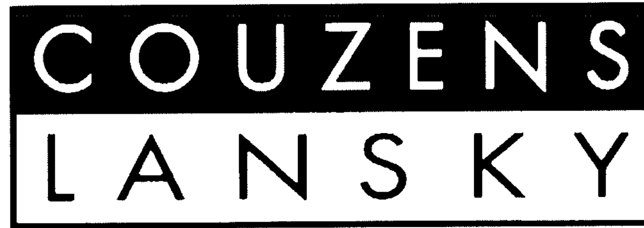

2012
CRITICAL LEGAL DEVELOPMENTS
Health Care and Taxes – Destination Unknown

VisTaTech Center, Livonia, Michigan

October 30, 2012

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THE PATIENT PROTECTION AND AFFORDABLE CARE ACT – A TIMELINE PERSPECTIVE

ALAN C. ROEDER
LAWRENCE F. SCHILLER

THE PATIENT PROTECTION AND AFFORDABLE CARE ACT – A TIMELINE PERSPECTIVE

I. PROVISIONS EFFECTIVE UPON ENACTMENT IN 2010.

The Patient Protection and Affordable Care Act of 2010, as modified by the Health Care and Education Reconciliation Act (together the PPACA) is a complex, broad health care statute. Key provisions are summarized below. Upon enactment the following were effective.

A. The Food and Drug Administration (FDA) is authorized to:

1. Approve generic versions of biologic drugs.

2. Grant biologics manufacturers 12 years before generics can be developed.

B. Medicaid drug rebate paid by manufacturers to states was increased to 23.1%.

C. Patient-Centered Outcomes Research Institute was established.

1. The primary function is undertaking comparative effectiveness research.

2. PPACA Section 1182(c)(1) provides "The Secretary shall not use evidence or findings from comparative clinical effectiveness research conducted under section 1181 in determining coverage, reimbursement, or incentive programs under title XVIII in a manner that treats extending the life of an elderly, disabled, or terminally ill individual as of lower value than extending the life of an individual who is younger, nondisabled, or not terminally ill."

D. Task force on Preventive Services and Community Preventive Services established.

E. Indian Health Care Improvement Act reauthorized.

F. Chain restaurants required to post caloric content of products and other information on menus.

1. Delayed due to lack of Regulations.

2. Some restaurants have begun posting.

G. States can seek a State Plan Amendment rather than a federal waiver for expanded family planning eligibility.

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H. New Health Insurance Tax Credit for Small Employers (Including Not-for-Profit Organizations).

1. Qualifying small employers can claim a credit to cover up to 35% of the cost of providing health insurance to employees.

2. Qualifying small employers that are tax-exempt non-profits can claim credits to cover up to 25% of employee health insurance costs. A qualifying small employer is one that: has no more than 24 full-time-equivalent (FTE) workers; pays an average FTE wage of less than $50,000; and has a qualifying healthcare arrangement in place.

3. A qualifying arrangement requires employers to: pay at least 50% of the cost of each enrolled employee's coverage and pay the same percentage for all employees (even those with more expensive family coverage or self-plus-one coverage). Section 45R;[1] IRS Notice 2010-44.

I. Liberalized Adoption Tax Credit. For 2010 and 2011, the statute made the adoption credit refundable, so it can be collected in full even if a taxpayer does not owe federal income tax. The maximum amount was $13,170 in 2010 and $13,360 in 2011. For 2012, there is a non-refundable tax credit capped at $12,650. The same caps would apply to tax-free employer adoption assistance payments. These amounts are reduced if income exceeds specified levels. Sections 36C and 23.

J. The Economic Substance Doctrine Was Codified. The economic substance doctrine is deemed to exist only if the transaction in question: changes the taxpayer's economic position in a meaningful way without regard to tax consequences and is entered into for a substantial non-tax purpose. A 20% penalty can be assessed on tax underpayments attributable to transactions that are disallowed because they lack economic substance. The penalty rises to 40% for "undisclosed economic substance transactions." Other penalties may also apply. Sections 7701(o), 6662(i), and 6676.

II. PROVISIONS EFFECTIVE IN 2010.

A. As of June 21, 2010, adults with pre-existing health conditions can join a temporary high-risk pool.

1. Must be uninsured for 6 months.

2. No age requirement.

[1] All Section references are to the Internal Revenue Code of 1986, as amended, except as otherwise noted.

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3. Limited out of pocket expenditure to $5,950 for individuals and $11,900 for families.

B. As of July 1, 2010, the National Prevention, Health Promotion and Public Health Council was established.

C. As of July 1, 2010, a 10% sales tax began for all indoor tanning.

D. Changes to Insurance Coverage as of September 23, 2010.

1. Prohibition on lifetime dollar limits on essential benefits. This does not restrict non-dollar limitations, such as limits on frequency of visits.

2. Health plans that cover dependent children must cover adult children until they turn 26. This includes those not living with parents, those not dependents on tax return, those who are no longer students and those who are married. This is a tax-free fringe benefit. Sections 105(b) and 162. Flexible spending arrangement (FSA), health savings account (HSA) and health reimbursement arrangement (HRA) reimbursements qualify.

3. Insurers are prohibited from excluding pre-existing conditions for children under 19, except in grandfathered individual insurance plans.

4. New insurance plans must cover preventive care and screens rated Level A or B by the U.S. Preventive Services Task Force, as well as childhood immunization and adult vaccinations recommended by the Advisory Committee on Immunization Practices. Co-payments, co-insurance and deductibles are prohibited when provided in-network.

5. Annual spending caps imposed.

   a. Currently $2,000,000 and eliminated in 2014.

   b. Applies to grandfathered group plans.

6. Coverage cannot be terminated when policyholders get sick.

7. Insurers must disclose administrative and executive expenses.

8. Policies must include an appeals process.

9. Health and Human Services website is to explain insurance in each state.

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III. PROVISIONS EFFECTIVE IN 2011.

A. Medical Loss Ratio. Insurers must spend 80% on health costs and claims for individual and small group insurers (85% for large group insurers); otherwise a rebate must be issued to the policyholders.

B. Center for Medicare and Medicaid Innovation established by the Centers for Medicare and Medicaid Services (CMS).

C. Must have prescription to pay for over-the-counter drugs, except insulin, from a FSA, HRA and HSA plans.

D. Increased Penalty on Nonqualified HSA and MSA Withdrawals. If you take money out of your HSA or Archer medical savings account (MSA) for any reason other than to cover qualified medical expenses, the former rules allowed you to usually owe federal income tax plus a 10% penalty tax, or a 15% penalty tax for an MSA. PPACA increased the penalty tax rate to 20% for nonqualified withdrawals. Sections 220(f) and 223(f).

