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Should or Can Your Clients Undo Large Taxable Gifts from 2010?

Last year, many clients were encouraged by their estate planning attorneys to make taxable gifts before tax rates were expected to rise this year.

The advice made sense since lifetime gifts are a key estate-planning tool. They reduce tax burdens on an estate, and if the assets increase in value after being disbursed, the appreciation is tax-free.

With both the gift tax and the estate tax automatically scheduled to increase to 55 percent in 2011, last year's 35 percent gift-tax rate on gifts greater than $1 million seemed like less of a sting.

Expect the Unexpected

However, Congress did what we might expect it to do. As a result, many of those same lawyers are now trying to figure out how to reverse those 2010 taxable gifts.

They're scrambling because of a sweeping tax overhaul that Pres. Obama signed Dec. 17th. Under the new law, the amount you can transfer tax-free during life went up from $1 million to $5 million ($10 million for married couples).

If some of these lawyers had instead told clients to wait until 2011 to make gifts, it might have been possible to avoid gift taxes entirely.

What's more, the tax on transfers that exceed the limit ***stayed*** at 35 percent, instead of going up to 55 percent.

The new rules don't affect the annual exclusion. Clients can still give as much as $13,000 per year ($26,000 for couples) to as many people as they like without it counting against the lifetime limit.

However, clients who were far more generous than that could develop a bad case of donors' remorse on April 15th.

So Now What?

Unfortunately, fixing this problem isn't as simple as returning an ugly tie to a department store.

The formal act of turning down a gift or inheritance is called a disclaimer. The receiver of the gift must disclaim within nine months of receiving it and may not have accepted any interest in the asset or any of its benefits.

These rules might not pose an obstacle for clients who transferred shares in a family limited partnership. But if a client transferred shares of publicly traded stock or cash and the recipient did anything to make the disclaimer invalid, it is a problem.

Your client may also be out of luck if the gift recipients sold the assets or otherwise already benefited from them.

If your client made a $1 million cash gift last year to a child who has already spent most of the money, then there is no chance of a disclaimer.

You Don't Have to Re-Write History

Simply returning a gift might seem like a smooth fix. But the person returning it is, in turn, making a gift of his own, which requires using his own gift tax exemption. Plus, it does not keep an original donor from owing a gift tax on April 15th.

One possible solution being suggested is a legal doctrine called rescission. You must show that there was a mistake in judgment made based on what the tax rates were expected to be in 2011, rather than a mistake of material fact.

Be aware that if there is no third-party record of a gift, a client might resort to rewriting history, meaning that those gifts suddenly "never happened." This is a bad idea, and you should caution clients against trying to defraud the IRS.

In the end, this wasn't the fault of the estate planning attorney who advised your client to make taxable gifts in 2010. That advice was good at the time, and no one has a crystal ball on what Congress will ever do.

As always, I hope this article has helped you and your clients. If you have a specific case or concern, please call our office.

This complimentary publication is provided courtesy of:

TIMOTHY O. DAVIS
Phone: 952-746-2104
Email: tdavis@hjlawfirm.com

SUSAN L. ANDERSON
Phone: 952-746-2123
E-mail: sanderson@hjlawfirm.com

Tim is a partner in the firm with 27 years of experience. Susan brings over 15 years experience. Both Tim and Susan specialize in Estate and Business Planning, Probate and Trust Law, and related Tax matters. They assist clients in creating estate plans that provide for the control, maintenance, and disposition of their assets in a manner consistent with their objectives.

Hellmuth & Johnson, PLLC has 38 attorneys and is a full service firm offering legal services to individuals and businesses, with a heavy concentration in real estate, real estate construction and litigation matters.

HELLMUTH & JOHNSON PLLC
ATTORNEYS AT LAW

10400 Viking Drive, Suite 500
Eden Prairie, MN 55344
Phone: (952) 941-4005
Fax: (952) 941-2337
Web: http://www.hjlawfirm.com

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