

## JULY 2012 NEWSLETTER

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# THE UNCERTAINTY OF FEDERAL ESTATE TAX RULES FOR 2013 AND ONWARD

## FIRM ALERT:

### **1. OMG! MY PARENTS ARE GETTING OLD!**

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Pozzuolo Rodden, P.C. are pleased to announce that Joseph R. Pozzuolo, Esquire, Jeffrey S. Pozzuolo, Esquire, and Stephen P. Taylor, Esquire have been retained to write two chapters of Faye Levow's new book titled OMG! My Parents Are Getting Old! This book is intended to be the definitive resource for families on what to do when you are caught up in the whirlwind of dealing with unprepared, aging parents. It is written to be very user friendly. Ms. Levow is targeting an October 2012 release date and the temporary website is:

[www.OMGMYPARENTSAREGETTINGOLD.com](http://www.OMGMYPARENTSAREGETTINGOLD.com). Joseph R. Pozzuolo and Jeffrey S. Pozzuolo wrote the chapter titled: Estate Planning for Pet Owners. Joseph R. Pozzuolo and Stephen P. Taylor wrote the chapter titled: Same Sex Couple Estate Planning. Pre-publication drafts are available by emailing Chrissy at: [chrissy@pozzuolo.com](mailto:chrissy@pozzuolo.com)

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## **2. QUESTION OF THE MONTH:**

### **SHOULD I SPECIFICALLY DESIGNATE A BENEFICIARY TO MY LIFE INSURANCE POLICIES, ANNUITIES AND INDIVIDUAL RETIREMENT ACCOUNTS?**

If there are any legal questions you would like this office to answer in the future, please email the question to us at [info@pozzuolo.com](mailto:info@pozzuolo.com). Commencing with this Newsletter, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in a new section of our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning and administration, tax and pension law, family law litigation.

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### **The Uncertainty of Federal Estate Tax Rules for 2013 and Onward**

After two years we are in the same place as we were in 2010: watching and waiting on what will be done with the Federal Estate and Gift Taxes (the "Transfer Taxes"). After the Economic Growth Tax Relief Reconciliation Act ("EGTRRA") rules from 2001 to 2010 and the patch work of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "TRUIRJA") passed on December 17, 2010, the patch is about to lapse to the pre-EGTRRA rules. Most importantly, this means the Estate Tax Exemption would drop from the current \$5,120,000 to \$1,000,000 and the maximum tax rate would increase from 35% to 55%. This would greatly increase the Transfer Taxes payable by privately held business owners with large estates.

The 2011-2012 TRUIRJA rules postponed the sunset of EGTRRA. It provided an Estate Exclusion of \$5,000,000 indexed for inflation for 2012, a Gift Tax Exemption that matches the Estate Tax Exemption, a marital portability of the exemption, and a maximum estate tax rate of 35% as outlined in the chart below.

	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>Estate/GST Tax</b>	Yes	Yes	Yes
<b>Estate/GST Exemption</b>	<b>\$5 M</b>	\$5 M with inflation	<b>\$1 M</b>
<b>Gift Tax Exemption</b>	<b>\$5 M</b>	\$5 M with inflation	<b>\$1 M</b>
<b>Exemption Spousal</b>	Yes	Yes	<b>No</b>
<b>Maximum Marginal Tax Rate</b>	<b>35%</b>	35%	<b>55%</b>

The temporary TRUIRJCA Estate and Gift Tax Exemptions of \$5,000,000 (indexed up to \$5,120,000 for 2012) allowed for tremendous wealth transfer opportunities. Secondly, it provided for a portability of the exemptions between spouses. In other words, a surviving spouse is permitted to use any unused exemption of a predeceased spouse if the predeceasing spouse's executor makes the proper election on the deceased spouse's federal estate tax return. This is important if the majority of the assets are titled in the name of one spouse and the less wealthy spouse dies first. Otherwise, the exemption is wasted. Under portability an asset owning surviving spouse may now use the unused exemption to receive a total exemption of \$10,000,000. Finally, while the pre-EGTRRA maximum tax rate was 55%, the TRUIRJCA capped the tax rates at 35%.

This provides substantial opportunities to gift or bequest assets out of an estate tax free or at tax preferred rates. This rule is to sunset on December 31, 2012, which would leave an estate tax exemption of \$1,000,000 and a maximum rate of 55%.

