‘Tis The Season

Like most Americans, your finances have probably declined in value this year. The silver lining to the bad economic scenario presents the "perfect moment" to make gifts to one’s heirs. Revenue procedure 2008-66 was recently issued by the IRS setting forth increases in certain exempt amounts that are indexed to inflation. Beginning with the calendar year 2009, the amount of the annual exclusion gift made to any person (other than gifts of future interests in property) increases from $12,000 per calendar year to $13,000 per calendar year.

Parents and grandparents who transfer assets that they believe are temporarily depressed (whether real estate, stocks or a stake in closely- held family business) have the opportunity to shift the effect of the rebound tax free to future generations.

Example: Edward wants to start a new business and approaches his father for a $70,000 loan for seed money. Father, instead of making a loan, sets up an Irrevocable Trust that is controlled by Edward for his own benefit. Father allocates a portion of his generation skipping tax exemption to the gift in the trust at that time using $70,000 of his $2 million current generation skipping tax ("GST") exemption.

Ten years later, Edward’s business (which is owned by Edward’s Irrevocable Trust) explodes in value and becomes a multi-million dollar closely- held company. While Edward is alive, his trust protects the value of his company from predators, creditors and spouses. When Edward dies, the trust holding the stock of his closely held business (now worth $10 million) passes tax free to Edward’s children. Edward avoids paying a 45% transfer tax at the time of his death saving the family $4.5 million in taxes and continuing the business for multiple generations thereafter.

Different Ways to Make Gifts

1. Medical/Education Exemption. In addition to making gifts directly to a person outright, any payments to a qualified educational institution or a medical provider is an unlimited exception to the current $12,000 annual limitation. For example, a grandparent can pay a grandchild’s tuition or medical expenses as long as the payments are made directly to the institution or the provider. This is the so-called "medical/education" exception to the gift tax.

2. Consider Making Gifts in Trust. If someone wishes to transfer a regular periodic gift of the maximum amount (currently $12,000 per year - next year $13,000) to an Irrevocable Trust for someone else, the donor can elect to treat such a gift to an Irrevocable Trust as a "Grantor Trust" for income tax purposes. Yet, the donor may elect to have the Trust qualify for a completed gift for gift tax purposes. This type of trust is known as an "Intentionally Defective Grantor Trust" ("IDGT"). By transferring amounts each year into an IDGT over a period of time and then paying the income taxes on that trust (an additional form of a gift), the principal of the IDGT can compound significantly because the IDGT itself does not pay income taxes on the trust assets. The compound growth over time can make this a significant estate planning tool for anyone you wish to benefit.

3. One Million Dollar Lifetime Gift Tax Exemption. In addition to the annual gift tax exclusions, every U.S. citizen also has the ability to transfer during his or her lifetime a gift of one million dollars tax free. This $1 million amount does subtract from the donor’s Application Exclusion Amount at the time of death. The current Applicable Exclusion Amount in 2008 for people dying in this year is $2 million. In 2009, the Applicable Exclusion Amount increases to $3.5 million. Thus, starting next year, a donor could give away up to $1 million during one’s lifetime and still have a $2.5 million Applicable Exclusion Amount available at the time of one’s death.

4. A Gift With Strings Attached. The use of gifts coupled with the structuring of an Irrevocable Trust for the benefit of a donee beneficiary is what we often refer to as a "gift with strings attached." Rather than allowing the donee beneficiary to simply dissipate the assets when they are young, a trust could be designed so that a third party could hold the assets, in trust, for the benefit of the beneficiary for a number of years. At some point, the donor may wish to give the beneficiary the right in the future to serve as trustee, or as a co-trustee, of his or her own trust. Trusts are very flexible. Trusts can be designed to accomplish whatever hopes, dreams and goals the donor has in mind for the recipient. The primary purpose of utilizing a trust is to prevent the beneficiary from having third parties wrestle control of trust assets away from the beneficiary during his or her lifetime. By utilizing a spendthrift clause, an Irrevocable Trust can bar the creditors of a beneficiary from reaching the trust assets. An Irrevocable Trust can

simply insulate a child from spousal claims in the event of a divorce. Additionally, an Irrevocable Trust can give the beneficiary a simple excuse to say "no" to their "friends" (whom we refer to as "predators") by blaming the donor for tying up the assets in a trust.

There are many other sophisticated gifting techniques to leverage the effect of one’s gifting strategies. If you are interested in exploring these opportunities, please feel to give us a call.