Fiscal Cliff Legislation 2013

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"Reader, suppose you were an idiot. And suppose you were a member of Congress. But I repeat myself." Mark Twain.

INTRODUCTION:

2012 proved to be a very busy year end for estate planning professionals. With the least productive Congress in over 50 years, the lawmakers grappled with many of the Bush-era expiring provisions in the tax code. Clients wanting to take advantage of certain 2012 laws and uncertain about any extension flocked to planners in an effort to save taxes. Clients were concerned about the $5,120,000 gifting exemption reverting to $1,000,000 and were certain that dividend rates would be going up in 2013. It is likely that more trusts were done toward the end of 2012 than any other year in recent memory.

Despite Congress being called back early to make sure America did not plunge off the "fiscal cliff" which could potentially send America back into recession, Congress did not meet the initial set of deadlines. However, knowing that banks and other financial institutions were closed on January 1st, Congress played out its negotiations without passing a bill until 15 minutes before the real midnight deadline on the 31st.

Confusion was prevalent as up to the minute news sources quoted key Congressman throughout the hours of December 31st. Some sources reported that no deal was in sight and America was plunging off the cliff. Others reported that a deal had been struck. What we now know is that many extensions of the Bush-era tax cuts were granted. This article will highlight some of those extensions and provide summary guidance for planners looking to serve clients in 2013.

WHAT HAPPENED:

The Fiscal Cliff (coined by Ben Bernanke for the 2013 economy but not the originator of the word; the earliest reference seems to be for a New York Times article in 1957 about homeownership) came about as a manufactured consequence of inability to act. Some have considered the 112th Congress the worst Congress in decades based on the following:

--They passed very few laws (220 bills total);

--With a 9% approval rating they were less popular than the IRS, Airline Industry, Lawyers, Banks, BP during the Oil Spill, Paris Hilton and Hugo Chavez just touching out Fidel Castro. (Sources Gallup Polls, NYT, CBS).

-- They are very polarized, in fact the most since the end of Reconstruction;

--They interrupted recovery and cause a loss to the US Credit Rating;

--Nothing was done timely;

--The FAA shutdown on July 23, 2011 causing 74,000 workers to be furloughed at a cost from uncollected airline ticket taxes was $350 million;

--33 attempts were made to repeal the Patient Protection and Affordable Care Act at an estimated cost of $50 million according to CBS news;

--Aversion to decision meant that many in the financial and estate planning world did not get much of a winter break over the holidays, including Congress itself.

Yet, despite all of these terrible report card measures, nothing much changed as we moved to the 113th Congress. President Obama was re-elected. Democrats and Republicans retained control of the Senate and House, respectively. Some faces changed, but we could be set up for another session of leadership measured by inability to act. There is no question that the fiscal cliff could have been averted with more organized planning and attention. However, it seems that Congress has taken the path of a new middle school child that fails to do their homework until the night before the exam and then tries to cram it all in. Inevitably the result is not as good as methodical study and timely preparation yields. Time will tell whether the "permanent" laws will stay permanent or be another label that can be peeled away like a size sticker on new clothes.

The American Taxpayer Relief Act of 2012

Signed by President Obama January 2, 2013

ESTATE TAXES:

The American Taxpayer Relief Act of 2012 (ATRA) repealed Title IX of EGTRAA and the 2010 Tax Relief Act Section 304. Thus, all estate, gift and generation skip tax laws that were in place in 2012 have been extended into 2013 and the foreseeable future with one significant change: The top tax rate for estate and gift tax is now 40% instead of the 2012 35% rates. The federal exclusion and GST exclusions continue to be indexed with inflation and are $5,250,000 for 2013 with a $14,000 gift tax exemption in 2013. Clawback, which seemed to be an issue for many if the prior law sunset, became irrelevant. The following table demonstrates the new tax rates for estates of decedents dying and generation skipping transfers, and gifts made after December 31, 2012:

Over $500,000 to $750,000; tax is $155,800 plus 37% over $500,000

Over $750,000 to $1,000,000; tax rate is $248,300, plus 39% of the excess over $750,000.