E. New Simple Cafeteria Plans for Small Employers. For employers with 100 or fewer employees, these plans are deemed to automatically satisfy all applicable cafeteria benefit plan nondiscrimination rules if they satisfy certain minimum standards for eligibility, participation, and contributions. Section 125(j).

F. Effective as of September 1, 2011, rate review requires individual and small group insurers to notify the public when planning to increase rates by an average of 10% or more.

G. Non-Discrimination Rules.

1. Insured health plans were to have become non-discriminatory as of January 1, 2011, using rules "similar" to the non-discrimination rules of Section 105(h).

2. Section 105(h) relates to a self-insured medical expense reimbursement plan (MERP), where the employer, at its own expense, acts as an insurer with respect to medical expenses.

3. Because the statute speaks in terms of "similar" non-discrimination rules, and since regulations have not yet been issued describing what the non-discrimination rules will look like, this provision has been delayed, and will not be enforced until regulations have been issued.

4. No regulations, even in proposed format, have been issued to date.

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IV. PROVISIONS EFFECTIVE IN 2012.

A. Employers must disclose value of benefits on Form W-2 (postponed from 1/1/11). The rule excludes employers with less than 250 Forms W-2.

B. As of August 1, 2012, all new plans must cover certain preventive services without cost sharing (the Contraceptive Mandate).

1. Mammograms.

2. Colonoscopies.

3. Women's preventive services.

V. PROVISIONS EFFECTIVE IN 2013.

A. Flexible Spending Accounts in Cafeteria Plans.

1. These are the accounts which individual employees can establish in a Section 125 Cafeteria Plan which pays for unreimbursed medical and health care expenses (such as deductibles and co-pays) on an annual use-it or lose-it basis. (This is not a so-called Medical Expense Reimbursement Plan, with respect to which there will continue to be no limit.)

2. The maximum annual limit on a per-participant basis will be $2,500, indexed for inflation in later years. Currently, the maximum is established by the employer.

3. This will apply to plan years commencing in 2013.

4. Beginning in 2011, the definitions for qualified medical expenses for FSAs, HSAs and MSAs are matched to those for itemized deductions of medical expenses.

B. Itemized deductions for unreimbursed medical expenses.

1. The deduction threshold for unreimbursed medical expenses will increase from 7.5% of Adjusted Gross Income (AGI) to 10% of AGI.

2. From 2013 until 2017, individuals will retain the 7.5% threshold for any of those years if the individual or spouse has attained the age of 65 before the end of that year.

C. Additional Medicare tax (HI) on high income individuals.

1. Increase in HI tax of 0.9% (to 2.35%) on certain earnings/wages:

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a. In excess of $250,000 for joint filers (on combined wages).

b. In excess of $125,000 for those married, filing separately.

c. In excess of $200,00 for all others.

d. Does not apply to the employer portion of HI (although employer must withhold).

e. Applies to self-employed, as well.

f. BEWARE of impact on estimated tax payments, since employee is liable if amounts are not withheld.

2. HI tax of 3.8% imposed on net investment income.

   a. Applies to individuals, estates and trusts.

   b. For individuals, tax is on the lesser of:

      i. Net investment income, or

      ii. The excess of modified AGI (MAGI) over the applicable threshold amount.

   c. Applicable threshold amount is:

      i. $250,000 for joint filers (on combined wages).

      ii. $125,000 for those married, filing separately.

      iii. $200,00 for all others.

   d. Net investment income is investment income reduced by properly allocated deductions (and does not include distributions from a qualified plan, 403(b) annuity or IRA).

   e. MAGI is AGI, as adjusted:

      i. Increased by amounts excluded from income as foreign earned income.

      ii. Reduced by deductions and exclusions disallowed with respect to foreign earned income.

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f. For trusts and estates, tax is on the lesser of:

i. Undistributed net investment income (differently defined), or

ii. Excess of AGI over dollar amount at which the highest estate and trust income tax bracket begins.

D. Elimination of deduction for Employer Part D. For tax years beginning after December 31, 2012, the deduction for the subsidy for employers who maintain prescription drug plans for the Medicare Part D eligible retirees will be eliminated.

E. As of August 1, 2013, the exemption expires for religious organizations to implement the Contraceptive Mandate.

VI. "THE" PROVISION EFFECTIVE JANUARY 1, 2014 – THE INDIVIDUAL MANDATE

Beginning in 2014, individuals not otherwise qualified for Medicare or Medicaid will be required to obtain minimum essential health coverage. Individuals without this minimum level of coverage will be required to pay a penalty (the Individual Responsibility Penalty) that is determined based on income level.

A. Minimum essential coverage includes government sponsored coverage, employer sponsored care, grandfathered health plans and plans offered in the individual market. Grandfathered coverage includes health care coverage an individual was enrolled in when the PPACA was enacted. It must provide the essential health benefits package, limit annual cost-sharing to the high-deductible health plan limit, limit the annual deductible for small group market plans to $2,000 (individual) and $4,000 (families), and not require cost-sharing for preventive services or immunizations.

B. The categories of essential health benefits are:

1. Ambulatory patient services.
2. Emergency services.
3. Hospitalization.
4. Maternity and newborn care.
5. Mental health and substance use disorder services, including behavioral health treatment.
6. Prescription drugs.
7. Rehabilitative and habilitative services and devices.

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8. Laboratory services.

9. Preventive and wellness services and chronic disease management.

10. Pediatric services, including oral and vision care.

C. Benefit Tiers. There are four benefit categories of plans plus a separate catastrophic plan to be offered in individual and small group markets, as well as through exchanges:

1. Bronze Plan – represents minimum creditable coverage and provides the essential health benefits, covers 60% of the benefit costs of the plan, with an out-of-pocket limit equal to the Health Savings Account (HSA) current law limit ($5,950 for individuals and $11,900 for families in 2011). Note that the amounts for 2011 are the same as 2010. Rev. Proc. 2010-22, 2010-23 IRB May 24, 2010).

2. Silver Plan – provides the essential health benefits, covers 70% of the benefit costs of the plan, with the HSA out-of-pocket limits.

3. Gold Plan – provides the essential health benefits, covers 80% of the benefit costs of the plan, with the HSA out-of-pocket limits.

4. Platinum Plan – provides the essential health benefits, covers 90% of the benefit costs of the plan, with the HSA out-of-pocket limits.

