How The American Taxpayer Relief Act of 2012 Will Effect You

On January 1, 2013, Congress passed the American Taxpayer Relief Act of 2012 ("ATRA") in an effort to stave off increased taxes and spending reduction measures that were required to take place in 2013 under previously enacted laws. Below is an explanation of a selection of issues addressed in ATRA that you should consider along with other estate planning strategies.

The Unified Credit

The Unified Credit encapsulates the exclusion amount, the gift exclusion and the generation-skipping transfer tax exemption. These provisions were provided for in ATRA as follows:

Federal Estate Tax Exclusion Amount

The estate tax exclusion amount will remain at $5.12 million, with adjustments for inflation, as set forth in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and extended in ATRA. In 2012, the inflation adjustment resulted in an Exclusion Amount of $5.120 million. Therefore there is no federal estate tax on estates that amount to less than $5.120 million (to be adjusted for inflation).

Lifetime Gifts Exclusion

The Lifetime Gift exclusion currently remains at $5.120 million, with adjustments for inflation. This tax law, interpreted along with the estate tax exclusion amount, means that if a person has made a gift of $2 million during her life time (and filed the required gift tax return), the amount of her estate that can pass tax free at her death is $3.120 million ($5.120 million - $2 million = $3.120 million).

Generation-Skipping Transfer Tax Exemption

The Generation-Skipping Transfer Tax exemption has also been made permanent at $5.120 million, to be adjusted for inflation. Generation-skipping gifts over and above this amount will be taxed at the rate of 40% under ATRA.

Annual Gifts - Increase

The Annual Gift exclusion amount increased from $13,000 to $14,000 under the American Taxpayer Relief Act. A person can make annual gifts to an unlimited number of individuals in the amount of up to $14,000 per year tax-free. Gift taxes will be avoided under this scenario so long as no more than $14,000 is paid from any one individual to any other individual in one calendar year. For example, if a married couple has 2 children, and 4 grandchildren, the husband and wife could each pay $14,000 to each child, and each grandchild, which would amount to $168,000 per year (2 individuals x $14,000 x 6 children/grandchildren), without having to pay any gift tax.

Federal Estate Tax - Limited Increase

The Federal Estate Tax is the tax on the amount of an individual's or married couple's estate that is in excess of the exclusion amount. As a result of the American Taxpayer Relief Act of 2012, the Federal Estate Tax rate has increased from 35% to 40%. This means that for all estates in excess of the exclusion amount referenced above, an estate over that limit will now be taxed at a rate of 40%.

Marital Deduction - No Changes

The "Marital Deduction" refers to marital assets that pass from one spouse to the other spouse tax-free following the death of the first spouse. For all U.S. citizens, the amount that can pass from one spouse to the other at death is unlimited. This tax law remains unchanged under the new legislation.

Highest Marginal Income Tax Rate - Limited Increase

The previous tax brackets of 10%, 15%, 25%, 28% and 33% are permanently extended through ATRA. As for the 35% bracket, it is limited to $400,000 for individual filers. ATRA provides for a new 39.6% bracket, which will be as follows:

Married Filing Jointly:	$450,000 of taxable income
Qualifying Widow(er):	$450,000 of taxable income
Head of Household:	$425,000 of taxable income
Single:	$400,000 of taxable income
Married Filing Separately:	$225,000 of taxable income

Charitable Deductions

The charitable deduction rate is linked to an individual or married couple's highest tax rate. For example, if an individual or married couple's top earnings are taxed at the rate of 35% , the deduction value of a charitable donation for that family is equal to the same rate of 35%. The deduction, however, has been capped at 35%, even for families who are taxed at the higher rate of 39.6%.

Itemized Deductions - Limited Reduction

As a result of the new legislation, individuals with income in excess of $250,000 and married couples with income in excess of $300,000, will see a reduction of 3% on the value of itemized deductions.

Tax on Dividends and Capital Gains - Limited Increase

The tax on capital gains and qualified dividends, under ATRA, will increase from 15% to 20% for gains or receipts for those that fall in the new 39.6% tax bracket. ATRA permanently retains the 0% and 15% rates on qualified dividends and long term capital gains for other tax brackets.

IRA Charitable Rollover - Extended

An IRA Charitable Rollover allows a donor to take an income tax deduction when she withdraws funds from a traditional IRA and donates those funds to a charity. Generally, when an individual makes a withdrawal from a traditional IRA, the withdrawal must be reported as ordinary income and taxed accordingly. However, when the withdrawn funds are donated to a charity, the individual may be entitled to an income tax deduction for the value of the donation.

This "IRA Charitable Rollover" allowance was set to expire in 2012. However, as a result of the new legislation, the charitable rollover has now been extended for 2 years, commencing with 2012. Additionally, charitable rollovers can still be made in January 2013 for the 2012 year.

For individuals who were required to take mandatory distributions for December 2012 as a result of the extension of the rollover, the distribution can still be donated to a qualified charity in January 2013 in order for the distribution to avoid taxation.

Temporary Suspension of Payroll Tax not Extended

Prior legislation temporarily suspended a portion of the payroll tax and that suspension expired in 2012. The suspension was not extended under the new legislation and now, as a result, payroll taxes will rise 2% for most wage earners earning less than approximately $110,000.

DID YOU WANT TO ADD YOUR THOUGHTS ON THE FISCAL CLIFF, AVERTED, HERE?

If you would like to discuss how the new law will impact you, please contact the attorneys at Cooper-Gordon LLP. They have over sixty years of combined experience in the areas of estate planning and estate and trust administration.