HILL WARD HENDERSON
ATTORNEYS AT LAW

ESTATE PLANNING ADVISORY MEMORANDUM
POST ELECTION 2012

"A BIRD IN THE HAND IS WORTH . . . ?"

As one of our clients recently put it, "a bird in the hand is worth way more than two in the bush." When it comes to tax law, we agree. The certainty of today's tax law is much more valuable than double the uncertainties of tomorrow's. Accordingly, this year many of our clients have been structuring their affairs to lock in today's favorable tax treatment.

Now that the 2012 elections are over, attention has turned to the immediate prospects of legislation to avert the so-called "fiscal cliff" that looms on January 1, 2013, because of laws that will take effect then. Negotiators on both sides currently are working on a yet undefined deal that may be enacted during the lame duck congressional session. This sort of brinksmanship has characterized our federal tax policy for some time now. Indeed, the tax law of today was the result of legislation passed in the lame duck session after the 2010 elections.

Absent another round of extension legislation or some other legislative solution adopted soon, on January 1, 2013, here is what will happen: income and long term capital gains tax rates will increase, new income taxes will be imposed, transfer tax exemptions will fall dramatically, and transfer tax rates will increase substantially. Accordingly, we encourage you to consider your personal situation and act prudently in light of the evolving legislative environment.

Looming Tax Law Changes

Federal Income Taxes. In late 2010, Congress extended the Bush-era federal individual ordinary income tax rates through 2012, which currently top out at 35%. Long-term capital gains and qualified dividend rates also were extended. In 2013, ordinary income tax rates and capital gains tax rates are scheduled to revert to their pre-2001 levels and ordinary income will be taxed at up to 39.6% and the long term capital gains rate will increase to 20%. The current very favorable 15% qualified dividends income tax rate is scheduled to increase to match ordinary income tax rates. Furthermore, starting in 2013, a new 3.8% Medicare surtax on unearned income and a 0.9% surtax on earned income will be imposed.

Federal Transfer Taxes. The 2010 law also implemented favorable estate, gift, and generation-skipping transfer ("GST") tax provisions that apply only through the end of 2012. In 2013, the estate, gift, and GST taxes ("transfer taxes") are scheduled to revert to pre-2001 law levels. The exemptions are scheduled to drop to $1 million and the maximum tax rate is scheduled to increase to 55%. See the table below. (Note that President Obama's continuing position has been that we should return transfer taxes to the 2009 structure, which provided for $3,500,000 estate and GST tax exemptions and only a $1,000,000 gift tax exemption with a 45 percent maximum rate for the gift, estate, and GST taxes. That position may be his administration's starting point in the current negotiations.)

	2012	**2013**
Estate Tax Exemption (Rate):	$5.12 million (35%)	$1 million (55%[1])
Gift Tax Exemption (Rate):	$5.12 million (35%)	$1 million (55%[1])
GST Tax Exemption (Rate):	$5.12 million (35%)	$1 million (55%)

[1] A surcharge tax of an additional 5% may apply to estates and lifetime transfers in excess of $10,000,000.

The 2010 law also allowed a surviving spouse to use the unused estate tax exemption of a deceased spouse, known as "portability," which likewise is scheduled to end in 2013.

2012 Year End Wealth Transfer Planning Opportunities

Between now and the end of 2012, we recommend that you revisit your estate plan and consider taking advantage of the opportunities available today to minimize your exposure to federal transfer taxes in the future. We think the following estate planning opportunities will be of most interest to you.

Annual Exclusion Gifts. Consider making "annual exclusion" gifts this year if you have not already done so. The current annual exclusion from gift tax is $13,000 per recipient ($26,000 per recipient if your spouse and you file gift tax returns and you both elect to split your gifts between you). In addition, unlimited gifts for educational or medical services may be made directly to the service provider without using any annual exclusion or gift tax exemption.

Gifts in Excess of Annual Exclusions. Gifts in excess of your annual exclusions first will consume your $5.12 million lifetime gift tax exemption. Given the looming sunset of the 2010 law, there might not be a better time to make these gifts. Some of the most effective wealth transfer strategies, such as lifetime spousal trusts, involve these gifts. Gifts in excess of your lifetime gift tax exemption currently are subject to a gift tax rate of only 35% (55% next year).

Tax Free Transfers to Lifetime Spousal Trusts. A popular strategy to use your $5.12 lifetime gift tax exemption is to make a gift to an irrevocable trust created for the benefit of your spouse. When properly structured, assets transferred to the trust (and future appreciation) are removed from your and your spouse's taxable estates yet distributions can still be made for the benefit of your spouse. These trusts also can be structured as dynasty trusts that can provide further leverage to this strategy and benefit future generations of your family.

Sale to Grantor Trust Strategy Enhanced. A strategy involving a sale to a grantor trust in exchange for a note at today's extremely low interest rates can be a powerful strategy to move wealth to younger generations at minimal tax cost. Before 2011 this strategy was hampered by the need to make what often would have been a taxable gift to fund the trust to provide sufficient equity before the sale occurred. This year's gift and GST tax exemptions often allow these gifts to these trusts to be sheltered from gift or GST tax.

Tax Free Transfers of Life Insurance in Trust. Life insurance owned by the insured is subject to estate tax at death. This tax exposure often can be avoided by using an irrevocable life insurance trust ("ILIT") during life to own the policy from inception. This strategy is particularly effective this year when used to transfer existing policies with cash value (such as whole and universal life policies) because of the today's gift tax and GST tax exemptions.

If you have any questions regarding the matters discussed in this memorandum or would like any additional information, please contact any of the lawyers listed below.

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