Exemptions create great era for gifting

BY MATT SORRELL

Individuals and couples with high net worths have a unique opportunity to pass on more of their wealth than ever before, but the window to take advantage of it is short. “Several years ago, Congress implemented a plan where they would increase the estate tax exemption at death, and keep the gifting exemption flat, with the goal of having it go entirely away for one year,” said Jennifer Davis, attorney and officer at Greensfelder, Hemker and Gale PC. “Last December, Congress and the president reached an agreement, because (the exemptions) were set to come back at an all-time low level of $1 million for both estate and gift, and raised the level to an all-time high of $5 million per person.”

Davis said that in recent years, while the estate exemption had been on the rise, the gifting exemption remained flat at $1 million to discourage lifetime gifts. She said the current deal also took the tax rate to an all-time low of 35 percent and reunified the exemptions, so that the estate tax and gifting exemptions are both at the same $5 million level.

“For the first time in years, there’s now an opportunity to make large gifts tax-free,” Davis said. “But it’s only in effect until Dec. 31 of next year.”

At that time, the gifting exemption rolls back to $1 million. Though there is a possibility the exemption could be renewed at a level above the $1 million mark, with the upcoming presidential election, and all of the political turmoil that will inevitably follow it, Davis said there is much skepticism about whether this will happen.

“This might be a one-time shot,” said Barbara Archer, president of Archer Wealth Management. “We have 14 months to be able to shelter that $5 million. If we go back on Jan. 1, 2013, to $1 million, it’s lost opportunity.”

It’s also an opportunity that apparently some in the industry are unaware of. Jeff Kane, partner in charge of the tax division at the St. Louis office of the accounting firm of Grant Thornton, said that he’s found in talking with other advisers that many don’t know about the increased exemption.

“More people need to know that it’s out there, and there’s a short time horizon,” he said. “It’s going away. It’s not going to stay this way. Who knows what it’ll look like.”

Davis said that the exemption levels, coupled with the current low interest rates and low asset values, make this the perfect time to pursue gifting. Under the rules, assets to be gifted are valued at the purchase cost. If the asset is left in the estate, it’s taxed at the value at date-of-death. Davis said the key to gifting is to gift assets that currently are valued at a low dollar amount but have the best potential to appreciate significantly over time. She said vacation homes are a great example, because home values are currently depreciated, the property isn’t in regular use, and giving up control of the asset isn’t a problem.

“It’s OK to not have control of the vacation home, but giving up control of the family company might be a little more painful,” she said, though she added that a popular option is for closely-held businesses to gift non-voting stock.

“Obviously you look at a business much differently than you do a vacation home,” Kane said. “But we’ve used the exemption at least twice this year in doing succession planning for the ownership of a company.”

While it seems that taking advantage of the increased gifting exemption is a no-brainer, there are potential risks that need to be considered. Davis said that once the exemption is reduced in 2013, there is a risk that there could be a resulting gap between gifts made under the $5 million exemption and whatever the estate tax exemption is on the date of death.

“We have no guidance from Congress on how they’re going to handle that gap. It’s an unknown, so it’s important to work with your adviser so that you understand the risk,” she said.

For those who don’t want to give up as much control of their assets, or who want to leverage their gift, Davis said there are other options. In this time of record low interest rates, Davis said it’s becoming popular to place assets in a grantor-retained annuity trust, where a percentage of the asset’s value is paid out annually.

“The theory is you retain the right to receive annuity payments for a short period of time. During that time the asset produces more income and appreciation than what you received back,” she said. The excess appreciation passes to the beneficiaries estate-tax-free.

“One of the additional advantages of having the grantor pay the taxes on the trust is that on the outside, they’re continuing to decrease their estate tax. They’re absorbing that tax themselves. They’re reducing their own estate while the trust grows.”

BRIAN CASSIDY

Jen Davis said ‘for the first time in years,’ there’s now an opportunity to make gifts of up to $5 million tax-free.