Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010

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May 18, 2011

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Tax and Accounting Center

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BNA Analysis of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), enacted December 17, 2010

By the Tax Management Staff, Arlington, VA

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The Act, in essence, is an extension of the 2001/2003 Bush-era tax cuts for two years. Also, the legislation includes a payroll tax holiday for 2011 and a change in the exemption amount and maximum tax rate for estate taxation. The Act incorporates many business and individual extensions of the so-called "annual extenders."

TITLE I—TEMPORARY EXTENSION OF TAX RELIEF

Temporary Extension of 2001 Tax Relief [Act §101]

The Act, by modifying the sunset provision in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) §901, extends for two years, from December 31, 2010, until December 31, 2012, the following provisions (primarily Titles I through IV of EGTRRA):

Reduction in income tax rates for individuals

Under pre-Act law, the 10% individual income tax bracket was set to expire at the end of 2010. Upon expiration, the lowest tax rate would have been 15%. The Act extends the 10% individual income tax bracket for an additional two years, through 2012. Under pre-Act law, the 25%, 28%, 33%, and 35% individual income tax brackets would have expired at the end of 2010. Upon expiration, the rates would have become 28%, 31%, 36%, and 39.6% respectively. The Act extends the 25%, 28%, 33%, and 35% individual income tax brackets for an additional two years, through 2012. [Code §1]

Repeal of phaseout for personal exemptions

Prior to EGTRRA, §151(d) provided a phase out of the personal exemption for certain higher income individuals. For 2006 through 2009, EGTRRA reduced the phase out amount and then repealed the personal exemption phase-out (PEP) for 2010. The Act extends the repeal of PEP for an additional two years, through 2012. [Code §151]

Phaseout of overall limitation on itemized deductions

Prior to EGTRRA, the amount of itemized deductions that a taxpayer could claim was reduced, to the extent the taxpayer's AGI is above a certain amount. EGTRRA phased out this reduction for 2006 through 2009 and then repealed this limitation on itemized deductions for 2010. The Act extends the repeal for an additional two years, through 2012. [Code §68]

Modifications to child tax credit

Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. EGTRRA increased the credit from $500 to $1,000 (which was phased in over time). The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2011, is allowed against the alternative minimum tax. EGTRRA also expanded the refundability of the child tax credit. The Act keeps the child tax credit amount at $1,000 per child, extends the allowance against the regular tax/AMT and maintains the refundability provisions (subject to the 2009 special rules discussed below at Act §103) through 2012. [Code §24]

Expansion of adoption credit and adoption assistance programs

EGTRRA increased the adoption credit and the employer-provided adoption assistance exclusion from $5,000 ($6,000 for a special needs child) to $10,000, adjusted for inflation. The Patient Protection and Affordable Care Act of 2010 (2010 PPACA) extended these benefits to 2011 and made the credit refundable (in making it refundable, the 2010 PPACA also redesignated the credit from §23 to §36C). The 2010 PPACA also increased the credit to $13,170 (adjusted for inflation, the 2011 amount is

$13,360). The Act extends for an additional year, through 2012, the increased adoption credit amount and the exclusion for employer-assistance programs as enacted in EGTRRA. Therefore, the current refundable credit will still exist through 2011. Thereafter, the nonrefundable pre-2010 PPACA §23 will replace it for 2012 (with the $10,000 deduction/exclusion—adjusted for inflation to $12,170). For 2013 and after, barring further legislation, the credit will revert back to pre-2001 EGTRRA levels; however, only adoptions for special needs children will qualify for the credit or assistance exclusion. [Code §§23, 36C, 137]

Refunds disregarded in the administration of Federal programs and federally assisted programs

EGTRRA provided that the refundable components of the EITC and the child tax credit do not make households ineligible for means-tested benefit programs and stated that these tax credits do not count as income in determining eligibility (and benefit levels) in means-tested benefit programs, and also do not count as assets for specified periods of time. The Act disregards all refundable tax credits and refunds as income for means tested programs, but does not apply to amounts received after December 31, 2012.

Dependent care credit

The dependent care credit allows a taxpayer a credit for an applicable percentage of eligible care expenses for children under 13 and disabled dependents. EGTRRA increased the amount of eligible expenses from $2,400 for one qualifying child/disabled dependent and $4,800 for two or more children/disabled dependents to $3,000 and $6,000, respectively. EGTRRA also increased the applicable percentage from 30% to 35%. The Act extends the changes made by EGTRRA for an additional two years, through 2012. [Code §21]

Allowance of credit for employer expenses for child care assistance

EGTRRA added §45F to provide employers with a credit of up to $150,000 per year for acquiring, constructing, rehabilitating or expanding property which is used for a child care facility, and for the operation of such facility. Set to expire at the end of 2010 under the EGTRRA sunset, the Act extends the credit provided for in §45F for an additional two years, through 2012. [Code §45F]

Elimination of marriage penalty in standard deduction

EGTRRA increased the basic standard deduction for married couples filing joint returns to twice the basic standard deduction for an unmarried individual filing a single return (phased in between 2005-2009). The Act extends the marriage penalty relief for the standard deduction for an additional two years, through 2012. [Code §63]

Phaseout of marriage penalty in 15-percent bracket

EGTRRA increased the size of the 15% regular income tax bracket for a married couples filing joint returns to twice the corresponding bracket for an unmarried individual filing a single return (phased in between 2005-2008). The Act extends the marriage penalty relief for the 15% bracket for an additional two years, through 2012. [Code §1]

Marriage penalty relief for earned income credit; earned income to include only amounts includible in gross income; simplification of earned income credit

EGTRRA increased earned income credit phaseout amount for married couples filing joint returns. EGTRRA also simplified certain aspects of the credit. The Act extends the marriage penalty relief the earned income credit for an additional two years, through 2012. [Code §32]

Modifications to education individual retirement accounts (now Coverdell education savings accounts)

Coverdell education savings accounts are tax-exempt savings accounts used to pay the higher education expenses of a designated beneficiary. EGTRRA increased the annual contribution amount from $500 to $2,000 and expanded the definition of education expenses to include elementary and secondary school expenses. The Act extends the changes to Coverdell accounts for an additional two years, through 2012. [Code §530]

Extension of exclusion for employer-provided educational assistance

An employee may exclude from gross income up to $5,250 for income and employment tax purposes per year of employer-provided education assistance. Prior to EGTRRA, this incentive was temporary and only applied to undergraduate courses. EGTRRA expanded this provision to graduate education and extended the provision for undergraduate and graduate education to the end of 2010. The Act extends the changes for an additional two years, through 2012. [Code §127]

Elimination of 60-month limit and increase in income limitation on student loan interest deduction

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses up to $2,500. Prior to EGTRRA, this benefit was only allowed for 60 months and phased-out for taxpayers with income between $40,000 and $55,000 ($60,000 and $75,000 for joint filers). EGTRRA eliminated the 60 month rule and increased the income phase-out to $55,000 to $70,000 ($110,000 and $140,000 for joint filers). The Act extends the changes to this provision for an additional two years, through 2012. [Code §221]

Exclusion of certain amounts received under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program

The National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program provide education awards to participants on the condition that the participants perform certain services. EGTRRA allowed the §117 scholarship exclusion to apply to these programs. The Act extends the income exclusion for these programs for an additional two years, through 2012. [Code §117]

Additional increase in arbitrage rebate exception for governmental bonds used to finance educational facilities

EGTRRA increased the small-issuer arbitrage rebate exception for school construction from $10 million to $15 million. The Act extends the $15 million arbitrage rebate exception for school construction for an additional two years, through 2012. [Code §148]

Treatment of qualified public educational facility bonds as exempt facility bonds

EGTRRA expanded the definition of a private activity for which tax-exempt bonds may be issued to include bonds for qualified public educational facilities. Bonds issued for qualified educational facilities are not counted against a state's private-activity volume cap. Instead, these bonds have their own volume capacity limit equal to the lesser of $10 per resident or $5 million. The Act extends the allowance to issue tax-exempt private activity bonds for public school facilities for an additional two years, through 2012. [Code §141]

Deduction for higher education expenses

EGTRRA created an above-the-line deduction for qualified tuition and related expenses. Currently, subject to income phase-outs, taxpayers are allowed to deduct a maximum of $4,000. As originally enacted by EGTRRA, this provision was to expire on December 31, 2005. However, the provision has been extended twice by subsequent legislation and expired at the end of 2009. The EGTRRA sunset provision extension simply keeps this provision in the Code even though it terminated after 2009. (But see Act §724 below for an extension of the termination provision.) [Code §222]

Tax treatment and information requirements of Alaska Native settlement trusts

EGTRRA allowed an election in which Alaska Native settlement trusts can elect to pay tax at the same rate as the lowest individual marginal rate, rather than the higher rates that generally apply to trusts. Beneficiaries of the trust do not pay tax on the distributions of an electing trust's taxable income. Finally, contributions by an Alaska Native corporation to an electing trust will not be deemed distributions to the corporation's shareholders. The Act extends the elective tax treatment for Alaska Native settlement trusts for an additional two years, through 2012. [Code §646]

Temporary Extension of 2003 Tax Relief [Act §102]

The Act extends the sunset provision of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) from December 31, 2010, until December 31, 2012. The sections of the 2003 JGTRRA included in the extension include:

Reduction in capital gains rates for individuals; repeal of 5-year holding period requirement

JGTRRA lowered the capital gains rates for taxpayers below the 25% bracket to its current level of 0%. For those in the 25% bracket and above, the capital gains rates were lowered to 15%. These rates are set to expire at the end of 2010. Upon expiration, the rates for capital gains become 10% and 20%, respectively. The Act extends the current capital gains rates for all taxpayers for an additional two years, through 2012. [Code §1]

Dividends of individuals taxed at capital gain rates

JGTRRA lowered the dividend rates for taxpayers below the 25% bracket to its current level of 0%. For taxpayers in the 25% bracket and above, the dividend rates were lowered to 15%. These rates are set to expire at the end of 2010. Upon expiration, the rates for dividends are subject to the ordinary income rates. The Act extends the current dividends rates for all taxpayers for an additional two years, through 2012. [Code §1]

Temporary Extension of 2009 Tax Relief [Act §103]

The Act extends and modifies the following provisions first enacted in 2009 ARRA:

American Opportunity Tax Credit

The 2009 ARRA created the American Opportunity Tax Credit as a temporary replacement of the HOPE credit. Generally, the credit is for up to $2,500 of the cost of tuition and related expenses paid during the taxable year. The credit is allowable for the first four year of post-secondary education. Under this tax credit, taxpayers receive a tax credit based on 100% of the first $2,000 of tuition and related expenses (including course materials) paid during the taxable year and 25% of the next $2,000 of tuition and related expenses paid during the taxable year. Further, 40% of the credit is refundable. However, the credit is subject to a phase-out for taxpayers with adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly). The Act extends the American Opportunity Tax Credit for an additional two years, through 2012. [Code §25A]

Child Tax Credit

Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. The 2001 EGTRRA expanded the refundability of the child tax credit. The amount that may be claimed as a refund was 15% of earnings above $10,000. The 2009 ARRA increased the refundability of the credit by providing that earnings above $3,000 would count towards refundability for 2009 and 2010. The Act extends the $3,000 refundability threshold for an additional two years, through 2012. [Code §24]

Earned Income Tax Credit

The 2009 ARRA increased the earned income tax credit to 45% of a working family's first $12,570 of earned income for families with three or more children and increased the beginning point of the phase-out range for all married couples filing a joint return (regardless of the number of children). The Act extends for an additional two years, through 2012, the 2009 ARRA provisions that increased the credit for families with three or more children and increased the phase-out. [Code §32]

TITLE II—TEMPORARY EXTENSION OF INDIVIDUAL AMT RELIEF

Extension of Increased Alternative Minimum Tax Exemption Amount

For a joint return or a surviving spouse, the Act increases the AMT exemption amount to $72,450 for tax years beginning in 2010, and $74,450 for tax years beginning in 2011. For an individual who is not married and is not a surviving spouse, the Act increases the AMT exemption amount to $47,450 for tax years beginning in 2010, and $48,450 for tax years beginning in 2011. Finally, the Act repeals the sunset provisions of the 2001 Economic Growth and Tax Relief Reconciliation Act that apply to the AMT. Effective for tax years beginning after December 31, 2009. [Act §201; Code §55]

Extension of Alternative Minimum Tax Relief for Nonrefundable Personal Credits

For tax years beginning after 2009, the Act extends through 2011 the special rule for determining the aggregate amount of otherwise allowable nonrefundable personal credits that the taxpayer may claim. [Act §202; Code §26]

TITLE III—TEMPORARY ESTATE TAX RELIEF

Reinstatement of Estate Tax; Repeal of Carryover Basis

The Act reinstates the estate and generation-skipping transfer taxes and repeals the carryover basis regime by amending each provision of the Code (§§121, 170, 684, 1014, 1022, 1040, 1221, 1246, 1291, 1296, 2210, 2664, 4947, 6018, 6019, 6075, 6716, and 7701) that was amended by Subtitle A or E of Title V of EGTRRA to read as if the EGTRRA amendments had never been enacted. The Act makes a conforming amendment causing §2505(a)(1) to read as if it had not been amended by EGTRRA §521(b)(2) (which had set the post-2009 amount exempted by the gift tax unified credit at $1 million).

For estates of decedents dying in 2010, the Act allows (in a non-Code provision) the executor to elect to apply the §1022 modified carryover basis regime or to apply the reinstated estate tax regime. The Act directs the Treasury Secretary (or the Secretary's delegate) to prescribe the time and manner for making the election. The Act allows executors to revoke such elections only with the consent of the Secretary (or delegate). Under the Act, the election does not affect whether any property is considered subject to the estate tax under §2652(a)(1) in determining the transferor for generation-skipping transfer tax purposes.

For estates of decedents dying after 2009 and before the Act's enactment (December 17, 2010), the Act extends (in a non-Code provision), for at least nine months after the Act's enactment date, the due dates for: (1) filing an estate tax return under §6018 (including any elections required to be

made on such returns) as in effect without the EGTRRA amendments, and without regard to the election described in the preceding paragraph; (2) making any estate tax payments; and (3) making §2518(b) disclaimers for any property interest passing by reason of the decedent's death.

For generation-skipping transfers made after 2009 and before the Act's enactment, the Act extends (in a non-Code provision), for at least nine months after the Act's enactment date, the due date for filing any §2662 generation-skipping transfer tax return (including any elections required to be made on such returns).

Effective for estates of decedents dying and transfers made after 2009, except that the amendment to §2505 is effective beginning in 2011. [Act §301; Code §§121, 170, 684, 1014, 1022 (repealed), 1040, 1221, 1246, 1291, 1296, 2210 (repealed), 2505, 2664 (repealed), 4947, 6018, 6019, 6075, 6716 (repealed), 7701]

Modifications to Estate, Gift, and Generation-Skipping Transfer Taxes

The Act reunifies and increases the amount exempted by the estate and gift tax unified credits by amending §§2010(c) and 2505(a)(1) to eliminate the reference to $1 million in the gift tax provision and to set the exemption (applicable exclusion amount) at $5 million (as adjusted for inflation in multiples of $10,000 after 2011).

The Act amends §§2001(c) and 2502(a) to reduce the maximum estate and gift tax rate to 35% for amounts over $500,000.

For generation-skipping transfers made during 2010, the Act treats (in a non-Code provision) the applicable rate determined under §2641(a) as being zero.

To reflect the differences in the unified credit resulting from different estate and gift tax rates, the Act amends §2001(b)(2) and adds §2001(g) providing that, in applying §2001(b)(2) to one or more gifts, the tax rates in effect at the decedent's death (rather than the rates in effect at the time of the gifts) are used to calculate the gift tax and the gift tax unified credit allowed. In addition, the Act adds a sentence to §2505(a) specifying that, in applying §2505(a)(2) for a calendar year, the gift tax rates for that year (rather than the rates in effect for prior years) are to be used in determining the gift tax unified credit allowable for preceding years.

The Act makes a conforming amendment striking §2511(c), which rovides a special gift tax rule for certain transfers in trust.

Effective for estates of decedents dying, generation-skipping transfers made, and gifts made after 2009, except that the amendment to §2505(a)(1) is effective for gifts made after 2010 and the amendment to §2502(a) is effective after 2010. [Act §302; Code §§2001, 2010, 2502, 2505, 2511]

Applicable Exclusion Amount Increased by Unused Exclusion Amount of Deceased Spouse

After the amendments to §2010(c) described above, the Act amends §2010(c)(2) and adds §2010(c)(3) to: (1) provide for the portability of spouses' unified credits by defining the applicable exclusion amount as the "basic exclusion amount" plus, in the case of a surviving spouse, the "deceased spousal unused exclusion amount"; (2) set the basic exclusion amount at $5 million; and (3) adjust the basic exclusion amount for inflation in multiples of $10,000 after 2011.

For surviving spouses of decedents dying after 2010, the Act defines (in new §2010(c)(4)) the deceased spousal unused exclusion amount as the lesser of: (1) the basic exclusion amount; or (2) the excess of the basic exclusion amount of the last deceased spouse of the surviving spouse over the amount as to which the tentative tax is determined under §2001(b)(1) on the deceased spouse's estate.

For a surviving spouse's estate to take into account the deceased spousal unused exclusion amount, the Act requires (in new §2010(c)(5)) the deceased spouse's executor to file an estate tax return computing such amount and making an irrevocable election allowing such amount to be taken into account. The Act does not allow the election if this return is filed after the due date (including extensions). Notwithstanding any §6501 statute of limitations, the Act allows the Secretary to examine a deceased spouse's return to make determinations about the unused exclusion amount after the expiration of the §6501 period for assessing estate or gift tax relating to the unused exclusion amount.

The Act requires (in new §2010(c)(6)) the Secretary to issue regulations to carry out these provisions.

The Act makes a conforming amendment to §2505(a)(1) (after the amendments made by Act §302 described above) providing that, in determining the amount exempted by the gift tax unified credit,

the §2010 applicable credit amount is that which would apply if the donor died at the end of the calendar year.

The Act makes a conforming amendment to the generation-skipping transfer tax exemption by replacing the reference to the §2010(c) applicable exclusion amount in §2631(c) with a reference to § 2010(c) basic exclusion amount.

The Act makes a similar conforming amendment to §6018(a)(1), replacing the reference to the applicable exclusion amount with a reference to the basic exclusion amount.

Effective for estates of decedents dying and gifts made after 2010, except that the amendment to §2631(c) applies to generation-skipping transfers made after 2010. [Act §303; Code §§2010, 2505, 2631, 6018]

Application of EGTRRA Sunset to this Title

The Act provides (in a non-Code provision) that the sunset provision in EGTRRA §901 applies to the amendments made by Title III of the Act. [Act §304]

TITLE IV—TEMPORARY EXTENSION OF INVESTMENT INCENTIVES

Extension of Bonus Depreciation; Temporary 100% Expensing for Certain Business Assets

The Act extends and temporarily increases the current §168(k) 50% bonus depreciation provision that applies to qualified property acquired after December 31, 2007, and before January 1, 2011. The Act extends bonus depreciation for property placed in service before January 1, 2013. In addition, the Act provides for temporary 100% bonus depreciation for property acquired and placed in service after September 8, 2010, and before January 1, 2012. This means that taxpayers are able to claim a 100% depreciation deduction for property acquired and placed in service in the latter third of 2010 and all of 2011 (and 2012, for certain property); property placed in service during 2012 (2013 for certain property) is eligible for 50% bonus depreciation.

Section 168(k)(4)(H) defines property that became eligible for bonus depreciation as a result of the American Recovery and Reinvestment Act of 2009, P.L. 111-5, as "extension property." The Act designates property eligible for bonus depreciation as a result of the Act's extension as "round 2 extension property." The Act provides that the limitation on the general business credit based on the amount of tax does not apply to round 2 extension property. In addition, the Act provides that the business credit increase amount applicable to allocations of bonus depreciation also does not apply to round 2 extension property.

The Act extends the provision allowing corporate taxpayers to elect to accelerate the AMT and research credits in lieu of bonus depreciation for taxable years 2011 and 2012.

Comment: In view of the 100% bonus depreciation that the Act allows for property acquired and placed in service from September 9, 2010, through December 31, 2011, taxpayers that acquire §179 property in excess of the expensing limitations during that period should consider whether it would be advantageous to claim 100% bonus depreciation or to accelerate AMT or research credits, rather than electing to expense the cost under §179. [Act §401; Code §168]

Temporary Extension of Increased Small Business Expensing

For taxable years beginning in 2010 and 2011, small businesses may elect to expense up to $500,000 of capital investment, with the phase out beginning at $2,000,000, but, under pre-Act law, is set to be $25,000 with a $200,000 limitation for 2012. The Act provides a $125,000 maximum cost of §179 property that may be expensed rather than depreciated in tax years beginning in 2012; the phase out threshold is $500,000. The Act provides inflation increases for both figures. The Act also provides a $25,000 maximum and $200,000 phase out threshold for tax years beginning after 2012; these figures are not to be adjusted for inflation.

