Thompson Coburn LLP
Private Client News Alert

American Taxpayer Relief Act of 2012

THOMPSON COBURN LLP

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After a heated legislative debate, the U.S. Congress passed the American Taxpayer Relief Act of 2012 (the “Act”), signed into law by the President on January 2, 2013. The Act in large part brought the country back from the “fiscal cliff,” but it did not address all of the debated fiscal cliff issues, most notably spending cuts.

Highlights of the estate, gift and generation-skipping transfer tax provisions are as follows:

• The estate, gift and generation-skipping transfer tax exemptions are set at $5 million, indexed for inflation from 2011. For 2013, the transfer tax exemptions are $5.25 million per individual.

• The top transfer tax rates are set at 40% (an increase from the 35% maximum tax rate in 2012 and a decrease from the 55% previously set for 2013).

• Spousal “portability” has been extended. The portability election allows a surviving spouse to use the unused estate tax exemption of the deceased spouse to shelter lifetime gifts from gift tax or to pass additional assets free of estate tax at the surviving spouse’s subsequent death.

• The estate and gift tax provisions have been adopted permanently. This marks the first time in more than a decade that taxpayers can engage in planning in a permanent estate and gift tax environment.

A major component of the fiscal cliff negotiations was how to address the expiration of the income tax cuts enacted by President George W. Bush. While a majority of Americans will not see an increase in their individual income taxes, many significant income tax provisions included in the Act will affect higher income individuals, trusts, and estates. Some of the key provisions include:

• The income tax provisions of the Bush-era tax cuts are extended, except that the top income tax rate for individuals is increased to 39.6% for taxable income above certain threshold amounts (indexed for inflation). For 2013, these threshold amounts are $400,000 for unmarried individuals, $425,000 for head of households, and $450,000 for married individuals filing jointly. For trusts and estates, the 35% tax bracket has been eliminated and the threshold amount for the 39.6% bracket is only $11,950 in 2013.

• The maximum tax rate on qualified dividends and long-term capital gains has been increased to 20%.

• Although not part of the Act, a new 3.8% tax on net investment income also is applicable beginning in 2013. The threshold amounts for this tax are $200,000 for single taxpayers and heads of households, $250,000 for married taxpayers filing jointly and $11,950 for trusts and estates.

• Individuals can continue to make tax-free distributions of up to $100,000 from individual retirement plans directly to charity in 2013 only.

• The phase-out of the personal exemptions and itemized deductions for individuals with adjusted gross income above certain amounts is reinstated.

Planning Opportunities

• Individuals who have foregone reviewing their estate plan due to the uncertainty in the tax laws can now engage confidently in planning. Given the higher tax exemptions, we urge individuals to confirm with us that their documents accurately memorialize their wishes, taking into account any discrepancy in the federal estate tax laws with their state estate tax laws which may result in the imposition of state, but not federal, estate tax. In many cases, as a result of the higher transfer tax exemptions and higher income tax rates, an increased focus on income taxes and basis step up at death may be appropriate.

• The higher tax exemptions may eliminate an individual’s expected estate tax liability, but other issues should still be addressed through the estate planning process, including such things as planning for minor children, planning for the individual’s incapacity, evaluating creditor protection opportunities, and planning for family members with special needs.

• The higher tax exemptions provide opportunities for large gifts and leveraged transactions designed to transfer large amounts of wealth with minimal transfer tax consequences. However, some of these planning techniques have been identified as potential targets for future legislation. Individuals should meet with us now to evaluate opportunities before Congress begins work on legislation addressing spending cuts.

• Individuals should plan proactively with their tax and investment advisors to minimize the impact of the higher income tax bracket, if applicable, and consider the impact of the 3.8% net investment income tax, particularly in the context of assets held in irrevocable trusts.

If you have further questions concerning the American Taxpayer Relief Act of 2012, please contact your Thompson Coburn attorney or one of the Private Client attorneys listed below:

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