



## Alerts

### American Taxpayer Relief Act of 2012 Will Be Effective January 1, 2013

January 3, 2013

*Estate Planning Alert*

Congress reached a fiscal cliff settlement over the New Year's holiday and President Obama is expected to sign it into law in the near future. The law is called the "American Taxpayer Relief Act of 2012" (Act). Among a variety of other issues, the Act addresses federal estate, gift and generation-skipping transfer tax laws.

Despite expectations to the contrary, the Act maintains the federal estate, gift and generation-skipping transfer tax laws in essentially the same form as they existed in 2012 — with one exception. The maximum federal estate tax rate will now be 40 percent. Other than increasing the top estate tax rate to 40 percent, Congress has ostensibly made the 2012 federal estate, gift and generation-skipping transfer tax laws permanent.

#### Key Provisions Under the American Taxpayer Relief Act of 2012

The key federal estate, gift and generation-skipping transfer tax provisions included in the Act are:

1. The applicable exclusion amount will remain at \$5 million and will continue to be adjusted for inflation. This means that each taxpayer may transfer up to \$5 million (plus the inflation adjustment) of value tax-free during his or her lifetime or at death. Married couples may transfer up to \$10 million (plus the inflation adjustment) of value. The inflation adjustment was \$120,000 in 2012. The 2013 inflation adjustment appears to be \$250,000.
2. A spouse's unused applicable exclusion amount may still be able to be used by a surviving spouse under some circumstances. This provision is referred to as "portability" and may help married couples who have not planned efficiently still avoid federal estate taxes.
3. The maximum federal estate tax rate will increase to 40 percent. This rate will also apply to federal gift and generation-skipping transfer taxes. This is an increase from the maximum 35 percent rate that applied in 2012.
4. State death taxes will continue to be allowed as deductions rather than as credits. Therefore, state estate tax laws based on the federal state death tax credit formula will not be effective. For example, estate tax laws in Florida and Indiana will no longer apply until changed by their respective legislatures. (Indiana will continue to have an inheritance tax, but it will phase out over time.) You will also need to be wary of state estate tax law changes in your state of residence.

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5. The general rules for valuations have not yet changed. Therefore, grantor retained annuity trusts and family limited partnerships remain viable opportunities.

### **Large Gifts Made in 2012 Remain Good Estate Tax Planning**

Many high net worth families made large gifts at the end of 2012. These gifts anticipated the expiration of the so-called “Bush tax cuts.” If the Act had not been passed, the tax-free amount for federal estate and gift tax purposes would have decreased automatically to \$1 million per taxpayer beginning in 2013. Rather than face the possibility of losing the ability to transfer \$4 million of wealth tax-free, large gifts were made in 2012.

The large gifts made in 2012 remain good estate tax planning. First, all appreciation occurring and all income generated after the 2012 gift was made will avoid federal estate taxes. Because of the power of compounding, this benefit can be extremely significant — particularly if generation-skipping transfer trusts were used as gifting vehicles in 2012. Second, if the donor created an intentionally defective grantor trust in 2012, all future income taxes paid on trust income by the donor will not count as additional gifts. This is very tax efficient. Third, there is no guarantee that Congress will not change its collective mind again in the future and reduce the \$5 million tax-free amount. Finally, the donee can enjoy the property transferred now and the donor will be alive to observe the benefits passed on to a younger generation without disrupting his or her own lifestyle.

### **Steps to Be Taken Now**

After digesting the new federal tax law changes, all taxpayers should consider taking the following actions:

1. If you did not make large gifts in 2012 and will have a taxable estate, you should consider making such gifts now. Congress may not be done making estate tax law changes. President Obama has already promised that: “Revenues have to be part of the equation in turning off the sequester.” We can only assume that he means estate tax increases as well as income tax increases. The resolution of the financial issues related to the sequester will occur in the next couple of months, so time is short. Gifting to newly created generation-skipping trusts, intentionally defective grantor trusts and grantor annuity trusts are particularly tax-efficient. Because President Obama has previously proposed limiting such techniques, you should consider acting before such techniques are limited or eliminated altogether by future tax law changes.
2. There is a second reason why you should consider making large gifts now, provided that you did not make large gifts in 2012 and will have a taxable estate. It is possible to create a lifetime applicable exclusion amount shelter trust (formerly called a unified credit shelter trust). Such trusts ensure the full use of your applicable exclusion amount while providing current financial benefits for your family, particularly for your spouse. This type of trust was used effectively in 2012 to receive large gifts. If you hesitated to fully utilize your available applicable exclusion amount in 2012, you should consider making a large gift to such a trust now.
3. If you are married, the marital trust allocations formula in your will or revocable trust declaration should be reviewed as soon as possible. It is quite possible that it will not work the way that it was intended. Because the federal tax laws now seem permanent, amending your will or revocable trust may be a good idea.
4. If you are married, you should review the balance of assets between spouses so that both spouses can use their full tax-free amounts.
5. If you have not yet planned for your business transition, you should do so now. It takes a long time to plan for a successful business transition and the current federal estate and gift tax laws now allow us to plan more efficiently for the needed ownership transfers.

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