SELECTED HIGHLIGHTS OF THE AMERICAN TAXPAYER "RELIEF" ACT OF 2012 (OR 2013)?

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As everyone has heard by now, perhaps in a desperate attempt to not miss all of the bowl games on New Year's Day 2013, Congress finally acted in the "13th hour" to pass the American Taxpayer Relief Act of 2012 ("ATRA 2012"). I suppose it could be said that the "Bush tax cuts" of 2001 "expired" for about half a day, but because the compromise "relief" was actually such a welcome respite from the series of "kick the can down the road" temporary tax laws filled with one and two-year extensions and sunsets that have characterized the last decade-plus of tax legislation, no one really cared. And because Congress was still "in session," their action was "retroactive" without having to say so. Thus, at least in the modified space-time continuum universe of federal tax law as memorialized in the Senate Bill 112, Tuesday, January 1, 2013 will be forever known as "legislative day, December 30, 2012." President Obama signed ATRA 2102 into law on Wednesday, January 2, 2013 using the autopen while on vacation in Hawaii.

This latest congressional effort has at last brought the prospect of real tax "permanence" to what has been an unsettled area of the law for 12 years. These changes are sweeping in breadth if not earth-shaking in depth, as they will affect almost every American taxpayer in some way except those at the very lowest end of the economic spectrum. As will be noted later, real tax "permanence" is not really likely, particularly on the income tax side, but at least future change will for the most part require affirmative intentional effort by Congress as opposed to patches and extensions.

I. Significant Income Tax Provisions

A. Individual Income Tax Rates

1. The federal income tax rates enacted under the Bush tax cuts are made permanent for all tax brackets under the 35% bracket. The 35% tax bracket is retained for all taxpayers (except trusts and estates) to the extent taxable income does not exceed $450,000 for joint filers, $425,000 for head of household filers, and $400,000 for single filers. Above these "applicable thresholds" (which will be indexed for inflation), the tax bracket will be 39.6%.

2. A chart of the most relevant tax brackets follows:

<table>
<tr><th colspan="7">Individual Income Tax Rates for 2013</th></tr>
<tr><th colspan="2">Taxable income</th><th rowspan="2">Ordinary income and Short-term Capital Gains</th><th rowspan="2">Dividends and Long-term Capital Gains</th><th colspan="2">Medicare</th></tr>
<tr><th>Single</th><th>Joint</th><th>Earned income</th><th>Net Investment Income
(“NII”)</th></tr>
<tr><td>Up to $8,925</td><td>Up to $17,850</td><td>10%</td><td rowspan="2">0%</td><td rowspan="5">2.9%</td><td rowspan="5">0%</td></tr>
<tr><td>$8,926-$36,250</td><td>$17,851 - $72,500</td><td>15%</td></tr>
<tr><td>$36,251 -$87,850</td><td>$72,501 - $146,400</td><td>25%</td><td rowspan="5">15%</td></tr>
<tr><td>$87,851-$183,250</td><td>$146,401-$223,050</td><td>28%</td></tr>
<tr><td>$183,251-$200,000</td><td>$223,050-$250,000</td><td>33%</td></tr>
<tr><td>$200,000-$398,350</td><td>$250,000-$398,350</td><td>33%</td><td rowspan="3">3.8%</td><td rowspan="3">3.8%</td></tr>
<tr><td>$398,350-$400,000</td><td>$398,351-$450,000</td><td>35%</td></tr>
<tr><td>$400,000 and up</td><td>$450,000 and up</td><td>39.6%</td><td>20%</td></tr>
</table>

B. Payroll Tax Holiday expiration

The one item not in ATRA 2012 which still creates a 2013 tax increase on nearly all taxpayers is the ending of the payroll tax holiday. For taxpayers with income under the Social Security limit, this results in a 2 percent decrease in their net take home pay. The payroll tax holiday was originally enacted for 2011 and extended into 2012 to spur spending in the economy. After two years of a payroll tax holiday, many taxpayers will feel the expiration of this benefit more than any other provision in ATRA 2012.

