Client Alert: Act Now or Pay More Taxes

By Robert Lyerly - Attorney & Certified Public Accountant

Nexsen Pruet's Estate Planning and Wealth Transfer Planning team is encouraging clients to consider making a gift of part or all of their estate exclusions now, or risk paying much more in taxes in the future.

If Congress fails to act during the next few months, the 2010 Tax Act, which extended the so-called Bush Tax Cuts, will expire at the end of 2012. If the cuts are allowed to expire, there will be major tax increases.

Tax Increases of up to 400%		
Type	**Current**	**If 2010 Tax Act expires**
Highest ordinary rate	35%	39.6%
Long term capital gains	15%	20%
Qualified dividends	15%	39.6%
Exclusion	$5.12 million	$1 million

Perhaps the most significant change is the potential of decreasing the exclusion from $5.12 million to $1 million. This is because the exclusion can be used in a number of ways, such as excluding assets from estate tax and gifts from the gift tax and generation skipping tax.

Exclusion Could Drop from $10.24 million to $2 million

To illustrate how this large exclusion offers planning opportunities that have never been available before, consider this. Currently, a married couple can exclude up to $10.24 million of property from estate tax at their deaths. It also means that a married couple can give away up to $10.24 million during their lifetime without gift tax or generation skipping tax.

If Congress fails to act, allowing the provisions to expire as scheduled on January 1, the estate exclusion will be reduced to $1 million per person, and the <u>$4.12 million dollar difference would be subject to the 55% Estate Tax rate</u>.

If someone took the maximum gift exclusion in prior years, when the limit was $1 million, the Bush Tax Cuts allow that taxpayer to utilize the remaining portion of the $5.12 million exclusion. Taking advantage of the $4.12 million dollar difference can result in a significant tax savings.

Other tax increases

Additionally, if the 2010 Tax Act expires, itemized deductions will be scaled back. That could increase the highest ordinary income tax rate to as much as 42 to 43%. Further, under the Affordable Care Act, there will be a 3.8% Medicare Tax that will apply to earned income as well as investment income over certain amounts. Planning is also required to minimize the impact of these new income tax rules.

Act now, or lose out

We are encouraging our clients to act now to consider making a gift of part, or all, of their estate exclusions now while the $5.12 million exclusion is in place. If clients do not act now, they will lose the ability to transfer a greater amount of assets in the future. Additionally, if an individual gives away part or all of his or her estate exclusion now, all appreciation on the assets transferred will be removed from his or her estate.

Since the values of real estate and investments have been depressed - from a valuation standpoint-this could also be a great time to make gifts of these assets.

There are a number of gift techniques available to make transfers and still maintain some control over the asset. These techniques include creating the following Trusts and Entities:

- Spousal Lifetime Access Trust (SLAT)
- Qualified Personal Residence Trust (QPRT)
- Grantor Retained Annuity Trust (GRAT)
- Sales of Assets to an Intentionally Defective Grantor Trust
- Irrevocable Life Insurance Trust
- Family LLC or Family Limited Partnership

Good time to create a Trust

While the generation skipping exclusion stands at $5.12 million, an individual can create an Irrevocable Trust and transfer the entire amount of assets into it. The Trust can be created to last forever or for a period of years (such as 500). Such a trust is called a Dynasty Trust. Once the initial transfer to the Trust is excluded from gift tax and generation skipping tax by the gift exclusion and the generation skipping exclusion, no estate or generation skipping tax will ever be paid on the trust assets. The income of the trust will be subject to income taxes but no transfer tax will apply. Earnings on these assets can compound and are not reduced by estate tax which generally will take 35% to 55% of the assets at each generational level. We believe this presents a great planning opportunity for our clients. If a trust is created properly, the Trust assets can also be protected from creditors and divorced spouses.

Another technique to consider is to create Grantor Trusts where the grantor transfers assets to the trust and retains powers which cause the income of the trust to be taxable to the grantor. In this situation, the grantor has to pay the income tax. The payment of the income tax is not a gift by

the grantor. This allows the trust to compound the earnings on the trust assets for the benefit of the beneficiaries on an after tax basis.

We are ready to help

Because of all of the estate planning opportunities, we recommend that you meet with a tax and estate planning attorney to discuss your planning opportunities as soon as possible. We strongly recommend that you make gifts as early as possible in 2012. It is possible that a law could be passed after the November election that will reduce the exclusion or repeal or limit some of the planning opportunities discussed in this alert. It takes time to create entities and to make transfers and, if you wait too long, you may not be able to complete the gifts by December 31, 2012.

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