2013 ESTATE TAX CHANGES
ROCK THE ESTATE PLANNING WORLD

BY JASON C. WALKER, ESQ. AND JEFFREY L. BURR, ESQ.

As recently as 2003, the federal estate and gift tax exemption was only $1 million. Now fast forward to 2014, just a little over 10 years later and the exemption is $5.34 million. That's more than five times greater than the exemption in 2003! Statisticians predict that less than 0.2 percent of estates will be subject to the estate tax at this $5.34 million level.[1] Besides the major increase in the exemption, other very favorable changes were brought about in the estate tax laws in 2013, including historic changes for same-sex couples who are married. This article will highlight some of the most important changes and planning opportunities available as a result of recent changes.

One big effect of the changes is that for the longest time the tax tail has been wagging the dog, and often more important non-tax issues took a back seat in estate planning. With the recent changes, we can now simplify our plans and focus more on non-tax concerns. Many married couples that have previously established revocable trusts now have an opportunity to simplify their estate plans in a way that can alleviate a huge administrative burden upon the passing of the first spouse to die.

Some Highlights of Gift and Estate Tax Laws

Unification of Estate and Gift Tax

For years the estate tax exemption was different from the gift tax exemption. Recent law re-unifies the exemption amount and tax rate that apply to both lifetime gifts and the estate tax.

$5.34 Million Exemption

The exemption amount is actually a cumulative credit available on gift tax and estate tax returns that allows a person in 2014 to transfer up to $5.34 million during life and at death, without paying any estate or gift tax. This exemption amount is indexed for inflation and will likely increase each year.

40 Percent Tax Rate

Each dollar transferred in excess of the exemption amount is subject to the gift or estate tax. The rates are graduated much like the income tax rates with the maximum tax rate of 40 percent.

Portability

The $5.34 million exemption amount is now "portable" between spouses, meaning that a surviving spouse gets to use

a deceased spouse's unused exemption amount. Portability is available regardless of whether a couple has executed estate planning. This levels the playing field for those with estates in excess of $5.34 million. An estate tax return[2] must be timely filed following the first spouse's death in order to claim and preserve the portability of the deceased spouse's unused exemption amount. Failure to properly make this filing will result in a loss of the first spouse's exemption amount. However, the Internal Revenue Service (IRS) recently provided relief[3] under this new law and an extension exists if certain criteria are met and the return is filed before the end of 2014.

This concept of portability presents an opportunity to simplify estate planning for many people. Under the old estate tax laws, assets transferring directly from one spouse to another would not utilize the exemption amount and therefore the deceased spouse's exemption would have been lost. Many people implemented a special type of trust in their estate planning to prevent the loss of the first spouse's exemption amount. These trusts are known as "credit shelter trusts," "exemption trusts," "bypass trusts" or "A-B Trusts" and they necessitate the division of the trust into two separate trusts upon the death of the first spouse.

What Needs Immediate Attention and Why

In many cases an old A-B Trust can be replaced by a "disclaimer A-B" trust to simplify a married couple's estate plan. This revised structure is advisable for the following reasons:

1. Fewer couples are going to be impacted by the federal estate tax now that the combined exemption amount is nearly $10.7 million; therefore the division of the trust does not provide any immediate estate tax benefit.

2. Because of portability, the required division in the case of an A-B trust is an unnecessary complexity that can be eliminated using the disclaimer A-B trust.

3. Because the bypass trust is required to file an income tax return, the surviving spouse will have increased costs for preparation of income tax returns, and the possibility of an increased income tax burden (discussed in item five, below).

4. With higher income tax rates, capital gain tax rates and the 3.8 percent "net investment income tax" applying to wealthier taxpayers, it can be a disadvantage to fully fund the bypass trust. In Nevada, a community property state, we are fortunate to have available what is known as a "double step-up in basis" for married couples. This means that assets transferring between married individuals receive an income tax basis step-up to fair market value upon the death of the first spouse and again at the death of the surviving spouse. However, assets funded into the bypass trust are not included in the estate of the surviving spouse and therefore don't qualify for the second step-up in basis. The result is the potential for higher capital gains on assets that were allocated to the bypass trust.

