Great Time to Transfer Assets

The gift tax exemption has been raised, and business values are still depressed. This is a great time to transfer assets.

By David A. Ludgin

From the moment the 2001 tax bill was enacted there was considerable uncertainty about what would happen come 2011, when the ten-year life-span of the 2001 law was scheduled to have run its course. Although it took Congress and the President until the third week of December 2010 to hammer out the rules, the changes to the federal estate tax and gift tax law made by the new 2010 tax bill represent a substantial liberalization of the law. This will give a big assist to many succession plans.

From an estate and succession-planning standpoint, the heart of the new law is this: The lifetime federal gift tax exemption has been increased to $5 million per donor. For a married couple, the combined lifetime gift tax exemption thus is $10 million. These limits are *in addition to* the gift tax "annual exclusion," which allows a donor to make gifts of $13,000 per year ($26,000 for a married couple) to any number of recipients.

Until Jan. 1, 2011, the lifetime gift tax exemption was $1 million ($2 million for a married couple). Under the new law, even for a donor who previously made gifts above the limit and thus paid gift tax, there is still an additional $4 million of lifetime gift tax exemption.

For families and their advisers, this presents the opportunity to draw on the proverbial "clean slate." One consequence of the economic downturn is that values have fallen. For those who own a closely held business, it is a safe bet that, were you to sell, you can expect a lower price than you might have received five or six years ago. Likewise, if you own commercial real estate, values undoubtedly are lower now than they were back then. If you have a desire to transfer part of a business or any other asset to family members, the combination of still-depressed asset values and a huge increase in the gift tax exemption makes this a nearly irresistible time to act.

Gifting or selling

Many business owners are open to some level of gift giving but are not ready to relinquish control. If you own a corporation, consider recapitalizing it so there will be both voting and non-voting stock, and then give away some portion of the non-voting stock. You retain control through the voting stock. Even an S corporation may do this; issuing voting and non-voting stock does not violate the prohibition against two classes of stock, as long as the rights of each share are identical, other than their voting characteristics. For a business that is organized as an LLC, reconfigure the operating agreement so that there are two types of membership units, voting and non-voting, and then give away some of the non-voting units.

In some instances, an intrafamily sale of assets may be the best solution, either instead of or in addition to giving a portion of the business as a gift. The value of the underlying business or other asset probably is less than it was several years ago. Moreover, if the interest being sold or given is a minority interest, it is appropriate to consider downward valuation adjustments for lack of marketability and lack of control. If the asset to be sold will be paid for entirely or partially by a promissory note, the minimum interest rate that must be charged to meet IRS requirements remains very low by historical standards.

Tax advantages

What are the benefits to a lifetime transfer of assets, as compared with a transfer upon death? Many states impose a state-level estate or inheritance tax but do not levy a state-level gift tax. Simply put, assets given away during one's lifetime will not be there at death to attract state-level tax. With many state-level estate or inheritance taxes topping out at 16%, the potential savings can be appreciable. Moreover, to the extent that the asset given away thereafter grows in value, that appreciation now will belong to the gift recipient and thus will not be subject to estate tax upon the gift-giver's eventual passing.

The newly increased gift tax exemption also offers an opportunity to "even up" prior transfers to children or grandchildren. Many grandparents establish a trust as each grandchild is born. If the grandchildren are far apart in age, the current balance of the eldest grandchild's trust may far exceed the balance of trusts established for his or her younger siblings or cousins. Now that each grandparent has an additional $4 million of gift tax exemption, in some instances it may be appropriate to make "catch-up" gifts to those grandchildren with smaller trust balances.

Time is of the essence

There is reason to move expeditiously to take advantage of the increased gift tax exemption. On Jan. 1, 2013, the estate and gift tax exemptions are set to return to $1 million. Whether that actually will happen is anyone's guess, but there is something to be said for striking while the iron is hot. Moreover, on the premise that the economy gradually will recover, it is reasonable to assume that in the near future asset values will increase.

Some commentators have noted a technical "glitch" in the new tax bill, which might conceivably impose eventual estate tax on assets given away this year and next, if the estate tax exemption does indeed drop to $1 million in 2013. There is some reason to think that Congress will repair this oversight in the coming months. In all events, however, with proper planning one will be no worse off for having made gifts in 2011 or 2012, and for the reasons outlined above one may come out far ahead.
For those in a position to think about wealth transfer, truly there has never been a better time than now.

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