

The Estate Analyst

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Doomsday Déjà Vu? Estate Planning for 2012

& Voices of 2011

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“It is always darkest just before the day dawneth.”

—Thomas Fuller (1650)

Unbelievably, but in a cruel and completely unjustified instant replay of 2010, the current estate tax is scheduled to expire at the end of the year. Again with the uncertainty. Again with the doomsday scenarios (unlikely), the procrastinating politicians (a given), and the entire exercise in futility (a constant).

Estate planners may be experiencing some estate tax reform fatigue by now, but, yes, the temporary estate tax fix enacted at the end of 2010 (The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010) is set to expire at the end of this year. And Congress can probably be counted on to provide the usual gridlock, missed deadlines, mixed signals, and 13th-hour “fix” with some retroactive repairs and ambiguous new rules.

Or the world may simply end on December 21, 2012. So good news, high estate tax exemptions might get another extension, but bad news, total Mayan apocalypse.

This is our annual review of predictions, forecasts, rule summaries, and cost of living adjustments. However, we can’t merely recite the rules and conditions applicable to 2012 without at least peeking ahead at the potential for Judgment Day in 2013—and whatever doomsday scenarios may apply to the Federal estate tax.

Rapture Sightings

Doomsday has been lurking about of late. A well-publicized end of the world was predicted by radio host Harold Camping. He pinpointed the event as commencing with a “Rapture” at 6 p.m. (New York time) on May 21, 2011, followed swiftly thereafter by a Judgment Day that would sweep around the Earth. Much to the chagrin of those who abandoned their life savings based on this prediction, this nonevent passed with only a flurry of Rapture jokes.

The doomsday du jour is based on the Mayan “Long Count” calendar, which anticipates the conclusion of the current 5,125-year era on December 21, 2012. After that, we start to degenerate into apocalyptic chaos. Or not.

Federal transfer taxes aren’t going to end the world as we know it; to be realistic, with so few estates affected by them for so many years, their relevance has become overstated. Yet the dramatic repeal of estate taxes provided a “Rapture” moment, if you will, and, after a decade of phasing in (the Congressional version of the Mayan Long Count), estate tax repeal actually arrived.

However, a complex budgetary failsafe that was inserted into parliamentary/operational procedures of Congress, thanks to the late Senator Byrd and the eponymous Byrd Rule, resulted in an automatic “repeal of the repeal” sequence that would have caused a reversion to 2001-vintage tax rules in 2011. To wit, Doomsday.

Congress narrowly averted this horror...by rescheduling its arrival until January 1, 2013. Thanks to this maladroitness, we may now re-experience the legislative procrastination that allowed the estate tax repeal to take effect in 2010, as well as the bizarre retroactive fix that arrived at the end of 2010 to create a two-year period of limbo.

What’s Next?

Asking Congress “What’s next?” is less gratifying than asking Lou Costello “Who’s on first?” We only know for certain what will happen if Congress fails to act. If that takes place, the Federal estate tax (and several other rules) will revert to 2001 levels. This would mean higher estate tax rates and lower exemptions for a higher number of estates.

Currently, less than 1% of all estates are exposed to the Federal estate tax. If the exemption reverted to \$1 million, perhaps 2% of estates would then be exposed—perhaps slightly more.

At least one Congressman supports a return to an estate tax at approximately these levels. Congressman Jim McDermott’s Sensible Estate Tax Act would have re-booted the transfer tax system with a \$1 million unified estate and gift tax exclusion (that would be indexed for inflation starting in 2013) and a 55% top estate tax rate. This is more austere than the similarly named proposal McDermott (D-WA) made in 2009.

It would be unfair to any of those affected, given the haphazard whipsawing of rules that impeded estate planning. If this came to pass, Congress might address such an injustice with a retroactive provision or transitional rules (as it did in 2010) to allow estates of decedents dying during or shortly after such a paradigm shift in transfer tax rules to adjust their estate posture in some useful way.

Maintaining the status quo is always one option that arises by default...by “de fault” of “de Congress” to agree on an alternative. This might be the least disruptive solution. The \$5 million exclusion for Federal estate tax that arrived in 2011 was indexed for inflation and rose to \$5,120,000 for 2012. If this approach were extended indefinitely, it would simply continue to keep pace with inflation, and we could expect it to reach \$5,240,000 for 2013 if inflation levels

remained the same. With portability of unused exclusions for married couples, the overall exclusion for a marital estate would reach \$10.48 million by 2013.