5. Catastrophic Plan – available to those up to age 30 or to those who are exempt from the mandate to purchase coverage and provides catastrophic coverage only with the coverage level set at the HSA current law levels except that prevention benefits and coverage for three primary care visits would be exempt from the deductible. This plan is only available in the individual market.

D. Penalty Amount. The Individual Responsibility Penalty is phased in between 2014 and 2016.

	Individual Responsibility Penalty (the greater of):	
Year	Minimum Fixed Amount	Percentage of Income
2014	$95	1%
2015	$325	2%
2016	$695	2½%

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1. After 2016, the penalty base will be indexed for inflation.

2. The fee for an uninsured individual under 18 will be one-half of the penalties for an adult.

3. The total household penalty will not exceed three times the minimum penalty amount, nor exceed the national average annual premium for the Bronze Level health plan offered through an exchange that year for that household size.

4. Low income individuals and families will receive assistance under the PPACA based upon a percentage of the Federal poverty level. Such individuals will be entitled to tax credits and cost-sharing measures.

E. Individuals not required to file an income tax return are not required to meet the minimum essential coverage standards.

F. The legislation provides a program for employer-sponsored early retiree reinsurance. Payments made to the reinsurance program are excludable from gross income calculations. Individuals can also purchase community living assistance services through a voluntary program under the new law, paying premiums through payroll deductions.

G. The law includes provisions that provide exceptions for religious conscience, an exclusion of undocumented residents from coverage, and several provisions for very specific situations, such as hardship and incarceration.

H. Automatic enrollment of new employees in employer's health plan.

1. Applies to employers which:

   a. Are subject to the FLSA, and

   b. Employ at least 200 full-time employees.

   c. Employees may opt out.

2. Requires continuation of current employees in health care plan, with notice to employees and opportunity for employees to opt out of automatic enrollment.

3. Implementation is pursuant to DOL regulations, and DOL has indicated that those regulations will not be issued by 2014, so implementation will be appropriately delayed.

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I. No discrimination based on wages, health status, genetic information, disability, evidence of insurability or other factors deemed improper by the Department of Health and Human Services.

J. Prohibition on pre-existing condition exclusions.

K. Prohibition on annual maximum dollar limits.

L. Guaranteed availability and renewability.

M. Waiting periods cannot exceed 90 days.

   1. Service as part-time employee (working less than 30 hours a week) is not counted towards the waiting period.

   2. For employees whose hours are reasonably expected to vary, a period of from 3 to 12 months can be utilized to determine whether the employee will be full-time without violating the 90-day waiting period limitation, as long as coverage is effective within 13 months of hire date plus the period of time to the first day of the next month (if the hire date was not on the first day of the month). (IRS Notice 2012-59.)

N. <u>Employer shared responsibility</u>.

   1. Applies to employers who employed at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year (applicable large employers, or ALE). Controlled group (and affiliated service group) rules apply and make controlled group members a single employer for this purpose.

   2. Penalty applies to ALE if either:

      a. ALE fails to offer minimum essential coverage under an eligible employer-sponsored plan to its full-time employees and their dependents, and any full-time employee is certified to receive a premium tax credit or cost sharing reduction, or

      b. ALE offers full-time employees the opportunity to enroll in minimum essential coverage and one or more employees is certified to receive tax credit or cost sharing reduction (generally because coverage is not affordable).

   3. Affordability is based on premiums not exceeding 9.5% of employee's household income for the year. Safe harbor approach bases affordability on the employee's W-2 wages (Box 1) rather than household income.

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4. Full-time employee for a month is one whose employment averages at least 30 hours of service a week (or 130 hours in a month). Employer can choose a standard measurement period of 3 to 12 months, consistently applied, to determine full-time status for the subsequent stability period (of at least 6 months, but not shorter than the standard measurement period), even if the employee is not full-time during the stability period. An administrative period (overlapping the last stability period and following the standard measurement period) of at least 90 days may fall between the standard measurement period and the stability period in order to verify eligibility and enroll employees in the health care plan.

5. Hours of service will follow pension rules—hours for which paid or entitled to payment for services performed or not performed—with a limit of 160 for any continuous period when no services are performed. Equivalencies will be permitted, as with pensions.

6. Full-time equivalencies (for purposes of determining ALE status) are determined by adding the hours of all employees not full-time (not more than 120 hours in a month per employee), and dividing by 120.

7. Penalty is $2,000, times number of full-time employees in excess of 30 (distributed proportionally among all related employers treated as a single employer).

8. No penalty for someone enrolled in Medicare.

9. The excise tax penalty is payable on notice and demand by the IRS and are non-deductible. Section 4980H(d). Information returns will be required.

10. An excise tax will also be imposed on employers with at least one full-time employee that receives a premium tax credit or cost-sharing reduction for insurance purchased through an exchange. The excise tax imposed on the employer equals the number of full-time employees who receive premium tax credits or cost-sharing assistance, multiplied by $3,000.

VII. <u>Provisions effective in 2018</u>.

A. High cost fully-insured health care coverage (Cadillac plan) subjects the insurer to an excise tax of 40% of the premium in excess of certain thresholds: $10,200 for individual coverage and $27,500 for families (subject to being increased annually for combination in growth in cost of health care and CPI). These premium levels increase to $11,850 for individuals and $30,950 for families, for retirees age 55 and over, and high professional risk employees. The excise tax will be imposed on the premium amount in excess of the stated threshold amounts. This tax is not imposed on employers unless they are self-funded.

B. All existing health insurance plans must cover approved preventive care and checkups without co-payment.

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IMPORTANT TAX CHANGES AND UPDATES – 2012

ERIC J. GOULD
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IMPORTANT TAX CHANGES AND UPDATES - 2012

I. SELECTED TAX PROVISIONS THAT EXPIRED AT THE END OF 2011

A. Business Provisions.

1. Research credit under Section 41(h)(1)(B).[1]

2. 15-year write-off for specialized realty assets, including qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property under Section 168(e). As of Jan. 1, 2012, all such property goes back to the 39-year period.

3. 100% bonus first year depreciation allowance for qualified property under Section 168(k)(1) and 168(k)(5).

4. Highest-ever Section 179 expense election of $500,000 and $2,000,000 ceiling.

5. Work opportunity tax credit (WOTC) for non-veterans under Section 51(c)(4).

6. Enhanced charitable contributions of computer equipment for educational purposes, food inventories, and book inventories to public schools under Section 170(e).

7. Inclusion of Puerto Rico as "within the U.S." for purposes of determining a taxpayer's qualified domestic production gross receipts under Section 199(d)(8).

