



Trusts & Estates Group Client Alert

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CHANGES TO ESTATE, GIFT, GENERATION-SKIPPING TRANSFER TAX AND CHARITABLE RELATED PROVISIONS IN RECENTLY ENACTED “AMERICAN TAXPAYER RELIEF ACT OF 2012” AND 2013 INFLATION ADJUSTMENTS

Signed by President Obama on January 3, 2013, H.R. 8, known as the “American Taxpayer Relief Act of 2012” (the “Bill”), addresses various expiring estate, gift and generation-skipping transfer (“GST”) tax provisions as well as extends or reinstates certain provisions affecting contributions by individuals to charity.

Estate, Gift and Generation-Skipping Transfer Tax Provisions

In the Bill, Congress made the following changes to the Federal estate, gift and GST tax provisions, effective for estates of decedents dying, gifts made or generation-skipping transfers occurring after December 31, 2012.

Estate Tax: The estate tax rate is effectively increased to 40%¹, while the estate tax applicable exclusion amount continues to be \$5,000,000, indexed for inflation with calendar year 2010 as the base year and reduced by the amount of any lifetime taxable gifts made. Thus, the estate tax applicable exclusion amount, as indexed, for 2013 is expected to be \$5,250,000, although the IRS has not yet issued a notice confirming the amount.²

Gift Tax: The gift tax rate is also increased to 40% and the gift tax applicable exclusion amount also continues to be \$5,000,000 per donor (or \$10,000,000 for married couples), indexed for inflation with calendar year 2010 as the base year. Thus, the gift tax applicable exclusion amount for 2013 is expected to be \$5,250,000.

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¹ There is a graduated rate schedule that has a highest estate tax rate of 40%, applicable to the assets in a taxable estate over \$1,000,000.

² Under the Bill, the state death taxes would continue to be deductible in calculating a decedent's Federal taxable estate. In New York, the top estate tax rate is currently 16%. The effect of the deductibility of state estate taxes for a New Yorker results in top marginal estate tax rates of 33.6% for Federal estate tax and 16% for New York estate tax, for an aggregate marginal estate tax rate of 49.6%.

GST Tax: For transfers to grandchildren or more remote descendants, transfers to other related individuals assigned to the generation of a grandchild or more remote descendant with respect to a donor or unrelated individuals who are more than 37½ years younger than the donor, the GST tax rate is similarly increased to 40%. The GST tax exemption amount is also retained at \$5,000,000, indexed for inflation with calendar 2010 as the base year. Thus, the GST exemption 2013 is expected to be \$5,250,000.

Portable Exemption: The Bill retains the provision that permits a decedent's estate to elect to have the decedent's surviving spouse "inherit" any of the decedent's unused estate tax applicable exclusion amount. For example, if a decedent had only used \$3,000,000 of his or her \$5,250,000 estate tax applicable exclusion amount, the remaining \$2,250,000 may be used by the decedent's surviving spouse.

Notably, the Bill did not modify any of the current provisions related to grantor retained annuity trusts ("GRATs"), valuation discounts on interests in family-owned entities, the viability of long-term or perpetual dynasty trusts or the income taxation of grantor trusts, all of which provisions the Obama administration sought to modify in its Fiscal Year 2012 Revenue Proposals. Thus, these strategies remain effective for estate planning purposes.

Certain Provisions Related to Contributions to Charity

The Bill also has reinstated what is known as the Pease Limitation which reduces certain allowable itemized deductions, including the charitable deduction, for certain higher-income taxpayers. Under the Pease Limitation as reinstated and modified by the Bill, the reduction equals the lesser of (i) 80% of the amount of itemized deductions otherwise allowable for the taxable year or (ii) 3% of the excess of adjusted gross income over a statutory floor. The statutory floor (which is indexed for inflation for taxable years after 2013) under the Bill is \$300,000 in case of a joint return, \$275,000 for a head of household or \$250,000 for an unmarried individual who is not a head of household. Please note that the Pease Limitation does not apply to any deductions by estate or trust.

The Bill also extends the exclusion from gross income for qualified charitable distributions of up to \$100,000 received from an individual retirement account (IRA) through December 31, 2013. A special rule was added that permits a taxpayer to elect to have a qualified charitable distribution made after December 31, 2012 and before February 1, 2013 as if made on December 31, 2012. Another special rule allows a distribution from an IRA to a taxpayer after November 30, 2012 and before January 1, 2013 to be treated as a qualified charitable distribution if such distribution is transferred in cash to a qualified charitable organization before February 1, 2013.

The Bill also extends to December 31, 2013 favorable deduction provisions for gifts of conservation easements.

2013 Inflation Adjustment

Under the Internal Revenue Code, certain exclusions and thresholds are subject to annual inflation adjustments. For 2013, the gift tax annual exclusion will increase from \$13,000 to \$14,000 per donee and from \$139,000 to \$143,000 in the case of gifts made to a non-citizen spouse. In addition, the threshold at which gifts received from foreign partnerships and corporations become reportable to the IRS will also increase from \$13,258 to \$15,102, while the threshold over which gifts from foreign individuals and estates are reportable will remain at \$100,000.

Statement About Circular 230

Amendments to a Treasury Department regulation, known as Circular 230, require lawyers and accountants to follow strict rules in issuing a written statement about a Federal tax issue. The most onerous rules of compliance under §10.35 of the Circular involve written advice about so-called Listed Transactions, arrangements that have tax avoidance as their principal purpose and what are called Marketed Opinions. We do not believe any issue discussed in this memorandum relates to a Listed Transaction. We believe the tax benefit sought is consistent with the Internal Revenue Code of 1986 as amended (Code) and Congressional purpose. That means the principal purpose is not tax avoidance. We also believe no issue discussed herein is a significant Federal tax issue – meaning that we believe the IRS does not have a reasonable basis for a successful challenge on the overall Federal tax treatment of the issues discussed in this memorandum. That means we do not think this memorandum must comply with §10.35 of the Circular. Nevertheless, we add the following statements to ensure compliance with said §10.35. Notwithstanding these statements, we believe the conclusions reached herein are correct.

1. The written advice contained in this memorandum is not intended or written by us to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties.
2. No one may use any part of this memorandum in promoting, marketing or recommending an arrangement relating to any Federal tax issue to any taxpayer.
3. Nothing herein shall be construed to impose a limitation on disclosure by any person of the tax treatment or tax structure of any transaction that is addressed herein.

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