TCV Estate Planning Alert

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The American Taxpayer Relief Act of 2012 (Act) was enacted on January 2, 2013. The Act for the most part extended the tax benefits for larger estates in existence before the cliff. We have put this Alert together to highlight the main estate, gift, and generation-skipping transfer (GST) tax laws included in the Act.

Estate Tax Exemption. The Act permanently maintains the $5 million estate tax exemption indexed to inflation. In 2012, the exemption was $5.12 million and in 2013, the inflation-adjusted estate tax exemption amount is $5.25 million. This means that married couples can plan their estates to avoid all federal estate taxes for estates under $10.5 million. Furthermore, "Portability" of this exemption is now permanent. In the past, the challenge in planning larger spousal estates was twofold. First, planners often used sophisticated documents to ensure both spousal exemptions, such as credit shelter trusts. The second step was the continual monitoring of how assets were held. For example, if all assets were held in joint name, assets would bypass a trust designed to use the first exemption thereby losing part or all of the first exemption. Fortunately the recent passage of "Portability" gives to the second spouse the unused exemption, thus restoring lost exemptions, regardless of errors in titling assets.

Vermont, however, did not change its exemption of $2.75 million. Vermont's tax bite above the exemption can be as high as 35%

Basis Adjustment for Property Acquired From a Decedent. The Act did not change the law regarding basis adjustment for property acquired from a decedent. Stepped up (or down) basis will continue to eliminate all pre-death capital gain or loss on the property.

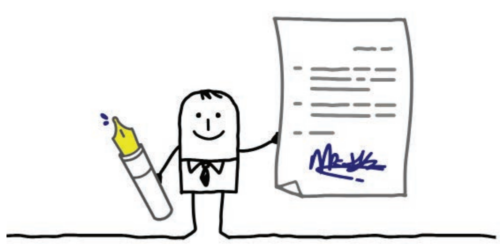
Gift Tax Exemption. The Act makes permanent the unification of the gift and estate tax exclusion amounts. This means that in 2013 each person can make lifetime gifts up to $5.25 million without paying gift tax. However, all gifts above the annual gift exclusions ($14,000 per person or $28,000 per married couple) will still be subtracted from Estate Tax Exemption.

GST Tax Exemption. The Act makes permanent the unification of the estate tax and GST tax exemption amounts. In 2013, grandparents can make transfers to grandchildren (or generation trusts) of up to $5.25 million without paying a GST tax.

Maximum Estate, Gift and GST Tax Rates. The Act did increase taxes for estates above the exemption(s). The maximum rate in 2012 was 35% and, moving forward, it will be 40%.

Vermont residents should take a second look at their estate plans. The generous federal exclusions and exemptions may create less urgency for a plan review and this may be a mistake. And my advice to those who wanted clarity before revisiting their plans, clarity has arrived. It's time to revisit the plans if you have not already done so recently, for two significant reasons: the Vermont Estate Tax and the cost of the infrastructure of a Credit Shelter Trust (a/k/a Trust B, Family Trust, etc.) whose only purpose was estate tax savings.

For example, if the marital assets amount to $3 million, the Vermont tax could be as high as $87,500 without planning. If the estate were held jointly, the tax would be due upon the second death.



We have many trusts that were drafted when the federal exemption was $1 million. The classic document first created a credit shelter trust equal to the federal exemption, with the balance passing to the spouse either outright or in a marital trust. If the $3 million were held in this type of trust, the Vermont tax would become due on the first death. Pre-existing documents can be easily amended to save all estate taxes, both federal and Vermont, on spousal estates under $5.5 million.

The infrastructure of a trust can be beneficial for many reasons, such as probate avoidance and management when beneficiaries or donors want to avoid guardianships. That said, if the only objective of the trust is to escape taxes, an existing trust should be revisited. For example, if a married couple's assets total $2 million, all in the name of the decedent, the typical credit shelter trust would surface upon death. The $2 million would be trapped in the trust for the surviving spouse, who would then encounter, in most cases, limited control for the balance of his or her life. Plus, there is the cost of the infrastructure of a trust. Fortunately for our clients, there are no additional costs. However, those who might use managers who are not designated as trustee managers, the cost of the fiduciary accounting, legal advice, and the tax return could be expensive.