8. Reduced S corporation recognition period for built-in gains tax under Section 1374(d)(7).

B. Individual Provisions.

1. Election to deduct state and local general sales taxes instead of state and local income taxes under Section 164(b)(5).

2. Above the line deduction of qualified tuition and related expenses under Section 222.

3. Treatment of mortgage insurance (PMI) premiums as deductible qualified residence interest under Section 163(h)(3).

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[1] All Section references are to the Internal Revenue Code of 1986, as amended.

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4. Elementary and secondary school teachers' above the line deduction of up to $250 of certain expenses under Section 62.

5. Full exclusion of gain on certain small business stock under 1202(a)(4). Exclusion is now only 50% of the gain.

6. Tax-free distributions (up to $100,000 annually for persons 70-1/2 and older) from individual retirement plans for charitable purposes under Section 408(d)(8).

C. <u>2012 Alternative Minimum Tax (AMT) Without Any Retroactive Patch</u>.

1. As of January 1, 2012, the AMT exemption amounts fell:

Filing Status	2012 Amount	2011 Amount
Joint, Surviving Spouse	$45,000	$74,450
Unmarried Individuals	$33,750	$48,450
Married Filing Separately	$22,500	$37,225

2. Individuals can no longer apply nonrefundable personal tax credits against the AMT. Section 26(a)(2).

3. A recent Congressional Research Service report notes that without Congressional action the combined effect of inflation and the reductions in the regular income tax will cause well over 30 million taxpayers (roughly 20%) to be hit by the AMT in 2012.

    a. For 2012, middle income taxpayers will find the AMT taking back the final year of savings from reduced tax rates and the marriage penalty relief.

    b. Without further action, by 2020 at least 58 million taxpayers will be subject to the AMT.

4. At the September 12, 2012 IRS Oversight Board meeting, the board advised that "should Congress delay a decision on retroactive extensions on already expired provisions, the IRS could be forced to delay [the 2012] filing season in order to reprogram its computer systems."

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II. TAX PROVISIONS TO END ON DECEMBER 31, 2012

A. WOTC for hiring qualified veterans hired after December 31, 2012 under Section 51(c)(4)(B).

B. 50% bonus first-year depreciation for qualified property under Section 168(k)(1).

C. No further credit for employer-provided child care facilities.

D. Temporary payroll tax cut of 2%. OASDI rates revert back to 6.2% for employees and 12.4% for persons subject to the self-employment tax.

E. Exclusion of discharged qualified principal residence debt from cancellation of debt income under Section 108(a)(1)(E).

F. The expanded American Opportunity Tax Credit (the Hope Credit). This non-refundable credit amount was 100% of the first $2,000 of qualified tuition and related expenses, and 25% of the next $2,000.

III. SELECTED TAX PROVISIONS IMPACTED BY SUNSET OF CURRENT PROVISIONS ON DECEMBER 31, 2012

A. Tax brackets change.

1. The 10% bracket disappears.
2. The top four brackets rise from 25%, 28%, 33% and 35% to 28, 31%, 36% and 39.6%.

B. Long-term capital gain tax rate will increase to 20% (18% for assets held more than five years). For lower-income taxpayers, the maximum rate will be 10% (8% for assets held more than five years).

C. Dividends are once again taxed at ordinary income rates.

D. Employer-provided educational assistance will be excluded from income only if it qualifies as a working condition fringe benefit under Section 132(j)(8).

E. Deduction for student loan interest is phased-out over lower AGI ranges and is limited to interest paid in the first 60 months.

F. The standard deduction for married taxpayers filing jointly (and qualified surviving spouses) is reduced from 200% to 167% of the standard deduction for single taxpayers.

G. Itemized deductions of higher-income taxpayers once again reduced by 3% of AGI above an indexed amount, but cannot exceed 80%.

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H. Personal exemptions of higher-income taxpayers once again phased-out when AGI exceeds an indexed amount.

I. For 2012, the Section 179 maximum expense election is $139,000 with a $500,000 investment ceiling. Starting in 2013, the maximum election is $25,000 and the investment ceiling is $200,000.

J. The credit for household and dependent care expenses is reduced:

1. Creditable expenses reduced from $3,000 to $2,400 for one qualifying individual and from $6,000 to $4,800 for two or more qualifying individuals.

2. Maximum credit percentage drops from 35% to 30%.

3. AGI-based percentage reduction begins at $10,000, instead of $15,000.

K. The maximum child credit drops from $1,000 to $500 and the credit is not allowed against AMT.

L. The accumulated earnings rate increases from 15% to 39.6% under Section 532.

M. The personal holding company tax rate increases from 15% to 39.6% under Section 541.

N. Increased withholding.

1. Backup withholding on gambling winnings increases from 25% to 28% under Section 3402.

2. Backup withholding on reportable payments increases from 28% to 31% under Section 3406.

3. Voluntary withholding on certain federal payments, including Social Security benefits increases from 7%, 10%, 15% or 25%, to 7%, 15%, 28% or 31% under Section 3402.

4. Voluntary withholding rates on unemployment benefits rise from 10% to 15% under Section 3402.

IV. <u>2012 YEAR-END PLANNING OPPORTUNITIES</u>

A. <u>Accumulated Cash in Corporations</u>.

1. Take advantage of the final year of the maximum 15% tax rate.

a. Dividends. While the tax rate is the same as for capital gains, there is a double tax through corporation.

b. Capital Gain. Have the benefit of basis recovery to reduce the amount subject to tax.

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2. After 2012:

   a. Dividends taxed as ordinary income.

   b. Maximum capital gain rate is 20%.

   c. Subject to 3.8% surtax on investment income and gains under Section 1411 (the "3.8% Surtax"). NOTE: Without Congressional action, dividends are taxed as ordinary income and are still subject to investment income surtax.

3. Redemption rules under Section 302 become relevant again!

4. Evaluate opportunities to accelerate income for cash method businesses by factoring or otherwise transferring accounts receivable.

5. Consider planning for December, 2012 corporate distributions with prompt execution at end of year if higher taxes on capital gains and dividends will take effect as of January 1, 2013.

B. <u>Individual capital gains and loss planning</u>.

1. Take advantage of the final year of the maximum 15% tax rate. Use capital losses to maximize the 0% range.

2. Evaluate overall tax bracket. Even with an extension, taxpayers may have lower rates in 2012 than 2013 based on other income.