Comment: In view of the 100% bonus depreciation that the Act allows for property acquired and placed in service from September 9, 2010, through December 31, 2011 (see Act §401, above), taxpayers that acquire §179 property in excess of the expensing limitations during that period should consider whether it would be advantageous to claim 100% bonus depreciation or to accelerate AMT or research credits, rather than electing to expense the cost under §179. [Act §402; Code §179]

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TITLE VI—TEMPORARY EMPLOYEE PAYROLL TAX CUT

Temporary Employee Payroll Tax Cut

For 2011 only, the Act reduces the Social Security (OASDI) tax rate on employees to 4.2% (from

6.2%) and reduces the self-employment tax (SECA) rate to 10.4% (from 12.4%). The employer OASDI tax rate stays at 6.2%. Also, the Act does not reduce the OASDI contribution base, which is $106,800 for 2011. Thus, the maximum OASDI tax in 2011 for employees is $4,485.60.

With regard to deductions for employment taxes, the rate reduction is not taken into account in determining the SECA tax deduction allowed for determining net earnings from self employment. As a result, the deduction for 2011 remains 7.65% of self-employment income (determined without regard to the deduction).

The income tax deduction allowed under §164(f) for taxable years beginning in 2011 is determined using 59.6% of the OASDI tax paid, plus one half of the HI tax paid.

For federal laws other than the tax Code, the rate of tax in effect under §3101(a) is determined without regard to the reduction in that rate under the Act.

Effective for remuneration received during 2011 and for self-employment income for taxable years beginning in 2011. [Act §601; Code §§1401, 1402, 3101, 3201, 3211]

TITLE VII—TEMPORARY EXTENSION OF CERTAIN EXPIRING PROVISIONS

Subtitle A—Energy

Incentives for Biodiesel and Renewable Diesel

For fuel sold or used after December 31, 2009, the Act provides that the credits for biodiesel, renewable diesel used as fuel, and biodiesel mixture, and the payments for non-taxable biodiesel mixture do not extend to such fuel sold or used after December 31, 2011. The Act also provides that biodiesel mixture credits properly determined during 2010 will be allowed, and any refunds or payments attributable to such credits will be made only in the manner the Secretary of the Treasury (or the Secretary's delegate) provides. [Act §701; Code §§40A, 6426]

Credit for Refined Coal Facilities

For facilities placed in service after December 31, 2009, the Act extends the renewable electricity production credit to facilities producing refined coal, placed in service before January 1, 2012. [Act §702; Code §45]

New Energy Efficient Home Credit

The Act extends the new energy efficient home credit for one year. Thus, to qualify, the new energy efficient home must be acquired from an eligible contractor on or before December 31, 2011. [Act §703; Code §45L]

Excise Tax Credits and Outlay Payments for Alternative Fuel and Alternative Fuel Mixtures

The Act provides that the credits for alternative fuel and alternative fuel mixture (excepting, in both cases, liquefied hydrogen) and payments for non-taxable alternative fuel and alternative fuel mixture (excepting, in both cases, liquefied hydrogen) applies to such fuels sold or used on or before December 31, 2011. Also, the Act excludes black liquor from credit eligibility. Further, the Act provides that credits for alternative fuel or alternative fuel mixture properly determined during 2010 will be allowed, and refunds or payments attributable to such credits will be made only in the manner the Secretary of the Treasury (or the Secretary's delegate) provides. Effective for fuel sold or used after December 31, 2009. [Act §704; Code §§6426, 6427]

Special Rule for Sales or Dispositions to Implement FERC or State Electric Restructuring Policy for Qualified Electric Utilities

Applicable to dispositions after December 31, 2009, the Act, for qualified electric utilities, extends the definition of "qualifying electric transmission transaction" to any sale or disposition before January 1, 2012. [Act §705; Code §451]

Suspension of Limitation on Percentage Depletion for Oil and Gas from Marginal Wells

Applicable to tax years beginning after December 31, 2009, the Act extends the temporary suspension of the taxable income limit on percentage depletion for oil and gas from marginal wells to such depletion determined before January 1, 2012. [Act §706; Code §613A]

Extension of Grants for Specified Energy Property in Lieu of Tax Credits

The Act amends the American Recovery and Reinvestment Act of 2009 by extending the grants for specified energy property in lieu of tax credits through 2011. [Act §707; ARRA §1603]

Extension of Provisions Related to Alcohol Used as Fuel

The Act provides that the alcohol fuels credit applies to any sale or use of such fuels for any period on

or before December 31, 2011. Also, the Act provides that the credit does not apply to any period before January 1, 2012, during which time the Highway Trust Fund gasoline excise tax financing rates are 4.3 cents per gallon. Further, the Act extends the reduced credit for ethanol blenders through 2011. Effective for periods after December 31, 2010.

Effective for sales and uses after December 31, 2010, the Act provides that the payments for non-taxable alcohol fuel mixture applies to such fuel sold or used on or before December 31, 2011.

Finally, effective January 1, 2011, the Act, by amending the Harmonized Tariff Schedule of the United States, extends the additional duties on ethanol through 2011. [Act §708; Code §§40, 6426, 6427]

Energy Efficient Appliance Credit

Effective for appliances produced after December 31, 2010, the Act provides the applicable amounts used to determine the energy efficient appliance credit for dishwashers, clothes washers and refrigerators manufactured in calendar year 2011 that meet specified energy-usage limits.

The Act decreases the aggregate credit amount allowed to $25,000,000, less the credit amount allowed in all prior tax years beginning after December 31, 2010. Also, the Act excludes the most efficient refrigerators and front-loading clothes washers from the aggregate credit amount. Finally, the Act increases the gross receipts limitation to 4%. Effective for taxable years beginning after December 31, 2010. [Act §709; Code §45M]

Credit for Non-Business Energy Property

The Act provides that the non-business energy property credit's placed in service date applies to property placed in service on or before December 31, 2011. The Act returns the provisions allowing the credit, establishing the credit amount and defining wood stoves and qualified natural gas, propane, or oil furnaces or hot water boilers to those in effect prior to amendment by the American Recovery and Reinvestment Tax Act of 2009. Thus, the credit is 10%, with a maximum of $500, with $200 of that for windows. Also, the Act provides that the 2009 International Energy Conservation Code should be followed defining qualified energy efficiency improvements, including insulation, exterior windows, skylights and doors. Further, the Act provides that the taxpayer may not include expenditures for qualified energy efficiency improvements made from subsidized energy financing. Effective for property placed in service after December 31, 2010. [Act §710; Code §25C]

Alternative Fuel Vehicle Refueling Property

Effective for property placed in service after December 31, 2010, the Act provides that the alternative fuel vehicle refueling property credit applies to any non-hydrogen related property placed in service on or before December 31, 2011. [Act §711; Code §30C]

Subtitle B—Individual Tax Relief

Deduction for Certain Expenses of Elementary and Secondary School Teachers

The Act extends the $250 above-the-line deduction for professional expenses incurred by elementary and secondary schoolteachers. The deduction, currently available for taxable years beginning in 2002-2009, is now available for taxable years beginning in 2002-2011. [Act §721; Code §62]

Deduction of State and Local Taxes

The Act extends the election available to taxpayers who itemize their deductions to deduct state and local sales taxes in lieu of state and local income taxes. The election, currently available for taxable years beginning in 2004-2009, is now available for taxable years beginning in 2004-2011. [Act §722; Code §164]

Contributions of Capital Gain Real Property Made for Conservation Purposes

The increased contribution limitations and carryover period of §170(b)(1)(E) and (b)(2)(B) for charitable contributions of certain conservation property expired on December 31, 2009. The Act extends this provision to include contributions made before January 1, 2012. [Act §723; Code §170]

Above-the-Line Deduction for Qualified Tuition and Related Expenses

The Act extends the above-the-line deduction for qualified tuition and related expenses. The maximum deduction amount is $4,000 in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return). The maximum deduction is $2,000 the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $80,000 ($160,000 in the case of a joint return). The deduction, currently available for taxable years beginning before 2010, is now available for taxable years beginning before 2012. [Act §724; Code §222]

Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes

Through 2011, the Act allows taxpayers age 70 $^1/_2$ or older to make tax-free distributions to charities from their traditional individual retirement accounts (IRAs) and Roth IRAs up to $100,000 per taxpayer, per taxable year. This provision had expired at the end of 2009. Thus, in order to, in effect, retroactively reinstate this provision, the Act permits individuals to make charitable transfers during January of 2011 as if they were made during 2010.

Effective for distributions made in taxable years beginning after December 31, 2009. [Act §725; Code §408]

Look-thru of Certain Regulated Investment Company Stock in Determining Gross Estate of Nonresidents

Section 2105(d) provides a look-thru rule for estates of nonresident aliens that hold an interest in a U.S. RIC. This provision expired with respect to decedents dying after December 31, 2009, but the Act extends it to include decedents dying before January 1, 2012. [Act §726; Code §2105]

Parity for Exclusion from Income for Employer-Provided Mass Transit and Parking Benefits

Prior to February 17, 2009, $100 per month could be excluded as qualified transportation fringe benefits in combined vanpooling and transit pass benefits and $175 per month in qualified parking benefits. All limits were adjusted annually for inflation. In 2009, the combined monthly exclusion for employer-provided vanpool and transit pass benefits was increased temporarily to the same level as the exclusion for employer-provided parking ($230 for 2010, as indexed for inflation). This provision is set to expire on December 31, 2010. The Act extends the increase in the monthly exclusion for employer-provided transit and vanpool benefits for one year, through the December 31, 2011.

Effective for months after December 31, 2010. [Act §727; Code §132]

Refunds Disregarded in the Administration of Federal Programs and Federally Assisted Programs

The Act adds §6409 to provide that refunds (or advance payments with respect to refundable credits) are disregarded for purposes of determining eligibility for benefits or assistance for certain Federal programs and certain Federally assisted state or local programs. Effective for amounts received after December 31, 2009, and expires for amounts received after December 31, 2012. [Act §728; Code §6409 (new)]

Subtitle C—Business Tax Relief

Research Credit

The §41 research credit for increasing research activities expired on December 31, 2009. The Act extends the credit for amounts paid or incurred on or before December 31, 2011, applicable to amounts paid or incurred after December 31, 2009. The December 31, 2008 termination date for the alternative incremental credit election remains unchanged. [Act §731; Code §41]

Indian Employment Credit

The §45A Indian employment credit for employing members of Indian tribes expired for taxable years beginning after December 31, 2009. The Act extends the credit to taxable years beginning on or before December 31, 2011, applicable to tax years beginning after December 31, 2009. [Act §732; Code §45A]

New Markets Tax Credit

The Act provides a new national designated investment limitation for the §45D new markets tax credit of $3.5 billion in 2010 and 2011, and permits unused credits to be carried over to 2016. [Act §733; Code §45D]

Railroad Track Maintenance Credit

The §45G railroad track maintenance credit for 50% of qualified railroad track maintenance expenditures expired for tax years beginning after December 31, 2010. The Act extends the credit to taxable years beginning before January 1, 2012. [Act §734; Code §45G]

Mine Rescue Team Training Credit

The §45N mine rescue team training credit for 20% of the cost of training rescue team members expired for tax years beginning after December 31, 2009. The Act extends the credit to taxable years beginning before January 1, 2012, effective for tax years beginning after December 31, 2009. [Act §735; Code §45N]

Employer Wage Credit for Employees Who Are Active Duty Members of the Uniformed Services

The §45P activated military reservist wage payment credit for 20% of differential wage payments made to activated military reservists expired for payments made after December 31, 2009. The Act

extends the credit for payments made before January 1, 2012, applicable to payments made after December 31, 2009. [Act §736; Code §45P]

15-Year Straight-Line Cost Recovery for Qualified Leasehold Improvements, Qualified Restaurant Buildings and Improvements, and Qualified Retail Improvements

The Act extends the special 15-year cost recovery period for certain leasehold improvements, restaurant buildings and improvements, and retail improvements. The 15-year cost recovery period, currently available for qualified property placed in service before 2010, is made available for qualified property placed in service before 2012. [Act §737; Code §168]

7-Year Recovery Period for Motorsports Entertainment Complexes

The Act extends the 7-year recovery period for motorsports entertainment complexes. The 7-year recovery period, currently available for property placed in service before 2010, is made available for property placed in service before 2012. [Act §738; Code §168]

Accelerated Depreciation for Business Property on an Indian Reservation

The Act extends the accelerated depreciation rules for business property on an Indian reservation. Currently available for qualified Indian reservation property placed in service before 2010, the accelerated depreciation rules are made available for qualified Indian reservation property placed in service before 2012. [Act §739; Code §168]

Enhanced Charitable Deduction for Contributions of Food Inventory

The §170(e)(3)(C) special rule for charitable deductions for contributions of food inventory expired on December 31, 2009. The special rule applied to contributions made from the taxpayer's trade or business, and applied only to food that was "apparently wholesome" (as defined under §22(b)(2) of the Act Emerson Good Samaritan Food Donation Act of as in effect on September 23, 2005). When the special rule applied, the determination of whether the contribution was a "qualified contribution" was made without regard to whether the contribution was by a C corporation. If the taxpayer was not a C corporation, the aggregate amount of food contributions for any taxable year which could be taken into account was limited to 10% of the taxpayer's aggregate net income for the taxable year from all trades or businesses from which food contributions were made for the year, computed without taking into account charitable contribution deductions. The Act extends the enhanced deduction to contributions made on or before December 31, 2011, applicable to contributions made after December 31, 2009. [Act §740; Code §170]

Enhanced Charitable Deduction for Contributions of Book Inventories to Public Schools

The §170(e)(3)(D) special rule for charitable deductions for contributions of book inventory to public schools expired on December 31, 2009. The special rule provided that if the contribution was a "qualified book contribution" and the required certification was provided, the determination of whether the contribution qualified for the §170(e)(3) enhanced contribution deduction was made without regard to whether the donee was an organization described in §501(c)(3) and exempt under §501(a). A "qualified book contribution" was a charitable contribution of books to a public school that was an educational organization and provided elementary or secondary education. The Act extends the enhanced deduction to contributions made on or before December 31, 2011, applicable to contributions made after December 31, 2009. [Act §741; Code §170]

Enhanced Charitable Deduction for Corporate Contributions of Computer Inventory for Educational Purposes

The §170(e)(6) special rule for charitable deductions for contributions of computer technology and equipment for educational purposes expired on December 31, 2009. Gifts deducted under §170(e)(6) had to meet the following requirements: (1) the donated property had to be computer technology or equipment; (2) the donor had to be a corporation other than an S corporation; (3) the donee had be (a) an educational organization described in §170(b)(1)(A)(ii), (b) an entity described in §501(c)(3) and exempt from tax under §501(a) that was organized primarily for purposes of supporting elementary and secondary education, or (c) a public library; (4) the contribution had to occur within three years of the date on which the donor acquired the property or, if the donor constructed the property, within three years of the date on which the property was substantially completed; (5) the original use of the property had to be either the donee's use or the donor's use; (6) substantially all of the use or disposition of the property by the donee had to be within the United States for educational purposes that were related to the purpose or function of the donee; (7) the donee could not sell the donated property, except to cover shipping, installation, and transfer costs; (8) the property had to fit productively into the donee's education plan; and (9) the property had to meet any standards prescribed by regulation to assure that it satisfied minimum functionality and suitability standards for educational purposes. The Act extends the enhanced deduction to contributions made on or before December 31, 2011, applicable to contributions made after December 31, 2009. [Act

§742; Code §170]

Election to Expense Mine Safety Equipment

The Act extends the election to expense mine safety equipment. The election is generally available for 50% of the cost of any qualified advanced mine safety equipment property. The election, currently available for property placed in service before 2010, is made available for property placed in service before 2012. [Act §743; Code §179E]

Special Expensing Rules for Certain Film and Television Productions

The Act extends the special expensing rules for certain film and television producers. The special expensing rules generally apply to the first $15 million of costs of qualified television or film productions. The special expensing rules, currently available for qualified television or film productions commencing before 2010, is made available for the first $15 million of costs of qualified television of film productions commencing before 2012. [Act §744; Code §181]

Expensing of Environmental Remedial Costs

The election to deduct environmental remediation costs in lieu of capitalization expired after December 31, 2009. The Act extends the election through December 31, 2011, applicable to expenditures paid or incurred after December 31, 2009. [Act §745; Code §198]

Deduction Allowable with Respect to Income Attributable to Domestic Production Activities of Puerto Rico

The domestic production activities deduction expired for activities in Puerto Rico after December 31, 2009. The Act extends the deduction through December 31, 2011, applicable to tax years beginning after December 31, 2009. [Act §746; Code §199]

Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations

Under §512(b)(13)(E), certain payments made to an exempt organization by a controlled organization must be treated as unrelated business income. For payments received or accrued before January 1, 2010, the amount taken into income was limited to "excess payments" as determined under §482. The Act extends this rule for excess payments to include payments received or accrued before January 1, 2012. [Act §747; Code §512]

Treatment of Certain Dividends of Regulated Investment Companies

The exemption from the 30% withholding tax under §871(k)(1) and (2) for qualified interest-related dividends and short-term capital gain dividends received by a foreign person from a regulated investment company (RIC) expired on December 31, 2009. The Act extends the exemption through December 31, 2011, applicable to tax years beginning after December 31, 2009. [Act §748; Code §871]

RIC Qualified Investment Entity Treatment Under FIRPTA

The inclusion of a regulated investment company (RIC) within the definition of a "qualified investment entity" for purposes of determining whether a distribution from a RIC is subject to FIRPTA tax and withholding pursuant to §§897 and 1445 expired for certain purposes after December 31, 2009. The Act, effective January 1, 2010, extends the inclusion of a RIC within this definition through December 31, 2011, for those situations in which that inclusion would otherwise have expired. However, the provision does not apply to the withholding requirement for any payment made before the December 17, 2010 enactment date of the Act, though a RIC that withheld and remitted tax on post-2009 distributions before such date is not held liable to the distributee for such amounts. [Act §749; Code §§897, 1445]

Exceptions for Active Financing Income

The exceptions from current inclusion under the subpart F rules for certain income derived in the active conduct of a banking, financing or similar business, in the conduct of an insurance business, or as a securities dealer expired for tax years beginning after 2009. The Act extends the exceptions for tax years of foreign corporations beginning before 2012, and for tax years of their U.S. shareholders with or within which such years, effective for tax years beginning after December 31, 2009. [Act §750; Code §§953, 954]

Look-thru Treatment of Payments Between Related Controlled Foreign Corporations Under Foreign Personal Holding Company Rules

The exception under §954(c)(6) from current inclusion as foreign personal holding company income for dividends, interest, rents, and royalties received by a controlled foreign corporation (CFC) from a related CFC, to the extent such amount was neither subpart F income nor treated as effectively connected income, expired for tax years beginning after 2009. The Act extends the exception for tax

years of foreign corporations beginning before 2012, and for tax years of their U.S. shareholders with or within which such years, effective for tax years beginning after December 31, 2009. [Act §751; Code §954]

Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property

Section 1367(a)(2) (as amended in 2006) provided that an S corporation shareholder's §1367(a)(2)(B) basis reduction resulting from the corporation's charitable contribution of property equaled the shareholder's pro rata share of the adjusted basis of the contributed property. The purpose of the 2006 amendment was to bring the basis reduction rules for S corporation shareholders into conformity with those for partners. This special rule expired on December 31, 2009. The Act extends the special basis-adjustment rule to contributions made on or before December 31, 2011, applicable to contributions made after December 31, 2009. [Act §752; Code §1367]

Empowerment Zone Tax Incentives

The Act extends for two years (through 2011) the designation of certain economically depressed census tracts as Empowerment Zones, within which businesses and individual residents are eligible for special tax incentives. Effective for periods after December 31, 2009. [Act §753; Code §§1391, 1202]

Tax Incentives for Investment in the District of Columbia

The Act extends for two years (through 2011) the designation of certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone, within which businesses and individual residents are eligible for special tax incentives. The Act also extends for two years (through 2011) the $5,000 first-time homebuyer credit for the District of Columbia. Effective for applicable events occurring after December 31, 2009. [Act §754; Code §§1400, 1400A, 1400B, 1400C]

Temporary Increase in Limit on Cover over of Rum Excise Taxes to Puerto Rico and the Virgin Islands

The Act extends for two years (through 2011) the provision providing for payment of $13.25 per gallon to cover over a $13.50 per proof gallon excise tax on distilled spirits produced in or imported into the United States. Effective with respect to distilled spirits brought into the United States after December 31, 2009. [Act §755; Code §7652]

American Samoa Economic Development Credit

The Act extends through 2011 the American Samoa economic development credit. Effective for taxable years beginning after December 31, 2009. [Act §756; Tax Relief and Health Care Act of 2006, Div. A, §119(d)]

Work Opportunity Credit

Under pre-Act law, businesses are allowed to claim a work opportunity tax credit equal to 40% of the first $6,000 of wages paid to new hires of one of nine targeted groups, including members of families receiving benefits under the Temporary Assistance to Needy Families (TANF) program, qualified veterans, designated community residents, and others. The program is currently set to expire August 31, 2011. The Act extends this provision through December 31, 2011. Effective for individuals who begin work for the employer after the December 17, 2010 date of enactment. [Act §757; Code §51]

Qualified Zone Academy Bonds

Qualified Zone Academy bonds (QZABs) are a form of tax credit bond which offer the holder a federal tax credit instead of interest and can be used to finance renovations, equipment purchases, developing course material, and training teachers and personnel at a qualified zone academy. Generally, a qualified zone academy is any public school (or academic program within a public school) below college level that is located in an empowerment zone or enterprise community and is designed to cooperate with businesses to enhance the academic curriculum and increase graduation and employment rates. The Act extends the QZAB program by providing an additional $400 million for 2011. The Act also repeals the direct subsidy feature created as part of the American Recovery and Reinvestment Act for 2011 and for any carryforward of unused allocation. Effective with respect to obligations issued after December 31, 2010. [Act §758; Code §§54E, 6431]

Mortgage Insurance Premiums

Taxpayers may itemize the cost of mortgage insurance on a qualified personal residence. The deduction is phased-out ratably by 10% for each $1,000 by which the taxpayer's adjusted gross income (AGI) exceeds $100,000, so that the deduction is unavailable for a taxpayer with an AGI in excess of $110,000. The deduction is set to expire December 31, 2010. The Act extends this provision for one year, through 2011. Effective for amounts paid or accrued after December 31, 2010. [Act

§759; Code §163]

Temporary Exclusion of 100 Percent of Gain on Certain Small Business Stock

Generally, non-corporate taxpayers may exclude 50% of the gain from the sale of certain small business stock acquired at original issue and held for more than five years. For stock acquired after February 17, 2009, and on or before September 27, 2010, the exclusion is increased to 75%. For stock acquired after September 27, 2010, and before January 1, 2011, the exclusion is 100%, and the alternative minimum tax preference item attributable for the sale is eliminated. Qualifying small business stock is stock from a C corporation whose gross assets do not exceed $50 million (including the proceeds received from the issuance of the stock) and that meets a specific active business requirement. The amount of gain eligible for the exclusion is limited to the greater of 10 times the taxpayer's basis in the stock or $10 million of gain from stock in that corporation.

