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RE: Planning for the 2012 Gifting Allowance While it is Still Available

Dear Client:

I wanted to make sure you are aware of the new $5,120,000 gifting allowance opportunity and the $5,120,000 credit shelter trust allowance that will apply until at least the end of 2012, and present significant opportunities for planning in 2012.

Many individuals will be taking advantage of this increased gifting allowance by gifting assets to descendants or to trusts established for descendants, forgiving notes owed to them by trusts or other entities, cancelling split-dollar life insurance arrangements, and terminating entities or other arrangements that may have been intended for estate tax avoidance purposes.

Individuals who are positioned to make use of gifting ability under the new $5,120,000 per person allowance are well advised to do so before 2013, in case the allowance reverts back to $1,000,000 at that time. We cannot predict whether the estate tax is going to be eliminated or kept at a $5,120,000 exclusion (or even a $10,000,000 exclusion), or if it will be reduced back to a $3,500,000 million (or even a $1 million) exclusion in 2013, when this new estate tax law will expire. Also, it is conceivable that Congress could pass laws related to the estate tax that might reduce or eliminate your ability to take discounts on family limited partnerships and similar entities. *Most importantly, although the estate tax exclusion may be kept at a higher level, some commentators believe that the gift tax exclusion will be reduced. So this may be a one-time opportunity to take advantage of the current gift tax allowance.*

The following are some planning ideas for the gifting allowance for 2012:

1. ***Outright Transfers to Individuals.*** You can make outright transfers to individuals to use some or all of your gift tax exclusions. This is the easiest. However, the problems with outright transfers are that the money becomes accessible to the recipient's creditors; it can be spent imprudently; the funds could become part of marital or divorce proceedings; the disability or death of the recipient could cause problems; and the amount will be included in the recipient's estate. This is why we prefer to wrap the gifts in trusts as discussed below.

2. ***Loan Forgiveness.*** This is an excellent opportunity to forgive any notes owed to you by children (or others), as a gift. This will eliminate the need for them to make payments in the future, and the forgiveness of the loan would be a gift to them which would come off your exclusion so that no gift tax would be due.

3. ***Employ a Spousal Lifetime Access Trust ("SLAT") or Dynasty Trust.*** This is a good technique for using one spouse's exclusion. The income and principal from the assets of this trust would go to your spouse, and so would be indirectly available to you. Your spouse could be trustee of this trust and receive income and principal for his or her health and support. Upon the death of your spouse, the remaining funds would pass to other beneficiaries or charities. If your spouse were not a beneficiary, the trust would be a dynasty trust for the education and support of your descendants. This trust would be set up as a "grantor trust" so that you would pay the income taxes, which would amount to additional gifts to your beneficiaries tax free.

4. ***Set Up an Asset Protection Trust ("APT").*** This is a good time to consider setting up *an Asset Protection Trust*. In light of the $5,120,000 gifting allowance, the trust can provide an arrangement whereby the trust assets would be considered as gifted, and would not be subject to federal estate tax upon your death. Nevertheless, the trust assets may be used for your spouse, or possibly even for both of you without being subject to federal estate tax on the death of the survivor of the two of you. This type of arrangement may also offer more creditor protection than you currently have in place. Such trusts would be set up in a jurisdiction with creditor protection trust statutes such as Alaska, Delaware, Wyoming, Nevada, South Dakota, or offshore, like Belize or Cook Islands.

5. ***Use a Qualified Personal Residence Trust ("QPRT").*** A QPRT could save a significant amount of federal estate taxes in the future. Your home, and possibly your vacation home, may be placed in special trusts that can remove the homes from the federal estate tax system on death, based upon a small gift amount that takes into account the present value of the home and a significant discount by reason of your retaining the right to live in the home rent-free for a selected term of years (e.g., 10 years). This can help assure that the property can be kept in the family for many years to come. A disadvantage is that if you die during the QPRT's term, the entire value of the property is included in your estate.

6. ***Gift or Sell the Home to an Irrevocable Grantor Trust ("IDGT").*** You could <u>gift</u> the home to an IDGT which would remove the entire value from your estate and use a substantial amount of your gift tax exclusion. Or, a <u>sale</u> to the IDGT, taking back a Note at the Applicable Federal Rate "AFR," would result in no gift tax exclusion being used. You may be required to pay a rental amount for continued use of the property when you visit it, and these funds can be held to pay the property taxes, insurances, and upkeep for the family without being considered a gift by you to the trust. Under the grantor trust rules the rent would not have to be recognized as income by the trust, and payment of rent would also reduce your taxable estate. This is a nice, straightforward and effective technique.

7. ***Grantor Retained Annuity Trust ("GRAT").*** Now is a good time to implement GRATs because of the low interest rate environment and depreciated asset values. In a GRAT, you would receive income for a period, such as an eight year term, and then the balance after the term, could be used for your spouse for life (in which case you receive indirect benefit from the income), and then to your heirs resulting in estate tax savings.

8. **Charitable Lead Trust with a Taxable Remainder ("CLT").** This is a very useful and underused technique. The structure of the trust is effectively the same as with the GRAT except the annuitant during the initial term is a charitable organization--possibly a donor advised fund at your local community foundation. The "remainder" value going to heirs comes within your gift tax exclusion. The income from the trust's assets at a low interest rate goes to a designated charity for a certain period of time, e.g., 10 years. After that time expires, the remainder of the assets and income are given to the trust's beneficiaries, usually your heirs. A charitable lead trust allows the grantor to provide for his/her survivors after death while reducing to a minimum the estate tax because some of the assets were given to charity.

9. ***Second to Die Life Insurance Trust ("ILIT"***). If you have a second to die life insurance policy held under a trust, and the trust was primarily established to have funds available on the death of the survivor of you to indirectly pay the federal estate tax. In light of the $5,120,000 per person gift and estate tax exclusions and portability, you may not need to worry about paying a federal estate tax. That brings up the question of whether it is worthwhile to continue funding the policy.

10. ***Family Limited Partnership or LLC ("FLP" or "FLLP")***. This is a very valuable arrangement to significantly reduce estate tax, but the partnership must be structured and continually managed with attention to important details. With a FLP, you could name yourself as the general partner. You will generally contribute most of the assets to the partnership. Typically, you will receive a 1% general partnership interest (to ensure your control) and the rest as a limited partnership interest. Your children or grandchildren will make modest contributions to the partnership in return for relatively small limited partnership interests. You will then begin to make gifts of your limited partnership interests to your children or grandchildren. These gifts will be subject to substantial discounts (e.g., 30% - 35%), thereby significantly reducing the amount of the value transferred by gift. In addition, the FLP gives you significant creditor protection, undue influence protection, and imposition of fiduciary duties upon your children for the things they do for you with respect to asset management.

If you would like to discuss any of these options further and see how they might work for you, please give me a call.

Best personal regards,

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