The Wealth Advisor

What the New Tax Law Means to You

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Providing trusted legal solutions in Estate Planning (trusts, wills & estates, wealth preservation strategies, & more), Trust Administration & Probate, Special Needs Trust Planning, Business Law & Planning (design, formation, succession, & transactions), and Elder Law (Medicaid planning for long-term care).

The law passed to deal with the so-called "fiscal cliff" included revisions to estate, gift and generation-skipping transfer ("GST") tax laws and income tax laws that will affect estate planning for the foreseeable future. In this edition of *The Wealth Advisor*, we will take a first look at those changes and what they will mean to you.

Changes to the Federal Estate Tax Law

* The federal gift, estate and GST tax provisions that had been put in place as temporary measures in December 2010 were made permanent as of December 31, 2012. This is great news because, for more than ten years, we have had uncertainty due to the fact that the estate, gift, and GST exemptions and rates and basic income tax provisions and rates all had expiration dates. And while "permanent" in Washington only means this is the law until Congress decides to change it, at least we now have some certainty with which to plan.

* The federal estate and gift tax exemption will remain at $5 million per person, adjusted annually for inflation after January 1, 2011. In 2012, the exemption (with the adjustment) was $5,120,000. The amount for 2013 is $5,250,000. This means that the opportunity to transfer large amounts during lifetime or at death remains.

Planning Tip: If you did not take advantage of the $5+ million gift tax exemption in 2011 or 2012, you can do so now.

Planning Tip: If you used your full $5.12 million exemption in 2012, you have an additional $130,000 exemption you can use in 2013. And, with the exemption amount now tied to inflation, you can expect to be able to transfer even more each year.

* The Generation-Skipping Transfer (GST) tax exemption also remains at the same level as the gift and estate tax exemption ($5 million, adjusted for inflation). The GST tax, which is in addition to the federal estate tax, is imposed on amounts that are transferred (by gift or at your death) and "skip" a generation; for example, a gift to a living child's

descendant.

Planning Tip: Having this permanent GST exemption will allow you to take advantage of planning that will greatly benefit future generations. For example, a dynasty trust that is properly set up can now last forever, and the trust assets should never be subject to federal estate, gift or GST tax.

Planning Tip: The downside of not having trust assets subject to estate tax is that they do not get a basis adjustment to fair market value at death. With proper planning, it is possible to elect estate inclusion at the death of a beneficiary to take advantage of the basis adjustment when the beneficiary does not have an otherwise taxable estate.

* Married couples can take advantage of these higher exemptions and, with proper planning, transfer up to $10+ million through lifetime gifting and at death.

* The tax rate on estates larger than the exempt amounts was increased from 35% in 2012 to 40% in 2013 and beyond.

* The "portability" provision was also made permanent. This allows the unused exemption of the first spouse to die to transfer to the surviving spouse, under certain conditions.

Planning Tip: While the "portability" provision may at first appear to be an easy way to use both spouses' estate tax exemptions, there are still many benefits to using trusts. This is especially true for those who want to provide for a surviving spouse yet be sure the rest of their estate will eventually go to their children (for example, those from a previous marriage). Plus, there is significant cost to using the "portability" provision because it requires filing an estate tax return, and there is no "portability" of any unused GST tax exemption.

* Separate from the new tax law, the amount for annual tax-free gifts has increased from $13,000 in 2012 to $14,000 in 2013 as a result of an inflation adjustment. This means you can now give up to $14,000 to as many individuals as you wish each year and not pay a gift tax. If you are married, your spouse can join you and, together, you can give up to $28,000 per person per year.

Planning Tip: Annual tax-free gifts are in addition to the $5+ million gift and estate tax exemption. This is another opportunity to transfer significant amounts out of your estate.

Changes to the Federal Income Tax Law

In addition to these changes to the federal gift, estate and GST tax laws, there are several changes to the federal *income* tax laws, including several income tax increases that can be mitigated by proper planning:

* The 2% Social Security tax holiday that was instituted as a stimulus measure was not extended, so everyone will see a decrease in net pay.

* Ordinary income tax rates increase from 35% to 39.6% for singles earning more than $400,000 a year ($450,000 a year for married couples). All other ordinary income tax rates effective in 2012 were made permanent.

* There is a new Medicare 0.9% surtax on ordinary income and a new 3.8% surtax on investment income. Both are applicable to income over $200,000 for singles ($250,000 for married couples) and were part of the 2010 health care bill.