The Act extends the 100% exclusion of the gain from the sale of qualifying small business stock that is acquired before January 1, 2012, and held for more than five years. Effective with respect to stock acquired after December 31, 2010. [Act §760; Code §1202]

Subtitle D—Temporary Disaster Relief Provisions

Subpart A—New York Liberty Zone

Tax-Exempt Bond Financing The time for issuing qualified New York Liberty Zone bonds expired after December 31, 2009. The Act extends the time for two years, through December 31, 2011, applicable to bonds issued after December 31, 2009. [Act §761; Code §1400L]

Subpart B—GO Zone

Increase in Rehabilitation Credit

The increased rehabilitation credit for qualified rehabilitation buildings and certified historic structures located in the Gulf Opportunity Zone expired after December 31, 2009. The Act extends the increased credit for two years, through December 31, 2011, applicable to amounts paid or incurred after December 31, 2009. [Act §762; Code §1400N]

Low-Income Housing Credit Rules for Buildings in GO Zones

Additional allocations of low-income housing credits made in 2006, 2007, and 2008 for buildings located in the GO Zone, the Rita GO Zone, or the Wilma GO Zone require that the buildings be placed in service before January 1, 2011. The Act extends the placed-in service date for one year, through December 31, 2011. [*Editor's Note*: Before passage, Senator Landrieu offered an amendment to extend the placed in service date through December 31, 2012, to allow current projects time for completion. However, the amendment was not put forth as the senator was assured by the leaders that the provision would be addressed early in the next Congress.] [Act §763; Code §1400N]

Tax-Exempt Bond Financing

The times for issuing qualified GO Zone bonds and for treating repair or reconstruction of buildings located in the GO Zone, the Rita GO Zone, or the Wilma GO Zone as qualified rehabilitation under §143 both expire after December 31, 2010. The Act extends that date for one year, through December 31, 2011. [Act §764; Code §1400N]

Bonus Depreciation Deduction Applicable to the GO Zone

The additional depreciation deduction for Gulf Opportunity Zone extension property expired after December 31, 2009. The Act extends GO Zone bonus depreciation provision through December 31, 2011, and requires that the property be placed in service by December 31, 2011, applicable to property placed in service after December 31, 2009. [Act §765; Code §1400N]

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ISSN 1947-3923

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Tax and Accounting Center

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Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (H.R. 4853), passed by the Senate December 15, 2010

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title; etc.

TITLE I—TEMPORARY EXTENSION OF TAX RELIEF

Sec. 101. Temporary extension of 2001 tax relief.

Sec. 102. Temporary extension of 2003 tax relief.

Sec. 103. Temporary extension of 2009 tax relief.

TITLE II—TEMPORARY EXTENSION OF INDIVIDUAL AMT RELIEF

Sec. 201. Temporary extension of increased alternative minimum tax exemption amount.

Sec. 202. Temporary extension of alternative minimum tax relief for nonrefundable personal credits.

TITLE III—TEMPORARY ESTATE TAX RELIEF

Sec. 301. Reinstatement of estate tax; repeal of carryover basis.

Sec. 302. Modifications to estate, gift, and generation-skipping transfer taxes.

Sec. 303. Applicable exclusion amount increased by unused exclusion amount of deceased spouse.

Sec. 304. Application of EGTRRA sunset to this title.

TITLE IV—TEMPORARY EXTENSION OF INVESTMENT INCENTIVES

Sec. 401. Extension of bonus depreciation; temporary 100 percent expensing for certain business assets.

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TITLE V—TEMPORARY EXTENSION OF UNEMPLOYMENT INSURANCE AND RELATED MATTERS

Sec. 501. Temporary extension of unemployment insurance provisions.

Sec. 502. Temporary modification of indicators under the extended benefit program.

Sec. 503. Technical amendment relating to collection of unemployment compensation debts.

Sec. 504. Technical correction relating to repeal of continued dumping and subsidy offset.

Sec. 505. Additional extended unemployment benefits under the Railroad Unemployment Insurance Act.

TITLE VI—TEMPORARY EMPLOYEE PAYROLL TAX CUT

Sec. 601. Temporary employee payroll tax cut.

TITLE VII—TEMPORARY EXTENSION OF CERTAIN EXPIRING PROVISIONS

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Sec. 701. Incentives for biodiesel and renewable diesel.

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Sec. 706. Suspension of limitation on percentage depletion for oil and gas from marginal wells.

Sec. 707. Extension of grants for specified energy property in lieu of tax credits.

Sec. 708. Extension of provisions related to alcohol used as fuel.

Sec. 709. Energy efficient appliance credit.

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Subtitle B—Individual Tax Relief

Sec. 721. Deduction for certain expenses of elementary and secondary school teachers.

Sec. 722. Deduction of State and local sales taxes.

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Sec. 724. Above-the-line deduction for qualified tuition and related expenses.

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TITLE VIII—BUDGETARY PROVISIONS

Sec. 801. Determination of budgetary effects.

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TITLE I—TEMPORARY EXTENSION OF TAX RELIEF

SEC. 101. TEMPORARY EXTENSION OF 2001 TAX RELIEF.

(a) TEMPORARY EXTENSION.—

(1) IN GENERAL.—Section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 is amended by striking "December 31, 2010" both places it appears and inserting "December 31, 2012".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall take effect as if included in the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001.

(b) SEPARATE SUNSET FOR EXPANSION OF ADOPTION BENEFITS UNDER THE PATIENT PROTECTION AND AFFORDABLE CARE ACT.—

(1) IN GENERAL.—Subsection (c) of section 10909 of the Patient Protection and Affordable Care Act is amended to read as follows:

"(c) SUNSET PROVISION.—Each provision of law amended by this section is amended to read as such provision would read if this section had never been enacted. The amendments made by the preceding sentence shall apply to taxable years beginning after December 31, 2011.".

(2) CONFORMING AMENDMENT.—Subsection (d) of section 10909 of such Act is amended by striking "The amendments" and inserting "Except as provided in subsection (c), the amendments".

SEC. 102. TEMPORARY EXTENSION OF 2003 TAX RELIEF.

(a) IN GENERAL.—Section 303 of the Jobs and Growth Tax Relief Reconciliation Act of 2003 is amended by striking "December 31, 2010" and inserting "December 31, 2012".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect as if included in the enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003.

SEC. 103. TEMPORARY EXTENSION OF 2009 TAX RELIEF.

(a) AMERICAN OPPORTUNITY TAX CREDIT.—

(1) IN GENERAL.—Section 25A(i) is amended by striking "or 2010" and inserting ", 2010, 2011, or 2012" .

(2) TREATMENT OF POSSESSIONS.—Section 1004(c)(1) of the American Recovery and Reinvestment Tax Act of 2009 is amended by striking "and 2010" each place it appears and inserting ", 2010, 2011, and 2012".

(b) CHILD TAX CREDIT.—Section 24(d)(4) is amended—

(1) by striking "2009 AND 2010" in the heading and inserting "2009, 2010, 2011, AND 2012" , and

(2) by striking "or 2010" and inserting ", 2010, 2011, or 2012" .

(c) EARNED INCOME TAX CREDIT.—Section 32(b)(3) is amended—

(1) by striking "2009 AND 2010" in the heading and inserting "2009, 2010, 2011, AND 2012" , and

(2) by striking "or 2010" and inserting ", 2010, 2011, or 2012" .

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2010.

TITLE II—TEMPORARY EXTENSION OF INDIVIDUAL AMT RELIEF

SEC. 201. TEMPORARY EXTENSION OF INCREASED ALTERNATIVE MINIMUM TAX EXEMPTION AMOUNT.

(a) IN GENERAL.—Paragraph (1) of section 55(d) is amended—

(1) by striking "$70,950" and all that follows through "2009" in subparagraph (A) and inserting "$72,450 in the case of taxable years beginning in 2010 and $74,450 in the case of taxable years beginning in 2011" , and

(2) by striking "$46,700" and all that follows through "2009" in subparagraph (B) and inserting "$47,450 in the case of taxable years beginning in 2010 and $48,450 in the case of taxable years beginning in 2011" .

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

(c) REPEAL OF EGTRRA SUNSET.—Title IX of the Economic Growth and Tax Relief Reconciliation Act of 2001 (relating to sunset of provisions of such Act) shall not apply to title VII of such Act (relating to alternative minimum tax).

SEC. 202. TEMPORARY EXTENSION OF ALTERNATIVE MINIMUM TAX RELIEF FOR

NONREFUNDABLE PERSONAL CREDITS.

(a) IN GENERAL.—Paragraph (2) of section 26(a) is amended—

(1) by striking "or 2009" and inserting "2009, 2010, or 2011" , and

(2) by striking "2009" in the heading thereof and inserting "2011" .

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

TITLE III—TEMPORARY ESTATE TAX RELIEF

SEC. 301. REINSTATEMENT OF ESTATE TAX; REPEAL OF CARRYOVER BASIS.

(a) IN GENERAL.—Each provision of law amended by subtitle A or E of title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 is amended to read as such provision would read if such subtitle had never been enacted.

(b) CONFORMING AMENDMENT.—On and after January 1, 2011, paragraph (1) of section 2505(a) of the Internal Revenue Code of 1986 is amended to read as such paragraph would read if section 521(b)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001 had never been enacted.

(c) SPECIAL ELECTION WITH RESPECT TO ESTATES OF DECEDENTS DYING IN 2010.—Notwithstanding subsection (a), in the case of an estate of a decedent dying after December 31, 2009, and before January 1, 2011, the executor (within the meaning of section 2203 of the Internal Revenue Code of 1986) may elect to apply such Code as though the amendments made by subsection (a) do not apply with respect to chapter 11 of such Code and with respect to property acquired or passing from such decedent (within the meaning of section 1014(b) of such Code). Such election shall be made at such time and in such manner as the Secretary of the Treasury or the Secretary's delegate shall provide. Such an election once made shall be revocable only with the consent of the Secretary of the Treasury or the Secretary's delegate. For purposes of section 2652(a)(1) of such Code, the determination of whether any property is subject to the tax imposed by such chapter 11 shall be made without regard to any election made under this subsection.

(d) EXTENSION OF TIME FOR PERFORMING CERTAIN ACTS.—

(1) ESTATE TAX.—In the case of the estate of a decedent dying after December 31, 2009, and before the date of the enactment of this Act, the due date for—

(A) filing any return under section 6018 of the Internal Revenue Code of 1986 (including any election required to be made on such a return) as such section is in effect after the date of the enactment of this Act without regard to any election under subsection (c),

(B) making any payment of tax under chapter 11 of such Code, and

(C) making any disclaimer described in section 2518(b) of such Code of an interest in property passing by reason of the death of such decedent,

shall not be earlier than the date which is 9 months after the date of the enactment of this Act.

(2) GENERATION-SKIPPING TAX.—In the case of any generation-skipping transfer made after December 31, 2009, and before the date of the enactment of this Act, the due date for filing any return under section 2662 of the Internal Revenue Code of 1986 (including any election required to be made on such a return) shall not be earlier than the date which is 9 months after the date of the enactment of this Act.

(e) EFFECTIVE DATE.—Except as otherwise provided in this section, the amendments made by this section shall apply to estates of decedents dying, and transfers made, after December 31, 2009.

SEC. 302. MODIFICATIONS TO ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES.

(a) MODIFICATIONS TO ESTATE TAX.—

(1) $5,000,000 APPLICABLE EXCLUSION AMOUNT.—Subsection (c) of section 2010 is amended to read as follows:

"(c) APPLICABLE CREDIT AMOUNT.—

"(1) IN GENERAL.—For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under section 2001(c) if the amount with respect to which

such tentative tax is to be computed were equal to the applicable exclusion amount.

"(2) APPLICABLE EXCLUSION AMOUNT.—

"(A) IN GENERAL.—For purposes of this subsection, the applicable exclusion amount is $5,000,000.

"(B) INFLATION ADJUSTMENT.—In the case of any decedent dying in a calendar year after 2011, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting 'calendar year 2010' for 'calendar year 1992' in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000." .

(2) MAXIMUM ESTATE TAX RATE EQUAL TO 35 PERCENT.—Subsection (c) of section 2001 is amended—

(A) by striking "Over $500,000" **and all that follows in the table contained in paragraph (1) and inserting the following:**

"Over $500,000 ...	$155,800, plus 35 percent of the excess of such amount over $500,000." ,

(B) by striking "(1) IN GENERAL.—" **, and**

(C) by striking paragraph (2).

(b) MODIFICATIONS TO GIFT TAX.—

(1) RESTORATION OF UNIFIED CREDIT AGAINST GIFT TAX.—

(A) IN GENERAL.—Paragraph (1) of section 2505(a), after the application of section 301(b), is amended by striking "(determined as if the applicable exclusion amount were $1,000,000)" **.**

(B) EFFECTIVE DATE.—The amendment made by this paragraph shall apply to gifts made after December 31, 2010.

(2) MODIFICATION OF GIFT TAX RATE.—On and after January 1, 2011, subsection (a) of section 2502 is amended to read as such subsection would read if section 511(d) of the Economic Growth and Tax Relief Reconciliation Act of 2001 had never been enacted.

(c) MODIFICATION OF GENERATION-SKIPPING TRANSFER TAX.—In the case of any generation-skipping transfer made after December 31, 2009, and before January 1, 2011, the applicable rate determined under section 2641(a) of the Internal Revenue Code of 1986 shall be zero.

(d) MODIFICATIONS OF ESTATE AND GIFT TAXES TO REFLECT DIFFERENCES IN CREDIT RESULTING FROM DIFFERENT TAX RATES.—

(1) ESTATE TAX.—

(A) IN GENERAL.—Section 2001(b)(2) is amended by striking "if the provisions of subsection (c) (as in effect at the decedent's death)" **and inserting** "if the modifications described in subsection (g)" **.**

(B) MODIFICATIONS.—Section 2001 is amended by adding at the end the following new subsection:

"(g) MODIFICATIONS TO GIFT TAX PAYABLE TO REFLECT DIFFERENT TAX RATES.—For purposes of applying subsection (b)(2) with respect to 1 or more gifts, the rates of tax under subsection (c) in effect at the decedent's death shall, in lieu of the rates of tax in effect at the time of such gifts, be used both to compute—

"(1) the tax imposed by chapter 12 with respect to such gifts, and

"(2) the credit allowed against such tax under section 2505, including in computing—

"(A) the applicable credit amount under section 2505(a)(1), and

"(B) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2)." .

(2) GIFT TAX.—Section 2505(a) is amended by adding at the end the following new flush sentence:

"For purposes of applying paragraph (2) for any calendar year, the rates of tax in effect under section

2502(a)(2) for such calendar year shall, in lieu of the rates of tax in effect for preceding calendar periods, be used in determining the amounts allowable as a credit under this section for all preceding calendar periods." .

(e) CONFORMING AMENDMENT.—Section 2511 is amended by striking subsection (c).

(f) EFFECTIVE DATE.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to estates of decedents dying, generation-skipping transfers, and gifts made, after December 31, 2009.

SEC. 303. APPLICABLE EXCLUSION AMOUNT INCREASED BY UNUSED EXCLUSION AMOUNT OF DECEASED SPOUSE.

(a) IN GENERAL.—Section 2010(c), as amended by section 302(a), is amended by striking paragraph (2) and inserting the following new paragraphs:

"(2) APPLICABLE EXCLUSION AMOUNT.—For purposes of this subsection, the applicable exclusion amount is the sum of—

"(A) the basic exclusion amount, and

"(B) in the case of a surviving spouse, the deceased spousal unused exclusion amount.

"(3) BASIC EXCLUSION AMOUNT.—

"(A) IN GENERAL.—For purposes of this subsection, the basic exclusion amount is $5,000,000.

"(B) INFLATION ADJUSTMENT.—In the case of any decedent dying in a calendar year after 2011, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting 'calendar year 2010' for 'calendar year 1992' in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

"(4) DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT.—For purposes of this subsection, with respect to a surviving spouse of a deceased spouse dying after December 31, 2010, the term 'deceased spousal unused exclusion amount' means the lesser of—

"(A) the basic exclusion amount, or

"(B) the excess of—

"(i) the basic exclusion amount of the last such deceased spouse of such surviving spouse, over

"(ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse.

"(5) SPECIAL RULES.—

"(A) ELECTION REQUIRED.—A deceased spousal unused exclusion amount may not be taken into account by a surviving spouse under paragraph (2) unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account. Such election, once made, shall be irrevocable. No election may be made under this subparagraph if such return is filed after the time prescribed by law (including extensions) for filing such return.

"(B) EXAMINATION OF PRIOR RETURNS AFTER EXPIRATION OF PERIOD OF LIMITATIONS WITH RESPECT TO DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT.—Notwithstanding any period of limitation in section 6501, after the time has expired under section 6501 within which a tax may be assessed under chapter 11 or 12 with respect to a deceased spousal unused exclusion amount, the Secretary may examine a return of the deceased spouse to make determinations with respect to such amount for purposes of carrying out this subsection.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this subsection." .

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 2505(a), as amended by section 302(b)(1), is amended to read as follows:

"(1) the applicable credit amount in effect under section 2010(c) which would apply if the donor died as of the end of the calendar year, reduced by" .

(2) Section 2631(c) is amended by striking "the applicable exclusion amount" and inserting "the basic exclusion amount" .

(3) Section 6018(a)(1) is amended by striking "applicable exclusion amount" and inserting "basic exclusion amount" .

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to estates of decedents dying and gifts made after December 31, 2010.

(2) CONFORMING AMENDMENT RELATING TO GENERATION-SKIPPING TRANSFERS.—The amendment made by subsection (b)(2) shall apply to generation-skipping transfers after December 31, 2010.

SEC. 304. APPLICATION OF EGTRRA SUNSET TO THIS TITLE.

Section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 shall apply to the amendments made by this section.

TITLE IV—TEMPORARY EXTENSION OF INVESTMENT INCENTIVES

SEC. 401. EXTENSION OF BONUS DEPRECIATION; TEMPORARY 100 PERCENT EXPENSING FOR CERTAIN BUSINESS ASSETS.

