FREDERICK J. TANSILL & ASSOCIATES
Since 1997
Attorneys and Counselors at Law
A Limited Liability Company
6723 Whittier Avenue
Suite 104
McLean, Virginia 22101
(703) 847-1359
email: fred@fredtansill.com **FAX: (703)847-1357**

Visit our website at www.fredtansill.com

MARCH 2013 NEWSLETTER

FEDERAL TRANSFER TAX (ESTATE, GIFT, GENERATION SKIPPING TRANSFER TAX-"GST") EXEMPTIONS REMAIN UNCHANGED FROM 2012, SUBJECT TO INFLATION ADJUSTMENT TAX RATE INCREASED TO 40%

	2012 Exemption	Tax Rate	2013 and Future Exemption *	Tax Rate
Gift tax	$5,120,000	*35%*	$5,250,000	*40%*
Estate tax	$5,120,000	*35%*	$5,250,000	*40%*
GST Tax	$5,120,000	*35%*	$5,250,000	*40%*

*Will be inflation adjusted each future year. Based on the formula for escalation, some have speculated that by 2020 the exemption may be $7.5 million per individual/$15 million per couple.

Recall that if Congress had done nothing, the exemptions would have shrunk dramatically and the tax rate would have risen to 55%. So the American Taxpayer Relief Act of 2012 ("ATRA") reflected as to transfers taxes a win, an unexpectedly good outcome for all taxpayers. Recall that only 10 years ago, in 2003, these exemptions were only $1 million. Not only are the exemptions going to increase indefinitely, and there is no scheduled sunset on the ever-expanding exemptions or on the relatively favorable 40% tax rate, but also portability of the estate and gift tax exemptions has been made a feature of the transfer tax system indefinitely.

Portability of Estate and Gift Tax Exemptions:

Going forward the unused portion of a deceased spouse's estate and gift (but not GST) tax exemptions accrue to the benefit of the surviving spouse, who may use them. This is known as "portability."

TRAP FOR THE UNWARY! As a condition of portability, a Federal estate tax return must be filed at the first spouse's death, expressly electing portability, even if no federal estate tax return would otherwise be required. However the Federal estate tax return requirements have been somewhat ameliorated for these reporting purposes.

Query: It is easy to imagine that in many cases the surviving spouse will forget the requirement to file the federal estate tax return or will conclude that it is too much trouble or too expensive to do so, and may believe that the survivor's estate (and gift) tax exemption will be sufficient to avoid estate tax at the survivor's death. Inevitably, in some cases unexpected inheritance or other windfall or appreciation of the surviving spouse's assets will push the survivor's estate into taxable territory. So, to be safe, would it not be prudent to file a federal estate tax return in many or most situations when the first spouse dies and to elect portability, just in case?

While portability is a welcome development, we believe that in most cases couples whose combined estates are at or near the federal estate tax exempt amount (or at or near the state estate tax exempt amount in the case of DC and Maryland residents) should continue to employ either a traditional bypass trust or a "standby" disclaimer trust (discussed further below). There are several reasons for this, some of the most important of which are stated below. First, when a bypass or disclaimer trust is funded at the first spouse's death, the full value of the trust assets, regardless of how much that value appreciates from the first spouse's death to the survivor's death, is excluded from the surviving spouse's estate for tax purposes, whereas portability shelters only the exemption amount that the deceased spouse did not use, with no indexing for inflation. Second, portability may be adversely impacted in some cases by the surviving spouse's remarriage, but remarriage has no effect on the tax benefits of a bypass or disclaimer trust. Third, assets held in a bypass or disclaimer trust should be protected from the claims of the surviving spouse's (and other beneficiaries') creditors; portability affords no such protection. And finally, the GST tax exemption is not portable, so couples with larger estates who wish to make use of both of their GST exemptions must do so by creating appropriate trusts in their estate planning documents.

STATE ESTATE TAX

Virginia - has no estate or gift tax.

Maryland - has an estate tax but no gift tax, recognizes unlimited marital and charitable deductions, has a $1 million exemption for assets passing to anyone other than a spouse or charity. The amount of the tax is calculated based on the old federal credit for state death taxes (which no

longer exists for federal estate tax purposes), and is approximately 10% of the value of the taxable estate in excess of $1 million.

