

# Nashville Bar Journal

March 2013 - VOL 13, NO. 2



~~~~~  
CAR-RT LOT C-003  
TRACY DRY KANE  
126  
DODSON PARKER BEHM & CAPPARELLA, P.C.  
1310 6TH AVE N  
NASHVILLE TN 37208-2604

~~~~~  
**ABC'S of the 2013 Tax Laws  
& Planning Thoughts to Address Them**  
Harlan Dodson, Tracy Kane and Jillian Mastroianni

~~~~~  
**NASHVILLE IS ON THE MAP:  
Human Trafficking in Middle Tennessee**  
Lynda Jones

~~~~~  
**Inked: First Amendment Protection for Tattoos**  
Kelly Frey

~~~~~  
**Demystifying Online Reputation Defense**  
Jabez LeBret



## ABC'S of the 2013 Tax Laws & Planning Thoughts to Address Them

by: Harlan Dodson, Tracy Kane and Jillian Mastroianni



The "American Taxpayer Relief Act" passed at the end of 2012 and is now law. The good news is that because it largely makes prior temporary provisions permanent (unless changed again later this year by Congress), for most taxpayers it does not require any immediate changes to documents or plans. This article provides a summary of some of the key provisions of the tax laws now in effect and a few planning points to address them.

### I. Key Federal Transfer Tax Provisions:

- A. The estate and gift tax exemption per person is combined at an amount indexed for inflation, which for 2013 is \$5,250,000. This amount, as indexed for inflation, will remain in effect in the future. The use of the exemption for gifts during lifetime reduces the exemption for estate tax purposes at death.
- B. The generation skipping transfer tax exemption is likewise at the indexed amount of \$5,250,000 for 2013. This amount, as indexed for inflation, will remain in effect in the future.
- C. The annual gift tax exclusion is \$14,000 per donee for 2013, and is indexed in future years. The annual generation skipping transfer tax exclusion per donee is \$14,000 for 2013, and is indexed for future years.
- D. The concept of "portability" is now permanently part of the law (again, unless changed by Congress). Portability is the right of a surviving spouse to use any unused estate and gift tax exemption of the deceased spouse for later application to gifts or to apply toward federal estate tax in

the surviving spouse's estate. Some technical requirements must be met in order to qualify, the most critical of which is that a timely federal estate tax return (Form 706) must be filed electing portability following the death of the first spouse.

### II. Key Tennessee Tax Provisions:

- A. Tennessee's gift tax is repealed.
- B. Tennessee's inheritance tax exemption is \$1,250,000 for decedents dying in 2013, \$2,000,000 for decedents dying in 2014, and \$5,000,000 for decedents dying in 2015. The Tennessee inheritance tax is repealed effective January 1, 2016.
- C. Tennessee has an income tax of 6% on certain forms of investment income (commonly referred to as the "Hall Tax").

### III. Key Federal Income Tax Provisions:

- A. The income of a High Income Taxpayer, defined as a married couple with \$450,000 of taxable income, or a single filer with \$400,000 of taxable income, will be subject to marginal income tax rates of 39.6% (up from 35%) on ordinary income and 20% (up from 15%) on capital gains income. Note, however, trusts and estates are taxed at a rate of 39.6% beginning at \$11,950 of taxable income.
- B. Separately, there is a phase out of certain itemized deductions for a married couple with



\$300,000 of taxable income, or a single filer with \$250,000 of taxable income. This is known as the "Pease" limitation.

C. Under the Affordable Care Act, there is a Medicare surtax of 3.8% on certain types of investment income for a married couple with \$250,000 of taxable income and on a single filer at \$200,000 of taxable income. This surtax applies to interest, capital gains, dividends, royalties and passive income from businesses in which the taxpayer does not participate. There are a number of exceptions, and the IRS has recently published detailed regulations as to what is subject to the tax and what is not. Note again, however, trusts and estates go to the 3.8% surtax at \$11,950 of taxable income.

D. In addition to any new taxes, there is still the 12.4% social security tax on the first \$113,700 of earned income and the Medicare tax of 2.9% on all earned income.

- a. For married filers with \$250,000 of earned income, and single filers with \$200,000 of earned income, there is an additional 0.9% added to the Medicare tax.
- b. Yes, there are *two* possible 3.8% Medicare taxes. One is on earned income and the other is on net investment income. First, there is the 2.9% on earned income for all taxpayers, then the additional 0.9% on earned income for married filers with \$250,000 of earned income, and single filers

with \$200,000 of earned income, for a total Medicare tax of 3.8% on **earned** income. Separately, there is a 3.8% Medicare tax on certain **net investment** income for a married couple with \$250,000 of taxable income and on a single filer at \$200,000 of taxable income.

- E. Retirement accounts continue to contain significant negative income tax risks unless carefully handled in the planning process.

#### IV. A Few Planning Points and Estate Administration Thoughts

The larger exemption amounts make wills and other planning documents that leave the estate outright to the surviving spouse, with a contingent disclaimer if the spouse wishes to do so, the usual choice for most people, unless there are other non-tax considerations.

