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THE PLANNER

A monthly newsletter for Accounting, and Financial Professionals with a focusing on Estate Planning, Elder Law, and Special Needs Persons.

The Planner is a newsletter to inform and educate Accounting and Financial Professionals of the ever changing areas of estate taxes, and elder law to better service their clients.

From: Louis Lepore

Louis Lepore is an attorney admitted to practice law in the states of New York, New Jersey, and Florida. He has dedicated his practice of law to providing quality legal representation and personal attention to all of his clients on Estate Planning, Elder Law issues, Probate, Business Succession Planning, Asset Protection, Tax and Business Planning.

On January 2, 2013, the President signed into law the American Taxpayer Relief Act of 2012 (the 2012 Tax Act) to deal with the so-called "fiscal cliff." The 2012 Tax Act 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 Counselor*, we will take a first look at those changes and what they will mean to you, your clients and your practice.

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 your clients did not take advantage of the $5+ million gift tax exemption in 2011 or 2012, they can do so now—and there are significant advantages to doing so sooner rather than later, as discussed below.

Planning Tip: For clients who used their full $5.12 million exemption in 2012, they have an additional $130,000 exemption they can use in 2013. And, with the exemption amount now tied to inflation, they 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. However, 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, which allows an executor to transfer the unused exemption of the first spouse to die to the surviving spouse, was also made permanent. While this may at first glance appear to be an easy way to use both spouses' estate tax exemptions, problems remain. For example, if the surviving spouse remarries and dies before spouse #2, all of spouse #1's exemption is lost. Also, 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.

Planning Tip: Trust planning remains the best option. It makes excellent use of both spouses' estate *and* GST tax exemptions. Trust planning can also provide for a surviving spouse and let the first spouse to die keep control over how his/her share of assets will be managed and distributed. This is important if there are children, and it is critical if there are children from a previous marriage.

* 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 your clients can now give up to $14,000 to as many individuals as they wish each year, and not pay a gift tax. For married clients, the spouse can join and, together, both spouses 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 for clients to transfer significant amounts out of their estates.

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 for inflation.

* Several business provisions were extended, including the R&D tax credit, work opportunity tax credit, accelerated depreciation, and Section 179 levels.

* The direct IRA to charity transfer for those over 70.5 years of age was reinstituted retroactive to 2012. A special catch-up rule allowed 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 they should do estate planning: taking care of themselves and their families. Proper estate planning is essential 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 assets are distributed the way the client wants;

* Protect an inheritance from irresponsible spending, from 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 the client's assets remains in the hands of the person they trust most;

* Provide responsibly for minor children or grandchildren;

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

* Protect the client, their family and the client's assets in the event of your incapacity;

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

* Help 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: Clients do not have to make transfers in cash or liquid assets or completely give away assets. One can transfer illiquid assets like a business, or a home or other real estate, to a trust. If you transfer a home, the owners can continue to live there and take the tax deductions. If a business is transferred, it can be done in such a way that owners 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: Clients can leverage their 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. Life insurance is also more important than ever because of its income tax benefits, given higher income tax rates.

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. Thus, it is beneficial to implement these strategies as soon as possible to increase the likelihood that they will be grandfathered should Congress decide to change the law.

Conclusion

For clients who 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 planning any longer. In fact, delaying planning could cause your clients to lose out on strategies that could have significant benefit to their families. Encourage your clients to take action today.

Regards,

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