Over $1,000,000; tax rate is $345,800, plus 40% of the excess over $1,000,000.

GST follows the same rates under the ATRA.

Note: These are “tentative tax rates” not including the exclusion that is permitted of $5,120,000. Thus, for practical purposes, the rate is really 40%.

ATRA also provided a technical correction to the portability rules replacing the term “basic exclusion amount” with the familiar “applicable exclusion amount” for all estates of decedent’s dying after December 31, 2010.

→PRACTICE TIP: Maybe time to take out of forms any language that refers to Basic Exclusion Amount.

Considering portability was continued, do we as practitioners need to continue to use Family Trust/Credit Shelter Trust planning? This author argues yes, because while the federal tax allows portability, Washington and Oregon still do not. The exclusions in those states are $2,000,000 and $1,000,000 respectively and as a result, this author believes that a place still exists for such tax planning.

INCOME TAXES:

Individual:

Individual rates at 10%, 25%, 28%, 33% and 35% were made permanent. High income taxpayers are taxed at 39.6% after 2012 above a certain threshold. High income taxpayers are those who have taxable income of: $450,000 married filing jointly; $425,000 head of household; and $400,000 for single taxpayers. Married filing separately is $225,000. These amounts are adjusted for inflation after 2013.

Marriage penalty relief was extended. A penalty exists whenever the tax on a couple's joint return is more than the combined taxes each spouse would pay if they weren't married and each filed as single or head of household. While some relief was granted by preventing the repeal of the 15% amount, the marriage penalty is not eliminated because the joint brackets are not simply double the single brackets. Inflation adjustments apply.

Reduced rates for Kiddie Tax. Withholding rates for a parent who elects to report a child's tax on the parent's return were reduced or stayed the same instead of rising as a result of the repeal of the EGTRRA changes. See Section 101(a)(1) of ATRA for more information.

Trusts and Estates:

25%, 28% and 33% trust and estate income tax rates are permanent extended. Top rate of 39.6% now exists after 2012. ATRA also changed the rule that modifies the rates to be applied under the statutory trusts and estate income tax rate schedule to specially provide that in applying that statutory rate schedule a 28% rate is substituted for the 31% rate and a 33% rate was substituted for a 36% rate. Following is the rate schedule approved by the IRS in Rev. Proc. 2013-15:

Not over $2,450	15% of taxable income.
Over $2,450 but not over $5,700	$367.50 plus 25% of the excess
Over $5,700 but not over $8,750	$1,180.50 plus 28% of the excess
Over $8,750 but not over $11,950	$2,034.00 plus 33% of the excess
Over $11,950	$3,090.00 plus 39.6% over the excess

Capital Gains and Dividends:

Capital Gains and Qualified Dividends.

The 0% and 15% rates were made “permanent.” Under ATRA, the 15% rate applies to the lessor of: (i) the portion of the adjusted net capital gain (or, if less, taxable income) that exceeds the amount that is taxed at a 0% rate; or (ii) the excess of the amount of taxable income that would otherwise be taxed at a rate below 39.6%, over the sum of the amounts that are taxed at ordinary income rates or the 0% capital gain rate. A new 20% rate applies to the adjusted net capital gain (or, if less, taxable income) that exceeds the amount that is taxed at the 0% or 15% rates.

In essence, if the tax would ordinarily be at the 10% or 15% rates, then the rate is 0% on capital gains. If the tax would ordinarily be at the 25%, 28%, 33% or 35% rates then the rate will be 15% on capital gains. If the tax would ordinarily be at the 39.6% rate, then the rate is 20% ($450,000; $425,000, $400,000 and $225,000 income levels depending on reporting).

Keep in mind that a new 3.8% net investment income tax (NIIT) applies to most capital gains starting in 2013. NIIT applies to taxpayers whose modified adjusted gross income exceeds $250,000 for joint returns and surviving spouses, $125,000 for separate returns and $200,000 in all other cases.