(a) IN GENERAL.—Paragraph (2) of section 168(k) is amended—

(1) by striking "January 1, 2012" in subparagraph (A)(iv) and inserting "January 1, 2014" , and

(2) by striking "January 1, 2011" each place it appears and inserting "January 1, 2013" .

(b) TEMPORARY 100 PERCENT EXPENSING.—Subsection (k) of section 168 is amended by adding at the end the following new paragraph:

"(5) SPECIAL RULE FOR PROPERTY ACQUIRED DURING CERTAIN PRE-2012 PERIODS.—In the case of qualified property acquired by the taxpayer (under rules similar to the rules of clauses (ii) and (iii) of paragraph (2)(A)) after September 8, 2010, and before January 1, 2012, and which is placed in service by the taxpayer before January 1, 2012 (January 1, 2013, in the case of property described in subparagraph (2)(B) or (2)(C)), paragraph (1)(A) shall be applied by substituting '100 percent' for '50 percent'." .

(c) EXTENSION OF ELECTION TO ACCELERATE THE AMT CREDIT IN LIEU OF BONUS DEPRECIATION.—

(1) EXTENSION.—Clause (iii) of section 168(k)(4)(D) is amended by striking "or production" and all that follows and inserting "or production—

"(I) after March 31, 2008, and before January 1, 2010, and

"(II) after December 31, 2010, and before January 1, 2013, shall be taken into account under subparagraph (B)(ii) thereof," .

(2) RULES FOR ROUND 2 EXTENSION PROPERTY.—Paragraph (4) of section 168(k) is amended by adding at the end the following new subparagraph:

"(I) SPECIAL RULES FOR ROUND 2 EXTENSION PROPERTY.—

"(i) IN GENERAL.—In the case of round 2 extension property, this paragraph shall be applied without regard to—

"(I) the limitation described in subparagraph (B)(i) thereof, and

"(II) the business credit increase amount under subparagraph (E)(iii) thereof.

"(ii) TAXPAYERS PREVIOUSLY ELECTING ACCELERATION.—In the case of a taxpayer who made the election under subparagraph (A) for its first taxable year ending after March 31, 2008, or a taxpayer who made the election under subparagraph (H)(ii) for its first taxable year ending after December 31, 2008—

"(I) the taxpayer may elect not to have this paragraph apply to round 2 extension property, but

"(II) if the taxpayer does not make the election under subclause (I), in applying this paragraph to the taxpayer the bonus depreciation amount, maximum amount, and maximum increase amount shall be computed and applied to eligible qualified property which is round 2 extension property.

The amounts described in subclause (II) shall be computed separately from any amounts computed with respect to eligible qualified property which is not round 2 extension property.

"(iii) TAXPAYERS NOT PREVIOUSLY ELECTING ACCELERATION.—In the case of a taxpayer who neither made the election under subparagraph (A) for its first taxable year ending after March 31, 2008, nor made the election under subparagraph (H)(ii) for its first taxable year ending after December 31, 2008 —

"(I) the taxpayer may elect to have this paragraph apply to its first taxable year ending after December 31, 2010, and each subsequent taxable year, and

"(II) if the taxpayer makes the election under subclause (I), this paragraph shall only apply to eligible qualified property which is round 2 extension property.

"(iv) ROUND 2 EXTENSION PROPERTY.—For purposes of this subparagraph, the term 'round 2 extension property' means property which is eligible qualified property solely by reason of the extension of the application of the special allowance under paragraph (1) pursuant to the amendments made by section 401(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (and the application of such extension to this paragraph pursuant to the amendment made by section 401(c)(1) of such Act)." .

(d) CONFORMING AMENDMENTS.—

(1) The heading for subsection (k) of section 168 is amended by striking "JANUARY 1, 2011" and inserting "JANUARY 1, 2013" .

(2) The heading for clause (ii) of section 168(k)(2)(B) is amended by striking "PRE-JANUARY 1, 2011" and inserting "PRE-JANUARY 1, 2013" .

(3) Subparagraph (D) of section 168(k)(4) is amended—

(A) by striking clauses (iv) and (v),

(B) by inserting "and" at the end of clause (ii), and

(C) by striking the comma at the end of clause (iii) and inserting a period.

(4) Paragraph (5) of section 168(l) is amended—

(A) by inserting "and" at the end of subparagraph (A),

(B) by striking subparagraph (B), and

(C) by redesignating subparagraph (C) as subparagraph (B).

(5) Subparagraph (C) of section 168(n)(2) is amended by striking "January 1, 2011" and inserting "January 1, 2013" .

(6) Subparagraph (D) of section 1400L(b)(2) is amended by striking "January 1, 2011" and inserting "January 1, 2013" .

(7) Subparagraph (B) of section 1400N(d)(3) is amended by striking "January 1, 2011" and inserting "January 1, 2013" .

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service after December 31, 2010, in taxable years ending after such date.

(2) TEMPORARY 100 PERCENT EXPENSING.— The amendment made by subsection (b) shall apply to property placed in service after September 8, 2010, in taxable years ending after such date.

SEC. 402. TEMPORARY EXTENSION OF INCREASED SMALL BUSINESS EXPENSING.

(a) DOLLAR LIMITATION.—Section 179(b)(1) is amended by striking "and" at the end of subparagraph (B) and by striking subparagraph (C) and inserting the following new subparagraphs:

"(C) $125,000 in the case of taxable years beginning in 2012, and

"(D) $25,000 in the case of taxable years beginning after 2012." .

(b) REDUCTION IN LIMITATION.—Section 179(b)(2) is amended by striking "and" at the end of subparagraph (B) and by striking subparagraph (C) and inserting the following new subparagraphs:

"(C) $500,000 in the case of taxable years beginning in 2012, and

"(D) $200,000 in the case of taxable years beginning after 2012." .

(c) INFLATION ADJUSTMENT.—Subsection (b) of section 179 is amended by adding at the end the following new paragraph:

"(6) INFLATION ADJUSTMENT.—

"(A) IN GENERAL.—In the case of any taxable year beginning in calendar year 2012, the $125,000 and $500,000 amounts in paragraphs (1)(C) and (2)(C) shall each be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 2006' for 'calendar year 1992' in subparagraph (B) thereof.

"(B) ROUNDING.—

"(i) DOLLAR LIMITATION.—If the amount in paragraph (1) as increased under subparagraph (A) is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

"(ii) PHASEOUT AMOUNT.—If the amount in paragraph (2) as increased under subparagraph (A) is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000." .

(d) COMPUTER SOFTWARE.—Section 179(d)(1)(A)(ii) is amended by striking "2012" and inserting "2013" .

(e) CONFORMING AMENDMENT.—Section 179(c)(2) is amended by striking "2012" and inserting "2013" .

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2011.

TITLE V—TEMPORARY EXTENSION OF UNEMPLOYMENT INSURANCE AND RELATED MATTERS

SEC. 501. TEMPORARY EXTENSION OF UNEMPLOYMENT INSURANCE PROVISIONS.

(a) IN GENERAL.—

(1) Section 4007 of the Supplemental Appropriations Act, 2008 (Public Law 110-252; 26 U.S.C. 3304 note) is amended—

(A) by striking "November 30, 2010" each place it appears and inserting "January 3, 2012";

(B) in the heading for subsection (b)(2), by striking "NOVEMBER 30, 2010" and inserting "JANUARY 3, 2012"; and

(C) in subsection (b)(3), by striking "April 30, 2011" and inserting "June 9, 2012".

(2) Section 2005 of the Assistance for Unemployed Workers and Struggling Families Act, as contained in Public Law 111-5 (26 U.S.C. 3304 note; 123 Stat. 444), is amended—

(A) by striking "December 1, 2010" each place it appears and inserting "January 4, 2012"; and

(B) in subsection (c), by striking "May 1, 2011" and inserting "June 11, 2012".

(3) Section 5 of the Unemployment Compensation Extension Act of 2008 (Public Law 110-449; 26 U.S.C. 3304 note) is amended by striking "April 30, 2011" and inserting "June 10, 2012".

(b) FUNDING.—Section 4004(e)(1) of the Supplemental Appropriations Act, 2008 (Public Law 110-252; 26 U.S.C. 3304 note) is amended—

(1) in subparagraph (E), by striking "and" at the end; and

(2) by inserting after subparagraph (F) the following:

"(G) the amendments made by section 501(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010; and".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the enactment of the Unemployment Compensation Extension Act of 2010 (Public Law 111-205).

SEC. 502. TEMPORARY MODIFICATION OF INDICATORS UNDER THE EXTENDED BENEFIT PROGRAM.

(a) INDICATOR.—Section 203(d) of the Federal-State Extended Unemployment Compensation Act of 1970 (26 U.S.C. 3304 note) is amended, in the flush matter following paragraph (2), by inserting after the first sentence the following sentence:

"Effective with respect to compensation for weeks of unemployment beginning after the date of enactment of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (or, if later, the date established pursuant to State law), and ending on or before December 31, 2011, the State may by law provide that the determination of whether there has been a state 'on' or 'off' indicator beginning or ending any extended benefit period shall be made under this subsection as if the word 'two' were 'three' in subparagraph (1)(A).".

(b) ALTERNATIVE TRIGGER.—Section 203(f) of the Federal-State Extended Unemployment Compensation Act of 1970 (26 U.S.C. 3304 note) is amended—

(1) by redesignating paragraph (2) as paragraph (3); and

(2) by inserting after paragraph (1) the following new paragraph:

"(2) Effective with respect to compensation for weeks of unemployment beginning after the date of enactment of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (or, if later, the date established pursuant to State law), and ending on or before December 31, 2011, the State may by law provide that the determination of whether there has been a state 'on' or 'off' indicator beginning or ending any extended benefit period shall be made under this subsection as if the word 'either' were 'any', the word "both" were 'all', and the figure '2' were '3' in clause (1)(A)(ii).".

SEC. 503. TECHNICAL AMENDMENT RELATING TO COLLECTION OF UNEMPLOYMENT COMPENSATION DEBTS.

(a) IN GENERAL.—Section 6402(f)(3)(C), as amended by section 801 of the Claims Resolution Act of 2010, is amended by striking "is not a covered unemployment compensation debt" and inserting "is a covered unemployment compensation debt".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in section 801 of the Claims Resolution Act of 2010.

SEC. 504. TECHNICAL CORRECTION RELATING TO REPEAL OF CONTINUED DUMPING AND SUBSIDY OFFSET.

(a) IN GENERAL.—Section 822(2)(A) of the Claims Resolution Act of 2010 is amended by striking "or" and inserting "and".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in the provisions of the Claims Resolution Act of 2010.

SEC. 505. ADDITIONAL EXTENDED UNEMPLOYMENT BENEFITS UNDER THE RAILROAD UNEMPLOYMENT INSURANCE ACT.

(a) EXTENSION.—Section 2(c)(2)(D)(iii) of the Railroad Unemployment Insurance Act, as added by section 2006 of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5) and as amended by section 9 of the Worker, Homeownership, and Business Assistance Act of 2009 (Public Law 111-92), is amended—

(1) by striking "June 30, 2010" and inserting "June 30, 2011"; and

(2) by striking "December 31, 2010" and inserting "December 31, 2011".

(b) CLARIFICATION ON AUTHORITY TO USE FUNDS.—Funds appropriated under either the first or second sentence of clause (iv) of section 2(c)(2)(D) of the Railroad Unemployment Insurance Act shall

be available to cover the cost of additional extended unemployment benefits provided under such section 2(c)(2)(D) by reason of the amendments made by subsection (a) as well as to cover the cost of such benefits provided under such section 2(c)(2)(D), as in effect on the day before the date of the enactment of this Act.

TITLE VI—TEMPORARY EMPLOYEE PAYROLL TAX CUT

SEC. 601. TEMPORARY EMPLOYEE PAYROLL TAX CUT.

(a) IN GENERAL.—Notwithstanding any other provision of law, —

(1) with respect to any taxable year which begins in the payroll tax holiday period, the rate of tax under section 1401(a) of the Internal Revenue Code of 1986 shall be 10.40 percent, and

(2) with respect to remuneration received during the payroll tax holiday period, the rate of tax under 3101(a) of such Code shall be 4.2 percent (including for purposes of determining the applicable percentage under sections 3201(a) and 3211(a)(1) of such Code).

(b) COORDINATION WITH DEDUCTIONS FOR EMPLOYMENT TAXES.—

(1) DEDUCTION IN COMPUTING NET EARNINGS FROM SELF-EMPLOYMENT.—For purposes of applying section 1402(a)(12) of the Internal Revenue Code of 1986, the rate of tax imposed by subsection 1401(a) of such Code shall be determined without regard to the reduction in such rate under this section.

(2) INDIVIDUAL DEDUCTION.—In the case of the taxes imposed by section 1401 of such Code for any taxable year which begins in the payroll tax holiday period, the deduction under section 164(f) with respect to such taxes shall be equal to the sum of—

(A) 59.6 percent of the portion of such taxes attributable to the tax imposed by section 1401(a) (determined after the application of this section), plus

(B) one-half of the portion of such taxes attributable to the tax imposed by section 1401(b).

(c) PAYROLL TAX HOLIDAY PERIOD.—The term "payroll tax holiday period" means calendar year 2011.

(d) EMPLOYER NOTIFICATION.—The Secretary of the Treasury shall notify employers of the payroll tax holiday period in any manner the Secretary deems appropriate.

(e) TRANSFERS OF FUNDS.—

(1) TRANSFERS TO FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND.—There are hereby appropriated to the Federal Old-Age and Survivors Trust Fund and the Federal Disability Insurance Trust Fund established under section 201 of the Social Security Act (42 U.S.C. 401) amounts equal to the reduction in revenues to the Treasury by reason of the application of subsection (a). Amounts appropriated by the preceding sentence shall be transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers which would have occurred to such Trust Fund had such amendments not been enacted.

(2) TRANSFERS TO SOCIAL SECURITY EQUIVALENT BENEFIT ACCOUNT.—There are hereby appropriated to the Social Security Equivalent Benefit Account established under section 15A(a) of the Railroad Retirement Act of 1974 (45 U.S.C. 231n-1(a)) amounts equal to the reduction in revenues to the Treasury by reason of the application of subsection (a)(2). Amounts appropriated by the preceding sentence shall be transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers which would have occurred to such Account had such amendments not been enacted.

(3) COORDINATION WITH OTHER FEDERAL LAWS.—For purposes of applying any provision of Federal law other than the provisions of the Internal Revenue Code of 1986, the rate of tax in effect under section 3101(a) of such Code shall be determined without regard to the reduction in such rate under this section.

TITLE VII—TEMPORARY EXTENSION OF CERTAIN EXPIRING PROVISIONS

Subtitle A—Energy

SEC. 701. INCENTIVES FOR BIODIESEL AND RENEWABLE DIESEL.

(a) CREDITS FOR BIODIESEL AND RENEWABLE DIESEL USED AS FUEL.—Subsection (g) of section 40A is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EXCISE TAX CREDITS AND OUTLAY PAYMENTS FOR BIODIESEL AND RENEWABLE DIESEL FUEL

MIXTURES.—

(1) Paragraph (6) of section 6426(c) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(2) Subparagraph (B) of section 6427(e)(6) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(c) SPECIAL RULE FOR 2010.—Notwithstanding any other provision of law, in the case of any biodiesel mixture credit properly determined under section 6426(c) of the Internal Revenue Code of 1986 for periods during 2010, such credit shall be allowed, and any refund or payment attributable to such credit (including any payment under section 6427(e) of such Code) shall be made, only in such manner as the Secretary of the Treasury (or the Secretary's delegate) shall provide. Such Secretary shall issue guidance within 30 days after the date of the enactment of this Act providing for a one-time submission of claims covering periods during 2010. Such guidance shall provide for a 180-day period for the submission of such claims (in such manner as prescribed by such Secretary) to begin not later than 30 days after such guidance is issued. Such claims shall be paid by such Secretary not later than 60 days after receipt. If such Secretary has not paid pursuant to a claim filed under this subsection within 60 days after the date of the filing of such claim, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621 of such Code.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to fuel sold or used after December 31, 2009.

SEC. 702. CREDIT FOR REFINED COAL FACILITIES.

(a) IN GENERAL.—Subparagraph (B) of section 45(d)(8) is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to facilities placed in service after December 31, 2009.

SEC. 703. NEW ENERGY EFFICIENT HOME CREDIT.

(a) IN GENERAL.—Subsection (g) of section 45L is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to homes acquired after December 31, 2009.

SEC. 704. EXCISE TAX CREDITS AND OUTLAY PAYMENTS FOR ALTERNATIVE FUEL AND ALTERNATIVE FUEL MIXTURES.

(a) IN GENERAL.—Sections 6426(d)(5), 6426(e)(3), and 6427(e)(6)(C) are each amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EXCLUSION OF BLACK LIQUOR FROM CREDIT ELIGIBILITY.—The last sentence of section 6426(d)(2) is amended by striking "or biodiesel" and inserting "biodiesel, or any fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp" .

(c) SPECIAL RULE FOR 2010.—Notwithstanding any other provision of law, in the case of any alternative fuel credit or any alternative fuel mixture credit properly determined under subsection (d) or (e) of section 6426 of the Internal Revenue Code of 1986 for periods during 2010, such credit shall be allowed, and any refund or payment attributable to such credit (including any payment under section 6427(e) of such Code) shall be made, only in such manner as the Secretary of the Treasury (or the Secretary's delegate) shall provide. Such Secretary shall issue guidance within 30 days after the date of the enactment of this Act providing for a one-time submission of claims covering periods during 2010. Such guidance shall provide for a 180-day period for the submission of such claims (in such manner as prescribed by such Secretary) to begin not later than 30 days after such guidance is issued. Such claims shall be paid by such Secretary not later than 60 days after receipt. If such Secretary has not paid pursuant to a claim filed under this subsection within 60 days after the date of the filing of such claim, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621 of such Code.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to fuel sold or used after December 31, 2009.

SEC. 705. SPECIAL RULE FOR SALES OR DISPOSITIONS TO IMPLEMENT FERC OR STATE ELECTRIC RESTRUCTURING POLICY FOR QUALIFIED ELECTRIC UTILITIES.

(a) IN GENERAL.—Paragraph (3) of section 451(i) is amended by striking "January 1, 2010" and

inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to dispositions after December 31, 2009.

SEC. 706. SUSPENSION OF LIMITATION ON PERCENTAGE DEPLETION FOR OIL AND GAS FROM MARGINAL WELLS.

(a) IN GENERAL.—Clause (ii) of section 613A(c)(6)(H) is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 707. EXTENSION OF GRANTS FOR SPECIFIED ENERGY PROPERTY IN LIEU OF TAX CREDITS.

(a) IN GENERAL.—Subsection (a) of section 1603 of division B of the American Recovery and Reinvestment Act of 2009 is amended—

(1) in paragraph (1), by striking "2009 or 2010" and inserting "2009, 2010, or 2011", and

(2) in paragraph (2)—

(A) by striking "after 2010" and inserting "after 2011", and

(B) by striking "2009 or 2010" and inserting "2009, 2010, or 2011".

(b) CONFORMING AMENDMENT.—Subsection (j) of section 1603 of division B of such Act is amended by striking "2011" and inserting "2012".

SEC. 708. EXTENSION OF PROVISIONS RELATED TO ALCOHOL USED AS FUEL.

(a) EXTENSION OF INCOME TAX CREDIT FOR ALCOHOL USED AS FUEL.—

(1) IN GENERAL.—Paragraph (1) of section 40(e) is amended—

(A) by striking "December 31, 2010" in subparagraph (A) and inserting "December 31, 2011" , and

(B) by striking "January 1, 2011" in subparagraph (B) and inserting "January 1, 2012" .

(2) REDUCED AMOUNT FOR ETHANOL BLENDERS.—Subsection (h) of section 40 is amended by striking "2010" both places it appears and inserting "2011" .

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to periods after December 31, 2010.

(b) EXTENSION OF EXCISE TAX CREDIT FOR ALCOHOL USED AS FUEL.—

(1) IN GENERAL.—Paragraph (6) of section 6426(b) is amended by striking "December 31, 2010" and inserting "December 31, 2011" .

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to periods after December 31, 2010.

(c) EXTENSION OF PAYMENT FOR ALCOHOL FUEL MIXTURE.—

(1) IN GENERAL.—Subparagraph (A) of section 6427(e)(6) is amended by striking "December 31, 2010 " and inserting "December 31, 2011" .

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to sales and uses after December 31, 2010.

(d) EXTENSION OF ADDITIONAL DUTIES ON ETHANOL.—

(1) IN GENERAL.—Headings 9901.00.50 and 9901.00.52 of the Harmonized Tariff Schedule of the United States are each amended in the effective period column by striking "1/1/2011" and inserting "1/1/2012".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on January 1, 2011.

SEC. 709. ENERGY EFFICIENT APPLIANCE CREDIT.

