

Do Not Miss Out on the Tax Planning Opportunity of a Lifetime!
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On December 17, 2010, Congress and President Obama signed legislation that took most people by surprise when they agreed to increase and unify the federal estate, gift, and generation-skipping transfer (“GST”) tax exemptions to a single sum of \$5 million per person for a temporary two year period of time. This amount has been further increased in 2012 by inflation adjustments to an amount of \$5.12 million per person. What this means is that an individual can give away property this year, either while living or at death, up to \$5.12 million in value without incurring gift or estate tax, assuming such individual has not previously used any of his or her federal exemption; and a married couple can give away up to \$10.24 million this year. This legislation also extended the beneficial Bush federal income tax cuts that cut capital gain tax rates to an all time low.

The federal legislation implemented at the end of December, 2010, is only in place until December 31, 2012. Unless Congress passes new legislation that either extends the current law or changes it to something different, on January 1, 2013, the gift, estate and GST tax law will automatically revert to the federal tax laws in place in 2000, which effectively reduces the gift and estate tax exemptions to \$1 million, and the GST exemption to \$1 million plus inflation adjustments. The gift, estate and GST tax rates will also revert to a top rate of 55% from the current flat rate of 35%. Additionally, the income tax cuts will also expire and revert of pre-2001 rate levels. This adverse change in the tax laws would result in many closely-held businesses being subject to federal and state estate tax laws, should the principal owner(s) die after 2012. Since most business owners reinvest a large portion of profits back in to the business, it is much more likely that there may not be enough other liquid assets in a business owner’s estate to pay the applicable taxes due at death. That being the case, a “fire sale” of the business under not so advantageous terms may be required to settle these tax liabilities.

In addition to all of the above, we have entered a historic period where the baby boomer generation is looking toward the next chapter in their lives and seeking to retire and transition businesses in record numbers. The intersection of all of these events has created the best tax planning opportunity that most of us will experience in our lifetime!

Although many of the ultra-wealthy are utilizing wealth-transfer strategies to take advantage of this temporary law, it is really the closely held business owner who has the greatest opportunity to benefit from this favorable, but likely expiring, legislation. With business and real estate values still depressed and interest rates at historical lows, the business owner who is looking to shift the business itself or some of its value at sale to the next generation or beyond has significant leverage to do so without incurring a current gift tax, paying historically low capital gains tax, and potentially avoiding or minimizing estate taxes for their loved ones in the future.

This article will briefly examine some of the techniques a business owner may utilize to take advantage of such tax planning opportunities before the window closes at the end of this year.

- Outright gifts of company stock or company real estate (“business interests”) to family members, with the possibility of using discounts on the basis of minority interests, lack of marketability, and built-in capital gains tax with respect to such interests, which can reduce value by a significant amount;
- Gifts of business interests in trust for the benefit of family members utilizing the same discount methods previously described to protect such assets from creditors and to maintain in management or use of company assets by selection of a trustee by the business owner. A trust can be short term, or long term with the potential to serve multiple generations, depending on the goals that the business owner is trying to achieve;
- Sale to a “grantor trust” to leverage and minimize the amount of gift exemption and GST exemption utilized, and to create an income stream for the business owner for a period of time;
- Gifts of business interests to a spousal lifetime access trust, which is primarily for the benefit of younger generations, but allows for a so-called “safety valve” by giving the independent trustee the ability to distribute income and/or principal to the business owner’s spouse while such spouse is living;
- Lump sum funding or pre-funding of premiums for life insurance owned by a life insurance trust, to keep the proceeds of such life insurance out of the insured’s estate;

Many of the above techniques can be used for transitioning the business to one or more family members at today’s value (or perhaps even less with available discounts) so that any appreciation of the business at the time of the business owner’s death is outside of his or her estate. Not only will such appreciation escape federal estate tax, but making such transfers now will also significantly reduce any state estate tax due at death.

If the business owner does not envision transitioning the business to any family members to continue to run the business, but instead foresees a sale of the business in the future, these techniques can still be successfully utilized to pass wealth down to younger generations while minimizing future estate taxes. The business owner can employ one of these techniques to transfer business interests to the next generation or beyond before any contemplated sale and have such family members benefit from the sale directly when such sale materializes.

Finally, it is important for the business owner to keep in mind that use of the wealth transfer methods described above do not need to be an all or nothing proposition to work successfully. Instead, depending on the business owner’s own financial needs and goals, these techniques can be structured to transfer only a small percentage or piece of the business interests or the entire business, or something in between. It is critical that the business owner, along with his or her team of advisors (business lawyer, estate planning lawyer, accountant and financial advisor) work together to determine what makes the most sense in each individual’s circumstances. However, I implore anyone thinking about taking advantage of this tax planning opportunity to start now, as the end of the year will be here before you know it!

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