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Estate and Gift Tax Planning: An Essential New Year's Resolution for 2012

WHITE PAPER

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Background

January 1, 2012, marked more than the ringing in of a new year—it also started the one-year countdown until the expiration of the \$5 million lifetime exemption for estate and gift tax that was included in the 2010 Tax Act. Unless Congress extends the exemption—which all observers agree is extremely unlikely—on January 1, 2013, the gift and estate tax exemption will revert to its previous level of \$1 million.

This year's deadline should prompt anyone with a net worth of \$1 million or more to make sure that they have developed a gift and estate planning strategy to take advantage of this window. While there is no one-size-fits-all solution, the Tax Act's provisions suggest that many taxpayers would benefit by gifting assets to their descendants rather than transferring these assets through a will. There are several reasons for this, but the most powerful comes from the fact that gift tax is *exclusive*. Like sales tax, for example, gift tax is *added to* the value of the article being taxed. Estate tax, on the other hand is *inclusive*—the tax is *subtracted from* the article being taxed. The difference can be considerable.

Seeing the Difference

Consider someone who has \$1,350,000 to transfer to a child. With a current tax rate of 35 percent, a gifting strategy allows \$1 million of the total amount to be used as the gift, with the remaining \$350,000 available to meet the tax obligation. Now imagine that same \$1,350,000 being left in an estate, subject to the same 35 percent estate tax rate. Thirty-five percent of the total is \$472,500, leaving only \$877,500 to be passed on.

There are other benefits as well. Once a gift is made, any subsequent appreciation in its value is not subject to estate tax, as it would be if bequeathed at a later time. In addition, any gift tax paid is added to the tax basis of the gift, decreasing the tax obligation of the recipient if he or she subsequently sells the asset. Finally, while most states have an estate tax, few have a gift tax.

The Importance of Having a Strategy

As compelling as gifting may be, it needs to be part of a larger coherent plan for transferring assets to one's descendants. In fact, gift and estate planning requires a cohesive strategy—it should be an ongoing process with a periodic review of one's assets, legacy goals and the needs of one's descendants. For some taxpayers, the \$5 million gifting exemption will prompt an overdue (or even a first) examination of these questions. Particularly in those cases, time is of the essence—designing and executing a gifting plan can easily take six months, given that it generally must include multiple consultations with accountants, attorneys and other advisors. If the estate includes businesses or other entities governed by operating agreements, or assets that require a formal valuation, the time period may be much longer.

The 2010 Tax Act's gift exemption has an unusual feature—portability. This means that any exemption that remains unused by one spouse at the time of his or her death can be transferred to the surviving spouse so that the couple can enjoy the full \$10 million combined exemption. However, this comes with several strings attached. The decedent spouse must elect to make such a transfer, and doing so requires

filing an extensive—and expensive—valuation of the estate. It provides no protection from state estate taxes. Furthermore, unless the 2010 Tax Act is extended, the portability provision will also be gone, as it was not part of the previous law. Finally, it cannot be used to make generation-skipping gifts, such as those to grandchildren. In these cases, a credit shelter trust, which allows unused tax credits to be passed from one family member to others, is more appropriate.

High-net-worth individuals with combined assets greater than \$10 million are likely to have additional strategies to consider, including large-note sale transactions, preferably to dynasty trusts, and the unwinding of split-dollar arrangements with life insurance trusts. The exemption increase also allows more funding of life insurance trusts, increasing the impact of these vehicles. So while the need to develop an estate and gifting tax planning strategy now is clear, the specifics will vary greatly from person to person. For those who have not already done so, a thorough review of their gifting and estate plans needs to be a part of their 2012 New Year's resolution.

How Reznick Group Can Help

Reznick Group's estate and gift tax planning professionals help individuals in a range of wealth categories to implement tax strategies designed to preserve their assets and their legacy wealth for subsequent generations. Our team of advisors is highly experienced in tax accounting analysis of wealth-transfer methodologies, including lifetime gifting, sale techniques and the use of flow-through entities such as limited liability companies or family limited partnerships.

For more information about Reznick Group's estate and gift tax services, please visit the [estate and gift tax section](#) of our corporate website or contact Tanya Rosenbaum, Senior Manager, at tanya.Rosenbaum@reznickgroup.com.

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