HINSHAW & CULBERTSON LLP

Estate Planning ALERT

Maximizing Your Gift Tax Benefits Before the Window of Opportunity Closes

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Many of our clients have been asking us for information regarding the impact President Obama's re-election will have on their estate tax planning options. There are steps you can take now to maximize your tax savings.

Gift Tax – The Window of Opportunity

A significant opportunity to capture tax savings currently exists, as the present $5.12 million federal gifting and estate tax exemptions will drop to $1 million on January 1, 2013. Additionally, the federal estate tax rate, which is now only 35 percent, is set to increase to 55 percent on January 1, 2013. These factors combine to create an opportunity that may never exist again in our lifetime.

Furthermore, if President Obama's suggested February 2012 budget takes effect, several restrictive measures will limit estate planning as we currently know it.

Will Congress Take Action?

Hopefully, there will be a political compromise between now and year-end. However, many experts who have significant political/legal observation histories feel that this will probably not be sorted out until 2013, with the compromise to be retroactive to January 1, 2013.

The Republican House of Representatives may be able to resist having some of the new restrictive estate tax provisions enacted. However, since many wealthy individuals have used some or all of their federal $5.12 million gifting exemption in 2011 and 2012, or are finalizing their plans to do so by December 31, 2012, we may not see significant resistance to allowing the gift tax exemption to fall to $1 million. This makes it even more imperative to review options and act in the next seven (7) weeks for gifting strategies of $1 million or more in 2012.

What Can You Do in 2012?

- *Make a gift in excess of $1 million*. Clients who have the financial means should consider making gifts exceeding $1 million in value to take advantage of all or part of the $5.12 million tax-free temporary gifting allowance.

- *List a spouse as a beneficiary of the trust*. If donors are hesitant to gift significant amounts because they fear the depletion of their assets, consider listing a spouse as a beneficiary. Structuring a trust in this way enables the donor to derive indirect benefit by being supported by the spouse while the spouse is being supported by the trust, for as long as the spouse is alive.

- *Create and fund a trust in an asset protection jurisdiction*. This is another strategy to combat the fear of running out of assets. The IRS has ruled in at least one case that the contributor can be a discretionary beneficiary and actually receive the benefit of trust assets if and when needed.

- *Create and fund an irrevocable trust to hold assets that would not be subject to federal estate tax, but would be considered as owned by the grantor for income tax purposes*. Several very important estate and gift tax provisions allowing this trust technique would be eliminated if President Obama's February 2012 budget suggestions are adopted.

  - Currently the grantor can pay the tax on dividends, interest and other income earned by a certain type of trust, so that the trust can grow faster and increase the assets that would pass free of estate tax. Under President Obama's proposal, this type of trust would be subject to estate tax upon the death of the grantor. However, trusts of this type existing before the end of this year will probably be grandfathered. The effect of being able to pay the income tax on behalf of this type of trust and be able to sell assets or discounted family interests to this type of trust in exchange for a low interest note has an incredible mathematical value.

  - Currently a certain type of trust can be used to avoid estate tax not only at the grantor's level, but also at the level of generations of descendants going for as long as 360 years if the trust is formed in Florida. President Obama's proposal would limit this "generation skipping dynasty" trust effect to 90 years.

  - President Obama's 2012 budget proposal would also eliminate discounts when valuing non-voting or minority interests in family or closely-held entities. Because of this, taxpayers with interests in family or closely-held companies are ensuring that their gifts of these interests are made before year-end so that non-voting or minority interests in family or closely-held entities can be valued using discounts. Likewise sales of family or closely-held company interests to trusts for family members should be implemented prior to year end.

- *Consider grantor retained annuity trusts*. The Obama budget proposals would largely curtail grantor retained annuity trust planning by requiring a minimum 10 year term and a positive remainder interest.

- *For taxpayers in the $2 million to $4 million net worth range, carry out normal year end gifting tactics*. Because the continuation of the $5.12 million exemption now seems highly unlikely, it may be a good idea to complete normal 2012 year end gifting to make maximum use of the $13,000 per person annual exclusion.

Please discuss the possibility of implementing one or more of these strategies with a member of Hinshaw's Estate Planning Practice Group. These are substantial opportunities that should be seized upon. We look forward to assisting you in determining the best options for capturing these potential tax savings.

Contact for more information: Marcia L. Mueller or Stephen A. Frost.