* The top capital gains and dividend rate increased to 20% for those earning more than $400,000 a year ($450,000 for married couples).

* The AMT exemption is now permanent. For 2013, it increased to $50,600 for single and to $78,750 for married taxpayers, with the exemption and phase out amounts indexed.

* Several business provisions were extended, including the R&D tax credit, work opportunity tax credit, accelerated depreciation, and Section 179 levels. (Business owners will want to consult their CPAs for advice.)

* The direct IRA to charity transfer for those over 70.5 years of age was reinstituted retroactive to 2012. A special catch-up rule allows transfers in January 2013 to be counted as 2012 distributions.

The Need for Proper Planning Remains

For most Americans, this tax legislation has removed the emphasis on estate *tax* planning and put the emphasis back on the real reasons we need to do estate planning: taking care of ourselves and our families. Proper estate planning is essential if you want to:

* Avoid state inheritance/death taxes that have lower exemptions than federal taxes;

* Avoid probate, which can be quite expensive and time consuming in some states;
* Ensure your assets are distributed the way you want;

* Protect an inheritance from irresponsible spending, a child's creditors, and from being part of a child's divorce proceedings;

* Provide for a loved one with special needs without losing valuable government

benefits;

* See that control of your assets remains in the hands of the person you trust most;

* Provide responsibly for minor children or grandchildren;

* Help protect assets from creditors and frivolous lawsuits (especially important for professionals);

* Protect you, your family and your assets in the event of your incapacity;

* Establish business succession planning at retirement, incapacity and/or death; or

* Help you create meaningful charitable gifts.

For Those with Larger Estates

Ample opportunities remain to transfer large amounts tax-free to future generations. But with the increase in estate *and* income tax rates, it is critical that professional planning begins as soon as possible.

Planning Tip: You do not have to make transfers in cash or liquid assets, or completely give away your assets. You can transfer illiquid assets like your business, or your home or other real estate, to a trust. If you transfer your home, you can continue to live there and take the tax deductions. If you transfer your business, you can do it in such a way that you can keep control and receive income. By planning now, future appreciation of these assets will not be subject to estate tax, and current depressed values can result in very favorable valuations.

Planning Tip: You can leverage your exemption and make it worth much more by using asset value discounts associated with lack of control and lack of liquidity and by using the tax-free growth inside a life insurance policy. Life insurance policy proceeds, when structured properly, can be completely free of probate; *and* income, gift and estate taxes; *and* can be protected from beneficiaries' creditors and predators--even divorce proceedings.

What to Expect in the Future

With Congress looking for more ways to increase revenue, many reliable estate planning strategies may soon be restricted or eliminated. Already being discussed are minimum terms for grantor retained annuity trusts (GRATs), elimination of valuation discounts for family limited partnerships, limits on installment sales to grantor trusts, and other changes to grantor trusts. Other revenue raisers may be proposed that have not yet been widely discussed.

Conclusion

If you have been sitting on the sidelines, waiting to see what Congress would do, the wait is over. Now that we have some certainty with “permanent” laws, there is no excuse to postpone your planning any longer. In fact, delaying your planning could cause you to lose out on strategies that could have significant impact on your family.

TEST YOUR KNOWLEDGE

1. The federal estate tax laws are now permanent. This means Congress can never change them. T F

2. The estate, gift, and generation skipping transfer (GST) tax exemptions are now set at $5 million and are adjusted for inflation. This means they are $5,250,000 in 2013. T F

3. If you have already used your $5.12 million exemption in 2012, you will not be allowed any additional exemption in 2013 or subsequent years. T F

4. Married couples can use both their exemptions and, in 2013, transfer up to $10,500,000 tax-free. T F

5. If you use your gift/estate tax exemption, you cannot make annual tax-free gifts. T F

6. The top estate tax rate is now 40%. T F

7. The capital gains and dividend tax rate is now 20% for everyone. T F

8. The payroll tax holiday ended, so everyone will see an increase in net pay. T F

9. There is no longer any need for those with estates smaller than $5 million to do estate planning. T F

10. There are proven estate planning techniques available now that may soon be eliminated as Congress looks for more ways to raise revenues. T F

Answers
True: 2, 4, 6, 10
False: 1, 3, 5, 7, 8, 9

avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax adviser based on the taxpayer's particular circumstances.