RECONSIDERATION OF ESTATE PLANNING UNDER NEW TAX LAWS

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The goal of estate planning is to provide for the management and transfer of a person's property in the event of their death or incapacity at the smallest financial cost to their family. A properly structured estate plan allows someone to choose his/her beneficiaries, provide for the management of their assets, and eliminate or reduce taxes. Without careful planning, a person's property may pass to unintended beneficiaries or may be reduced in value by unnecessary taxes.

Estate planning also addresses such questions as how property should be held, whether it should be owned jointly or separately, whether trusts are needed for management, control or tax savings, whether lifetime gifts should be made, and who should make legal, financial and medical decisions if a person cannot make them.

For the past several years the general public has been inundated with information regarding the use of revocable living trusts as an estate planning tool. Many attorneys and financial planners have promoted the revocable living trust as superior to a tax planning will as an estate planning tool. This has resulted in many clients, especially senior citizens, demanding revocable trusts for their estate without understanding the possible results or alternatives. This will be especially true in the future since, as discussed below, the federal estate tax will affect many less taxpayers under the American Taxpayer Relief Act of 2012 recently passed by Congress and signed by the President as part of the "fiscal cliff" negotiations.

For example, many clients find that they can adequately provide asset management in cases of illness or incapacity through the simpler step of implementing a General Durable Power of Attorney, rather than a revocable living trust. This document enables a trusted individual to manage your assets in the event you are no longer capable of doing so.

Also a Medical Durable Power of Attorney allows each spouse (or other parties, i.e., children) to make medical decisions on behalf of the other spouse in the event the injured or ill spouse can no longer make those decisions.

Finally, Colorado allows an individual to execute a document that will instruct family and medical providers as to how he/she is to be treated in the event he/she is unable to communicate, and they are in a terminal condition or in a persistent vegetative state. This document is commonly called a Living Will.

The above documents and a Will can be a less expensive alternative to a Revocable Living Trust.

The federal government imposes a gift tax on lifetime gifts and an estate tax on transfers at death. Under the American Taxpayer Relief Act, this tax is at a maximum rate of 40%. The best way to understand federal estate taxes is to focus on the exceptions from estate taxation. The general rule is that every time an individual transfers property or money (including via beneficiary designation for life insurance and retirement plans), either during his or her lifetime or at death, to another individual, there is imposed gift and/or estate taxes. The three exceptions to this general rule are the basis for most estate planning steps taken by taxpayers.

The first exception is the unlimited marital deduction. Husbands and wives can make gifts to each other in unlimited amounts on unlimited occasions without incurring any gift or estate taxes.

The second exception is the $14,000 annual exclusion ($28,000 for husband and wife) per donee.

The third exception, which is the primary basis for implementing a tax planning will or revocable living trust, is the amount of property, life insurance and retirement plans that a taxpayer can pass to a non-spouse (i.e., children) estate tax free. Sometimes this exclusion is called the "unified credit." Again, under prior law, this exclusion was going to be reduced to $1,000,000 after 2012. At the conclusion of the "fiscal cliff" negotiations, the applicable exclusion was allowed to remain at $5,120,000. In addition, under the new rules, married couples are entitled to use each other's unused unified credit, effectively eliminating any estate tax for married couples up to $10,500,000. This ability to use a prior deceased spouse's exclusion is called "portability." Finally, beginning in 2013, the exclusion is $5,250,000 and is indexed for inflation.

In summary, although the federal estate tax will affect fewer taxpayers, all individuals should have an appropriately drafted Will, Durable Power of Attorney, Medical Power of Attorney, and Living Will.