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Top 10 Ways to Transfer Wealth

By Elizabeth Harris – February 1, 2012

When President Obama signed the Tax Relief Act into law last December, the new legislation paved the way for individuals and families to give away an unprecedented amount of money without triggering any IRS penalty. Through 2012, the lifetime gift exclusion rises from $1 million to $5 million, with a 35 percent tax rate on anything over that amount. The change means individuals can give up to $5 million tax-free; couples, twice that. For the same period, the estate tax allows a $5 million exemption. Estate attorneys and financial planners advise their clients to act now—before the generous new limits disappear. Here are 10 strategies for doing just that.

01. SIMPLE GIFTS

The new $5 million gift-tax threshold set for each individual encourages outright gifting. Drew McMorrow, managing director and senior client advisor with Waltham, Mass.-based Ballentine Partners, advises his clients to take advantage of these generous limits to provide responsible adult children and grandchildren with portfolios of their own. "It's not healthy for adults, even young adults in formative years of learning the financial ropes of life, to live under the wing of trustees all the time," McMorrow says.

02. IRREVOCABLE LIFE INSURANCE TRUSTS

The new legislation makes irrevocable life insurance trusts, already a key estate planning technique, even more attractive. Funding a trust using the new $5 million threshold, which then pays for life insurance premiums, creates a multiplier effect. Another aspect of their appeal is that life insurance trusts settle exactly how much each heir will receive. All planning should be reviewed when tax laws change, as they are likely to in the future, says Virginia-based Jonathan Forster, a partner and national chairman of the wealth management group at Greenberg Traurig, a law firm, but the irrevocable life insurance trust "doesn't have to be revisited every time Congress acts."

03. GRANTOR RETAINED ANNUITY TRUSTS

Many estate attorneys and planners expected a tax change to grantor retained annuity trusts, or GRATs, and were pleased that the new legislation left this planning tool untouched. The GRAT helps shift future appreciation of contributed assets to children at a minimal tax cost. To work, the assets transferred to the trust must appreciate at a higher rate than an IRS-set hurdle rate. Today's low interest rate environment means a low investment performance bar to cross; the February IRS rate was 2.8 percent.

04. INCOME TAX PAYMENTS

Don't overlook the value of paying the annual income tax for the gains and taxable earnings of assets held in grantor trusts. While not a particularly complex strategy, it will prove valuable over time. "None of the income tax payments are considered gifts," McMorrow explains. "This is a way of leveraging up the exemption."

05. DYNASTY TRUSTS

The substantial gift-tax exemption aids planning for future generations through dynasty trusts, also known as generation-skipping trusts. Families who establish dynasty trusts in Delaware could shield their assets from estate taxes for up to 500 years. "For people who are very wealthy, this is a boon," Forster says. Moving the assets now also protects all future appreciation from taxes.

06. DISCOUNTING APPRECIATED ASSETS

The higher lifetime gift-tax exemption provides a great opportunity to look at assets you can discount such as businesses, family limited partnerships and real estate. Say, for example, that a business is valued at $7.5 million, but for gift purposes you can discount that value to $5 million—you can apply the full gift-tax exclusion while gaining a higher actual value. "We're leveraging our exclusion," according to Allen Laufer, managing director and director of financial planning with New York City-based Silvercrest Asset Management Group.

07. QUALIFIED PERSONAL RESIDENCE TRUSTS

Thanks to the higher gift-tax exemption, the qualified personal residence trust, or QPRT, benefits even more people than it used to. For clients with substantial value tied up in residential property who intend their children to own it eventually, the higher exemption lets them allocate a larger amount to the QPRT. The contribution requires making a taxable gift, but the higher gift allowance provides a bigger exemption. "It's a good strategy for getting a residence off the balance sheet," McMorrow says.

08. DEFECTIVE GRANTOR TRUSTS

Avoid gift and estate taxes with the defective grantor trust. If you seed a defective grantor trust with, say, $1 million, then sell assets worth up to nine times that amount with the trust issuing a note to the grantor, any gains in the trust assets in excess of the note's interest grow tax-free. "The sooner you can use the exemption, the better," Laufer says.

09. ROTH IRA CONVERSIONS

Proposed income-tax hikes in the future make the next two years an ideal time to convert traditional IRAs to Roth IRAs. With the top income tax rate capped at 35 percent today, you can likely secure a lower tax bill now.

10. ANNUAL GIFTS

Don't neglect the relatively modest but still significant annual $13,000 tax-free gifts. (No matter what it means to you, it can mean a lot to the recipient.) This sum, as well as education and health-related expenses paid directly to schools or health care providers, should continue since such gifts and payments don't count toward the estate tax exemption, making it a use-it-or-lose-it gift. "Annual gifting makes sense for continuing to move wealth," Forster says. "You can't accumulate it."