

# Robert S. Keebler, CPA, MST, AEP (Distinguished)

## Analyzing the 2010 Election Not to Incur the Federal Estate Tax

### Relevant Statutes and Act Sections

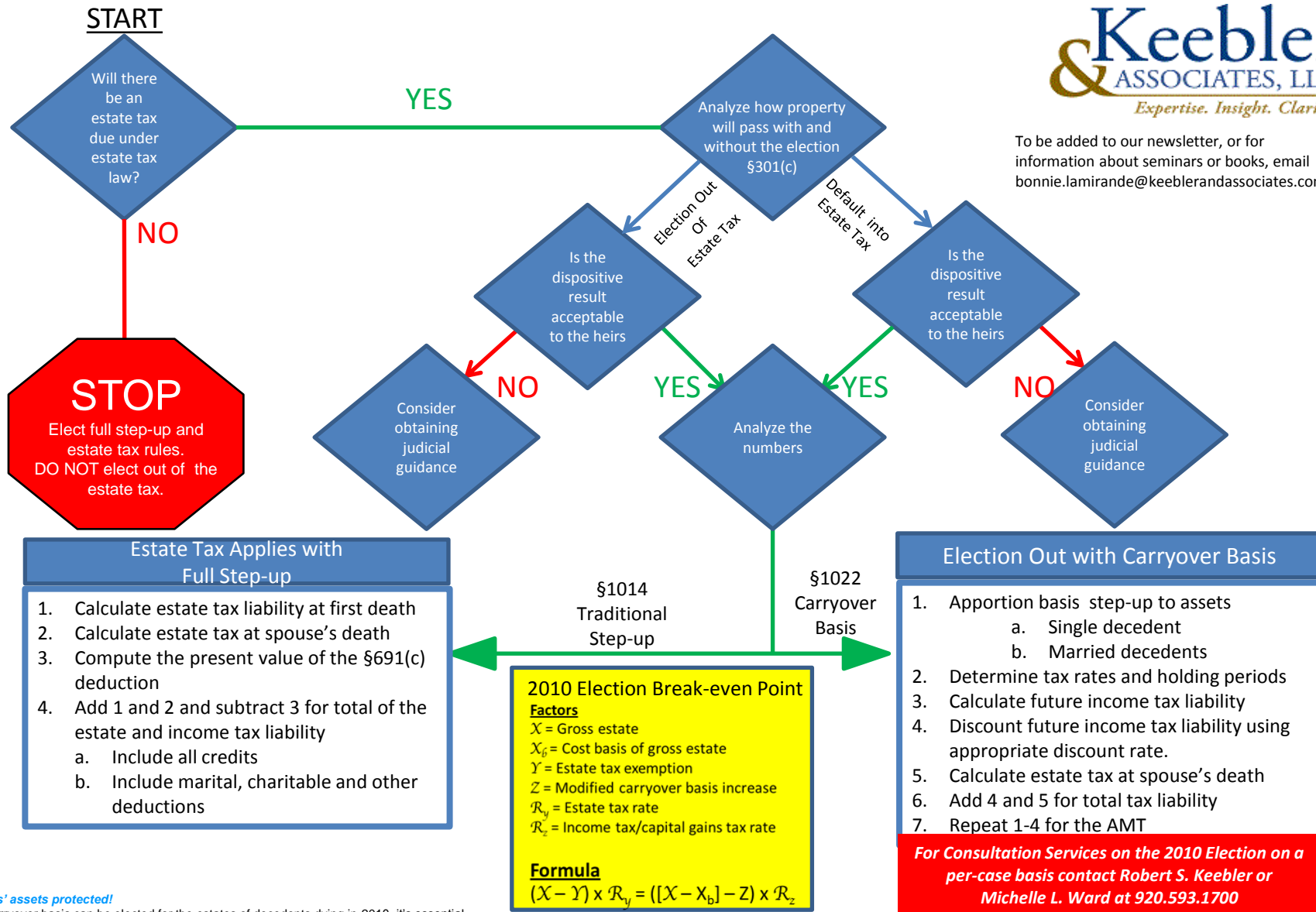
- §301 of Tax Relief, Unemployment Insurance Reauthorization & Job Creation Act of 2010 ("2010 Act") – Reinstatement of estate tax and repeal of carryover basis
- §301(c) of 2010 Act – Special election for 2010 deaths
- §301(d) of 2010 Act – Extension of reporting requirements and disclaimers
- IRC §121 - Excludes up to \$250,000 of gain (\$500,000 for married taxpayers filing jointly) on the sale of a home.
- IRC §691(c) – Income tax deduction for the estate tax paid
- IRC §1014 – Traditional Step-up Basis
- IRC §1022(b)&(c) Allows a basis adjustment of \$1.3 million for qualifying property
- IRC §1022(c) Allows a basis adjustment of an additional \$3 million for qualifying property passing to a spouse
- IRC §2505 – Unified credit against gift tax
- IRC §2518 – Disclaimer Provisions
- IRC §2010 – Unified credit against estate tax & portability between spouses
- IRC §2001 – Estate tax rate
- IRC §2502 – Gift tax rate
- IRC §2641 – GST tax rate
- IRC §2631 – GST exemption
- **See also:**
  - Notices 2011-66 and 2011-76
  - Revenue Procedures 2011-41 and 2011-44

### Alternative Minimum Tax Issues

- All issues discussed apply separately for AMT purposes.

