The Estate Update

A newsletter provided for the benefit of the clients and friends of
The Peninsula Center for Estate Planning and Elder Law

A message from the Firm:

It is hard to believe it has been a year since out last Newsletter. We were not-so-patiently waiting throughout 2012 for anticipated changes to the estate, gift, and income tax laws, which finally came on January 2, 2013. Last year brought a frenzy of uncertainty which resulted in a lot of last minute gifting and tax planning in attempts to provide protection against falling off the "fiscal cliff." Now that the dust has settled, we are happy to bring you this edition of The Estate Update in an attempt to help you clear the haze and finally begin to move forward with certainty.

This issue will take a look at the new legislation as it applies to changes in the estate, gift, and income tax arenas. Decisions regarding spending cuts have been deferred, including possible cuts to programs that serve the elderly. If you have questions or need additional information, please contact us directly.

We welcome all of the new clients and friends who joined us in 2012 and we look forward to working with you in future years as part of our "firm family." We wish everyone a healthy and prosperous 2013.

Helena

The American Taxpayer Relief Act Of 2012

Legislators were very busy New Year's Eve and into the early morning hours of New Year's Day to draft and ultimately pass legislation to avoid what was commonly referred to as "The Fiscal Cliff." But what really happened? In summary, not much. Rather, the legislation in large part made permanent the system that has been in effect for the past two years. The new law did put off for two months some important spending cuts that must take place. It is these additional cuts that could have a significant impact on our senior population and their loved ones.

Estate Taxes: Under federal law, there is a certain amount that can be transferred without incurring any tax liability. Without the new legislation, that amount, called the "applicable exclusion amount" would have automatically reverted to $1 million per person. Since 2010, every individual could transfer up to $5 million tax-free during life or at death. This year's new "fiscal cliff legislation" did not change the applicable exclusion amount, but since the exclusion amount is adjusted for inflation, it is now $5.25 million for individuals who die in 2013.

Under the old law, the estate and gift tax rate would have increased to a maximum of 55% effective January 1, 2013. However, the new legislation implemented a flat tax rate of 40% on all transfers, which is up 5% from the rate in place since 2009, but is still better than 55%.

Married Couples: The new legislation did not change prior law providing that spouses do not have to pay estate tax on assets passing to them as a result of the first spouse's death. Instead, any estate tax due is postponed until the second spouse dies. This is called the "marital deduction." If the surviving spouse is not a U.S. citizen, then there are restrictions on how much can be passed to the surviving spouse tax-free.

The new law did, however, make permanent the concept of “portability” which permits a surviving spouse to transfer to herself any of her deceased spouse’s unused exemption if done within 9 months of the deceased spouse’s death.

Lifetime Gifts: The current applicable exclusion amount of $5.25 million per individual is an exclusion which can be applied against both lifetime gifts and transfers at death. For example, an individual could transfer assets of $2 million during his lifetime and an additional $3.25 million at death, and the total transferred would not be subject to either gift or estate tax. However, if an individual transferred more than the $5.25 limit, that individual’s estate would owe a tax of 40% on the excess transferred. The donor should report any gifts made during her lifetime to the IRS, even if no gift tax would be due.

Annual Exclusion Gifts: As most of you know, there is an amount each year that can be transferred without counting toward the $5.25M exclusion. In 2013, that amount is $14,000 per person. For example, an individual can give three different people $14,000 in 2013. Couples can double this amount and give $28,000 per person per year.

Long-Term Care Planning Note: It is important to remember that most gifts will cause a penalty for Medicaid purposes. Individuals often believe that because they can transfer $14,000 per person, per year under the gift tax rules, the same applies to Medicaid. However, the rules for Medicaid are very different, so if you are concerned about paying for long-term care costs, please call us before making any gifts.

Changes to the Income Tax Rules: There are a few changes to the income tax rules that are worth mentioning here. However, if you would like information on other changes in the income tax arena, please see your tax advisor.

•The Social Security tax will increase by 2% for all working taxpayers.

•Ordinary income tax rates increase from 35% to 39.6% for singles earning more than $400,000 a year ($450,000 a year for married couples). All other ordinary income tax rates effective in 2012 were made permanent.

•There is a new Medicare 0.9% surtax on ordinary income and a new 3.8% surtax on investment income for those individuals earning over $200,000 ($250,000 for married couples).

•The top capital gains and dividend rate increased to 20% for those earning more than $400,000 a year ($450,000 for married couples).

Spending Cuts: The current fiscal cliff legislation did not address the automatic spending cuts that were to take place on January 1, 2013. Instead, the automatic cuts, known as sequestration, were pushed back two months to March 1, 2013. Sequestration was one portion of the spending cuts included in the Budget Control Act passed and signed in August, 2011.

The Budget Control Act of 2011 allowed the president to raise the debt ceiling by $2.1 trillion, and it instituted two rounds of significant spending cuts. One round of cuts involved government programs like defense spending, education funding, the FBI and other government agencies that would receive automatic budget cuts relative to their scheduled growth over the next 10 years.

The second half of the spending cuts was supposed to be decided on by Congress through a Joint Select Committee on Deficit Reduction. This Committee (referred to as the "supercommittee") was to come up with a list of cuts that would then be put to Congress for a full vote. If the committee couldn't agree on the cuts, $1.2 trillion in further spending reductions over 10 years would be implemented starting

Jan. 1, called the "sequester." No cuts have yet been agreed upon. Congress has until March 1, 2013, to come to an agreement. Programs like Medicare, Medicaid and Social Security have been the topic of discussion for the second portion of the spending cuts.

Conclusion: The fiscal cliff legislation is in place; however, there is more legislation to occur that could have a significant impact on those affected by programs like Medicare, Medicaid and Social Security. While many families may not be affected by the current estate and income tax rules, there are many who could have their life savings consumed by long-term care costs. We help seniors and their families plan ahead to avoid a financial crisis, even if a health care crisis occurs. If you would like to learn more or if we can help someone you know, please give us a call.

Planning for College Students

My son already knows what he is getting for his 18th birthday – a power of attorney and a medical directive. WHY? Because once they are adults under the law, parents don't have any right to obtain information regarding or make decisions on behalf of their children. Even though you are still paying the bills, you have no rights. And, if an emergency arises, you have no authority to decide what should be done for your child from a financial, legal, or a medical standpoint.

I recommend that every "child" over the age of 18 have in place a power of attorney, medical directive, HIPAA authorization, and even a living will. These documents will ensure your child's protection and your right to step in if something happens. Without these important documents in place, your only option at that time would be to institute a guardianship proceeding on behalf of your child. Not only would this be expensive, but it would involve the courts in your personal family business.

You may ask "Does my child also need a will?" This is really a personal choice. Without a will, any assets owned by the child would pass to the parents under the intestacy laws (unless the child had children of his own). We can certainly prepare a will if desired, but wills are not as crucial as the other legal documents for young people.

If you are interested in discussing this further, please contact us. We commonly prepare what we refer to as "College Power Packs" for children and grandchildren of clients who are heading off to college. However, whether the child is leaving for college or not, this matter should be addressed once the child attains the age of 18 to both ensure his protection and your piece of mind.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from his or her tax advisor based on the taxpayer's particular circumstances.

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