5. Trust income tax rates. Irrevocable non-grantor trusts are taxed very similarly to individuals. However, trusts operate on a compressed schedule of tax rates and the maximum income tax rate of 39.6 percent applies when there is $12,150 or more of undistributed trust income. Although not common, some bypass trusts do not strictly require the distribution of income to the surviving spouse. In a situation like this, the overall income tax burden of the surviving spouse and the bypass trust could be much higher than if all of the income is distributed to and reported by the surviving spouse.

> With the recent changes, we can now simplify our plans and focus more on non-tax concerns.

Non-Tax Developments Impacting Estate Planning

Simplification may not be for everyone, however. As discussed in the opening paragraph, non-tax issues are an important part of estate planning. Clients in their second or third marriage and/or those with children from prior relationships often find comfort in keeping the bypass trust in place for non-tax reasons. The bypass trust typically allows up to one-half of the trust to become irrevocable upon the death of the first spouse. This has the effect of securing a portion of the trust so that the surviving spouse cannot disinherit the children from the other relationship or other important beneficiaries of the bypass trust. Another benefit of the bypass trust is that the assets held by such a trust can be considered asset-protected since it is an irrevocable trust with spendthrift language and the deceased spouse is deemed to be the settlor. Certain creditors of a surviving spouse would not have an enforceable claim against the bypass trust.

Same-Sex Marriages

The *Windsor*[4] and *Perry*[5] cases have impacted estate planning and the gift and estate tax. These cases along with an IRS Ruling late in 2013[6] paved the way for equal treatment under the federal tax code for same-sex couples that are now legally married (note that civil unions and domestic partnerships do not currently qualify). As long as a couple has been legally married in a state that recognizes such a marriage, the couple shall be deemed to be married for federal tax purposes even if they reside in a state, such as Nevada, which does not recognize same-sex marriages. In the context of estate planning and the gift and estate tax laws, a few of the related benefits that are newly available to married same-sex couples are summarized below:

Marital Deduction

All married individuals now have the unlimited marital deduction available under the gift and estate tax laws.

Gift Splitting

Spouses may join together to make a taxable gift. This opens up advanced estate planning opportunities to those in a same-sex marriage.

Portability

This benefit, as explained above, is now available for same-sex couples that are legally married.

continued on page 28

2013 ESTATE TAX CHANGES

continued from page 27

Double Step-Up in Basis

A step-up in basis is allowed upon the death of both spouses for jointly owned and community property assets.

Retirement Plans

Married same-sex married couples now have the same spousal roll-over opportunities for IRAs, 401(k)s and other qualified plans.

In conclusion, taking a close look at a married couple's revocable trust can reveal some real opportunities for simplification and maybe even some income tax savings. The opportunity to simplify and change a joint trust is typically available only if both spouses are still living and in possession of their capacity; so the time to act is now! Additionally, same-sex couples that are married have new options to evaluate in their estate planning. If estate planning is not your area, you now have the basic tools to spot some of these issues and refer your client to an attorney who is familiar with the intricacies of estate planning and estate and gift taxation. ■

1 Jane G. Gravelle, The Estate and Gift Tax Provisions of the American Taxpayer Relief Act of 2012, Congressional Research Service, http://www.fas.org/sgp/crs/misc/R42959.pdf.
2 Internal Revenue Service Form 706.
3 Rev. Proc. 2014-18.
4 *United States v. Windsor* (570 U.S. [133 S.Ct. 2675](2013)).
5 *United States v. Perry* (570 U.S. [133 S.Ct. 2652](2013)).
6 Rev. Rul. 2013-17.

JEFFREY L. BURR is the founding partner of Jeffrey Burr Estate Planning and Probate Attorneys. He has been recognized as one of the top tax and estate planning attorneys in Nevada.

JASON WALKER is an associate at the firm, and has a Master of Laws in taxation (LL.M).