

Permanent Estate & Gift Tax Relief

On January 1, 2013, Congress averted the so-called fiscal cliff by approving new legislation titled the American Taxpayer Relief Act of 2012 (“ATRA-2012”). President Obama has signed the bill into law.

In addition to extending the Bush-era income tax cuts for 98% of U.S. Taxpayers, the new law also extends the sweeping changes originally made to the federal estate and gift tax rules under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“2010 Tax Act”).

Extended Estate & Gift Tax Relief

ATRA-2012 generally extends current estate and gift tax policy, centered around a \$5,120,000 unified exemption amount, which will be further increased for inflation to \$5,250,000 (or twice that amount for married couples) for 2013. The Generation-Skipping Tax exemption is also extended at the inflation-indexed amount of \$5,250,000. The single modification ATRA-2012 makes to these rules is an increase in the top tax rate on transfers above the exemption amount from 35% to a new maximum tax rate of 40%.

These changes are quite dramatic considering that the exemption amount would have reverted to \$1,000,000 and the top estate tax rate would have ballooned to 55% if Congress hadn’t acted to avoid the fiscal cliff. The table below summarizes how the exemption amount and tax rate have changed since 2000.

Decedents dying in:	Estate Tax Exemption Amount	Tax Rate
2000-2001	\$675,000	55%
2002-2003	\$1,000,000	49-50%
2004-2005	\$1,500,000	47-48%
2006-2008	\$2,000,000	45-46%
2009	\$3,500,000	45%
2010	\$5,000,000 (or unlimited ¹)	35%
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$5,250,000	40%

¹ An executor of the estate of a decedent dying in 2010 could opt out of the estate tax in exchange for Modified Carryover Basis.

Quite significantly, the new law is permanent, which is a welcome departure from the uncertainty that has surrounded federal tax policy over the past decade. Congress established the permanency of the new legislation by striking the “sunset” provision from the original Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”).

Other important rules extended

- **Unification.** ATRA-2012 extended the 2010 reunification of the exemption amount for estate and gift tax purposes, meaning the exemption may be used during lifetime to make tax-free gifts, or at death to shield bequests from the estate tax. (EGTRRA had “de-coupled” the estate and gift tax systems, limiting the gift tax exemption to \$1 million, while incrementally increasing the estate tax exemption.) The extension of the unified exemption amount will continue to provide affluent families with tremendous flexibility to transfer wealth to children and grandchildren in a tax-efficient manner.
- **Portability.** ATRA-2012 also extends the ability of a deceased spouse’s estate to transfer any unused portion of the deceased spouse’s exemption amount to a surviving spouse. (Prior to 2011, careful trust planning was required to ensure that married couples did not “under-use” their respective estate tax exemptions at the death of either spouse.)

For example, assume Husband dies in 2013 having made lifetime gifts to children, consuming \$2 million of his exemption. At death, he leaves his remaining \$3.25 million estate to his surviving spouse. The executor of Husband’s estate may elect to permit the surviving spouse to use Husband’s unused \$3.25 million exemption, giving the surviving spouse an \$8.5 million exemption (her original \$5.25 million exemption, plus the deceased spouse’s \$3.25 million unused exemption).

Although the “portability” of the estate tax exemption is designed to prevent married couples from wasting some or all their respective exemption amounts, trust planning for married couples may still provide meaningful benefits, such as eliminating estate taxes on post-mortem appreciation, and protecting the inheritance of heirs.

What was not included in the legislation

- **No GRAT limitations.** The new law did not contain restrictions or limitations on the use of Grantor Retained Annuity Trusts (GRATs), which had been recently debated in Congress. As a result, short-term GRATs are still a viable strategy to transfer wealth in a tax-efficient manner. GRATs are typically designed to shift the appreciation on assets to children or other beneficiaries as a tax-free gift. For example, an individual may transfer \$1,000,000 to a GRAT in exchange for the right to receive a stream of annual annuity payments that will return the original \$1,000,000 principal, plus a small percentage of appreciation measured by a government interest rate



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published each month. If the assets appreciate above the government rate (currently near all-time lows), a tax-free gift will pass to the beneficiaries after the final annuity payment has been made.

- **No valuation discount limitations.** The new law did not contain restrictions or limitations on the applicability of valuation discounts to intra-family transfers of business interests. Such limitations have been proposed periodically in Washington dating back to the Clinton administration.

Summary

By making the current estate and gift tax rules permanent, Congress has ensured that the vast majority of U.S. Taxpayers will not be subject to federal estate taxes. Nevertheless, the benefits of having a qualified estate planning attorney prepare a comprehensive and thoughtful estate plan will continue to be important and beneficial to individuals and families. A good set of estate planning documents should generally include: a revocable living trust, a pour-over will, a power of attorney for financial matters, and advance health care directives. In light of the rule changes outlined above, existing estate planning documents should be reviewed by a qualified attorney.

This information is not provided as legal advice, but for information purposes only. You are strongly advised to seek advice from competent legal and tax counsel to determine the applicability of this information to your estate and financial planning decisions. You are also encouraged to seek qualified legal counsel to determine if any estate planning documents should be prepared which relate to this information and to have legal counsel prepare all estate planning documents you may need to carry out your estate plan.