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TRUSTS & ESTATES LAW UPDATE

JANUARY 2013

On January 1, 2013, the much anticipated "fiscal cliff" was averted when the Senate, by a vote of 89-8, and later the House of Representatives, by a vote of 257 to 167, passed the 2012 Taxpayer Relief Act ("Act"). The Act was signed into law by President Obama on January 2, 2013.

The provisions of the Act prevent many of the tax hikes that were scheduled to go into effect at the expiration of the Bush era tax cuts and retain several favorable tax breaks that were scheduled to expire, however, the Act will also increase income taxes for some high income individuals.

Permanent Estate, Gift and GST Tax Rules

The Act makes the following changes of special interest to estate planners:

- The Act permanently continues to set the exemption equivalent of the unified credit at $5 million, indexed for inflation after 2011. This applies for both estate and gift tax purposes.
- The GST exemption will permanently be the same as the estate tax exemption.
- The top estate and gift tax rate will be 40%, for transfers over $1 million after 2013. Thus, the estate and gift taxes continue to be a single flat rate, once the donor or decedent's transfers exceed the applicable exclusion amount.
- The GST tax rate is set permanently at 40%.
- Portability is made permanent.
- The state death tax credit remains history, and the state death tax deduction is made permanent.
- The Act includes none of the Administration's proposed "loophole closing" changes, such as tightening the rules on grantor retained annuity trusts, family limited partnerships, and intentional grantor trusts.
- Although not part of the Act, the annual exclusion gift for 2013 has been increased to $14,000.

A few of the other key provisions of the Act are summarized below.

- *Tax rates.* For tax years beginning after 2012, the 10%, 15%, 25%, 28%, 33% and 35% tax brackets reflecting the Bush tax cuts will remain in place and are made permanent. This means that, for most Americans, the tax rates will stay the same. However, there will be a new 39.6% rate, that will apply for income over: $400,000 (single), $425,000 (head of households), $450,000 (joint filers and qualifying widow(er)s), and $225,000 (married filing separately). These dollar

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About Giordano, Halleran & Ciesla:

Giordano Halleran & Ciesla is a multi-specialty law firm dedicated to providing sophisticated, complex legal services and solutions. The attorneys maintain personal relationships and gather in-depth knowledge of clients' businesses and industries to construct both sound legal advice and effective strategies to resolve business issues. With a focus on responsiveness and producing results with outstanding value to their clients' bottom line, the firm provides experienced legal representation in a wide variety of practice areas, including: Corporate and Business; Creditors' Rights and Bankruptcy; Environmental; Healthcare; Intellectual Property and Technology; Labor and Employment; Litigation; Real Estate, Land Use and Development; and Trusts and Estates.

amounts will be inflation-adjusted for tax years after 2013.

- *Capital gains and qualified dividends rates.* The new law retains the 0% tax rate on long-term capital gains and qualified dividends, modifies the 15% rate, and establishes a new 20% rate. Beginning in 2013, the rate will be 0% if income falls below the 25% tax bracket; 15% if income falls at or above the 25% tax bracket but below the new 39.6% rate; and 20% if income falls in the 39.6% tax bracket. It should be noted that the 20% top rate does not include the new 3.8% surtax on investment-type income and gains for tax years beginning after 2012, which applies on investment income above $200,000 (single) and $250,000 (joint filers). So actually, the top rate for capital gains and dividends beginning in 2013 will be 23.8% if income falls in the 39.6% tax bracket. For lower income levels, the tax will be 0%, 15%, or 18.8%.
- *Personal exemption phaseout.* Beginning in 2013, personal exemptions will be phased out (i.e., reduced) for adjusted gross income over $250,000 (single), $275,000 (head of household) and $300,000 (joint filers).
- *Itemized deduction limitation.* Beginning in 2013, itemized deductions will be limited for adjusted gross income over $250,000 (single), $275,000 (head of household) and $300,000 (joint filers).
- *AMT relief.* The new law provides permanent alternative minimum tax (AMT) relief. Prior to the Act, the individual AMT exemption amounts for 2012 were to have been $33,750 for unmarried taxpayers, $45,000 for joint filers, and $22,500 for married persons filing separately. Retroactively effective for tax years beginning after 2011, the new law permanently increases these exemption amounts to $50,600 for unmarried taxpayers, $78,750 for joint filers and $39,375 for married persons filing separately. In addition, for tax years beginning after 2012, it indexes these exemption amounts for inflation.
- *Tax credits for low to middle wage earners.* The new law extends for five years the following items that were originally enacted as part of the 2009 stimulus package and were slated to expire at the end of 2012: (1) the American Opportunity tax credit, which provides up to $2,500 in refundable tax credits for undergraduate college education; (2) eased rules for qualifying for the refundable child credit; and (3) various earned income tax credit (EITC) changes.
- *Payroll tax cut is no more.* The 2% payroll tax cut was allowed to expire at the end of 2012.

