Estate Planning SMARTS

Update 3

How the 2012 Tax Law Affects Your Estate Plan

An update to *Estate Planning Smarts*, *2d edition*.

By Deborah L. Jacobs

The New Year's Day tax deal, known as the American Taxpayer Relief Tax Act Of 2012, ended an 11-year period of uncertainty about estate tax exemptions and rates. Mostly what Congress did in this area was to make permanent the system that has been in effect for the past two years and which was described in *Estate Planning Smarts, 2d edition* (published in 2011).

The Basics

Here's what you need to know about the new law. Changes are highlighted in yellow.

- The amount that you can pass through your own estate plan without having to worry about taxes, known as the basic exclusion, is **$5.25 million** in 2013. Indexed for inflation after 2011, it was $5.12 million for deaths in 2012. **(It will continue to be indexed for inflation.)** The tax on the rest of the estate has gone up to a maximum of 40 percent, from 35 percent (see Chapter 3).
- As in the past, there is an unlimited deduction from estate and gift tax that postpones the tax on assets spouses inherit from each other until the second

spouse dies. This marital deduction, as it is called, applies only if the inheriting spouse is a U.S. citizen (see Chapter 3).

- The 2010 tax law gave married couples a wonderful tax break, which the new law **has made permanent.** Starting for deaths in 2011 and now going forward, the surviving member of a married couple can carry over the estate tax exclusion of the spouse who died most recently and add it to her or his own. Portability, as tax geeks call it, allows married couples to transfer $5.25 million apiece ($10.5 million together) tax-free (see Chapter 3).
- The lifetime gift tax exclusion and the estate tax exclusion are expressed as a total amount – currently $5.25 million per person – and it is possible to use this exclusion (sometimes called the “unified credit”) to transfer assets at either stage or a combination of the two. If you exceed the limit, you (or your heirs) will owe tax of up to **40 percent** (see Chapter 15).
- Anyone can give another person **$14,000** per year without it counting against the lifetime exclusion. (The amount, which is adjusted for inflation, went up at the end of 2012.) Spouses can combine this annual exclusion to double the size of the gift. Don’t confuse this with the basic exclusion – that $5.25 million discussed above (see Chapter 13).
- Generation-skipping transfer tax applies, on top of estate or gift tax, to assets given to grandchildren (or to trusts for their benefit). But here, too, the law offers a **$5.25 million** exemption (indexed for inflation), whether the transfer is made during life or at death, before a **40 percent** levy applies. There is no portability for this tax, but for transfers during life married couples can combine each of their exemptions to give away a total of $10.5 million (see Chapter 14).
- For income tax purposes, the cost basis of inherited assets gets adjusted to the fair market value on the date of the owner’s death. This limits the capital-gains tax inheritors must pay if they sell the property (see Chapter 15).

Should You Redo Your Will?

Nearly 2.5 million Americans die each year, and many haven’t signed the basic documents needed to protect loved ones. But let’s say you took this important step within the past five years. The latest tax law probably doesn’t give you any reason to alter your plan. Still, you should revisit it if there have been changes in your finances or your personal life (see Chapter 19).

Miscellaneous Changes

The new tax law makes the following additional changes that affect material covered in *Estate Planning Smarts, 2d edition.*

Giving IRA assets to charity. The so-called IRA charitable rollover – an on again, off-again rule first introduced in 2006, allows people 70½ and older to transfer as much as $100,000 per year from their traditional IRAs to charity. The provision last expired at the end of 2011. In the new tax law, **Congress has extended it** through 2013, with a brief window of opportunity for 2012 donations that ends Jan. 31, 2013 (see Chapter 17).

Coverdell Education Savings Accounts. These accounts, sometimes referred to as education IRAs, can pay for any level of schooling. Certain attractive features, scheduled to expire at the end 2012, **are now permanent**. You can make 2012 contributions through April 15, 2013 (see Chapter 9).

Converting a traditional 401(k) or 403(b) to a Roth account. If you do not plan to use all your retirement assets yourself, the simplest, best tax-saving strategy is to create a Roth account. One of a handful of ways to do this is within a company plan. Previously, you had to be entitled to distributions from these accounts to use this strategy. Under the new tax law **anyone can do it**, provided the company plan allows it (see Chapter 7).

Deborah L. Jacobs, a lawyer, award-winning journalist and senior editor at Forbes, is the author of the bestselling book *Estate Planning Smarts: A Practical, User-Friendly, Action-Oriented Guide.* This third update to that book assumes that you have the second edition of the book, published in 2011. To keep readers current between editions, Jacobs also blogs at www.forbes.com/deborahjacobs/blog and tweets at http://twitter.com/djworking. You can register at www.estateplanningsmarts.com to receive e-mail notifications of future updates and editions.