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Commentator ALERT

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American Taxpayer Relief Act of 2012

Gift, Estate and Generation-Skipping Transfer Tax Matters

The American Taxpayer Relief Act of 2012 (the "2012 Tax Act") continues important gift, estate and generation-skipping transfer ("GST") tax provisions that were to expire on January 1, 2013, thus preventing substantial increases in these taxes in and after 2013. Of course, Congress can change the law at any time, but at least for now we have more certainty than before.

The only material ***change*** from the prior law (other than eliminating the "sunset" provisions) is that the maximum gift, estate and GST tax rate was increased from 35% to 40%. This rate applies after the first $1,000,000, with lower brackets applying to lesser amounts. This can be confusing due to the much larger exemption from these taxes, but the net effect is that, when tax is due, it will be $54,200 less than if the 40% rate applied from the first dollar.

Perhaps of greater importance are the tax provisions that were not ***changed*** but rather were ***continued***. One of the most important is that the tax-free amount (the "Unified Exemption") remains at $5,000,000 for gift, estate and GST tax purposes. Indexing for inflation, in place since 2011, also remains in effect under the 2012 Tax Act, resulting in the tax-free amount for 2013 being $5,250,000.

The Unified Exemption applies to the gift, estate and GST taxes. As a simplified example of how this works with the gift and estate tax, a person can make a gift of $5,250,000 (which can be doubled for married persons) and pay no current gift tax, but when that person dies, he or she will have "used up" $5,250,000 of whatever the Unified Exemption is at that time. All taxable gifts made over the years have to be taken into account when determining when the taxpayer reaches the Unified Exemption amount.

The 2012 Tax Act continues opportunities to make large lifetime gifts without gift tax. Many individuals made substantial gifts in 2011 and 2012 to take advantage of the large Unified Exemptions then available. The continuation of historically high Unified Exemptions in 2013 and later years extends the ability to take advantage of the increased gifting opportunities for individuals who have not fully exhausted their Unified Exemptions through prior gifts.

The Unified Exemption applies to the GST tax as well. Any client with any legacy/estate plan that may entail gifts and/or post-death distributions to third and/or lower generation persons will need professional counsel to minimize exposure to the GST tax.

Another major benefit to the Unified Exemption continuing at a higher level than many thought would be the case is that many taxpayers may now be able to consider simplifying their legacy/estate plans. However, even persons who may have no gift, estate or GST tax exposure need to keep in mind the "people" aspects of their legacy/estate plans. For example, many spouses want to leave as much as possible in trust, with restrictions, on the first death. This is common among spouses in multiple marriages who often have "his" and "her" (and sometimes "our") children, as well as other spouses who want to insure inheritance by children after the second death, rather than risking having assets left to a subsequent spouse and/or others.

The 2012 Tax Act also continues portability as a feature of the law. Portability may be beneficial to married couples, to reduce or eliminate estate tax on the death of the survivor. Essentially, if a married decedent does not leave sufficient assets to use up all of his or her Unified Exemption, the excess can be carried over by the surviving spouse. For portability to be available to the estate of the survivor, an estate tax return has to be filed for the first spouse to die, even though no tax is due, to verify the amount of the Unified Exemption to be carried over. As a simplified example, if Mr. Brown died in 2013 having made no lifetime taxable gifts and leaving assets valued at $2,250,000 to persons other than his wife or charity, $3,000,000 of his Unified Exemption would be left unused. Portability allows this to be used by his widow, effectively increasing her Unified Exemption to $8,500,000 (plus increases in her "base" Unified Exemption of $5,000,000 due to inflation since 2011).

Portability may be beneficial to reduce or eliminate estate taxes on the second death. This may be attractive to some married persons who would simply leave everything outright to each other but for the estate tax, but portability alone may not maximize estate tax savings that may be afforded by use of a trust that "shelters" assets on the first death. Also, portability will not change the legacy/estate plan for married clients who want to impose first death restrictions to protect second death inheritances.

In Brief:
The 2012 Tax Act continues:

- important gift, estate and GST tax provisions (preventing them from reverting to less favorable provisions);
- the unified gift, estate and GST exemption as indexed ($5,250,000 for 2013);
- opportunities to make large life time gifts without gift tax; and
- beneficial major estate and gift tax savings opportunities.

However, the 2012 Tax Act does increase the maximum gift, estate and GST tax rate to 40%.

Perhaps more important for many clients is that the 2012 Tax Act does not impair a number of beneficial major estate and gift tax savings techniques that had been proposed to be limited or made less favorable. For example, so-called "defective" grantor trusts, sales to grantor trusts, valuation discounts, dynasty trusts and GRATS remain unchanged by the 2012 Tax Act.

Finally, under the 2012 Tax Act, state-level estate/inheritance taxes continue to be deductible in determining the taxable estate at the federal level. However, Michigan does not have an estate/inheritance tax. Taxpayers subject to inheritance taxes of other states will continue to benefit from inheritance tax planning.

Please contact your attorney at Kemp Klein with any questions, concerns and the like you may have regarding your legacy/estate plan, whether existing or just contemplated at this time. In any event, please keep in mind that regardless of tax considerations, there are important "people planning" matters that should be properly addressed. Accordingly, it remains our advice that all clients should review their legacy/estate plans annually and should meet with their Kemp Klein attorney for an overall review at least every three to four years and more often if the clients and/or their family experience any significant changes, such as inheritances, death, divorce, employment changes, changes in life insurance or other death benefits and the like that may affect their legacy/estate plans.

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