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April Fools' Day in January for Estate Planners – Donor's Remorse?

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January 2 felt like a mix between the *Twilight Zone* and April Fools' Day for us, and we suspect for most of our fellow estate planners (as well as for many of our clients). During prior years in our careers, we've had a few time- sensitive year-end matters to manage for clients, but the end of 2012 was far busier than any prior year in our combined 30 years of practice (we were coordinating with clients up until about 4:00 p.m. on New Year's Eve). After inquiring with our colleagues, and as we recently learned from other estate planners at an annual estate planning conference we attended in Orlando, Fla., in January, many have had similar experiences, recounting stories of coordinating with clients and their financial advisors on the very last day of the year.

We were extremely busy working with clients from right around Election Day until December 31 – helping many assess whether to and how to capture the $5.12 Million exemption from the federal gift, estate and generation skipping transfer taxes for the benefit of their families before it was potentially was reduced to $1 Million on January 1 under the law as it then existed. And then, when we heard the news on January 2nd, that Congress had increased the exemption to $5.25 Million, we learned that all of the effort and stress for us and our clients was for no apparent immediate gain.

So, it now appears that those clients who chose to not let the tax tail wag the dog have no reason for regrets, and we'll learn over the coming months whether those who chose to act wish they had also stayed on the sidelines. To date, we've not heard of any "donor's remorse" among our clients, but perhaps that's because they remain in shock for the time being.

As a matter of fact, for several reasons, we don't expect that our clients who took action in December will have donor's remorse. First of all, although, technically the exemption is now "permanently" set at $5 Million, as indexed for inflation (whereas, previously, ever since the 1997 Tax Act under President Clinton, it had been a moving target, and set to revert to $1 Million this year), there's no guarantee that Congress will not reduce the exemption in the future. After all, in 1997, the exemption was only $600,000, and we have not had nearly enough inflation for it to reach $5.25 Million (on an economic basis) over the last 15 years. So, in the event the exemption will be reduced down the road, clients who took action last year will not likely need to rush around again to develop and implement a plan to lock in the exemption before it expires.

Another reason not to have donor's remorse is that it is generally always good planning to transfer assets sooner rather than later for transfer tax planning purposes. By doing so, the appreciation is transferred out of a taxpayer's taxable estate. While it's true that appreciated assets will not benefit from the basis step-up at death for capital gains tax purposes, for the time being, the federal estate tax rate remains significantly higher than the capital gains tax rate, even with the new Medicare tax, so, it can be a good arbitrage to opt to potentially pay more capital gains tax in order to save estate tax. Also, for the time being, there are a number of planning techniques available using grantor trusts that allow taxpayers to have their cake and eat it too – if monitored successfully, grantors will be able to, prior to death, swap appreciated assets in such trusts for higher basis assets and thus secure a basis step up while still avoiding estate taxation on the appreciation in the assets.

For taxpayers who live in Pennsylvania and New Jersey a significant advantage to making multi-million dollar gifts last year (or any year) is the ability to save state inheritance and estate taxes at death. For a typical Pennsylvania resident who lives more than a year after the transfer, the savings on a $5.12 Million gift will be, at least, $230,000. For a New Jersey resident, the savings could be at least $405,000. Although that's far less than the savings of more than $2 Million that could have been realized if the federal exemption from estate tax had dropped to $1 Million, it is still a pretty good return on investment for the cost and effort of implementing the planning.

In some cases, the effort to put planning in place last year was a welcome opportunity for procrastinating clients to develop their long term (and likely permanent) estate plan that they wanted to address in the first place. It gave them a deadline to help them focus (a deadline which, in retrospect, was much more pleasant than a terminal illness often provides for our clients). Those clients have the satisfaction of knowing that they have now checked this project off of their list and they can now spend their time and efforts on more pleasant matters like planning for their next series of vacations instead of their deaths. Also, in the long term, they have very likely saved significant costs and hassle for their progeny in administering their estates since they have gotten their affairs in better order and already taken the step of moving assets from their names to the names of their children or a trust. That step would have otherwise ultimately needed to be addressed at their deaths through the probate and estate administration process.

A final benefit that has inured to our clients who took action last year is the opportunity to have the pleasure of observing their children enjoy part of their inheritance during their lifetimes. There are few greater pleasures in life than the act of giving. Most of our clients elect to defer giving significant gifts to their children during their lifetimes, both because they are concerned that they may need the resources to meet their retirement needs and because they do not want to spoil their children and obviate the need for them to work hard to accomplish their own successes in life. By accelerating the timing of these gifts that would have ultimately been bestowed anyway, at a somewhat random time in the future triggered by their deaths, these proactive donors have the satisfaction of observing their children's receipt of part of their inheritance as well as the opportunity to help steward their decision-making in how to incorporate such additional wealth into their lifestyles. For parents easing into their retirement years with time on their hands, the opportunity to reconnect with their children through this meaningful parenting act may be the best benefit of all.

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