

WILLMS, S.C.

LAW FIRM

TO: Clients and Friends of Willms, S.C.

FROM: Andrew J Willms

DATE: March 2, 2012

RE: Estate Tax Changes May Be In Store

On February 13, 2012, President Obama released his budget proposal for the federal government for 2013. That proposal includes significant changes to the federal estate tax in an effort to increase tax revenues collected from estates and trusts. This memorandum summarizes those changes.

Under the Internal Revenue Code, both gifts during life and transfers at death are currently taxed at a flat rate of 35%, unless an exclusion or exemption applies to shelter the transfer from taxation. The annual exclusion allows all U.S. citizens to make gifts each year of up to \$13,000 per recipient without the imposition of federal gift taxes. In addition, all U.S. citizens are entitled to a "federal gift tax exemption" which shelters up to \$5,000,000 in gifts that exceed the annual exclusion from the federal gift tax.

All U.S. citizens are also entitled to a \$5,000,000 estate tax exemption. However, the amount of the gift tax exemption used to shelter lifetime gifts from the federal gift tax is deducted from the estate tax exemption available at death. In 2010, the estate tax was changed such that if the taxable estate of a person who is married at the time of death is less than his or her federal estate tax exemption, the unused portion is "portable." That is, it may be added to the surviving spouse's federal estate tax exemption, thereby increasing the amount of assets that can be sheltered from estate taxes when the survivor dies.

Both the federal estate tax exemption and the federal gift tax exemption are scheduled to be reduced to \$1,000,000 in 2013 unless Congress and the President can reach an agreement on how to prevent that from happening. In his budget proposal for 2013, President Obama called for an estate tax with a \$3.5 million exemption and a tax rate of

45%. This would be consistent with the estate tax laws as they were in effect in 2009. The President would also make the portability of the estate tax exemption permanent.

The President's proposal does not stop there, however. It also includes several additional changes that would greatly limit the estate tax strategies that can currently be used to reduce federal estate taxes on larger estates (i.e. estates that exceed the federal estate tax exemption amount). If adopted, these changes would:

- Require most "grantor trusts" established after the law takes effect to be included in the taxable estate of the person who creates the trust.
- Limit the ability to avoid estate taxes on life insurance proceeds through trust ownership of the insurance policy.
- Significantly curtail the ability to lessen estate taxes by claiming valuation discounts.
- Require a 10 year minimum term for grantor retained annuity trusts (GRATs).
- Limit the duration of trusts sheltered from the federal estate tax by the generation skipping transfer (GST) tax exemption.
- Require tax basis for estate and gift tax to be valued and reported using consistent methods.

It seems to us that any legislation that would extend or change the existing estate tax system will not be passed until after the 2012 elections. However, because of the impact these laws could have on your estate planning, if your estate is greater than the reduced estate tax exemption proposed by President Obama (\$3.5MM if single or 7.5MM if married), then I suggest you schedule an appointment with us your earliest convenience to discuss whether you ought to take action now before these changes are given a chance to take effect.

End of Memo