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MP&S Tax Alert: What the American Taxpayer Relief Act Means for Your Estate Plan

2013 Tax Law Changes Warrant a Review of Your Estate Plan

The American Taxpayer Relief Act of 2012 (ATRA), signed into law Jan. 2, 2013, primarily addresses income taxes. However, it also provides substantial estate tax relief compared to the changes that otherwise would have gone into effect in 2013. In addition, it provides increased estate tax law certainty. Nevertheless, ATRA is not all positive for estate planning, as it increases the estate tax rate compared to the 2012 estate tax law regime.

The many changes going into effect in 2013 warrant a review of your estate plan. Here are some of the most important changes to consider.

Exemptions and Rates

Without congressional action, gift, estate and generation-skipping transfer (GST) tax lifetime exemptions would have dropped precipitously (by more than $4 million) and the top tax rate would have jumped significantly (by 20 percentage points, to 55%) beginning in 2013. ATRA increases transfer taxes for some families, but much less dramatically. It retains the 2012 $5.12 million lifetime exemptions —indexing them for inflation— and increases the top rates by only five percentage points, from 35% in 2012 to 40% in 2013 and future years.

As a result of ATRA, the exemptions remain at an all-time high level and will keep up with inflation for future years. This means that, even if you used up your exemptions in 2012 to lock them in, you will still have additional exemptions available in future years as a result of indexing. In addition, the top rate, though higher than it was in 2012, is still quite low historically.

It is important to review your estate plan in light of these changes. Doing so will allow you to make the most of available exemptions and ensure your assets will be distributed according to your wishes. Without a review, it is possible the exemption and rate changes could have unintended consequences on your estate plan.

Exemption Portability

Federal legislation in 2010 included a provision that — temporarily — provided significant estate planning flexibility to married couples. If one spouse died in 2011 or 2012 and part (or all) of his or her lifetime estate tax exemption was unused at his or her death, the estate could elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption.

While this relief had been somewhat hollow in most cases, because it applied only if the surviving spouse made gifts using the exemption or died by the end of 2012, ATRA has now made the portability provision permanent.

Making asset transfers between spouses during life and/or setting up certain trusts at death can produce similar results to portability. However, making the portability election is simpler and provides flexibility as well as a fall back if sufficient planning has not been done before the first spouse's death.

Still, using lifetime asset transfers and trusts can provide benefits that exemption portability does not offer. For example, portability does not protect future growth on assets from estate tax as effectively as applying the exemption to a credit shelter trust does.

Importantly, please also be aware that the provision does not allow the deceased spouse's remaining GST tax exemption to be used by the surviving spouse, and, in addition, some states (including New York) do not recognize exemption portability.

Other Provisions

ATRA maintains several other provisions that affect estate planning, including:

- The federal estate tax deduction (rather than a credit) for state estate taxes paid,
- Deferral and installment payment of estate taxes attributable to qualified closely held business interests, and
- GST tax protections, including deemed and retroactive allocation of GST tax exemptions, relief for late allocations, and the ability to sever trusts for GST tax purposes.

Certain income tax provisions can also be beneficial for estate planning purposes. For example, ATRA makes it easier to convert an existing traditional 401(k), 403(b) or 457(b) account into a Roth account. Roth accounts can be attractive from an estate planning perspective because they don't require you to take distributions during your life, allowing you to let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

Charitable Giving Breaks

ATRA also extends two valuable charitable giving breaks through 2013 (retroactive to Jan. 1, 2012) that might help you achieve your estate planning goals if you are charitably inclined. The following two breaks had expired Dec. 31, 2011:

1. Tax-free IRA distributions for charitable purposes. If you're age 70½ or older, you can make a direct contribution from your IRA to a qualified charitable organization without owing any income tax on the distribution. If you're subject to required minimum distributions (RMDs), the contribution can be used to satisfy that requirement. The maximum allowable distribution for charitable contribution purposes is $100,000 per tax year.

2. Contributions of capital gains real property for conservation purposes. You can make such a contribution and take a larger deduction than is allowed for most other capital gains property contributions. Specifically, your deduction for a contribution of capital gains real property for conservation purposes generally can be up to 50% of your adjusted gross income (AGI) rather than the 30% of AGI limit that normally applies to contributions of capital gains property.

Increased Estate Tax Law Certainty

ATRA has brought some welcome stability to the estate, gift, and generation-skipping transfer (GST) tax regimes by eliminating the application of expiration dates to lifetime exemption amounts and tax rates.

For more than a decade, much uncertainty due to expiring exemptions and rates had made estate planning a challenge. The fact that rates, exemptions and other estate-tax-related breaks under ATRA will not expire will make it easier to determine how to make the most of your exemptions and keep taxes to a minimum while achieving your other estate planning goals.

Of course, just because the provisions (e.g., exemption amounts, tax rates) under ATRA do not expire, and thus have been called "permanent," does not mean legislation could not be signed into law in the future that would change exemptions, tax rates or tax breaks yet again — or even repeal the estate tax.

(While many still support estate tax repeal, repeal is probably unlikely for at least the next four years, given the current balance of power in Washington and concerns about deficit reduction). Accordingly, it is always a good idea to build flexibility into an estate plan that will allow it to adapt to changing circumstances.

Many Reasons for a Plan Review

The 2013 federal estate tax law changes are not the only reason to review your estate plan. For example, the state estate tax continues to be a consideration. If you live in a state (such as New York) with an estate tax, the exemption amount could be dramatically lower than the federal exemption amount. Accordingly, improper planning could lead to an unpleasant surprise in the form of significant state estate tax liability. Further complicating matters is that, even if your state does not have an estate tax, it's possible you may be subject to estate tax in other states in which you own property.

Finally, changes in your personal or business situation may also require a change in your estate plan. Births, deaths, marriages, divorces, and changes in your personal finances or your business can all have an impact.

To help minimize your tax liability and facilitate the distribution of your assets according to your wishes, you should consider reviewing your estate plan currently. We would be pleased to help you determine how ATRA and other changes will impact your estate plan and what plan revisions can help you achieve your goals.

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If you have questions about anything you read in this Alert or in the MP&S tax guide, please contact an MP&S tax advisor or Steven Eliach, JD, LLM, the Principal-in-Charge of the MP&S Tax Practice, by phone at 212.503.6388 or by email at seliach@markspaneth.com.

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