Alerts and Updates

Obama Administration's 2013 Budget Proposal Includes Key Changes to Income Tax and Transfer Tax Provisions

February 27, 2012

On February 13, 2012, the Obama administration presented its revenue proposals for fiscal year 2013. Among these proposals are several significant changes to various income tax and transfer tax provisions.

Income Tax Proposals

These proposals would be effective beginning January 1, 2013.

- *Reinstate limitation on itemized deductions for upper-income taxpayers* – Itemized deductions generally would be reduced by 3% of the amount by which adjusted gross income (AGI) exceeds $250,000 for married taxpayers filing jointly, $225,000 for head-of-household taxpayers, $200,000 for single taxpayers or $125,000 for married taxpayers filing separately.

- *Reinstate phase-out of personal exemptions for upper-income taxpayers* – The personal exemption would be reduced by 2% of the exemption amount for each $2,500 ($1,250 if married filing separately) by which AGI exceeds $250,000 for married taxpayers filing jointly, $225,000 for head-of-household taxpayers, $200,000 for single taxpayers or $125,000 for married taxpayers filing separately.

- *Reinstate higher income tax brackets* – Part of the 33% income tax bracket would be replaced with a 36% income tax bracket, and all of the 35% income tax bracket would be replaced with a 39.6% income tax bracket.

- *Sunset reduced tax rates on qualified dividends for upper-income taxpayers* – Qualified dividends would be taxed as ordinary income for income that would be taxable in the 36% or 39.6% income tax brackets.

- *Sunset reduced tax rates on capital gains for upper-income taxpayers* – Net long-term capital gain would be taxed at a 20% tax rate for capital gain income that, but for the preferential tax treatment of long-term capital gain, otherwise would be taxable in the 36% or 39.6% income tax brackets.

- *Limit value of specified deductions and exclusions for upper-income taxpayers* – Certain specified exclusions and deductions (such as tax-exempt state and local bond interest, employee contributions to defined contribution retirement plans and IRAs, and itemized deductions) that otherwise would reduce taxable income in the 36% or 39.6% income tax brackets would be limited to 28%.

- *Modify minimum required distributions rules* – The minimum required distribution (MRD) rules for IRAs and other tax-favored retirement plans would not apply if the total value held in such accounts for an individual does not exceed $75,000, and would phase-in if the total value is between $75,000 and $85,000.

Transfer Tax Proposals

Except as noted below, these proposals would be effective as of the date the proposals are enacted, rather than January 1, 2013.

- *Restore estate, gift, and generation-skipping transfer taxes to 2009 parameters* – The maximum estate, gift and generation-skipping transfer (GST) tax rate would be 45%. The estate tax and GST tax exemptions would each be $3.5 million, and the gift tax exemption would be $1 million. However, the "portability" of unused estate and gift tax exemptions between spouses would continue. This provision would be effective beginning January 1, 2013.

- *Require consistency regarding basis for transfer tax and income tax purposes* – An executor would be required to report the basis of property transferred at death and a donor would be required to report the basis of property transferred by gift. The recipient in either case would be required to use that basis.

- *Modify rules on valuation discounts* – An additional category of "disregarded restrictions" would be defined that would be ignored for purposes of valuing an interest in a family-controlled entity that is transferred to a family member if, after the transfer, the restriction may lapse or may be removed by family members. Instead, the interest would be valued by substituting alternate assumptions specified in treasury regulations for the disregarded restrictions in the entity’s governing instrument.

- *Modify requirements for GRATs* – A grantor retained annuity trust (GRAT) would be required to have a minimum term of 10 years and a maximum term of the life expectancy of the annuitant plus 10 years. In addition, the value of the remainder interest of a GRAT (*i.e.*, the amount of the gift resulting from the GRAT) would be required to be greater than zero. Lastly, the amount of the annuity may not decrease.

- *Limit duration of GST tax exemption* – On the 90th anniversary of the creation of a trust, the GST exemption allocated to the trust would terminate so that distributions from the trust after that date to "skip" generations would incur GST tax.

- *Modify transfer tax rules with respect to grantor trusts* – The estate tax and gift tax treatment of grantor trusts would change so that (a) the assets of a grantor trust would be subject to estate tax at the grantor's death, (b) any distribution from a grantor trust to a beneficiary during the grantor's lifetime would be subject to gift tax and (c) the assets of a grantor trust would be subject to gift tax if the trust ceases to be a grantor trust during the grantor's lifetime.

- *Extend estate tax lien* – In the case of an election to defer estate tax on an interest in a closely-held business, the term of the estate tax lien (10 years) would be extended for the full estate tax deferral period (15 years).

For Further Information

If you have any questions about this *Alert* or would like more information, please contact Michael D. Grohman, Barry L. Small, any member of the Wealth Planning Practice Group or the attorney in the firm with whom you are regularly in contact.