C. Medicare surtax begins in 2013

1. Passed as a new tax to help pay for “Obamacare,” as a part of the Health Care and Education Reconciliation Act of 2010, for tax years beginning on

and after January 1, 2013, there is now an additional Medicare tax on earned income and net investment income, further increasing the effective tax rates for those making more than $250,000 for joint filers ($200,000 for single) - and those amounts are currently NOT indexed for inflation. The Medicare tax applies to the lesser of a taxpayer's NII or their modified adjusted gross income ("MAGI") in excess of these levels.

a. The earned income portion of the additional Medicare tax is a 0.9 percent surtax on wages and self-employment income in excess of those levels. Employers will be required to withhold this amount if their employee's income exceeds $200,000.

b. The net investment income ("NII") portion of the additional Medicare tax is a 3.8 percent surtax on three (3) categories of gross income reduced by deductions properly allocable to such income:

   (1) Gross income from interest, dividends (qualified and nonqualified), annuities, royalties, rents, substitute interest payments, substitute dividend payments, and income from passive activities, unless such income is derived in the ordinary course of a trade or business that is neither:

      (a) A passive activity with respect to the taxpayer, nor

      (b) A financial instrument or commodities business.

   (2) Other gross income derived from a trade or business that is either: (1) a passive activity with respect to the taxpayer or (2) a financial instruments or commodities business; and

   (3) Net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property except to the extent the gain is from the sale of property held in an active trade or business other than a financial instruments or commodities business.

c. The 3.8 percent additional Medicare tax on NII is payable with the filing of the return or through the remittance of estimated tax payments. Of course, taxpayers can use the prior year safe harbors for estimated tax purposes applicable to their income levels.

d. The additional Medicare tax applies in addition to the alternative minimum tax ("AMT").

e. Proposed regulations explain some of the additional Medicare tax provisions. Of these, perhaps the most important for high income taxpayers is the opportunity to make a "fresh start" grouping election in order to determine material participation under Section 469. Thus, to the extent income producing activities can be grouped together and deemed to be non-passive, taxpayers could save the additional Medicare tax on this amount.

2. For high-income ("HI") taxpayers making over $450,000, there are now effectively several different marginal tax rates that will apply depending on the type of income:

Type of Income	Marginal Income Tax	Add'l Medicare Tax Rate	Combined Marginal Tax Rate
Wages, Self-Employment Earnings	39.6%	0.9%	40.5%
Interest, Rents, Royalties, Annuities, Passive Income, Short-Term Capital Gains	39.6%	3.8%	43.4%
Qualified Dividends, Long-Term Capital Gains	20%	3.8%	23.8%
Non-passive Income, Tax Refunds, Retirement Distributions, Unemployment Compensation, SSI	39.6%	0%	39.6%
Long-Term Capital Gains related to Non-passive Income	20%	0%	20%

D. Phase-out of Personal Exemptions and Itemized Deductions

1. The former personal exemption phase-out and itemized deduction phase-out (the "PEP" and "Pease" limitations, respectively) are reinstated starting in 2013, affecting taxpayers reporting MAGI over $300,000 for joint filers, $275,000 for HoH filers, and $250,000 for single filers. These thresholds will be adjusted annually for inflation.

2. The Pease limitation reduces the amount of certain itemized deductions by three percent (3%) of the amount of a taxpayer's income that exceeds the threshold amount, up to a ceiling of eighty percent (80%) of their itemized deductions.

3. The PEP phaseout applies to the same taxpayer income thresholds as the Pease limitation, and it is possible for higher income taxpayers to completely lose the benefit of their personal exemptions. The personal exemption for 2013 is $3,900. Complete PEP phaseout will apply at $422,501 for joint filers, $372,501 for single filers, $397,501 for HoH filers, and $211,251 for married filing separately filers.

E. Capital Gains and Qualified Dividends

1. Under ATRA 2012, long-term capital gains and qualified dividends for taxpayers who are not in the 39.6% ordinary income tax bracket will continue to be subject to a 15% tax rate (0% for taxpayers in the 10% or 15% ordinary income tax brackets). "Qualified dividends" included any dividends from a domestic corporation, qualified foreign corporation or mutual funds, partnerships, REITs or common trust funds passing through

dividends from either domestic or qualified foreign corporations (but not "dividends" from a money market or bond mutual funds which are actually paying interest from the underlying securities.

2. For joint filers that exceed the applicable threshold ($450,000 for joint filers and $400,000 for single filers) and are, therefore, in the 39.6% marginal tax bracket, will be subject to a federal tax rate of 20%.