3. The wash sale rule under Section 1091 applies to losses, not gains. It may be beneficial to sell appreciated assets and recognize gain to date at low rate, and then repurchase to increase basis. Planning can also minimize impact on wash sale rule (i.e. sell Mutual Fund A's large cap growth fund, purchase Mutual Fund B's large cap growth fund).

4. Do not let the tax tail wag the dog – evaluate property values and trends. Do not defer gain or risk increased loss if property is declining in value.

5. Be sure to consider the 3.8% Surtax.

6. Be sure to evaluate straddling of sales between 2012 and 2013, especially for individuals receiving Social Security.

C. <u>Retirement plan strategies</u>.

1. Distributions from Roth accounts avoid the 3.8% Surtax.

   a. Tax-free distributions are not included in modified AGI (MAGI).

   b. Traditional IRA and 401(k) distributions will be included in MAGI.

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c. Investment income excludes distributions from tax-favored retirement plans.

2. Consider Roth conversion rollovers in 2012.

3. Evaluate delayed first year required minimum distributions.

   a. Double distribution in 2013 could result in exceeding MAGI threshold.

   b. Could be subject to higher tax rate.

   c. May cause more Social Security benefits to be subject to tax.

   d. May also impact deductions and/or credits subject to an AGI floor, such as the deduction for medical expenses.

4. Consider extra withdrawals from annuities, 401(k) plans, IRAs, and non-college use 529 plans for high tax bracket clients with upcoming cash needs.

D. Charitable Contributions. Consider delaying payment of charitable contributions until 2013. The value of the deduction is greater in light of the potential increased income tax rates and the 3.8% Surtax.

V. RECENT DEVELOPMENTS AND UPDATES

A. Federal Tax Issues.

1. Substantiation of Charitable Deductions. Section 170(f)(8) requires a charitable organization receiving $250 or more from a contributor to provide a contemporaneous written acknowledgement, which **must** state if the organization provided any goods or services in consideration, in whole or in part, for the contributed property or cash.

   a. If goods or services were provided, the statement must include a description and good faith estimate of the value of any goods or services provided.

   b. Failure to have a contemporaneous written acknowledgement with the required language results in the donor's inability to claim a charitable contribution. *Durden v. Commissioner*, TC Memo 2012-140 (5/17/2012).

2. Reasonable Compensation. The IRS continues to raise "reasonable compensation" as an issue with respect to S corporations, seeking to increase FICA and Medicare tax collections. Should qualified dividends once again become taxed as ordinary income, the IRS will be motivated to raise the issue with C corporations, reclassifying compensation as constructive dividends subject to tax at the corporate and individual level.

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a. The United States Supreme Court declined to review a decision of the Eighth Circuit Court of Appeals that an S corporation paying unreasonably low salary was liable for employment taxes on dividends reclassified as salary. _Watson, P.C. v. United States_, 668 F.3d 1008, 109 AFTR 2d 2012-1059 (8th Cir. 2/21/2012), *cert. denied*, ____ U.S. ____, (10/1/2012).

b. The Seventh Circuit Court of Appeals held that over $850,000 paid in each of three years to entities owned by the founding shareholders of an accounting firm operated as a C corporation should be characterized as nondeductible dividend distributions. Mulcahy, Pauritsch, Salvador & Co. v. Commissioner, 680 F.3d 867, 109 AFTR 2d 2012-2140 (7th Cir. 2012).

3. Bankruptcy Protection of Alleged "Retirement Funds" Received in Divorce. In _In re Ahmed_, 110 AFTR 2d 2012-5348 (E.D.MI. 9/29/2012), the court ordered funds paid from ex-husband's 401(k) to ex-wife to pay for her equity in their home. She then contributed these into her IRA in less than 60 days. This constituted a taxable distribution to him. In her subsequent bankruptcy, she was not allowed to exempt the full IRA account as "retirement funds."

B. Michigan Tax Issues.

1. Statute of Limitations for Sales and Use Tax. On June 27, 2012 a new section was added to MCL 205.27a, stating "(12) [t]he filing of a return includes the filing of a combined, consolidated, or composite return whether or not any tax was paid and whether or not the taxpayer reported any amount in the tax line including zero." The Department of Treasury had been auditing taxpayers for more than four years, claiming the statute of limitations did not apply even if a Sales, Use and Withholding Tax (SUW) Return was filed. The new statutory language clarifies that as long as a SUW return is filed, the statute begins to run, even if the return only reported withholding taxes.

2. Preservation of Principal Residence Exemption If In a Nursing Home or Assisted Living Facility. Public Act 324 of 2012, effective October 9, 2012, allows a homeowner to retain a local Michigan property tax principal residence exemption after moving into a nursing home or assisted living facility if the homeowner manifests an intent to return to his or her home, evidenced by:

a. Continued ownership of the property while residing in facility;

b. No establishment of a new principal residence;

c. Maintaining or providing for the maintenance of the property while residing in the nursing home or assisted living facility; and

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d. The property being unoccupied, not listed for sale, unrented, and not being used for any business or commercial purpose.

3. Use Tax on Property Purchased For Purpose of Resale. In Knight Facilities Management, Inc. v. Dept. of Treasury, Michigan Court of Appeals Docket No. 305787 (9/27/2012), the Dept. of Treasury was unsuccessful in its attempt to impose use tax on supplies purchased through Knight Facilities for its customers, delivered by the supplier directly to the customers, for which the customers paid sales tax directly to the state. The court found that the Department of Treasury was trying to "double-dip" on the taxes and that property purchased for resale is completely exempt from the imposition of the use tax.

4. Inclusion of Compensation for Leased Employees under the SBT. The Department of Treasury continues to audit and challenge the exclusion of compensation paid to leased employees. The result is to increase the tax base and reduce or eliminate the small business credit. While taxpayers have consistently prevailed in the Michigan Tax Tribunal, the issue lingers on. In Adamo Demolition Co. v. Dept. of Treasury, MTT Docket 427308 (9/13/2012), in light of statutory authority and significant case authority, Tribunal Judge Copping found the Department's position "devoid of arguable legal merit" and awarded Adamo Demolition its costs. Perhaps Treasury will finally get the message as the SBT cases dwindle to a close.

5. Michigan Corporate Income Tax (CIT) and Flow-Through Entity (FTE). MCL 206.703(16) was added as of June 28, 2012 to provide an exemption from FTE reporting for qualifying corporate members of the FTE.

   a. Each corporate member must complete an exemption certificate form, certifying:

      i. It will file any required CIT return.

      ii. It will pay CIT on the distributive share of the business income received from the FTE.

      iii. It will submit to the taxing jurisdiction of the state for purposes of collection of the tax.

   b. The FTE must attach a copy of the exemption certificate to its Annual Withholding Reconciliation Return.

