CASNER & EDWARDS

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American Taxpayer Relief Act – Summary of Income, Estate, and Gift Tax Law Changes

Dear Clients and Friends,

On January 2, 2013, President Obama signed into law a major tax bill known as the American Taxpayer Relief Act of 2012 ("ATRA"). The new law provides for revised income tax rates, limitations on certain deductions, and makes permanent the $5 million exemption from the federal estate and gift tax (indexed for inflation), with a 40% estate and gift tax rate. The income, gift and estate tax provisions of ATRA are summarized below, along with corresponding planning opportunities for our clients.

Please note that the tax rates and exemptions of ATRA are **permanent**, and will not expire unless and until new tax legislation is passed.

Income Taxes

Under ATRA, the **top income tax rate** for 2013 and future years increases to 39.6% (up from 35%) for individuals with taxable income over $400,000 a year ($450,000 for joint filers, and $425,000 for heads of household).

Beginning in 2013, an additional 3.8 percent Medicare surtax applies to the lesser of (i) net investment income or (ii) the excess of modified adjusted gross income (AGI) over $200,000 for individuals and $250,000 for married couples filing jointly. This surtax was enacted as part of the Affordable Care Act.

The 2% reduction in payroll taxes will **expire** for 2013 and beyond.

The "patch" for the **alternative minimum tax** (AMT) is now permanent. The AMT exemption amounts for 2012 are $50,600 (for individuals) and $78,750 (married filing jointly) and the exemption amounts are indexed for future years. ATRA also allows the nonrefundable personal credits against the AMT.

Beginning in 2013, **qualified dividends and long-term capital gains** will now be taxed at 20% (up from 15%) for individuals with taxable income over $400,000 ($450,000 for joint returns).

The **Personal Exemption Phaseout** (PEP), which had previously been suspended, is reinstated for 2013 with a starting threshold of $300,000 for joint filers and a surviving spouse ($275,000 for heads of household, $250,000 for single filers, and $150,000 for married taxpayers filing separately). The total amount of exemptions that can be claimed by a taxpayer subject to the limitation is reduced by 2% for each $2,500 (or portion thereof) by which the taxpayer's adjusted gross income exceeds the applicable threshold.

The **“Pease“ limitation on deductions**, which had previously been suspended, is reinstated for 2013 with a threshold of $300,000 for joint filers and a surviving spouse, $275,000 for heads of household, $250,000 for single filers, and $150,000 for married taxpayers filing separately. Thus, for taxpayers subject to the “Pease” limitation, the total amount of their itemized deductions is reduced by 3% of the amount by which the taxpayer's AGI exceeds the threshold amount, with the reduction not to exceed 80% of the otherwise allowable itemized deductions.

For estates and trusts, the 39.6% income tax rate applies to undistributed net income in excess of a very low amount: $11,950 in 2013. In addition, the 20% tax imposed on qualified dividends and long-term capital gains will apply to trusts and estates with undistributed net income in excess of that amount.

> **Comment**: The top 39.6% tax rate, combined with the 3.8% tax on net investment income over the threshold amount, provides a good incentive for fiduciaries to distribute income to beneficiaries who will not have to pay those taxes.

Gift Taxes

The **gift tax exemption for 2013 is $5.25 million**. Estate, gift and generation-skipping taxes continue to be **unified**, so that the $5.25 million exemption also applies to the estate and generation-skipping taxes. The exemption amount for all three taxes will also be indexed for inflation in future years. Thus, taxpayers who had not used up their full gift tax exemption in 2012 have another opportunity to do so in 2013. Even those taxpayers who previously made taxable gifts up to the 2012 exemption limit of $5.12 million can now make another $130,000 in taxable gifts without paying any gift tax. Taxable gifts in excess of the $5.25 million exemption amount made in 2013 will be taxed at a flat rate of 40%, an increase of 5% over the 35% rate that had been in effect in 2011 and 2012.

> **Comment**: ATRA presents another opportunity to make “taxable” gifts in 2013, without paying any gift tax. Even taxpayers who have previously made $5.12 million in taxable gifts will be able to make additional gifts of $130,000 without paying any gift tax. Taxpayers should evaluate the potential for estate liquidity problems created by a large taxable gift.

IRA Charitable Rollover

ATRA extends the IRA Charitable Rollover through 2013. This provision allows individuals who are at least 70 1/2 years old to transfer up to $100,000 per year directly to a public charity without being treated as a taxable withdrawal from the IRA. The transfer can be counted toward the required minimum distribution, and will not be included in the individual’s taxable income. An individual can also make a rollover during January of 2013 and have it count as a 2012 rollover. Also, individuals who took a distribution in December of 2012 will be able to contribute that amount to a charity and count as an eligible charitable rollover to the extent it otherwise meets the requirements for an eligible charitable rollover. Please note that the IRA Charitable Rollover may not be used for contributions to donor-advised funds, supporting organizations or private non-operating foundations.

Comment: If you are over age 70 1/2 and have excess assets in your IRA that could be used for charitable gifts, you have an extended opportunity to transfer up to $100,000 of your IRA to a charity.

Estate Tax

ATRA permanently sets the estate tax exemption at **$5.25 million, indexed for inflation, with a flat tax rate of 40% on excess estate assets over the exemption amount**.

The estate tax exemption is **"portable"**, and portability has been made permanent. The personal representative of a deceased spouse's estate may transfer any unused exemption to the surviving spouse, so a married couple can exempt up to $10.5 million (and likely more in years after 2013, taking into account inflation adjustments) from federal estate tax without using so-called "credit shelter" trust structures. Portability also applies for the gift tax exemption.

Comment: If asset protection is a concern, you may choose to keep all of your assets in one spouse's name. However, given that state estate tax (in Massachusetts, for example) often has a much lower exemption than federal estate tax, it is generally advisable to keep assets somewhat divided between spouses.

Generation-Skipping Transfer Tax

The federal **generation-skipping transfer (GST) tax has an exemption of $5.25 million** per person in 2013, indexed for inflation thereafter. However, the **GST exemption is not portable** between spouses, so careful planning is still required to ensure that a married couple makes complete use of their combined $10.5 million of GST exemption.

Comment: In 2013 and beyond, you will be able to make gifts to grandchildren or more remote descendants up to $5.25 million (less the amount of your GST exemption that was used in prior years), without paying any GST tax.

Please feel free to contact any member of our Private Client & Wealth Management practice with any questions you may have and to discuss their relevance to your particular situation, or about any other estate planning or administration matter.

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