Historically, public sentiment favors higher taxes during difficult economic times. Political realities may not translate this into higher estate tax rates, but options such as scaling back the exclusion to \$3.5 million (the 2009 level), restricting portability of the exclusion, and/or reinstating a credit for state death taxes may come into play.

The Transition Ends

Last year, the Federal estate and gift tax got back together. No surprise there; the two had been part of a unified system from 1976 through 2001 and were only separated by the attempted repeal of the estate tax that was initiated in 2001. That repeal spent 10 years being phased in and was apparently going to be dead on arrival.

Yet bipartisan agreement that the estate tax should be restored did not translate into an agreement about how. As a result, the repeal took effect, and the reinstated estate tax arrived with transitional provisions to allow estates of decedents dying during 2010 to elect to apply the rules in effect in 2010 (with no estate tax and a carryover basis) or the estate tax and stepped-up basis that was reinstated for 2011 and 2012.

The time to make the election for 2010 decedents was extended several times, and the final deadline became January 17, 2012.

Tax Thresholds for 2012

SOCIAL SECURITY: After two years without any cost of living increase, Social Security benefits for 2012 rose by 3.6%.

Context: Gasoline prices peaked at more than \$4 per gallon in 2008 and fell to an average of \$2.50 per gallon in 2009. With lower energy costs, there was actually negative inflation, also known as deflation. As a result, there was no cost of living increase for Social Security payments in 2010 or 2011.

SOCIAL SECURITY WAGE BASE: The first \$110,100 of income is subject to Social Security tax withholding for 2012. This is up from \$106,800, which had applied for 2009 through 2011.

WITHHOLDING TAX HOLIDAY: A 2% tax holiday that applied to employees in 2011 was extended temporarily. An employee's share of withholding for Social Security taxes was reduced to 4.2% (instead of 6.2%) in 2011. The Temporary Payroll Tax Cut Continuation Act of 2011 temporarily extends the two percentage point payroll tax cut for employees through February 29, 2012. About 160 million workers are affected. Additional adjustments during 2012 are possible.

INCOME TAX BRACKETS: Tax cuts that were supposed to expire were extended at the end of 2010 and remain in effect for 2011 and 2012. As a result, similar income tax brackets that applied in 2010 (10%, 15%, 25%, 28%, 33%, and 35%) continue to apply in 2012 but with slight

upward adjustments for the specific dollar amounts. For example, married couples filing jointly reached the 25% bracket for income above \$69,000 in 2011, but that level is increased to \$70,700 in 2012. The top rate of 35% kicks in at \$388,350 (up from \$379,150) for unmarried individuals, as well as those married couples filing jointly.

TRUST INCOME TAXES: For estates and trusts, the income tax for 2012 ranges from 15% for amounts less than \$2,400 and 35% for amounts exceeding \$11,650 (up from \$11,350).

STANDARD DEDUCTION: The 2012 standard deduction for single persons is \$5,950, up from \$5,800, and for married couples filing jointly is \$11,900, up from \$11,600.

EXPATRIATES: For expatriation, the threshold limit for 2012 is an average of \$151,000 of net income tax for the five years prior to loss of citizenship, up from \$147,000 for 2011.

FOREIGN EARNED INCOME: The exclusion for foreign earned income for 2012 is \$95,100, up from \$92,900.

KIDDIE TAX: For 2012, a child's gross income must be more than \$950 but less than \$9,500 to be subject to the "kiddie tax." The alternative minimum tax exemption for a child for whom the "kiddie tax" applies under section 1(g) is \$6,950, up from \$6,800 last year.

TOP ESTATE TAX RATE: The top Federal estate tax rate for 2012 is 35%, the same as 2011. The tax had been repealed in 2010 and had previously had a top rate of 45% in 2009. If Congress fails to act, the estate tax will return in 2013 with a top rate of 55% and an additional 5% surtax for estates exceeding \$10 million, up to \$17,184,000.

ESTATE TAX EXEMPTION: With the return of the Federal estate tax, the exemption has also returned. However, the exemption is now larger and portable. The exemption is \$5 million for 2011 and will be indexed for inflation starting in 2012. The exemption is also portable, in that the unused portions of the exemption can be utilized by a surviving spouse.

GENERATION-SKIPPING TRANSFER TAX: The GST tax remains tied to the estate tax and therefore returned at a 35% top rate and a \$5 million exemption in 2011. The GST exemption rose to \$5,120,000 for 2012.

