The American Taxpayer Relief Act of 2012
Estate and Gift Tax Provisions

Evan H. Ice
Stevens & Brand, L.L.P.

For the past several months, the hottest term in the media and by the water cooler was "fiscal cliff." Simply defined, the fiscal cliff was the potential doom and gloom created by a number of national financial issues all coming to a head on January 1, 2013. After highly publicized discussions between the Speaker of the House and the President that ended in a stale-mate, the Senate led the way to approve a Bill providing compromise solution to avert the fiscal cliff. The House ultimately approved the Senate Bill, with vocal criticism by a number of Republicans because of the lack of strong spending cuts, and the President signed The American Taxpayer Relief Act of 2012 (the "Act") into law. Although the Act deals with a wide variety of issues, including income tax rates, credits and deductions, and Alternative Minimum Tax, this summary focuses on the estate and gift tax provisions.

Summary

The Act makes permanent all of the beneficial provisions of the *Economic Growth and Tax Relief Reconciliation Act of 2001* ("EGTRRA") and the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* ("TRA 2010") that were in effect in 2012 (except that the maximum marginal rate for estate and gift taxes has changed from 35% to 40% beginning in 2013), meaning that they will not automatically "sunset" at some point in the future, but rather remain in effect into the future without the need for any further action from Congress. **Therefore, unlike the situation that has existed since 2001, we now know that exemption will not be reduced, rates will not be further increased, and all of the other helpful provisions of EGTRAA and TRA 2010 will not be lost *unless and until* Congress enacts new legislation that expressly makes changes.**

Unified Estate and Gift Applicable Exclusion Amount

Rather than a temporary extender, the Act **permanently** sets the estate and gift tax applicable exclusion amount (referred to here as the "exemption") at $5 million (as adjusted for inflation in multiples of $10,000 after 2011). The $5 million (as indexed for inflation) exemption is the same exemption that was in place for 2010 through 2012, and is more than the $3.5 million amount that the Obama Administration had advocated. Although the gift tax exemption was lower than the estate tax exemption from 2004 through 2010, and many viewed its "reunification" with the estate tax exemption in 2011 and 2012 as very fragile, Congress has chosen to permanently reunify the two exemptions. **Adjusted for inflation, the unified estate and gift tax exemption is expected to increase to $5.25 million for 2013.**

Taxpayers and estate planners have been pleading for permanent legislation that can be relied upon for planning purposes, and now we apparently have it. In short, the adoption of the Act "sunsets" the sunset provisions in EGTRAA and TRA 2010. Thus, this marks the first time since 2001 that we have had permanent estate and gift tax legislation, upon which citizens should be able to place some reliance.

Top Estate Tax Rate

The Act sets the top marginal estate tax rate at 40 percent, up from the 35 percent rate of 2010 through 2012, but less than the 45 percent rate of 2009 law that had been the Obama Administration position. With 40 percent being the midpoint of those two positions, this is an obvious compromise. **The 40 percent rate is the *only* change from the 2012 estate tax law.**

Portability

The Act **permanently** adds "portability" to the estate tax laws. Portability was first introduced in TRA 2010 but sunset on December 31, 2010. Portability means that the surviving spouse's exemption is increased by his or her previously deceased spouse's unused exemption. This means that if a husband predeceases his wife and has a $1 million taxable estate, his estate can transfer to his surviving wife his $4 million (indexed for inflation) unused exemption by filing a United States Estate Tax return. The surviving spouse can then add the unused $4 million exemption to her own $5 million (indexed for inflation) exemption, for a total $9 million exemption. Thus, if the first spouse to die leaves his entire estate to his surviving spouse outright, his surviving spouse can potentially have the full $10 million exemption at her death, for her estate.

Generation Skipping Transfer Exemption

The Act also **permanently** sets the Generation Skipping Transfer Tax (GST) exemption at $5 million (as indexed for inflation). Thus, the GST exemption and the unified estate and gift exemption are permanently coordinated. GST exemption is also set at an inflation-adjusted $5 million. However, as with prior law, the GST exemption is *not* portable. Thus, to preserve the GST exemption of the first spouse to die, the use of a “credit shelter” or “bypass” trust is needed.

State Estate Taxes

Before EGTRAA, estates could take a dollar for dollar credit (up to a specified maximum, depending upon the size of the estate) for estate or inheritance taxes paid to a state. A state estate or inheritance tax that coordinated with the United States state estate tax credit is commonly referred to as a “pick-up tax.” For 2004 through 2009, EGTRRA repealed the state estate tax credit and changed it to a deduction. TRA 2010 continued this for 2010 through 2012. This meant that a state estate tax was no longer a dollar for dollar reduction of United States estate tax. As a result, many states, including Kansas, repealed their respective estate and inheritance taxes. The Act continues state estate taxes as a deduction and not a credit. Thus, do not look for the Kansas Legislature to readopt the Kansas estate tax in the near future.

What to Do?

Individuals who have been waiting to see what Congress will do before they engage in any significant estate planning need wait no longer. Individuals who did simple estate planning based upon the assumption that Congress would extend the estate tax exemption at $3.5 million to $5 million may not need to do anything further. Individuals who have done more complicated estate tax planning may want to reconsider whether the continued complexity is necessary (assuming what they have already done is not irrevocable). Higher marginal income tax rates for high income earners (not covered in this article) may make gifting more advantageous, even if the gifting is not done for estate tax purposes. There is certainly no “one size fits all” answer - everyone’s circumstance is different.

Because the portability provisions have now been made permanent, married couples may be more inclined to proceed with fairly simple “all to surviving spouse” Will and Revocable

Trust estate planning, relying on portability to take advantage of both spouse's estate exemptions, rather than creating a more complicated "bypass" or "credit" trust when the first spouse dies. Note however, that there are a variety of advantages of employing trusts at the first spouse's death. For instance, spouses with children from a prior marriage may not be inclined to follow an "all to surviving spouse" planning scheme. Similarly, an "all to surviving spouse" planning scheme does nothing to provide remarriage protection. In addition, the GST exemption is not portable, so couples wanting to maximize generation skipping transfers will still need to create a trust at the death of the first spouse to die. Finally, individuals who are skeptical about what Congress may do in the future may not want to rely upon the Act as truly being permanent.

Although any legislation is as permanent as shifting sand, now is the time to consult with an advisor to determine if action is necessary to effectuate an estate plan that maximizes your goals.