

ALERTS

The New Tax Act Brings Certainty to Estate and Gift Taxes

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The American Taxpayer Relief Act of 2012 (the “Act”), which was signed into law by President Obama on Jan. 2, 2013, made permanent the \$5 million exemption (indexed for inflation) for federal gift, estate and generation-skipping transfer (“GST”) taxes and set the maximum rate at 40 percent (up from 35 percent in 2012) with respect to transfers in excess of these exemptions. The indexed amount for 2013 is \$5.25 million. The Act also makes permanent the so-called “portability” rules, which allow a surviving spouse to use a deceased spouse’s unused exemption from federal gift and estate tax (but not from GST tax). In addition, certain techniques that were threatened under prior proposals remain intact. In light of this new certainty on taxes and rates, as well as the continued viability of certain estate planning strategies, you may wish to take advantage of the techniques described in this *Alert*. We also recommend that you review your estate plans in light of the new legislation.

Consider Making Lifetime Gifts and Creating Trusts Now

You should consider making lifetime gifts, in trust or outright, in order to use your federal lifetime gift tax exemption now instead of waiting to use your federal estate tax exemption at death. A married couple can transfer \$10.5 million during their lifetimes, which can benefit multiple generations with no additional wealth transfer tax. (This amount will increase annually with inflation.)

- *Lifetime Gifts.* A lifetime gift will appreciate outside of your estate, thereby avoiding federal and state estate tax on the appreciation.
- *State Tax.* Certain states, such as New York, impose state estate taxes but do not currently impose state gift taxes. Residents of these states will avoid state wealth transfer tax by making lifetime gifts.
- *Inflation Adjustment.* Even if you made gifts in the amount of the 2012 federal lifetime gift tax exemption — \$5.12 million — you can still take advantage of inflation adjustments to the federal lifetime gift tax exemption. The federal lifetime gift tax exemption has risen to \$5.25 million in 2013, thereby enabling you to shield an additional \$130,000 from federal gift tax this year (or \$260,000 total per married couple).
- *Short-Term GRATs.* Short-term grantor-retained annuity trusts, or “GRATs,” which had been threatened under earlier legislation, remain a viable technique. With this technique, the donor retains the right to receive an annuity for a period of time. After that period expires, any remaining property passes to specified beneficiaries — usually the donor’s descendants (outright or in trust) — free of any gift tax. Short-term GRATs significantly reduce the volatility embedded in a longer-term GRAT. Legislation has been introduced on numerous occasions that would require the minimum annuity term to be 10 years. Such a rule was *not* included in the 2012 legislation.
- *Gifts of Discounted Assets.* Valuation discounts (e.g., discounts for lack of control and lack of marketability), while targeted in the past, remain viable at present.
- *Grantor Trusts/Sales to Grantor Trusts.* A popular estate planning technique is the sale or gift of assets to an “intentionally defective grantor trust” (a trust that is out of your estate for federal estate tax purposes but taxable to you for income tax purposes). You would either gift assets (frequently at a discounted value) to the grantor trust or sell assets in exchange for a note. Because of the grantor trust status, no gain is realized on the sale. In the case of a sale, if the transferred assets earn more than the required interest rate, the note can be paid down; this is a very effective technique presently since interest rates are at historic lows. In addition, any appreciation will ultimately pass to the specified beneficiaries. The president’s 2012 budget proposal recommended legislation that would include property transferred to a grantor trust in the donor’s estate for federal estate tax purposes. Since

no such legislation has yet passed, the use of grantor trusts remains an effective technique.

Review Your Wills/Revocable Trusts Now

- Many married couples' estate plans include so-called "credit shelter" (or "by-pass") trusts, which have historically been needed in order to use the federal estate tax exemption of the first spouse to die. With portability now permanent, certain of these trusts may no longer be needed. The state estate tax exemption is not portable, however.
- Since the GST tax exemption is not portable between spouses, you should, however, consider including a trust in your Will (to the extent you have not already done so) to maximize the use of your GST tax exemption.
- Your estate plan should be revised as required to reflect any gifts made in 2011 or 2012 that would alter the plan.
- Many Wills and revocable trusts include a provision creating a credit shelter trust that will be funded with the *maximum* amount that can pass free of federal estate tax at the person's death. Your estate plan and your finances should be reviewed to determine whether it is appropriate for you and your spouse to fund your respective credit shelter trusts with the full \$5.25 million (or possibly a lesser amount). In addition, consideration should be given to the resulting state estate tax. For example, in New York, a credit shelter bequest funded with the maximum federal exemption will result in over \$400,000 of New York estate tax on the death of the first spouse. However, for this amount of tax, you will have successfully sheltered the full federal exemption amount from federal estate tax on the death of the second of you to die.

Please contact your attorney at Schulte Roth & Zabel at your earliest convenience if you wish to discuss these or other gifting opportunities as they may apply to your specific financial and personal situation.

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