
Attorney at Law

Manish C. Bhatia

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Phone: (773) 991-8423 • E-mail: manish@mcb-law.com • Web: www.mcb-law.com

Estate and Gift Tax Aspects of the American Taxpayer Relief Act of 2012

On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 (the “ATRA”) into law. Failure to pass the new law would have resulted in a significant decrease in the estate and lifetime gift tax exemptions and a significant increase in the maximum estate and gift tax rates. Unlike past estate and gift tax legislation, the ATRA provides permanent exemption and tax rate solutions.

Estate and Gift Tax Exemption

Legislation over the past decade has provided for significant fluctuations in the federal estate and lifetime gift tax exemption, including the threat of a decrease from a \$5 million exemption in 2012 to a \$1 million exemption in 2013. The uncertainty made it very difficult to plan for estate tax liability since the turning of the calendar could have transformed an estate owing zero estate tax to an estate with a multi-million dollar estate tax bill on its hands. The ATRA permanently sets the federal estate and lifetime gift tax exemption amounts at \$5 million, indexed for inflation. This indexed amount is \$5.12 million for 2012 and \$5.25 million for 2013. Additionally, the ATRA permanently sets the maximum federal estate and gift tax rates, which have fluctuated between 35 and 55 percent in recent years, at 40 percent.

The Illinois estate tax exemption was previously set to increase from the 2012 amount of \$3.5 million to \$4 million in 2013. Since the federal government has maintained an exemption above this amount, this state exemption is likely to remain in place. The Illinois death tax rates range from 0.8 percent to a maximum of 16 percent.

Portability

In additional long-term guidance, the ATRA makes “portability” permanent. Portability allows a surviving spouse to make an election on the decedent’s federal estate tax return to use the decedent’s unused federal exemption amount, in addition to his or her own exemption.

Due to the uncertain future of portability, it was previously difficult to plan using this option. Although the ATRA has resolved the issue of federal portability, state estate and inheritance taxes continue to present a roadblock in terms of planning with portability. Since Illinois does not yet offer the portability feature, the benefits of federal portability remain somewhat limited.

State Death Tax Deduction

The ATRA extends the deduction that is allowed to estates for state estate taxes. Prior to 2005, estates would receive a credit for the amount paid, rather than a deduction.

Generation Skipping Transfer Tax

The ATRA also sets the generation skipping transfer (“GST”) tax exemption at \$5 million, indexed for inflation, with a permanent maximum tax rate of 40 percent. Essentially, a GST exemption equal to the estate and gift tax exemption allows a transfer of assets to any individual or class of individuals without incurring any of the three transfer taxes—estate, gift or GST tax.

Annual Gift Tax Exclusion

The annual gift tax exclusion, which was already indexed for inflation prior to the ATRA but had remained at \$13,000 since 2009, has increased to \$14,000 per donee for 2013. Gifts in excess of the annual exclusion amount require a federal gift tax return to be filed, whether the giftor intends to pay the gift tax or use his or her lifetime gift tax exemption. Additionally, the annual gift exclusion for gifts from a U.S. citizen spouse to a non-U.S. citizen spouse has increased from \$139,000 in 2012 to \$143,000 in 2013.

The annual exclusion provides a significant gifting opportunity for those who have or are approaching a taxable estate as well as those who would like to begin transferring or gifting assets during their lifetime. Whether the intention is to transfer assets to an irrevocable trust, such as an Irrevocable Life Insurance Trust or Gift Trust, to be held for the benefit of the grantor’s beneficiaries or to transfer funds directly to loved ones so that they can enjoy it during the giftor’s lifetime, the increased annual gift tax exclusion is a flexible tool that should be considered in estate tax planning.

Grantor Retained Annuity Trusts

The current administration has long targeted Grantor Retained Annuity Trusts (“GRATs”), specifically “rolling” GRATs—the process of using short term GRATs, usually with two to three-year terms, to increase the likelihood of success. President Obama has long sought a ten-year minimum term for GRATs, which would significantly limit their use. However, since the ten-year limit was not

included in the ATRA, the opportunity to use short-term GRATs remains and should be considered by those who are in a position to make large lifetime gifts.

Overall, the ATRA significantly increased the planning opportunities for individuals, couples and families by raising the estate, gift and GST exemptions to historic levels and expanding or retaining additional planning techniques. If you do not currently have an estate plan in place or if you have had a significant change in your family or financial situation since your estate planning documents were prepared, speak to an estate planning attorney immediately to discuss your needs and opportunities.



Manish C. Bhatia is an Illinois attorney focusing his practice in the area of Estate Planning. Manish has focused his education and practice on Tax Planning, Estate Planning and Business Succession Planning since the first year of law school. He has also added Asset Protection, Elder Law and Nonprofit Organizations/Charitable Giving to his fields of practice. Manish is Vice President of Professional Development for the Indian American Bar Association and a board member of the Young Professionals of Evanston.

Manish C. Bhatia
1222 Chicago Ave., #305
Evanston, IL 60202

Phone: (773) 991-8423
Email: manish@mcb-law.com
Web: www.mcb-law.com

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