DAY PITNEY LLP

Estate Planning Update

January 2013

The following is a brief summary of some estate planning developments and opportunities that may be of interest to you. We hope you find this helpful and look forward to hearing from you with any questions.

FEDERAL TAX UPDATE

As has been widely reported, on January 2, President Barack Obama signed the American Taxpayer Relief Act of 2012. The act avoids the significant tax increases that would have gone into effect as of January 1 for most taxpayers as a result of the expiration of a variety of tax reductions enacted in 2001 and 2003. The following summarizes some of the provisions of the new law.

ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAXES

The top rate for estate, gift and generation-skipping transfer taxes is increased from 35% to 40%. The exemption for all three taxes continues to be $5,000,000 adjusted for inflation. The actual exemption for 2013 is projected to be $5,250,000, an increase from the $5,120,000 exemption in effect for 2012.

INCOME TAXES

The top income tax rate is increased to 39.6% from 35%, applicable to married taxpayers earning more than $450,000, heads of household earning more than $425,000 and single taxpayers earning more than $400,000 (with each of these thresholds subject to inflation adjustment in the future). For estate and trust income taxes, the top tax bracket is also 39.6%, applicable to estates and trusts earning more than approximately $12,000 of income. Any taxpayers subject to the 39.6% income tax rate will also be subject to a 20% tax rate on both long-term capital gains and qualified dividends (increased from 15% in 2012). These increased income tax rates are in addition to the previously enacted 3.8% Medicare surtax on investment income, so that the top tax rate for long-term capital gains and qualified dividends is now 23.8%.

In addition, the limitations on itemized deductions and personal exemptions that expired three years ago have been reinstated. Married taxpayers earning more than the "applicable threshold" of $300,000 (or $275,000 for heads of household and $250,000 for single taxpayers) will have itemized deductions reduced by 3% of their adjusted gross income in excess of the applicable threshold (up to a maximum reduction of 80% of their itemized deductions). Again, the income thresholds will be adjusted for inflation in future years. For taxpayers subject to significant state income taxes and property taxes, the 3% limitation is likely to be more relevant than the 80% reduction – effectively meaning that an amount equal to 3% of the difference between their adjusted gross income and the applicable threshold is added to their taxable income through a cutback in their deductions. There is no comparable cutback for purposes of the alternative minimum tax (or "AMT"), so for those who are subject to the AMT the cutback may have little or no impact.

IRA CHARITABLE ROLLOVER

The IRA charitable rollover (permitting direct distributions from an IRA to be excluded from income and count as part of the required minimum distribution) has been extended to apply to IRA distributions made in 2012 and 2013. Because of the late enactment, special provisions are included to permit 2012 income rollover treatment for distributions made before February 1 (including withdrawals made in December 2012 that were subsequently transferred to a charity during January 2013).

PLANNING CONSIDERATIONS

Except for the IRA charitable rollover provision, all the provisions mentioned above are permanent changes to the tax code. Although "permanent" changes are not exempt from future action, the threat of "sunset" provisions looming over the past decade has passed, and thus these changes offer a measure of stability for planning purposes.

Budget battles loom, of course, and some provisions previously proposed by the president may surface again as Congress looks for new sources of revenue, including possible limitations on grantor-retained annuity trusts and restrictions on valuation discounts. Until such measures are introduced, however, the current planning environment continues to offer many attractive options for those interested in making gifts. In addition, even those who made maximum "exemption capture" gifts in 2012 have additional exemption available in 2013 (projected to be about an additional $130,000). Please let us know if you have any questions about the new law or would like to discuss any planning opportunities that may make sense for you.

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