2012 Estate Planning Opportunities

1) Enhanced $5,120,000 federal gift and generation-skipping tax exemption through December 31, 2012. Exemptions are scheduled to revert to $1,000,000 on January 1, 2013.

2) Gifts can be further leveraged through discounting techniques:

- **a.** Minority interests in closely-held businesses will generally be discounted for lack of control, lack of marketability, lack of diversity, etc.
- **b.** Limited partnership interests holding real estate and marketable securities are discounted when transferred as a result of the prohibition on owner's participation in management activities.
- **c.** Life insurance is an excellent way to leverage gifts for kids, grandkids and future generations.

3) Clients should consider making gifts to an irrevocable trust rather than outright to individual family members:

- **a.** Grantor appoints friendly trustee and can retain rights to remove and replace the trustee.
- **b.** Grantor's spouse can be an eligible beneficiary in the discretion of the friendly trustee.
- **c.** Trustee can have ability to loan assets to grantor at a reasonable interest rate.
- **d.** Trust can provide creditor protection from liabilities of grantor and trust beneficiaries.
- **e.** Trust can be a "grantor trust" for income tax purposes, meaning that until grantor's death the trust is not considered to be a separate taxpayer for income tax purposes.
- **f.** Grantor can retain power to swap assets with the trust at fair market value.
- **g.** Trust can appoint a "trust protector" with power to change terms of the trust to account for changing future circumstances.
- **h.** If properly established and operated, trust assets will not be includible in the taxable estate of the grantor or any trust beneficiaries.

4) Take advantage of enhanced generation-skipping opportunities. Client gift into an irrevocable trust, above, can be to a multiple generation "dynasty" trust. Assets held in trust provide creditor protection and are exempt from federal estate taxation upon death of trust beneficiaries.

5) Use historically low interest rates to further enhance growth opportunities of assets outside of client's estate. Client can sell or loan assets to irrevocable trust in exchange for a low interest term loan Discountable assets, such as closely-held stock or family limited partnership interests would be sold at their discounted fair market value.

Current Applicable Federal Rates (AFR) (April 2012) at time of writing this piece is as follows:

a. Short-term (3 years or less) .25%

b. Mid-term (greater than 3, up to 9 years) 1.15%

c. Long-term (greater than 9 years) 2.72%

Note that before engaging in a sale of assets to an irrevocable trust, the trust should have "seed" value equal to at least 10% of the value of the sale transaction. That 10% can be a currently funded gift or the current value of assets that have been gifted to the trust in the past or over a number of years.

Recent transaction example: Client's net worth approximately $60 million, owned $30 million of municipal bonds paying a bit over 5%. One option was to sell $20 million of the bonds to the trust for a 9 year interest only note at the mid-term AFR, currently 1.15%. So each year the trust will collect $1 million in interest income on the bonds, and will pay $230,000 to the grantor, leaving the trustee with $770,000 net cash flow for 9 straight years. At the end of 9 years, the note payable can be renewed for an additional 9 year term at the new mid-term interest rate, switched to a demand loan or long-term loan, or the note can be paid off by the trustee with available trust funds.

6) Use Split Dollar (economic benefit or loan) arrangements to leverage gift exemptions and annual exclusions. Life insurance policy would be owned by irrevocable trust or other third party, with premiums paid by the grantor/insured or spouse. Premium payor is entitled to all of policy cash value (economic benefit arrangement) or cash value equal to cumulative premiums paid (Split Dollar loan).

Annual gift is not the value of premiums paid by insured, but the much lower term value of the death benefit protection or the AFR interest rate applied to the cumulative premiums.

7) Similar to Split Dollar arrangement, consider part-gift, part-loan arrangements. Client will make gifts to irrevocable trust equal to available annual exclusion amounts. Client will then make loan to trust for remainder of required annual life insurance premium. Loan will bear interest at the demand loan Applicable Federal Rate – equal to ½ of each year's January and July short-term AFR.

8) Grantor Retained Annuity Trusts (GRATs) can be used to leverage a portion of lifetime gifting exemption. Client transfers assets to trust for a particular term of years. Trust pays out a fixed value of trust to client each year for trust term. The present value of client's retained interest is subtracted from value of asset transferred to trust to determine current taxable gift value. At end of trust term, any remaining assets are transferred gift-tax free to client's irrevocable trust or to kids. This technique is best used with discounted assets with good cash flows.

9) Window of opportunity may be closing for many of these planning options. The enhanced gift, generation-skipping tax exemptions and estate tax rates and exemptions, as well as the Bush era tax cuts enacted in 2003 are all scheduled to sunset on December 31, 2012. Congress is looking at many different options to raise revenues in order to cut federal deficits and to spare some of the scheduled sunset changes. Included among options being considered by Congress:

a. Eliminating ability to create an irrevocable "grantor trust" that is not includable in grantor's taxable estate.

b. All states have rules against perpetuities, with some more liberal than others. Creating a 90-year rule against perpetuities for generation-skipping trusts – meaning that after 90 years, a generation-skipping tax will be imposed on the assets in a generation-skipping trust.

c. Eliminating discounts on transfers of non-business property.

d. Requiring a minimum 10% taxable gift on transfers into a GRAT.

e. Requiring that GRATs must last for a minimum of 10 years.

f. Restricting Crummey withdrawal rights as creating annual exclusion gifts.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act of 2010) extends the "sunset" provision contained in The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which was to repeal the EGTRRA tax law changes on December 31, 2010, to December 31, 2012. Unless there is future legislation, the tax laws affected by the provisions of the Tax Relief Act of 2010 will revert on January 1, 2013 to their status prior to EGTRRA; this affects income tax rates and deductions, as well as gift, estate and generation-skipping transfer tax rates and exemptions.

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