

## **BARBER EMERSON, L.C.**

### Summary of Advantages and Disadvantages of Outright Gifts

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The gift tax and estate tax exemptions, which have been separate since 2001, have been reunified under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act"), at the unified exemption amount of \$5,000,000.00, for the year 2012. With unification of estate and gift tax exemptions, an individual is now able to make up to \$5,000,000.00 of gifts during his or her lifetime, without paying any gift tax. Any gift tax exemption used to make tax free lifetime gifts will, however, be deducted at death from the available estate tax exemption. If Congress does not act to extend the 2010 Act beyond the year 2012, the estate and gift tax exemptions are scheduled to revert to \$1,000,000.00, and the maximum transfer tax rate is scheduled to increase from 35% in 2012 to 55% in 2013 and beyond.

The primary advantage of making an outright gift during one's life, as opposed to at the time of one's death, is to shift any appreciation of the gifted assets to the next generation, and perhaps to shift taxable income to a lower bracket taxpayer. The sooner a gift is made, the more appreciation and taxable income that will be shifted. Another advantage of making an outright gift, as opposed to other estate planning techniques such as creating a grantor retained annuity trust (GRAT) or a sale to an intentionally defective grantor trust (IDGT), is that no value is returned to the donor. The entire amount of the gift is removed from the donor's estate.

For example, assume in the year 2012 a Father gifts \$1,000,000.00 to his Son. As a result of the gift, Father's unified gift and estate tax exemption amount will decrease from \$5,000,000.00 to \$4,000,000.00, but no gift tax will be owed at the time of the gift. Furthermore, if at the time of Father's death in the year 2032 the \$1,000,000.00 gift has appreciated to \$4,000,000.00, none of the \$3,000,000.00 of appreciation will be included in Father's taxable estate. On the contrary, however, if Father does not make the \$1,000,000.00 gift to Son in 2012, but rather leaves the same assets to his son by will, the \$1,000,000.00 of value and the \$3,000,000.00 of appreciation (totaling \$4,000,000.00) will both be included in Father's taxable estate.

An outright gift of appreciated assets will be beneficial, however, only if the estate taxes saved from removing the value of the assets and the post-gift appreciation of the assets from the donor's estate is greater than the cost of losing the income tax step-up in basis available if the donor held the assets until the time of his or her death. The loss in the step-up in basis occurs because generally, a donee takes the donor's income tax basis, whereas if the donor held the asset until the time of death, the asset's basis would be "stepped-up" to its date of death value. The loss in step-up in basis will be significant, however, only if and when the asset is sold. Thus, if the asset is one not likely to be sold by the donee, the loss of the step-up in basis is not particularly significant. Consequently, before appreciated assets are gifted, a thorough analysis of the potential gift, estate, and income tax consequences should be conducted.

Furthermore, an outright gift of assets only will be beneficial if the assets appreciate in value during the donor's lifetime. If the gifted assets ultimately depreciate in value, part of the donor's unified estate and gift tax exemption will be wasted.

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