



Planning Pointers

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To Give Or Not To Give — That Is The 2012 Question

After several years of uncertainty concerning the federal estate, gift, and generation-skipping transfer tax laws, Congress in December 2010 passed legislation creating higher exemption amounts (\$5.0 million in 2011 and \$5.12 million in 2012), with a lower top tax rate of 35 percent. As of January 1, 2013, however, without further Congressional action, the exemption amount will decrease to \$1 million, with a top tax rate of 55 percent.

Congress could, but most likely will not, act on these taxes before the 2012 elections. A lame duck Congress could take steps to prevent the automatic reversion to a \$1 million exemption with a top tax rate of 55 percent, but what steps it may take are uncertain. Likewise, Congress could extend the current laws until the new Congress has time to study the matter, but even then, the end result is unknown.

Many articles have appeared encouraging taxpayers to take advantage of the generous terms and certainty of the current laws by making sizable lifetime gifts before the end of 2012. Failure to act may be a lost opportunity. Several other factors, however, including the following, may impact a decision to make such gifts:

- **CONNECTICUT GIFT TAXES**

Connecticut imposes a gift tax with an exemption amount of only \$2 million, significantly less than the current \$5.12 million allowed under federal law. For Connecticut residents, taxable gifts (excluding gifts of out-of-state property) of over \$2 million would trigger a Connecticut gift tax, at graduated rates ranging from 7.2 percent to 12.0 percent. (Non-Connecticut residents who make taxable gifts of real estate and/or tangible personal property located in Connecticut are also subject to the Connecticut gift tax.) For some taxpayers, taxable gifts in excess of \$2 million, with payment of the resulting Connecticut gift tax, may constitute a prudent and economical tax-planning step. (Currently, the other New England states and New York do not impose a state gift tax.)

- **SO-CALLED “CLAWBACK” ISSUE**

If a taxpayer makes a sizeable gift in 2012 and the federal estate and gift tax exemption is decreased from the current \$5.12 million, all or a portion of the 2012 gift may be “clawed back” and subject to tax in the taxpayer’s estate. If so, such a tax could be substantial,

and the taxpayer or his/her estate might not have sufficient funds to pay that later tax. Many commentators hope and expect that the clawback will not be applied, but the risk of a possible clawback exists.

- **LOSS OF STEP-UP IN BASIS**

Recipients of lifetime gifts succeed to the donor’s income tax cost basis, whereas property inherited from a decedent’s estate receives a step-up in basis for income tax purposes equal to the fair market value of the property as of the decedent’s date of death. Thus, for highly appreciated, low-cost basis property, the loss of a step-up in basis could negatively impact the recipient for income tax purposes, if he or she subsequently sells the gifted assets.

If, after considering the above factors, a taxpayer decides to make sizable gifts in 2012 (even if using only a federal exemption equal to the Connecticut exemption amount), other considerations, such as the following, may need to be addressed:

- **CHOICE OF DONEE**

A donor’s children may be the first choice to receive any 2012 gifts, but, to take advantage of



the current generation-skipping transfer tax exemption, taxpayers also may want to include grandchildren and more remote descendants. The selection of recipients could impact the choice of assets to be gifted and the form of the gift.

• **CHOICE OF ASSETS TO BE GIFTED**

Cash is a simple asset to give, with no valuation issues, but donors may want to consider assets which are expected to appreciate in value, such as currently undervalued real estate. Gifts of fractional interests in partnerships or other business entities, which often allow the value of the gift to be

discounted for gift tax purposes, may be appealing. In addition, Connecticut residents may want to consider gifts of real estate and/or tangible personal property located outside Connecticut.

• **FORM OF THE GIFT**

Outright gifts offer simplicity. A trust, however, might allow the donor to (1) establish control over the use of the gifted assets, (2) retain for the donor and/or the donor's spouse an interest in the gifted property, and/or (3) create a dynasty trust to benefit many generations of descendants.

The current federal gift tax exemption amount is at the highest

level in recent history, and the possibility that the exemption amount may be reduced makes significant gifting in 2012 attractive to many taxpayers. As summarized above, however, and because each taxpayer's situation is unique, there are multiple factors to consider other than only the 2012 federal exemption amount. An experienced tax advisor and estate planning attorney can assist the taxpayer in considering those factors and in making an informed decision. Time is running out, however, because any such gifts must be completed before January 1, 2013.

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