F. Alternative Minimum Tax "Patch"

1. The AMT exemption amount for 2012 is set at $78,750 for joint filers, $50,600 for single filers, and $22,500 for estates and trusts. The exemption amount is made permanent and will be automatically indexed for inflation from the 2012 levels. For 2013, the AMT exemption amount is $80,800 for joint return filers, $51,900 for unmarried individuals, and $23,100 for estates and trusts.

2. The AMT exemption is also subject to a "phase-out for higher-income taxpayers. The exemption will continue to be reduced by an amount equal to 25% of the amount that AMT income exceeds $150,000 for joint filers and $112,500 for single filers. This means that the AMT exemption is fully phased out once AMT income reaches $465,000 for joint filers and $314,900 for single filers. For 2013, these thresholds are $153,900 for joint filers and $115,400 for single filers.

G. Extender and miscellaneous items of special interest

1. Notwithstanding the earlier comments on tax permanence, there are <u>numerous</u> targeted impact provisions that were extended for <u>temporary</u> periods. These are the most notable for estate planners:

a. Direct tax-free IRA contributions to charity by taxpayers over age 70½ are extended **<u>for 2013 only</u>**. Maximum amount is $100,000.

b. Conservation contributions of capital gain real estate.

(1) Effective for contributions made in taxable years beginning after 2005 and before 2012 (by 2010 extension), §170(b)(1)(E), as added by the Pension Protection Act of 2006 (2006 PPA), allowed an individual to deduct any §170(h)(1) qualified conservation contributions to the extent the aggregate of such contributions does not exceed **<u>50%</u>** of the individual's contribution base over the amount of all other charitable contributions allowable under §170(b). Qualified farmer's or rancher's deduction is allowable up to **<u>100%</u>** of their contribution base. The applicable carryover period for excess qualified conservation contribution deductions was also extended

from 5 years to 15 years. ATRA 2012 further extends these contribution limitations and carryover periods for contributions of conservation property made in taxable years beginning **on or before December 31, 2013**.

2. ATRA 2012 expands the ability for employees to convert traditional retirement accounts (like 401(k) or 403(b)s) into Roth accounts. Conversion is now allowed for distributions from these accounts to be moved directly into an employer-offered Roth account, regardless of whether the taxpayers separated from service, reached age 59-1/2, died or became disabled or received a qualified reservist distribution.

3. ATRA 2012 also makes permanent a handful of technical provisions enacted in 2001, related to the allocation of GST exemption, the GST inclusion ratio, conservation easements, and the extension of time to pay estate tax under Section 6166.

II. Fiduciary income taxes

A. In general, trusts and estates are taxed much like individuals. The most significant difference occurs where the trust or estate makes distributions to beneficiaries, in which case the trust or estate deducts the distribution which typically draws out the fiduciary income to the extent it exists (termed "distributable net income" ("DNI"), and causes the beneficiary to be taxed on it instead.

B. The other enormously significant difference from individuals is the extreme income tax bracket compression that trusts and estates are subject to with respect to their undistributed income. For 2013, a fiduciary is in the maximum marginal rate bracket at $11,950 of income, compared to $400,000 single filers/$450,000 joint filers for individuals.

C. Bracket chart below:

Fiduciary Income Tax Rate Brackets for 2013

Taxable income	**Ordinary income and Short-term Capital Gains**	**Dividends and Long-term Capital Gains**	**Medicare** **Net Investment Income ("NII")**
$0 to $2,450	15%	0%	0%
$2,450 to $5,700	25%	15%	
$5,700 to $8,750	28%		
$8,750 to $11,950	33%		
N/A	~~35%~~		
$11,950 and up	39.6%	20%	3.8%

D. Estates and trusts are subject to the Medicare tax, imposed on the <u>lesser</u> of: (1) undistributed net investment income, or (2) the excess of the estate or trust's adjusted gross income over the dollar amount at which the highest tax bracket begins. Because the highest tax bracket for estates and trusts begins at a relatively low level of income ($11,950 for 2013), the Medicare tax is of particular concern to them.

