FINALLY! PERMANENT (MOSTLY) TAX LEGISLATION

THE AMERICAN TAXPAYER RELIEF ACT OF 2012 (THE "ACT")

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Just how much change is there in the American Taxpayer Relief Act of 2012? Not much for most individuals and businesses, when compared to the tax laws in effect during the past two years. One welcomed change is that many provisions of the Act are permanent.

Married couples filing jointly with taxable income up to $450,000 and single filers with taxable income up to $400,000 will have the same ordinary income, capital gain and dividend tax rates. The current $5,000,000 gift, estate and generation skipping transfer ("GST") tax applicable exclusion, indexed for inflation, has been made permanent. A number of business tax incentives have been extended. Although there are some changes as discussed in this article, the "fiscal cliff" turned out to be more a political sideshow than a financial crisis.

INCOME TAXATION OF INDIVIDUALS

The marginal income tax rate for individuals *on taxable incomes exceeding* $450,000 for married couples and $400,000 for single filers increases from 35% to 39.6%. In addition, the capital gains and dividends tax rate increases from 15% to 20% *for such income above these thresholds*. For those with incomes below these thresholds, the tax rates and brackets remain at 2012 levels.

The Act extends some tax benefits and allows others to expire. The "payroll tax holiday" which provided a temporary increase in a worker's take-home pay was not extended. As a result, the employee's portion of Social Security tax goes back to 6.2% (from 4.2%) on earned income up to the 2013 taxable wage limit of $113,700. This will mean a $1,000 tax increase for a worker earning $50,000 per year. Itemized deductions and personal exemptions are phased out for married couples filing jointly with an annual income over $300,000 and for single filers with annual income over $250,000. The exemption for the alternative minimum tax has been permanently indexed for inflation. While most of the individual provisions in the Act provide more certainty with permanent changes, some are temporary. One example is that the tax-free treatment for distributions from individual retirement accounts up to $100,000 to qualifying public charities which expired in 2011 has been extended through December 31, 2013.

ESTATE PLANNING

The gift, estate tax and GST applicable exclusions have been permanently unified in the amount of $5,000,000 which, indexed for inflation, will be $5,250,000 in 2013. At least as important, “portability” of a deceased spouse’s unused applicable exclusion has been permanently extended allowing a surviving spouse to elect to increase his or her estate tax applicable exclusion by the amount of his or her deceased spouse’s unused exclusion. For example, if a husband with no prior taxable gifts dies in 2013 leaving his entire estate to his wife, she can make the portability election on his estate tax return and then have an exclusion of $10,500,000. For taxable estates or gifts exceeding an individual’s applicable exclusion, the maximum tax rate has been increased from 35% to 40% beginning in 2013.

Perhaps as important as the changes mentioned above, the Act did not address several key estate planning issues. These include proposals, not enacted, restricting the use of valuation discounts for transfers between related parties, estate tax inclusion of so-called “defective grantor trusts,” and implementing a minimum term for grantor-retained annuity trusts.

BUSINESS PROVISIONS

The Act extends and expands a number of key business tax incentives. It provides a $500,000 maximum cost of “section 179 property” that may be expensed rather than depreciated in tax years beginning in 2012 and 2013. The related investment limitation is $2,000,000 after which the deduction is reduced dollar for dollar by the cost of qualified property placed in service during the year. After 2013, these amounts will be $25,000 and $200,000. In addition, 50% bonus depreciation and the S Corporation recognition period for built-in gains of five years have both been extended through 2013.

CONCLUSION

The 2012 Act contains many changes and implications for every taxpayer. Notably, most provisions in the Act are permanent and will allow for business and tax planning with more certainty than we have had for over a decade. With the higher estate and gift tax exclusion and portability, individuals can engage in estate planning with more emphasis on personal and family goals and less on the more restrictive tax provisions prior to the enactment of "portability." For more detailed discussion and analysis of your personal and business situation, or an update of your existing estate plan, please contact one of the attorneys in our firm.