(a) DISHWASHERS.—Paragraph (1) of section 45M(b) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting a comma, and

by adding at the end the following new subparagraphs:

"(C) $25 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings),

"(D) $50 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 295 kilowatt hours per year and 4.25 gallons per cycle (4.75 gallons per cycle for dishwashers designed for greater than 12 place settings), and

"(E) $75 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 280 kilowatt hours per year and 4 gallons per cycle (4.5 gallons per cycle for dishwashers designed for greater than 12 place settings)." .

(b) CLOTHES WASHERS.—Paragraph (2) of section 45M(b) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting a comma, and by adding at the end the following new subparagraphs:

"(E) $175 in the case of a top-loading clothes washer manufactured in calendar year 2011 which meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor, and

"(F) $225 in the case of a clothes washer manufactured in calendar year 2011—

"(i) which is a top-loading clothes washer and which meets or exceeds a 2.4 modified energy factor and does not exceed a 4.2 water consumption factor, or

"(ii) which is a front-loading clothes washer and which meets or exceeds a 2.8 modified energy factor and does not exceed a 3.5 water consumption factor." .

(c) REFRIGERATORS.—Paragraph (3) of section 45M(b) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting a comma, and by adding at the end the following new subparagraphs:

"(E) $150 in the case of a refrigerator manufactured in calendar year 2011 which consumes at least 30 percent less energy than the 2001 energy conservation standards, and

"(F) $200 in the case of a refrigerator manufactured in calendar year 2011 which consumes at least 35 percent less energy than the 2001 energy conservation standards." .

(d) REBASING OF LIMITATIONS.—

(1) IN GENERAL.—Paragraph (1) of section 45M(e) is amended—

(A) by striking "$75,000,000" and inserting "$25,000,000" , and

(B) by striking "December 31, 2007" and inserting "December 31, 2010" .

(2) EXCEPTION FOR CERTAIN REFRIGERATORS AND CLOTHES WASHERS.—Paragraph (2) of section 45M(e) is amended—

(A) by striking "subsection (b)(3)(D)" and inserting "subsection (b)(3)(F)" , and

(B) by striking "subsection (b)(2)(D)" and inserting "subsection (b)(2)(F)" .

(3) GROSS RECEIPTS LIMITATION.—Paragraph

(3) of section 45M(e) is amended by striking "2 percent" and inserting "4 percent" .

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by subsections (a), (b), and (c) shall apply to appliances produced after December 31, 2010.

(2) LIMITATIONS.—The amendments made by subsection (d) shall apply to taxable years beginning after December 31, 2010.

SEC. 710. CREDIT FOR NONBUSINESS ENERGY PROPERTY.

(a) EXTENSION.—Section 25C(g)(2) is amended by striking "2010" and inserting "2011 ".

(b) RETURN TO PRE-ARRA LIMITATIONS AND STANDARDS.—

(1) IN GENERAL.—Subsections (a) and (b) of section 25C are amended to read as follows:

"(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

"(1) 10 percent of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during such taxable year, and

"(2) the amount of the residential energy property expenditures paid or incurred by the taxpayer during such taxable year.

"(b) LIMITATIONS.—

"(1) LIFETIME LIMITATION.—The credit allowed under this section with respect to any taxpayer for any taxable year shall not exceed the excess (if any) of $500 over the aggregate credits allowed under this section with respect to such taxpayer for all prior taxable years ending after December 31, 2005.

"(2) WINDOWS.—In the case of amounts paid or incurred for components described in subsection (c)(2)(B) by any taxpayer for any taxable year, the credit allowed under this section with respect to such amounts for such year shall not exceed the excess (if any) of $200 over the aggregate credits allowed under this section with respect to such amounts for all prior taxable years ending after December 31, 2005.

"(3) LIMITATION ON RESIDENTIAL ENERGY PROPERTY EXPENDITURES.—The amount of the credit allowed under this section by reason of subsection (a)(2) shall not exceed—

"(A) $50 for any advanced main air circulating fan,

"(B) $150 for any qualified natural gas, propane, or oil furnace or hot water boiler, and

"(C) $300 for any item of energy-efficient building property." .

(2) MODIFICATION OF STANDARDS.—

(A) IN GENERAL.—Paragraph (1) of section 25C(c) is amended by striking "2000" **and all that follows through** "this section" **and inserting** "2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009" .

(B) WOOD STOVES.—Subparagraph (E) of section 25C(d)(3) is amended by striking ", as measured using a lower heating value" .

(C) OIL FURNACES AND HOT WATER BOILERS.—

(i) IN GENERAL.—Paragraph (4) of section 25C(d) is amended to read as follows:

"(4) QUALIFIED NATURAL GAS, PROPANE, OR OIL FURNACE OR HOT WATER BOILER.—The term 'qualified natural gas, propane, or oil furnace or hot water boiler' means a natural gas, propane, or oil furnace or hot water boiler which achieves an annual fuel utilization efficiency rate of not less than 95." .

(ii) CONFORMING AMENDMENT.— Clause (ii) of section 25C(d)(2)(A) is amended to read as follows:

"(ii) a qualified natural gas, propane, or oil furnace or hot water boiler, or" .

(D) EXTERIOR WINDOWS, DOORS, AND SKYLIGHTS.—

(i) IN GENERAL.—Subsection (c) of section 25C is amended by striking paragraph (4).

(ii) APPLICATION OF ENERGY STAR STANDARDS.—Paragraph (1) of section 25C(c) is amended by inserting "an exterior window, a skylight, an exterior door," **after** "in the case of" **in the matter preceding subparagraph (A).**

(E) INSULATION.—Subparagraph (A) of section 25C(c)(2) is amended by striking "and meets the prescriptive criteria for such material or system established by the 2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009" .

(3) SUBSIDIZED ENERGY FINANCING.—Subsection (e) of section 25C is amended by adding at the end the following new paragraph:

"(3) PROPERTY FINANCED BY SUBSIDIZED ENERGY FINANCING.—For purposes of determining the

amount of expenditures made by any individual with respect to any property, there shall not be taken into account expenditures which are made from subsidized energy financing (as defined in section 48(a)(4)(C)).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2010.

SEC. 711. ALTERNATIVE FUEL VEHICLE REFUELING PROPERTY.

(a) EXTENSION OF CREDIT.—Paragraph (2) of section 30C(g) is amended by striking "December 31, 2010" and inserting "December 31, 2011.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2010.

Subtitle B—Individual Tax Relief

SEC. 721. DEDUCTION FOR CERTAIN EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS.

(a) IN GENERAL.—Subparagraph (D) of section 62(a)(2) is amended by striking "or 2009" and inserting "2009, 2010, or 2011".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 722. DEDUCTION OF STATE AND LOCAL SALES TAXES.

(a) IN GENERAL.—Subparagraph (I) of section 164(b)(5) is amended by striking "January 1, 2010" and inserting "January 1, 2012".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 723. CONTRIBUTIONS OF CAPITAL GAIN REAL PROPERTY MADE FOR CONSERVATION PURPOSES.

(a) IN GENERAL.—Clause (vi) of section 170(b)(1)(E) is amended by striking "December 31, 2009" and inserting "December 31, 2011".

(b) CONTRIBUTIONS BY CERTAIN CORPORATE FARMERS AND RANCHERS.—Clause (iii) of section 170(b)(2)(B) is amended by striking "December 31, 2009" and inserting "December 31, 2011".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2009.

SEC. 724. ABOVE-THE-LINE DEDUCTION FOR QUALIFIED TUITION AND RELATED EXPENSES.

(a) IN GENERAL.—Subsection (e) of section 222 is amended by striking "December 31, 2009" and inserting "December 31, 2011".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 725. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR CHARITABLE PURPOSES.

(a) IN GENERAL.—Subparagraph (F) of section 408(d)(8) is amended by striking "December 31, 2009" and inserting "December 31, 2011".

(b) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendment made by this section shall apply to distributions made in taxable years beginning after December 31, 2009.

(2) SPECIAL RULE.—For purposes of subsections (a)(6), (b)(3), and (d)(8) of section 408 of the Internal Revenue Code of 1986, at the election of the taxpayer (at such time and in such manner as prescribed by the Secretary of the Treasury) any qualified charitable distribution made after December 31, 2010, and before February 1, 2011, shall be deemed to have been made on December 31, 2010.

SEC. 726. LOOK-THRU OF CERTAIN REGULATED INVESTMENT COMPANY STOCK IN DETERMINING GROSS ESTATE OF NONRESIDENTS.

(a) IN GENERAL.—Paragraph (3) of section 2105(d) is amended by striking "December 31, 2009" and inserting "December 31, 2011".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after December 31, 2009.

SEC. 727. PARITY FOR EXCLUSION FROM INCOME FOR EMPLOYER-PROVIDED MASS TRANSIT AND PARKING BENEFITS.

(a) IN GENERAL.—Paragraph (2) of section 132(f) is amended by striking "January 1, 2011" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to months after December 31, 2010.

SEC. 728. REFUNDS DISREGARDED IN THE ADMINISTRATION OF FEDERAL PROGRAMS AND FEDERALLY ASSISTED PROGRAMS.

(a) IN GENERAL.—Subchapter A of chapter 65 is amended by adding at the end the following new section:

"SEC. 6409. REFUNDS DISREGARDED IN THE ADMINISTRATION OF FEDERAL PROGRAMS AND FEDERALLY ASSISTED PROGRAMS.

"(a) IN GENERAL.—Notwithstanding any other provision of law, any refund (or advance payment with respect to a refundable credit) made to any individual under this title shall not be taken into account as income, and shall not be taken into account as resources for a period of 12 months from receipt, for purposes of determining the eligibility of such individual (or any other individual) for benefits or assistance (or the amount or extent of benefits or assistance) under any Federal program or under any State or local program financed in whole or in part with Federal funds.

"(b) TERMINATION.—Subsection (a) shall not apply to any amount received after December 31, 2012." .

(b) CLERICAL AMENDMENT.—The table of sections for such subchapter is amended by adding at the end the following new item:

"Sec. 6409. Refunds disregarded in the administration of Federal programs and federally assisted programs." .

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received after December 31, 2009.

Subtitle C—Business Tax Relief

SEC. 731. RESEARCH CREDIT.

(a) IN GENERAL.—Subparagraph (B) of section 41(h)(1) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) CONFORMING AMENDMENT.—Subparagraph (D) of section 45C(b)(1) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 2009.

SEC. 732. INDIAN EMPLOYMENT TAX CREDIT.

(a) IN GENERAL.—Subsection (f) of section 45A is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 733. NEW MARKETS TAX CREDIT.

(a) IN GENERAL.—Paragraph (1) of section 45D(f) is amended—

(1) by striking "and" at the end of subparagraph (E),

(2) by striking the period at the end of subparagraph (F), and

(3) by adding at the end the following new subparagraph:

"(G) $3,500,000,000 for 2010 and 2011." .

(b) CONFORMING AMENDMENT.—Paragraph (3) of section 45D(f) is amended by striking "2014" and inserting "2016" .

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years beginning after 2009.

SEC. 734. RAILROAD TRACK MAINTENANCE CREDIT.

(a) IN GENERAL.—Subsection (f) of section 45G is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenditures paid or incurred in taxable years beginning after December 31, 2009.

SEC. 735. MINE RESCUE TEAM TRAINING CREDIT.

(a) IN GENERAL.—Subsection (e) of section 45N is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 736. EMPLOYER WAGE CREDIT FOR EMPLOYEES WHO ARE ACTIVE DUTY MEMBERS OF THE UNIFORMED SERVICES.

(a) IN GENERAL.—Subsection (f) of section 45P is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments made after December 31, 2009.

SEC. 737. 15-YEAR STRAIGHT-LINE COST RECOVERY FOR QUALIFIED LEASEHOLD IMPROVEMENTS, QUALIFIED RESTAURANT BUILDINGS AND IMPROVEMENTS, AND QUALIFIED RETAIL IMPROVEMENTS.

(a) IN GENERAL.—Clauses (iv), (v), and (ix) of section 168(e)(3)(E) are each amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) CONFORMING AMENDMENTS.—

(1) Clause (i) of section 168(e)(7)(A) is amended by striking "if such building is placed in service after December 31, 2008, and before January 1, 2010," .

(2) Paragraph (8) of section 168(e) is amended by striking subparagraph (E).

(3) Section 179(f)(2) is amended—

(A) by striking "(without regard to the dates specified in subparagraph (A)(i) thereof)" in subparagraph (B), and

(B) by striking "(without regard to subparagraph (E) thereof)" in subparagraph (C).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2009.

SEC. 738. 7-YEAR RECOVERY PERIOD FOR MOTORSPORTS ENTERTAINMENT COMPLEXES.

(a) IN GENERAL.—Subparagraph (D) of section 168(i)(15) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2009.

SEC. 739. ACCELERATED DEPRECIATION FOR BUSINESS PROPERTY ON AN INDIAN RESERVATION.

(a) IN GENERAL.—Paragraph (8) of section 168(j) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2009.

SEC. 740. ENHANCED CHARITABLE DEDUCTION FOR CONTRIBUTIONS OF FOOD INVENTORY.

(a) IN GENERAL.—Clause (iv) of section 170(e)(3)(C) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made after

December 31, 2009.

SEC. 741. ENHANCED CHARITABLE DEDUCTION FOR CONTRIBUTIONS OF BOOK INVENTORIES TO PUBLIC SCHOOLS.

(a) IN GENERAL.—Clause (iv) of section 170(e)(3)(D) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made after December 31, 2009.

SEC. 742. ENHANCED CHARITABLE DEDUCTION FOR CORPORATE CONTRIBUTIONS OF COMPUTER INVENTORY FOR EDUCATIONAL PURPOSES.

(a) IN GENERAL.—Subparagraph (G) of section 170(e)(6) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made in taxable years beginning after December 31, 2009.

SEC. 743. ELECTION TO EXPENSE MINE SAFETY EQUIPMENT.

(a) IN GENERAL.—Subsection (g) of section 179E is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2009.

SEC. 744. SPECIAL EXPENSING RULES FOR CERTAIN FILM AND TELEVISION PRODUCTIONS.

(a) IN GENERAL.—Subsection (f) of section 181 is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to productions commencing after December 31, 2009.

SEC. 745. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

(a) IN GENERAL.—Subsection (h) of section 198 is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenditures paid or incurred after December 31, 2009.

SEC. 746. DEDUCTION ALLOWABLE WITH RESPECT TO INCOME ATTRIBUTABLE TO DOMESTIC PRODUCTION ACTIVITIES IN PUERTO RICO.

(a) IN GENERAL.—Subparagraph (C) of section 199(d)(8) is amended—

(1) by striking "first 4 taxable years" and inserting "first 6 taxable years" ; and

(2) by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 747. MODIFICATION OF TAX TREATMENT OF CERTAIN PAYMENTS TO CONTROLLING EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Clause (iv) of section 512(b)(13)(E) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments received or accrued after December 31, 2009.

SEC. 748. TREATMENT OF CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.

(a) IN GENERAL.—Paragraphs (1)(C) and (2)(C) of section 871(k) are each amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 749. RIC QUALIFIED INVESTMENT ENTITY TREATMENT UNDER FIRPTA.

(a) IN GENERAL.—Clause (ii) of section 897(h)(4)(A) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall take effect on January 1, 2010. Notwithstanding the preceding sentence, such amendment shall not apply with respect to the withholding requirement under section 1445 of the Internal Revenue Code of 1986 for any payment made before the date of the enactment of this Act.

(2) AMOUNTS WITHHELD ON OR BEFORE DATE OF ENACTMENT.—In the case of a regulated investment company—

(A) which makes a distribution after December 31, 2009, and before the date of the enactment of this Act; and

(B) which would (but for the second sentence of paragraph (1)) have been required to withhold with respect to such distribution under section 1445 of such Code, such investment company shall not be liable to any person to whom such distribution was made for any amount so withheld and paid over to the Secretary of the Treasury.

SEC. 750. EXCEPTIONS FOR ACTIVE FINANCING INCOME.

(a) IN GENERAL.—Sections 953(e)(10) and 954(h)(9) are each amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) CONFORMING AMENDMENT.—Section 953(e)(10) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2009, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.

SEC. 751. LOOK-THRU TREATMENT OF PAYMENTS BETWEEN RELATED CONTROLLED FOREIGN CORPORATIONS UNDER FOREIGN PERSONAL HOLDING COMPANY RULES.

(a) IN GENERAL.—Subparagraph (C) of section 954(c)(6) is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2009, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.

SEC. 752. BASIS ADJUSTMENT TO STOCK OF S CORPS MAKING CHARITABLE CONTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Paragraph (2) of section 1367(a) is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made in taxable years beginning after December 31, 2009.

SEC. 753. EMPOWERMENT ZONE TAX INCENTIVES.

(a) IN GENERAL.—Section 1391 is amended—

(1) by striking "December 31, 2009" in subsection (d)(1)(A)(i) and inserting "December 31, 2011" ; and

(2) by striking the last sentence of subsection (h)(2).

(b) INCREASED EXCLUSION OF GAIN ON STOCK OF EMPOWERMENT ZONE BUSINESSES.—Subparagraph (C) of section 1202(a)(2) is amended—

(1) by striking "December 31, 2014" and inserting "December 31, 2016" ; and

(2) by striking "2014" in the heading and inserting "2016" .

(c) TREATMENT OF CERTAIN TERMINATION DATES SPECIFIED IN NOMINATIONS.—In the case of a designation of an empowerment zone the nomination for which included a termination date which is contemporaneous with the date specified in subparagraph (A)(i) of section 1391(d)(1) of the Internal Revenue Code of 1986 (as in effect before the enactment of this Act), subparagraph (B) of such section shall not apply with respect to such designation if, after the date of the enactment of this section, the entity which made such nomination amends the nomination to provide for a new termination date in such manner as the Secretary of the Treasury (or the Secretary's designee) may provide.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to periods after December 31, 2009.

SEC. 754. TAX INCENTIVES FOR INVESTMENT IN THE DISTRICT OF COLUMBIA.

(a) IN GENERAL.—Subsection (f) of section 1400 is amended by striking "December 31, 2009" each place it appears and inserting "December 31, 2011" .

(b) TAX-EXEMPT DC EMPOWERMENT ZONE BONDS.—Subsection (b) of section 1400A is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(c) ZERO-PERCENT CAPITAL GAINS RATE.—

(1) ACQUISITION DATE.—Paragraphs (2)(A)(i), (3)(A), (4)(A)(i), and (4)(B)(i)(I) of section 1400B(b) are each amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(2) LIMITATION ON PERIOD OF GAINS.—

(A) IN GENERAL.—Paragraph (2) of section 1400B(e) is amended—

(i) by striking "December 31, 2014" and inserting "December 31, 2016" ; and

(ii) by striking "2014" in the heading and inserting "2016" .

(B) PARTNERSHIPS AND S-CORPS.—Paragraph (2) of section 1400B(g) is amended by striking "December 31, 2014" and inserting "December 31, 2016" .

(d) FIRST-TIME HOMEBUYER CREDIT.—Subsection (i) of section 1400C is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to periods after December 31, 2009.

(2) TAX-EXEMPT DC EMPOWERMENT ZONE BONDS.—The amendment made by subsection (b) shall apply to bonds issued after December 31, 2009.

(3) ACQUISITION DATES FOR ZERO-PERCENT CAPITAL GAINS RATE.—The amendments made by subsection (c) shall apply to property acquired or substantially improved after December 31, 2009.

(4) HOMEBUYER CREDIT.—The amendment made by subsection (d) shall apply to homes purchased after December 31, 2009.

SEC. 755. TEMPORARY INCREASE IN LIMIT ON COVER OVER OF RUM EXCISE TAXES TO PUERTO RICO AND THE VIRGIN ISLANDS.

(a) IN GENERAL.—Paragraph (1) of section 7652(f) is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distilled spirits brought into the United States after December 31, 2009.

SEC. 756. AMERICAN SAMOA ECONOMIC DEVELOPMENT CREDIT.

(a) IN GENERAL.—Subsection (d) of section 119 of division A of the Tax Relief and Health Care Act of 2006 is amended—

(1) by striking "first 4 taxable years" and inserting "first 6 taxable years", and

(2) by striking "January 1, 2010" and inserting "January 1, 2012".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 757. WORK OPPORTUNITY CREDIT.

(a) IN GENERAL.—Subparagraph (B) of section 51(c)(4) is amended by striking "August 31, 2011" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to individuals who begin work for the employer after the date of the enactment of this Act.

SEC. 758. QUALIFIED ZONE ACADEMY BONDS.

(a) IN GENERAL.—Section 54E(c)(1) is amended—

(1) by striking "2008 and" and inserting "2008," , and

(2) by inserting "and $400,000,000 for 2011" after "2010," .

