

Estate Planning & Federal Tax Update

FROM SPILMAN THOMAS & BATTLE, PLLC

Estate Planning Now: How the new tax bill impacts your estate plan

John F. Allevato and Elizabeth A. Summers

With the American Taxpayer Relief Act of 2012 (the "ATRA") passed and the fiscal cliff safely averted, the time has come to turn your attention to your estate plan.

What Did the ATRA Accomplish?

The fiscal cliff threatened to reduce the estate and gift tax credit from \$5 million to \$1 million, and raise the maximum estate tax rate from 35% to 55%. By contrast, the ATRA:

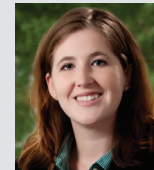
- Set the unified estate and gift tax exemption amount at \$5 million, indexed for inflation (indexed at \$5,250,000 in 2013)
- Set the GST exemption at \$5 million, indexed for inflation (indexed at \$5,250,000 in 2013)
- Preserves portability – the ability of spouses to utilize each other's unused exemptions – resulting in a total exemption amount of over \$10 million this year for a married couple
- Permanently sets the maximum estate tax rate at 40%

What Does the ATRA Mean for My Present Estate Plan?

The ATRA provides some hard and fast rules (and some permanency) for an area of the law that has been in flux for nearly a decade. Everyone now has a \$5 million exemption (indexed) from the gift and estate tax – meaning such taxes won't apply to most people.

Now that we finally have a permanent framework of laws to work with, it is critical that you make an appointment with us to reevaluate your estate plan. For clients with projected estates of under \$5 million (\$10 million for married couples), ILITs and other complex trust strategies may no longer be the most efficient vehicles for transferring wealth. A holistic evaluation of your estate plan is required to determine whether a trust is right for you in light of the new laws. In addition, you may wish to take advantage of this new stability in the estate and gift tax laws to budget for major gifts or utilize planning vehicles that may be made unavailable by later legislation. >

Introducing...



Elizabeth A. Summers joined Spilman in August of 2012 after graduating from the Washington & Lee University School of Law. Liz is a native of Indiana and completed

her undergraduate work at Kenyon College in Gambier, Ohio in 2007. Liz will be working in Spilman's Charleston office, primarily with John F. Allevato in the firm's Estate Planning and Federal Taxation practice. Please feel free to contact Liz directly if you have questions or need any assistance. Liz can be reached at 304-720-4090, or by email at esummers@spilmanlaw.com.

David Croft to Speak at Heckerling Institute



David R. Croft, Member in Charge of Spilman's Wheeling, WV office, will speak at the 47th Annual Heckerling Institute on Estate Planning in Orlando, Florida, which

commences on January 14, 2013. David's topic will be "Estate and Income Tax Planning with Mineral Interests," and will be given in conjunction with the Institute. The Heckerling Institute is widely recognized as the largest Estate Planning Conference of its kind, and it is an honor for David to be chosen to present. David's practice focuses on Estate Planning and Federal Taxation matters, and he works not only out of the firm's Wheeling office, but also spends time in its Morgantown location. In addition, David is a Certified Public Accountant. His practice includes consulting on oil and gas tax matters, especially as they interact with trusts and federal income taxes. The firm's Wheeling office is conveniently located within the Marcellus Shale formation and the newly discovered Utica Shale formation.

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PPACA, ATRA and Now:

What does it mean to me?

John F. Allevato

Aside from the federal estate tax revisions noted above, 2013 ushers in the beginning of other income tax changes that will force us to reevaluate earlier strategies and planning. In addition, the thinking out of Washington right now is that federal tax changes are not done – it is likely that the administration or Congress may introduce other bills to revise our federal tax system.

The Patient Protection and Affordable Care Act (“PPACA”) that passed in 2011, commonly referred to as “Obamacare,” ushered in new taxes, some of which are first applicable in 2013. These new taxes from the PPACA, when combined with the ATRA changes, require a “fresh look” at your business and investment vehicles.

1. New Higher Income Tax Bracket

The centerpiece (but by no means the only increase) of the ATRA was the imposition of a new higher income tax bracket, kicking in for individual taxpayers with taxable income of at least \$400,000 and joint filers with taxable income of at least \$450,000. This new bracket is at 39.6%. The other brackets stay, meaning we still have brackets of 10, 15, 25, 28, 33 and 35%. These thresholds are and continue to be indexed for inflation – meaning it will take slightly more taxable income each year to work your way up to the highest bracket.

> PLANNING POINT

Business owners, it may be time to reconsider the use of pass-through entities for the conduct of your business, such as S



For taxpayers (married filing jointly) making over \$450,000 per year, there are a number of different marginal tax rates that apply, depending on type of income earned.