E. As normally the case with Subchapter J income (with the notable general exception of capital gains), the Medicare tax applies only to the <u>undistributed</u> NII of an estate or trust. Thus, if a fiduciary makes a distribution to beneficiaries, the undistributed NII (and potential liability for the Medicare tax decreases, while the beneficiary's NII (and potential liability for the Medicare tax) increases. However, because the threshold amount for individuals is much higher than the threshold amount for estates and trusts, for all but those situations where the beneficiaries are in the maximum income tax brackets, a distribution will in all likelihood reduce the overall amount of Medicare tax paid.

III. Estate, Gift, and Generation-Skipping Taxes

A. ATRA 2012's "biggest" news (and perhaps a bit of a surprise) was the permanent adoption of the recent unified exemption level of $5 million from its 2010 level, indexed for inflation since 2011. The inflation adjustment made the exemption $5,120,000 in 2012, and now makes it $5,250,000 in 2013. Again, for the first time in 12 years, there is no scheduled expiration or "sunset" of the exemption.

1. Significantly, the $5,250,000 exemption is unified in amount across all three of the federal transfer taxes. Thus, every US resident taxpayer has an exemption sufficient to transfer and exempt $5,250,000 of gifts, generation-skipping transfers, and transfers by decedents dying in 2013.

2. But for ATRA 2012, this unified exemption amount would have dropped from $5,120,000 to $1,000,000, prompting unusual worry for many, and feverish significant gifting on a scale perhaps never witnessed in the United States late in 2012 by those who feared this most obvious "poster child" of the perfect storm of a triumvirate of tax provision sunsets, budget negotiations, and automatic spending cuts dubbed the "fiscal cliff."

3. This change, if left alone, especially coupled with "portability" of the exemption discussed in detail below, has effectively exempted all but the most wealthy Americans from exposure to the federal transfer tax system.

B. Interestingly, the only transfer tax rate/system change from 2012 estate tax law was the adjustment of the estate, gift and GST tax rate to a 40 percent maximum rate, applicable to a taxable estate or cumulative gifts of $1 million.

1. The 40 percent gift tax rate translates into a 28.57 percent tax-exclusive rate (if the donor survives for three years after the gift).

2. State estate taxes continue to be deductible in calculating the federal taxable estate. Thus for the majority of states, the 40% federal estate tax will be the only estate tax rate above the exemption level because those state either have no estate tax of their own, or have a state estate tax "coupled" to the old federal state death tax credit which no longer applies.

C. There is no Virginia estate tax for decedents whose death occurred on or after July 1, 2007. Virginia also has no gift, generation-skipping or inheritance taxes.

D. The federal annual exclusion amount for gift tax purposes is $14,000 for 2013 by virtue of its applicable inflation adjustment.

E. The permanence of ATRA and the full retention of the exemption levels of the 2010 Tax Act totally erased fears of the much-talked about "clawback" of avoided gift taxes from transfers exempted at high exemption levels upon a later death when a much lower exemption might be in effect.

IV. Portability

A. A new concept first enacted in the 2010 Tax Act is that of "portability," or the ability of a first spouse to die to effectively "pass" their unused unified exemption amount to their spouse. This effectively means that even with a lack of any transfer tax planning and death with a "sweetheart" will or no will at all, a married couple can transfer $10,500,000 worth of assets to their heirs without paying any federal transfer taxes. This "new" provision of the federal transfer tax system was also made permanent in ATRA 2012.

B. Portability of any unused applicable exclusion amount for a surviving spouse of a decedent who dies after 2010 is accomplished if the decedent's executor makes an appropriate election on a timely filed estate tax return that computes the unused exclusion amount. The unused exclusion amount is referred to in the statute as the "deceased spousal unused exclusion amount" (or "DSUE amount ").

C. The surviving spouse can use the DSUE amount either for gifts by the spouse or for estate tax purposes at the surviving spouse's subsequent death. An individual can use the DSUE amount only from his or her "last deceased spouse."

D. Statutory Provisions

1. <u>Estate Tax Exclusion Amount</u>. The portability concept was implemented by amending Section 2010(c) to provide that the estate tax applicable exclusion amount is (1) the "basic exclusion amount" ($5.0 million, indexed from 2010 beginning in 2012), plus (2) for a surviving spouse, the "deceased spousal unused exclusion amount." Section 2010(c)(2). This limits the unused exclusion to the amount of the basic exclusion amount.

