

January 2013

TRUSTS & ESTATES ALERT

NEW "FISCAL CLIFF" LAW ENACTS ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAX PROVISIONS

On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 (the "Act") into law. In addition to permanently extending certain of the Bush-era income tax cuts that were scheduled to expire at the end of 2012, the Act makes significant "permanent"* changes to the federal estate, gift and generation-skipping transfer ("GST") tax laws.

Estate, Gift and GST Tax Provisions

The Act provides the following with respect to estate, gift and GST taxes:

Exemption Amounts and Tax Rates: The Act permanently sets the estate and gift tax exemption amounts, as well as the GST tax exemption amount, at \$5 million, adjusted for inflation. For 2013, the exemption amount is \$5.25 million. The federal estate and gift tax exemption amounts remain "unified," which means that the amount of exemption that is applied to taxable gifts made during your lifetime will reduce the amount of exemption that is available to your estate when you die. The value of assets transferred for estate, gift or GST purposes that exceeds the corresponding exemption amount will be taxed at a rate of 40% (increased from a rate of 35% in 2012).

The New York estate tax regime is not affected by the Act and continues to apply. The threshold for paying New York estate tax remains at \$1 million, with a top estate tax rate of 16%. Any New York estate tax paid continues to be deductible for federal estate tax purposes, resulting in a top marginal combined tax rate of 49.6%. New York does not have a gift tax.

Portability: The Act makes permanent the so-called "portability" provisions passed in 2010 that are designed to help married couples avoid wasting the unused estate and gift tax exemption of the first spouse to die. Portability is especially helpful if the first spouse to die did not have many assets or left all of them to the surviving spouse in a manner that qualifies for the unlimited estate tax marital deduction. The surviving spouse can recoup the unused exemption of the deceased spouse and apply that additional exemption to gifts or bequests that the surviving spouse makes during lifetime or at death. Portability does not, however, apply to unused GST transfer tax exemption.

Expiring Income Tax Provision

Charitable Contributions from IRAs: The Act extends through 2013 the ability of an individual who has attained age 70½ to make a tax-free distribution, up to \$100,000, from an IRA directly to a qualified charity. A special rule allows an individual who took a required minimum distribution ("RMD") in December of 2012 to elect to treat all or part of the RMD (up to \$100,000) as a qualified charitable distribution in 2012 if it is transferred to a qualified charity **before February 1, 2013**. In addition, a qualified charitable distribution made directly to a charity **in January of 2013** may be treated as having been made on December 31, 2012 so that another qualified charitable distribution can be made from the IRA in 2013.

Impact on Estate Planning

Even with a \$5 million inflation-adjusted exemption amount, estate planning still remains imperative for many reasons, including the following:

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Estate Planning Techniques: Grantor retained annuity trusts ("GRATs"), intentionally defective grantor trusts, dynasty trusts, and certain minority-interest gifts continue to be some of the most effective techniques for reducing or eliminating gift tax on lifetime transfers and for reducing the taxable value of estates. Although the Obama administration and the IRS have proposed various changes to the law that would restrict the use of such techniques, none of these were affected by the Act. However, repeal or limitation of these techniques may become attractive revenue enhancers in the expected negotiations to reduce the federal deficit. The window within which to take advantage of these opportunities may therefore be very limited, and now is the time to act.

Formula Bequests: The estate plans of many married couples contain "credit shelter" formula bequests that utilize the entire available federal estate tax exemption, with the balance of the estate passing outright to, or in trust for, the surviving spouse. Because of the mismatch between the federal estate tax rules and the state estate tax rules, a credit shelter bequest that is funded with the full federal estate tax exemption may generate substantial state estate taxes on the death of the first spouse to die (e.g., more than \$400,000 in New York). If desired, estate plans can be amended in order to decrease or even eliminate the state estate tax consequences.

Spousal Lifetime Access Trusts: For married clients who wish to take maximum advantage of the generous federal gift tax exemption, spousal lifetime access trusts may offer substantial federal and state estate tax savings, while allowing funds to remain available to the donor's spouse and other family members.

Asset Protection Trusts: Aside from planning to reduce estate and gift taxes, many states (although not New York) now offer the possibility of conferring creditor protection for donors as well as beneficiaries through transfers to asset protection trusts. These can be designed solely for creditor protection purposes (with no gift tax cost) or also designed to take advantage of the federal gift tax exemption. We can advise you about the best options to consider.

We invite you to contact a member of the Phillips Nizer LLP Trusts & Estates Department to discuss your present estate plan and the tax-savings opportunities that are available to you, including those that may be eliminated or restricted in the upcoming deficit reduction legislation.

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*While the Act describes many of the tax changes as "permanent," this is a somewhat misleading term, as the relief granted by the Act will last only until Congress decides to change it. Indeed, additional tax legislation can be expected as Congress considers the federal debt ceiling and spending issues.

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