GIFT TAX: The annual gift tax exclusion remains at \$13,000 in 2012 for the fourth year in a row. An increase to \$14,000 in 2013 might be triggered if there is sufficient inflation during 2012. The lifetime exemption is \$5,120,000 for 2012 and is now unified with the estate tax.

IRA CONTRIBUTIONS: Maximum contribution limits for traditional IRAs for 2012 are limited to the lesser of compensation or \$5,000 or up to \$6,000 for "catch up" contributions of those age 50 or more. Deductibility of contributions is reduced for individuals earning more than \$58,000 and for married persons filing jointly with income exceeding \$92,000.

Sources: For 2012, see Rev. Proc. 2011-104, 2011-52, and 2011-12.

TRANSFER TAXES IN TRANSITION

2009	2010	2011	2012	2013
Top estate tax rate of 45%	Federal estate tax repealed	Top estate tax rate of 35%	Top estate tax rate of 35%	Potential reversion to top estate tax rate of 55%
Estate tax exemption of \$3.5 million	Estates of decedents dying in 2010 are able to elect to apply estate tax under 2011 rules	Estate tax exemption of \$5 million	Estate tax exemption adjusted to \$5,120,000	Estate tax exemption potentially reverts to \$1 million
No portability of exemption	No portability of exemption	Unused portion of exemption is “portable” for surviving spouse	Unused portion of exemption is “portable” for surviving spouse	Portability of exemption ends if 2001 rules are reinstated
Gift tax top rate is 45% with \$1-million lifetime exclusion (not coordinated with estate tax exclusion)	Gift tax top rate is 35% with \$1-million lifetime exclusion (not coordinated with estate tax exclusion)	Gift tax top rate is 35% with \$5-million lifetime exclusion that is coordinated with estate tax exclusion and portability provisions	Gift tax top rate is 35% with \$5-million lifetime exclusion that is coordinated with estate tax exclusion and portability provisions	Gift tax rate reverts to 55%, \$1- million exclusion is coordinated with estate tax and portability ends
\$13,000 annual gift tax exclusion	\$13,000 annual gift tax exclusion	\$13,000 annual gift tax exclusion	\$13,000 annual gift tax exclusion	\$13,000 annual gift tax exclusion (subject to ongoing COLA)
Stepped-up basis for capital gains at death	Carry-over basis for capital gains at death or stepped up basis if election is made	Stepped-up basis for capital gains at death	Stepped-up basis for capital gains at death	Stepped-up basis for capital gains at death

Voices of 2011

Many well-known people departed in 2011. Here is a look back at selected quotes.

“It’s more fun to be a pirate than to join the navy.” —Steve Jobs (1982)

“I wanted an electric train for Christmas but I got the saxophone instead.” —*Clarence Clemons*

“Just win, baby.” —*Al Davis, owner Oakland Raiders*

“The federal government has sponsored research that has produced a tomato that is perfect in every respect, except that you can't eat it. We should make every effort to make sure this disease, often referred to as ‘progress,’ doesn't spread.” —*Andy Rooney*

“Being the richest man in the cemetery doesn't matter to me ... Going to bed at night saying we've done something wonderful... that's what matters to me.” —*Steve Jobs (1993)*

“I had my Olympic gold medal cut up into 11 pieces. Gave all 11 of my kids a piece. It'll come together again when they put me down.”—*Joe Frazier*

“I've learned that everyone wants to live on top of the mountain, but all the happiness and growth occurs while you're climbing it.” —*Heavy D, rapper*

“Yesterday's the past, tomorrow's the future, but today is a gift. That's why it's called the present.” —*Bil Keane, cartoonist and creator of Family Circus*

“Please, don't stop throwing those balls. Because that's so important. That's why daddies bring their little boys to the ballgame is for memories like that. Please don't stop.” —*SuZan Stone, mother of 39-year-old Shannon Stone, writing to Josh Hamilton, who threw the ball that led to her son's tragic accident*

“If we are to change our world view, images have to change. The artist now has a very important job to do. He's not a little peripheral figure entertaining rich people, he's really needed.” —*Vaclav Havel*

“Your time is limited, so don't waste it living someone else's life. Don't be trapped by dogma— which is living with the results of other people's thinking. Don't let the noise of others' opinions drown out your own inner voice. And most important, have the courage to follow your heart and intuition. They somehow already know what you truly want to become. Everything else is secondary.” —*Steve Jobs (2005)*