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The Rush to Avoid Gift Taxes
How to Make Sure You Don't End Up With 'Donor's Remorse'

By Kelly Greene – March 16, 2012

As the deadline approaches for taking advantage of the government's $5 million gift-tax exemption, estate planners are dealing with the fear of "donor's remorse." Families are looking to set up so-called irrevocable trusts to pass along assets to their heirs without paying gift tax—but worry they will change their minds later in life or will need to get the money back one day.

An irrevocable trust can't be undone, making it one of the best ways to move assets out of an estate—and thus avoid estate taxes.

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But what if you run out of money later in life? Or have a fight with one of your kids? Or want to change the terms if your son develops a drug problem, or your daughter turns into a shopaholic? If you have an irrevocable trust, you generally are out of luck.

"Irrevocability is a serious proposition," says Joe McDonald, an attorney who helped found Concord Trust in Concord, N.H. "What it really means is that you can't get the assets back. It means you can't amend the trust."

There are, however, ways to make trusts more flexible, while still technically giving away your assets and lowering your estate's tax bill down the road.

The gift-tax exemption is a gift horse to many wealthier families. At the beginning of last year, the exemption shot up from $1 million for single filers and $2 million for married couples to $5 million and $10 million, respectively. (Congress changed the rules on estate taxes at the same time, raising that exemption to $5 million and lowering the rate to 35%, also for two years.)

But the exemption lasts only through the end of 2012, after which the old limits will return unless Congress intervenes.

That makes it tempting to give your kids as much as possible now. Here are some tools.

- **Self-settled trusts. With a self-settled trust, a type of irrevocable trust, the donor can give the assets away—but also can have a way to tap them in a pinch, Mr. McDonald says.**

First, a word about these trusts: They are authorized in only a handful of states, including Alaska, Delaware, New Hampshire and South Dakota. If you don't live in one of those states, you would transfer the assets you want to give away to a third-party trustee.

To be allowed to use the assets after putting them in such a trust, the donor would be designated as a beneficiary who is "eligible" but not "entitled." The trustee would decide whether an eligible

beneficiary could get a requested distribution. And the trust's assets generally wouldn't be subject to the donor's creditors, Mr. McDonald says.

The problem with self-settled trusts: They haven't been around long enough to have gone through many legal tests. Private-letter rulings, which are Internal Revenue Service decisions on individual cases that don't set legal precedent, have found that one transfer into a self-settled trust in Alaska was a completed gift and that another trust there was outside an estate.

Mr. McDonald suggests that donors who want access to some assets, but are worried about the lack of legal precedent, could put the bulk of their gift into a more traditional trust and the rest—maybe one-quarter—into a self-settled one.

- **Trust protectors. You can design a trust to have a third-party "trust protector"—often a relative overseeing a professional trustee. The protector can drop a beneficiary, veto distributions, amend the trust's terms or move it to another state if the laws there turn out to be more advantageous, Mr. McDonald says.**

You also can form an investment committee and a distribution committee so that you aren't leaving all decisions to a corporate trustee, adds David First, a CPA in charge of the trust-and-estates practice at New York accounting firm Marcum. For the investment committee, you could appoint three different investment advisers (who could be replaced by the trust protector). The distribution committee could be a group of family members who work well together, almost like a board of directors, he says.

- **Spousal beneficiaries. If you are looking for a strategy that's less involved than a self-settled trust, but you still are concerned about having access to the assets, you could designate your spouse as a "discretionary" beneficiary of a more traditional trust, says Diana Zeydel, an estate-planning attorney at Greenberg Traurig in Miami. You could draft the trust so that a distribution could be made to your spouse from time to time.**

- **An even easier strategy, she says, would be for each spouse to create a trust for the other. You just have to have enough differences between the two trusts so that they aren't considered "reciprocal," or mirror images, Ms. Zeydel says. "That is one of the ways where you give [your assets] away, but they haven't left the senior generation."**

- "Grantor" trusts. Whichever type of trust you use, make sure it is designated as a grantor trust, meaning the donor pays any income tax or capital-gains tax owed on the assets each year, Mr. McDonald says—so those payments aren't considered additional gifts.

For example, if you put an asset with an $8 million gain into a trust and you pay more than $100,000 in taxes, the payment isn't considered a gift because you have a legal obligation to pay it. Estate planners, says Mr. McDonald, are watching a proposal in President Obama's budget that could eliminate this advantage.