

A Golden Age of Gift Giving

By Kelly Greene – May 25, 2012

With the government's \$5.12 million gift-tax exemption set to fall to \$1 million at year-end, more families are using the current leeway to do some financial housekeeping, experts say.



Phil Foster

“Cleanup gifts,” as estate planners call them, can be used to forgive intrafamily loans, equalize gifts to children or grandchildren, pass along an interest in a family business or preload a life-insurance trust, among other strategies.

“This is our opportunity to clean up errors and mistakes and make sure things are smooth sailing going forward,” says James Lamm, an estate-planning lawyer at Gray Plant Mooty in Minneapolis.

At the beginning of last year, the gift-tax exemption climbed from \$1 million for single filers and \$2 million for married couples to \$5 million and \$10 million, respectively, while the top rate fell to 35% from 45%.

Indexed for inflation, the limits this year are \$5.12 million and \$10.24 million. (Congress changed the limits for estate taxes, too, raising

that exemption to the same amount and lowering the maximum rate to 35%, also for two years.)

But the gift-tax exemption is set to go back to \$1 million and the top rate to 55% on Jan. 1 unless Congress intervenes. Estate planners don't expect lawmakers to address the issue until after the November election, and at that point some experts consider it likely that even if the estate-tax exemption gets pegged at \$3.5 million, the gift-tax exemption could be allowed to fall back to \$1 million.

The upshot: If you are planning to make gifts to your family for any reason, it is likely that you have more leeway now than later. And by passing along assets now, you also might avoid future estate taxes, Mr. Lamm says.

But before families start writing checks, the most important thing to consider is whether or not they should make gifts in the first place.

“Everybody is trying to save taxes to the extent that they can, but at the end of the day they want to make sure there is money in their bank account for themselves,” says Hilary Pierce, a partner and head of the estate-planning group at Sideman & Bancroft in San Francisco.

If you still feel comfortable with the idea of making gifts after subjecting yourself to that gut check, here are some ways to tidy up your planning:

Forgive and forget. Well-off families who used up the former exemption of \$1 million would sometimes turn to low-interest family loans to continue transferring assets to children and grandchildren.

Forgiving such a loan now makes it possible to take advantage of the current exemption without shelling out cash.

It is important to “follow all the formalities” when wiping loans off your balance sheets, Mr. Lamm says. “Otherwise, the IRS might say that it wasn’t a loan, that it was a gift back when you made it,” which could subject you to a lower gift-tax limit from when you made the loan.

To avoid that problem, some attorneys recommend two independent steps: First, give your child money. Later, he or she can use it to pay back the loan. That way, you give validity to the original loan and avoid the possibility of creating what’s called “cancellation of indebtedness income,” on which your kids could owe tax, says Todd Steinberg, an estate-planning lawyer and shareholder at Greenberg Traurig in McLean, Va.

Even out the score. If your grandchildren span a wide age range, your children have different numbers of children or you have been married more than once, the cumulative value of gifts you have made to various family members to help pay for education, weddings, homes or other items might vary widely, says Jay Rivlin, a partner at McDermott Will & Emery in New York.

Mr. Lamm has seen many clients give each grandchild \$13,000 a year, the maximum amount that can be given before counting toward the lifetime gift-tax exemption. But since grandchildren are born at different times, “I have seen some cases with a \$300,000 to \$400,000 spread between the youngest and oldest grandchildren,” he says.

To fix those problems, clients often include language in a will or trust to “equalize” gifts to grandchildren. Right now, though, families can address those issues in hopes of avoiding conflicts later, Mr. Lamm says.

Give away the store. With the current gift-tax exemption and valuation discounts for minority stakes in a business, you could move at least part of a family enterprise out of your estate, Mr. Lamm says. Treasury officials have proposed doing away with such valuation discounts, “so why not lock it in this year?” he asks.

Set up a backstop. It is a longtime, plain-vanilla estate-planning tool: an irrevocable trust with your children, grandchildren and spouse as beneficiaries.

Now, with a sexy new acronym, so-called spousal limited-access trusts, or SLATs, are getting a lot of attention from people “who are worried about taxes but also about giving too much away,” says Robert Morrill, managing partner at Gilmore, Rees & Carlson, a Wellesley, Mass., law firm that specializes in trusts and estates.

Such trusts can get assets out of a husband’s or wife’s estate while taking advantage of the full gift-tax exemption.

Mr. Morrill encourages clients to assume the surviving spouse isn’t going to reclaim any assets from the trust, though there is an escape hatch: The trustee could make distributions for the surviving spouse “if fortunes change after the trust is funded,” he says.