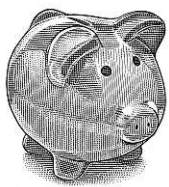


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JUMBO JUNGLE



Feathering the Kids' Nests

Some homeowners race to transfer property to their children before lifetime gift-tax exemptions expire Dec. 31

BY ANNAMARIA ANDRIOTIS

WANT TO GIVE the kids a little something extra for the holidays? Get going. The generous lifetime gift-tax exemption—in which couples can give up to \$10.24 million to descendants tax free—expires at the end of the year.

The lifetime exemption will drop to \$1 million for individuals (from \$5.12 million) and to \$2 million for couples (from \$10.24 million) if Congress doesn't intervene. While some experts expect Congress to act, they think the resulting cap will still drop.

So for wealthy families, there's a limited window to give sizable assets—including real estate—to children while avoiding a tax hit.

"It's been an instigator for our clients to take action," says Andy Berg, chief executive of Homrich Berg, a wealth-management firm in Atlanta.

Jeff Sica, a financial planner in Morristown, N.J., owns multiunit properties in several cities, including Denver and Houston. While he knew he ultimately would gift them to his three children, the changing tax landscape accelerated his plans. Earlier this year, he moved some of the properties into a trust. When Mr. Sica dies, those properties won't be subject to an estate tax, saving his heirs hundreds of thousands of dollars. "We have the ability to gift a lot more now than in years to come," he says. "If you can gift in advance, why would anyone wait?"

The current exemption is part of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. That law includes the higher lifetime limits, as well as a relatively low 35% maximum tax rate on gifts that exceed these limits. Come Jan. 1, gifts over the limit are set to hit a maximum 55% tax rate.

Wealthy families have been taking various measures to prepare for lower exemption limits and higher tax rates. Some people gift properties using a separate vehicle, such as a limited-liability company or a trust. These allow parents to maintain some control, and since these vehi-

Taking Account

Three examples of how parents are arranging their finances to make full use of the lifetime gift-tax exemption:

Put property in a limited-liability company.

Up to 15% to 20% of its value could be shaved off because multiple owners create what's called a lack of marketability. The lower value helps parents stay below exemption limits.

Set up a qualified personal residence trust.

This allows parents to retain control of the property for a specific period of time.

Have a child's trust buy the parent's property, with the transaction financed by the parent.

The parent then pays rent, which the child uses to pay off the loan. Only the initial amount gifted in the trust—not the entire value of the house—is applied to the exemption limit.



EXCLUSION VS. EXEMPTION

An **annual exclusion** that allows people to give away as much as \$13,000 per year (or \$26,000 for married couples) to a relative or friend or any other people. This does not expire Dec. 31; in fact, the cap is expected to rise to \$14,000 (\$28,000 for married couples) in 2013.

A **lifetime exemption** in which an individual can give up to \$5.12 million to descendants tax free. (The limit for couples is \$10.24 million.) Those levels are expected to expire Dec. 31, bringing the limit to \$1 million for individuals and \$2 million for couples.

specializes in estate and gift planning at law firm Schiff Hardin LLP, headquartered in Chicago, says many of her clients with real-estate investments often opt for an LLC. These have an added benefit. When buildings are owned by several family members through an LLC, they're not as marketable as when one person owns them outright. If one relative sells his share of the family-owned LLC, an outsider could be less inclined to buy since he'll have to negotiate with a group of other, related LLC members.

That's what is called a "lack of marketability," under which appraisers can apply a discount of up to 15% to 20% on a property's valuation, says Erin Fukuto, a partner with accounting firm Raimondo Pettit Group based in Torrance, Calif. So properties that would be appraised at \$12 million could be valued as \$10.2 million for gifting purposes, within couples' lifetime-exemption threshold. There can be another potential appraised discount of up to

15% if the children are receiving a minority interest in the properties.

When gifting a primary residence, Mr. Berg says that many of his firm's clients set up a qualified personal residential trust, which allows parents to retain control of the property and remain in the residence for the number of years they choose. It also helps discount the property under what's called a "present value factor" since the child won't actually receive the property for a while. So, the property's value that counts against the parents' lifetime exemption will actually be lower than its appraised value. The discount will depend on several factors, including the period parents choose and their age when the term ends; for example, by applying the present-value factor, a \$2 million residence gifted this month by a 60-year-old parent who retains control of it for 10 years would be roughly \$1.5 million, says Ms. Fukuto.

The strategy isn't without pitfalls. If parents die before the allotted period

ends, the property will return to the estate and ultimately incur the estate tax. If parents outlive this period, they'll have to move out of the home or start paying rent to the trust.

