Estate, Gift, and GST Tax Legislation FAQs -

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The estate, gift and generation-skipping tax provisions of the Tax Relief, Unemployment Compensation Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) reinstated the estate and GST taxes in 2010 and reunified all three taxes in 2011 and 2012 with a $5.0 million exemption and a 35% tax rate. Following is a list of frequently asked questions regarding the provisions of the Act, with the answers provided by the professional tax staff at BNA Tax and Accounting. Due to the nature of the legislation, the questions and answers first describe the actions to be taken for transfers that occurred in 2010, and then address planning for 2011 and 2012.

Questions and Answers for 2010 Transfers

My decedent died in 2010, but before December 17, 2010, the day the President signed the legislation. There was no federal estate tax on the day he died. Is the estate now subject to estate tax?

The estate is subject to federal estate tax, but with a $5.0 million exemption and a 35% tax rate. If the estate is under $5.0 million and the decedent had not previously used his $1.0 million gift tax exemption, there is no tax and no need to file a federal estate tax return. A state return may still be required.

If the estate exceeds $5.0 million (or as little as $4.0 million, if the gift tax exemption were used), you may want to consider the available election to opt out of the estate tax. The tradeoff for this election is that the estate must use carryover basis for its assets. Estates that do not elect out of the estate tax can use the traditional step-up in basis at death.

If a decedent died in 2010, what's the deadline for filing the estate tax return?

Although the normal filing deadline is nine months after the date of death, if a decedent died between January 1, 2010 and December 16, 2010, it is not necessary to file the return until September 19, 2011. The IRS has not said whether it will allow an automatic six-month extension of this deadline, as it does with the nine-month deadline.

Suppose the estate is considering whether to elect carryover basis. What is the deadline for that decision?

The deadline for filing Form 8939, on which the carryover basis election will be made, is April 18, 2011. The IRS has not indicated whether it will allow extensions of that due date, but it is expected to do so.

I am advising the executor of a 2010 estate, which will be valued at about $7.5 million. What are the considerations in deciding whether to elect out of the estate tax?
For an estate of that size, the election out may make sense. If the decedent was married, the estate should qualify for a $4.3 million basis step-up, which may be sufficient to bring the basis of the estate assets up to fair market value. If that is not enough, you may also be able to use the decedent's capital loss carry forwards and NOLs, if any, to further increase the basis of the assets. Unfortunately, the IRS has not issued any guidance on how to allocate these basis increases to the estate assets, and the April 18, 2011, deadline is approaching.

Is there any other special relief for estates of decedents dying in 2010?
Yes. If a decedent died between January 1 and December 16, the recipient of any property from the estate may make a tax-qualified disclaimer at any time up to September 17, 2011. Normally, such disclaimers must be made within nine months of the date of death, but Congress has provided additional time in which to make that decision. Check your state disclaimer rules before deciding whether to use this grace period.

My advisor persuaded me to make a taxable gift in 2010, to take advantage of the 35% gift tax rate. But now I learn that there would have been no tax (or less tax) if I had waited until 2011 or 2012. Does the legislation provide me any relief?
No, the legislation did not increase the $1.0 million gift tax exemption in effect for 2010 and it does not allow you to go back and undo the gift. But your advisor should be looking at your state's law on gifts, to determine if there is any way the gift can be rescinded or disclaimed. That may be your only option. Because your 2010 gift tax is due on April 18, 2011, you should act soon.

What did the legislation do for the generation-skipping tax in 2010? I heard that generation-skipping transfers made in 2010 were subject to considerable uncertainty until Congress acted.
The status of 2010 generation-skipping transfers was subject to considerable uncertainty until the legislation passed in December. The legislation reinstated the generation-skipping tax for 2010, but at a 0% tax rate. This means that any direct skips, taxable distributions, or taxable terminations in 2010 were subject to the GST

tax, but at a 0% rate (although the direct skips were still subject to gift or estate tax) and no tax is due.

I made a large gift to a generation-skipping trust in 2010. Does this mean that the trust will never be subject to the generation-skipping tax?
No, it is not quite that simple. If the trust had beneficiaries, such as your children, who are not skip persons, the trust will be subject to the generation-skipping tax when distributions are made to grandchildren or lower-generation beneficiaries, or at the end of the interest of the last non-skip-person beneficiary. These events will occur after 2010, when the GST tax rate will be 35% or higher. The good news is that the legislation increased your GST exemption to $5.0 million for transfers made in 2010. You have until April 18, 2011 to allocate this exemption to the trust on your gift tax return. The transfer may also be subject to the automatic allocation rules.

Is there any way that I can avoid future GST tax on this trust without allocating my GST exemption? I would hate to pass up a 0% tax rate.
You may, under some circumstances, be able to avoid future generation-skipping tax on the trust without using up your exemption. If the non-skip person beneficiaries of the trust are willing to disclaim their interest in the trust, the trust would become a skip person and qualify for the 0% tax rate. But you first need to determine whether it will be feasible to make a tax-qualified disclaimer, which must be made within nine months of the date of the initial transfer.

