"Fiscal Cliff" Tax Bill: The Highlights

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On New Year's night the House of Representatives passed the Senate-approved tax and spending bill aimed at averting the well-publicized "fiscal cliff" stemming from a combination of expiring tax cuts and steep budget cuts.

While the measure is expected to raise taxes by about $600 billion over 10 years, it offers some comfort for many taxpayers who may have been preparing for the worst. Here are some of the tax-related highlights:

ESTATE AND GIFT TAXES

For the most part, the new fiscal cliff law makes permanent the system that has been in effect for the past two years. Had Congress not acted, the estate tax-free amount would have automatically reverted to $1 million per person, and the rate for most estates would have gone up to 55%. But after the dust settled from the recent legislation, the main thing that the lawmakers changed is the gift and estate tax rate, which has gone up to a top rate of 40% from a maximum of 35%.

Other estate and gift tax provisions include the following:

- The new law preserves the right to leave your unused federal estate and gift tax exemption to your surviving spouse (the "exemption portability" feature). Under this provision, widows and widowers can add to their own exclusion any unused exclusion of their deceased spouse. This enables them together to transfer up to $10.24 million tax-free. (*Note:* The "portability" is not automatic. The personal representative handling the estate of the spouse who died will need to transfer the unused exclusion to the survivor, who can then use it to make lifetime gifts or pass assets through his or her estate. The prerequisite is filing an estate tax return when the first spouse dies, even if no tax is owed.)
- The new law also preserves the unlimited deduction from estate and gift tax that postpones the tax on assets inherited from a deceased spouse until the second spouse dies. This "marital deduction" applies only if the inheriting spouse is a U.S. citizen.
- The lifetime gift tax exclusion and the estate tax exclusion are still merged as a "unified credit" – currently $5.25 million per person – that can be used to transfer

assets via gifting or inheritance. Estates that exceed the limit of the unified credit are subject to a tax of up to 40%.

- The annual gift exclusion went up to $14,000 on January 1, meaning that you can now give another person $14,000 per year without it counting against your lifetime exemption, and so can your spouse. Spouses can combine this annual exclusion to double the size of the gift. For example, this year, relying on the annual exclusion, a married couple with a child who is married and has two children could make a joint cash gift of $28,000 to the adult child, to the child's spouse, and to each of their two grandchildren, providing the family with $112,000 a year. Only gifts that exceed the limit count against the lifetime exclusion.

INCOME TAXES

The decade-old Bush-era tax cuts are preserved on incomes up to $400,000 for individuals and $450,000 for couples. Earnings above those amounts will be taxed at a rate of 39.6%, up from the current 35%. The new law extends existing caps on itemized deductions and the phase-out of the personal exemption for individuals making more than $250,000 and married couples earning more than $300,000.

CAPITAL GAINS AND DIVIDENDS

Tax rates on capital gains and dividend income exceeding $400,000 for individuals and $450,000 for families increase from 15% to 20%.

ALTERNATIVE MINIMUM TAX (AMT)

Removing the need for annual "patches" to protect taxpayers from inflation-related AMT liability, the new law permanently indexes the AMT for inflation and spares nearly 30 million middle- and upper-middle income taxpayers from being hit with higher tax bills.

TAX CREDITS

The new law preserves the child tax credit, earned income tax credit, and a maximum $2,500 credit for college tuition. For business owners, it extends for one year the accelerated "bonus" depreciation of business investments in new property and equipment, a tax credit for research and development costs and a tax credit for renewable energy such as wind-generated electricity.

PAYROLL TAXES

The 2-percentage-point cut in the employee's portion of the payroll tax, first enacted two years ago, was allowed to expire. The tax rate returns to 6.2% from 4.2%.

CONTACT US

This article provides a brief summary of the tax-related highlights of this important legislation, and we anticipate more details and analysis in the near future. For now, if you have any questions regarding the new law's impact on your estate planning situation, please contact Ron Adams at radams@halaw.com or 480-345-8845.

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