### **Uncertainty in 2013:**

There is much uncertainty and speculation as to what the final 2013 estate and gift tax rules will be. The possible options are: 1) allowing the TRUIRJCA to lapse; 2) a continuation/modification of the TRUIRJCA/EGTRRA rules; 3) a complete repeal of the Wealth Transfer Taxes; or, 4) a completely new scheme.

If Congress does not act by 2013, as stated, the TRUIRJCA sunsets. This means, the federal estate and gift tax exemption drops down to \$1,000,000, the maximum marginal tax rate goes back up to 55%, and a loss of the spousal portability. This would cause a tremendous increase in Wealth Transfer Taxes in taxable estates above \$1,000,000.

The second option is the TRUIRJCA rules with a higher maximum tax rate, a lower exemption amount, and keeping the spousal portability. For instance, President Obama's 2012 proposed amendment is a permanent \$3,500,000 exemption and a maximum tax rate of 45% with portability. There was another proposal in fall 2011 called The Sensible Estate Tax Act of 2011 with a \$1,000,000 exemption indexed for inflation from 2000, a maximum tax rate of 55%, and portability. Neither were passed, but it seems most proposals were some form of a TRUIRJCA/EGTRRA increased exemption with portability.

Third, Congress could simply repeal the Wealth Transfer Taxes. This is highly unlikely with the current political state of the economy and the .99% versus the .01% mentality.

Fourth, Congress could throw us a curveball and add new features. They could scrap the current frame work, add in different types of exemptions or tax in a different manner. It is speculative whether any major changes will be added considering it is an election year and the preoccupation with boosting the economy and healthcare.

Lastly, Congress could allow it to lapse if there is a Congressional stalemate.

It is the opinion of this office with the .99% versus the .01% mindset of the country that a modification of the TRUIRJCA/EGTRRA rules will be the 2013 rule considering the most recent proposals and the fact Congress is preoccupied enough with the economy and focusing on elections to make any drastic changes. However there is uncertainty to what the exemption be or the maximum tax rate will be. This could range from \$1,000,000 to \$5,000,000 and 35% to 55% depending on the deal struck in Congress. Spousal portability has stuck on the prior proposals, but this could also be changed.

**Conclusion:**

There is much uncertainty about the future state of the Wealth Transfer Tax system for 2013 and going forward. The best way to prepare for this is to take advantage of the current favorable 2012 treatment, if possible, by using the \$5,120,000 exemption by gifting before it is possibly lost forever. If the rules become more relaxed, then this can be addressed in the future, but if they tighten back to pre-EGTRRA rules, the current 2012 estate tax advantages have been locked in.

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**QUESTION OF THE MONTH:**

**SHOULD I SPECIFICALLY DESIGNATE A BENEFICIARY TO MY LIFE INSURANCE POLICIES, ANNUITIES AND INDIVIDUAL RETIREMENT ACCOUNTS?**

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**I. Name a Beneficiary**

First, you should always name a beneficiary. Not naming a beneficiary is a big mistake. If you do not name a beneficiary, then the applicable contract language will control. For example, when a person dies, his IRA most likely goes into his estate if he did not designate a beneficiary. All assets in the IRA must then be distributed within five years to the estate's beneficiaries, eliminating any opportunity for tax deferral and potentially triggering a large tax bill. Not naming a beneficiary is similar to not leaving a will when you die – your property will go to someone, but maybe not the person you wanted it to go to.

Second, you should make sure to update your beneficiary designations and to name contingent beneficiaries where possible. Circumstances and relationships, such as marriage, divorce, birth and death, change and you must make sure to account for those changes in your beneficiary designations.

Third, you should take time to consider who or what to name as beneficiary as you can benefit from specific financial and estate planning aspects depending on who you name as beneficiary.

**II. Who can I name as beneficiary?**

**A. Individuals as Beneficiaries**

**Spouse.** Many people name their spouses as primary beneficiary of their accounts. That way, the funds will be available to maintain the welfare of the spouse. At death, the funds pass

free of estate tax to the spouse because of the unlimited marital deduction.

With an IRA, spouses have the great flexibility. Your spouse can rollover your IRA into her own account. If your spouse is younger than you, she can defer for longer the income taxes she will have to pay on distribution because she will not have to take any required minimum distributions (RMD) from the account until she is 70½. Your spouse will also have the advantage of your joint life expectancies which will be used to calculate the minimum payments that must be made and which will make minimum payouts smaller.