6. CIT forms are expected to be finalized when the Legislature adjourns in December. Forms will be posted to the Dept. of Treasury website. Paper forms and instructions are expected to be distributed in January, 2013.

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PTIN Renewal Period Underway for All Tax Professionals; Registered Tax Return Preparer Candidates Urged to Schedule Tests

WASHINGTON — The Internal Revenue Service today reminded the nation's 730,000 federal tax return preparers that they must renew their Preparer Tax Identification Numbers (PTINs) for 2013. Also, preparers who have a competency test requirement should take the time now to schedule an appointment for the exam.

Anyone who is a paid federal tax return preparer must register with the IRS and have a PTIN, as must all Enrolled Agents. Additionally, some return preparers have new continuing education and competency test requirements.

"We ask that you renew your PTIN as soon as possible to avoid a last-minute rush. It's easy to let this slip as the holiday season approaches," said Carol A. Campbell, Director, IRS Return Preparer Office. "And, if you have a testing requirement and haven't yet scheduled an appointment, please do so at the same time."

The online PTIN renewal process takes about 15 minutes. Renewed PTINs will be valid for calendar year 2013. The IRS also has significantly upgraded the PTIN system to make it easier to use and more intuitive.

Preparers who have forgotten their log-in information, password, or email address can use online tools to resolve these issues. Get started at www.irs.gov/ptin.

New continuing education and testing requirements also apply to approximately 340,000 preparers who previously had no such requirements. These preparers must certify when renewing their PTIN for 2013 that they have completed the 15-hour requirement for continuing education in 2012. Learn more about the 2012 continuing education requirement at www.irs.gov/taxpros/ce.

Additionally, preparers with a testing requirement should schedule their tests, whether it is the Registered Tax Return Preparer (RTRP) test or the more extensive Special Enrollment Exam (SEE) for those interested in becoming Enrolled Agents. Compare the tests and credentials at www.irs.gov/taxpros/tests. The RTRP test can be scheduled online through the PTIN system by selecting "next steps and additional requirements" from the PTIN account Main Menu. The SEE can be scheduled online at www.prometric.com/see. Preparers who wait until next year to schedule a test may find it difficult to arrange the test at a convenient date, time and location.

Enrolled Agents, Certified Public Accountants and attorneys are exempt from the new continuing education requirements because they already pass more extensive tests and take continuing education courses to satisfy their professional credentials.

For more information about requirements for federal tax professionals, go to www.irs.gov/for-Tax-Pros.

Thank you for subscribing to the IRS Newswire, an IRS e-mail service.

www.michigan.gov
(To Print: use your browser's print function)

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Last Update: September 04, 2012

Contact: Mario Morrow 517-373-9280
Agency: Licensing and Regulatory Affairs

Scam Targets Corporations; LARA alerts Michigan businesses of scheme collecting $125 fee to file annual minutes to avoid "bad standing" with the State

September 4, 2012 - Michigan Department of Licensing and Regulatory Affairs (LARA) Director Steven H. Hilfinger today warns Michigan corporations of a non-governmental entity called "Michigan Corporate Compliance Company" trying to collect a $125 fee to file corporate meeting minutes. The misleading compliance solicitation implies that Michigan requires corporations and limited liability companies to complete an Annual Meeting Disclosure Statement and is designed to look like an official document, but it is not.

"Beware of mailings that appear to come from the State of Michigan offering assistance in performing non-existent or non-required services," Hilfinger said. "Our corporation customers should only respond to correspondence from LARA. No such letters are being sent from the LARA Corporation Division, no matter how official they may look."

Michigan businesses are receiving an official-looking form called the "Annual Meeting Disclosure Statement." (Click here to view sample document.) The form implies that the recipient is obligated to complete and return it with a fee payment for the preparation of corporate meeting minutes to avoid "administrative dissolution or revocation." The accompanying instructions for completing the form list a return address at 5859 West Saginaw Highway, #221, Lansing, Michigan.

"Annual meeting minutes for Michigan corporations are best prepared either by corporate officers, directors, or by a business attorney, but are not required to be filed with our Corporation Division," said Hilfinger. "This is not to be confused with the legally required annual report or annual statement which can be filed online along with the applicable fee to the State of Michigan."

Michigan appears to be the latest state where corporations are being targeted to file annual minutes for a fee. Similar solicitation mailings have occurred in several other states including California, Colorado, Florida, Georgia, Indiana, Illinois, Massachusetts, and Texas where corporations have been victimized by such scams. These entities operate under identical or similar names and request payment fees ranging from $125, $150, $175 to $239 for the completion and submittal of an annual minutes statement.

The phony letters can look authentic. They may be addressed to the corporation, the resident agent, director or officers; cite a Michigan statute or a federal statue; and may appear to be issued by the Michigan Department of Licensing and Regulatory Affairs, Bureau of Commercial Services, Corporation Division. If such notices are received, they are to be disregarded because they are neither issued by LARA nor any governmental agency.

Any Michigan corporation that receives a notice to have annual meeting minutes prepared and pay a fee to avoid dissolution of their corporation are advised to do the following:

1. Keep the notice, mailing envelope, and return envelope.
2. Contact the United States Postal Inspections Service to report mail fraud at: (877) 876-2455 or http://postalinspectors.uspis.gov/forms/MailFraudComplaint.aspx
3. Or contact the Michigan Office of the Attorney General at P.O. Box 30212, Lansing, MI 48909.

Legitimate notices and mailings to Michigan corporations are issued from LARA's Corporation Division and are mailed to the resident agent at the registered office address on record. When receiving any official-looking document, please review carefully and read the small print. If you are not sure, please contact the LARA Corporation Division at (517) 241-6470.

Customers with questions about their corporation, limited liability company or limited partnership are encouraged to use the Business Entity Search at www.michigan.gov/entitysearch to check their status. If an annual report or statement needs to be filed, customers may file online using www.michigan.gov/fileonline. Additional information is available on the Corporation Division website at www.michigan.gov/corporations or by calling the Corporation Division at (517) 241-6470.

For more information about LARA, please visit www.michigan.gov/lara
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ESTATE AND GIFT PLANNING TODAY FOR AN UNCERTAIN FUTURE

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ESTATE AND GIFT TAX PLANNING TODAY FOR AN UNCERTAIN FUTURE

I. OVERVIEW OF CURRENT ESTATE AND GIFT TAX LAW

A. Estate, Gift and Generation Skipping (GST) Tax Exemptions

1. The present estate, generation skipping transfer and gift tax exemption is $5,120,000, with a 35% tax on excess amounts.

