SWEET & MAIER, S.C.
MEMORANDUM

TO: **Our Clients**

FROM: **Attorney John L. Maier, Jr.**
Attorney Marcus L. Weden

DATE: **November 9, 2012**

RE: **2012 Federal Estate Tax Changes**

Generally speaking, our firm sees a flurry of tax planning activities when the Federal government passes new legislation. In this case, we are sending you the attached letter and this Memorandum due to the absence of concrete Federal legislation on the estate and gift tax. As you may have read about in the newspapers, or heard about on the news broadcasts, the future of the Federal estate and gift tax has been uncertain for a period of time.

Regardless of your political preferences, as a result of the recent general election, President Obama was elected to a second term in office, and there is a "divided" Congress. Early in his second term, the President (and Congress) will be faced with several large tax and budgetary issues, including the "Bush-era tax cuts", the "fiscal cliff", and the expiration of the preferential Federal estate and gift tax exclusion and rates.

The purpose of this Memorandum is to (1) discuss the history of the Federal estate and gift tax, (2) discuss the current Federal estate and gift tax as effective through December 31, 2012, and (3) discuss how taxpayers can engage in an estate planning strategy that avoids uncertainty and minimizes estate tax.

1. A Brief History of the Federal Estate Tax

The Economic Growth and Relief act of 2001, commonly called the "Bush tax cuts", made significant changes to the Federal estate and gift tax rules. Among other things, it incrementally increased the estate tax (but not gift tax) exclusion amount every year, while gradually reducing the top effective estate and gift tax rate. Prior to this legislation, the pre-2001 estate and gift tax exclusion amount and tax rates were $1M and 55%, respectively. In other words, over time, you could leave more property at your death without paying tax to the IRS.

Under the Bush tax cuts, the estate tax was fully phased out for 2010. The Bush tax cuts also contained a "sunset" provision whereby the Federal estate tax was reinstated to pre-2001 rules in 2011. In 2010, however, Congress passed the 2010 Tax Relief, Unemployment Reauthorization, and Job Creation of 2010 Act ("2010 Act") in response to the economic crisis facing the country. The 2010 Act extended the sunset of the Bush tax cuts and made important changes to the estate and gift tax in 2011 and 2012, as discussed below.

2. Federal Estate and Gift Tax Rules Effective through December 31, 2012 under the 2010 Act

Under the 2010 Act, the unified estate **and** gift tax exclusion amount was increased to an inflation adjusted $5.12M per individual ($10.24M per couple). Any amounts in excess of the exclusion are taxed at 35%. Please note that the 2010 Act unified the federal estate and gift tax exclusion amount by increasing the gift tax exclusion from $1M to $5.12M (the Bush tax cuts left the gift tax exclusion amount at $1M). Therefore, 2010 Act created a historically high gift tax exemption amount, and provided a unique opportunity for taxpayers to make gifts free of tax.

In addition, the 2010 Act introduced "portability" of the unused exclusion amount of a deceased spouse to a surviving spouse for decedents who die in 2011 and 2012. Under the portability rule, a surviving spouse could use the sum of his or her own base exclusion amount ($5.12M) plus the unused exclusion amount of the most recent deceased spouse. The unused exclusion amount from the deceased spouse could be used to offset subsequent gifts or the surviving spouse's estate tax. However, under current law, the surviving spouse must use the expanded exclusion amount before the 2010 Act sunsets on January 1, 2013.

As discussed above, both the Bush tax cuts, and the 2010 Act, will expire on January 1, 2013. It is unclear what, if anything, Congress and the President will do regarding the estate and gift tax in the near future. Given the partisan atmosphere in Washington D.C., there is a great degree of uncertainty as to whether any action will be taken, or whether a bipartisan agreement can be reached. Some pundits have suggested that the parties will reach a "middle ground" with a $3.5M estate tax exclusion amount and a 45% tax rate.

With all of these various possibilities for what the federal estate and gift tax will be next year, we know two things for certain. First, if Congress and the President fail to act, current law will sunset and automatically revert back to the pre-2001 rules. If that happens, 2013 will see a $1M estate and gift tax exclusion and a 55% tax rate. Second, if the President and Congress instead work out a "deal", we will have a new set of Federal estate and gift tax laws. In either case, tax lobbyists are now predicting that we are likely to experience a decrease in the amount of property taxpayers can leave at death without having to pay a significant amount of tax to the IRS. Hence, these changes have the potential to impact the estates of many taxpayers.

3. Estate Planning for an Uncertain Future

Given the uncertainty described above and the likelihood that the exemption amount will decrease, it is imperative that our clients aggressively and proactively manage their estate to maximize the benefits available under current law. As discussed above, the 2010 Act increased the gift tax exclusion amount to its **highest level in history**. Furthermore, the unique combination of depressed asset values and historically low interest rates, provide a unique opportunity to pass large amounts of wealth without paying estate and gift taxes.

However, this opportunity is limited and we recommend that you do not look this "gift horse" in the mouth. Instead, a careful review of your estate plan and careful planning will allow you to "lock in" lifetime gifts under the $5.12M exclusion amount that is allowable under current law through 2012. Through careful planning, up to $10M of assets (together with the income and future appreciation) may be removed from a married couples' taxable estate and the estate of their children and grandchildren.

Accordingly, we recommend that you consider making lifetime gifts before the end of 2012 to utilize some or all of the gift tax exclusion amount. We have substantial flexibility in structuring these gifts to protect your financial security while transferring wealth tax free.

Examples of planning techniques include:

- Making lifetime gifts to utilize a portion, or all, of the current $5.12M exclusion amount while the amount is "locked in" at a historically high amount. Such gifts could include divesting of a family business, transferring family property, or straight gifts of cash or other assets.

- Developing a plan to make sufficient tax free (i.e., excluded) gifts such that your estate does not exceed the exemption amount in effect on the date of death. Such gifts may include: utilizing the annual exclusion (which was increased to $14,000 for 2013), tuition payment and/or Section 529 plans, and charitable contributions.

- Giving gifts that do not impact your standard of living, such as debt forgiveness, paying down you children's debt, or making below market interest rate loans.

Conclusion

Put simply, we are concerned about all of our clients! While reverting back to the 2001 federal estate tax will not impact all taxpayers, we believe that **any** individuals with assets in excess of $1M should consider various planning techniques that are currently available but may not be available in the future. Furthermore, we strongly advise that all of our clients review their financial position and current estate plan, if any, to ensure that you have a plan for the future to dispose of your assets upon death.

At Sweet & Maier, S.C., we routinely work with clients to develop estate plans that effectuate the dual goals of (1) efficiently and effectively disposing of assets upon death and (2) minimizing all estate and gift taxes. Please contact **as soon as possible** to schedule a time to review your estate plan.