WILLMS, S.C.

LAW FIRM

TO: Clients and Friends of Willms, S.C.

FROM: Maureen L. O'Leary

DATE: November 27, 2013

RE: Annual Exclusion Gifting After the American Taxpayer Relief Act of 2012

Have you considered whether you want to make any gifts before the end of the year? In 2013, the annual exclusion for gifts is $14,000. This means that everyone can give up to $14,000 in 2013 to as many people as they desire, without any gift tax consequences.

For example, a married couple could give up to $28,000 ($14,000 x two donors) to each of their children in 2013. A married couple could also give up to $28,000 to each of their sons-in-law, daughters-in-law, grandchildren, etc. This allows for the possibility of significant gifts without gift tax and without the use of any of the donor's lifetime gift tax exclusion.

The lifetime gift tax exclusion in 2013 is $5,250,000 per person. This means that in addition to annual exclusion gifts, everyone can give away up to $5,250,000 over the course of their lifetime without gift tax. Unlike the annual exclusion, the $5,250,000 limit does not apply to each beneficiary, but rather is a $5,250,000 combined limit for all gifts made to all beneficiaries.

Although a $5,250,000 lifetime gift tax exclusion may seem high, there are numerous reasons why it is wise not to waste your lifetime gift tax exclusion. For example, every dollar you use of your lifetime gift tax exclusion reduces the amount of your estate tax exclusion that is available to shelter your assets from estate tax at the time of your death. Furthermore, it is possible that the lifetime gift tax exclusion and estate tax exclusion amounts may drop in the future. Therefore, annual exclusion gifting can be a valuable opportunity to transfer assets without using any of your lifetime exclusion.

There can be many benefits from making annual exclusion gifts up to $14,000 per person, such as:

1. If there is a possibility your estate may exceed the estate tax exclusion amount at the time of your death, annual exclusion gifting is an easy and tax-free way to slowly reduce the size of your estate.

2. Annual exclusion gifts may allow the recipients to contribute to an IRA, 401(k) or similar plan that provide various income tax benefits. The recipient may not have otherwise been in a position to contribute to such plans without the gift.

3. Annual exclusion gifts may allow the recipients to pay premiums on a life insurance policy they might not otherwise afford. The life insurance policy could prove to be a valuable investment, and the eventual death benefit is income tax free to the beneficiary.

4. Annual exclusion gifts consisting of a few shares of stock in the family business can be a good way to introduce younger family members to business ownership and allow for a smooth, steady and gradual transition of ownership.

Oftentimes, there is no need to file a gift tax return when gifts are within the annual exclusion amount. However, sometimes it is necessary or at least prudent to file a gift tax return even when gifts are limited to the annual exclusion amount, such as when gifts are made to trusts or the gifted assets are hard to value. We would be happy to advise you regarding whether we recommend a gift tax return be filed for your particular situation.

However, the landscape of annual exclusion gifting after the American Taxpayer Relief Act of 2012 is not the same as it was prior to the Act. The American Taxpayer Relief Act of 2012 was signed into law on January 2, 2013 and provides for a "permanent" combined estate and gift tax exclusion amount of $5,000,000 indexed for inflation (thus, $5,250,000 in 2013).

Prior to 2013, many families were in the practice of making annual exclusion gifts of family business interests, such as LLC Units and shares of stock, for the purpose of reducing the size of their estates. However, if the estate tax exclusion amount remains high, some families may no longer need to worry about estate tax. In that case, there may not be any estate tax benefits resulting from annual exclusion gifting. However, this is hard to determine because the exclusion amount is only "permanent" until Congress and the President decide to change it again.

If you are considering gifting assets such as LLC Units or shares of stock, the income tax basis of those business interests should first be considered. The income tax basis of an asset gifted during life is the same in the hands of the recipient as it was in the hands of the donor. As a result, if you gift a share of stock with an income tax basis of $10,000 but a fair market value of $50,000, the recipient's basis in the stock will also be $10,000. Accordingly, if the stock is sold, it will result in taxable gain for income tax purposes. In contrast, if you were to retain ownership of the stock until your death and then the same

recipient inherited the stock at that time, the fair market value of the stock at the time of your death becomes its new income tax basis. For example, if the stock has a $10,000 basis and a fair market value of $50,000 at the time of your death, the recipient who inherits the stock receives a stepped up basis to $50,000. As a result, the recipient could sell the stock after your death without any income tax consequences.

We understand that the issues surrounding whether to make gifts, how much to gift and what assets to gift can be very complicated. Please do not hesitate to contact us if you are considering making gifts before year-end. We would be happy to talk to you about the pros and cons of making the gift and suggest ways to maximize the benefits of any gifts you make.

<u>END OF MEMO</u>