

ABOUT THE AUTHOR



Terry LaBant leads our Wealth Strategies team. Terry has 20 years of experience consulting with clients in six core

areas that influence the creation, preservation and protection of family wealth. They include: tax planning, business planning, succession planning, estate planning, retirement planning and asset protection.

'Tis the Season for Giving?

The 2010 Tax Act brought back the estate tax with higher exemptions and lower tax rates. It also provided for a reunification of the gift and estate tax exemption amounts for the first time in several years.

The higher gift tax exemption and lower tax rates available under the 2010 Tax Act provide the most important and often overlooked planning opportunity for our clients. Congress realized in hindsight the scope of benefits it had created. The Congressional "Super Committee" even considered measures to remove the gift tax planning benefits it created less than a year earlier.

Although the Super Committee may not have completed its mission, we now know that Congress may revisit its stance on gift taxes and the planning opportunities that it affords. Although the 2010 Tax Act is considered a temporary measure that is scheduled to sunset on December 31, 2012, does the higher gift tax exemption amount represent a tax planning opportunity worth considering? We certainly think so.

Historical Perspective

Historically, each taxpayer has had a gift tax exclusion amount that could be used to make taxable gifts during life without paying any related gift tax. During the Bush Tax cut years and throughout 2010, the gift tax exclusion amount was frozen at \$1 million and a flat 45% tax rate applied thereafter to taxable gifts made during 2010.

Under the 2010 Tax Act, each taxpayer now has a gift tax exclusion amount that will shelter the first \$5 million of taxable gifts from gift tax. A flat 35% tax rate will apply to taxable gifts made thereafter.

If a taxpayer makes gifts to grandchildren, they could be subject to a separate generation-skipping transfer ("GST") tax. This separate tax is designed to discourage gifts to grandchildren and younger family generations and encourage the payment of estate tax at each family generation. However, the separate GST tax exemption amount will shelter the first \$5 million of taxable gifts from GST tax. So, even gifts to grandchildren are advantageous under the 2010 Tax Act.

'Tis the Season for Giving?

As noted above, this represents the first time in several years that the gift and estate tax exemptions are the same. Tax rates are now historically low and exemption amounts are historically high. This means that you can make greater lifetime gifts without paying any tax.

Caveats

You will reduce your gift and estate tax applicable exemption amounts when you make taxable gifts to your children and, as noted above, you also will reduce your GST tax exemption if you make these gifts directly to grandchildren or to trusts for their benefit.

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And, time remains of the essence to complete these gifts since the changes provided under the 2010 Tax Act currently are scheduled to expire after December 31, 2012 (unless Congress acts earlier). Afterwards, the gift, estate and GST tax exemptions are scheduled to fall to \$1 million (the latter two indexed for inflation), and the tax rates are scheduled to increase to 55%.

To complicate matters further, recent House proposals have sought to change the gift and GST tax exemption amounts to 2009 levels. During 2009, as a reminder, the gift tax exemption amount was \$1 million and the GST tax exemption amount was \$3.5 million. These proposed changes would further complicate and reduce the benefits of making gifts otherwise available under the 2010 Tax Act. So, the clock may be ticking even louder for those considering larger gifts for the benefit of their family.

Planning Opportunity

We met with two separate clients recently who inquired about the benefits of making large gifts to their families. One client owned a business that he intended to sell within the next several years. Another client owned real estate that had remained in the family for generations.

The business and the real estate each were valued historically low in light of current market conditions. However, each asset also maintained significant built-in value potential for appreciation. Their assets differed, but their concerns were similar.

Each client asked the right questions. Should they consider making large gifts of their assets to their families in light of opportunities afforded by the 2010 Tax Act? With laws subject to change by 2013, is there any downside to acting now?

In other words, what may happen from a tax perspective to clients who make large gifts now if Congress later would reduce their gift and estate tax exemption amounts or change tax rates?

The Clawback Question

Some originally speculated that such changes could result in a “clawback” of the gifts and result in clients receiving gift tax bills or worse yet having to pay an estate tax that exceeds the remaining assets of their estate! Most commentators believe that Congress never intended such a result and the IRS even has agreed publicly.

If clawback could become a concern, it may affect estate taxes but not gift taxes based on how each is calculated. If it would affect estate taxes, individuals would be no worse off later than they could be if making taxable gifts now. This remains true because lifetime gifts always are always added back when determining an individual’s estate tax liability.

Gift Away

Even so, there are additional reasons that still favor lifetime gifts. Although taxable lifetime gifts are always added back when calculating estate taxes, the future appreciation of the gifted assets is never included for that purpose. In fact, the removal of asset appreciation from your estate remains a key benefit to making lifetime gifts.

There also are gift techniques that are designed to keep the value of your gifts within the \$5 million lifetime gift tax exemption limit if necessary. For example, you can use certain trusts with retained rights to lower the value of your gifts for tax purposes. You also can partially gift and partially sell property to avoid triggering gift taxes. In each case, gifts are minimized and future appreciation is moved out of an estate to contain taxes. All of these techniques still work under the new law.

Annual Gifts that Remain Free

This discussion focuses on planning when you make taxable gifts. As a reminder, you still can make annual exclusion gifts without reducing your lifetime gift tax exemption at all. For 2011 and 2012, taxpayers can make gifts to anyone in the amount of \$13,000 each year (\$26,000 for married couples when a spouse joins in the gift) without reducing their lifetime exemption amounts. Each person also can make unlimited gifts to benefit anyone at any time when paying educational tuition expenses or medical care directly to the service provider. These additional gifts remain a great benefit as well because they help reduce your estate.

Note: The 2010 Tax Act provided for an inflation adjustment that increased the estate, gift and GST tax exemption amounts to \$5.12 million for 2012.

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Some materials referenced are based on the The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Act"). The materials are as of the date of publication and are subject to change due to changes in the legal and/or regulatory environment and may not necessarily come to pass. This discussion is intended to be informational only and is not exhaustive or conclusive.

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