(b) REPEAL OF REFUNDABLE CREDIT FOR QZABS.—Paragraph (3) of section 6431(f) is amended by inserting "determined without regard to any allocation relating to the national zone academy bond limitation for 2011 or any carryforward of such allocation" after "54E)" in subparagraph (A)(iii).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to obligations issued after December 31, 2010.

SEC. 759. MORTGAGE INSURANCE PREMIUMS.

(a) IN GENERAL.—Clause (iv) of section 163(h)(3)(E) is amended by striking "December 31, 2010" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid or accrued after December 31, 2010.

SEC. 760. TEMPORARY EXCLUSION OF 100 PERCENT OF GAIN ON CERTAIN SMALL BUSINESS STOCK.

(a) IN GENERAL.—Paragraph (4) of section 1202(a) is amended—

(1) by striking "January 1, 2011" and inserting "January 1, 2012" , and

(2) by inserting "AND 2011" after "2010" in the heading thereof.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to stock acquired after December 31, 2010.

Subtitle D—Temporary Disaster Relief Provisions

PART

Subpart A—New York Liberty Zone

SEC. 761. TAX-EXEMPT BOND FINANCING.

(a) IN GENERAL.—Subparagraph (D) of section 1400L(d)(2) is amended by striking "January 1, 2010" and inserting "January 1, 2012" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to bonds issued after December 31, 2009.

Subpart B—GO Zone

SEC. 762. INCREASE IN REHABILITATION CREDIT.

(a) IN GENERAL.—Subsection (h) of section 1400N is amended by striking "December 31, 2009" and inserting "December 31, 2011" .

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid or incurred after December 31, 2009.

SEC. 763. LOW-INCOME HOUSING CREDIT RULES FOR BUILDINGS IN GO ZONES.

Section 1400N(c)(5) is amended by striking "January 1, 2011" and inserting "January 1, 2012" .

SEC. 764. TAX-EXEMPT BOND FINANCING.

(a) IN GENERAL.—Paragraphs (2)(D) and (7)(C) of section 1400N(a) are each amended by striking "January 1, 2011" and inserting "January 1, 2012" .

(b) CONFORMING AMENDMENTS.—Sections 702(d)(1) and 704(a) of the Heartland Disaster Tax Relief Act of 2008 are each amended by striking "January 1, 2011" each place it appears and inserting "January 1, 2012".

SEC. 765. BONUS DEPRECIATION DEDUCTION APPLICABLE TO THE GO ZONE.

(a) IN GENERAL.—Paragraph (6) of section 1400N(d) is amended—

(1) by striking "December 31, 2010" both places it appears in subparagraph (B) and inserting "December 31, 2011" , and

(2) by striking "January 1, 2010" in the heading and the text of subparagraph (D) and inserting

"January 1, 2012".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2009.

TITLE VIII—BUDGETARY PROVISIONS

SEC. 801. DETERMINATION OF BUDGETARY EFFECTS.

The budgetary effects of this Act, for the purpose of complying with the Statutory Pay-As-You-Go Act of 2010, shall be determined by reference to the latest statement titled "Budgetary Effects of PAYGO Legislation" for this Act, jointly submitted for printing in the Congressional Record by the Chairmen of the House and Senate Budget Committees, provided that such statement has been submitted prior to the vote on passage in the House acting first on this conference report or amendment between the Houses.

SEC. 802. EMERGENCY DESIGNATIONS.

(a) STATUTORY PAYGO.—This Act is designated as an emergency requirement pursuant to section 4(g) of the Statutory Pay-As-You-Go Act of 2010 (Public Law 111- 139; 2 U.S.C. 933(g)) except to the extent that the budgetary effects of this Act are determined to be subject to the current policy adjustments under sections 4(c) and 7 of the Statutory Pay-As-You-Go Act.

(b) SENATE.—In the Senate, this Act is designated as an emergency requirement pursuant to section 403(a) of S. Con. Res. 13 (111th Congress), the concurrent resolution on the budget for fiscal year 2010.

(c) HOUSE OF REPRESENTATIVES.—In the House of Representatives, every provision of this Act is expressly designated as an emergency for purposes of pay-as-you-go principles except to the extent that any such provision is subject to the current policy adjustments under section 4(c) of the Statutory Pay-As-You-Go Act of 2010.

Passed by the Senate December 15, 2010.

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ISSN 1947-3923

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Estate Tax

Treasury, IRS Extend Deadline for Filing Form 8939; New Deadline, Guidance to Come

The Treasury Department and the IRS March 31 announced in IR-2011-33 that the April 18 deadline for filing Form 8939 has been extended and the form should not be filed with the final Form 1040 of persons who died in 2010.

Form 8939, *Allocation of Increase in Basis for Property Acquired from a Decedent*, is an informational return used to establish basis for income tax purposes of property acquired from a person who died in 2010. Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the estate tax was repealed for persons who died in 2010, and executors of the estates of some of those decedents were previously required to file Form 8939, the notice said.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, enacted in December, reinstated the estate tax for persons who died in 2010. The notice said the law allows executors of the estates of decedents who died in 2010 to elect to have the rules of the estate tax not apply to the property of a decedent's estate.

Guidance that announces the form's new due date will be issued at a later date, and Form 8939 will be released soon after, Treasury and IRS said. The future guidance will provide a deadline for electing to have the estate tax rules not apply to the estates of persons who died in 2010, they said. The prior deadline was April 18, which remains the deadline for filing a decedent's final Form 1040 this filing season.

Form 8939 and the guidance will be made available at IRS.gov.

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Estate Planning Effects and Strategies Under the "Tax Relief... Act of 2010"

March 2011

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I. Brief Historical Background of TRA 2010

Republican leaders came to agreement with President Obama on December 6, 2010 to extend the "Bush income tax rates" for two years, not limited to just "middle class" taxpayers with less than $200,000 ($250,000 joint returns) and to extend unemployment benefits. Surprisingly, the agreement included extension of the estate tax for two years with a $5 million exemption and 35% rate (the exemption amount and rate urged by various Republican leaders over the last several years). (Apparently, the final "sticking points" in "making a deal" on the overall agreement were the estate tax provisions requested by Republican leaders and the renewal of "refundable tax credits" as urged by the Administration, and the final agreement came in meetings between Vice President Biden and Senate Minority Leader Mitch McConnell.)

Following discussions (and probably negotiations) with Congressional staffers about the details of the estate tax provisions and all of the other details of the broad agreement regarding taxes and unemployment insurance, the Senate Finance Committee released an amendment sponsored by Senators Harry Reid and Mitch McConnell containing the statutory language being considered by the Senate. The bill is an amendment of H.R. 4853 (which authorizes funding of the Airport and Airway Trust Fund), and proposes the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010." (This proposal is referred to in this summary as "TRA 2010.")

The TRA 2010 proposal comes on the heels of a proposal by Senate Finance Committee Chair Max Baucus on December 2, 2010 of a Senate amendment of the same H.R. 4853, which amendment proposed the "Middle Class Tax Cut Act of 2010." That bill was defeated by the Senate on December 4, 2010, but of interest to the estate planning community are various estate and gift tax measures that were included in it. The following is a link to the "Baucus bill" containing the proposed Middle Class Tax Cut Act of 2010, a Summary of the proposal, and estimated budget effects of the proposal: http://finance.senate.gov/legislation/details/?id=bda915fc-5056-a032-5262-6a1899fee4e3. The following summary sometimes refers to differences between TRA 2010 and the "Baucus bill."

TRA 2010 was approved by the Senate on December 15 (by a vote of 81-19) and by the House on December 16 (by a vote of 277-148). President Obama signed the legislation on December 17, 2010 (the date of enactment). Joint Committee on Taxation revenue estimates of the bill are available at http://op.bna.com/dt.nsf/r?Open=vmar-8bz3bn.

II. Title and Temporary Relief

A. Short Title. The "short" title is "Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010." [TRA 2010 § 1.] How's that for a *short* title?

B. Temporary Extension of Tax Relief. TRA 2010 generally provides various tax provisions that apply for just two years. This is accomplished first by extending the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") generally for two years, including the extension of the "Bush tax cuts" and the estate tax provisions. [TRA 2010 § 101(a) amends EGTRAA (effective as if enacted as part of EGTRRA in 2001) by amending section 901 of EGTRRA (the sunset provision) to extend the EGTRRA sunset to specified events occurring after December 31, 2012 (instead of December 31, 2010). Therefore, all of the provisions of EGTRRA generally are extended through 2012.]

In addition, TRA 2010 provides that the EGTRRA sunset provisions in section 901 of EGTRRA apply to all of the amendments in the title containing the estate and gift tax

provisions. The effect is that the estate, gift and GST amendments made by TRA 2010 also sunset after 2012. [TRA 2010 § 304 says that section 901 of EGTRRA applies "to the amendments made by this title. "This title" refers to all of the "Temporary Estate Tax Relief" provisions in title III of TRA 2010), so the estate, gift and GST tax amendments made by TRA 2010 also sunset after 2012. The Senate amendment as originally proposed referred to "amendments made by this section," which was nonsensical. If that had not been changed, the transfer tax changes in TRA 2010 would have been permanent under a literal application of the statutory language. However, the word "section" was changed to "title" before the Senate and House vote. Interestingly, getting congressional approval for this important technical change was quite difficult.]

III. Brief Summary of Tax Provisions Other Than Estate, Gift and GST Tax Provisions

A. Income Tax Rates. Taxpayers at every income level would have the lower rates enacted in EGTRRA continued for two years. The top rate, on taxable income above $379,150, will stay at 35% instead of increasing to 39.6%. (Two-year cost: $186.8 billion)

B. Itemized Deductions. The personal exemption phase-out and itemized deduction limitation were both repealed for one year under EGTRRA. The repeal of both of these provisions is extended for an additional two years. This is important, for example, with respect to deductions available for large charitable contributions. Prior to the phase-out of the limitations on itemized deductions, the allowable total amount of itemized deductions was reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeded a threshold amount that was indexed annually for inflation. The otherwise allowable itemized deductions could not be reduced by more than 80%. For high income taxpayers, reducing the otherwise allowable charitable deductions (as well as other itemized deductions) by as much as 80% is a substantial tax detriment. (Cost: $20.7 billion)

C. Capital Gains and Dividends Rates. Lower capital gains and dividend rates are extended for two years. The lower rates are: taxpayers below 25% bracket - 0%, taxpayers above 25% bracket - 15%. If those rates expire, the rates would become 10% and 20%, respectively, and dividends would be taxed as ordinary income. (Cost: $53.2 billion)

D. Social Security Tax Cut of 2%. All taxpayers, including self-employed individuals, have a one year reduction in the "social security payroll tax" of 2 percentage points in 2011. For individuals, the employee rate is reduced from 6.2% to 4.2% (the old age, survivors, and disability insurance tax on the taxable wage base ($106,800 in 2010)). The employer tax rate remains at 6.2%. For self-employed individuals, the rate is reduced from 12.4% to 10.4% for taxable years of individuals that begin in 2011. (Cost: $112 billion)

E. Alternative Minimum Tax. The AMT exemption amounts are increased to $47,450 ($72, 450 for joint returns) for 2010 and to $48,450 ($74,450 for joint returns) for 2011. (Over 20 million households are spared from tax increases averaging $3,900 as a result of this change.) (Cost: $136.7 billion)

F. IRA Charitable Rollover. Among the tax extenders are the IRA Charitable Rollover provisions, which technically expired at the end of 2009. The IRA Charitable Rollover is extended for two years, through 2011, which allows individuals who are at least 70 ½ to transfer up to $100,000 per year directly to a qualified public charity (not a donor advised fund or supporting organization) without being treated as a taxable withdrawal from the IRA. The transfer can be counted toward the required minimum distribution. The measure applies to all charitable distributions throughout 2010, and distributions made any time

during 2010 or in January of 2011 can be counted toward the $100,000 limit for 2010. Individuals who have already taken their 2010 required minimum distributions cannot "undo" those distributions and instead make a charitable distribution to satisfy their 2010 required minimum distributions. (Cost: $979 million)

G. Deduction for State and Local Sales Taxes. The federal deduction for state and local sales taxes is extended for 2010 and 2011. (This is near and dear to residents of the nine states without state income taxes.) (Cost: $5.5 billion)

H. Estate, Gift and GST Tax Cost. The estate, gift and GST provisions are discussed in detail below. (Cost: $68.1 billion)

IV. General Summary of Estate, Gift and GST Tax Provisions

A. Estate, Gift and GST Tax Exemptions and Rates. TRA 2010 generally sets the estate, gift and GST exemption at $5.0 million, indexed from 2010 beginning in 2012, [TRA 2010 § 302(a)(1)] and sets the maximum rate at 35%. [TRA 2010 § 302(a)(2)]. The $5 million exemptions generally apply in 2010 [TRA § 302(f)], except that the gift exemption remains at $1.0 million for 2010 [TRA § 302(b)(1)(B)].

B. Estate Tax in 2010.

1. Default Rule — Estate Tax Applies in 2010. The estate tax applies to estates of decedents dying in 2010. As discussed above, the estate tax exemption in 2010 is $5.0 million and the rate is 35%. (For various issues discussed below, it is important to keep in mind that the *default* rule is that the estate tax applies in 2010.) This reenactment of the estate tax for 2010 is in a complicated section of TRA 2010 that sunsets certain provisions of EGTRRA as if they had never been enacted. TRA 2010 § 301(a) provides that "[e]ach provision of subtitle A or E of title V of [EGTRRA] is amended to read as such provision would read if such subtitle had never been enacted." Subtitle A contains I.R.C. § 2210, which says that Chapter 11 [containing the estate tax provisions] does not apply to decedents dying after 2009 (except as to certain distributions from QDOTs) and I.R.C. § 2664 (which says that Chapter 13 does not apply to GST transfers after 2009). Subtitle E contains the carryover basis provisions. The Code would be interpreted as if those provisions of EGTRRA (repealing the estate and GST tax and enacting carryover basis) had never been enacted. [TRA 2010 § 301(a).] The provision retroactively applies to decedents dying after and generation-skipping transfers after December 31, 2009. [TRA 2010 § 301(e).]

2. Carryover Basis Election for 2010 Decedents. Executors (within the meaning of I.R.C. § 2203) of estates of decedents who die in 2010 (all of 2010, not just decedents who die on or before the date of enactment, as provided in the Baucus bill) may elect to have the modified basis rules of I.R.C. § 1022 apply "with respect to property acquired or passing from the decedent" within the meaning of I.R.C. § 1014(b)) instead of the estate tax. [TRA 2010 § 301(c).]

Statutory Provisions Regarding Carryover Basis Election. The carryover basis election is described in TRA 2010 § 301(c). It is a complicated section, applying double and triple negatives.

> "Notwithstanding subsection (a) [which says that subtitle A or E of title V of EGTRAA are treated as having never been enacted], in the case of a

> decedent dying after December 31, 2009, and before January 1, 2011, the executor (within the meaning of section 2203 of the Internal Revenue Code of 1986) may elect to apply such Code as though the amendments made by subsection (a) do not apply with respect to chapter 11 of such Code and with respect to property acquired or passing from such decedent (within the meaning of section 1014(b) of such Code.)" TRA 2010 § 301(c).

Applying this language in steps:

- If this election is made, the amendments made by TRA 2010 § 301(a) do not apply. This involves a triple negative. The estate tax was repealed by I.R.C. § 2210 ("chapter 11 shall not apply..."), which was included in subtitle A of title V of EGTRRA, for decedents dying after 2009 (Negative 1-estate tax does *not* apply). The repeal of the estate tax is repealed, effective 1-1-2010, under TRA 2010 § 301(a) (as if subtitle A "had never been enacted") (Negative 2, negating Negative 1-so estate tax *does* apply). If the carryover basis election is made, the "repeal of the repeal" in TRA 2010 § 301(a) does not apply (Negative 3). This means that the estate tax does *not* apply. (Is your head swimming yet?)
- Similarly, carryover basis does apply under a similar stepped analysis if the election is made. Carryover basis was instituted under I.R.C. § 1022, as included in subtitle E of title V of EGTRRA for decedents dying after 2009. The carryover basis provisions are repealed, effective 1-1-2010, under TRA 2010 § 301(a) (as if subtitle E "had never been enacted"). If the carryover basis election is made, the amendments in TRA 2010 § 301(a) do not apply, so the repeal of carryover basis is undone, so carryover basis *does* apply.
- The election (which undoes the "repeal of the repeal" of the estate tax and reinstitutes carryover basis) applies "*with respect to chapter 11 of such Code....*" This clause, perhaps among other things, means that the amendment in § 301(a) that repeals subtitle A of title V of EGTRRA, which contained I.R.C. § 2210 repealing the estate tax and § 2664 repealing the GST tax, does not apply with respect to chapter 11 (meaning that the estate tax *is* repealed), but does continue to apply with respect to the repeal of § 2664. Therefore, the repeal of the GST tax repeal is not undone. That is a technical correction of the similar provision in the Baucus bill.
- The election applies "with respect to property acquired or passing from such decedent (within the meaning of section 1014(b)...)." This is an obvious reference to carryover basis applying for property acquired or passing from the decedent. (It would seem that the provision could have referred just to property "acquired from such decedent" because I.R.C. § 1022(e), which remains in effect because subtitle E of title V of EGTRRA is not repealed as a result of the election, defines "property acquired from the decedent" as including property passing from the decedent by reason of death to the extent that it passes without consideration.)

Have a Process. The executor should have a checklist and a process for making the decision. Fiduciaries are not guarantors of results, but they must demonstrate that they exercise their discretion. Projections and assumptions in the analysis should be documented and shared with the affected parties. In a Uniform Trust Code state, consent can be obtained from the beneficiaries including by virtual representation.

If consents cannot be obtained from the beneficiaries, get court approval. The fiduciary will be in the crosshairs of whoever is disappointed. There is time to accomplish this, but the key is having a process with a checklist approach, documentation in the file of the analysis, and consents or court approval.

In Many Estates The Decision Will Be Easy. The decision will be easy and straightforward for many estates: (1) The taxable estate may clearly be under $5 million (select estate tax regime); (2) The taxable estate may be well over $5 million and the current estate tax will substantially exceed the ultimate income tax that will be paid on appreciation (select carryover basis regime); (3) The estate may have appreciation that can easily be covered by the $1.3 million and $3.0 million (if applicable) basis adjustments (bearing in mind that retirement benefits and other IRD assets cannot receive a basis step-up in any event) (select carryover basis regime); or (4) The estate may be only nominally above $5 million with a great deal of appreciation that cannot be covered by the basis adjustments (select estate tax regime). (However, even in those "easy" situations, the executor must determine whether the election will change the amounts of bequests passing under the will.)

Factors in Decision Making Process. The executor will have to consider a variety of factors in making this decision, such as whether the election will change the amounts passing under formula bequests as discussed in section IX.A.1 and IX.B of this outline (including that the election will result in assets passing under the "alternate non-marital deduction manner" if the will contains a "Clayton marital trust"), the amount of estate tax payable currently vs. the gain that would be subject to income tax on a future sale of assets (keeping in mind that income tax rates may *exceed* estate tax rates, 35% estate tax for excess over $5 million vs. 15% rate [but for recapture items the income tax rates could be 25%, 28% or even 35% and the income tax rates may be expected to increase in future years]), anticipated dates of sale, the character of the gain (for example, the Joint Committee on Taxation Technical Explanation (p. 40) says that "real estate that has been depreciated and would be subject to recapture if sold by the decedent will be subject to recapture if sold by the heir"), anticipated state income taxes (including determination of domicile of the beneficiaries and their personal income tax situations), anticipated cash needs of beneficiaries, whether depreciation can be used to derive current income tax benefits even without selling an asset, ability to allocate basis adjustments up to fair market value at the date of death for assets that will likely be sold in the near future, anticipated future capital gains rates (and ordinary income rates for "ordinary income property"), determination of which beneficiaries bear estate taxes and comparison to persons who bear income tax attributable to lack of basis step-up, whether aggressive positions would be taken on the estate tax return or have been taken on prior gift tax returns (and whether there is any question whether disclosures on gift tax returns satisfied the adequate disclosure regulations) that would be highlighted by filing an estate tax return, and weighing the present value of anticipated income tax costs against the current estate tax amount. Some rather subtle effects of making the election include: there will be no benefit of a deduction against federal estate taxes for the payment of state death taxes, there will be no § 691(c) deduction for estate taxes attributable to income in respect of a decedent property, there will be no ability to use a prior

transfer credit under § 2013, the election may impact the ability to make a QTIP election for only state purposes, there will be a step-up (or step-down) in basis for *both* halves of community property if the carryover basis election is not made, and the election may impact the expenses and complexity of administering the estate (by making or not making the election).

Consideration of the detailed tax effects of carryover basis is particularly sensitive for real estate or other depreciable property, especially if the property has a "negative basis" due to refinancings or other reasons.