2. <u>Deceased Spousal Unused Exclusion Amount ("DSUE Amount")</u>. The "deceased spousal unused exclusion amount" is the lesser of (1) the basic exclusion amount or (2) the basic exclusion amount of the surviving spouse's last deceased spouse over the combined amount of the deceased spouse's taxable estate plus adjusted taxable gifts (described in new Section 2010(c)(4)(B)(ii) as "the amount with respect to which the tentative tax is determined under Section 2001(b)(1)"). This is the last deceased spouse's remaining unused exemption amount, strictly defined as the predeceased spouse's basic exclusion amount less the combined amount of the taxable estate plus adjusted taxable gifts of the predeceased spouse.

3. <u>Statute of Limitations Extended</u>. Notwithstanding the statute of limitations on assessing estate or gift taxes for the predeceased spouse, the Service may examine the return of a predeceased spouse at any time for purposes of determining the DSUE Amount available for use by the surviving spouse. Section 2010(c)(5)(B).

4. Timely Filed Estate Tax Return and Election for Predeceased Spouse's Estate. The executor of the first spouse's estate must file an estate tax return on a timely basis and make an election to permit the surviving spouse to utilize the unused exemption. Section 2010(c)(5)(A). Even small estates of married persons must consider whether to file an estate tax return for the first deceased spouse's estate (discussed below).

5. Only Last Deceased Spouse's DSUE Amount. Only the most recent deceased spouse's unused exemption may be used by the surviving spouse, which is different from prior portability legislative proposals. Section 2010(c)(5)(B)(i). The Joint Committee on Taxation states that this requirement applies even if the last deceased spouse has no unused exclusion and even if the last deceased spouse does not make a timely election.

6. Gift Taxes. Portability applies to the gift tax exemption as well as the estate tax exemption. The 2010 Tax Act amended Section 2505(a)(1), which describes the "applicable credit amount" for gift tax purposes, by referring to the applicable credit amount under Section 2010(c) "which would apply if the donor died as of the end of the calendar year...." (Under Section 2505(a)(2), the credit amount is further reduced by the amounts of credit allowable in preceding years.) The applicable credit amount under Section 2010(c) includes the DSUE Amount, so that amount is also included in the gift exemption amount.

7. Small Estates. For smaller estates, the simplicity advantage of portability is certainly significant. In considering whether to make the portability election, consider not only the cost of filing the estate tax return, but also the cost of maintaining a bypass trust for future years.

E. Some Advantages of Traditional Use of Bypass Trusts

1. There is no portability of the GST exemption.

2. The DSUE Amount is not indexed for inflation, but appreciation in the assets is included in the gross estate of the surviving spouse, unlike the growth in a bypass trust, which is excluded from the survivor's estate.

3. There may not be portability of state estate tax exemption amounts.

4. The DSUE Amount from a particular predeceased spouse will be lost if the surviving spouse remarries and survives his or her next spouse.

5. As mentioned, there is no statute of limitations on values for purposes of determining the DSUE Amount that begins to run from the time the first deceased spouse's estate tax return is filed whereas the statute of limitations does run on values if a bypass trust is funded at the first spouse's death.

6. Beneficiaries other than just the surviving spouse can benefit from the assets left to a bypass trust.

7. Use of a bypass trust avoids the risk in a "blended family" that the surviving spouse might make gifts to persons other than the first decedent's family.

8. Filing an estate return for the first spouse's estate might be avoided if the estate and credit shelter trust are small enough.

9. Leaving all property to a surviving spouse ignores other standard benefits of trusts, including asset protection, asset management, and restricting transfers of assets by the surviving spouse.

F. Some Advantages of Portability

1. Qualified Retirement Plans. For a client who has large amounts of retirement or IRA benefits, funding a bypass trust without using the retirement or IRA benefits is difficult. Meanwhile, optimal income tax deferral can be obtained by leaving the retirement and IRA benefits directly to the surviving spouse, and rely on portability to use the deceased spouse's unused estate tax exclusion amount at the surviving spouse's subsequent death.

2. Avoid Retitling Assets. If one spouse owned most of the marital assets, in order to utilize the exemption amount of the less-wealthy spouse if he or she died first, the wealthier spouse would have to retitle assets into the name of the less wealthy spouse or fund an inter vivos QTIP trust for that spouse, often unpopular with the wealthier spouse. Portability can be used to take advantage of the less wealthy spouse's exclusion amount if he or she should die first.

