



The Exemption *to the* Rule

Tax exemptions set to expire in 2012 offer plenty of short-term opportunities for clients' wealth transfer needs

BY DARIN GIBSON | GREG BETZA ILLUSTRATION

The long-awaited Tax Relief Act of 2010 is providing an unprecedented opportunity through the end of 2012, for everyone—not just the ultra-wealthy—to benefit from short-term tax breaks impacting gifting and estate planning. The Tax Act, which was signed by President Obama in December 2010, provided a number of short-term opportunities, the most substantial being an increase of the gift tax, estate tax and generation-skipping (GST) tax exemptions, which have been raised to \$5 million.

Those who act now by establishing new trusts, giving substantial gifts or revisiting life insurance policies will be able to transfer considerable wealth without being significantly taxed.

Since the exemption is only valid until 2013, acting quickly and efficiently is necessary to completely take advantage of the Tax Act. It's imperative for individuals to examine new retirement planning, wealth management and transfer opportunities that have been made available.

WHAT CHANGES DID THE TAX ACT REALLY MAKE?

Before the Tax Act, the maximum federal tax rate had been reduced by Congress gradually since 2001. In 2010, the lifetime gift tax exclusion was \$1 million, and there was no estate tax or generation skipping transfer tax. When the Act passed, the tax rate was significantly lowered to 35%, and the lifetime gift tax exclusion amount was boosted up to \$5 million, providing opportunity to transfer large assets tax free. As mentioned before, the bill is only temporary, and on Dec. 31, 2012, it's expected to return to a maximum 55% tax rate with a \$1 million exclusion—unless Congress takes action.

Although this Act offers the chance to transfer wealth tax-free, it is no time to be careless when it comes to compliance. People who use this window of opportunity to make substantial transfers and plans for retirement should file appropriate tax returns and seek counsel from a knowledgeable advisor.

STRATEGIES FOR REAPING MAXIMUM BENEFITS FROM THE TAX RELIEF ACT

Time is of the essence when it comes to the Tax Relief Act. There are a number of ways individuals can take full advantage of the Act to transfer wealth, prepare for the future and offer security for their descendants. The following are seven prospects worth exploring before time runs out.

Take Time to Revisit Existing Life Insurance. All life insurance plans should be fully reviewed whenever new tax legislation is passed to prepare for future changes. With the current Act, establishing an irrevocable life insurance trust (ILIT) is an excellent way to leverage the short-lived reunification, because it solidifies how much an heir will receive and doesn't have to be revisited when Congress passes a new bill. This may be a good opportunity to gift an existing personally owned policy into an ILIT or gift enough funds to an ILIT to purchase additional insurance. If existing insurance is owned under a split dollar agreement, the higher gifting limits may facilitate the termination of that agreement.

Establish a Generation-Skipping Trust. For couples, there's no better time than now to take advantage of both spouses' \$5 million exclusion—instated with the Tax Act—to establish a generation-skipping trust fund. Specifically for high-net-worth families, the new exclusion provides an exceptional opportunity to pass funds down generations during their lifetime. To further leverage the exclusion amounts, families can fund the trust with assets that have been discounted. Some advisors think Congress may limit valuation discounts in the future.

Take Advantage of Gift Splitting. In addition to establishing generation-skipping trusts, spouses can take full advantage of the Tax Act by coupling the new exclusion with gift splitting. Gift splitting is a tax rule which allows married couples to split a total value as if each contributed half of the amount. It is most useful for couples where one spouse holds most of the assets. This strategy allows couples to increase their total gift exclusion amount by combining individual allowances; with the limited time Tax Act, a couple may gift up to \$10 million by gift splitting.

Repair Failed Estate Planning Strategies. Not every estate planning initiative pans out the way you hope. Many techniques do not perform the way they were expected. This current window of opportunity is an ideal time to re-examine past initiatives and use the \$5 million exemption to make sizeable gifts to remedy failed tactics.

Create a Family Limited Partnership. Family limited partnerships, or FLPs, are an effective way to manage family assets, while ensuring a tax-efficient transfer of wealth to others. An FLP allows the owners to gift a majority of the partnership to family members in the form of limited partnership interests. Since limited partners have no control in managing

the partnership, valuation discounts may be applied for gift tax purposes. It's important to work with a trusted consultant when it comes to FLPs, as overly aggressive structures that seek high valuation discounts catch the eye of taxation authorities. The value of FLPs has been enhanced in this new Tax Act, since assets may be easily transferred between family members transfer tax-free. The increased lifetime gift-tax exclusion also allows you to pass discounted assets such as family businesses, partnerships and real estate.

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Leverage Grantor Retained Annuity Trusts. Grantor retained annuity trusts have a specific lifetime and are one of the most transfer-tax-efficient estate planning strategies. When the GRAT is established, the individual is making a gift of the remainder interest in the trust. The GRAT pays the person establishing the GRAT an annual payment for the term of the trust. At the end of the GRAT's lifespan, the beneficiary can receive the assets, transfer tax-free. GRATs have the advantage of allowing transfers of future appreciation. The Tax Relief Act of 2010 makes GRATs one of the best techniques to shift significant wealth out of taxable estates. Because interest rates are at a low, they are highly effective in transferring assets without incurring out-of-pocket gift taxes.

Transfer Your IRA to a Roth IRA. If you won't need it for personal living expenses in the future, transferring a portion or an entire traditional IRA to a Roth IRA can be a useful estate planning technique. Since there are no minimum distributions, a Roth IRA account can grow larger than it otherwise would in a traditional IRA and your beneficiaries can withdraw from the account free of income tax. Since income taxes are expected to rise in the future, taking advantage of the capped income tax rate is an excellent wealth transfer strategy.

The techniques stated above are just a selection of new options that are more appealing than ever due to the Tax Relief Act. Although acting quickly is important, taking time to discuss all options with a knowledgeable advisor is essential to ensuring that wealth transfer and estate planning initiatives go off without a hitch. **IA**

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