If there is any possibility that the election may impact the amounts of bequests under the will, attempt to get consents of all of the parties or court approval of the election decision. (Equitable adjustments among the parties may be appropriate.) If the election benefits the executor personally, consider whether there are gift tax implications of the election. *See generally* Blattmachr, Heilborn & Gans, *Gifts by Fiduciaries by Tax Options and Elections*, 18 PROB. & PROP. 39 (Nov. Dec. 2004).

Practical Planning Pointer: The executor should carefully document and retain the analysis of the rationale for whatever decision is made regarding the carryover basis election.

Procedural Issues; Time and Manner of Election and Reporting. Section 301(c) says the election is to be made "at such time and in such manner" as prescribed by the Secretary of the Treasury or his delegate (interestingly, not requiring regulations). An IRS Release on February 16, 2011 states that the election to have the carryover basis regime apply "*should not* be made on the decedent's final income tax return." (emphasis in original) An IRS technical advisor has indicated informally that IRS officials are considering the possibility of having the election made simply by filing Form 8939 instead of filing Form 706. (See Section IV.B.3.b of this outline below regarding the carryover basis report.)

In light of the fact that the statute extends the due date of the estate tax return for 2010 decedents who died before December 17, 2010 to no earlier than September 19, 2011, there will presumably be a similar due date for the election for the estate tax not to apply to the estate.

Practical Planning Pointer: Estates of decedents dying in 2010 with gross estates under $5 million would not be required to file an estate tax return under I.R.C. § 6018(a)(1), and there is nothing in TRA 2010 changing that result. Those estates will not make the carryover basis election, so those estates apparently will not have to file either an estate tax return or the carryover basis report that would apply under § 6018 to estates that make the carryover basis election. (There has been no official confirmation of this by the IRS, but it seems the clear answer under the statutory language.) For estates that are over $5 million and that may want to make the carryover basis election so that the estate tax will not apply, planners are quite anxious to find out exactly what must be filed and when in order to make sure that the estate tax does not apply. For estates of decedents who died earlier in 2010, there seems to be no necessity of filing an extension of time to file the estate tax return, because of the extended September 19, 2011 due date. (However some cautious planners may do so anyway.) Query whether a further discretionary six-month extension under I.R.C. § 6081(a) will be allowed?

GST Impact of Election. If the carryover basis election is made, the last sentence of TRA 2010 § 301(c) adds that for purposes of I.R.C. § 2652(a)(1), "the determination of whether any property is subject to the tax imposed by such chapter 11 shall be made without regard to any election made under this subsection." Section 2652(a)(1) defines "transferor" for GST tax purposes as the last person who was subject to a transfer tax. This sentence means that for GST purposes the decedent is deemed to be subject to the estate tax and is therefore the "transferor" even though chapter 11 does not apply to the decedent in that circumstance. See section VIII.G of this outline for a discussion of this last sentence of TRA § 301(c).

Basis Adjustments. If the carryover basis system applies, the estate is entitled to the $1.3 million basis adjustment for assets passing to any beneficiary (§ 1022(b)) and the $3.0 million basis adjustment for assets passing to a surviving spouse or "QTIP-type" trusts (§ 1022(c)).

Holding Period. The automatic long-term capital gains holding period under § 1223(11) will not apply in 2010, because § 1041(a) does not apply. The decedent's holding period may be tacked to the estate or beneficiary's holding period if the basis is determined "in whole or in part" from the decedent's basis. If the decedent's basis is higher than the fair market value at the time of death, the decedent's basis would play no factor in determining the basis, so tacking may not be available. That has been the position of the IRS in the past in other contexts, but we do not know if the IRS will apply that same argument in the context of the carryover basis regime. (That would be a reason for selling loss assets before the decedent's death.) Otherwise, tacking apparently would be available, even if the basis has been adjusted to the date of death value by basis adjustment allocations, because the basis is the decedent's basis plus the amount of allocated basis adjustment.

Adjustments to $1.3 Million Basis Adjustment. The $1.3 million amount is increased by net operating losses and capital loss carryovers. I.R.C. § 1022(b)(2)(C). These generally would appear on the decedent's final Form 1040. A complexity is that if there is a joint return, the surviving spouse may have gains that offset some of the losses and there is no guidance on how to determine the decedent's share of the losses.

In addition, the $1.3 million amount is increased by any losses that would have been allowable under §165 if the decedent's property had been sold at fair market value before the decedent's death. Section 165 allows both business losses and investment losses, excluding only personal losses. The adjustment for depreciated business and investment property can be quite significant, probably a much bigger factor than the adjustment for net operating losses and net operating loss carryovers. It is not clear how this rule will apply to passive losses. They would be deductible under § 165 so they would seem to increase the $1.3 million amount. However, § 469(g)(2) describes how unused passive losses at death are treated, and the §1022 and § 469 treatment is inconsistent. Fortunately, both sections grant full regulatory authority to the IRS, so the IRS will need to provide guidance.

An unanswered question is whether the $3,000 per year limitation under § 1211 will apply for this purpose. Under § 165(f), losses from sales or exchanges of

capital assets are allowed only to the extent allowed in §§ 1211 and 1212. Under § 1211, the deduction for capital losses that are not offset by capital gains is limited to $3,000 per year. Therefore, apparently there is the possibility that a substantial amount of built-in losses at death will not be added to the $1.3 million amount. The Senate Report to the 2001 Tax Act does not address this apparent limitation. It merely says that "[t]he $1.3 million is increased by the amount of unused capital losses, net operating losses, and *certain* 'built-in' losses of the decedent." (emphasis added).

While there can be a step DOWN in basis at death, the aggregate amount by which estate assets (other than personal use assets) receive a decrease in basis (except as limited by the $3,000 limit if there are not enough gains in the year of death to offset the losses) is added to the $1.3 million amount to result in additional increased basis for *other* assets that are appreciated at the time of death (assuming the estate has appreciation in appreciated estate assets exceeding the $1.3 million [and $3.0 million, if applicable] basis adjustments that would be allowed in any event).

Community Property. Both halves of community property can qualify for receiving basis adjustments and are subject to the modified carryover basis system (i.e., subject to a potential reduction in basis for depreciated assets). If there is substantial appreciation in community property, being able to get both halves of the community property stepped-up may be critically important in the election decision.

3. Extension of Time to File and Pay Estate Tax and GST Tax and to Make Disclaimers.

   a. Estate Tax. The estate tax return and payment date of estate tax is extended to no earlier than nine months after the date of enactment. The extension applies to estates of decedents dying from January 1, 2010 to the day before the date of enactment (i.e., to December 16, 2010). (The extension in the Baucus bill was only for four months rather than nine months.) [TRA 2010 § 301(d).]

      Practical Planning Pointer: The date of enactment is December 17, 2010, so the due date is extended to September 17, 2011, which falls on a Saturday, so the due date of estate tax returns for 2010 decedents is no earlier than September 19, 2011.

   b. Carryover Basis Report. Under current law, the carryover basis report under § 6018 is required to be filed with the decedent's final income tax return. I.R.C. § 6075(a). EGTRRA amended § 6018 for decedents dying after 2009 to refer to a carryover basis information return instead of the estate tax return (because the estate tax does not apply under EGTRRA to decedents dying after 2009). That amendment to § 6018 (and the change to § 6075(a) regarding the due date of the carryover basis report) were in subtitle E of title V of EGTRRA, and TRA 2010 § 301(a) interprets the Code as if subtitle E had never been enacted. Therefore, the default rule under TRA 2010 is that § 6018 now refers to the estate tax return, not the carryover basis information report. However, if the carryover basis election is made, the amendment in § 301(a) does not apply as to the estate tax or

carryover basis, so § 6018 continues to refer to the carryover basis report and not the estate tax return and § 6075(a) continues to require that the report be filed with the decedent's final income tax return. Section 301(d)(1)(A) extends the filing date of the estate tax return, but *not* the carryover basis report. While it refers to extending the due date for filing any return under § 6018 and while that will mean the carryover basis report if the carryover basis election is made under § 301(c) of TRA 2010, § 301(d)(1)(A) specifically says the extension applies to any return under § 6018 "as such section is in effect after the date of this enactment of this Act *without regard to any election under subsection (c)*." Therefore, this provision in § 301(d)(1)(A) of TRA 2010 does not override § 6075 regarding the due date of the carryover basis report.

The IRS issued a draft of Form 8939 for comments on December 16, 2010. The draft form does not include instructions. The draft form does not contain any reference to an election provision (in light of the fact that the draft was prepared before TRA 2010 was enacted providing for the election). The form contemplates that the specific assets passing to each distributee (together with the carryover basis, value, holding period and basis adjustment allocation for each asset) will be listed on the form. (The form does not address what will happen if the executor has not paid all debts and expenses, paid all taxes and made final distributions of the assets to the beneficiaries by the time the form is due. Until all of that has happened, the executor cannot know what specific assets will pass to the respective beneficiaries. Informal indications from IRS officials are that the "estate" would likely be shown as the distributee of undistributed items, and that no further reporting would be necessary after the distributions are made.)

An IRS Release on February 16, 2011, available at http://www.irs.gov/pub/irs-pdf/f8939.pdf, gave the first official preliminary guidance regarding procedures and filing dates for the Form 8939. An announcement on March 2, 2011, available at http://www.irs.gov/formspubs/article/0,,id=236791,00.html, described similar information regarding Publication 4895. These Releases give the following guidance:

- The IRS will issue, in order, (1) Form 8939, and shortly thereafter (2) instructions for Form 8939, followed by (3) Publication 4895, Treatment of Property Acquired From a Decedent Dying in 2010.
- The final Form 8939 will be posted at least 90 days before it is required to be filed.
- The Form 8939 *should not* be filed with the decedent's final income tax return (emphasis in original). ." (OBSERVATION: This is despite the literal wording of § 6075(a) providing that "[t]he return required by section 6018 with respect to a decedent shall be filed *with* the return of tax imposed by chapter 1 for the decedent's last taxable year" [(i.e., the decedent's final income tax return] (emphasis added).

- The carryover basis election under § 301(c) of TRA 2010 *should not* be made on the decedent's final income tax return (emphasis in original).
- Instructions on how to make the carryover basis elections under § 301(c) will be described on the Form 8939, in the instructions to Form 8939, and in Publication 4895. The March 2, 2011 Release says that "[t]he election is made by filing Form 8939."
- The March 2, 2011 Release says that Publication 4895 is only relevant for estates that file the Form 8939.
- The latest information on these issues can be found at www.irs.gov/form8939.

A summary of a conversation between Robert Chapman, of the IRS Tax Forms & Publications Desk, and Carol Cantrell on February 3, 2011 (in response to comments filed by the American Bar Association Tax and Real Property, Trust and Estates Law Sections on January 31, 2011) was published by Leimberg Information Services on Feb 8, 2011. Mr. Chapman's comments included the following:

- The Form 8939, Instructions to the Form 8939 and the Publication 4895 are expected to be released by May 2011.
- The IRS will issue guidance regarding whether appraisals are required and whether group and de minimis rules will be allowed.
- There is no place to report the surviving spouse's one-half of community property on the Form 8939 and the IRS will give guidance; he was asked to clarify that the surviving spouse's one-half would be eligible for the step-up and as well as a step-down in basis and he hinted that it is, by noting that the question of whether both halves of community property is adjusted is the same for both § 1014 and § 1022.
- The estate would be shown as the recipient of property not yet transferred by the time the Form 8939 is filed.
- An amendment would not be required to report subsequent transfers or distributions by the estate.
- Property that is sold by the estate cannot qualify for the $3.0 million spousal basis adjustment, even if the sale proceeds are distributed to the surviving spouse.
- The IRS may add Schedule R from Form 706 (for reporting generation-skipping transfers and exemption allocations) to the Form 8939 so that executors who need to report generation-skipping transfers or exemption allocations will not have to file both the Form 8939 and Form 706.
- The IRS prefers to make the mere act of filing the Form 8939 as the affirmative election under § 301(c) of the Tax Relief . . . Act of 2010 out of the estate tax regime and into carryover basis, rather than providing a box to check. He agrees that the Form 8939 should

contain a statement to the effect that filing the form constitutes the election.

- The IRS is likely disinclined to allow a "protective election" out of the estate tax regime in the event an IRS audit adjustment makes the election more advantageous.

On March 1, 2011, the IRS filed another request for comments regarding the Form 8939, stating that comments should be received by May 6, 2011 to be assured of consideration (suggesting that the Form 8939 will not be released before that date).

c. Disclaimers. The time for making any disclaimer under I.R.C. § 2518(b) for property passing by reason of the death of a decedent (who dies after 2009) is extended to nine months after the date of enactment. [TRA § 301(d)(1)(C).] (The Baucus bill applied the disclaimer extension, as well as the other extensions, only for 2010 decedents who die before the date of enactment and referred to an extension before the time of "receiving" a disclaimer rather than the time for "making" a disclaimer.) This opens up additional planning flexibility, in light of the dramatic change in estate tax treatment under TRA 2010. Concerns with being able to take advantage of this additional time include (1) that beneficiaries may have already accepted benefits, not realizing that the disclaimer period would be extended, and (2) state law requirements for disclaimers often refer to nine months after the transfer, so disclaimers during the extended time period may not satisfy the state law requirements. Query whether states will respond by amending their disclaimer statutes for decedents dying in 2010 before the date of enactment? Section 2518(c)(3) may provide a way for getting around a continuing state law 9-month limitation on disclaimers.

Section 2518(c)(3) provides that a transfer that does not qualify as a disclaimer under local law may still constitute a qualified disclaimer under federal law, as long as the disclaimer operates as a valid transfer under local law to the persons who would have received the property had it been a qualified disclaimer under local law.

The legislative history to § 2518(c)(3), passed in 1981, says that mere acts of receiving property to be able to make a transfer complying with the statute are not treated as acceptance that would preclude a disclaimer. "[T]he individual's direction of the transferor to the individual who would have taken under local law pursuant to an effective disclaimer will not be construed as acceptance of the property." H. Rept. 97-201, 1981-2 C.B. 352, 392. The Tax Court has made clear that §2518(c)(3) applies to a transfer made by the original beneficiary, not by the executor.

> "The transferor (i.e., the beneficiary) referred to in section 2518(c)(3) is not the same transferor of section 2518(b)(i.e., the estate or executor). Section 2518(c)(3) assumes that a transfer to the beneficiary has already occurred under local law because a disqualified disclaimer did not avoid the transfer. That beneficiary can still avoid the effects of the disqualified disclaimer by making a written transfer to the person who would have received the property (e.g., a surviving spouse) had the

> beneficiary made an effective disclaimer." *Bennett v. Commissioner*, 100 T.C. 42 (1993).

There must be a "written transfer" for § 2518(c)(3) to apply. Case law has held that a purported "disclaimer" that has no effect under state law does not satisfy the transfer requirement. *Bennett v. Commissioner*, 100 T.C. 42 (1993). In *Bennett*, purported disclaimers did not satisfy state law (among other things, they were not timely). The estate argued that the disclaimers satisfied §2518(c)(3), but the court disagreed because the beneficiaries did not make "actual written transfers of their interests in the Memorial Trust to the person who otherwise would have received those interests had the disclaimers been valid under local law." The court stated that §2518(c)(3) "should not be viewed as a catch-all provision to save defective or disqualified disclaimers" but that it applies when a "would be disclaimant makes an actual written transfer to the person who otherwise would have received the property had the disclaimer been valid under local law." The court quoted some of the legislative history:

> "In order to provide uniform treatment among States, the committee believes that where an individual timely transfers the property to the person who would have received the property had the transfer made an effective disclaimer under local law will be treated as an effective disclaimer for Federal estate and gift tax purposes provided the transferor has not accepted the interest or any of its benefits." H. Rept. 97-201, 1981-2 C.B. at 392.

Section 2518(c)(3) requires a written transfer of the person's "entire" interest in the property disclaimed. There is no law as to what that means (and no regulations have been issued regarding § 2518(c)(3)). The legislative history is scant as to the meaning of this requirement:

> "A transferor will not be considered a transfer of the entire interest in the property if, by reason of the transfer, some or all of the beneficial enjoyment in the property returns to the transferor or the transferor has any period after the transfer to control the beneficial enjoyment from the property." H. Rept. 97-201, 1981-2 C.B. at 392.

It is not clear whether that means that the person's entire interest in a particular "severable" interest (such as the income interest) must be disclaimed or whether literally the entire interest in the property must be disclaimed. Alternatively, is it sufficient for a person to disclaim her entire interest in an undivided one-half interest in Blackacre, or must her entire interest in Blackacre be transferred?

If the disclaimant lives in one of the few states that has a state gift tax, an issue with making transfers that qualify as disclaimers under § 2518(c)(3) is that a state gift tax will apply to the transfer, if it is not a transfer that constitutes a disclaimer under state law.

Practical Planning Pointer: If a transfer is intended as a qualified disclaimer under § 2518(c)(3) even though it does not meet the requirements under state law for a disclaimer, recite in the deed or other transfer document that

the transfer is intended as a qualified disclaimer for federal tax purposes and that the assets are passing to the same persons who would have received the property had the transferor made a valid disclaimer.

Extended Due Date: The extended disclaimer period runs until September 19, 2011 for 2010 decedents who die before December 17, 2010. Presumably the "holiday" rule under I.R.C. § 7503 will apply because it refers to the day "prescribed under authority of the internal revenue laws for performing any act;" it is not limited just to tax returns. (For decedents who die on or after December 17, the 9-month period will run as usual, which will be sometime on or after September 17, 2011.)

d. GST Tax Returns. The date for filing any return under § 2662 to report a "generation-skipping transfer" made in 2010 before the date of enactment (i.e., before December 17) is extended to no earlier than 9 months after the date of enactment (or September 17, 2011, which is a Saturday, so the extended due date would be no earlier than September 19, 2011). [TRA § 301(d)(2).]

Practical Impact: For generation-skipping transfers (i.e., direct skips, taxable distributions or taxable terminations), the due date for reporting the transaction on an appropriate return is extended to no earlier than September 19, 2011. (The GST transfer would be reported on the form, but the GST tax rate would be zero. Query whether there is any penalty for failing to file the return on time if the penalty is based on the amount of unpaid tax?) The time for filing a timely return to make a timely allocation of GST exemption to a direct skip or to make a timely election out of automatic allocation to a direct skip would be extended to September 19, 2011. (For a lifetime direct skip that would be reported on a gift tax return, if the income tax return is extended, the extended due date (October 17, 2011) would be past the September 19 date in any event.)

Practical Planning Pointer: While the time to file GST returns to report "generation-skipping transfers" (i.e., direct skips, taxable distributions or taxable terminations, § 2611(a)) that occur before December 17, 2010 is extended, there does not appear to be an extension of time for filing a return to make timely allocations of GST exemption (or elect out of automatic allocations) for "indirect skip" transfers to trusts that are not direct skips.

e. Applicability of Extensions. The extension period for filing returns and paying estate taxes and for making disclaimers applies to estates of decedents dying in 2010 and before the date of enactment (December 17, 2010). Similarly, the extended due dates for GST returns applies for a generation-skipping transfers made in 2010 before the date of enactment. [TRA 2010 § 301(d).]

C. Portability. The executor of a deceased spouse's estate may transfer any unused estate exemption to the surviving spouse. [TRA 2010 § 303.]

1. Estate Tax Exclusion Amount Definition Change. The portability concept is accomplished by amending § 2010(c) to provide that the estate tax applicable

exclusion amount is (1) the "basic exclusion amount" ($5.0 million, indexed from 2010 beginning in 2012), plus (2) for a surviving spouse, the "deceased spousal unused exclusion amount." [§ 2010(c)(2), as amended by TRA § 302(a).]

2. Deceased Spousal Unused Exclusion Amount (or "DESUEA"). The "deceased spousal unused exclusion amount" is the lesser of (1) the basic exclusion amount or (2) the basic exclusion amount of the surviving spouse's last deceased spouse over the combined amount of the deceased spouse's taxable estate plus adjusted taxable gifts (described in new § 2010(c)((4)(B)(ii) as "the amount with respect to which the tentative tax is determined under section § 2001(b)(1)").

   The first item limits the unused exclusion to the amount of the basic exclusion amount. Therefore, if the estate tax exclusion amount decreases by the time of the surviving spouse's death, the lower basic exclusion amount would be the limit on the unused exclusion of the predeceased spouse that could be used by the surviving spouse.

   The second item is the last deceased spouse's remaining unused exemption amount. Observe that it is strictly defined as the predeceased spouse's basic exclusion amount less the combined amount of taxable estate plus adjusted taxable gifts of the predeceased spouse. This appears to impose a privity requirement (discussed below in section IV.C.6 of this outline).

