



TAX ALERT

Countdown to 2013

If you are considering significant gift-giving, you may want to make those gifts before year-end. In less than six months, the chance to make large gifts, free of gift tax, will end unless Congress acts. On January 1, 2013, the current transfer tax rules will revert to the pre-2001 rules, with a gift tax exemption of only \$1 million and a GST exemption of only \$1 million (adjusted for inflation).

	Current Law	2013 Law
Gift Tax Exemption (the amount that may be transferred during life free of Federal gift tax)	\$5,120,000	\$1,000,000
Top Gift Tax Rate	35%	55%
Generation-Skipping Transfer (GST) Tax Exemption	\$5,120,000	\$1,000,000*
Top GST Tax Rate	35%	55%

*adjusted for inflation

Taxes will significantly increase for gifts made in 2013.

	Gift Tax Due
Gift of \$5,120,000 in 2012	- 0 -
Gift of \$5,120,000 in 2013	\$2,111,000

	GST Tax Due
Gift of \$5,120,000 in 2012	- 0 -
Gift of \$5,120,000 in 2013	\$2,068,000

Taxes on a gift of \$5,120,000 in 2013 to a GST exempt trust will total \$4,179,000 (i.e., gift tax of \$2,111,000 plus GST tax of \$2,068,000), versus no taxes in 2012.

What Might Congress Do This Election Year?

1. ***Congress does nothing.*** With gridlock in Washington, the return of the pre-2001 rules of only a \$1 million gift and estate tax exemption, a \$1 million GST tax exemption (adjusted for inflation), and a 55% rate seems quite possible.

2. ***The Democrats Retain the White House and Control the House and Senate.*** The Obama 2013 Budget Proposals include only a \$1 million gift tax exemption, a \$3.5 million estate and GST tax exemption, and a 45% top rate.

3. ***The Republicans Control the White House and the House and Senate.*** The current gift tax, GST tax, and estate tax exemption of \$5,120,000 might be made permanent with the current top 35% rate.

Likely Scenario: Neither party controls the White House and both the House and Senate. Stalemate continues, and the pre-2001 rules return.

What to Consider

Following are steps to take advantage of the \$5,120,000 gift and GST tax exemption amounts during the remaining months of 2012:

- ***Outright Gifts.*** Make outright gifts to children and more remote descendants.
- ***Gifts in Trust.*** Make gifts to GST tax exempt trusts for the benefit of children and more remote descendants. Use assets you expect to appreciate to increase the tax savings of such a gift. Your spouse can also be a beneficiary of such trusts entitled to discretionary distributions, with no adverse tax consequences.
- ***Forgive Loans.*** If you have made loans to children or others, consider forgiving such loans thereby using a portion of the increased gift tax exemption.
- ***GRATs.*** Use a grantor retained annuity trust (GRAT) when making a gift. A GRAT is a trust to which you gift assets, retaining the right to receive an annuity from the trust for a certain period of time. Upon the termination of such period, the GRAT assets pass in trust for children free of estate and gift tax. GRATs are an excellent wealth transfer tool, particularly in light of continuing historically low interest rates.
- ***Intentionally "Defective" Irrevocable Grantor Trusts.*** Use an irrevocable "grantor" trust to make a large gift to a trust for the benefit of descendants. Under this type of grantor trust, the assets of the trust are not subject to estate, gift, or GST taxes, but you pay the income tax on trust income, thus maximizing the amount being transferred from your taxable estate to the beneficiaries. You can sell assets to the trust, without triggering capital gains tax on the sale. Your spouse can also be a beneficiary of the trust entitled to discretionary distributions, with no adverse tax consequences.
- ***Both Spouses Create Trusts for One Another.*** Both spouses can use their exemptions to create an irrevocable trust for the benefit of the other spouse and descendants. Spouses thereby keep benefits from the trusts, if they are carefully crafted. Such trusts must be designed to avoid the "reciprocal trust" rule, whereby the courts "uncross" the trusts, a result that defeats the trusts' tax advantages.

Take Action Before Year-End

Until January 1, 2013, or until the date on which Congress might take action, you can take advantage of current law, including the ability for a married couple to transfer up to \$10,240,000 in assets, gift tax free. If you would like to discuss the opportunities still available this year, please contact me at 312-840-7009.

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