Qualified dividends are for the most part treated the same.

NOTE: Sale of assets now held more than five years will not be taxed at a lower rate than sales of assets held more than one year.

EXTENTIONS OF MISCELLANEOUS PROVISIONS:

Many other laws that were set for repeal were "permanently" extended by ATRA. The list is numerous and there are a variety of sources available documenting such extensions. Some of the more relevant to a practice are as follows:

--Section 1202: 100% gain exclusion on qualified small business stock was retroactively restored and extended through December 31, 2013.

--Section 306(a)(A)(D): To the extent an individual shareholder recognizes ordinary income on the disposition of Section 306 stock (other than a redemption), that amount may be treated as qualified dividend income is now permanent.

--Personal exemptions now phase out when AGI exceeds $300,000 for joint returns and $250,000 for single filers.

--Overall limitation on itemized deductions is restored and applies when AGI exceeds $300,000 for joint returns and $250,000 for single filers.

--May still claim a deduction for state and local sales tax instead of income tax.

--Exclusion for debt discharge income from home mortgage forgiveness is extended for one year until December 31, 2013.

--The per child child tax credit is $1,000 and is refundable for all taxpayers with qualifying children to the extent of 15% of the taxpayer's earned income in excess of threshold amounts.

--AMT exemption amounts are increased to $50,600 for unmarried taxpayers and $78,750 for joint filers for 2012 and are indexed for inflation after 2012. No more "patches" for a while?

--AMT rates on capital gains and qualified dividends are 0%, 15% and 20% after 2012.

--Child tax credit can permanently offset AMT.

--Expensing rules for qualified film and television productions are retroactively extended for two years to productions beginning before Jan 1, 2014 (expensing vs. capitalizing).

--Section 179 deductions increased with larger phase-out levels. ($500,000 subject to a phase-out for 2012 and 2013 of $2,000,000). After 2013, the maximum will be $25,000 and phase-out will drop to $200,000. Now is the time to buy to expense rather than capitalize!

--Off the shelf computer software as qualifying property through 2013.

--Can still amend or irrevocably revoke 179 without IRS consent.

--For qualified property acquired and placed in service before January 1, 2014, additional first year depreciation may be as high as 50% of the cost of the investment placed in service.

--Tax free IRA distribution of up to $100,000 if donated to charity is extended through December 31, 2013.

--S-corporation's contribution of property to charity only reduced shareholder's basis by the contributed property's basis extended.

--Shortened S-corp. built in gains period extended upon conversion from C to S (5 years instead of 10).

--The termination date is now December 31, 2013 for special UBTI rules related to payments made under binding written contracts (i.e. income is received from a taxable or tax-exempt subsidiary that is 50% controlled by the parent tax-exempt organization, to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax-exempt).

CONCLUSION:

With the end of the 112th Congress and beginning of the 113th Congress, we can hope that the newly minted Congress will allow some level of certainty to continue so that Americans can plan estates in a meaningful and thoughtful manner. For the wealthy Americans, additional planning techniques will need to be explored or else such individuals will be paying higher taxes during life and at death.

While the above is a summary of ATRA, code sections and regulations should be consulted. Nothing herein shall be deemed to be an opinion nor should it be relied upon as authority for legal interpretation of a particular fact pattern. The above is presented for general information in summary format only.

Your Speaker:

Robert Kabacy is the managing partner of the Estate and Business Departments of Kell, Alterman & Runstein, LLP which has been around since 1929. His practice primarily consists of estate planning, business transition, taxation and corporate matters. He has written a book, "Last Wishes" and has published the world's first iTunes app specifically for estate planners, known as "Tax-Calc Now." He serves on the national planned giving advisory board of the American Cancer Society and serves on the board of the Ronald McDonald House Charity. He lives with his wife Krista, son Andrew and greyhound, Candy. When not practicing law, he pursues his hobby of magic and continues to swim recreationally after being a four year all American and national record holder in collegiate swimming.