Legal Brief

A Time for Gifting for Future Generations

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("TRA 2010") became law. Many articles have discussed the income tax aspects of TRA 2010, but some of the best tax-savings measures lie with the expansion of the U.S. Estate, Gift and Generation-Skipping Transfer Tax exemptions. With the expanded exemptions, and current economic conditions, taxpayers have a unique two-year window (which could be extended) to transfer wealth to future generations. This article will briefly explore a few of these opportunities.

Increase in the Estate and Gift Tax Exemptions

Both the Federal Estate and Gift Tax laws provide every taxpayer with an exemption that permits the transfer of assets free of these taxes. Between tax years 2004 and 2009, the exemption amounts applicable to the Estate and Gift Tax were different. With the passage of TRA 2010, both exemption amounts are set at $5 million through 2012.

When an individual makes a lifetime transfer of a present interest, the exemption amount is reduced by the value of the gift that exceeds the annual exclusion, currently $13,000. The exemption amount remaining at the taxpayer's death can be used to transfer assets free of Estate Tax. With the passage of TRA 2010, any remaining exemption amount not used by a taxpayer can generally be transferred to the taxpayer's surviving spouse. This "portability" of the exemption amount, though currently scheduled to expire in 2012, may become permanent. The increased exemption amount and the use of portability should help simplify most estate plans by reducing the need for exemption planning, which involves mandatory funding of testamentary trusts.

Without further congressional action, the new exemption amount will be reduced to $1 million in 2012. Therefore, taxpayers currently have a limited window to transfer up to $5 million each ($10 million for a married couple) free of the Estate or Gift Tax.

Generation-Skipping Transfer Tax ("GST Tax") Exemption

TRA 2010 also permits every individual a $5 million exemption from the GST Tax (that is, a tax on transfers to grandchildren and more remote descendents). The $5 million GST Tax and Gift Tax exemptions make this an ideal time to make transfers to grandchildren, or to create trusts for their benefit. Without congressional action, the GST Tax exemption will be reduced to approximately $1.4 million in 2013. If the transfer is made prior to 2012, neither the Gift nor GST Tax exemption amount should be "clawed back." Note: GST gifts also use up your Gift Tax exemption.

Grantor Retained Annuity Trust (a "GRAT")

A GRAT permits an individual to transfer assets (often S Corporation stock) into a trust that will pay the Grantor an annuity for a specified period, with the remainder passing to the Grantor's children. The value of the gift is determined by the value of the interest retained by the Grantor. If the GRAT is structured properly, the remainder interest can be valued at or near zero (referred to as a "zeroed out GRAT") and the transfer uses no Estate and Gift Tax exemption amount. Tax legislation introduced in recent years has attempted to impose a minimum GRAT term of 10 years, and to prohibit the use of the "zeroed out GRAT." However, neither was accomplished by TRA 2010. Current economic conditions make this is an ideal time to transfer your business interests to children using a GRAT. ☆

Impacts of TRA 2010 on Charitable Giving:

- By increasing the Estate and Gift Tax exemption amount, post-mortem charitable giving is likely to decrease.
- Phase out of itemized deductions, which affects charitable contributions, delayed through 2012.
- Extended the ability to make rollover contributions of IRAs up to $100,000 to charity through 2011.

For more information on estate, gift and generation-skipping transfer tax exemptions, contact Jim Spoden at MacDonald, Illig, Jones & Britton, LLP at 814/870-7710 or jspoden@mijb.com.

Jim Spoden is a senior partner at MacDonald, Illig, Jones & Britton, LLP. He concentrates his practice in the area of corporate, commercial and business law, with a special emphasis on taxation and estate planning for small business owners. He also is active in the area of business formation, mergers, acquisitions and divestitures.