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New Changes in the Tax Law

by Ted Simpson

Back in January, we informed you about an important new law passed by the Federal government. It is called the American Taxpayer Relief Act of 2012 which is known by its initials ATRA. It makes many important changes to the Internal Revenue Code. In this article, we will discuss some of the provisions that you may wish to consider in connection with your income and estate planning.

ATRA makes permanent the $5 million gift, estate and generation-skipping transfer (GST) exemptions that initially became effective in 2011 and were to expire at the end of 2012. The $5 million exemption amount is indexed for inflation and was increased to $5,250,000 this year. That means, of course, that a married couple may have $10.5 million of exemption together. This permits a taxpayer to transfer significant amounts out of his or her taxable estate. Whether, and to what extent, an individual uses the exemption during life, in our view, is an individual judgment. In some cases, there may be additional benefits of using the exemption such as protecting property from claims of creditors and protecting property from state death tax at death. In some cases, it may be possible to use the exemption during your lifetime without giving up the benefits of the property. That can be a complicated matter. In any event, if you would care to discuss this matter, please let us know.

As mentioned above, each spouse has his or her own estate tax exemption. Generally, planning for married couples has involved making sure that the estate tax exemption of the spouse dying first

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The Closely-Held Business Team attorneys at Harrang Long Gary Rudnick are committed to serving the needs of business owners in a responsive and proactive manner. They understand the challenges and the opportunities provided by the law in today's business climate, and are focused on the advancement of each client's success in business.

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is used, usually by placing an amount equal to his or her exemption into a trust from which the surviving spouse may benefit but will not be included in the survivor's estate for Federal tax purposes. ATRA offers a type of alternative. Under ATRA, the exemption amount need not pass into a trust when the first spouse dies. Rather, the exemption of the first spouse to die can be inherited for later use by the surviving spouse. This is a concept called "portability."

The initial reaction of many people is that the portability option will greatly simplify estate planning. One reason is that it permits the entire estate of the spouse dying first to be given directly to the surviving spouse, without sacrificing the exemption of the first spouse to die. However, in some ways, it makes planning for a married couple more complicated. Whether it is better for you to take advantage of this portability rule, permitting the exemption to be inherited by the surviving spouse or to engage in a more traditional structure for a married person (in part by creating a separate trust) depends upon many factors. These factors include whether there is concern that property inherited outright by the surviving spouse might become subject to claims of his or her creditors, including a claim by a subsequent spouse. Also, there are potential income tax advantages of using trusts. This decision may be further complicated because of state death taxes.

We regard this as an especially important matter for you to consider. We look forward to discussing it with you.

As you likely are aware, ATRA increased the top Federal income tax bracket from 35% to 39.6%, effective for this year. In addition, the new 3.8% Medicare Tax has just taken effect; it applies to most dividends, interest, rents, royalties, certain annuities and capital gain. Although the 39.6% and 3.8% tax rates (with a combined rate of 43.4%) apply only to individuals with relatively high levels of income, these rates of tax apply to trusts at about $12,000 of income. One immediate reaction is that trusts should not be used as part of an estate plan. However, a flexible trust may help your family reduce income taxes.

We think this is an important matter and look forward to discussing it with you.

Obviously, no one can forecast future changes to the tax law. However, a number of proposals made by the Obama administration with respect to estate, gift and GST tax matters were not adopted. It is understood that Congress may consider closing what it views as "loopholes." Some of these loopholes might be adopted later this year. We cannot forecast what loopholes will be closed, but we will mention some of them.

One proposal would eliminate certain discounts in valuation with respect to closely-held businesses, including holding companies such as a family partnership or limited liability company. These discounts can significantly reduce tax when an interest in the business is transferred (during lifetime or at death) to others. We wish to emphasize that we do not know if, or when, this proposal would be adopted but, if minimizing taxes on your business entity is important to you, we think it would be appropriate to discuss with you ways in which you could avoid this adverse change.

Another proposal would curb the use of what has become a relatively standard and widely used estate planning arrangement called a "grantor retained annuity trust" or "GRAT." This type of trust provides for you to receive annuity payments for a stated number of years and then the balance of the trust passes to and in trust for your descendants. An advantage of this type of trust is that there is no risk of any significant gift tax. Under the proposal, this option would be substantially curbed. If you think you might wish to consider taking advantage of a GRAT, please let us know.

Another proposal would limit the length of time a trust can be protected from estate, gift and GST tax to 90 years. Although that seems like a very long time, it could mean that property in the trust would be taxed while your grandchildren or great grandchildren are still living. If a property owner creates a trust for descendants before the provision takes effect, it is likely the trust could avoid tax for an indefinite

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period of time. If that is important to you, we should discuss steps you might take to avoid that adverse change.

We believe ATRA represents an important change in law and, for many individuals, the Act changes the framework under which estate planning is done. If you wish to discuss how ATRA will affect your estate plan or how you can benefit from the changes in the law, please let us know.

As always, if you have any questions about income or estate planning, or any other issue relating to your closely-held business, feel free to contact Randy Duncan, Ted Simpson *or another member of our Closely-Held Business Team at 503-242-0000.*

John Witherspoon Named HLGR Shareholder

We are pleased to announce that John T. Witherspoon has been named shareholder.

"As an established law firm with a long history and reputation to protect, our shareholder admission process is rigorous and thorough," said firm president Jens Schmidt. "We evaluate attorneys on several measures, from ethics and service to clients, to business development and 'fit' with other shareholders and existing clientele. We have all consistently found John to be a valuable contributor to our firm's and clients' success. We were unanimous in our decision to invite him to become a shareholder."

Witherspoon was previously an associate with HLGR. Before that, he was an associate with Lukins & Annis, P.S., in Spokane, WA. In his seven years in practice in Oregon and Washington, he has served clients in a variety of industries demonstrating a great depth of business and legal acumen. As a member of HLGR's closely-held business team, he focuses on the practicalities of adding value to the client's bottom line.

You may contact John by calling 503.242.0000 or emailing him at john.witherspoon@harrang.com.