KEEPING UP WITH THE EVER-CHANGING ESTATE TAX

WHY CREATE AN ESTATE PLAN?

As 2013 started, the estate planning world had a new law: The American Taxpayer Relief Act of 2012 (ATRA), enacted January 2, 2013.

In order to understand the current estate tax situation, we have to go back to 2001, and look at how we got to the current state of affairs.

HISTORICAL REVIEW: THE REPEAL OF THE ESTATE TAX

During the first half of 2001, both houses of Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001, or "EGTRRA," and President Bush signed the Act into law. EGTRRA made changes to a wide range of tax laws, including far-reaching changes to the federal estate tax system.

It gradually increased the amount of money that people could pass on, tax-free, at death. In 2002, the amount an individual could pass on without paying estate tax was $1 million. By 2008, the amount excluded from estate tax increased to $2 million, and in 2009, the estate tax exclusion amount jumped to $3.5 million.

Finally, in 2010, the federal estate tax was repealed altogether.

Because of budgetary issues, the repeal was designed to be effective for one year only. The estate tax repeal, and EGTRRA itself, were scheduled to "sunset" on December 31, 2010. But that didn't happen.

2011: THE ESTATE TAX IS BACK

At the end of 2010, no one quite knew what, if anything, Congress was going to do about the estate tax. Initially, 2010 marked a one-year repeal of the estate tax. If Congress chose to do nothing, we were facing a return to the $1 million estate tax exclusion, with a top tax rate of 55%.

On December 17, 2010, after lengthy discussion and debate, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which became known as "TRA 2010."

ATRA made TRA 2010 permanent and changed the rate of taxation.

In late 2017, Congress passed yet *another* tax law, which doubled the exemption to $10 million (adjusted for inflation from the 2011 base year). However, after 2025, that law "sunsets" or

expires, and the law reverts to the prior law's "permanent" $5 million exemption (adjusted for inflation from the base year of 2011).

THE GOOD NEWS

When it comes to the estate tax, TRA 2010 made three major changes. These involve the estate tax exclusion amount, the tax rate and a new portability provision.

FEDERAL ESTATE TAX EXCLUSION

As you know, not everyone's assets are subject to the estate tax. Each person gets what's called an "estate tax exclusion." This is the amount of property that can be passed to your heirs and beneficiaries free of the estate tax at the time of your death. For the years 2010, 2011, and 2012, the *temporary* exclusion amount was set at $5 million (inflation adjusted). ATRA made this amount permanent and adjusted it for inflation. The 2017 law doubled the ATRA exclusion amount (temporarily). In 2019 it is $11.4 million.

FEDERAL ESTATE TAX RATE

If the value of your estate exceeds your exclusion amount, and therefore ends up being subject to the estate tax, the top tax rate was 35% through 2012. ATRA increased the rate for 2013 and later to 40%.

PORTABILITY

With TRA, Congress also introduced a new "portability" provision. This is where one spouse can add their deceased spouse's remaining estate tax exclusion to their own exclusion to shelter more from taxes. This portability provision, also known as the "Deceased Spousal Unused Exclusion Amount," can be used to shelter the assets of the surviving spouse. However, portability only applies if the estate of the first spouse to die files an estate tax return, even if it would not otherwise be required. Further, portability does not provide remarriage protection, asset protection, or other advantages which might be available with proper planning. ATRA made portability permanent.

FEDERAL GIFT TAX

What happens to the gift tax under the new law?

ANNUAL EXCLUSION

The annual exclusion amount for the federal gift tax is $15,000 for 2019, and it will be adjusted for inflation in 2020 and later years.

This means the maximum value of gifts you can give to a single recipient without filing a gift tax return and without tapping into your lifetime exclusion, (discussed below), is $15,000 per year. Spouses can combine their annual gift tax exclusions and give gifts of up to $30,000 in value to each recipient each year.

Lifetime Exclusion

What if your annual gifts to one recipient are more than the annual exclusion amount? You can use a portion of your estate tax exclusion to make lifetime gifts, but then your exclusion would not be available at death.

You can use your entire exclusion during life. Of course, then you would not have any available at death.

Federal Gift Tax Rate

As with the estate tax, the top gift tax rate for the years 2011 and 2012 was 35%. ATRA increased the rate to 40% for 2013 and later years.

STATE ESTATE AND INHERITANCE TAXES

In addition to the federal estate and gift taxes, outlined above, many states have a separate state estate tax or inheritance tax. A *state* estate or inheritance tax typically applies to those who die when residents of the state or owning property in the state. A state estate tax typically works just like the federal estate tax. You add up your estate and then you get taxed on everything over a certain amount. An inheritance tax is similar but is based on the relationship between the deceased person and the person receiving property. The problem is that the state estate and inheritance taxes typically kick in at a much lower level than the federal estate tax. In other words, an estate which might escape without owing any federal estate tax might end up paying a significant state estate tax.

What Is My Estate Worth?

