WEALTH TRANSFER PLANNING 2012

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Exemption Amounts

- Exemption for Gift, Estate, and Generation-Skipping Transfer Tax Through December 31, 2012 is $5.12 Million.
- Exemption for Gift and Estate Tax January 1, 2013 will be $1 million.
- Exemption for Generation-Skipping Transfer Tax January 1, 2013 should be $1,120,000 indexed for inflation since 2003.

Tax Rates

- Maximum Gift, Estate, and Generation-Skipping Transfer Tax Rate in 2012 is 35%.
- Maximum Gift, Estate, and Generation-Skipping Transfer Tax Rate in 2013 will be 55%.

OBAMA ADMINISTRATION PROPOSALS

- Exemption for Estate and Generation-Skipping Transfer Tax would be $3.5 Million.
- Exemption for Gift Tax would be $1 Million.
- Maximum Gift, Estate, and Generation-Skipping Transfer Tax Rate would be 45%.

Obama Administration Proposals
Continued

- Would eliminate or restrict estate planning using grantor trusts, grantor retained annuity trusts, generation-skipping trusts, and valuation discounts.

Estate Planning Opportunity

- Large and expiring exemption amounts.
- Expiring 35% maximum gift, estate and generation-skipping transfer tax rate.
- Low valuations of certain assets, e.g. real estate.
- Low interest rates used to value term interests.
- Obama Administration proposals to restrict estate planning strategies.

Gifts in 2012

- Taxpayers can make tax free gifts of up to $5.12 million in 2012. In the case of married couples that is $10.24 million.
- The gifts remove the assets given and future appreciation in these assets from the donor's estate.

Possible Clawback

- Because estate tax is a tax on the total of the gifts made by the decedent during his life and his taxable estate less the gift taxes that would have been payable on the gifts at the current estate tax rates, the gifts sheltered by the $5.12 million exemption when made could generate estate tax when the donor died if the estate tax exemption amount were then less than $5.12 million.

- Many, if not most, commentators think, however, this clawback was not intended and that, if necessary, transition relief would be enacted to prevent this from happening.

Valuation Discounts

- If the gifts are of minority interests in closely held companies, the value of the interests is discounted for lack of control and lack of marketability. The combined discounts can be as much as 45%.
- The Obama Administration proposes to limit such discounts in the case of family controlled companies. The limitations would apply to transfers of interests after the date of enactment.

ADVANTAGES OF GIFTS IN TRUST

- Creditor protection: Through spendthrift clauses the ability of the beneficiaries' creditors to reach trust assets can be restricted.

- Generation-skipping: Through the allocation of GST exemption (currently $5.12 million (or $10.24 million in the case of a married couple) the trust assets and the appreciation in these assets can be exempted from estate tax and generation-skipping transfer tax for the term of the trust. Trusts formed and administered in states that have repealed the rule against perpetuities can have perpetual life.

Obama Administration Proposal as to Duration of Generation-Skipping Trusts

- The Obama Administration would limit the exemption of trusts from generation-skipping transfer tax through the allocation of GST exemption to the trusts to 90 years.

- The proposal would apply to trusts created after the date of enactment.

GRANTOR TRUSTS

- Grantor trusts are trusts treated as owned by the grantor for income tax purposes.
- They can currently be structured in such way that they are not treated as owned by the grantor for gift, estate, or generation-skipping transfer tax purposes.
- The grantor is taxable on the income of such trusts as if he owned the assets. The grantor's payment of this income tax liability is a tax free gift to the beneficiaries.
- A grantor can sell appreciated assets to such a trust without income tax liability as the sale is ignored for income tax purposes.

Grantor Trusts

Continued

- If the assets sold are minority interests in a closely held company, the sale price can include appropriate discounts for lack of control and marketability.
- The sale can be on an installment basis to allow the trust to pay for the assets over time. The interest rate can be the applicable federal rate. The long term applicable federal rate, which applies to promissory notes with a term of over 9 years, is currently 2.4% per annum.
- The sale freezes the value of the seller's interest in the assets sold to the consideration received. Future appreciation in the assets sold is not part of the seller's estate.

Obama Administration Proposals for Grantor Trusts

- The Obama Administration proposals would:
  a. include the assets of a grantor trust in the grantor's estate for estate tax purposes;
  b. subject to gift tax any distribution from the trust to a beneficiary during the grantor's lifetime; and
  c. subject the remaining trust assets to gift tax if the trust ceased to be treated as owned by the grantor during the grantor's life
- The proposals would be effective for trusts created after the date of enactment.

Grantor Retained Annuity Trusts

- IRC §2702 provides that if an interest in a trust is transferred to a family member, the value of any interest retained by the grantor is valued at zero for purposes of determining the value of the gift to the family member unless the retained interest is a qualified interest.
- A fixed annuity is one form of qualified interest. A grantor retained 15annuity trust ("GRAT") is a trust in which the grantor has retained a fixed annuity.
- The present value of the annuity retained by the grantor is valued using 120% of the midterm applicable federal rate as the discount rate. 120% of the midterm applicable federal rate is currently 1%.
- The lower the discount rate used to value the annuity, the greater its present value, and the smaller the value of the remainder interest given away.
- It is possible under current law to reduce the value of the remainder interest in a GRAT to zero. Such a GRAT is called a zeroed out GRAT.

Obama Administration Proposals as to GRATs

- The Obama Administration proposes certain changes to the rules governing GRATs that would reduce their estate planning value, including requiring a minimum term of 10 years and prohibiting zeroed out GRATs. The proposal would apply to trusts created after the date of enactment.

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