Mathieu & Ranum, PLLC

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*An Idaho Law Firm with a National Perspective*

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**A New Tax Law? A New Paradigm?**

“Would you tell me, please, which way I ought to go from here?"  
"That depends a good deal on where you want to get to."  
"I don't much care where –"  
"Then it doesn't matter which way you go.”   
― [Lewis Carroll](http://www.goodreads.com/author/show/8164.Lewis_Carroll), [*Alice in Wonderland*](http://www.goodreads.com/work/quotes/2933712)

The night before a new Congress was to begin, our Federal Government addressed the “Fiscal Cliff” by changing tax laws. However, it left for continued debate, the important issues of:

(1) The debt ceiling that we will crash through in just a few weeks;

(2) The spending cuts that the Republications have been promoting; and

(3) “Sequestration” (automatic governmental spending cuts, should total government spending exceed the budget that Congress had previously set).

Nevertheless, the legislation that was passed finally provides some tax certainty for all but the wealthiest Americans.

**SYNOPIS**

**Finally some Permanency Regarding Estate, Gift, and Generation Skipping Taxes for Most Taxpayers – At Least Until Congress changes its Mind Again**

For the first time in more than a decade, we have some certainty regarding Federal taxes. The 157 page American Taxpayer Relief Act of 2012 (ATRA) made permanent the estate, gift and generation skipping tax (“GST”) $5,000,000 per person lifetime exemptions ($5,250,000 for 2013), the AMT income exemption, inflation-indexing of these exemptions, and “portability” of these exemptions between spouses. It also fixed the top estate, gift and GST tax rate at 40% as compared to 35% previously.

Everyone can now more squarely focus on the most fundamental issues of estate planning: succession planning, leaving a legacy, creditor protection of heirs, and retirement planning - and can now, for the most part, address all of that without the tax tail wagging the dog.

However, the wealthiest Americans whose estates are still subject to the estate, gift and GST taxes still face some tax uncertainties. While they have the same non-tax issues as everyone else, they also face the uncertainty of how Congress will address the deficit which could include blessing President’s Obama’s desires regarding limiting GRATs terms to 10 years, eliminating valuation discounts regarding gifts, and possibly removing grantor trusts as an income, estate, gift, and generation skipping tax management tool.

**Income Tax Planning is Now Squarely in the Arena of Effective Estate Tax Planning**

The Act made the Bush era income tax rates permanent. However, for married taxpayers earning $450,000 or more, single taxpayers earning $400,00 or more, and heads of households earning $250,000 or more, all of their income in excess of these thresholds is now taxed at 39.6% and all of their capital gains in excess of these thresholds taxed at 20%. Also, there is a phase out of personal exemptions and itemized deductions at lower thresholds, $250,000 of income for single taxpayers, $275,000 for heads of household and $300,000 for married taxpayers filing jointly.

There is a new Medicare tax of 3.8% tax on passive net investment income, interest, capital gains, rents, and royalties for those whose adjusted gross income ("AGI") is over $200,000 for single taxpayers or $250,000 on a joint tax return. This tax is in addition to any AMT. There is also a new rule that medical expenses can only be deducted if they exceed 10% of an individual's AGI.

The Act does extend a number of individual and business tax incentives and credits that were set to sunset in 2012 for either one or five years. However, the income tax costs of this Act can be substantial. Thus, income tax planning could become the new estate planning tax paradigm for many taxpayers.

**SOME INTIAL SUGGESTIONS**

Therefore, we are urging our clients to:

1. Review existing wills and revocable trusts to determine if the plan they reflect accomplish their non-tax objectives.
2. Evaluate existing irrevocable trusts established for receiving gifts for heirs and escaping transfer taxes between generations. If individuals keep assets in their own name, rather than gifting them to irrevocable trusts, that will permit the value of the assets to be “stepped up” at the individual’s death for purposes of calculating the basis on which capital gains taxes are calculated on any future sales. This strategy therefore could be one that delivers more long-lasting financial value to the family as a whole than placing the assets in trust now. The “step-up” at death does not occur if the assets are already in an irrevocable trust.
3. Compare the income and capital gains tax rates for existing irrevocable trusts to their own personal income and capital gains rates. For trusts, the highest tax rates of 39.6% for income and 20% for capital gains kick in at $11,950 of income for 2013. Therefore, there is a tax argument against creating irrevocable trusts during lifetime, although there are a number of non-tax arguments for creating them. Of course creating such trusts at death, if properly drafted, can provide creditor and divorce protection for the beneficiaries of such trusts.
4. Evaluate existing FLPS and LLCs and consider creating new ones for their ability to claim tax deductions that might be phased out if an individual of substantial income held the assets directly in his or her own name. Also, consider the creditor protection provided by such entitles regarding the assets held by them.
5. Evaluate existing life insurance policies and Irrevocable Life Insurance Trusts established to pay estate taxes. Do not cancel them without reviewing whether they can accomplish other purposes or could be restructured to do so.
6. Review all documentation regarding any last minute rush gifts in 2012, and if they contributed cash to these gifts, and want to, and can, substitute assets that require appraisals, do so!
7. If their estates are potentially subject to the estate tax, consider the value to them of establishing GRATS, making tax-discounted gifts to FLPs or LLCs, and/or creating grantor trusts before Congress addresses the deficit and potentially eliminates these transfer tax-management tools.

**CONCLUSION**

The new Act permits all of us to now focus on the most fundamental issues of estate planning – succession planning, creditor and divorce protection for heirs, and leaving a positive legacy for future generations. It also impacts retirement planning for some because of the new higher top income tax rate, phase out of personal and other deductions, the Medicare Tax, and the higher threshold regarding medical expense deductions.

At Mathieu & Ranum, we have always emphasized non-tax estate planning goals and retirement planning as the first orders of business. However, we urge you to consult with your legal and accounting professionals about the specific implications of the new Act for you.

**IMPORTANT NOTICE**

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