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Expiring Tax Saving Opportunities

Did you know that on January 1, 2013 (just ten months from now), our tax laws in the U.S. will be changing? Based on the increases required under the Patient Protection and Affordable Care Act passed in 2010 and expiring Bush tax cuts, our taxes will look like this:

- Top tax rate on ordinary income will rise from 35% to 43.8%
- Top tax rate on capital gains will rise from 15% to 23.8%
- Top tax rate on dividends will rise from 15% to 43.8%
- Gifts and Estate tax exemption will decrease from $5,120,000 to $1,000,000 while top rate increases from 35% to 55%

These changes will take effect automatically on January 1st, unless Congress and the President agree to an alternative tax policy. It is a fact that Congress and President Obama did not agree on tax policy often in 2011 and that our federal government is running up huge budget deficits. Thus, higher taxes will likely be the law in 2013. Therefore, now appears to be an opportune time to proactively implement strategies to decrease your tax base. Here are some techniques that can decrease your income tax base or estate tax base, or both:

1. **Transfers to Trusts**. You can transfer assets to trusts via gifts or sales and remove those assets from your estate tax base and income tax base for certain trusts. Some trusts simply freeze the value of the assets for purposes of determining your estate tax liability. An additional benefit of transferring property to trusts is that the **assets are protected from your and your beneficiaries' creditors**. Examples of this strategy include: (a) sales to grantor trusts, (b) gifts to grantor retained annuity trusts or "GRATs", (c) gifts to irrevocable life insurance trusts or "ILITs", and (d) gifts to charitable trusts, such as CRTs and CLTs (that can also provide you with an income tax deduction).

2. **Using Limited Partnerships**. Gifts through limited partnerships tend to lower your estate tax base because they can create discounts that you can apply to the gifts. For example, if you give someone $1,000,000 of land, it is a $1,000,000 gift. If you contribute the same land to a limited partnership and you gift ownership units in the limited partnership, the gift could be in the range of $700,000 (i.e., a 30% discount). Thus, you can give more for less. Furthermore, the limited partnership structure can provide you and your beneficiaries with additional asset protection. **Taking advantage of transactions that utilize limited partnerships and other discounting environments may not be an option in the future**. Over

the last couple of years, proposals have been issued to eliminate discounts involving non-operating businesses, such as land.

3. **Additional Strategies**. Family loans and private annuities can also freeze the value of assets for estate tax calculations and shift the income tax liability on assets to beneficiaries in lower income tax brackets. In general terms, both of these strategies involve selling high income producing and/or high appreciating assets for the promise to receive a series of fixed payments. After the transaction is consummated, all income generated by and appreciation in value of the sold assets, in excess of the fixed payments, passes to the beneficiary that purchased the asset. These strategies can be set up to not cause any gift tax liability, but may trigger capital gain income tax. However, **with the current capital gain tax rate due to rise from 15% to 23.8% next year, paying that tax now at the lower rate would be more beneficial**. Plus, paying the capital gain tax now would also give your beneficiaries a higher income tax basis in the asset and save her or him income taxes on her or his subsequent sale of the asset. These strategies can be structured so that the beneficiary's obligation to pay the fixed payments can end at your death, which results in a windfall to the beneficiary.

We have only briefly summarized these estate and income tax strategies. If you would like to have a more in-depth discussion, we would be happy to sit down with you personally to specifically discuss how much estate and income tax you might save. Furthermore, these tax saving strategies can be integrated with other business and estate planning techniques, such as transferring control of the family business or home to certain beneficiaries and other family assets to other beneficiaries, to create cost savings. Please note that some of these strategies can take a few months to implement and each needs to be in place by December 31, 2012 in order to take advantage of the current tax rates and exemptions. Therefore, please do not hesitate to contact Ted A. Koester at 312-924-4257 or via e-mail at tkoester@lksu.com (Ted A. Koester's profile).