District of Columbia - has an estate tax but no gift tax, recognizes an unlimited marital and charitable deductions, has a $1 million exemption for assets passing to anyone other than spouse or charity. The amount of the tax is calculated based on the old federal credit for state death taxes (which no longer exists for federal estate tax purposes), and is approximately 10% of the value of the taxable estate in excess of $1 million.

RECONSIDER YOUR EXISTING ESTATE PLANNING

Virginia Residents

As noted above, Virginia has no estate or gift tax, and thus Virginia residents only need to concern themselves with the federal transfer tax regime. Most married couples in Virginia whose combined estates are at or below the current federal estate tax exemption of $5.25 million (and are not likely to exceed that amount in the future) can have fairly simple documents (e.g., all to the surviving spouse at the first death, all to the children outright or in trust at the second death) with no transfer tax planning. Those couples whose combined estates are currently less than the federal exemption but might exceed it in the future can consider a fairly simple "standby" tax plan in which the entire estate passes to the surviving spouse at the first spouse's death, but the survivor has the option to disclaim all or some portion of his or her inheritance into a trust for the benefit of the survivor (and/or the children) if it proves necessary to utilize all or some portion of the predeceased spouse's exemption. Thus, many Virginia couples who signed documents containing traditional "bypass trust" tax planning a few years ago when the exempt amount was much smaller may now be able to simplify their estate plans if they wish to do so.

Maryland and DC Residents

Because Maryland and DC residents are subject to two estate tax regimes with differing exemption amounts (a state exemption of $1 million and a federal exemption of $5.25 million and growing), their estate planning is unfortunately, but necessarily, more complicated. (We also note that Maryland imposes a separate inheritance tax on inheritances received by persons who are not close relatives, but this will not affect most people.)

Married residents of Maryland and DC whose combined estates are worth $1 million or more (or are likely to reach that level in the future) should utilize bypass trust or disclaimer trust planning in order to take advantage of the first spouse's state estate tax exemption and thus minimize the state taxes due at the survivor's death.

Maryland and DC couples whose combined estates are worth $5.25 million or more (or are likely to reach that level in the future) will also typically wish to take advantage of the first spouse's

federal estate tax exemption in order to minimize the federal estate tax due at the survivor's death. In Maryland, it is possible through the use of one or more trusts to structure a couple's estates in such a way as to take full advantage of both spouses' state and federal tax exemptions and defer all state and federal taxes until the survivor's death. In DC however, it is not possible to take full advantage of the federal estate tax exemption available to the predeceased spouse without paying substantial DC estate tax at his or her death. This presents DC residents with a quandary to which there is no perfect solution. Some couples may prefer to defer all estate taxes, DC and federal, until the surviving spouse's death and rely on portability to get some (but as discussed above, not all) of the advantages of the predeceased spouse's federal exemption. Others may prefer to pay DC tax at the first death in order to take maximum advantage of the first spouse's federal exemption. Which choice is best for a particular couple depends on numerous factors including the size of their estate, their ages, their tolerance for complexity in order to save taxes, and the likelihood that the surviving spouse will continue to reside in DC for life.

In light of these complexities, and the increasing divergence between the DC and Maryland exemptions on the one hand, and the federal exemption on the other hand, we encourage all DC and Maryland residents to revisit their estate plans to see if they are still appropriate for today's transfer tax regimes.

Now that the federal estate tax is settled for the foreseeable future, and there is no indication of impending changes in estate taxation in Virginia, Maryland and D.C., should you restructure your estate plan? If you remain single since we last prepared documents for you, there should probably be no tax reason to change your documents.

GIFT TAX ANNUAL EXCLUSION

For 2013 the exclusion has been increased to $14,000 per donee (from $13,000 in 2012). So a couple with three children and four grandchildren may give away $28,000 to each child and $28,000 to each grandchild, for a total of tax-free annual gifts of $196,000 that do not use up any estate or gift tax exemptions. Recall that payments made directly to a service-provider for another party's (child's, grandchild's, or any person's) education or medical care are not considered gifts and therefore do not use any gift tax annual exclusion or lifetime gift-tax exemption.

STEP-UP IN INCOME TAX BASIS AT DEATH

Under the new law effective for taxpayers dying in 2013 and thereafter, inherited assets will receive in the hands of the inheriting party a new (generally stepped-up) income tax basis at fair market value on date of death, as generally under prior law. On the other hand, assets received by lifetime gift have a carryover income tax basis of the asset in the hands of the recipient identical to the basis in the hands of the donor, as generally under prior law.