2. Under current law, these tax provisions under Title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act of 2010) sunset and will not apply to estates of decedents dying, gifts made or generation skipping transfers made after December 31, 2012. Unless Congress acts, the estate, GST and gift tax rules after 2012 will revert to those in place before the enactment of EGTRRA, except for the few provisions made permanent or extended by other legislation (e.g., the Pension Protection Act of 2006 repealed the sunset provisions of EGTRRA related to pension and IRA provisions and qualified tuition plans.)

3. Absent Congressional action, the estate and gift tax lifetime exemption will revert to $1,000,000 on January 1, 2013, with a 55% top tax rate and a 5% surtax on large estates phasing out the graduated rates. A credit would be allowed regarding state death taxes. The GST exemption will revert to $1,000,000, plus an inflation adjustment.

4. The portability of the unused estate tax exemption amount of the first spouse to die, allowing the unused amount to be carried over to a surviving spouse, expires for deaths after 2012.

5. The current annual exclusion for gifts of present interests is $13,000 per donor, per donee, with annual inflation adjustments. The amount will be $14,000 for 2013. An unlimited gift tax exclusion is also available for amounts paid to health care providers for medical services for the donee and for tuition payments paid on behalf of a donee directly to an educational organization. Section 2503(e) [1]. Under current law, these would continue.

6. The current administration has submitted several proposals to Congress that would curtail or eliminate numerous estate, GST and gift tax techniques now in use. Some of these include:

    a. Limiting the maximum term of Grantor Retained Annuity Trusts (GRATs).

    b. Limiting the maximum term of generation skipping transfers.

[1] All Section references are to the Internal Revenue Code of 1986, as amended.

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c. Limiting some discounts regarding minority, non-voting or otherwise restricted business interests.

d. Limiting the use of defective grantor trusts that remove assets from the grantor's estate but leave the grantor subject to any related income taxes.

B. Expected Action from Congress - What the Pundits Are Saying.

C. Planning Ideas as We Face an Uncertain Estate, GST and Gift Tax Future.

II. TAKING ADVANTAGE OF THE CURRENT GIFT AND GST TAX LAW AND EXCLUSION BY MAKING LARGE GIFTS NOW – ONE CLIENT'S PLAN

Objective: Transfer ownership from married couple to adult children, without use of trusts, allowing for discounted valuation and removal from taxable estate.

A. Assumptions.

1. Real Property LLC (the LLC) purchased real estate for $500,000 in April, 2012.

2. The LLC is currently a single member limited liability company owned by the Husband Living Trust.

3. Anticipated ownership:

   1% Husband Living Trust
   1% Wife Living Trust
   49% Child 1
   49% Child 2

4. Child 1's and Child 2's membership interests will be non-voting interests. Such interests provide ownership but exclude rights to change the LLC's manager or otherwise affect decision making, as would be with voting interests.

5. The LLC is managed by Father as manager.

6. Significant gift tax exclusion remains.

7. November, 2012 Applicable Federal Rates (AFR): Short-term (less than 3 years) is 0.22%, mid-term (3-9 years) is 0.89% and long-term (greater than 9 years) is 2.40%. The 2012 blended AFR for demand loans is 0.22% (this rate is adjusted annually in July).

   a. October, 2012 AFRs: short-term was 0.23%, mid-term was 0.93% and long term was 2.36%.

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b. September, 2012 AFRs: short-term was 0.21%, mid-term was 0.84% and long term was 2.18%

8. Membership interests in the LLC will be subject to a discounted valuation to reflect various factors, including lack of marketability, ownership of a minority interest (lack of control), and lack of voting power. This analysis assumes an approximated 30% valuation discount. The discounted value of a 1% non-voting interest will be $ 3,500 (5,000 – 1,500). An appraisal should be secured to document and support the actual discount rate.

9. Annual income from the property is nominal – less than $20,000.

10. The LLC will distribute funds sufficient for the members to pay their respective state and federal income tax.

B. Transfer of Interest to Mother's Living Trust – No tax implications for transfer of assets between spouses. The 1% membership interest may be either a voting interest or a non-voting interest.

C. Gift of Non-Voting Membership Interests To Children

1. Transfer a 49% non-voting interest to each of Child 1 and Child 2. The non-voting interests will create a discount in determining value.

2. Advantages:

a. Remove future appreciation from taxable estate and freeze value.

b. Children will have carryover basis based on Father's cash contributed (i.e. basis is not discounted even though value is for gift tax purposes).

c. Maximize use of gift tax exemption in 2012 before any change or reversion.

d. Transaction is straightforward and simple to execute.

3. Disadvantage. Gifts of membership interests have been successfully challenged by the IRS as not being made for bona fide consideration when the donor retains possession or rights to income from the property and/or control over the property as the sole manager and majority owner of the voting interests (argument would be Father and Mother are one unit so, in effect, Father has retained control), resulting in inclusion in donor's gross estate under Section 2036.

4. Example – Gift of the 49% interest will be valued at $171,500. Father's basis of a 49% interest is $245,000 and carries over to children.

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5. Alternate – structure transaction gifting of a portion of the membership interest, and selling the remaining membership interest, as discussed in D. below.

D. Sale of Non-Voting Membership Interests on Installment Basis To Children

1. Sell the 49% interest at fair market value for promissory note with interest only at AFR. If the LLC includes voting and non-voting interests, non-voting interests may support an additional valuation discount (in comparison to voting interests, perhaps 5%).

2. Advantages:

   a. Remove future appreciation from taxable estate and freeze value.

   b. No gift tax considerations in connection with sale. Future gifts can be made to children in the form of cash to support payments of interest and/or principal, or cancellation of loan interest and/or principal.

   c. While the LLC has minimal available cash flow, any distributions provide:

      i. An ability to pay interest at extremely low interest rates.

      ii. With ability to prepay the note, excess cash (after payment of interest and income taxes) can be used to pay down the principal.

   d. Sale of membership interests will not result in gain, as there is no appreciation in value.

   e. Payment for interests constitutes bona fide consideration, avoiding possible inclusion in Father's estate under Section 2036 (See C.3. above).

   f. Allows for significant leverage and cash flexibility due to historically low interest (AFR) rates.

3. Disadvantages:

   a. Promissory note includible in estate if there is a balance due at the date of death.

   b. May lose benefit of elevated gift tax exemption if Congress fails to maintain exemption level of $5,000,000, adjusted for inflation. Without action before December 31, 2012, exemption reverts to only $1,000,000.

