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Finally "Permanent" Estate Tax Laws: What It Means To Your Estate Plan

On January 1, 2013, Congress passed the American Taxpayer Relief Act of 2012 ("ATRA"). ATRA makes permanent the $5 million estate and gift tax exemptions and made other favorable extensions of the existing tax laws. Thankfully, these laws are not set to expire. In other words they are permanent – or as permanent as any law can be.

Gift, Estate, and GST Tax Laws

The gift, estate, and generation-skipping transfer (GST)[1] tax exemptions are now $5 million, indexed for inflation. For 2013, with the inflation adjustment, the exemption is $5,250,000. In a change from prior law, the estate, gift and GST tax rates have been increased from 35% to 40%. At the end of this Newsletter is a chart illustrating these exemptions and rates. You can make lifetime gifts up to a maximum of $5.25 million without incurring a gift tax. Any gifts made during life in excess of the annual exclusion (the $14,000 gift tax annual exclusion remains unchanged) reduce the estate tax exemption available at death. If you make no taxable gifts during lifetime, then you will have the full $5.25 million estate tax exemption available at death.

Consider Lifetime Gifts

Many people made large gifts in 2012 in anticipation of the exemptions being reduced to $1,000,000. For those who still have a large portion of your exemption remaining, and you have a large enough estate that you expect to be paying estate tax when you die, then now is still a great time to make a gift. It is more tax efficient to use gift tax exemption while you are alive as opposed to estate tax exemption when you die. The benefit of a lifetime gift is that all of the future income and appreciation on the gifted assets passes estate tax free to the donee. The primary downsides to a lifetime gift are that you will not receive a "step-up"[2] in basis when you die and you can no longer use the assets gifted.

Missouri Estate Tax Laws

Missouri's estate tax is equal to the federal credit for state estate taxes paid (referred to as a "pick-up tax"). As there is currently no federal credit for state estate taxes (there is only a deduction), there is currently no Missouri estate tax.

Illinois Estate Tax Laws

For 2013 and going forward, Illinois has a $4 million exemption. If you use a traditional credit shelter trust to take advantage of the full $5.25 million federal estate tax exemption in 2013, then, assuming the trust is fully funded, there will be an Illinois estate tax on $1.25 million (the value of the credit shelter trust that exceeds the Illinois $4 million exemption). The Illinois estate tax on a $5.25 million estate is $357,143 (the tax is actually on the $1.25 million in excess of the Illinois exemption). However, Illinois law allows your executor to make an election to defer the Illinois estate tax on any portion of your estate passing to a "QTIP" credit shelter trust. The value of the QTIP trust will be subject to Illinois estate tax at the surviving spouse's death.

To take advantage of this Illinois election, consider implementing a QTIP credit shelter trust. Many credit shelter trusts will not qualify for the election, such as those that do not require all of the income to be paid to the spouse and those that allow distributions to be made to other beneficiaries.

Portability

The executor of a deceased spouse's estate may transfer any unused estate tax exemption to the surviving spouse. Some clients have heard that this estate tax "portability" means they can now

[1] The GST tax is a tax on transfers to grandchildren or other individuals two or more generations younger than you.

[2] Under the "step-up" in basis rules the beneficiaries of your estate receive an income tax basis on the property they inherit equal to the fair market value of the property at the time of your death. This eliminates any built-in gain on the property that would otherwise be subject to income tax upon the sale of the property by the beneficiary. The step-up in basis only applies to assets that are subject to estate tax at your death. With a gift, the donee receives a basis in the gifted assets equal to your basis in those assets before the gift. This is called "carry-over" basis.

leave their entire estate to the surviving spouse, outright, and forego the use of a credit shelter trust. However, utilizing a credit shelter trust will allow you to shield more of your assets from estate taxes (as the future income and appreciation on the assets of the credit shelter trust will escape estate taxes) and will allow you to take advantage of both spouses' GST exemption. In addition, if creditor or divorce protection (protecting against your spouse remarrying and leaving your assets to the new spouse) is important to you, then you must leave assets to your spouse in trust, not outright.

Planning for Estates Under $5 Million

If the combined value of your and your spouse's assets is less than $5 million and is not expected to ever increase above $5 million, then consider not utilizing a traditional credit shelter trust (as estate taxes are not an issue). If you use a traditional credit shelter trust, then you will lose out on the step-up in basis. This could mean higher capital gains taxes when your children (or other beneficiaries) eventually sell the assets they inherit from you.

Existing Credit Shelter Trusts

Existing irrevocable credit shelter trusts (where the first spouse has passed away) should be reviewed to determine if they are still necessary given the $5,250,000 estate tax exemption. It may be beneficial to modify or terminate certain trusts to achieve a step-up in basis at the second spouse's death if estate taxes are no longer an issue.

Exemption Amounts and Top Transfer Tax Brackets

Year	Estate Tax Exempt Amount	GST Exempt Amount	Estate, Gift and GST Tax Top Bracket	Gift Tax Exempt Amount	Annual Exclusion
2001	$675,000	$1,060,000	55%	$675,000	$10,000
2002	$1,000,000	$1,100,000	50%	$1,000,000	$11,000
2003	$1,000,000	$1,120,000	49%	$1,000,000	$11,000
2004	$1,500,000	$1,500,000	48%	$1,000,000	$11,000
2005	$1,500,000	$1,500,000	47%	$1,000,000	$11,000
2006	$2,000,000	$2,000,000	46%	$1,000,000	$12,000
2007	$2,000,000	$2,000,000	45%	$1,000,000	$12,000
2008	$2,000,000	$2,000,000	45%	$1,000,000	$12,000
2009	$3,500,000	$3,500,000	45%	$1,000,000	$13,000
2010	Repealed	Repealed	Repealed	$1,000,000	$13,000
2011	$5,000,000	$5,000,000	35%	$5,000,000	$13,000
2012	$5,120,000	$5,120,000	35%	$5,120,000	$13,000
2013	$5,250,000	$5,250,000	40%	$5,250,000	$14,000

Income Taxes in 2013 and Beyond

Under ATRA the income tax brackets of 10%, 15%, 25%, 28%, 33%, and 35% are still in place, but now there is a 39.6% bracket for single individuals with income over $400,000 ($450,000 for joint filers). The capital gains and qualified dividend tax rates have increased from 15% to 20% for single taxpayers with taxable income over $400,000 ($450,000 for joint filers) per year. Single taxpayers with taxable income up to $400,000 ($450,000 for joint filers) per year will still have a 15% capital gain/qualified dividends tax rate. The 0% rate will still apply if your income falls below the 25% regular income tax bracket. These rates do not include the new 3.8% tax explained below.

3.8% Medicare Tax

Starting in 2013, there is now a 3.8% Medicare tax on the net investment income of certain high income taxpayers (joint filers with an income above $250,000, singles with income above $200,000, and trusts with income above $11,950). This tax is in addition to the income tax and is not deductible. Net investment income includes interest, dividends, rents, royalties, capital gains, and trade or business income that is a passive activity. It does not include tax-exempt income, IRA/401(k) distributions, or active trade or business income.

For More Information:

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