2013 Budget Proposals Raise Stakes for 2012 Planning

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For 2012, there is a $5,000,000 exemption for federal gift, estate and generation-skipping transfer ("GST") taxes and the maximum tax rate for all three transfer taxes is 35%. As current law stands, the federal gift, estate and GST tax rules as they existed in 2001 are scheduled to return on January 1, 2013. This would include a $1,000,000 estate, gift and a GST tax exemption amount and a maximum tax rate of 55%.

Many, if not most, practitioners believe that these exemptions are too low and that Congress will ultimately settle at some higher amount (e.g., $3.5 million). Whether the gift tax exemption will remain unified at that amount or return to $1,000,000 is also unknown. Additionally, most believe that the new portability rules will eventually be extended as well.

On February 13, 2012, the Obama administration released its fiscal 2013 budget and the Treasury's General Explanations of the budget (referred to as the "Greenbook"). These new budget proposals include the following estate, gift and GST tax provisions: (i) $3,500,000 estate and GST tax exemptions, (ii) a $1,000,000 gift tax exemption, and (iii) a 45% tax rate. The proposal would also extend the portability rules.

It is unlikely that we will know anything more than the above prior to the November 2012 elections and possibly not until sometime in 2013. In any event, these proposals add additional incentive for our clients to act during 2012 while the planning environment is so favorable.

Many commentators believe that at least some of the $5,000,000 gift tax exemption will go away. The proposed return to a $1,000,000 gift tax exemption increases the pressure on clients to act during 2012. It is hoped that the current unified gift and estate tax exemption structure will survive, but the proposal clearly indicates this administration's desire to bifurcate those exemptions and provide a much smaller exemption for lifetime transfers.

In addition to other perceived advantages to 2012 planning, the following two items included in the proposed budget are apt to weigh heavily on our clients.

First, the budget proposal introduces the concept that the assets of a grantor trust will be included in the grantor's estate for estate tax purposes. This would take away the transfer tax efficient technique of transferring assets to a grantor trust and allowing the grantor to continue to pay the income tax on future income. Additionally, assets can currently be sold to the trust by the grantor with no gain recognition. If adopted, the proposal would end this very attractive planning technique. In this regard, however, the proposal also contains the very important concept that existing trusts would be grandfathered into the system. Accordingly, clients should now carefully consider the use of this technique during 2012 while it remains available.

Secondly, the budget proposal introduces the concept that trusts exempt for GST tax purposes may exist for only a limited term. The proposal includes a provision whereby a trust's inclusion ratio for GST purposes would automatically reset to 1.0 90 years from the date of creation, effectively ending such a trust's GST exemption. Currently, there is no time limit for such trusts other than the applicable state law which limits the length of trusts to the "rule against perpetuities," a time period which ends 21 years after the death of everyone alive at the trust's creation. In this regard, many states have extended or even abolished this rule so that trusts have no termination period and therefore, for GST purposes, last forever. It is important that our clients know of this proposal to limit the GST period and also point out that again, like the grantor trust proposal above, the budget provision would grandfather existing trusts from this rule.

Thus, the current favorable planning environment, the threat of a less lenient tax environment on the horizon and the ability to lock in valuable planning techniques for years to come will likely prompt our clients to become very active in the planning arena this year.

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