

Howe Estate Planning Update

FOR ADVISORS

TEMPORARY ESTATE TAX CHANGES



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On December 17, 2010, the President signed into law The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “Act”). The estate tax section of the bill carries the title “Temporary Estate Tax Relief” and includes Sections 301, 302, 303 and 304. Those sections are summarized briefly below.

Section 301 reinstates the estate tax and repeals carryover basis. Executors of decedents who passed away in 2010 are permitted to elect either to apply the 2010 existing carryover basis laws or to use the new \$5 million applicable exclusion amount and 35% estate tax rate that will apply for deaths in 2011 and 2012. More on this in the article following.

Section 302 addresses the gift, estate and GSTT exclusion amounts. The estate tax applicable exclusion amount will be \$5 million for 2011 and for executors who elect to apply that amount to 2010. The GSTT exemption will also be \$5 million, and this amount will be adjusted for inflation starting in 2012 in \$10,000 increments.

The gift tax is again reunified with the estate tax. Therefore, the 2011 estate and gift tax exemptions will be the same.

Section 303 creates marital deduction “portability.” The applicable exclusion amount for a surviving spouse will be the basic exclusion amount of \$5 million with cost of living increment plus the deceased spouse’s unused exclusion amount. The unused exclusion amount will not be adjusted further for inflation.

In order to benefit from this provision, the deceased spouse must die after 2010 and the surviving spouse must die before 2013, or Congress must extend portability.

If the deceased spouse transfers all assets to surviving spouse using the unlimited marital deduction, then the surviving spouse should have available the full value of both exclusions. However, the executor of the deceased spouse will be required to file IRS Form 706 to establish the amount of unused exclusion.

(Cont.)



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The amount of exclusion cannot exceed twice the basic exclusion amount and for surviving spouses who remarry, only the remaining exclusion of the most recently deceased spouse may be utilized.

Section 304 contains the sunset provision. These changes only apply through the end of 2012.

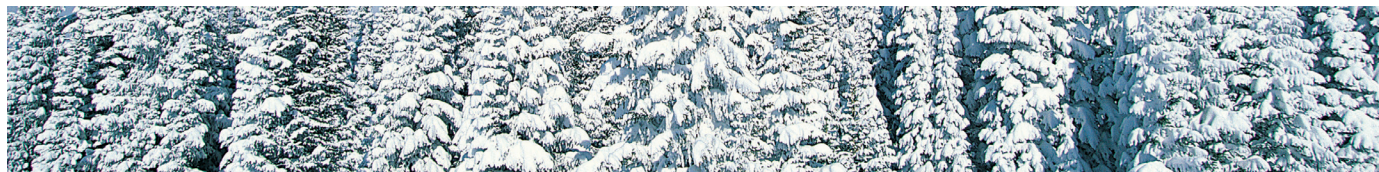
RETAINED LIFE ESTATE RESULTS IN ESTATE TAX INCLUSION



In two recent tax court cases, the taxpayer was reminded that the retention of what amounts to a life estate in property by the grantor of a gift results in the full date of death value of the property being included in the grantor's taxable estate on death. In *Estate of Axel O. Adler et al. v. Commissioner*; T.C. Memo. 2011-28; No. 25113-08 (30 Jan 2011), the grantor deeded interests in his real estate to his children, expressly retaining the full use of the property and the right to all of the income for his lifetime. One of the issues addressed in the court's opinion was whether valuation discounting of the gifts to the children due to lack of marketability and control would be allowed. The court pointed to Internal Revenue Code section 2036(a), which provides that if a decedent has owned property and made a transfer other than a bona fide sale and has retained the possession or enjoyment of the property for his lifetime, that asset is included in the estate at date of death value. The court held that

since, under that Code section, the decedent had not in fact transferred the property to his children, no fractional interest discounting was possible.

