

Federal Estate Tax Eliminated 2010

Problems, Problems, Problems

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2001 Tax Act

Economic Growth and Tax Relief Reconciliation Act of 2001 dramatically changed federal estate tax laws.

2001 Tax Act

Increased exemptions and lowered top marginal tax rates as shown

Calendar Year	Estate and GST Tax Transfer Exemption	Highest Estate and Gift Tax Rate (and GST Tax Rate)
2001	\$675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	No Tax	No Tax
2011	\$1,000,000	55%

Culmination was elimination of federal estate tax for estates for people dying in 2010.

Government Estimates

- 6,000 Estates Benefit
- Beneficiaries of 70,000 estates adversely affected

No estate taxes means:

- IRS must issue new regulations to interpret law
- IRS must create new tax return forms required

OMG



Problem 1

Carry over basis replaces step-up basis

- Step-up basis = Date of death value
- Carryover basis = What decedent paid for asset less depreciation and capital withdrawals plus capital contributions
- This will apply to all property (other than cash) IRC 1022

Each Estate given \$1,300,000 of step-up basis to allocate to carryover basis property and among the beneficiaries IRC 1022(b)

An additional \$3,000,000 of step-up basis is available to allocate to carryover basis property left to a surviving spouse. IRC 1022(c)

Problem 2

If no federal estate tax in 2010, no federal estate tax return will need to be filed

BUT,

A Federal Return regarding the allocation of step-up basis will have to be filed.

Allocation Return must list (IRC 6018)

- Name and TIN of the recipient of property
- Accurate description of property
- Decedent's adjusted basis of property and date of death fair market value
- Decedent's holding period for such property
- Sufficient information to determine whether any gain on sale would be treated as ordinary income
- Amount of step-up basis allocated to such property
- Anything else IRS decides

Problem 3

Any person required to file ... who fails to furnish such information on the date prescribed therefor ... shall pay a penalty of \$10,000 ... for each such failure. IRC 6018(a)

Person could be Executor, Trustee or even beneficiary.

Problem 4

Beneficiaries of tax free estates may suddenly have to pay new taxes

2009 Example

Asset	DOD Value
Home	\$500,000
Vacation Home	\$500,000
Rental Property	\$500,000
Stock	\$500,000
Business	\$1,500,000
Total Assets	\$3,500,000

No Federal Estate Taxes

2010 Example

Asset	Basis	DOD Value
Home	\$100,000	\$500,000
Vacation Home	\$100,000	\$500,000
Rental Property	\$20,000	\$500,000
Stock	\$300,000	\$500,000
Business	\$20,000	\$1,500,000
Total Basis	\$540,000	\$3,500,000
Step-Up Allocation	\$1,300,000	
Totals	\$1,840,000	\$3,500,000
Capital Gains Tax	More than \$300,000	

Problem 5

Prior tax planning may result in accidental disinheritance of surviving spouse.

For years, many estate planning attorneys have used the By-Pass Trust technique to minimize estate taxes for the benefit of the family. Also known as Credit Shelter Trust or A/B Trust

Purpose of By-Pass Trust – avoid having all the assets end up in estate of surviving spouse where there is only one exemption

By-Pass Trust

Income and principal usually used for benefit of surviving spouse

Typical Language

“I leave to my spouse in her own name free of trust the minimum amount necessary to decrease the federal estate tax on my estate to zero.”

“The rest I leave to a By-Pass Trust for the benefit of my spouse (and children?).”

More Typical Language

“I leave in trust for the benefit of my spouse (and children) the maximum amount that can be left free of the federal estate tax.”

“The rest I leave to my spouse in her own name free of trust.”

Sometimes, the non-spousal amount was directed to specific beneficiaries (children and/or others)

“I leave to my children the maximum amount that can be left free of the Federal Estate Tax. The rest ...

Similar, problems can exist with other formula provisions, i.e. Generation Skipping Transfers

Problem 6

In 2011, Federal Estate Tax reinstated

\$1,000,000 Exemption per estate

\$1,000,000 Exemption for GST

55% top Marginal Rate

Step-up Basis Reinstated

2011 Example

Asset	DOD Value
Home	\$500,000
Vacation Home	\$500,000
Rental Property	\$500,000
Stock	\$500,000
Business	\$1,500,000
Total Assets	\$3,500,000

\$1,573,000 Federal Estate Taxes

Will/Can Congress “fix” it?

Since 2001, no one thought Congress would permit the elimination of estate taxes in 2010.

Would require “retroactive” law.

United States v. Carlton, 512 U.S. 26 (1994) holds that Congress can impose a retroactive tax if supported by a legitimate legislative purpose furthered by rational means.

Problem 7

Estate Tax: Fixed or not fixed, problems with formula clauses may still exist

If exemption reinstated at \$1,000,000 formula may restrict amount you would want to go By-Pass Trust.

Pay 41% tax now to avoid 55% tax later.

Fluctuations in market may still cause all of estate to go to By-Pass Trust with nothing to spouse.

If jointly owned and beneficiary directed property already go to spouse, there may not be enough other assets to justify cost and trouble of By-Pass Trust

Solutions

- Watch for Congressional Action
- Determine and document current basis of property
- Review personal financial statement
- Review estate planning documents and look out for formula clauses
- Insist on flexible planning in documents

Thank you!