Where there is a married couple with a possible concern about federal estate tax or Tennessee inheritance tax, a will that leaves all to the surviving spouse should also contain a provision for a contingent disclaimer that allows the surviving spouse to use a disclaimer to fund a trust, which would use the decedent's federal estate tax exclusion and/or Tennessee inheritance tax exclusion. This allows for post-death planning based on the situation with assets and tax laws at that time.

While Tennessee still has an inheritance tax (until 2016), practitioners should consider using a Tennessee gap marital trust, so any disclaimer above the current year's exclusion would not create Tennessee inheritance tax liability.

Given the larger federal estate tax exemptions, it is important to consider the

impact of formula clauses in wills tied to the federal estate tax exemption. A will that leaves the entire amount of the federal estate tax exemption in a bypass trust may considerably overfund that trust. For example, for a couple where the husband had an estate of \$3,000,000 and the wife has an estate of \$2,000,000, there may be no reason to fund a bypass trust at all.

Regardless of what happens with the exemptions, the human reasons for using trusts, such as protection from divorce, creditors or health issues, providing professional management, and assuring that a share passes to children or other issue still remains a strong reason to consider them in planning.

Portability could be especially useful for assets that are not suitable for the family or bypass trusts, such as retirement accounts or expensive family homes. Congress may change the law again, however, so planning documents need to be drafted to work if portability were repealed or significantly restricted.

Because of the expense of preparing Form 706, which must be filed in order to elect portability, and the time required to do so, a decision whether to elect portability needs to be made early in the administration of a decedent's estate. That said, anytime there is a surviving spouse, the executor should file Form 706 unless there is a conscious and documented decision not to do so.

Portability issues also need to be considered in drafting pre- or post-nuptial agreements. For example, parties to such an agreement should agree to permit use of the **deceased spousal unused exclusion (DSUE)**, and provide for which party pays for the filing of Form 706.

Continued on Page 14 ➡

Since an estate is at risk of additional income tax above \$11,950 of taxable income in any year, planning as to the distribution of income out of the estate to beneficiaries, or otherwise managing assets, should occur as a specific decision at the beginning of the administration of an estate.

Because a trust is likewise at risk of additional income tax above \$11,950 of taxable income in any year, planning as to the distribution of income out of the trust to beneficiaries, or otherwise managing assets, should occur at the drafting stage and as a specific decision at least annually thereafter.

With the higher transfer tax exemptions, families have far more flexibility in the use of gifting for inter-generational wealth planning. However, with the higher exemptions, it is easy to become careless with filing gift tax returns. Timely and complete filings of Form 709 for gifts above the annual exclusion remain important.

The absence of a Tennessee gift tax and the larger federal exemptions will avoid the need for many of the transactions commonly used for planning purposes in which assets were sold in exchange for a promissory note with forgiveness equal to the annual exclusion amount.

Life insurance continues to provide tax-free build up in the policy and income tax free proceeds, so for now, it continues to furnish protection from the increasing income taxes.

The deficit remains in the trillions and the Administration and Congress will continue to discuss changes to the tax laws, so stayed tuned! ■



*Harlan Dodson is a partner with Dodson, Parker, Behm & Capparella, PC. He has taught wills and estate planning at the Nashville*

*School of Law for over 30 years and is the editor to West Publishing Company's Tennessee Practice Series volumes on business formation and estate planning as well as author of Introduction to Estate Planning and Administration in Tennessee.*

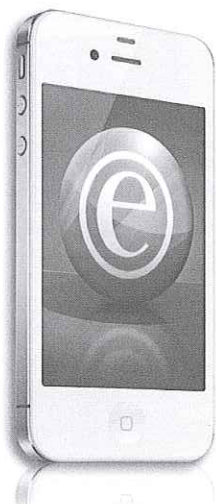


*Tracy Kane is an attorney with Dodson, Parker, Behm & Capparella, PC, providing business law and estate planning advice to busi-*

*nesses and their owners. She is a graduate of Vanderbilt University Law School and former law clerk to the Honorable Richard Dinkins on the Tennessee Court of Appeals.*

*Jillian Mastroianni is an attorney with Dodson, Parker, Behm & Capparella, PC and graduate of Vanderbilt University Law School.*

## Collect fees on the courthouse steps! We have apps for that!



Accept Credit Cards with the NBA's Preferred Provider, ePaymentAmerica! We've saved NBA members 20% on card processing fees.

**Sign up for NBA Member Benefits!**  
**[www.epaymentamerica.com/nba](http://www.epaymentamerica.com/nba)**  
**(888) 385-5311**