Here are other strategies:

- **Get around the deadline.** It can take months to gift a home, since it requires a home appraisal and changing the title on the property, leaving parents at risk of missing the deadline, assuming tax changes do indeed take effect in January. But certified financial planner Stewart Welch says he has been working with clients to transfer publicly traded stocks into trusts—often a one-day transaction—and adding language to the trust that allows parents to swap those securities with real estate of the same value next year.
- **Gift cash toward real estate.** Parents can also use the lifetime gift-tax exemption to gift cash to their children that would help them with a home purchase. They can also gift the remaining balance on a loan they may have previously given their children. When Marv Pollack of Chicago purchased his home seven years ago, his mortgage was provided by his father rather than a bank. With the higher lifetime gift-tax exemption nearing an end, his father decided to gift the balance of the mortgage, reducing the value of his estate.
- **You want to continue using the property.** Tom Bentley, principal at Truepoint Inc., a fee-only wealth-advisory firm in Cincinnati, says he's working with a client who gifted 10% of the value of his vacation home to a child in an irrevocable trust, with the child serving as the trustee. The trust, under the direction of the child, then bought the entire home from the parent, returning the 10% down payment and borrowing the remaining 90% from the parent. The parent, who retains the home, pays rent to the trust. The child uses those payments to pay back the parent what he owes on the loan. Under this scenario, a \$1 million home can be given to an heir in trust but only 10%—or \$100,000—of its value would count as part of the lifetime gift-tax exemption.

SPREAD SHEET

Mind If I Stay a Few Days?

LOOKING FOR A new BFF to go visit over the holidays? Start your search in Malibu, Calif.

The upscale enclave on the Pacific Ocean has the most homes for sale that come with guesthouses, with 136 in a single ZIP Code. Scottsdale, Ariz., ranks second, and Paradise Valley, Ariz., is third, according to data from Realtor.com.

Of course, while guesthouses provide convenience and privacy, owning one offers financial advantages.

Guesthouses add "tremendous value to properties," about a quarter-million dollars on average, says Shen Schulz, a real-estate agent at Sotheby's International Realty in Malibu. Owners who wish to rent their guesthouses out can often get about \$1,200 to \$2,500 a month, depending on the size, Mr. Schulz says.

Jennifer Miller, who works in construction and has lived in Malibu for 35 years, had a guesthouse built behind her California ranch-style home about 20 years ago. She



planned to use the space for visitors, but soon realized that she didn't have legions of family and friends visiting as often as she thought they would. In July, Ms. Miller began renting the house out to short-term guests for \$200 to \$300 a night. Since then, she has rented about five times.

"It's really fun," she says. "We've met really interesting people, who tend to be a bit more laid back."

Ms. Miller's guesthouse is modest, under 750 square feet, with a bedroom, living room, kitchen and balcony near the water. But some guesthouses can rival full-size homes, with multiple bedrooms and bath-

rooms, fireplaces and private patios, says Marilyn Proctor, owner of Proctor Property Management in Santa Fe, N.M.

Guesthouses—or casitas, as they're known in Santa Fe—are highly coveted, Ms. Proctor says. "A lot of people who live here look to purchase properties with a casita or turn part of their property into a casita," she adds.

Next door in Arizona, the average list price for single-family homes with a guesthouse in one area of Scottsdale is about \$2.5 million, according to Arizona Regional Multiple Listing Service data. Here, guest homes can be more than 2,000 square feet.

And guesthouses don't have to house guests. Perry Bergelt, owner and broker of Arizona Luxury Real Estate in Scottsdale, says people there often use a guesthouse as an office or a separate suite for a nanny. "It gives the privacy and separation of another house," he says. "You can walk around in your underwear, and it's fine."

—Sanette Tanaka

Bring Your Toothbrush

The top 10 areas with homes for sale that have guest houses

ZIP CODE	CITY	ACTIVE LISTING
90265	Malibu, Calif.	136
85262	Scottsdale, Ariz.	130
85253	Paradise Valley, Ariz.	122
92067	Rancho Santa Fe, Calif.	107
85255	Scottsdale, Ariz.	99
87501	Santa Fe, N.M.	84
90210	Beverly Hills, Calif.	76
33480	Palm Beach, Fla.	75
87506	Santa Fe, N.M.	75
87505	Santa Fe, N.M.	63

Source: Realtor.com listings



BE MY GUEST

A guesthouse in Scottsdale, Ariz., where a broker says the spaces can be more than 2,000 square feet.



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Illustration by Lauren Tamaki