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c. Interest will be taxed upon receipt as ordinary income; although the interest may be deductible by children against investment income (income from the LLC constitutes investment income).

4. Example – The discounted purchase price of the 49% interest will be $171,500. If the notes are interest only, the interest due at 0.23% is $394.45, the interest due at 0.93% is $1,594.95, and the interest due at 2.36% is $4,047.40. To the extent the LLC makes cash distributions, the out of pocket cost is reduced or eliminated.

E. <u>Gift of Cash Allowing Children to Purchase Non-Voting Membership Interests</u>

1. Gift cash to each of Child 1 and Child 2, allowing them to each purchase a 49% non-voting interest. The purchase price of the non-voting interests will reflect a discounted value which reduces the amount of cash to be gifted.

2. Advantages:

   a. Remove future appreciation from taxable estate and freeze value.

   b. Maximize use of gift tax exemption in 2012 before any change or reversion.

   c. Sale of membership interests will not result in gain, as there is no appreciation in value.

   d. Payment for interests constitutes bona fide consideration, avoiding possible inclusion in Father's estate under Section 2036.

3. Disadvantages:

   a. Children's basis in their membership interests will be based on the actual purchase price, reflecting the discounted value.

   b. Father will realize a loss on the sale of the membership interests but may not currently benefit from the loss, as it results from a related party transaction. The loss may be claimed in the future should the interests be sold to a bona fide third party.

4. Example – The 49% interest will be valued at $171,500. A gift of $171,500 to each daughter will allow them to purchase the interest for that amount giving them each a basis of $171,500. Father's basis in each 49% interest is $245,000. This creates a loss of $73,500 that will be disallowed as it is a transaction between related parties under Section 267.

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III. REASONS TO MAXIMIZE GIFTS NOW

A. The lifetime exclusion is scheduled to drop dramatically. Estates over $1,000,000 run the risk of an estate tax that would not apply up to $5,120,000 for deaths occurring in 2012. Use all or part of the larger current amount. Would this be grandfathered? Would Congress try to tax the excess over $1,000,000 used in 2012?

B. Portability is set to expire in 2013.

C. The annual exclusion is still available but may not be sufficient to allow an estate to be reduced below whatever the 2013 and later estate tax exemption turns out to be.

D. Discounts for minority, non-voting or otherwise restricted interests are available, subject to current judicial interpretations of present law.

E. Gifts made now would remove expected appreciation from the donor's estate.

F. Generation skipping transfers in trust can avoid inclusion of these assets in the estate of the subsequent generations and shelter the assets involved from the beneficiaries' creditors. There is no maximum time limitation on this under the Internal Revenue Code; state rule against perpetuities statutes would apply.

G. Gifts in excess of the current exemption incur a 35% gift tax, versus the 55% (plus surtax) that applies after 2012.

H. Any current gift tax paid is excluded from the donor's estate at death (a tax exclusive result), rather than being part of the amount subject to tax as occurs with assets held at death and used to pay the estate tax then (tax inclusive).

I. For transactions involving an interest rate factor (e.g. GRATs, loans, purchases with loaned money, etc.), rates are at historically low levels, which can minimize the resulting gifts.

J. Maximize the odds of enjoying grandfathered status under any less favorable tax provision enacted after the date of the transaction used.

IV. TECHNIQUES TO CONSIDER

A. As always, the first step is a review with the client and key advisors to determine each client's goals, budget, assets, projected needs, existing documentation, sophistication level, and risk tolerance. Options can then be developed so that clients can make informed decisions.

B. Review present documentation for adequacy and consistency with the clients' wishes.

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1. Be sure any divisions of the estate tied to the estate tax exemption at time of death will carry out the intent of the client.

2. Be sure trustees are appropriate.

3. Be sure restrictions on beneficiaries that the client wants are included.

C. Consider annual exclusion gifts.

D. Consider significant gifts under the current $5,120,000 lifetime exclusion.

E. Consider gifts in trust for asset protection, generation skipping, Medicaid or special needs planning, transfers for the benefit of a minor, asset restriction (second marriage, spendthrift spouse or children, etc.), and the like.

F. Consider Entity Gifts.

1. Allows minority interest discounting.

2. Allows the donor to retain effective control.

3. Allows centralization of business management and activity.

4. Use a valuation adjustment clause reducing the gift if the IRS successfully challenges the valuation of the initial gift.

5. Basis carries over. Should the donor retain this asset until death to obtain a step up in basis for the heirs? Should an asset that has appreciated little to date be used?

G. Consider an asset sale.

1. This is particularly useful if the transfer under consideration exceeds the remaining lifetime gifting exclusion amount of the donor as a sale at fair market value occurs, not a gift.

2. Future appreciation will be excluded from the estate of the seller.

3. Interest must be charged on the sales price owing or money loaned to make the purchase, but the rates are historically low.

4. A sale will result in a new basis.

H. Consider Qualified Personal Residence Trusts.

1. Available for the principal residence and one other residence.

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2. The gift is discounted for the value of the right to use the home by the donor for the period chosen.

3. These arrangements are statutory. Section 2702.

I. Consider an insurance "tune-up"

1. Gift substantial premiums or cash value life insurance policies before January 1, 2013.

2. Rescue old split dollar policies.

3. Implement dynasty trusts to use the current GST and maximum duration rules.

4. Transfer existing policies into Irrevocable Life Insurance Trusts where taxable estates are anticipated; or replace such insurance with new policies in Irrevocable Life Insurance Trusts where appropriate to avoid the three year inclusion rule.

5. Is existing life insurance adequate to cover estate taxes if the estate tax exclusion drops to $1,000,000 in 2013, as scheduled under current law? Will the client still be insurable when Congress changes the exemption?

J. Consider a transfer to a spouse, followed by a gift by the recipient spouse to children or others, in order to use the gift tax exemption of the recipient spouse.

K. Consider a Grantor Retained Annuity Trust.

1. The GRAT is a trust that provides an irrevocable right to receive a fixed amount payable annually to the holder of the interest for a fixed term of years or life. The future discounted value of the amount transferred to the GRAT is a gift to the remainder beneficiary at the time of the contribution.

2. Numerous technical rules under Treasury Regulation 25.2702-3 must be complied with.

3. The required payout is tied to the applicable federal rate. Since these rates are at historically low levels, the GRAT can remove the appreciation of the gifted asset in excess of the applicable interest rate from the estate of the donor.

4. There are current administration proposals in Congress to restrict the use of GRATs.

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