# 2012 Taxpayer Relief Act

**Estate, Gift and Generation-skipping Transfer Taxes.**

1. *Estate and Gift Tax in General.* On January 1, 2013, a new tax law, the American Taxpayer Relief Act of 2012 (2012 Tax Act) was enacted. The 2012 Tax Act made permanent many provisions included in the 2010 Tax Relief, Unemployment Insurance Authorization, and Job Creation Act (2010 Tax Act). The 2010 Tax Act re-unified the estate and gift taxes providing an exclusion amount for both taxes of $5,000,000 per person. The 2012 Tax Act retains the unification of estate and gift taxes with a $5,000,000 gift and estate tax exclusion amount adjusted for inflation beginning with 2012. Inflation adjustments for 2012-2017 have increased the 2017 exclusion amount to $5,490,000. This exclusion amount may be used during your lifetime without paying a gift tax. To the extent you don't fully use the $5,490,000 for gifts during life, the exclusion amount remaining at your death may be used to shelter from estate taxes property with a value of the remaining exclusion amount. A 40% tax rate will apply to the transfer of assets that exceed the unified gift and estate tax exclusion amount. The 2012 Tax Act removed the sunset provision in the 2010 Tax Act and restored a sense of permanency to the estate planning world.

2. **Increase in gift and estate tax exclusion amounts 2010 - 2017.**

| Calendar Year | Estate tax exclusion amount | Highest estate tax rates |
|---|---|---|
| 2010 | $ 5,000,000 | 35% |
| 2011 | $ 5,000,000 | 35% |
| 2012 | $ 5,120,000 | 35% |
| 2013 | $ 5,250,000 | 40% |
| 2014 | $ 5,340,000 | 40% |
| 2015 | $ 5,430,000 | 40% |
| 2016 | $ 5,450,000 | 40% |
| 2017 | $ 5,490,000 | 40% |
| **Calendar Year** | **Gift tax exclusion amount** | **Highest gift tax rates** |
| 2010 | $ 1,000,000 | 35% |
| 2011 | $ 5,000,000 | 35% |

| 2012 | $ 5,120,000 | 35% |
|---|---|---|
| 2013 | $ 5,250,000 | 40% |
| 2014 | $ 5,340,000 | 40% |
| 2015 | $ 5,430,000 | 40% |
| 2016 | $ 5,450,000 | 40% |
| 2017 | $ 5,490,000 | 40% |

3. *Portability*. The 2010 Tax Act introduced a new element into the estate planning realm, namely portability. This concept was continued and made permanent with the 2012 Tax Act. Portability is the ability of a surviving spouse to use any unused gift or estate tax exclusion amount of their deceased spouse. For example, husband dies in 2017 leaving an estate worth $3,000,000. If he made no taxable gifts during his life, he would still have the full $5,490,000 exclusion amount available at his death. If all his property passed to his wife outright or in a marital trust, his property would pass under the estate tax marital deduction and none of his exclusion amount would be used at his death. That would mean his entire $5,490,000 estate and gift tax exclusion amount would be unused. Under previous estate and gift tax laws, husband's exclusion amount would have been wasted and wife would have only her $5,490,000 exclusion amount to use for gifts during the rest of her life and at death. Under the 2012 Tax Act, husband's personal representative may file an estate tax return with the IRS and designate the husband's $5,490,000 unused exclusion amount as being reserved for use by wife. Wife would then have a total gift and estate tax exclusion amount of $10,980,000 to be applied to gifts she makes during her life or to her estate upon her death.

4. *Gifts Using Portability.* When a surviving spouse makes lifetime gifts, he or she first applies any deceased spouse unused exclusion amount to the gifts and applies his or her exclusion amount second. A surviving spouse may only apply the deceased spouse unused exclusion amount of her last deceased spouse. Remarrying does not eliminate a deceased spouse unused exclusion amount received from a previous deceased spouse. However, the death of the second spouse will eliminate any remaining amount of the first deceased spouse's unused exclusion amount. Therefore, a surviving spouse who remarries may want to consider making gifts to use any remaining amount of her deceased spouse's unused exclusion amount to avoid its loss in the event his or her second spouse dies.