FEDERAL GIFT TAX RETURNS FOR LARGE GIFTS IN 2012 DUE BY APRIL 15, 2013 (or extended filing date for income tax returns)

For those of you who made large gifts - - above $13,000 to any donee - in 2012, do not forget to report the gift on a Federal gift tax return, Form 709, which is due by the deadline for filing your personal income tax return. We can help you with this return if you like.

OTHER ESTATE PLANNING CONSIDERATIONS IN POST-ATRA WORLD

There is as much reason to use the $5.25 million gift tax exemption in 2013 as there was in 2012. The financial planning world was in an uproar in late 2012 because of the fear that the opportunity to make large gifts would go away, but if did not. So it is worth reflecting on why large gifts seemed like a good idea in 2012, and are still a good idea early in 2013.

* Sheltering from the future estate tax future appreciation on assets given away.
* There is a concern that (a) in the continuing budget resolution debates in March, or (b) in the debt ceiling debate scheduled for April - May, certain tax-advantaged estate planning techniques could be eliminated or curtailed in pursuit of President Obama's goal to find more revenue. The techniques at risk could include:
  - GRATs (10 year minimum may be imposed.)
  - Valuation discounts for gifts and estates, e.g., for fractional LLC interests.
  - Perpetual generation-skipping transfers may be limited, e.g. to 90 years.
  - Grantor trust tax planning, for instance, intentionally defective grantor trusts (IDGTs) might be included in the settlor's taxable estate.
* Gifts made before any tax law change may be grandfathered.
* Another $130,000 has been added to the lifetime gift tax exemption in 2013.

HEALTH CARE TAX CHANGES

In 2013

Dividend Income Rates

The Bush tax cuts created the concept of "qualified dividend income," which currently allows dividends received from domestic corporations and certain foreign corporations to be taxed at the taxpayer's long-term capital gain rate. Prior to this, all dividend income was taxed as ordinary income. If Congress fails to extend these provisions, the qualified dividend income provisions will expire, and all dividends will once again be taxed as ordinary income. Most notably, taxpayers in the highest marginal income tax bracket who currently enjoy the 15 percent rate on qualified dividend income will be taxed at 39.6 percent for dividends received from the same issuer in 2013. Further, the 3.8 percent Medicare contribution tax discussed below will increase the effective rate of tax on dividend income for certain higher-income taxpayers to as high as 43.40 percent. The following table sets forth the scheduled rate increases.

Maximum Rates	2012	2013	2013 (including Medicare contribution tax)
Qualified Dividend Income	15%	39.6%	43.4%
Ordinary Dividend Income	35%	39.6%	43.4%

New Medicare Contribution Tax

The Supreme Court upheld "Obamacare." In the majority opinion chief Justice Robert wrote "The federal government does have the power to impose a tax on those without health insurance."

A new 3.8% Medicare contribution tax on certain unearned income of individuals, trusts, and estates took effect in January, 2013. This provision was enacted as part of the Affordable Care Act. For individuals, the 3.8% tax is imposed on the lesser of the individual's net investment income or the amount by which the individual's modified adjusted gross income (AGI) exceeds certain thresholds ($250,000 for married individuals filing jointly or $200,000 for unmarried individuals). For purpose of this tax, investment income includes interest, dividends, rental income, annuities, royalties, income from trades or businesses that are passive activities or that trade in financial instruments and commodities, and net gains from the disposition of property held in a trade or business that is a passive activity or that trades in financial instruments and commodities. Investment income excludes distributions from qualified retirement plans and excludes any items that are taken into account for self-employment tax purposes. The tax does not apply to non-resident aliens.

Other Changes

The employee portion of the hospital insurance payroll tax (Medicare) will increase by 0.9 percent (from 1.45% to 2.35%) on wages over $250,000 for married taxpayers filing jointly and over $200,000 for other taxpayers. The employer's portion of this tax remains 1.45 percent for all wages. This provision was also enacted as part of the Affordable Care Act.

Also part of the Affordable Care Act, the threshold for claiming the itemized medical and dental expense deduction is scheduled to increase from 7.5 to 10% of AGI. The 7.5% threshold will continue to apply through 2016 for taxpayers (or spouses) who are 65 and older.

In 2014

Everyone must have health insurance or pay a tax - $95 or 1% of income, whichever is higher.

Businesses with more than 50 full time employees must provide health insurance coverage to all employees. The rules here are very intricate.

