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American Taxpayer Relief Act of 2012

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On New Year's Day 2013, to avoid the so-called "fiscal cliff," Congress passed the American Taxpayer Relief Act of 2012 ("2012 Act"). The 2012 Act raises taxes on some taxpayers while retaining most of the provisions enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA," generally referred to as the "Bush tax cuts") and the two-year extension of EGTRRA enacted at the end of 2010. Most of the changes introduced by the 2012 Act relate to income tax; however, there are important changes to the gift, estate, and generation-skipping transfer tax provisions as well.

Under the 2012 Act, the gift, estate, and generation-skipping transfer tax provisions of Internal Revenue Code are now "permanent," meaning that the sunset provisions of EGTRRA have been repealed. The current law has no expiration date. The $5 million exemptions for the gift tax, estate tax and the generation-skipping transfer tax (collectively, the "transfer taxes") are still provided and are to be indexed for inflation. The exemptions are indexed to $5.25 million this year, so that taxpayers who gave away the full $5.12M in 2012 can still give an additional $130,000 this year sheltered by the gift tax and/or generation-skipping transfer tax exemptions. To the extent that gift tax or estate tax is incurred under the 2012 Act, the top marginal rate was increased from 35% to 40%. In addition, "portability," which permits a surviving spouse to use any unused estate tax exemption of the deceased spouse, has been made permanent.

Also notable for this year is that the annual exclusion amount – the amount of an annual gift each taxpayer can give to an unlimited number of persons without needing to report the gifts to the Internal Revenue Service – has increased due to inflation and is now $14,000 per donee. Not all gifts qualify for the gift tax annual exclusion, however.

Despite the fact that the 2012 Act eliminated the uncertainty arising out of the EGTRRA sunset provisions, there are pending legislative proposals by the Obama administration to reform the transfer tax laws in a manner that will limit the planning options currently available to taxpayers. Possible changes include: (i) limiting or eliminating minority discounts for family companies or partnerships; (ii) limiting the number of generational transfers of assets held in trust which can be sheltered by the GST exemption; (iii) limiting the benefits of grantor trust status of a trust; and (iv) mandating a minimum 10-year term for grantor retained annuity trusts. We do not yet know when Congress will take up the question of tax reform, but it is clear that fiscal issues are going to be a recurring item on the Congressional agenda this year in the debt ceiling debate and any negotiations over the sequester.

In light of the foregoing, individuals who wish to take advantage of the planning opportunities under current law that may be eliminated and/or who wish to use their unused portion of the increased exemption amounts by making gifts this year should do so promptly because of the risk of additional changes to the tax code this year. Individuals wishing to make annual exclusion gifts in 2013 would also benefit from completing those gifts sooner rather than later, so that there is enough time to carry out whatever steps may be necessary to complete them, especially in light of possible additional tax changes which may add pressure to year-end planning.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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