Tax Planning In Light of Scheduled Tax Increases
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You may recall that back in 2001 Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001. This massive piece of legislation formed the centerpiece of President George W. Bush's tax policy and in conjunction with some additional 2003 legislation became know as the "Bush-era tax cuts." Because the 2001 legislation purported to create a large federal deficit beyond ten-years of enactment, and because of legislative rules concerning legislation creating such deficits (a discussion of which is beyond the scope of this article) the 2001 legislation contained a "sunset" provision. This sunset provision called for the elimination of all Bush-era tax cuts following 2010, and a reversion to tax laws as they existed before the 2001 legislation.

In 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("TRA 2010"), which, among other things, extended the Bush-era tax cuts two years, and with respect to the federal estate, gift, and generation skipping transfer taxes actually reduced the maximum tax rate to 35% and increased the exemption from these taxes to $5 million for 2011 and 2012 (indexed for inflation). Still, because TRA 2010 was largely an extension of the Bush-era tax cuts, it merely extended application of the sunset provision described above.

As a result and unless Congress acts soon, on January 1, 2013 we will revert to tax laws as they existed in 2001 before the Bush-era tax cuts. When planning for these looming tax increases there isn't a single solution for that works for all taxpayers. However, your tax and financial advisers, and the attorneys at FGMC can assist and help identify a plan and strategy that works for you. The remainder of this article highlights a small portion of the looming changes in tax laws, how they might impact you, and some ideas that might help you plan accordingly.

Estate, Gift and Generation Skipping Transfer Taxes

Transfer Tax Exemptions

The exemption from federal estate, gift and generation skipping transfer taxes after indexing for inflation currently sits at $5.12 million *per person*. On January 1, 2013 this exemption will fall to approximately $1 million per person. This means that over the remainder of this year taxpayers have a window of opportunity to convey $4 million of wealth to their loved ones, tax-free.

Many strategies exist that are designed to maximize the use of this exemption and the amount of wealth you can transfer. There are even strategies for taxpayers that aren't quite ready to part with this kind of wealth. For example and for those concerned about the need for assets later in life, a spousal lifetime access trust (SLAT) is an irrevocable trust formed for the benefit of your spouse. Because this is an irrevocable trust, trust assets are effectively removed from your taxable estate tax-free by utilizing your transfer tax exemption. Best of all, because your spouse is the beneficiary of the SLAT, you continue to indirectly benefit from trust assets.

Grantor retained annuity trusts and qualified personal residence trusts are other types of trusts in which the creator of the trust (known as the "Settlor" or "Grantor") continues to retain an interest in trust assets.

Transfer Tax Rates

The top marginal rate for estate, gift, and generation skipping transfer taxes is scheduled to rise from the current 35% to 55% (with an additional surtax of 5% for estates valued between approximately $10 and $17 million) at year-end. This presents yet another reason for engaging in transfer tax planning this year.

For those individuals who believe their estates are below the $1 million exemption amount, keep in mind that the insurance policies you own on your life may be included as part of your taxable estate. So 55% of that million dollar policy you've taken out for the benefit of your young children may actually wind up in Uncle Sam's hands instead. Fortunately, there are planning opportunities that exist specifically with respect to life insurance.

Income Taxes

Income Tax Rates

Current tax rates on ordinary income range from 10% to 35% for individuals. Those rates will expand to 10% to 39.6% next year. Furthermore, dividends will once again be taxed as ordinary income (for people in the top marginal tax brackets this change alone will represent a near 165% increase in the applicable tax rate). The capital gain tax rate will rise from the current 15% to 20% next year.

Also, as a result of the Patient Protection and Affordable Care Act taxpayers with adjusted gross incomes above $200,000 ($250,000 for married couples filing joint returns) will be hit with two additional tax increases. A 0.9% hospital insurance tax will apply to earned income such as salaries and wages and a 3.8% tax will apply to investment income, such as interest, dividends, and capital gains (but neither of these taxes will apply to distributions from most retirement plans).

Taxpayers may want to consider *accelerating* the recognition of income to 2012 to avoid paying the higher rates next year, or delaying deductions to next year.

Conclusion

With tax exemptions scheduled to decrease and tax rates scheduled to increase clients should review their existing estate plans. Because we expect a very busy fourth quarter we encourage clients and friends to contact their financial advisors or the attorneys at FGMC. If its been a while since you've had a comprehensive review of your estate plan now is an excellent time to do this with a competent advisor.