KELLY, OLSON, MICHOD, DEHAAN & RICHTER, LLC

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Federal Tax Update

INSIDE THIS ISSUE:

To Gift, or Not To Gift – That is the Question

For a limited time, each of us can give away up to $5.12M without incurring any gift or other transfer tax – perhaps even more by using valuation discounts. The current gift, estate and generation skipping transfer tax exemptions of $5.12M will expire on December 31, 2012.

Unless Congress acts, on January 1, 2013, these $5.12M exemptions will drop to $1M. Moreover, the transfer tax rates on amounts in excess of $1M will increase. Consequently, you will be able to transfer less tax-free, and you will pay more tax on taxable transfers, beginning January 1, 2013.

While most people think Congress will eventually make changes, no one knows what those changes will be, nor when they might be implemented. (Congress waited until December 17, 2010 to enact a retroactive estate tax for 2010.) Hence, if you ever thought about or are interested in making substantial gifts to your children, grandchildren or anyone else – and want to avoid transfer taxes – or if you are interested in saving estate and generation skipping transfer taxes in the future, then NOW is perhaps the best time to act.

Appraisals and transfers can take more time than you would expect. You have only a few months left to take advantage of the largest transfer tax exemptions and lowest transfer tax rates ever. Call us now to discuss how your desires can best be implemented under the current law before it changes, and to implement a plan of action before year-end.

REASONS TO GIFT

There are many reasons for making substantial gifts before year-end.

- You can benefit loved ones while you are alive.
- The lifetime gift tax exemption is at an historic high. Never since the gift tax was imposed has a married couple been able to transfer up to $10.24M gift tax free.
- The gift tax rate is at an historic low, as are the interest rates which are used to calculate split interest gifts and sale techniques.
- Transfer tax savings devices like Grantor Retained Annuity Trusts, Family Limited Liability Companies, and sales to Grantor Trusts are still viable, but are being scrutinized by the IRS.
- None of the appreciation realized on the gifted assets after the gift will be included in your estate. With values still fairly depressed, the future up-side could be significant.
- A current gift freezes the value of the gifted assets for estate and

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generation skipping transfer tax purposes.

- Because the gift tax is computed on a tax-exclusive basis, the current effective gift tax rate is only 26%.
- There is no Illinois gift tax, and only a limited Illinois estate tax exemption (currently $3.5M). So, if you are an Illinois resident, by gifting assets during life, you can reduce the amount of state estate tax your estate will pay.

Annual exclusion gifts are still a good idea, especially if you are not in a position to make large gifts to children or grandchildren. The annual exclusion amount for 2012 is $13,000, per recipient.

REASONS NOT TO GIFT

While there are many reasons to make gifts, there are potential downsides.

- While gifting substantial assets now may make "tax-sense," you never want to risk your own financial security. That would not make "common sense."
- The recipient of the gift will take your income tax basis in the asset. That means the recipient may end up paying capital gains tax if the recipient sells the gifted asset, although capital gains tax rates have, in the past, always been lower than transfer tax rates. Conversely, your assets receive a step-up in basis when you die, minimizing the capital gains taxes on sales of inherited assets, but perhaps increasing your transfer taxes.
- There is the risk that the asset will decline in value after you make the gift, thereby essentially wasting a portion of your gift tax exemption.
- There is a risk that if you make gifts of $5.12M now, and the estate tax exemption is reduced to $1M when you die, the $4.12M difference might be subject to estate tax. This is what is known as the "clawback." The risk of clawback is small, and there are ways to address it.

Tuition and health care gifts are still gift tax free and do not reduce your lifetime gift tax exemption. However, these gifts must be made directly to the eligible institutions.

SOME GIFTING IDEAS

- If your children owe you money, you can forgive those debts. This would be a good way to make gifts without necessarily jeopardizing your financial security.
- You can pay your children's mortgages or other debts.
- You can gift all or part of your interest in your vacation home.
- You can give part of your interest in the family business. There are various techniques available to effectuate a gift of a portion or all of the family business but still leave you, the donor, in control.
- Gifts of cash, securities, or other assets can be made outright or in trusts, with the trust protecting the gifted asset from the recipient's creditors, spouses, and further transfer taxes.

BOTTOM LINE

If you are even remotely interested in taking advantage of this window of opportunity, please contact us soon.

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