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Several tax cuts now become permanent

The American Taxpayer Relief Act of 2012 (ATRA) was signed into law on Jan. 2, making several of the Bush-era tax cuts permanent. What does this mean for estate planning at the federal and state levels?

Federal: Depending on the year of death, a decedent may pass a certain amount of assets free of estate tax (the estate tax exemption). In addition, during an individual's lifetime, she may gift assets through an annual gift exclusion (currently $14,000 per person) and a lifetime gift exemption (which reduces the estate tax exemption at death).

When an individual makes gifts in excess of her annual gift exclusion, she uses up a portion of her lifetime gift exemption and must file a gift tax return. Transfers to a "skip person" (a grandchild) are also subject to generation skipping transfer (GST) limitations.

In 2012, the federal estate tax exemption, lifetime gift exemption and GST exemption were all fixed at $5 million, adjusted for inflation at $5.12 million.

Absent ATRA, in 2013, these levels were scheduled to revert to only $1 million. ATRA, however, fixed these exemptions at $5 million, adjusted for inflation (expected to be $5.25 million for 2013). In 2012, the maximum estate tax rate, gift tax rate and GST rate at the federal level was 35 percent. ATRA increased this maximum rate to 40 percent.

Illinois: Many individuals fail to recognize that several states impose a state level estate tax, including Illinois. In December 2011, Illinois passed legislation setting the estate tax exemption at $4 million for 2013 and beyond. Prior to 2009, Illinois estate tax law typically followed, or was "coupled" with the federal law.

If the federal exemption was $1 million, the Illinois exemption was also $1 million. Since 2009, however, Illinois has "decoupled" with the Illinois exemption, and, as of 2013, it stands at $4 million while the federal exemption is $5.25 million.

Absent proper planning or updating outdated documents, an Illinois estate tax may be due on the first spouse's death, even if no federal estate tax is due. In the state of Illinois, tax rates on taxable estates can be as high as 16 percent and clients with outdated estate plans may be subject to an estimated tax of about $300,000 to the state of Illinois on the first spouse's death. For 2013 decedents, the credit shelter trust would be fully funded with the federal exemption of $5.25 million, but only $4 million would pass estate tax free at the state level. The balance of $1.25 million would be subject to taxation in the state of Illinois.

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THE BUZZ

LINDSEY PAIGE MARKUS

Lindsey Paige Markus, a principal at Chuhak & Tecson P.C., draws on her early career in business, finance and clinically applied neuroscience to communicate with clients and develop creative solutions to fit their estate planning and asset protection needs. Lindsey was named an Illinois Super Lawyers Rising Star in 2010, 2011 and 2012. She is licensed in Illinois and Florida.

Documents should include language which allows for a special marital trust to be created for state level purposes and may result in an estimated at least $300,000 of estate tax deferral.

Portability: Similar to the 2010 Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act, ATRA allows for "portability" between spouses of the maximum estate tax exemption. ATRA has made this permanent.

A surviving spouse may take advantage of the unused portion of the federal exemption of a predeceased spouse, thereby providing the surviving spouse with a larger exclusion amount. Importantly, the deceased spousal exclusion amount is only available to the surviving spouse if an election is made on a timely filed estate tax return. If the surviving spouse is predeceased by more than one spouse, the exclusion amount available would be limited to the lesser of $5.25 million or the unused exclusion of the last deceased spouse.

$100,000 IRA charitable rollover: ATRA also reinstated the IRA charitable rollover for 2013 and provided opportunities to treat distributions for 2012 as charitable distributions for eligible individuals age 70½ or older.

- 2013 — May contribute up to $100,000 from their IRAs directly to qualified charities without having to pay any income taxes on the distribution.
- 2012 — Those who took a withdrawal from their IRA in December 2012 may make a cash contribution of all or part of the amount of the withdrawal up to $100,000 before Jan. 31, 2013, and treat the charitable donation as a direct distribution to a charity and qualify as an IRA charitable rollover gift for 2012.
- 2012 — Those who did not take a distribution in 2012 may make a cash contribution of all or part of the amount of the withdrawal from their IRA up to $100,000 to a qualified charity by Jan. 31, 2013, and the charitable donations will be deemed to have been made in 2012.

The charitable rollover is an attractive tool for a variety of individuals, including a) high income taxpayers who might be subject to the reinstated limitations on overall itemized deductions; b) taxpayers who do not itemize deductions; and c) lower income taxpayers who might otherwise be subject to limits on charitable deductions.

Chuhak & Tecson P.C. Principal Mitchell D. Weinstein assisted with this column.