4. *Generation-Skipping Tax.* The 2012 Tax Relief Act provides a $5,000,000 exemption amount for the generation-skipping transfer (GST) tax. This amount is adjusted for inflation in the same manner as the gift and estate tax exclusion amount. Portability does not apply to the GST tax exemption. The GST exemption amounts and tax rates for years 2011 – 2017 are as follows:

| **Calendar Year** | **GST tax exemption amount** | **Highest estate tax rates** |
|---|---|---|
| 2011 | $ 5,000,000 | 35% |

| 2012 | $ 5,120,000 | 35% |
|---|---|---|
| 2013 | $ 5,250,000 | 35% |
| 2014 | $ 5,340,000 | 40% |
| 2015 | $ 5,430,000 | 40% |
| 2016 | $ 5,450,000 | 40% |
| 2017 | $ 5,490,000 | 40% |

5. *Need for Estate Tax Planning*. Obviously, estate tax planning will still be advantageous for estates valued over $5,490,000; however, the provisions of the new law do not eliminate the need for estate tax planning for estates less than $5,490,000. Even if the $5,490,000 estate, gift and GST tax exclusion amount exceeds the value of an estate, there will still be many non-tax reasons for estate planning. Probate avoidance upon death and disability will remain extremely important reasons to use revocable trust estate planning. Family partnerships or limited liability companies will continue to provide valuable business continuation planning and asset protection for partners or members from creditors and divorce. They also permit the older generation to shift taxable income to a younger generation without giving up control of the property owned by the partnership or limited liability company. Protection of property passing to spendthrift or disabled spouses, children, and grandchildren will remain an important reason for trust planning. Marital trust planning will remain important in second or blended marriages to provide a life income to a second spouse and protect principal for children of the first marriage. Charitable remainder trusts will continue to provide significant income tax savings through income tax deductions and their ability to convert appreciated, low income property to higher income property without capital gain. Insurance trusts will remain valid to provide insurance as a means of equalizing an estate between children who want to continue the family business and those who would rather liquidate it and receive their share.

**Step Up in Basis.**

1. *Step Up in Basis.* The 2012 Tax Act retains the step up in income tax basis for property acquired from a decedent. This means that the tax basis of a decedent's property is increased to its fair market value as of the date of the decedent's death. When the decedent’s children or spouse later sell the property, there will be little or no capital gain tax.

2. *Using Portability for Basis Step Up.* Before portability existed, the basic principal of estate planning was to use each spouse’s unified credit equivalent or exclusion amount at their death to avoid estate taxes at both deaths. When the first spouse died, property with the value of his or her exclusion amount was set aside in a bypass or credit shelter trust because, if the exclusion amount was not used, it was lost. The property allocated to the bypass trust escaped estate tax by allocation of the first-to-die’s exclusion amount and received a step up in income tax basis to the fair market value on the date of death. When the second spouse died, the property in the bypass trust was not included in his or her estate for estate tax purposes and it did not receive another step up in income tax basis.

With portability, the exclusion amount of the first-to-die will not be lost if the deceased spouse's personal representative or trustee makes an election to carry the deceased spouse's unused exclusion amount forward for the surviving spouse. If the portability election is made, the surviving spouse's estate will include both the surviving spouse's property and the deceased spouse's property he or she received on the first death. The surviving spouse will have his or her estate tax exclusion amount and his or her deceased spouse's unused exclusion amount to apply to avoid or reduce estate taxes. Also, the surviving spouse's property and the deceased spouse's property the surviving spouse received on the first death will all receive an income tax basis step up. Therefore, if the married couple own appreciating property, electing portability on the first death and obtaining the income tax basis step up for all their property may reduce income taxes for property sold after the second death.