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BLOG POST

Wealth Transfer Tax Provisions of the American Taxpayer Relief Act of 2012

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After more than a decade of uncertainty, guessing and conjecture, the United States once again appears to have permanency with respect to the Federal estate, gift and generation-skipping transfer (“GST”) taxes. Under the American Taxpayer Relief Act of 2012, the following laws would be made permanent for transfers of wealth (either during life or at death) occurring after December 31, 2012:

- The Federal estate, gift and GST exemption amounts would each be made permanent at $5 million, indexed for inflation;
- The top tax rates for transfers in excess of the exemption amounts are increased from 35% to 40% - marking the first increase in the estate tax rate since 1941;
- Making permanent the “portability” of a deceased spouse’s unused estate tax exemption amount to his or her surviving spouse; and
- Making permanent several other taxpayer friendly technical rules that have been available since 2001, but never on a certain basis.

Opportunities Made Available under the American Taxpayer Relief Act of 2012
Although the American Taxpayer Relief Act of 2012 would make permanent the $5 million estate tax exemption amount (indexed for inflation) and therefore avoid a return to the 2001 level of $1 million, U.S. citizens and residents should continue to consider taking advantage of the $5 million gift and GST exemption amounts by engaging in lifetime estate planning transactions that could potentially result in tremendous estate tax savings.

Lifetime transfers of assets are economically efficient because once transferred, the value of the assets can experience significant growth in the hands of the new owners (typically, children, grandchildren or trusts for their benefit), as opposed to in the transferor’s hands. As a result, the amount of the growth will not be subject to wealth transfer taxes upon the transferor’s death. Because asset growth can sometimes be “explosive” in nature (think, for example, the right type of undeveloped mineral interest that suddenly becomes the subject of a successful exploration and development effort), it is better to transfer assets sooner rather than later. Even if no “explosive” growth is expected, it is still better to transfer assets sooner rather than later because any appreciation in value will occur in the hands of the recipient of the gift. On the other hand, if the senior generation continues to retain the assets instead of deciding to give them to the succeeding generations, the growth in value on the retained assets continues to accrue in the hands of the senior generation, compounding the effect of the wealth transfer tax problem and increasing the overall tax ultimately due.

In addition, even with the permanence of exemption amounts and rates, additional laws could be enacted that restrict the manner in which taxpayers can take advantage of the increased exemption amounts. President Obama has already identified many of these proposed changes in his General Explanations of the Administration's 2013 Revenue Proposals (released February 13, 2012), so time remains of the essence.

For more information, contact ***Glen Eichelberger*** or Brian Teaff.