3. Surviving Spouse's Increased Gift Capacity. Leaving assets to the surviving spouse or QTIP and using portability allows the surviving spouse to makes gifts using both spouses' exemption amounts. For instance, that full amount can be gifted to a trust that is a grantor trust as to the surviving spouse. Thus, portability may be desirable even for very large estates.

4. Consumption. If the surviving spouse consumes assets at a rate higher than the growth rate during his or her remaining lifetime, so that there is a net decrease in the estate (which is more likely to happen in smaller estates), portability is preferable to using a bypass trust.

G. Some Portability Details and Mechanics

1. Portability Election. Temp. Treas. Reg. § 20.2010-2T(a)(2) provides that upon timely filing a complete and properly-prepared estate tax return, the portability election is deemed to be made. The election, once made, is

irrevocable after the due date, plus extensions actually granted, have passed. Prior to that time, an election can be superseded by a subsequently filed return. Temp. Treas. Reg. § 20.2010-2T(a)(4).

2. Timely Filed Return. The portability election must be made on the deceased spouse's timely filed estate tax return, and that no election can be made after the "time prescribed by law (including extensions) for filing such return." (i.e., within nine months of the deceased spouse's death, plus extension (if an extension has been timely obtained). The IRS has specifically stated that although the Code does not specify a due date for the smaller estates not otherwise required to file an estate tax return, if such small estate wishes to take advantage of portability, they will be subject to the same time period for filing as those estates that have met the threshold for filing. Temp. Treas. Reg. § 20.2010-2T(a)(1).

3. "Complete" Estate Tax Return. Temp. Treas. Reg. § 20.2010-2T(a)(7)(i) clarified that an estate tax return will be considered "complete and properly prepared" if it is prepared in accordance with the instructions for the return and if the requirements of Treas. Reg. § 20.6018-2 (the person responsible for filing return), § 20.6018-3 (the return must contain adequate information regarding assets, deductions and credits), and § 20.6018-4 (the documents that must accompany return) are satisfied.

4. Special Rule for Smaller Estates. Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii) establishes a "special rule" designed to mitigate the costs and burden of valuing certain estate assets for small estates (i.e., estates with asset values below the normal filing threshold for an estate tax return). Under the special rule, marital and charitable deduction property is not required to be valued and the executor is only required to report an estimated value. As to such property, the executor will only have to report the description, ownership, and/or beneficiary of such property, along with all other information necessary to establish the right of the estate to the marital or charitable deduction.

   a. The special rule does not apply if the value of such property relates to, affects or is needed to determine the value passing from the decedent to another beneficiary. For example, if 50% of the estate is passing to the surviving spouse and 50% to a child, the value of all the estate property is needed and the special rule does not apply. See Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii) (C), Ex. 3.

   b. The special rule is unavailable if: (i) only a portion of an interest in property qualifies for the marital or charitable deduction (e.g., 50% of a house to the surviving spouse), (ii) the value of all property is needed to determine eligibility for the provisions of Sections 2032, 2032A or 6166, (iii) in the case of a partial disclaimer of marital or charitable deduction property, or (iv) in the case of a partial QTIP election.

c. When using this special rule, the new regulations require that the executor use due diligence in estimating the value of the entire estate (including the property not being formally valued). The new regulations contemplate that the estate tax return will be revised to allow the executor to indicate that the total estate value falls within preset ranges. Until the new estate tax return form is released, the executor must attach a separate statement to the estate tax return, signed under penalties of perjury, estimating the estate's total value, rounded to the nearest $250,000.

d. Documents using formula provisions, however, will not usually qualify for the special rule. See Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii) (C), Ex. 2.

5. Opting Out of Portability. The portability election will be considered not made if the executor affirmatively states on a timely filed return (or on an attachment thereto) that the estate is not electing portability under Section 2010(c)(5). Temp. Treas. Reg. § 20.2010-2T(a)(3). The current draft version of the estate tax return has a box for opting out. The other way not to elect portability is to simply not file a timely estate tax return.

