Patterson Belknap Webb & Tyler LLP

Trusts and Estates Alert January 2013

Estate Planning Implications of the Fiscal Cliff Deal

After a last-minute deal to avoid the fiscal cliff was passed by Congress on January 1, 2013, President Obama signed into law the new American Taxpayer Relief Act ("ATRA 2012") on January 2, 2013. ATRA 2012 extends indefinitely the historically large Federal gift, estate, and generation-skipping transfer (GST) tax exemptions, while introducing a modest increase in top rates for those taxes.

Exemptions previously scheduled to decrease on December 31, 2012 are extended indefinitely. Clients who did not use their Federal exemptions in 2012 will continue to have the opportunity to do so. Under ATRA 2012, the favorable $5 million Federal gift and estate tax exemption amounts will continue indefinitely, allowing each individual to transfer that amount during lifetime or upon death without the imposition of Federal gift or estate tax. Without action by Congress, the exemption amounts would have reverted to $1 million per individual. In addition, the $5 million Federal GST tax exemption will continue, allowing clients to provide for significant generation-skipping transfers without the imposition of tax.

The $5 million exemption amount for all three taxes is indexed for inflation after 2011. The inflation indexed amount was $5,120,000 in 2012, and is expected to be $5,250,000 for 2013, though the IRS has not yet confirmed the latter amount. Importantly, clients can expect to acquire additional incremental exemption amounts in each new calendar year as a result of this indexing.

Unlike prior acts, ATRA 2012 does not contain a "sunset" provision, and therefore establishes the exemption amounts at $5 million (with inflation indexing after 2011) without an expected expiration date.

Top gift, estate and GST tax rates are set at 40%. ATRA 2012 establishes the top gift, estate, and GST tax rates at 40% for gifts made and decedents dying in 2013 and thereafter. This top rate is higher than the 2012 rate of 35%, but lower than the 55% rate that would have come into effect on January 1 in the absence of legislation. This top rate will apply to transfers exceeding the exemption amounts described above.

New York continues to impose a separate estate tax with an exemption of $1 million and a top rate of 16%. Under ATRA 2012, state estate taxes will continue to be deductible from Federal estate taxes, resulting in a top combined estate tax rate for New Yorkers of 49.6%.

Full repeal of the estate tax is no longer anticipated. For more than a decade, clients and estate planners have lived with the uncertainty of whether the estate tax would ultimately be repealed. Most commentators now believe that full repeal is no longer anticipated.

Portability of exemptions between spouses is extended indefinitely. ATRA 2012 extends indefinitely the portability of gift and estate tax exemptions. Portability allows a surviving spouse to use the unused exemption amount of a deceased spouse if the deceased spouse's executor so elects. Portability may enhance planning opportunities available to certain clients, but relying on portability rather than careful planning techniques will not produce the most tax advantageous result in many cases, and in some circumstances the opportunity to use the deceased spouse's exemption may be lost. In addition, portability is not available for a deceased spouse's unused GST exemption.

Existing estate plans should be reviewed. Many estate plans for married couples include credit shelter planning designed to minimize Federal estate taxes. The tax and other consequences of this planning have changed under ATRA 2012 due to the increasing Federal estate tax exemption and inflation indexing. If your estate planning documents contain a credit shelter bequest, we recommend you contact us to review your estate plan and discuss whether it is still the most appropriate structure for you.

Annual exclusion amount is increased for 2013. The inflation-adjusted gift tax annual exclusion amount has increased to $14,000 from $13,000. The annual exclusion amount for gifts to a spouse who is not a U.S. citizen has increased to $143,000.

Early estate planning is still key. Present gifts continue to carry significant potential benefits, including the ability to shelter future appreciation from transfer taxes. Powerful and tax-efficient planning techniques such as GRATs, sales to grantor trusts and intra-family loans continue to be particularly attractive at historically low interest rates.

Potential future legislation. It is important to note that there may be a push for additional revenue-raising legislation as political debates continue. The current administration has expressed its desire to limit the advantages of GRATs, grantor trusts, GST-exempt dynasty trusts, and transfers in family entities that qualify for valuation discounts. Clients who might consider employing those techniques may wish to do so sooner rather than later.

If you have any questions about how ATRA 2012 may impact your family or your estate plan, or what planning opportunities the new law may present for you, please feel free to contact us.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

Christopher C. Angell	**212-336-2770**	**ccangell@pbwt.com**
Michael S. Arlein	**212-336-2588**	**msarlein@pbwt.com**
Hugh J. Freund	**212-336-2370**	**hjfreund@pbwt.com**
Carolyn B. Handler	**212-336-2480**	**cbhandler@pbwt.com**
Dana W. Hiscock	**212-336-2290**	**dwhiscock@pbwt.com**
John Sare	**212-336-2760**	**jsare@pbwt.com**
Catherine Grevers Schmidt	**212-336-2116**	**cgschmidt@pbwt.com**

Patterson Belknap Webb & Tyler LLP

1133 Avenue of the Americas New York, NY 10036-6710 212.336.2000 www.pbwt.com