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Trusts & Estates Newsletter

JULY 2012

Not So Fast: The Complexities of Making Lifetime Gifts Using the $5.12 Million Federal Gift Tax Exemption

In prior Trusts & Estates Newsletters, we alerted you to the changes to the federal and Connecticut estate, gift and generation-skipping transfer taxes that resulted from legislative action at the end of 2010 and in 2011. Among those changes was an increase in the amount that each person may give away free of federal gift tax in 2012 to $5.12 million. That exemption amount is slated to expire at the end of 2012 and, if Congress takes no action, will revert to $1 million in 2013.

This increased exemption may provide certain clients with a unique opportunity to make significant lifetime gifts prior to year-end. However, while there has been much discussion of this "opportunity" in the press, there are many factors that impact whether making such gifts this year makes sense. Therefore, we thought it would be helpful to summarize some of the considerations that are part of that analysis and highlight some of the potential drawbacks of such gifts.

The primary consideration in determining whether to make gifts in 2012 to take advantage of the $5.12 million gift tax exemption is your comfort level. Put simply, not all clients will be comfortable with the idea of giving away such large sums because they are concerned they will need those funds during their lifetimes. However, if you are married, we can assist you in creating a gifting strategy that will allow you and your spouse to use all or a portion of the current $5.12 million gift tax exemption while still having access to the gifted property if needed during your lifetimes. If you are not married, there may be other ways to benefit from the gifted property. Such planning is somewhat complex and is not free of risk, and therefore not all clients may want to engage in it.

There are other potential drawbacks to making gifts in 2012 to take advantage of some or all of the present $5.12 million gift tax exemption. First and perhaps most important, property given away during life does not receive a step-up in basis at the donor's death. This may make 2012 gifts less appealing for those clients who would be using low basis assets for the gifts. In fact, it may take a number of years of appreciation of the gifted assets for the estate tax benefits of the gift to outweigh the capital gains cost of the gift if it were later to be sold by the recipient. The loss of the step-up in basis would be particularly unfortunate for clients who decided to make gifts now only to find that the gift tax exemption is not significantly reduced in 2013 and beyond.

In addition to the loss of step-up in basis for gifted property, Connecticut residents have a unique consideration in deciding whether to make gifts to use the $5.12 million federal gift tax exemption. Unlike other states, Connecticut imposes its own gift tax, against which each individual has a $2 million exemption. A $5.12 million gift over and above $13,000 annual exclusion gifts would create a Connecticut gift tax liability of approximately $240,000. However, gifts of out-of-state real property are not subject to the Connecticut gift tax. Accordingly, the Connecticut gift tax must be considered as part of the gifting

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Stuyvesant K. Bearns
James T. Betts
Coleman H. Casey
Bernardo G. Cuadra
Danielle P. Ferrucci
Stephen K. Gellman
Bryon W. Harmon
Charles B. Kaufmann, III
Lori E. Romano
Lesley I. B. Schless
Lyn Gammill Walker

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analysis. Finally, there is the possibility that if the $5.12 million gift tax exemption rolls back to $1 million at the end of 2012, the benefit of the expanded exemption amount might roll back as well, and the difference between the two exemption amounts might be includible in the donor's estate at death. This possibility is referred to among practitioners as the "clawback." Commentators have generally downplayed the possibility of the "clawback" taking effect, but until the legislative dust settles this possibility cannot be dismissed completely.

It is important to look beyond the headlines and not assume that gifts to use the $5.12 million federal gift tax exemption are appropriate for all situations. While taking advantage of the 2012 opportunity may be suitable in some circumstances, each client must weigh all of the relevant factors to determine whether to proceed with taxable gifts in 2012. Clients interested in making such gifts should contact their attorney in the Trusts & Estates Practice Group to determine whether such gifting is appropriate for their particular situation.

News from Our Trusts & Estates Group

Bryon Harmon recently earned certification as a **Certified Financial Planner**™ by the Certified Financial Planner Board of Standards, Inc. To receive the certification, candidates must meet relevant requirements for education, experience and ethics. In addition, successful candidates must pass a rigorous two-day examination on topics such as investment, estate, income tax, retirement and employee benefits planning.

One Constitution Plaza
Hartford, CT 06103-1919
860-251-5000

289 Greenwich Avenue
Greenwich, CT 06830-6595
203-869-5600

300 Atlantic Street
Stamford, CT 06901-3522
203-324-8100

12 Porter Street
Lakeville, CT 06039-1809
860-435-2539

1133 Connecticut Avenue NW
Washington, DC 20036-4305
202-469-7750

www.shipmangoodwin.com

Trusts & Estates

Stuyvesant K. Bearns
(860) 435-2330
sbearns@goodwin.com

James T. Betts
(860) 251-5150
jbetts@goodwin.com

Coleman H. Casey
(860) 251-5112
ccasey@goodwin.com

Bernardo G. Cuadra
(860) 251-5770
bcuadra@goodwin.com

Danielle P. Ferrucci
(860) 251-5105
dferrucci@goodwin.com

Stephen K. Gellman
(860) 251-5109
sgellman@goodwin.com

Bryon W. Harmon
(860) 251-5106
bharmon@goodwin.com

Charles B. Kaufmann, III
(203) 869-5600
ckaufmann@goodwin.com

Lori E. Romano
(203) 869-5600
lromano@goodwin.com

Lesley I. B. Schless
(203) 863-6431
lschless@goodwin.com

Lyn Gammill Walker
(860) 251-5146
lwalker@goodwin.com

www.shipmangoodwin.com/trustsandestates/

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