My advisor told me that I hit a tax home run by making a direct skip transfer in 2010, when the GST tax rate was zero. Is there anything else I should do to nail this down?
Yes. You still need to opt out of the automatic allocation of your $5.0 million GST exemption to this transfer. Direct skip transfers, whether outright or in trust, are automatically allocated a portion of your exemption, which will be wasted if allocated to a transfer subject to a 0% tax rate. You must file a 2010 gift tax return by April 18, 2011, on which you elect out of the automatic allocation.

If an estate is subject to estate tax in 2010, does it qualify for portability of the estate tax exemption? Should I make the portability election?
No. As explained below, portability of the exemption applies only to the estates of those dying in 2011 and 2012.

The will of my decedent, who died in 2010, contains a formula clause that funds a credit shelter trust. My state enacted corrective legislation early in 2010, which applied the 2009 $3.5 million estate tax exemption in interpreting credit shelter formula clauses. How do I reconcile the reenactment of the estate tax in 2010 with the terms of this state law?
You need to read your state statute very carefully. Most such statutes provide that they are inoperative if the federal tax is reenacted. If so, your formula clause should be interpreted using a $5.0 million estate tax exemption. But if your 2010 estate elects out of the estate tax (and into carryover basis), it is not clear how these state statutes will be applied. Some states may enact further corrective legislation, so keep a watch on what's happening in your state capital.

Questions and Answers for 2011 and 2012 Planning

In addition to addressing the mess that it created for 2010, what did Congress do going forward?
Congress applied a two-year “patch” to the estate, gift and generation-skipping taxes, effective in 2011 and 2012. For those two years only, the legislation reunified all three taxes, with a $5.0 million exemption and a 35% tax rate. The $5.0 million exemption will be indexed for inflation in 2012 only. In 2013, the taxes remain unified but we go back to an inflation-adjusted $1.0 million exemption and a 55% tax rate. At this point, no one can confidently predict how Congress will address this 2013 tax increase.

It looks like we have a two-year window in which to take action. What's being recommended?
Because the $5.0 million exemption is temporary, it may make sense to use your gift and GST exemptions before they drop to $1.0 million in 2013. The best way to do this would be by making a $5.0 million gift to a generation-skipping trust. Some commentators have cautioned that the gift tax saved will be clawed back by the estate tax when the donor dies, although there may still be some good reasons for making large gifts in 2011 or 2012, especially of property with potential for appreciation.

I hear a lot about portability of the estate tax exemption. How does that work?
Portability of the estate tax exemption is part of the two-year patch, and is effective only in 2011 and 2012. If a married individual dies in either of those years, and does not use up his entire $5.0 million estate tax

exemption, his estate may pass the unused exemption to his spouse. If she then dies in 2011 or 2012, her estate may combine her $5.0 million exemption with her spouse's unused exemption in calculating the estate tax. Unless Congress extends it, portability ends after 2012.

It looks like portability is designed for large estates. Should a small or mid-sized estate consider it?
All estates of married decedents should consider the portability election. Given the flux in the estate tax law, it will be difficult to predict whether a surviving spouse may need to use the portable exemption. Making the election in the estate of the first spouse to die will preserve that option. Failure to make the election means that it is lost forever.

Can portability be stacked? If I survive my current spouse, and then remarry and outlive my new spouse, can they both “port” their exemptions to me?
No. You can only use the portable exemption of the spouse to whom you were most recently married.

How will I make the portability election for an estate? Will it require the filing of an estate tax return?
In order to “port” the unused exemption to a surviving spouse, the estate of the deceased spouse must file an estate tax return and elect to transfer the unused exemption. Although the IRS has yet to issue any guidance on the election, it is likely that, regardless of the size of the estate, the IRS will require the filing of a complete estate tax return so that the amount of the unused exemption can be accurately determined.

Does portability mean the end of credit shelter trusts? When my clients learn about portability, they will assume that I am recommending a credit shelter trust only to increase my fee.
Portability of the exemption is not a replacement for credit shelter trusts. It is a fall-back for those who neglected to create them. Credit shelter trusts still have many advantages, including: (1) sheltering post-death appreciation from the estate tax; (2) protection of trust assets from creditors; and (3) protection of trust assets when surviving spouses remarry. And remember, portability ends on December 31, 2012.

Given the short-term nature of the legislation, and the uncertainty regarding a 2013 fix, how do we advise clients on their estate plans?
Flexibility is the key, because most clients will not want to rewrite their wills and trusts in 2013. For

married couples, that flexibility can be provided by leaving the estate outright to the surviving spouse, but with the option of disclaiming into a credit shelter trust. If there are concerns about state estate tax and the state allows a QTIP election, the credit shelter trust should be QTIPable, i.e., it should also qualify for the QTIP election.

Some clients will not want to leave property outright to the surviving spouse, either because of marital discord or due to concerns about subsequent marriages. In that case, they may want to leave their estate to a QTIP trust, with the trustee being given the ability to elect QTIP treatment for only a portion of the trust. This could be drafted as a Clayton-type trust, with the unelected portion pouring over into a credit shelter trust.