BY JULIE MALEKHEDAYAT, CPA

game changers 2010

Estate Planning and Administration for 2010 Decedents

The end of 2010 will bring an end to a host of new and changing estate and gift tax rules the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 put into action. Alas, effective only in 2010 is the act's repeal of the estate and generation-skipping transfer (GST) taxes and change in the maximum gift tax rate.

In 2011, after EGTRRA's sunset, the transfer tax rules are scheduled to revert back to pre-EGTRRA status ($1 million exemption and maximum 55 percent tax rate for gift, estate and GST taxes).

Although practitioners believed Congress would act well before EGTRRA's sunset date and change the 2010 estate laws, other pressing issues, including the nationwide economic woes and health care reform, have so far stolen the legislative spotlight and no changes to the status quo have been enacted.

Thus, if Congress does not reinstate or modify the estate and gift tax rules for 2010—either retroactively or prospectively—the current scheme of no estate taxes, no GST taxes and a gift tax rate of 35 percent will apply in 2010. Assets inherited from 2010 decedents will pass to beneficiaries under a set of new modified carryover basis rules under IRC Sec. 1022 instead of the familiar stepped-up basis rules of IRC Sec. 1014.

Modified Carryover Basis

The modified carryover basis rules provide for a $1.3 million step-up in tax basis over the decedent's tax basis, up to the fair market value at the date of death, for the assets of decedents dying in 2010 (the aggregate basis increase), plus an additional $3 million step-up for assets passing to a surviving spouse. Additional increases also may be available for a decedent's unused capital loss and net operating loss carryovers and certain built-in losses. Both halves of community property assets owned by the decedent qualify for allocation of the aggregate basis and the spousal basis increases.

Reporting Requirements

No estate tax returns will be required. Instead, the executor of a 2010 decedent's estate must allocate the available basis increases among the decedent's assets. For estates with a total asset value (other than cash) exceeding the $1.3 million aggregate basis increase, the allocation must be reported to the IRS on an as-yet unreleased form. Gift tax returns will still be required for gifts to any one individual in excess of the $13,000 annual exclusion.

New Risks and Responsibilities

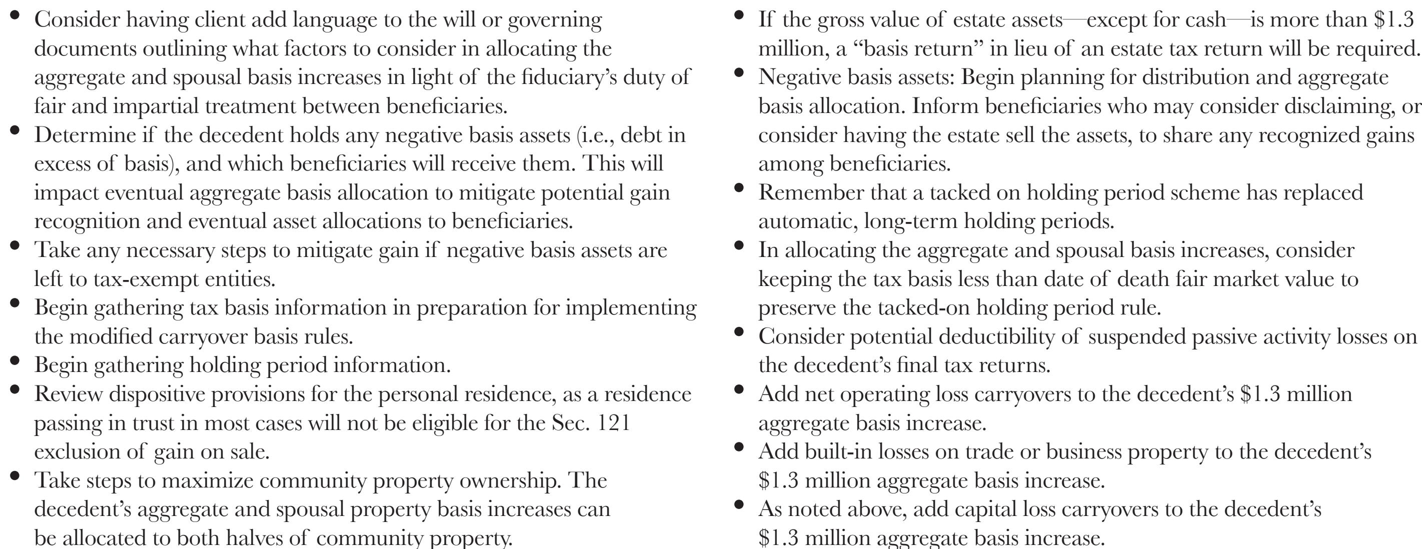
The administration of the estates of 2010 decedents under these new rules will therefore be especially challenging. Everyone involved—including fiduciaries, attorneys and accountant advisers—will have the additional responsibility and related risks of allocating the new aggregate basis increase and the additional spousal basis increase among assets hence among beneficiaries receiving those assets. Additionally, actions taken before death can significantly impact the post-death options available, and may even increase the aggregate basis increase amount.