Type of Income	Marginal Income Tax Rate (%)	Additional Medicare Tax Rate (%)	Combined Marginal Tax Rate (%)*
Wages and Self-Employment Earnings	39.6	0.9	40.5
Unearned Income (Interest, Rents, Royalties, Dividends, Short-Term Capital Gains)	39.6	3.8	43.4
Dividends (qualified) and Net Long-Term Capital Gains (attributable to passive activities)	20.0	3.8	23.8
Other Taxed Income (IRA and qualified plan distributions, unemployment compensation, taxable SS benefits)	39.6	0	39.6

* Without consideration of phase out of exemptions and itemized deductions.

corporations, limited liability companies or partnerships. Why? Regular corporation tax rates are now lower than individual tax rates—so some businesses may, surprisingly, be better off as a regular corporation (C Corporation). We would be happy to discuss this in more depth with you as to your particular situation.

2. Medicare Unearned Income Surtax

This new tax, applicable beginning January 1, 2013, is a tax of 3.8% on “unearned income” (defined as

interest, dividends, royalties, rents, and net capital gains, including gains from sales of a residence over \$500,000 for joint filers). What is notable is what is NOT defined as unearned income subject to this new tax – such as municipal bond interest or qualified plan (including IRA) distributions. This tax applies to the unearned income of individual or joint filers which is the lesser of: (x) net investment income; or (y) the excess of your adjusted gross income over \$200,000 (as to an individual) or \$250,000 (as to joint filers).



Estate Planning Now cont'd

1. Family Trusts

Even if your estate will come in below the \$5 million (single) or \$10 million (married) threshold, you may still wish to consider either retaining an old Family Trust or establishing a new and different one. Family Trusts protect assets from creditors and predators and can provide a source of income to your spouse and children. The addition of Family Trust provisions can also provide welcome flexibility for other types of trusts, such as contingent trusts or trusts for the management of assets in the event of a disability. An individualized assessment of your estate plan is necessary to determine whether or not a Family Trust may help you achieve your goals.

2. GRAT

Another option to consider is a Grantor Retained Annuity Trust, or GRAT. While the GRAT's future as an estate planning tool is uncertain, so far it remains available in 2013. GRATs work in the following way: a grantor places assets into a GRAT, which then distributes a series of annuity payments to the grantor equal to what he or she contributed, plus a federally-determined “hurdle rate” – currently just over 1%. Any

appreciation above and beyond the required annuity payout passes tax-free to the named beneficiary of the GRAT at the end of the GRAT term. A GRAT is an excellent vehicle because it's a “heads, I win; tails, I tie” strategy. At best, you can pass significant wealth to a designated beneficiary, completely tax-free. At worst, you get back the investment you put in.

President Obama has specifically targeted GRATs for restrictive legislation. Although no official action has been taken yet, it is unclear how long this vehicle will be available. If you are interested in a GRAT, please contact us as soon as possible to discuss whether this sort of trust may be a good option for you.

3. Gifting

Now that the estate and gift tax credit has stabilized and the economy appears to be on the mend, you may wish to consider doing some major gifting. Now that we finally have a permanent set of standards to work with, it's easier than ever before to budget for the making of a generous gift or gifts while still maintaining your accustomed standard of living. If you think a major gift may be right for you, schedule an appointment for us to help you create a strategy to accomplish your goals.

What Should You Do Now?

- Contact us soon to schedule an appointment to review your current estate plan and formulate a customized strategy going forward. It is possible that you may not need a trust for federal estate tax reasons – but may need one for other reasons.
- Begin considering whether you may be interested in a GRAT or major gift in 2013.



PPACA, ATRA cont'd

> PLANNING POINT

This new tax should cause all taxpayers to revisit their investments, including real estate investments and all activities classified as passive, including trust income. The new tax would be in addition to the regular income tax rates, which just went up for higher income folks. Combined with the Additional Medicare Tax described below, and the phase out of itemized deductions and exemptions (that's back, too), the top tax bracket (now applicable to individuals making over \$400,000 this year and \$450,000 for joint filers) for unearned income could be effectively as high as 45% – just at the federal level.

3. Additional Medicare Tax

Another part of the PPACA is the "Additional Medicare Tax" – a .9% surtax on earned income (wages, self-

employment income, and the like) in excess of \$200,000 for individuals and \$250,000 for joint filers. This tax will apply beginning this year.

4. Capital Gains and Qualified Dividends

We've gotten used to capital gains and qualified dividends being taxed at a 15% maximum rate. The new maximum rate for these items of income is 20%. This rate will apply to those taxpayers in the highest tax bracket (now 39.6%) – those having at least \$400,000 of taxable income for individuals and \$450,000 for joint filers.

Of course, that maximum 20% rate is not entirely accurate, as the Medicare Unearned Income Surtax described above (of 3.8%) would likely apply to this income as well, meaning that the highest bracketed taxpayers may pay a final capital gains and dividends tax rate of 23.8%.

> PLANNING POINT

Investors should consider allocating assets that generate taxable income (such as corporate bonds or higher dividend paying stocks) to tax-deferred accounts, such as retirement plans and the like. Taxable accounts should own municipal bonds, investments that pay smaller dividends, mutual funds that have low turnover (and as a result, lower capital gains distributions), or ETFs. Strategic asset allocation will help minimize the amount of your investment income subject to the Medicare Unearned Income Surtax and the higher tax rates now in effect.

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