### Form 8939

- Due January 17, 2012.
- Cannot be extended.



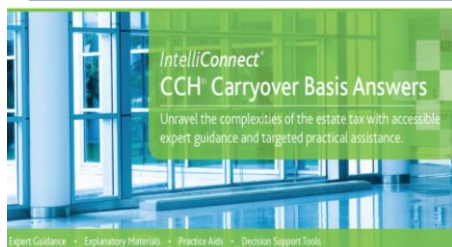
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## Examples

### Estate Tax vs. Modified Carryover

Alex is a single taxpayer who dies in 2010 leaving all of his \$6,000,000 of assets to his son Nicholas, who plans to sell the assets immediately after they are received (at which time they are assumed to still have a fair market value of \$6,000,000). Alex's aggregate basis in the assets is \$1,700,000 and all the assets are eligible for a basis increase. Alex's executor can choose between using the modified carryover basis rules and avoiding the estate tax, or, in the alternative, subjecting the property to estate tax with a 35% tax rate and \$5,000,000 exemption, but gaining the benefit of the stepped-up basis rules. If the executor elects to apply the estate tax, the estate tax payable will be \$350,000— $(\$6,000,000 - \$5,000,000 \text{ exemption amount}) \times 0.35$ . Nicholas takes a basis of \$6,000,000 in the assets; when he sells them, he has no capital gain. Thus, the total tax paid by the family is \$350,000.

If the executor instead elects to apply the carryover basis rules, the estate tax does not apply. Nicholas takes a basis of \$3,000,000 (Alex's \$1,700,000 basis + \$1,300,000 basis increase under Code Sec. 1022(b)) in the assets and recognizes a gain of \$3,000,000 when they are sold (\$6,000,000 sale proceeds - \$3,000,000 basis). The sale results in a capital gain of \$3,000,000, on which Nicholas will pay income tax of \$450,000 (assuming the 15% capital gain tax rate applies because Nicholas is in the 28% income tax bracket). The total tax paid by the family under this alternative is \$450,000. Thus, the family is better off if the executor chooses to apply the estate tax.

Note: Repeat this process for AMT purposes.

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Educational Information: Email

[bonnie.lamirande@keeblerandassociates.com](mailto:bonnie.lamirande@keeblerandassociates.com) to be added to our newsletter, for previous write-ups about new IRA regulations, licensing agreements, seminars, CDs or books, webinars and speeches.

### Carryover Basis Election for Larger Estates

Assume the same facts as in Example 1, except that Alex's assets have a fair market value of \$10,000,000 instead of \$6,000,000.

If the executor elects to apply the estate tax, the estate tax payable will be \$1,750,000— $(\$10,000,000 - \$5,000,000 \text{ exemption}) \times 0.35$ . Nicholas takes a basis of \$10,000,000 in the assets, so there is again no capital gain on the sale. The total tax paid by the family is \$1,750,000.

If the executor elects to apply the carryover basis rules, there is no estate tax. Nicholas again takes a basis of \$3,000,000 in the assets and recognizes a gain of \$7,000,000 on the sale. The income tax payable is \$1,050,000  $(0.15 \times \$7,000,000)$ . Now, the family is better off if the executor elects to use the modified carryover basis rules. Note that the larger the estate, the more favorable the carryover basis rules will be when compared with paying estate tax. Given the \$3 million basis assumed above, the break-even estate value would be \$6,500,000. The tax payable under the two alternatives would be as follows:

#### Estate Tax

$\$1,500,000 \times 0.35 = \$525,000$

#### Modified Carryover Basis Rules

$\$3,500,000 \times 0.15 = \$525,000$

### Assets Ineligible for a Basis Step Up

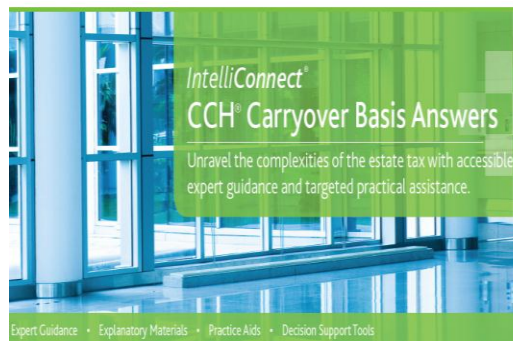
Keith dies on October 12, 2010, survived by his wife Linda and children James and Melissa. The following assets were included in his gross estate when he died:

#### Asset Built-in Gain

General power of appointment over assets in Trust X.....	\$3,800,000
IRA.....	2,500,000
Undeveloped real estate.....	300,000
Rental real estate.....	300,000
Stock in a domestic international sales corporation (DISC).....	1,900,000

Although Keith's estate has \$8.8 million of potential basis increase available to allocate (\$1.3 million generally, plus \$3 million for property going to a surviving spouse), only \$600,000 can be used (with regard to the two parcels of real property). Because the IRA is an item of income in respect of a decedent (IRD), it is not eligible for a basis increase under Code Sec. 1022(f). The general power of appointment is treated as property not owned by the decedent under Code Sec. 1022(d)(1)(B)(iii). And, finally, the carryover basis increase provisions do not apply to stock in a DISC (Code Sec. 1022(d)(1)(D)(ii)).

For Consultation Services on the 2010 Election on a per-case basis contact Robert S. Keebler or Michelle L. Ward at 920.593.1700



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