

The 2013 Estate Tax: Where We Landed

Estate tax law for 2013 has been rewritten but remains largely the same as it was in 2012. This article summarizes the provisions of the Estate Tax law after the most recent revision.

Summary

The estate tax law is now made “permanent” in the Internal Revenue Code. The terms of that tax of interest to most Americans may be summarized as follows:

- Each individual taxpayer may exclude up to \$5.12 million in assets
- Eligible spouses may “stack” the exclusion amount up to \$10.24 million
- Establishes tax rates escalating to a top rate of 40%
- Three new tax brackets are added

The 2013 Version of the Estate Tax Law

For the most part, the revised Estate tax law “lands” pretty close to where we started. The terms of the law in effect in 2012 is continued, with a few important differences.

The Similarities. There are many similarities between previous law and the current version of Estate Tax law. In 2013, individual taxpayers may exempt up to \$5.25 million in assets from the Federal Estate Tax. This figure is up from the \$5.12 million exemption provided in 2012. This exclusion alone effectively liberates roughly 98% of the populace from paying estate taxes. The exclusion amount will continue to be adjusted annually for inflation, which in all likelihood means the exclusion amount will continue to increase.

The exclusion is even higher for married couples, who may “stack” their individual exclusions to effectively exempt \$10.5 million from the Estate Tax in 2013. Not only that, the exclusion remains “portable” between a husband and wife. This means that the amount of exclusion that was not used by the first spouse when he or she died may be used by the second spouse to die without having to set up trusts or the like to transfer the exclusion.

Perhaps an example is in order. Let’s say the husband dies first in 2013 with an estate of \$1.5 million. The husband would then have “unused” exemption of \$3.75 million. That unused exemption is automatically transferred to his wife, whose estate will now enjoy a combined Estate Tax exclusion of \$8 million upon her death. That exclusion will be adjusted annually by the statutory inflation adjustment.

As before, transfers between spouses remain free of Estate Tax regardless of the value of the property which is transferred.

Under the new law, the Federal gift tax exemption remains the same as the Federal Estate Tax exclusion amount. This means an individual may make gifts during his or her lifetime equal to the exclusion amount without paying gift tax. The amount of those gifts, however, will reduce the exemption amount available upon the death of the person making the gifts.

The Differences. There are some important differences in the 2013 version of Estate Tax law as compared to 2012. The current law is now made “permanent.” Now, permanence does not mean the same thing in Washington D.C. as it does for the rest of us. Congress and the President could still change the law tomorrow, or next year; the law is not “permanent” in that sense. In this case, permanent means that for the first time in 10 years, the Estate Tax law will not automatically change if Congress fails to act.

The 2013 Estate Tax law adds three tax brackets and increases the maximum tax rate to 40% (up from 35%). No, this is not what made the law “permanent” but it is close.

Another important distinction for the 2013 version of the Estate Tax law is that the exemption amount will be disregarded for purposes of determining the tax rate. (In “tax-speak,” the “tax is computed prior to the estate tax exemption.”) This means anyone whose estate is large enough to pay Federal estate taxes will pay 40% on the first dollar; the lower tax brackets will not apply.

What This Means for You

The compromise struck in Washington D.C. is good news for the vast majority of tax-paying Americans. Most citizens will continue to be untouched by the Federal Estate Tax because the exemption amount is so high they do not even have to plan for it. These people can retain their focus on the non-tax reasons for estate planning, many of which are reviewed in our Article “Reasons to Sign up an Estate Plan.”

This development is not as beneficial for those with estates large enough to incur the Estate Tax. First and foremost, the Estate Tax rate is effectively increased to 40% on the first taxable dollar, and remains at that level until the last dollar is accounted for. Secondly, people in this category must more fully consider their alternatives, such as lifetime gifts and transfers, asset planning, and whether to resort to other planning devices which effectively transfer some of their assets so as to avoid the Estate Tax. In a real sense this is a good problem to have, but it is a matter which must be diligently and continuously attended to nonetheless.

The good news for everyone is that the roller coaster ride is over. The Estate Tax law is no longer subject to automatic revision, but rather those amendments which may occur according to the ordinary political ebb and flow.