



## CLIENT ALERT   ESTATE PLANNING

### Gifts Under the Tax Relief Act of 2010

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In December 2010 The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the “Act”) became law. The Act reinstated the federal estate and generation-skipping transfer taxes effective for decedent’s dying and transfers made after December 31, 2009 and re-coupled the estate and gift tax exemptions for 2011 and 2012. The Act also increased the lifetime gift tax exemption to \$5 million per person and set the highest gift tax rate at 35% for transfers made after 2010.

Unfortunately, the compromise reached by Congress (and which culminated in the passage of the Act) only stays in place for the next two years (i.e. for gifts made prior to January 1, 2013). Unless Congress acts to extend the provisions of the Act before the end of 2012, the gift tax rules in effect prior to 2001, which featured a \$1 million lifetime gift tax exclusion with a top tax rate of 55%, will spring back into place. Therefore, during 2011 and 2012 individuals with gifting in mind can take advantage of a once-in-a-lifetime opportunity to benefit their heirs at a reduced tax cost.

Generally, it is more tax efficient to make lifetime gifts than to pass assets at one’s death, because the gift tax is tax-exclusive while the estate tax is tax-inclusive. For example, if we assume a flat 50% estate and gift tax rate, and you make a \$2 million taxable gift during your lifetime, then you would pay \$1 million of gift tax on the gift. Thus, you would have reduced your estate by a total of \$3 million (1/3 to the federal government in the form of gift tax and 2/3 to the beneficiary of your gift). However, if you did not make the gift during your lifetime and died with the same \$3 million, your estate would end up paying \$1.5 million in estate tax, and your heirs would only receive the other \$1.5 million. Therefore, while the rate of tax is the same you would pay more estate tax than gift tax, because the estate tax is tax-inclusive (you pay tax on the tax) while the gift tax is tax-exclusive (you do not pay tax on the tax).

There are a number of gifting strategies available to individuals that are willing and able to take advantage of them. Making low interest loans to family members is a great way to transfer wealth from parents to children, because it enables the borrower to take advantage of interest rate arbitrage. Making gifts and using your \$5 million lifetime gift tax exemption is also an

excellent way to take advantage of the exemption available until the end of 2012 and move appreciating assets out of your estate.

The gift tax annual exclusion is one of the most effective, but also one of the most under-utilized, parts of the Federal transfer tax system. In 2011, the Code permits you to make gifts of \$13,000 to as many different donees (i.e., children and grandchildren) as you desire. In addition, spouses may “split” their gifts and increase each gift in 2011 to \$26,000 per donee. In 2011 (and years after), if a couple had three children and five grandchildren they could remove \$208,000 from their estates each year to benefit their heirs by taking advantage of the annual exclusion and gift-splitting rules. You are also permitted to make unlimited gifts directly to the provider of medical and educational services to a beneficiary. The Code also permits you to make a \$65,000 (\$13,000 x 5) contribution this year to an educational 529 Plan for the benefit of an heir and thus avoid gift tax by “spreading” the gift over 5 years using your annual exclusion (\$130,000 for couples splitting their gifts).

Because some of the gifting opportunities created by the Act may only be available until the end of 2012, we encourage you to contact a member of our Firm’s Estate Planning, Trust and Wills Department now to discuss and assess whether a lifetime gifting strategy makes sense for you. We look forward to hearing from you.

**About the Author:** Mr. Fernandez focuses his practice on structuring and implementing business transactions and tax planning for closely held businesses and individuals. His work includes assisting clients with all legal and tax aspects of the formation and operation of various business entities, including proprietorships, partnerships, corporations, limited liability companies and joint ventures. If you have any questions about the impact of the Act, please contact Mr. Fernandez ([afernandez@wispearl.com](mailto:afernandez@wispearl.com)) or one of the other attorneys in Wisler Pearlstine’s Business Corporate Tax, or Estate Planning, Trust and Wills Practice Groups.

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