American Taxpayer Relief Act of 2012 Becomes Law

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Many farmers and ranchers finally have an increased level of certainty regarding their federal estate and gift tax planning. After several years of worrisome temporary changes and “sun setting” unified credit exclusion amounts, the January 3, 2013 passage of the American Taxpayer Relief Act of 2012 has made permanent the federal estate tax and federal gift tax exclusion at the inflation adjusted amount of $5,000,000 per person or $10,000,000 per married couple. If Congress had failed to act, federal estate tax and federal gift tax exclusion amounts would have reverted back to $1,000,000 per person and federal estate tax rates would have gone up from 35 to 55 percent, which means that individual’s estates over $1,000,000 would have been required to pay a 55 percent tax on asset transfers on amounts over $1,000,000. With the increase in land values this would have created a serious tax consequence for many farmers and ranchers throughout the state.

**Unified Credit $5,000,000 Per Person (inflation adjusted)**

The unified credit exempts assets from “federal transfer taxes.” We have two types of “federal transfer taxes,” the federal estate tax, which applies when assets are transferred at a time of death transfer; and federal gift tax, which applies when assets are transferred during the lifetime of the giver when annual amounts of the gift are greater than the annual gift tax exclusion amount (see example on next page). These two taxes have a unified credit or exclusion amount, which means that if an individual gives away assets during their life, the amount of those lifetime transfers (over the annual gift exclusion amount) will be deducted from the exclusion amount they have available at the time of their death. An individual can either pass $5,000,000 (inflation adjusted)
to his/her heirs during his/her lifetime, or $5,000,000 (inflation adjusted) at the time of his/her death, but not both.

For the past several years there have been many temporary fixes and adjustments to both estate and gift tax exclusion amounts, as well as whether or not these exclusion amounts were unified. The January 3, 2013 passage of the American Taxpayer Relief Act of 2012 has made permanent a unified federal estate tax and federal gift tax exclusion amount at the inflation adjusted amount of **$5,000,000 per person.** The time of death estate tax exclusion and the lifetime gift tax exclusion is adjusted annually for inflation, so in 2013 the inflation adjusted amount is expected to be $5,250,000 per person. The federal estate tax rate has been permanently raised from 35 to 40 percent on amounts over $5,000,000 (inflation adjusted). It should be noted that the word permanent does not mean that the law cannot be changed, because of course the House of Representatives and the Senate can change the law if they see fit. Permanent refers to the fact that the unified credit will no longer be up for periodic review and exclusion amounts will not change every few years, as they have in the recent past.

**Annual Gift Exclusion $14,000 (2013)**

Amounts gifted under the annual exclusion of $14,000/person/year for 2013 do not count against the lifetime gifting exclusion or the unified credit. For example, a husband and wife could each gift $14,000 to all three of their children each year without reducing their federal unified credit. $14,000 x 3 children for each the husband and wife = $84,000 annually. If the three children are married, you could gift to each of your children’s spouses as well and increase the annual amount that could be gifted to your children and their spouses to $168,000 without reducing the unified credit of $5,000,000 (inflation adjusted) per person, or $10,000,000 (inflation adjusted) for a married couple. As long as the gift is valued below the annual gift exclusion it does not reduce the lifetime gift exclusion of $5,000,000 (inflation adjusted). If larger gifts over the annual exclusion are given it will reduce the unified credit. For example, if I make a gift to my son of $100,000, the first $14,000 passes without triggering federal estate tax or federal gift tax, nor does it create the requirement to file a federal gift tax return (although there may be good accounting reasons to do so). The next $86,000 of the $100,000 gift will, however, reduce my unified credit from $5,250,000 to $5,164,000. I therefore only have a remaining credit of $5,164,000 to be used to transfer assets at a time of death or to gift assets during my lifetime.

**Portability Continues Available**

An important concept in estate planning is to make sure each spouse’s unified credit is applied and not wasted. The Portability provision under the new law allows a surviving spouse to file with the IRS to transfer the unused portion of their deceased spouse’s $5,000,000 (inflation adjusted) unified credit to themselves, so the surviving spouse can now have up to $10,000,000 (inflation adjusted) unified credit. There are some time limits on this provision. This can be done after the death of the first spouse even though the deceased spouse did not make any plans for such a provision, but this is not a substitute for good planning.

Farm and ranch estate planning is now much easier to do. Even though land may increase in value faster than the inflation adjustment in the unified credit, we have a much more predictable situation to work with regarding farm and ranch asset transfers to the next generation.

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