

ClientAlert

Private Clients

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Effects of the New US Tax Law on Estate Planning

On January 3, 2013, President Obama signed the American Taxpayer Relief Act of 2012 into law. As a result, for the first time in over 12 years, there is now some certainty in the Federal estate tax, the Federal gift tax and the Federal generation-skipping transfer (or "GST") tax. Under the new law, in general:

- The exemption from the Federal gift tax is US\$5.25 million in 2013. This amount will rise with inflation in future years.
- The exemptions from the Federal estate tax and the GST tax are US\$5.25 million each in 2013. These exemptions will also rise with inflation in future years.
- The tax on amounts transferred in excess of these exemptions is now 40 percent.
- The estate and gift tax exemptions are "unified." This means that the amount of the estate tax exemption available at death will be reduced by the amount of the gift tax exemption used for lifetime gifts.
- The estate tax exemption is "portable" between spouses. This means that if one spouse dies with an estate valued at less than his or her available estate tax exemption, the "unused" portion of his or her exemption may be used by the surviving spouse to exempt certain gifts made during life or bequests made at death.
- In addition to the gift tax "exemption," there remains a gift tax "annual exclusion." This is the amount that any one donor can give away every year to an unlimited number of donees without triggering a gift tax and without reducing the amount of the gift tax exemption. The annual exclusion amount is US\$14,000 for 2013. It too will rise with inflation in future years.
- These exemptions, rates and portability provisions have no scheduled expiration and are not slated to change (except for the inflation adjustments mentioned above). Of course, a future Congress can always change the law.



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Here are some considerations for your estate planning in light of the new law:

- If you already used your gift tax exemption on gifts to individuals or trusts before December 31, 2012, you still obtained significant tax benefits even though the exemption did not decrease from the amount in effect last year.
 - Using the exemption early through lifetime gifts (rather than waiting to use it on bequests made at death) excludes from Federal estate and gift tax not only the amount of the gift, but also all the income and future appreciation on the gifted assets from the date of the transfer.
 - Many states (such as New York) have a state-level estate tax in addition to the Federal estate tax, but do not have a gift tax. In many cases, the state's estate tax exemption is much lower than the Federal exemption. (For example, New York's exemption is US\$1 million and it is not indexed for inflation.)
 - If you reside in such a state and made a gift of your Federal exemption amount last year, you avoided paying the state estate tax that would otherwise have been due had you waited until death to make the transfer. In the case of a New York resident, this represents a potential tax savings of more than US\$400,000.
- If you did not use all of your Federal gift tax exemption last year, you should consider doing so now.
 - As shown above, lifetime gifts are almost always more tax-efficient than bequests made at death.
- Remember that, with the inflation adjustments, the amount that you can give away tax-free will increase each year.
 - For example, if you made a gift of US\$5.12 million to a trust for your children in 2012 (the maximum available exemption last year), you can add another US\$130,000 to the trust this year, and potentially more in future years.
- You should review your plan to see if it contains "formula" transfers that are affected by the new law.
 - For example, a will may leave "the amount exempt from the GST tax" to grandchildren or a trust for their benefit.
 - Before 2001, such a formula would have left the grandchildren a gift of US\$1 million.
 - Under the new law, the amount of this gift will be increased to US\$5.25 million, and it will increase more in future years because of the inflation adjustment. Depending on your assets and beneficiaries, you may wish to consider placing a dollar amount "cap" on such a formula.
- Similarly, many wills give the amount of the testator's remaining estate tax exemption to a so-called "By-Pass" or "Credit Shelter" trust for the benefit of the surviving spouse and descendants, with the balance of the testator's assets being left to the surviving spouse so that they qualify for the "marital deduction" and thus are not taxed.
 - If the testator did not use any exemption during life, the above formula plan would require that the full Federal estate tax exemption amount pass to the By-Pass trust.
 - Although this amount is exempt from Federal taxation, it may trigger a state-level estate tax (as stated above, many states have their own state estate taxes with exemptions that are lower than the Federal exemption). For a testator residing in New York, where the state estate tax exemption is only US\$1 million, a formula gift of the full Federal exemption to a By-Pass trust would trigger a New York estate tax of more than US\$400,000.
 - Depending on your assets and beneficiaries, you may want to consider limiting the amount passing to your By-Pass trust to the lower of the Federal exemption or the state exemption.

Please contact any member of the White & Case Private Clients Group if you would like to discuss your estate planning.

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