**Non-spouse beneficiaries.** In reality, you can name anyone as beneficiary of your financial accounts. You may name a parent, child, grandchild, other relative or friend as beneficiary. You may name your spouse as primary beneficiary and another individual, such as your child, as a contingent beneficiary. That way, in case your spouse dies before you do, or if your spouse disclaims their interest, the property automatically goes to your children.

In the case of an IRA, after you die, non-spouse beneficiaries can extend the required minimum distribution, (RMD), over their own life expectancies. You may even create separate accounts for each beneficiary so that younger beneficiaries may take advantage of smaller distribution requirements.

It is important to remember that anytime you name an individual as beneficiary, you ultimately lose control of the account. After you die, your beneficiary can do whatever he/she wants with your money. The beneficiary could cash out the entire account, thereby ruining any plans you may have intended for long-term, tax-deferred growth. That money could also be available to the beneficiary's creditors, spouses and ex-spouses. The beneficiary may even be able to designate new beneficiaries, who you would not have desired receive the money, of your accounts

## **B. Entities as Beneficiaries**

**Trust.** You can name a trust as beneficiary of your accounts. The benefit of naming a trust as beneficiary is that, through the trust, you still control to whom the money is distributed and when and how it is distributed after your death. For example, suppose you want your IRA money to ultimately go to your child. However, you are afraid your child will squander the money if you name him as primary beneficiary. By naming a trust as beneficiary of your IRA, you can restrict the distributions to your child. You could schedule payouts that last for years preventing your child from cashing out the account. You can direct that the IRA money is to be used for specific purposes to benefit your child, such as paying for education or for medical costs. You could even direct that the income and principal interests of the trust be split, so that one person receives the income of the trust while another person receives principal. The main benefit of naming a trust as beneficiary of your life insurance or IRA is that you can still control when and how the money is paid out after your death.

Of course, naming a trust as beneficiary requires additional planning. You must actually create the trust and it must be drafted correctly. The trust must also meet certain IRS and other legal and regulatory requirements so that you do not face detrimental tax consequences.

**Charity.** You can name a charity as beneficiary of your IRA or life insurance policy. The most significant benefit of doing so is that you can provide financial means to the charity of your choice. Doing so also offers tax benefits. At your death, your estate can take a charitable deduction for the amount left to charity. Meanwhile, if you name a charity as beneficiary to your IRA, the charity can take income tax-free withdrawals from your IRA following your death. A non-charity beneficiary would have to pay income taxes on the distributions from the IRA. If you have the means, there is often no better asset than an IRA to satisfy your charitable objective.

**Your Estate.** You may name your estate as beneficiary of your accounts, but it is unwise to do so. Most likely, your estate becomes the beneficiary because you have failed to otherwise name a designated beneficiary or failed to update your beneficiary designations after a beneficiary died. When your estate is the beneficiary of an account, the account will have to go through the expense and time delay of probate. Also, in the case of an IRA, the money will have to be paid out faster than the RMD guidelines for each beneficiary, usually five years.

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### **Publications**

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: [http://pozzuolo.com/Pubs\\_Articles.shtml](http://pozzuolo.com/Pubs_Articles.shtml)

### **Corporate/Tax**

Design Buy-Sell Agreements For Maximum Utility

Deferred Compensation Rewards And Retains Key Employees

How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool

Protecting A Client's Business From Unfair Competition Using Restrictive Covenants

Money Purchase Pension Plan Falls Out Of Favor

Why An Employment Contract Is Mandatory

What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs

Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules

How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend

Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business

How To Look, Act And Sound Like A Professional Corporation

How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations

How to Structure a Suitable Buy-Sell Agreement

### **Estate Planning**

Estate Planning For Pet Owners

The Limited Liability Company -A Sophisticated Tool For Estate Planning

Diversify Strategies For An Effective Estate Plan

Use Wills To Maximize Family Protection And Minimize Tax

Six Proven Estate Planning Techniques

Divorce Raises The Need For Performing An Estate Planning Review

Divorce and Estate Planning

Remarriage Situations Can Raise Special Estate Planning Considerations

College Funding Tool Offers Estate Planning Advantage

Drafting The Durable Power Of Attorney For Wealth Protection Purposes

Why Living Wills Advance Directives Are An Essential Part Of Estate Planning

Special Needs Trust - An Estate Planning Tool For The Disabled

Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples

***Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.***

This newsletter is courtesy of Pozzuolo Rodden, P.C.

To subscribe, unsubscribe, or for any questions, please contact us at [INFO@POZZUOLO.COM](mailto:INFO@POZZUOLO.COM).