In *Estate of Adelina Cheng Van et al. v. Commissioner*; T.C. Memo. 2011-22; No. 5456-04 (26 Jan 2011), the taxpayer got a similar result. In that case, the decedent had deeded her home during her life to a daughter and two grandchildren, apparently without any express reservation of a life estate or any other interest in the property. However, because she continued to occupy the home for her lifetime, presumably without paying rent to the legal owners, section 2036(a) required the inclusion of the full date of death value of the home in the decedent's taxable estate. This case is interesting because the tax court obviously looked beyond the documentation and found an implied reservation of a life estate based on the behavior of the family after the deeding of the home to the family members.



CAN CLIENTS UNDO THEIR 2010 TAXABLE GIFTS?

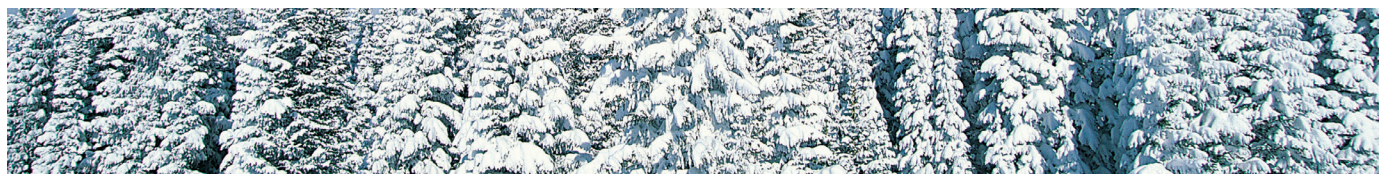
I was not able to attend the 45th Annual Heckerling Institute on Estate Planning last month, but I have been reading that one of the topics discussed there was the quandary of clients who made large taxable gifts in 2010. The problem, in a nutshell, is that in 2010, many taxpayers chose to pay a 35% gift tax by making taxable gifts over the (then) \$1 million lifetime gift tax exemption. The rationale for making taxable gifts was sound. At the time the gifts were made both the gift tax rate and the top estate tax rate were set to increase to 55% in 2011. In that light, a 35% gift tax on gifts of more than \$1 million in 2010 looked like a bargain.

However, on December 17, Congress surprised everyone by changing wealth transfer taxes retroactive to January 1, 2010 and prospectively for 2011 and 2012. Clients who acted promptly on the advice of their trusted advisors and made those taxable gifts earlier in 2010, rather than waiting until New Year's Eve, as some clients have been known to do, may be experiencing "donor's remorse." So what, if anything, can be done?

First, it is very important to tell clients that they cannot simply take back their gifts. The person giving back the gift would thereby be making their own gift, which creates an additional tax problem, instead of solving the original problem. Additionally, rewriting history is not a good way to go. Simply because there is no written record of the 2010 gift (or so the client may think) does not mean that undoing the gift is not actionable as tax fraud.

It may, however, be possible for the recipient of the gift to disclaim the gift and then have the donor "regift" it in 2011. Disclaiming has technical requirements as to timing and procedure, and once the recipient receives any benefit from the gift it can no longer be disclaimed. Your clients should discuss this possibility with their attorney before attempting to fix their problem with a disclaimer.

Finally, clients may look to the Internal Revenue Service for relief. Clients always have the option of seeking a private letter ruling. Additionally, we may, at some point in the future, get clarification or even lenience from the IRS.





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A PERSONAL NOTE FROM KIRSTEN HOWE, ATTORNEY AT LAW



Dear Colleagues:

As you have undoubtedly heard by now, on December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). The sunset on December 31 of what have come to be known as the "Bush era" tax cuts, at the same time that many Americans' federal unemployment benefits were about to run out, prompted the President to broker a deal with Republican leaders and push it through the lame-duck Congress just days before recess. Undoubtedly everyone has an opinion about the wisdom and necessity of this bill, but now that it is law, my job is to understand and work with it to our clients' benefit.

In addition to increases to the gift tax and GSTT exemption amounts, we also have at least one brand-new concept to work with, which is the portability of the estate tax exemption. At this point, that will only apply when a spouse dies in 2011 or 2012.

Please recycle or, better yet, pass this newsletter on to a friend after you've read it. I hope this new year brings happiness to you and your family.

Warmly,

Kirsten Howe

Kirsten Howe,
Attorney at law