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Gift Taxes

Fiscal Cliff Unified Estate, Gift Tax Exemptions Seen as Windfall by Advisers

Estate tax advisers and attorneys issued a collective sigh of relief Jan. 2 in reaction to the passage of provisions in fiscal cliff legislation that keep estate and gift tax exemptions at $5 million for 2013 and for the foreseeable future.

The American Taxpayer Relief Act of 2012 (H.R. 8), enacted by Congress Jan. 1, kept the estate and gift tax exemption unified at $5 million (see related story in this issue) and made the exemptions permanent.

The gift tax would have dropped to $1 million if Congress had not reached a deal on the legislation, prompting some to call it the forgotten issue of the estate tax negotiations.

While many observers had focused on the possibility that the estate tax exemption could drop to the level in President Obama's 2012 budget proposals—$3.5 million—few were focusing on a provision that called for the gift tax to tumble to $1 million.

''The two big things that people were worried about did not come to pass,'' Beth Kaufman, an attorney with Caplin & Drysdale, told BNA Jan. 2. The estate and gift taxes remain unified, and because the exemption level is not going down, clawback has ceased to be an issue.

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RICHARD BEHRENDT
SENIOR VICE PRESIDENT, BAIRD

Instead, the current $5 million exemptions will even retain the $120,000 inflation adjustments they picked up in 2012, and those adjustments will increase the exemptions over time.

For 2013, according to Internal Revenue Service inflation factors, the exemption is estimated to be $5.25 million, according to Richard Behrendt, senior vice president with Baird in Milwaukee. If inflation were to rise to 3 percent, the exemption could become almost 6.5 million by 2020, said Behrendt. Inflation is currently 1.8 percent.

In addition, because exemptions will no longer be reduced, practitioners can put to rest any concerns IRS might try to claw back estate tax exemptions at the time of death. Even if taxpayers used their $5 million exemption while they had it in 2011 or 2012, and it later decreased, the Service will no longer be able to take the position that the value of the exemption at the time of death was less, and force the taxpayer to pay taxes on it.

Rates Go Up a Little. The only slightly sour note for estates—an increase in the estate and gift tax rates from 35 percent to 40 percent—would be viewed as nothing more than ''a rounding error for some of the larger estates,'' Behrendt said. Kaufman said the rates were a small price to pay for the other benefits that were received.

All the provisions from 2012 were extended with the exception of the rates, which means portability of the estate tax and gift tax was also extended. Under the portability rules, a spouse is allowed to use the unused estate and gift tax exemption amounts of a deceased spouse.

Perhaps the biggest windfall was the permanency of the provisions. A permanent estate tax has been lacking for more than a decade so the fact that wealth planners will now know what they are dealing with from year to year is the biggest bonus, most said.

There is also no restriction on grantor retained annuity trusts or the use of valuation discounts.

The big bonanza in gift-giving most likely occurred in 2012, as affluent taxpayers rushed to take advantage of what they thought would be a fleeting $1 million gift exemption, Kaufman said. But there are still good reasons to make gifts. Not everyone got it done in 2012, and there is always the lure of getting the future appreciation of the assets out of the estate.

States: 'No More Free Lunch'? Furthermore, with only one state—Connecticut—having a gift tax, others may attempt to follow and put a limitation on the amount of gifts that can be transferred, said John McManus, with McManus & Associates in New York.

''Other states, knowing the permanency of this gift tax exemption, may use this opportunity to say 'no more free lunch,' and impose their own gift tax exemption,'' he said, and they could do it retroactively.

Many states now have estate tax exemption amounts that are much lower than the federal exemption, although residents enjoy unlimited exemption for gifts at the state level.

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Connecticut's law requires anyone who gives a gift of $2 million or more to pay gift tax even though the federal exemption is $5 million. Other states could follow and impose a gift tax at a lower exemption amount than the federal level, he said.

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