ROBINSON & COLE LLP
ATTORNEYS AT LAW

Attorney Advertising

Planning Pointers

April 2013

New Federal Estate and Gift Tax Laws

In December 2012, Congress appeared to be on course to allow the generous federal estate and gift tax laws, which had been enacted in 2010, to sunset on December 31, 2012. On January 1, 2013, however, as part of its efforts to address the infamous "fiscal cliff," Congress passed the American Taxpayer Relief Act of 2012 (the "Act"), which included estate and gift tax provisions similar to those passed in 2010 but with no sunset provisions.

KEY PROVISIONS OF THE ACT

1. The federal lifetime gift and estate tax exemption as of January 1, 2013, is $5,000,000 (indexed for inflation to $5,250,000 for 2013), reduced by any portion of the exemption applied to transfers made prior to 2013.

2. "Portability," a concept that allows the estate of a deceased spouse to transfer to the surviving spouse the deceased spouse's unused federal estate and gift tax exemption amount, became permanent.

3. Taxable transfers made after fully using a taxpayer's exemption amount (plus any inherited unused exemption of a predeceased spouse) are taxed at the flat rate of 40%.

4. The federal generation-skipping transfer tax exemption as of January 1, 2013, is $5,000,000 (indexed for inflation to $5,250,000 in 2013), reduced by any portion of the exemption applied to transfers made prior to 2013.

5. Portability does not apply to the federal generation-skipping transfer tax, so that a surviving spouse cannot use a deceased spouse's unused generation-skipping transfer tax exemption.

6. The Act does not include sunset provisions and therefore can only be revised by federal legislation.

INTERPLAY OF THE ACT WITH STATE LAWS

The laws of those states that impose an estate tax (and, in the case of Connecticut, a gift tax) often do not parallel the federal estate and gift tax laws. Most states do not provide for portability. Also, the exemption amounts and tax rates vary from state to state.

For example, Connecticut's lifetime gift and estate tax exemption is $2,000,000. Tax rates imposed on taxable Connecticut transfers after the exemption has been fully used range from 7.2% to 12% for cumulative transfers in excess of $10,000,000.

The estate tax exemption for several other states is even lower than Connecticut's. For example, each of New York, Massachusetts and Rhode Island has an estate tax exemption of $1,000,000, while New Jersey's estate tax exemption is only $675,000. Each of these states imposes varying progressive tax rates on estates where the value of a decedent's taxable assets exceeds that decedent's unused portion of the state's exemption amount. (None of these states currently imposes a gift tax on lifetime transfers.)

Some states, however, do not impose any estate tax, such as Florida and New Hampshire, while others impose an inheritance or succession tax, such as Pennsylvania and Maryland.

GIFT AND ESTATE TAX PLANNING FACTORS TO CONSIDER

1. Although federal law provides a sizeable exemption amount, most states do not. The significant differences between the federal and state gift and estate tax laws create opportunities as well as challenges for many taxpayers and their advisors. Creative estate planning allows taxpayers to maximize the use of both the federal and state gift and estate tax exemptions.

2. For taxpayers whose estates do not approach the federal gift and estate tax exemption level, state estate (and, if applicable, gift) tax planning is still important.

3. Portability can simplify estate planning and may provide some tax benefits, but it has drawbacks:

    - It is not available with respect to (i) the generation-skipping transfer tax exemption or (ii) state estate and gift tax exemptions.

    - It requires an election to be made on a timely filed federal estate tax return at the first spouse's death.

    - The surviving spouse's remarriage may result in the loss of portability of the first spouse's unused exemption amount.

    - Portability does not provide certain benefits available with a credit shelter trust, i.e., a trust established by the first spouse to die for the benefit of the surviving spouse (and/or descendants), which is funded with the deceased spouse's unused exemption amount. Benefits of a credit shelter trust include:

        - Protection of the assets held in the credit shelter trust from the creditors of the surviving spouse and/or descendants;

        - Exclusion of the trust assets (and their appreciation) from the surviving spouse's taxable estate at his or her later death; and

        - Control over the disposition of the trust assets at the surviving spouse's death.

4. Lifetime gifts by residents of states that do not impose a gift tax can avoid that state's estate tax, while taking advantage of the sizeable federal lifetime gift and estate tax exemption. Residents of states that impose a state gift tax, e.g., Connecticut, who own tangible personal property or real estate in states that impose no gift tax, can achieve similar results by making lifetime transfers of such out-of-state property.

5. Although the Act set the federal estate and gift exemption amount and tax rates, Congress is considering other steps that will impact estate and gift tax planning, such as:

    - Imposing restrictions to limit the tax benefits of grantor retained annuity trusts (GRATs), i.e., trusts that currently allow the transfer of assets at significantly discounted values for gift tax purposes.
    - Limiting the duration of "dynasty trusts" so that the trust assets are not sheltered from the estate and gift taxes for multiple generations.
    - Including in a taxpayer's taxable estate assets (which currently are not so included) that are held in an irrevocable grantor trust, i.e., a trust established by the taxpayer under which the taxpayer has retained no interest but still is required to pay the income taxes on the income generated by that trust.

SUMMARY

Despite the generous provisions and relative certainty of the current federal estate and gift tax laws, other factors need to be considered when addressing estate and gift tax planning. A review of current estate plans with experienced estate planning and tax advisors is prudent in light of these recent tax law changes.

For more information or if you have questions regarding the matters discussed in this legal update, please contact a member of our Individual Clients Group:

William C. Ely	J. C. David Hadden	Edward J. Heath
Christopher J. Hug	Judith M. Keppelman	Linda J. McDowell
Kelley Galica Peck	Jeanmarie B. Shea	

If you wish to evaluate how this information may impact you, please contact Robinson & Cole in Connecticut at (860) 275-8200r in Massachusetts at (617) 557-5912. If you would like to receive future editions of Planning Pointers, please contact us at planningpointers@rc.com to be added to the mailing list.

Pursuant to the rules of professional conduct set forth in Circular 230, as promulgated by the United States Department of the Treasury, unless we expressly state otherwise in this communication, nothing contained in this communication was intended or written to be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Code of 1986, and it cannot be used by any taxpayer for such purpose. No one, without our express prior written permission, may use or refer to any tax advice in this communication in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement relating to any one or more taxpayers.

© 2013 Robinson & Cole LLP. All rights reserved. No part of this document may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior written permission. This document should not be considered legal advice and does not create an attorney-client relationship between Robinson & Cole and you. Consult your attorney before acting on anything contained herein. The views expressed herein are those of the authors and not necessarily those of Robinson & Cole or any other individual attorney of Robinson & Cole. The contents of this communication may contain attorney advertising under the laws of various states. Prior results do not guarantee a similar outcome.