To determine what your "estate" is worth (and could be taxed on), let's break it down. You'll need to include all of the following assets for both you and your spouse:

- Checking and Savings Accounts
- Home and Other Real Property
- Timeshares
- Cars and RVs
- 401ks and Other Retirement Accounts
- Deferred Annuities
- Pensions

- Profit Sharing Accounts
- Stocks, Bonds and Trading Accounts
- Life Insurance (full matured face values, not cash values)
- Collections
- Jewelry
- Furniture
- Antiques and Artwork
- All Other Personal Property
- Ownership in Businesses

As you can see, your combined estate value can quickly add up!

PLANNING AMID THE UNCERTAINTY

While today's tax law provides for a substantial exclusion, we do not know what the tax law might be in the future. Just as easily as Congress passed prior laws, it could pass another law that changes the exclusion again, or otherwise upsets the apple cart that is your estate plan. That's why it is important to review your estate plan periodically with an experienced estate planning attorney.

THOSE WITH $5.7 MILLION IN COMBINED NET WORTH

If you and your spouse have a combined net worth of $5.7 million or more, or if you are single and have a net worth of $5.7 million or more, having an estate tax plan in place is essential. And remember, the IRS counts assets like life insurance policies and retirement accounts; so, you may have a higher net worth than you realize.

An estate planning attorney can let you know for certain whether you need to worry about estate tax planning, and if you do (and choose not to rely on portability), he or she can help you shelter your estate tax exclusion in a Family Trust so that your hard-earned assets go to your loved ones instead of to Uncle Sam, other creditors, or a future divorcing spouse. An estate planning attorney may also be able to help you save more by using advanced estate planning methods like an Irrevocable Life Insurance Trust, a Family Limited Partnership, or a Grantor Retained Annuity Trust.

With the future of the estate tax in such a state of uncertainty, it's essential that you stay in touch with your estate planning attorney. He or she can keep you updated on any changes in the law – and let you know if your tax planning strategy needs to change accordingly.

THOSE WITH LESS THAN $5.7 MILLION IN COMBINED NET WORTH

If your combined net worth is under $5.7 million, it doesn't mean you are off the hook and should not put a plan in place. There are other important reasons families set up estate plans like wills

or Living Trusts. Those reasons may include wanting to avoid the public and sometimes expensive process of probate, added complications of blended families and remarriages with step-children, protection from divorce (yours or your children's) or creditor protection. Consulting with an experienced estate planning attorney can help you sort through your goals and concerns to determine which type of plan is best for your personal situation.

WHAT SHOULD I DO IF I HAVE AN ESTATE PLAN?

As we have seen time and time again, the tax laws continue to change — sometimes benefiting us and sometimes not. With this in mind, it is important to do regular reviews of your estate plan to make sure you are taking full advantage of all the tax savings opportunities and avoiding paying too much in taxes whenever possible. Also, if you have had changes in your family situation (births, adoptions, divorces, marriages, remarriages or deaths), your estate plan needs to evolve and change, addressing any new goals or concerns you may have.

THOSE WITH SIMPLE TRUSTS

A simple trust, such as a Revocable Living Trust, may not minimize your estate taxes. Your estate planning attorney can help you find an appropriate estate planning method, like an AB Trust if appropriate, to shelter your assets and reduce your estate tax liability.

THOSE WITH WILLS

A will guarantees that your remaining assets (home and other real property), regardless of their worth, will be subject to a public probate process, which many families wish to avoid. In some states, probate can be a lengthy and costly process which can hold up valuable funds while it runs through the court system. Even if you are not worried about your family having to deal with the probate process, you may want to protect them and your hard-earned assets from other everyday situations which can result in a significant loss of those assets. These asset-losing snags often come into play when you have blended families, remarriages with step-children, creditor problems, divorces (yours or your children) or if you become disabled. Will-based plans often do not provide appropriate provisions to address these common concerns. It is always good to review your will-based plan with an estate planning attorney to make sure it addresses all of your current, and more importantly, future concerns.

ESTATE PLANNING IS MORE THAN JUST TAX PLANNING

Whether or not you think your estate will be affected by the changes in the tax law, it is essential that you have an estate plan in place. Why? Because tax planning is just one small portion of a comprehensive estate plan.

An estate plan brings certainty and stability to the lives of your loved ones. It gives them direction for how your assets are to be managed should you become disabled or pass away. It allows you

to decide who will care for your minor children and to have a plan in place for providing for your children, even after you're gone. Most of all, it allows you to protect your loved ones from the turmoil and uncertainty that are guaranteed if you fail to plan.

ABOUT THE ACADEMY

This report reflects the opinion of the American Academy of Estate Planning Attorneys. It is based on our understanding of national trends and procedures, and is intended only as a simple overview of the basic estate planning issues. We recommend you do not base your own estate planning on the contents of this Academy Report alone. Review your estate planning goals with a qualified estate planning attorney.

The Academy is a national organization dedicated to promoting excellence in estate planning by providing its exclusive Membership of attorneys with up-to-date research on estate and tax planning, educational materials, and other important resources to empower them to provide superior estate planning services.

The Academy expects Members to have at least 36 hours of legal education each year specifically in estate, tax, probate and/or elder law subjects. To ensure this goal is met, the Academy provides over 40 hours of continuing legal education each year. The Academy has also been recognized as a consumer legal source by *Money Magazine, Consumer Reports Money Adviser* and Suze Orman in her book, *9 Steps to Financial Freedom*.