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TRUSTS & ESTATES
ALERT
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2013 Brings Estate, Gift & GST Tax "Permanency" At Last

By Barbara E. Little

The uncertainty of the last two years was put to rest on January 2, 2013 when President Obama signed into law the "American Taxpayer Relief Act of 2012" (ATRA). The new law saved us from the "Fiscal Cliff" and forestalled significant tax increases for most taxpayers and across-the-board budget cuts. The impact of ATRA is far-reaching and affects all taxpayers (individuals, businesses, estates and trusts) and types of tax (income, capital gains, alternative minimum tax, business, estate, gift and generation-skipping transfer tax). In a series of Alerts, we will explore the full extent of ATRA. This *Alert* provides a brief summary of ATRA's impact on the gift, estate and generation-skipping transfer tax (GST).

Overview

ATRA makes "permanent" the Bush-era tax provisions with minor modifications. The new tax brackets, rates, exemptions and patches do not sunset and will not change unless Congress enacts new legislation that expressly makes a change.

The following chart highlights the various tax rates under ATRA:

	2012	2013 and Beyond
Maximum Income Tax Rate	35% ($388,350 joint & single)	39.6% ($400,000 single/$450,000 joint/$11,951 trusts[1])
Maximum Capital Gain Rate	15% ($35,350 single/$70,700 joint)	20% ($400,000 single/$450,000 joint/$11,951 trusts[1])
Medicare Tax on Wages, Self Employment Earnings	Not Applicable	0.9% ($200,000 single/$250,000 joint)
Medicare Tax on Interest, Rents, Royalties, Annuities, Passive Income, Qualified Dividends & Capital Gains	Not Applicable	3.8% ($200,000 single/$250,000 joint)
Payroll Tax	4.2% (earnings up to $110,100)	6.2% (earnings up to $113,700)
Gift Tax	$5.12 million exemption Maximum rate: 35%	$5.25 million[1] exemption Maximum rate: 40%
Estate Tax	$5.12 million exemption Maximum rate: 35%	$5.25 million[1] exemption Maximum rate: 40%
GST Tax	$5.12 million exemption Maximum rate: 35%	$5.25 million[1] exemption Maximum rate: 40%

1. The inflation index for 2013 has not been confirmed; therefore, this amount is approximate.

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As of January 1, 2011, the estate, GST and gift tax rate was 35 percent with a unified $5 million exemption. Under ATRA, as of January 1, 2013, the estate, GST and gift tax rate increases from 35 to 40 percent. The unified exemption remains at $5 million (indexed for inflation). In addition, the portability of the exemption to a surviving spouse is preserved under the new law. The exemption amount is indexed for inflation, allowing individuals to acquire additional exemption each year.

Gifting

Annual exclusion gifts are not affected by ATRA. The annual exclusion amount is indexed for inflation, and thus, for 2013, a taxpayer may give up to $14,000 annually to an unlimited number of individuals without using any of the taxpayer's exemption (and without paying any gift tax). Payments made directly to an educational institution for tuition costs or to a medical care provider for medical costs (including medical insurance) are also excluded from gift tax.

There are leveraging benefits to lifetime gifts, as all future appreciation on such gifts will escape gift and estate tax. Also, lifetime gifts benefit from the tax exclusive nature of the gift tax versus the tax inclusive nature of the estate tax. The gift tax is based only on the amount transferred, and the funds used to pay the gift tax are also removed from the taxpayer's estate. If the donor waits until death, the funds used to pay the estate tax will be included in the taxable estate. For individuals who have used the $5.12 million of gift tax exemption that was available in 2012, approximately $130,000 of new gift tax exemption is available in 2013.

In prior discussions, President Obama proposed a minimum 10-year term on Grantor Retained Annuity Trusts (GRATs) and would have prohibited zeroed out GRATs (GRATs designed to incur no gift tax exposure). Those limitations are absent from ATRA. Consequently, short-term zeroed out GRATs are still valuable avenues for transferring wealth, especially with the Section 7520 rate remaining low (only 1 percent for January 2013).

All of these factors continue to make lifetime gifts very attractive for those able to make gifts and retain a comfortable standard of living.

Estate Tax

For 2013, the estate tax rate is 40 percent and the maximum estate tax exemption is $5.25 million (less any exemption used during the decedent's lifetime). The new law did not reinstate the state death tax credit. ATRA continues to allow estates to take a deduction for state death taxes paid. This does not provide a dollar for dollar reduction at the federal level. In fact, for those states imposing an estate tax (e.g., New York and New Jersey), full utilization of the federal estate and GST exemption at the first spouse's death can be expensive. In such states significant state death taxes may be due when the first spouse dies. In states that do not impose a gift tax, the state death tax impact does not apply lifetime gifts - another example of the advantage of lifetime gifts. We encourage all clients to review their wills and other estate planning documents to make sure these documents still reflect their intentions in light of the increased exemption amounts and new portability rules.

Generation-Skipping Transfer (GST)

As of January 1, 2013, the GST tax rate is 40 percent with a GST exemption of $5.25 million. However, portability does not apply to the GST exemption. Therefore, it remains important for married couples to carefully divide their assets in order to maximize use of their individual GST exemptions. Some interest groups were lobbying to limit the duration of a GST Trust to 90 years. This lobbying effort was unsuccessful. GST Trusts may last as long as permitted under state law. (In some states, including Pennsylvania and New Jersey, there is no limitation on the duration of perpetual trusts.)

Portability

An important component of ATRA is that it "permanently" provides for portability of the estate and gift tax exemption (although not for the GST exemption).

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This means that married couples can take advantage of a combined "total" of $10.5 million in gift and estate tax exemptions, regardless of the way assets may be titled. Under this new rule, a surviving spouse may use any exemption amount not used by the first spouse to die (plus all prior deceased spouses' unused exemption amounts). The formula for portability is:

$5.25 million exemption of first spouse to die
Less exemption used by first spouse for lifetime gifts
Less exemption used by first spouse for gifts at death
Plus any unused exemption of any prior deceased spouse of the first to die

= Unused exemption of first spouse

Plus $5.25 million exemption of surviving spouse
Less exemption already used by surviving spouse for lifetime gifts

= Balance of exemption available for surviving spouse to use for lifetime gifts or gifts at death

For individuals in states that have decoupled from the federal estate tax (e.g., New York and New Jersey), portability may provide more flexibility and planning opportunities to close the gap between a state's exemption amount and the federal exemption amount. Special attention must be given to this option, however, due to portability only applying to the estate exemption, not the GST exemption.

Concluding Reflection

Assuming Congress does not undo these "permanent" taxes, ATRA provides opportunities to engage in long-term planning that reflects personal goals and values while maximizing the benefits of the current exemption and tax rate. ◆

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