HECKSCHER TEILLON
TERRILL & SAGER, P.C.
PERSONAL, TRUST & ESTATE LAW

(610) 940-2600
100 Four Falls, Suite 300
West Conshohocken, PA 19428

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As most of you undoubtedly know, today the President signed the American Taxpayer Relief Act of 2012 (the "New Year's Day Act") which includes a variety of changes to the Internal Revenue Code that will, at least for now, resolve the "fiscal cliff" that has been a major concern for many months. While we continue to evaluate the myriad details of the New Year's Day Act, we wanted to share with you immediately our understanding regarding the key estate tax, gift tax and generation-skipping tax ("GST") elements of the legislation.

As we reported in earlier Client Alerts (all of which are available on our website), prior to the New Year's Day Act the federal estate tax, gift tax and GST laws were scheduled to change dramatically as of January 1, 2013. For example, although the gift tax exemption was $5,120,000 in 2012, it was scheduled to be reduced to $1,000,000 in 2013. The gift tax rate (for amounts passing by gift above the exemption and not otherwise deductible) was a flat 35% in 2012, but was scheduled to be graduated rates as high as 55% in 2013. Similar changes were in store for the estate tax and the GST. The combination of reduced exemptions and increased rates would have substantially increased the amount of tax many of our clients or their estates would pay.

The potential for such dramatic increases in 2013 was the primary impetus for many of our clients to make significant gifts prior to the end of 2012. Although driven to completion in 2012 by the now-averted 2013 increases in the estate tax, gift tax and GST tax, those gifts continue to be good planning. Lifetime gifts move future appreciation in the value of the gifted assets out of the donor's taxable estate. Lifetime gifts also generally reduce the state death taxes to be paid at the donor's death and avoid possible future decreases in the estate tax exemption or increases in the tax rate (perhaps without enough notice to effectively plan at that time). Finally, in some cases, the donor's retention of the obligation to pay income tax on the taxable income of the gifted assets can further increase the benefit to the recipient.

The New Year's Day Act, at least with regard to the estate tax, gift tax and GST provisions, made "permanent" the 2012 laws, with only a few important changes. The $5,120,000 estate tax, gift tax and GST exemption was retained and will be inflation adjusted, which for 2013 means that those exemptions will be $5,250,000, an increase of $130,000 over the 2012 exemptions. However, the tax rate on estates, gifts and GST transfers above the exemption was increased to 40%, from the 35% rate in effect in 2012 (although less than the anticipated 2013 rate of 55%).

The New Year's Day Act also extended and made permanent other important but less politically charged provisions of the law as it existed in 2012, and thereby avoided other changes that would have taken place on January 1, 2013. For example, the so-called state death tax credit was scheduled to be reinstated in 2013. In many states this would have resulted in considerable increases in state death taxes. The New Year's Day Act "permanently" eliminated the state death tax credit. As a result, there will continue to be a wide variation in how and at what rates states impose death taxes, making this an important element of planning for individuals who have ties to more than one state.

In addition, the so-called "portability" or transferability rules that simplify the use of the estate and gift tax exemptions for many of our married clients was scheduled to expire in 2013. The

New Year's Day Act made the portability rules permanent. Although in many cases the transfer to the surviving spouse of the estate tax exemption of the first spouse to die, using the portability rules, is not the best use of that exemption at the first spouse's death, it is an important option for many of our clients.

For many of you, the most important changes in the New Year's Day Act are those having to do with marginal income tax rates, the AMT, the tax rates on dividends and capital gains and related income tax changes. Although you should discuss these issues primarily with your accountant or other income tax advisors, we are happy to discuss with you the ways in which the planning we do for estates and trusts may be helpful in those areas. If you are a beneficiary or fiduciary of an estate or trust we are available to discuss with you how the income tax changes will affect the estate or trust and its beneficiaries.

Finally, although not part of the New Year's Day Act, the "annual exclusion amount" will be $14,000 in 2013, an inflation-adjusted increase of $1,000 from 2012. This is the maximum amount that an individual can gift to a beneficiary in a calendar year without using gift tax exemption or paying gift tax (subject to exceptions for gifts to a spouse or charity, or the direct payment of tuition or medical expenses).

Although the changes in the estate tax, gift tax, and GST are "permanent" and do not include the sort of phase out/phase in provisions with which we have become familiar over the past decades, there is no way to know whether or when these taxes will be revised again in the future. We are all aware that the federal debt limit will require continued negotiations in Washington and the federal deficit will need to be addressed soon as well. In the past President Obama has proposed various changes to the estate and gift tax, including changes to the rules governing grantor retained annuity trusts (GRATs) and income-tax grantor trusts; it remains to be seen whether those changes will be enacted in the coming months. While we would be as pleased as all of you if the estate tax, gift tax and GST changes were truly permanent, only time will tell.

Each of you may wish to consider how the new law affects your planning. Those who made gifts in 2012 or before may wish to consider "topping off" the gifts to use the increase in the gift tax and GST exemptions. Some who did not make gifts may wish to reevaluate the benefits of making significant gifts. If you have postponed a review of your estate plan pending some sort of permanence in the law, this may a good time to review your plan. For some married clients, the new "permanence" of the gift tax, estate tax and GST exemptions, and the portability rules, may suggest that it is time to update your planning.

As always, we at HTT&S stand ready to work with you and your other advisors to consider and, if appropriate, implement new and updated planning. And, as always, when additional details of the New Year's Day Act and its impact become clearer, we will report our conclusions and recommendations in future Client Alerts.

Happy New Year!

Martin A. Heckscher	MAHeckscher@htts.com	610-940-4170	Pamela S. Dumont	PSDumont@htts.com	610-940-4184
L. Pierre Teillon, Jr.	LPTeillon@htts.com	610-940-4169	Adam T. Gusdorff	AGusdorff@htts.com	610-940-5405
John A. Terrill, II	JATerrill@htts.com	610-940-4172	Carolyn D. Meisel	CMeisel@htts.com	610-940-5407
Margaret E. W. Sager	MEWSager@htts.com	610-940-4171	David M. Brown	DBrown@htts.com	610-940-4185
Kim D. Fetrow	KDFetrow@htts.com	610-940-4173	Bradley D. Terebelo	BDTerebelo@htts.com	610-940-4191
Thomas O. Hiscott	TOHiscott@htts.com	610-940-4179	Jennifer K. Roche	JKRoche@htts.com	610-940-4187
Jill R. Fowler	JRFowler@htts.com	610-940-4181	Sipi S. Gupta	SGupta@htts.com	610-940-4197
David R. Elwell	DRElwell@htts.com	610-940-5415	Alex Lyden-Horn	ALydenhorn@htts.com	610-940-5416