State-sponsored health insurance exchanges become available. Adults with pre-existing conditions cannot be denied coverage or have their insurance canceled because of pre-existing conditions.

In 2015

If you do not have health insurance, the tax rises to the greater of $325 or 2% of income.

PERSONAL INCOME TAX CHANGES FOR 2013

Overview, General Income Tax Rates

Under ATRA the Bush-era tax rates are permanently extended for most taxpayers. In general, and subject to the new health care tax discussed above, individuals with taxable income under $400,000 ($450,000 for joint filers) will continue to receive the benefit of the Bush tax cuts. However, a top rate of 39.6% - - the highest rate under President Clinton and President George H. W. Bush - - will be effective for individuals with taxable incomes above these amounts.

Capital Gains/Qualified Dividend Tax Rates

A top rate of 20% for long term capital gains and qualified dividends applies to individuals with taxable incomes above $400,000, and joint filers with taxable income above $450,000.

Long term capital gains and qualified dividends will continue to be taxes at 15% permanently for taxpayers with taxable incomes below these amounts.

Trusts and Estates

Trusts and estates are subject to the 39.6% rate on ordinary income and the 20% rate for long term capital gains and qualified dividends at just $11,950 of taxable income. The 3.8% medicare surtax is imposed on certain taxes of investment income of trusts and estates with modified adjusted gross income above $11,950.

Personal Exemption Phase-Out

The personal exemption phase-out has been reinstated beginning in 2013 for single filers with adjusted gross income above $250,000 ($300,000 for joint filers).

"Pease" Limitation on Itemized Deductions

The "Pease" provision phases out itemized deductions by the lesser of 3% of adjusted gross income or 80% of otherwise allowable deductions. Not all deductions are phased out. Home mortgage interest, taxes and charitable deductions ARE subject to the phase-out, but not medical and dental and some others. This limitation does NOT apply to trusts and estates.

The following chart demonstrates the cumulative impact in 2013 of the tax increases for taxable incomes above $400,000 single/$450,000 joint:

	Wage Income	**Interest Income**	**Dividends**	**Long Term CapitalGains**
Top Rate	*41.05% **	*39.6%*	*20%*	*20%*
Phase-out of itemized deductions **	*1.2%*	*1.2%*	*1.2%*	*1.2%*
Medicare Tax	*.9%*	*3.8%*	*3.8%*	*3.8%*
Combined top rate	***43.15%***	***44.6%***	***25%***	***25%***

* includes 1.45% employee share of Medicare tax (an additional 1.45% applies to self-employed)
** estimated by Price Waterhouse Coopers

Individual Retirement Accounts

For 2013 only (for now) individuals may make tax-free gifts to charity up to $100,000 from traditional or Roth IRAs.

WHAT FURTHER INCOME TAX CHANGES DOES THE FUTURE HOLD?

President Obama has been adamant that he wants to "close tax loopholes." What might he have in mind?

- 20% capital gains tax treatment of "carried interest" in private equity and hedge fund investments. (Even Peggy Noonan, Wall Street Journal editorial page contributor and speech writer for Ronald Reagan, has called for closure of this "loophole.")
- Itemized deductions. There have been a number of proposals to eliminate or curtail specific itemized deductions or to cap the maximum amount of itemized deductions that may be claimed by a taxpayer, e.g. to an amount less than $50,000 in a calendar year. This was proposed by Mitt Romney and endorsed by Republican leadership.

The Washington Post reported in a recent front page story that trade associations and corporations have been very active in hiring tax lobbyists anticipating a substantial rewrite and reform of the Internal Revenue Code in 2013. The Senate Budget Committee recently passed a budget resolution proposing substantial tax increases. Of course, the Republican controlled House has been adamant that it will not approve any tax increases. So we will wait and see what happens, but the momentum for tax reform is strong in both parties, and even if it is revenue neutral, there will be winners (whose tax goes down) and losers (whose tax goes up).

Review of Your Situation

If you would like us to review the desirability of any changes or additions to your estate plan in light of the recent tax law changes, please contact us to set up an appointment.

Frederick J. Tansill, Owner/Manager
(703) 847-1359
fred@fredtansill.com

Cynthia L. Brown, Counsel
(703) 288-0121
cindy@fredtansill.com

Brooke C. Tansill, Associate
(703) 288-0126
brooke@fredtansill.com

Nivin Joudeh, Office Manager/Sr. Paralegal
(703) 288-0119
nivin@fredtansill.com