

# TAX WARRIOR

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## WINTER 2011 NEWSLETTER

### INTRODUCTION

With the passage of the Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010 (Tax Relief Act of 2010), substantial changes have been made in the estate planning arena. This newsletter will focus some of the aspects of these changes and to encourage you to re-evaluate your estate planning structure with your advisor.

### BACKGROUND

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) making substantial changes to Federal Estate Tax (FET) over the following ten years. The Act increased the credit available against Federal Estate Tax until January 1, 2010 when the estate tax was repealed. The repeal was for one year and was to return in January 1, 2011, with a one million dollar credit per person against Federal Estate Tax and a significant increase in the Federal Estate Tax rates. With the uncertainty it created, it was presumed Congress would make changes to remove the uncertainty before 2010. This did not happen. Therefore, the government received no estate tax revenue for 2010.

President Obama requested Congress establish an Estate Tax Patch for 2010 in November of 2009, extending the estate tax to 2010 with a \$3,500,000 exclusion amount. The House of Representatives passed such a measure but the Senate did not, so it did not pass. They could have passed it in 2010 prior to September, but they did not. This meant estates of a number of billionaires dying in 2010 escaped Federal Estate Tax because of Congress's inactivity.

### TAX RELIEF ACT OF 2010

On December 17, 2010, President Obama signed The Tax Relief Act of 2010 which went into effect immediately. The Act provided for an "Applicable Exclusion Amount" of 5 million dollars per person or ten million dollars per couple. It provided for an estate tax rate of 18% for amounts up to ten thousand dollars, to a maximum rate of 35% for estates over \$500,000.00. This Act is applicable for 2010 through 2012. January 1, 2013, however, the estate tax goes back to the one million dollar exemption and higher estate tax rates.

As of January 1, 2011, the gift tax applicable exclusion amount is equal to the estate tax applicable exclusion amount or five million dollars.

Both the gift tax and estate tax Applicable Exclusion Amount will be subject to indexing for inflation beginning in 2012.

With the passage of the Tax Relief Act of 2010, the step-up in basis rules under Internal Revenue Code Section 1014 were applied to estates of those who died after 2010. The basis of assets from a decedent will be based on their date of death valuation.

### **GHOST OF 2010/ESTATE TAX ELECTION**

With 2010's repeal of the estate tax, basis determinations for 2010 were to be made under a carry-over basis method governed by Internal Revenue Code Section 1022. The carry-over basis creates a nightmare. To resolve some of these issues, the 2010 Act provides an election available for estates of decedent that passed away in 2010 to be taxed under the Tax Relief Act of 2010 and the five million dollar exemption, or under the 2010 estate tax repeal, with the carry-over basis rules. (This election protects the 2010 billionaire estates)

- a. 2010 "Carry-Over" Basis issues. If an estate elects the estate tax repeal, there is no Federal Estate Tax, but the "carry-over" basis rules apply. The "Carry-Over" basis rules state that the basis for any assets in the estate of the decedent would be the lesser of the adjusted basis of the property in the hands of the decedent on the day before the decedent's death, or the fair market value of the property on the date of death. The basis could decrease depending on the date of death value. An increase in basis is available up to a maximum amount of 1.3 million dollars to be apportioned among the assets of the decedent's estate, but may not exceed the fair market value of any such asset as of the date of death.

Three determinations are required. First, determine the adjusted basis the decedent had in each asset the day before the decedent's death. Second, determine value of the asset as of the decedent's date of death.

Third is the allocation of the 1.3 million basis increase to the individual assets.

- b. Reporting Requirements. The reporting requirements for either election would be due nine months after the date of signing of the Tax Relief Act of 2010 which would create a due date of September 17, 2011. For those using the five million dollar exemption for 2010 estate, would require the filing of the estate tax return, IRS Form 706.

For those electing to apply the estate tax repeal and the "carry-over" basis, the reporting would be done on IRS Form 8939.

There is also a requirement basis determinations be provided to the beneficiaries receiving assets from the estate.

**Caution!!!!**With the repeal of the estate tax, many 2010 estates may not have complied with the requirements under the “carry-over” basis method. Any Executor, Trustor or other fiduciary required to furnish any such information to the IRS and fails to, shall be subject to a penalty of \$10,000.00 (IRC 6716). If it is considered intentional disregard, the penalty could be 5% of the fair market value of the gross estate (IRC 6019 and IRC 6018).

**Note:** Considering the confusion occurring, it would be wise to file the appropriate reporting form to the IRS for either election whether or not the value of the estate is under the amount requiring reporting. This would avoid problems in the event of after discovered property.

### **Temporary Aspects of Law**

The frightening aspect of the 2001 Act was the return of the Estate Tax with the lower credit on January 1, 2011. That has now been pushed back to January 1, 2013 so it is still looming on the horizon. Do not assume Congress will extend the Tax Relief Act of 2010. Remember Congress sat on the 2001 Act for nine years before they decided to do something. Also, the latter part of 2012 may be a far different economic and political landscape.

### **Unused Exclusion Amount**

Prior to 2010, any unused credit against Federal Estate Tax that was not used in the estate of the first spouse to die between a married couple, was simply lost. The Tax Relief Act of 2010 provides that any unused exclusion amount may be applied for the benefit of the surviving spouse’s estate. This carry-over of the exclusion will apply for tax years 2011 and 2012. A note of caution, the “carry-over” of any unused exclusion has to be elected on the tax return for the estate of the deceased spouse in failing to do that, you lose the “carry-over”. A good practice would be to do this on every estate on the passing of the first spouse in case rampant inflation occurs or the surviving spouse wins the lottery. The unused exclusion for the surviving spouse will only apply for the passing of both spouse’s in the years 2011 and 2012.

### **Planning Opportunities**

The Tax Relief Act of 2010 did not address valuation, minority and other discounts for gifting, dynasty trusts, and grants with the increased Gift Tax exclusion, there is more flexibility for funding Irrevocable Life Insurance Trusts and other Trusts having estate tax savings aspects to them. These vehicles, however, would have to be instituted in 2011 to 2012.

### **Economic Effect**

The Tax Relief Act of 2010 is a huge body of legislation affecting nearly every facet of our economic structure. This newsletter only addresses the estate and gift tax aspects, which is a small portion of the Act. It is difficult to find anything in this portion of the Act designed for the economic health of our country. The estate and gift tax provisions appear to channel money to the upper levels of our economy, without any reference as to how this will strengthen our economy.

From our recent economic problems it appears the so-called “Trickle Down Theory” does not work. (See article “Did We Time Warp Back To The Middle Ages?” at [www.taxwarrior.net](http://www.taxwarrior.net)) It is therefore unlikely these provisions will result in a trickle down effect. The new estate and gift tax laws are a buffet of tax savings techniques. Take full advantage of them. They may not last!

