

January 2013

What Action Did Congress Take That Impacts Estate and Gift Tax Planning?

On January 1, 2013, Congress passed the “American Taxpayer Relief Act of 2012,” which is being described as a compromise deal to avert the fiscal cliff. This new law approves the first “permanent” set of estate, gift and generation-skipping transfer tax provisions in 12 years.

The new Act continues many of the estate tax provisions that were in effect in 2012. Most significantly, the federal estate tax exemption remains at \$5 million, indexed for inflation from 2011, which means that, for 2013, the federal estate tax exemption is \$5.25 million. Similarly, the federal gift tax exemption remains at the same high level (\$5.25 million), as does the federal generation-skipping transfer tax exemption. All three of these exemptions are indexed for inflation and therefore we can expect to see the exemptions increase in future years to reflect cost of living increases. In addition, the portability of the federal exemption between spouses is retained under the new law.

However, the new Act does change the estate and gift tax rates. If an estate exceeds the federal exemption amount, it will be taxed at a top rate of 40%, which has been increased from the previous 35%. The same 40% rate applies to taxable gifts (i.e., lifetime gifts in excess of the available gift tax exemption).



Did Anything Change With the State of Washington Estate Tax?

While the Act goes a long way toward providing federal estate tax relief, we do need to keep in mind that the State of Washington has a separate estate tax. The State of Washington exemption remains at only \$2 million per person. If you have an estate that exceeds the \$2 million exemption, the Washington estate tax is imposed at rates of 10% on the first \$1 million in excess of the exemption and escalates quickly to 14% through 19% on additional excess. In addition, there is no spousal portability in the State of Washington. However, lifetime gifts are not taxed by the State of Washington.

What About Income Taxes?

For those making less than \$400,000 (single individuals) or \$450,000 (married filing joint filers), income tax rates have not been increased by the Act. For those above these thresholds, the applicable rate is increased to 39.6 percent. The new Act also makes the qualified dividend provision of the Code permanent, maintaining the 15 percent rate on capital gains and qualified dividends for those with taxable income under \$400,000 (single individuals) or \$450,000 (joint filers). However, the maximum capital gain and qualified dividend rate for taxpayers in excess of these threshold amounts is 20 percent.

The phaseout of personal exemptions and itemized deductions has been reinstated, though the thresholds are increased to \$250,000 (single individuals) or \$300,000 (joint filers).

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What About Income Taxes? *(continued)*

Along with many other individual tax provisions, the deduction of state and local general sales taxes and the IRA charitable rollover have been extended through 2013. Many individual and business tax credits and other tax provisions were also extended. In addition, the exemption amount for the alternative minimum tax has been permanently indexed for inflation.

Don't forget that as a result of 2010's health care reform legislation there are additional taxes effective January 1st of this year. First, for individuals with wages over \$200,000 or married filing joint filers with wages over \$250,000, there is an additional .9% on wages in excess of the thresholds. In addition, if adjusted gross income exceeds these same thresholds, there is an additional 3.8% tax on the lesser of net investment income or the amount in excess of the thresholds. This tax also applies to estates and trusts though the threshold is the dollar amount at which the highest trust and estate tax bracket begins.

What Does This Mean to You?

There are still opportunities to use the exemptions in your short term and long term gift and estate planning. If you used your exemption in the prior years, you may wish to use the additional exemption amount in 2013. If you haven't used your exemption, it may be a good time to review your plan and determine if any lifetime gifting is right for you. As part of your plan, income producing assets should be reviewed for an opportunity to transfer to individuals in a lower tax bracket.

For Washington estate tax purposes, we recommend that married couples have wills that enable both spouses to fully use their Washington estate tax exemption by creating a tax exempt trust on the first spouse's death. For all clients, we recommend continuing to consider making lifetime gifts to remove future appreciation from their potentially taxable estates and take advantage of the absence of any Washington gift tax and use. Plus, clients should continue to make gifts using the annual exclusion, which is now \$14,000 per individual.

Even if you do not think gift and estate tax planning is necessary, keep in mind planning for asset protection, succession, and retirement, for you and your family. Keeping your documents updated and maintaining the entities you have formed are also important.



A Final Note

Although the current federal tax laws are being described as "permanent," we need to be mindful of the fact that they will last only until Congress decides to change the federal tax again. Moreover, certain estate planning techniques may still be placed on the chopping block.

We are here to help and would be happy to answer any questions you may have about how the new law affects you and your family.



Kari Brotherton
brotherton@ryanlaw.com
206.654.2227



Nancy Kennedy
kennedy@ryanlaw.com
206.654.2233



Joel H. Paget
paget@ryanlaw.com
206.654.2215