What do these changes mean to you?

1. **Review Existing Estate Plan.** It is critical that all estate planning documents and overall estate plan be reviewed in light of the Act in order to avoid unwanted estate tax and asset transfer consequences and to maximize the benefits available under the new law. This is also an appropriate time to review the ownership of your assets to confirm that the manner in which you own your assets is coordinated with your estate planning documents. In addition, this may also be a good time to confirm who the beneficiaries are of your retirement plans and life insurance policies to ensure that they too are consistent with your estate planning objectives.

2. **Taking Advantage of the Increased Gift and GST Tax Exemptions.** Clients who did not do so in late 2012 should consider making gifts to use the increased gift and GST tax exemptions. Such gifts will remove future appreciation and accumulated income from the client's estate and that of the beneficiaries, without additional gift, estate, or GST tax. Clients who made $5.12 million gifts in 2012, furthermore, can make another $130,000 in gifts, because of the inflation adjustment in the applicable exclusion amount. Coupled with the $14,000 per donee annual exclusion, the prudent estate planning client can make very significant lifetime transfers without incurring a gift tax.

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3. **Integrating Portability Into the Estate Plan.** Portability was made permanent by the new law. Generally, the conventional By-Pass trust is a superior vehicle for reducing estate tax than a portability election, because it avoids estate taxes on the appreciation and accumulated income in the By-Pass trust between the deaths of the two spouses. Portability, however, can be a superior technique in cases where: (a) the couple holds most of their assets in a form that cannot be used to fund a By-Pass trust, such as joint tenancy with a right of survivorship or contractual rights (such as life insurance and retirement benefits); (b) the estate consists largely of retirement benefits that will make funding a By-Pass Trust less effective as a means of avoiding estate taxes; or (b) the decedent dies without having an estate plan that includes a By-Pass trust. In addition, most wills for married couples should now address the question of whether the executor should be required to elect portability, or be given discretion to elect portability.

4. **Discount Planning.** For those clients with potentially taxable estates, valuation discount planning remains an important element in the estate plan. The courts have made it clear that a well-planned and well-executed family limited partnership or LLC can produce significant valuation discounts, but they have also made it very difficult to implement these techniques.

5. **Filing All Returns on Time.** The law continues to get more complicated and the burdens of filing timely gift and estate tax returns grow ever more significant. In addition to penalties for late filing and late payment, there are many elections that can be made only on a timely filed return.

6. **State Estate Taxes.** Residents of both New Jersey and New York still have other concerns – the state estate tax. In New Jersey, the state exemption amount remains at $675,000 and in New York the state exemption amount remains at $1 million. This means that residents of those states may be subject to state estate tax even if there is no federal estate tax. While the state estate taxes are not as burdensome as the federal tax, they remain substantial nonetheless. Therefore, despite the relaxation of the federal estate tax, the overall cost of estate taxes will remain a concern for many.