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Holy gifting: an estate planner's dream (… or nightmare)

By Marc J. Cusano

Attorneys who practice any level of estate planning are, at this very moment, standing on hallowed ground.

To understand why, we must go back in time, ironically to just a few months prior to 9/11.

On June 7, 2001, Congress mobilized its forces and enacted the Economic Growth and Tax Relief Reconciliation Act of 2001, or EGTRRA, which ushered in significant changes to the tax code.

Under EGTRRA, the amount that an individual could pass estate-tax-free at death gradually increased from $675,000 in 2001 to its zenith of $3.5 million in 2009, with a scheduled repeal of the estate tax entirely in 2010.

After that, the tax was scheduled to be reinstated for deaths occurring in 2011 with a $1 million exemption amount and top tax rate of 55 percent.

The common assumption at the time was that congressional action would produce estate and gift tax reform before the repeal.

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As the adage goes, you can't always get what you want. And when it comes to Congress, sometimes you don't get anything at all. That's exactly what happened in 2010; no congressional action and no estate tax. None.

Practitioners, especially those who only draft basic estate plans as an ancillary part of their practice, must wake up to the potential liability they face for failure to properly address this year's gifting opportunity.

But surely, you say, someone must have gotten what they wanted? George Steinbrenner, former owner of the New York Yankees, and his family got exactly what they wanted: a savings of $500 million to $600 million on their tax bill. All because Mr. Steinbrenner, and other billionaires that year, had the good sense to die in 2010, leaving Congress to make no cents.

At the end of 2010, almost 10 years after EGTRRA was enacted and just before the clock struck 12 and the mouse ran down the exemption amount to $1 million, Congress finally passed new legislation.

On Dec. 17, 2010, the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 (or 2010 Tax Relief Act) was enacted. The law placed the 2011 exemption amount at $5 million with a top rate of 35 percent, and for this year indexed that figure for inflation, resulting in an unprecedented $5.12 million exemption amount.

However, it was not a fix but merely a patch. On Jan. 1, 2013, just a few short months from now, the estate tax exemption will plummet to $1 million with a top tax rate of 55 percent.

But have no fear, congressional action is almost certainly somewhat likely to produce estate and gift tax reform before then. Now where have I heard that before? The two certain things in life, death and taxes, have never produced so much uncertainty.

To top it off, for the past two years, an individual's lifetime *gift* tax exemption has mirrored the estate tax exemption so that this year you can give away up to $5.12 million during life without incurring any gift tax. That was not always the case. Throughout the term of EGTRRA, the lifetime gift tax exemption had remained at $1 million even while the estate tax exemption crept higher and higher.

But on their due date of Jan. 1, 2013, the estate and gift tax exemptions will buddy up and become the proud parents of a beautiful little $1 million exemption for both transfers made during life and those made at death.

The lifetime gift amount is over and above the $13,000 in annual gifts that a person may give, per recipient. That will not change in 2013, but the opportunity to give away up to $5.12 million without tax (up to $10.24 million for a married couple) may never come again.

Hallowed ground

As prudent estate planners we must recognize that we are standing on holy ground.

The primary meaning of the word holy is "separate." It comes from an ancient word that means "to cut" or "to separate." A more modern interpretation would be "a cut above the rest."

That an individual can give away up to $5.12 million in assets this year is far and away a cut above the prior $1 million limit. It is a transcendent opportunity in the sense that it goes above and beyond what we have considered to be the norm.

We will, one day, look back on this watershed moment as one in which we either exercised wisdom or foolishness, resulting in fulfillment or regret.

First, there are the obvious planning opportunities. Practitioners should be alerted to the fact that far more clients will have taxable estates under the new law. Those clients who otherwise have not been concerned about or subject to estate taxes must be informed not only about the impending change in the law, but also what to do about it. They are now ripe for more sophisticated planning.

Of course, Massachusetts has had its own state estate tax on anything above $1 million since 2003 when it decoupled from the federal system. While many clients have been motivated by that to engage in more advanced planning, many others have remained lukewarm.

The selling point is that the state estate tax will not go away in 2013, but rather will be added to the federal tax to produce a fat, juicy tax bill. If the state tax alone didn't make your clients' blood hot, combining it with a federal tax will certainly start the cauldron boiling.

As a result, basic credit shelter and marital trust planning will become even more crucial for married clients, which would protect up to $2 million in assets from Uncle Sam. And for both single and married clients, irrevocable trusts, such as life insurance trusts, defective grantor trusts and personal residence trusts, as well as closely held businesses, are just a few of the tools that should find their way into the utility belts of more estate planners.

The difference between the wise and the fools will be the use of their tools.

Second, and more importantly, there is also the not-so-obvious planning landmine to consider.

Practitioners, especially those who only draft basic estate plans as an ancillary part of their practice, must wake up to the potential liability they face for failure to properly address this year's gifting opportunity.

Where does your duty lie? Let us not overlook the price to be paid for failing to keep clients reasonably informed in an area we claim to have expertise.

That price could look something like this: A single client with a $2 million taxable estate dies in 2013. Suppose that gifting was not addressed until after the first of the year when only $1 million could be gifted away, possibly because the client said he was not concerned about state estate taxes, while unaware of the impending federal tax. Or, maybe it was because his attorney was unfamiliar with the tax laws.

Whatever the reason, this year's gifting window had closed. The resultant tax bill in that scenario would be a whopping $435,000! However, if gifting had been completed before the end of this year, then the full $2 million could have been gifted away and no estate tax would be due.

Failing to inform your clients of the significant tax savings that can be achieved in today's environment could be disastrous. A $435,000 mistake is not likely to end well for any party involved.

To add insult to injury, the price tag could increase when you consider that assets gifted away may grow significantly.

For example, a transfer of $1 million today to a child in a trust that was invested broadly could grow in 30 years to nearly $6 million, at a 6 percent rate of return every year.

In that case, the parents would not only have removed the original $1 million from their taxable estate, but also any appreciation of the assets from the date of transfer. That could result in significant tax savings. Without making the $1 million gift, the parents would pay tax on the $5 million of appreciation, or more than $2 million in estate taxes.

The large amount that can be gifted this year acts as leverage for even more savings, and fodder for even more attorney liability.

The moral of this holy story is this: Estate planning professionals must not only recognize they are in the midst of an extraordinary opportunity, but also that the opportunity contains traps for the unwary.

You have the chance to impact the lives of clients by helping them protect what they have worked so hard to achieve. Or you can help them lose it. The choice is yours.

Choose wisely.

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