide other financial assistance during the recent recession. With the current high gift tax exclusion, a simple cash gift (or forgiveness of indebtedness) would enable the borrower to repay the lending parent or other benefactor and, thus, eliminate the children's indebtedness to parents or others.

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Succession Planning

Family business owners often complain about the confiscatory impact of the federal estate tax on their business succession plans. With an exclusion that is five times greater than what it used to be, these business owners should be maximizing the use of the gift tax exclusion to transfer family business interests to children (or to trusts for their benefit) to facilitate an appropriate business succession plan. For many, the ability to transfer a family business using the current gift tax exclusion may obviate the need for costly life insurance coverage.

Grandfathered Tax Benefits

Securing the tax advantages of grantor trust status and perpetual allocation of the generation-skipping transfer (GST) tax exemption in 2012 before the possible enactment of President Obama's Green Book proposals that would subject grantor trust assets to federal transfer taxes by requiring them to be included in the grantor's gross estate, and limiting the period for which GST exemption can be allocated may be recommended (see *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals*, February, 2012, at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf). One may take advantage of these current benefits by establishing a grantor dynasty trust now, funding it in 2012, and allocating GST exemption. Another approach would be to have a parent (or other benefactor) establish an irrevocable trust, make a $5,000 gift to the trust which incorporates a so-called "*Crummey*" withdrawal power, and then have the intended taxpayer (typically a child) become the grantor of that trust for income tax purposes. This technique is generally referred to as a Beneficiary Defective Irrevocable Trust, or "BDIT." If the BDIT is not used presently by the child through a note sale transaction, the BDIT can still be established in 2012 in order to obtain favorable "grandfathered" status as to the trust's grantor trust status for income tax purposes and other GST benefits. This type of BDIT can be descriptively referred to as a "standby BDIT."

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