

ESTATE PLANNING: IMPACT OF NEW TRANSFER TAX LAWS



The American Taxpayer Relief Act of 2012 (the “Act”) was signed into law by the President on January 2, 2013. The Act makes changes to the estate, gift and generation-skipping transfer (GST) tax rules, which could affect estate planning decisions and tax planning strategies.

THE AMERICAN TAXPAYER RELIEF ACT OF 2012

Unlike previous laws, which provided only temporary changes to the transfer tax rules, the Act makes permanent changes to the transfer tax rules for 2013 and subsequent years. The new transfer tax rules are no longer subject to phase-outs or other sunset provisions. Although the Act intends these changes to be permanent, it is possible that there may be further revisions by Congress to the transfer tax rules as negotiations regarding the federal debt ceiling and federal deficit continue.

The key changes made to the transfer tax rules under the Act are summarized as follows:

- **Transfer Tax Exemptions:** In 2012, the estate, lifetime gift and GST tax exemptions were set at \$5,000,000 (\$5,120,000 after adjustment for inflation). Under the Act, all of these exemptions are now permanently set at \$5,000,000, and will continue to be adjusted
- **Transfer Tax Rates:** In 2012, the federal estate, gift and GST tax had a top marginal rate of 35%. Under the Act, the top marginal tax rate for the federal estate, gift and GST tax is increased to 40%. In addition, concern about recapture, or “clawback,” where the estate tax exemption at death is lower than the lifetime gift tax exemption, is eliminated now that the estate and lifetime gift tax exemptions are the same.
- **Portability:** The portability rules for married couples, which were set to expire in 2013, are now permanent under the Act. The portability rules allow a surviving spouse or his or her estate to make use of any unused estate and gift tax exemption remaining from the estate of the first spouse to die.
- **Annual Gift Tax Exclusion:** While not part of the Act, the annual gift tax exclusion increased from \$13,000 in 2012 to \$14,000 in 2013 (or \$28,000 for married couples). The annual exclusion is the maximum amount that a

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donor can give to another individual without incurring gift tax consequences. In future years the annual exclusion amount may increase after adjustment for inflation.

- **GRATs, Dynasty Trusts, IDGTs, Valuation Discounts and AFR:** Despite some speculation, no changes were made to the taxpayer friendly rules that permit certain estate and tax planning techniques, such as short-term and zeroed-out grantor retained annuity trusts (GRATs), long-term dynasty trusts, intentionally defective grantor trusts (IDGTs), valuation discounts for transfers between family members and use of the applicable federal rate (AFR) for loans to family members and certain trusts. Certain budget proposals, however, could, if enacted, reduce or eliminate the benefits of these techniques. Individuals who have not yet utilized these estate and tax planning techniques might consider doing so early in 2013, in the event legislation is introduced that could have adverse consequences for such techniques.

PRIOR GIFTS STILL BENEFICIAL

Although the impact of reduced exemptions and significantly increased rates has been avoided under the Act, gifts made prior to the end of 2012 are still beneficial. Lifetime gifts shift future income and appreciation from those gifted assets out of an individual's estate and may hedge against future decreases in the estate tax exemption or increases in the tax rates. Lifetime gifts may

be further augmented if the donor retained the obligation to pay the income taxes incurred on the gifted assets.

NEW OPPORTUNITIES UNDER THE ACT

If an individual's lifetime gift tax exemption was fully utilized in 2012 (\$5,120,000), the Act presents the opportunity to give an additional \$130,000, after adjustment for inflation in 2013. An individual who has not made prior gifts, or has not used all of the lifetime gift exemption, should consider the benefits of making larger gifts with the increased exemption amount.

Individuals who did not have the opportunity to review their estate plan until after the tax legislation was finalized, or have any other questions about how the Act might impact them, should contact us to discuss their estate planning goals.

The Wealth Planning Group is ready to assist our clients in creating or refining an estate plan to meet current family objectives and terms of the new law.

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