Planning Considerations

Following is a summary of pre- and post-death planning issues and considerations. Practitioners will want to review the 2010 rules with an eye to identifying key points and action items, keeping in mind that all could change by an act of Congress. More than ever it will be important to continue monitoring pending legislation in this area.

Pre-death Planning

- Review asset allocation formula clauses in the governing documents to determine if the absence of estate and GST taxes in 2010 adversely impacts the intentions of the client in determining who gets how much of the estate.
- Consider that the $1.3 million aggregate basis step-up is not allocable to a qualified terminable interest trust assets upon the death of the surviving spouse.
- Similarly, consider that power of appointment assets are not eligible for the aggregate basis increase.
- Think about selling loss assets before death to preserve the losses for allocation as additional basis increases. Loss assets will have a fair market value basis in the hands of beneficiaries, so potential income tax deductible losses and increased basis adjustments will be forgone if the assets are not sold before death.



- Consider having client add language to the will or governing documents outlining what factors to consider in allocating the aggregate and spousal basis increases in light of the fiduciary's duty of fair and impartial treatment between beneficiaries.
- Determine if the decedent holds any negative basis assets (i.e., debt in excess of basis), and which beneficiaries will receive them. This will impact eventual aggregate basis allocation to mitigate potential gain recognition and eventual asset allocations to beneficiaries.
- Take any necessary steps to mitigate gain if negative basis assets are left to tax-exempt entities.
- Begin gathering tax basis information in preparation for implementing the modified carryover basis rules.
- Begin gathering holding period information.
- Review dispositive provisions for the personal residence, as a residence passing in trust in most cases will not be eligible for the Sec. 121 exclusion of gain on sale.
- Take steps to maximize community property ownership. The decedent's aggregate and spousal property basis increases can be allocated to both halves of community property.

Post-death Issues

- Consider making the Sec. 645 election for living trusts if distributions of appreciated assets will be made in satisfaction of pecuniary bequests.
- Begin gathering date of death asset valuations.
- Appraisals: Make sure the appraiser notes the appraisal reports are for both carryover basis and estate tax purposes.
- If the gross value of estate assets—except for cash—is more than $1.3 million, a "basis return" in lieu of an estate tax return will be required.
- Negative basis assets: Begin planning for distribution and aggregate basis allocation. Inform beneficiaries who may consider disclaiming, or consider having the estate sell the assets, to share any recognized gains among beneficiaries.
- Remember that a tacked on holding period scheme has replaced automatic, long-term holding periods.
- In allocating the aggregate and spousal basis increases, consider keeping the tax basis less than date of death fair market value to preserve the tacked-on holding period rule.
- Consider potential deductibility of suspended passive activity losses on the decedent's final tax returns.
- Add net operating loss carryovers to the decedent's $1.3 million aggregate basis increase.
- Add built-in losses on trade or business property to the decedent's $1.3 million aggregate basis increase.
- As noted above, add capital loss carryovers to the decedent's $1.3 million aggregate basis increase.
- Community property: The decedent's aggregate and spousal property basis increases can be allocated to both halves of community property owned by the decedent at death. CPA

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Money Talks Preparing Spouses to Deal with Financial Planning

By Michael B. Allmon, CPA

We've all heard that communication is key in a successful relationship, whether business or personal. Yet too often we, as CPAs, encounter situations where a surviving spouse had a minimal role in managing finances—and little to no information regarding their financial issues. CPAs and financial advisers can help—during life and at death.

The first step is to raise the subject with our client either during the tax interview or whenever estate planning is discussed. Once the dialogue has begun we should encourage open financial communication between both spouses and parties in a relationship. We should also provide some subjects for clients to consider that are pertinent to their individual needs, including:

1. Estate plans—After explaining how such plans work, make sure your clients answer the questions: Who should the surviving spouse talk to first (i.e., family attorney, investment adviser, insurance broker, etc.)? Who is and what are the roles of the executor/trustee? If the client has children, who are the guardians should something happen? Have we reduced our estate taxes as we wish and have we done so efficiently?

2. Current investments and accounts—What do we own? Why? Who is our adviser? Do we have an investment policy statement that clearly states our investment goals? Is the statement provided to all of our financial advisers? Is our asset allocation appropriate for our stage of life and risk tolerances?

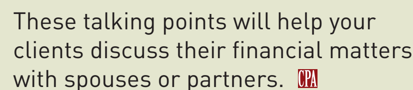
3. Insurance—What do we have? Why? Who is our contact? Should we discuss all types of insurance—life, disability and umbrella liability protection? If either of us is involved in a business as an owner, have we reviewed coverage so that we are protected both as owners and as employees?

4. Letters of instruction-advantages/disadvantages—If there are letters of instruction, are we sure that they do not conflict with the formal estate plans? Can this be effective for some issues?

5. Closely-held business—Does the less involved spouse know about succession plans—are there such plans? If not, there should be. What are the terms of any buy-sell agreements?

6. Legacy planning, if relevant—How do we want future generations to remember us? What charities would we like to support for maybe many generations?

These talking points will help your clients discuss their financial matters with spouses or partners. CPA



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