6. Person Responsible for Making Portability Election

a. Estates with Executors. The appointed executor, qualified and acting within the United States, may file the estate tax return electing (or not) portability. Temp. Treas. Reg. § 20.2010-2T(a)(6).

b. Estates without Executors. If, and only if, there is no appointed executor, the typical rule under Section 2203 applies that any person in actual or constructive possession of the decedent's property may file the return and affect the portability election. Once the election is made by a non-appointed executor, the election cannot be superseded by the action of another non-appointed executor (unless the person is the successor to the person making the election). In most cases in which there is not an appointed executor, the surviving spouse should be in possession of some of the deceased spouse's property, thereby permitting the surviving spouse to file the return and affect the election.

7. Use of DSUE

a. How Soon? The new regulations provide that the portability election applies "after the deceased spouse's death." This means that the surviving spouse can use the DSUE Amount immediately after the deceased spouse's death.

b. Last Deceased Spouse Defined. The new regulations provide that the term "last deceased spouse" means "the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse." Temp. Treas. Reg. § 20.2010-1T(d)(5). Remarriage alone does not change the last deceased spouse. However, marriage and the subsequent death of the new spouse (but not divorce) would change who becomes the surviving spouse's "last deceased spouse."

c. Ordering Rule. Temp. Treas. Reg. § 20.2025-2T(b) provides that when a surviving spouse makes a taxable gift such spouse first uses the DSUE Amount of the person who was the "last deceased spouse" at the time of the gift, before the surviving spouse has to use his or her own basic exclusion amount.

d. Limitation to Two Exemption Amounts. Code Section 2010(c)(4) was designed to limit the amount of exemption to double the basic exclusion amount. However, a surviving spouse could make taxable gifts during their lifetime to take advantage of the DSUEs from their predeceased spouses. Thus, although hoarding of exemptions from multiple deceased spouses until death is still limited under Code Section 2010(c)(4), if a surviving spouse has multiple spouses who predecease them, but make lifetime taxable gifts (using the DSUE Amount of each such spouse while it is available), then the surviving spouse could use more than "double" their basic exclusion amount.

e. See the NEW page 4 of Form 706 (attached).

V. Possible Future Estate and Gift Tax changes

ATRA 2012 was also notable for what it did NOT do in the transfer tax arena. The Obama administration has proposed numerous restrictions that would dramatically impact estate planning in the future if enacted. Four (4) proposals in the 2013 Obama administration budget that are extremely broad-reaching are discussed below in very summary fashion. These proposals have been floated for several years now, so it is certainly very possible some or all of them can appear in tax legislation in the near future.

A. Include Grantor Trusts in the Grantor's Estate.

1. A Trust (to the extent taxable to the grantor under the grantor trust rules), would: (1) include the trust assets in the grantor's gross estate, (2) impose a gift tax on any trust distribution during the grantor's lifetime, and (3) impose a gift tax on the trust funds if the grantor ceases to be the deemed owner of the trust during his or her lifetime. The proposal also would

apply to some trusts where there is a non-grantor deemed owner of a trust under Section 678.

2. This would eliminate the tax efficiency of using sales and other transfers to an irrevocable grantor trust, by providing that a grantor trust always would be included in the donor's gross estate and distributions from a grantor trust to a person other than the grantor would be taxable gifts.

B. Valuation Discount Limitations

1. The Administration proposed amending Section 2704(b) to add a new category of disregarded restrictions that would be ignored in valuing an interest in a family-controlled entity transferred to a member of the family, if after the transfer the restriction would lapse or could be removed by the transferor and/or the transferor's family.

2. Also under the proposal, certain interests (to be identified in Regulations) held by charities or others who are not family members of the transferor would be deemed to be held by the transferor's family to address "de facto" control situations.

C. Limitations on GRATs

1. The Administration also proposed requiring that all GRATs last for a minimum term of ten (10) years and a maximum term of the grantor's life expectancy plus ten (10) years.

2. The proposal also would have required that all GRATs have some minimum remainder interest (to avoid "zeroed out" GRATs).

D. Dynasty Trust Limitations

1. The Administration would limit the use of dynasty trusts by providing that the allocation of GST exemption to a transfer protects that transfer from GST tax for no more than 90 years, and that on the 90th anniversary of the creation of a trust, the GST exemption allocated to the trust would terminate and the inclusion ratio would move to one.

2. Contributions to a trust from different donors would be deemed to be held in separate trusts under Section 2654(b), and each such separate trust would be subject to the same 90-year rule, measured from the date of the first contribution by the grantor of that separate trust.