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FISCAL CLIFF UPDATE – ESTATE, GIFT AND GST TAX

On January 1, 2013 Congress passed the American Taxpayer Relief Act (the "Act"), which President Obama signed into law on January 2nd in order to avoid the so-called "fiscal cliff." The Act permanently extended a number of temporary and expiring tax cuts and has significant impact on estate, gift, and generation-skipping transfer ("GST") tax laws. On April 10, 2013 President Obama released his most recent budget proposal, which potentially may impact some of the "permanent" provisions of the Act. Where applicable, the budget's impact on the Act is noted below.

FEDERAL ESTATE, GIFT AND GST TAX IN 2013

- The Act makes permanent the federal estate, gift, and GST tax lifetime exemption amount of $5,000,000, indexed for inflation. For 2013, the applicable exemption amount will be $5,250,000. The maximum rate for estate, gift, and GST taxes increased from 35% to 40%, but is below the 55% rate that would have gone into effect had the Act not been signed.

  President Obama's budget proposal would raise the maximum rate for estate, gift, and GST taxes to their 2009 levels of 45%, and would also lower the applicable lifetime exemption amount for estate and GST taxes to $3,500,000, and for gift tax to $1,000,000. These lifetime exemptions would not be indexed for inflation. These proposed changes would not take effect until 2018.

- The federal estate and gift taxes remain "unified," meaning that any amount of exemption used during a decedent's lifetime will reduce, dollar-for-dollar, the amount of exemption that is available to such decedent's estate at death. Similarly, any lifetime use of the GST exemption reduces the amount of exemption available at death.

- The Act also makes permanent the concept of "portability," which allows a decedent's surviving spouse to make use of the deceased spouse's unused exemption. Portability, however, only applies to estate and gift tax exemptions; a deceased spouse's unused GST tax exemption is not portable. Portability is also a purely federal concept. To date, no state has adopted portability.

- Though not specifically provided for in the Act, the 2013 gift tax annual exclusion increased from $13,000 to $14,000 per donee, or $28,000 if a husband and wife elect to split their gifts in 2013. The gift tax annual exclusion for gifts made to non-citizen spouses increased from $139,000 to $143,000.

- The Act also extends the deduction available to a decedent's estate for federal estate tax purposes for state estate and inheritance taxes paid.

POSSIBLE FUTURE LEGISLATIVE CHANGES

Grantor Retained Annuity Trusts (GRATs) & Sales to Intentionally Defective Grantor Trusts (IDGTs)

- GRATs and sales to IDGTs are common estate planning techniques used to take advantage of the low interest rate environment. For the month of April, for example, the Section 7520 rate, which is the interest rate used to value annuities or interests for a term of years, is 1.4%. In short, the idea behind a GRAT or a sale to an IDGT is that a donee contributes assets to a trust, and receives, either via a fixed annuity or via annual payments on a promissory note, assets back from the trust over a period of years. To the extent the assets in the GRAT or the IDGT appreciate in excess of the applicable interest rate, that appreciation in value is kept in the trust and passes to the beneficiaries of the trust free of estate or gift taxes. With such low interest rates, it's easy to see why these are such popular techniques now.

  President Obama's budget proposal contains various provisions which would impose restrictions on the use of GRATs and sales to IDGTs.

Duration of GST Tax Exemption

- Under existing law, the use of the GST exemption can shelter trusts for the benefit of grandchildren and more remote generations from the GST tax for an indefinite period, indeed in perpetuity in certain jurisdictions.

  President Obama's budget proposal would limit the duration of the GST exemption to 90 years, thereby subjecting any GST trust to GST tax after the expiration of that period.

PLANNING FOR 2013 AND BEYOND

- Review your existing estate plan and determine whether the dispositive provisions are still appropriate given the adoption of the new exemptions and rates of tax, and in light of the President's budget proposal.

- Consider using your gift tax annual exclusion and also consider use of your remaining gift tax exemption.

- Consider the impact of your state's estate tax, if any. If you are currently domiciled in a state with an estate or inheritance tax (for example, New York, New Jersey or Connecticut), you may wish to consider making federally taxable gifts to lessen your potential state estate tax liability. This may be an especially attractive option for domiciliaries of states without a separate state gift tax. Connecticut is currently the only state in the country with a separate state gift tax.

- Consider taking advantage of low interest rates by use of a GRAT or a sale to an IDGT before any possible future legislation limits or removes the viability of these options.
- Consider making gifts of fractional interests in closely held business entities to take advantage of discounts for lack of control and lack of marketability. This planning technique was not addressed in the President's budget proposal.
- Consider GST tax planning.

Please contact us if you have any questions concerning any of the Federal estate, gift or GST tax aspects of the Act or any of the proposed estate planning techniques listed above.

ABOUT CURTIS

Curtis, Mallet-Prevost, Colt & Mosle LLP is a leading international law firm providing a broad range of services to clients around the world. Curtis has 16 offices in the United States, Europe, Central Asia, the Middle East and Latin America. The firm's international orientation has been a hallmark of its practice for nearly two centuries.

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