3. Statute of Limitations on Review of Predeceased Spouse's Estate to Determine Unused Exclusion Amount. Notwithstanding the statute of limitations on assessing estate or gift taxes for the predeceased spouse, the IRS may examine the return of a predeceased spouse at any time for purposes of determining the deceased spousal unused exclusion amount available for use by the surviving spouse. I.R.C. § 2010(c)(5)(B), as amended by TRA 2010 § 303(a).

4. Must be Timely Filed Estate Tax Return and Election for Predeceased Spouse's Estate. The Act continues the position of prior portability bills that the executor of the first spouse's estate must file an estate tax return on a timely basis and make an election to permit the surviving spouse to utilize the unused exemption. § 2010(c)(5)(A), as amended by TRA 2010 § 303(a). (Therefore, even small estates of married persons must consider whether to file an estate tax return for the first deceased spouse's estate.)

   It is possible that the IRS will develop a "Form 706-EZ" if the estate is filing only for the purpose of making the portability election.

5. Only Last Deceased Spouse's Unused Exclusion Amount Applies. Only the most recent deceased spouse's unused exemption may be used by the surviving spouse (this is different from prior portability legislative proposals). I.R.C. § 2010(c)(5)(B)(i), as amended. An explanation of TRA 2010 by the Joint Committee on Taxation reiterates that this requirement applies even if the *last* deceased spouse has no unused exclusion and even if the *last* deceased spouse does not make a timely election. Joint Committee on Taxation Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" Scheduled for Consideration by the United State Senate, 52 n.57 (Dec. 10, 2010)[hereinafter Joint Committee on Taxation Technical Explanation].

6. Privity Requirement. A spouse may not use his or her spouse's "deceased spousal unused exclusion amount." This is sometimes referred to as the "privity" requirement. For example, assume H1 dies and W has his deceased spousal unused exclusion amount, and assume W remarries H2. If W dies before H2, H2 may then use the deceased spousal unused exclusion amount from W's unused basic exclusion amount, but may not utilize any of H1's unused exclusion amount. The definition of the "deceased spousal unused exclusion amount" has no element at all that might include a deceased person's unused exclusion from a prior spouse in determining how much unused exclusion can be used by a surviving spouse. However, the Joint Committee on Taxation Technical Explanation has an Example that appears inconsistent with this conclusion.

> "Example 3. [Husband 1 dies with $2 million of unused exclusion amount.] Following Husband 1's death, Wife's applicable exclusion amount is $7 million (her $5 million basic exclusion amount plus $2 million deceased spousal unused exclusion amount from Husband 1). Wife made no taxable transfers and has a taxable estate of $3 million. An election is made on Wife's estate tax return to permit Husband 2 to use Wife's deceased spousal unused exclusion amount, which is $4 million (Wife's $7 million applicable exclusion amount less her $3 million taxable estate). Under the provision, Husband 2's applicable exclusion amount is increased by $4 million, i.e., the amount of deceased spousal unused exclusion amount of Wife." Joint Committee on Taxation Technical Explanation at 53.

This example assumes that Wife's deceased spouse unused exclusion amount, which could be used by Husband 2, is Wife's $7 million exclusion amount (which includes the deceased spousal unused exclusion from Husband 1) less her $3 million taxable estate. This would suggest that Husband 2 *does* get to take advantage of the unused exclusion amount from Husband 1. One might argue that this is just a matter of determining whether Wife first uses her own exclusion or first uses Husband 1's unused exclusion before using her own. If she first uses the unused exclusion that she received from Husband 1, her $3 million taxable estate, less Husband's 1's $2 million exclusion, would leave $1 million of taxable estate to be offset by $1 million of Wife's basic exclusion, leaving unused exclusion of $4 million for Husband 2. However, that approach is not consistent with the statutory definition of the "deceased spousal unused exclusion amount." Under the statutory definition, the deceased spousal unused exclusion amount that Husband 2 could have from Wife is determined as follows:

Lesser of:

(1) Basic exclusion amount		$5 million
Or		
(2) Wife's basic exclusion amount	$5 million	
Less		
Wife's taxable estate plus adjusted taxable gifts	$3 million	
Item (2)		$2 million

There is nothing in the statutory definition that makes any references whatsoever to the amount of Wife's unused exclusion from Husband 1 in determining the amount of the unused exclusion that Husband 2 has from Wife. However, the Joint Committee on Taxation Technical Explanation appears to adopts a concept of first using any deceased spousal unused exclusion at the death of a surviving spouse, and the IRS might be expected to interpret the statute in that manner.

7. Applies for Gift Tax Purposes. Portability applies for the gift exemption as well as the estate exemption. TRA 2010 § 303(b)(1) amends I.R.C. § 2505(a)(1), which describes the "applicable credit amount" for gift tax purposes, by referring to the applicable credit amount under § 2010(c) "which would apply if the donor died as of the end of the calendar year..." (Under § 2505(a)(2), the credit amount is further reduced by the amounts of credit allowable in preceding years.) The applicable credit amount under § 2010(c) includes the deceased spousal unused exclusion amount, so that amount is also included in the gift exemption amount.

Example 1. Husband 1 dies in 2011 with a taxable estate of $1 million, leaving a "deceased spousal unused credit amount" for Wife of $4 million. If later in 2011 Wife makes a large gift, her gift exemption under § 2505(a) is the estate tax applicable credit amount under § 2010(c) that would apply if Wife died as of the end of 2011. If Wife died at the end of 2011, her estate tax applicable credit amount would be her basic exclusion amount ($5 million) plus the amount of her deceased spousal unused credit amount ($4 million), or $9 million.

Example 2 (Gift in 2011). Assume the same facts as Example 1, but assume Wife makes a taxable gift of $4 million in 2011. (Apparently, it makes no difference whether Wife makes the gift before or after Husband 1 dies — her gift exemption is determined as if she had died on the last day of the calendar year, which would be after Husband 1 died.) Does the 2011 gift utilize Wife's own gift exemption amount first, or does it utilize her deceased spousal unused exclusion amount from Husband 1 first? Example 3 in the Joint Committee on Taxation Technical Explanation might be read as saying that the deceased spousal unused credit would be used first (at least for estate tax purposes). However, there is nothing in the statutory language suggesting that either spouse's credit would be used first. It just says that Wife has a credit on $9 million of exclusion in 2011 (or $3,130,800 of credit). Her gift of $4 million generates no gift tax:

Gift tax on $4 million	$1,380,800
Less gift unified credit	- 1,380,800
Gift tax paid	0

Example 3 (Additional Gift in 2012). Assume the same facts as in Examples 1-2, assume Wife makes another taxable gift of $4 million in 2012, and assume there is no inflation adjustment to the $5 million basic exclusion amount. (If there had been an inflation adjustment, Wife's basic exclusion amount would be inflation adjusted, but the $4 million of deceased spousal unused exclusion would not be adjusted.) Wife's gift unified credit is (1) the estate tax applicable credit amount she would have if she died at the end of 2012 [§ 2505(a)(1)], less (2) the amounts allowable as credit against the gift tax for preceding years [§ 2505(a)(2)]. This amount is:

(1) Estate tax applicable credit amount if die at end of 2012 (tentative tax on basic exclusion amount ($5 million assuming no inflation adjustment) and deceased spousal unused exclusion amount ($4 million, never inflation adjusted), combined $9 million)	$3,130,800
Less (2) Amounts allowable as credit for preceding years	- 1,380,800
Available gift tax unified credit amount for 2012	1,750,000

Gift tax calculation:

Gift tax on gifts for all periods ($8 million)	$2,780,800
Gift tax on $4 million gifts in 2011	- 1,380,800
Gift tax before credit	1,400,000
Less gift unified credit	- 1,400,000
Gift tax paid	0

Available gift tax unified credit available for future years (as long as Wife has this same deceased spousal unused exclusion amount):

Credit amount on $9 million	$3,130,800
Gift credit used in 2011	- 1,380,800
Gift credit used in 2012	- 1,400,000
Remaining gift credit	350,000

(That would cover additional gifts of $1 million.)

Example 4 (Husband 2 Dies, Additional Gift in 2013). Assume the same facts as in Examples 1-3, assume Husband 2 dies in 2013 with a taxable estate of $6 million and no unused exclusion amount, assume TRA 2010 is extended to apply in 2013, and assume the estate tax basic exclusion amount has been inflation adjusted to $5,020,000. Assume Wife makes a gift of $1 million in 2013.

Wife's gift tax unified credit:

(1) Estate tax applicable credit amount if die at end of 2013 (tentative tax on basic exclusion amount ($5.02 million) and deceased spousal unused exclusion amount (0), combined $5.02 million	$1,737,800
Less	
(2) Amounts allowable as credit for preceding years (1,380,800 for 2011 + 1,400,000 for 2012)	- 2,780,800
Remaining gift credit	0

Gift tax calculation:

Gift tax on gifts for all periods ($9 million)	$3,130,800
Gift tax on $8 million gifts in 2011-2012	- 2,780,000
Gift tax before credit	350,000
Less gift unified credit	- 0
Gift tax paid	350,000

Practical Planning Pointers.

(a) There is no concept of "using Husband 1's unused exclusion first," leaving Wife with $1.0 million of her own gift exemption amount after Husband 2 died, and Wife no longer had any deceased spousal unused exclusion after Husband 2 died. However the Joint Committee on Taxation Technical Explanation Example 3 suggests that there is a concept of using the deceased spousal unused exclusion first in the estate tax context. Whether this would be extended to the gift tax context is not clear.

(b) A surviving spouse may consider using the deceased spouse's unused exclusion amount with gifts as soon as possible (particularly if she remarries) so that she does not lose it if the new spouse predeceases or if the basic exclusion amount is decreased (remember that the deceased unused exclusion amount is the lesser of the basic exclusion amount or the amount from the unused exclusion calculation).

(c) Under the statutory procedure there is no way that Wife can utilize her deceased spousal unused exclusion amount with out using her own basic exclusion amount. However, the Joint Committee on Taxation Technical Explanation Example 3 suggests that can be done.

(d) The recapture/clawback issue discussed in section IV.E.2-5 of this outline can also arise in the context of gifts using the surviving spouse's "deceased spousal unused exclusion" for making gifts. If the spouse later remarries and the subsequent spouse dies, with less unused exclusion, the spouse will not have as much deceased spousal unused exclusion for estate tax purposes as when the gifts were made, so the exclusion amount for estate tax purposes will be less than for gift tax purposes when the gifts were made. This issue is different than the general recapture/clawback issue discussed below because it potentially applies under current law even if Congress does not later reduce the exemption amount. Also, the statute indicates that the unused exclusion amount can be decreased if the basic exemption amount is decreased by the time of the surviving spouse's death, perhaps suggesting legislative intent to apply the recapture tax in the somewhat analogous situation of lifetime gifts exceeding the total exclusion amount available at the surviving spouse's death. *See* Evans, *Problems With Portability, Part 2*, LEIMBERG INFOR. SERVICES EST. PL. NEWSLETTER 1777 (Feb. 16, 2011). This may result in additional estate taxes being due at the donor's death. The clawback issue in this context may be resolved differently than in the context of making gifts under a larger gift exemption than the estate exemption that exists at the donor's death.

(e) If an individual makes lifetime gifts in excess of the gift exclusion amount, the excess reduces the DESUEA for that individual's surviving spouse, even though the individual had to pay gift tax on that excess gift amount. (This is because the DESUEA is (i) the basic exclusion amount, minus (ii) the sum of the individual's taxable estate and adjusted taxable gifts. There is no distinction for adjusted taxable gfits that were subject to actual payment of gift tax.) *See* Evans, *Problems With Portability, Part 2*, LEIMBERG INFOR. SERVICES EST. PL. NEWSLETTER 1777 (Feb. 16, 2011).

8. Not Apply for GST Tax Purposes. Portability does not apply to the GST exemption.

9. Effective Date — Decedents Dying After 2010. The provision applies to the estates of decedents dying and gifts made after 2010. [TRA § 303(c)(1).] The Joint Committee on Taxation Technical Explanation takes the clear position that portability applies only if the first spouse dies after 2010. Joint Committee on Taxation Technical Explanation, at 51-52 ("Under the provision, any applicable exclusion amount that remains unused as of the death of a spouse who dies after December 31, 2010 (the 'deceased spousal unused exclusion amount'), generally is available for use by the surviving spouse, as an addition to such surviving spouse's applicable exclusion amount.")

10. Planning Observations.

    a. Heightened Significance in Light of Exemption Amount Increase. Portability takes on increased importance in light of the increase of the exemption amount to $5.0 million. Marrying a poor dying person to be able to use his or her unused exemption amount (which could be close to the full $5.0 million) may yield dramatic tax savings.

    b. Impact on Decision to Remarry. Portability may impact the decision of a surviving spouse to remarry. If the new spouse should predecease the surviving spouse, the unused exemption of the first deceased spouse would no longer be available to the surviving spouse, and the new spouse may have little or no unused exemption.

    c. Impact of Decision to Divorce. Portability could even encourage the spouses of wealthy families to divorce, each to remarry poor sickly individuals, and not to remarry after the new poor spouses die. This could add an additional $10 million of estate and gift tax exemption available to the family.

    d. Gift Tax Exclusions of Multiple Deceased Spouses. The statute itself has no limits on being able to take advantage of the exemptions from multiple deceased spouses for gift tax purposes. For example, if H1 dies with substantial unused exclusion, the surviving spouse (W) could make lifetime gifts using her own exclusion and H1's unused exclusion. (As discussed above, W would have to use her own basic exclusion amount in order to use the deceased spousal unused exclusion amount from H1 unless Example 3 of the Joint Committee on Taxation Technical Explanation is applied for gift tax purposes.) If W remarries and H2 also dies with unused exclusion, W could then make additional gifts using H2's unused exclusion (before she remarries and her next husband dies). Courts or the IRS may address a "sham marriage" concept to put some limits on using the exclusions of multiple poor sickly spouses. Also, there may be a recapture of estate tax attributable to the excess of the gift exemptions utilized with lifetime gifts over the estate exemption at the donor's death. See section IV.E.5 of this outline for a summary of the conclusions from the analysis of examples regarding the recapture issue.

e. Only Available Two Years. Like the rest of the estate and gift tax provisions in TRA 2010, the portability provision expires after 2012. The apparent anticipation is that Congress will extend this benefit following 2012, but there are no guarantees. In light of this, few planners may be willing to rely on portability and forego using bypass trust planning in the first deceased spouse's will. The possible exception would be if the surviving spouse intends to make gifts soon after the first spouse's death to utilize the unused exclusion — but if the spouse is willing to do that, it would seem better to just use bypass trust planning in the spouses' wills. The Fiscal Year 2012 Revenue Proposals (released February 14, 2011), include a provision that would permanently extend the provisions in the Tax Relief ... Act of 2010 regarding the portability of unused exemption between spouses. (Estimated 10-year cost: $3.681 billion.)

f. Reasons for Using Trusts Even With Portability. There are various reasons for continuing to use bypass trusts at the first spouse's death and not rely on the portability provision including, (a) there is no assurance that portability will apply after 2012, (b) the deceased spousal unused exclusion amount is not indexed, (c) the unused exclusion from a particular predeceased spouse will be lost if the surviving spouse remarries and survives his or her next spouse, (d) growth in the assets are not excluded from the gross estate of the surviving spouse unlike the growth in a bypass trust which is excluded, (e) there is no portability of the GST exemption, and (f) there are other standard benefits of trusts, including asset protection, providing management, and restricting transfers of assets by the surviving spouse. On the other hand, leaving everything to the surviving spouse and relying on portability offers the advantages of simplicity and a stepped-up basis at the surviving spouse's death.

Practical Planning Pointer: Few individuals will be willing to rely on portability of the estate tax exemption in planning their estates, because of the fact that portability only exists for two years and because there are a variety of other reasons for continuing to use appropriate "bypass" planning with trusts.

g. Not Available For Non-Resident Aliens. If a non-resident alien ("NRA") spouse dies first survived by a citizen spouse, there is no DESUEA because the NRA is merely entitled to a unified credit of $13,000 under § 2102 and does not have a "basic exclusion amount" that could be partly unused. If the citizen spouse dies first, the surviving NRA is not entitled to an exclusion under § 2101(c)(2) that includes the DESUEA, but is merely entitled to a unified credit of $13,000 under § 2102.

h. Priority for Treasury Guidance. Portability is not on the Treasury priority guidance plan. However, there are informal indications that the Treasury will issue guidance on portability and that it will be a priority, right behind providing guidance for 2010 decedents' estates.

D. Gift Exemption and Change in Method for Calculating Gift Tax.

1. Unification of Gift Exemption Beginning in 2011. The gift exemption remains at $1,000,000 in 2010. [TRA § 302(b)(1)(B).] Beginning in 2011, the gift exemption

amount is the same as the estate tax exclusion amount, or $5.0 million, indexed from 2010 beginning in 2012. Section 2501(a)(1), as amended by TRA 2010 §§ 301(b) & 302(b)(1), provides that the unified gift tax credit is:

"(1) the applicable credit amount in effect under section 2010(c) which would apply if the donor died as of the end of the calendar year..."

(The last phrase, beginning with "which would apply if the donor died as of the end of the calendar year" is the clause that provides portability of the gift exclusion.)

The Baucus bill did not unify the gift and estate exclusion amounts.

Practical Planning Pointer--Huge Implications for Future Transfer Planning Opportunities: The $5.0 million gift exclusion amount beginning in 2011 will open up a new paradigm of thinking regarding transfer planning strategies. The ability to make transfers of up to $10 million per couple without having to pay gift taxes paves the way for many transfer planning opportunities that, with leveraging strategies, can transfer vast amounts of wealth outside the gross estate. For example, a couple could give $10 million to grantor trusts, and sell $90 million of assets to the trusts with extremely low interest rate notes. The couple would continue to pay all of the income taxes on the grantor trusts, further depleting their estates and allowing the trusts to compound tax-free. Perhaps the notion of the estate tax being a "voluntary tax" will become reality.

2. Change in Gift Tax Calculation Method; Effect of Changed Calculation Method. For gift tax purposes, the gift tax calculation includes subtracting a unified credit, and the amount of unified credit available for a particular year is determined after subtracting the amount of credit already used from prior gifts. In calculating the amount of credit used on prior gifts, use the gift tax rate for the year of the current gift to determine the tentative tax on the applicable exclusion amount that was applicable for offsetting the gift tax on prior gifts. [TRA § 302(d)(2), amending I.R.C. § 2505(a).] (Query how to apply the rates in the current year for purposes of subtracting the gift credit amounts used in prior years when gifts were made in years before 1998 for which there was a fixed credit amount rather than an applicable exclusion amount? For example, in 1987-1997, the unified credit against gift tax was $192,800. For those years, will the actual amount of gift credit used in the prior year be subtracted under § 2505(a)(2) or will an implicit amount of exclusion attributable to the credit in that prior year be determined and then use the current year rate to determine the tentative tax on that implicit amount of exclusion?)

The effect of this change is to "correct" an anomaly that existed under prior law. If an individual had made gifts before 2010 over $500,000, the gifts used more credit (calculated at 37% and 39% rates) than gifts would use at a 35% rate. The result was that donors who had made prior taxable gifts over $500,000 could not make additional gifts in 2010 (at a 35% rate) equal to the difference between $1 million and the prior gifts. (For example, a donor who had made taxable gifts before 2010 of $961,538.46 would not be able to make additional gifts in 2010 (calculating the credit at a 35% rate) without paying gift tax.)

Practical Planning Pointer: The amendments to § 2505 mean that a donor can make gifts equal to the difference between the current applicable exclusion amount for gift tax purposes and the amount of prior taxable gifts without having to pay gift tax.

Steven Schindler, attorney in Seattle, Washington, provides this example of the effect of the amendments to § 2505(a):

> "For example, a donor who, in 2009, made her first taxable gift in the amount of $900,000, utilized $306,800 of credit (when $345,800 was available). The same donor in 2010 only has $330,800 in total credit, and, having used $306,800 in 2009, only has $24,000 in remaining credit to apply against 2010 gifts. At the 35% gift tax rate, this amount of credit only protects $68,571 in taxable gifts. If the donor makes a gift of the remaining $100,000, thinking that she has $1 million in total lifetime exemption equivalent, the donor would owe gift tax of $11,000 under the unamended § 2505(a).
>
> Under TRA 2010 § 302(d)(2) we would not look to the 2009 return to determine how much credit was used. Instead, we would re-determine in 2010, for purposes of calculating gift tax on any 2010 gift, the amount of credit that would have been used on the 2009 gift if the tax rates in effect in 2010 were applicable in 2009. Applying the maximum 35% rate to the $900,000 gift, only $295,800 in credit would have been used, leaving $35,000 in remaining credit for 2010, permitting a full $100,000 gift."

3. Gift Tax Effects if Donor Previously Made Gifts Above $5 Million in Prior Years. If a donor has made over $5 million of gifts in prior years, can the donor make use of the additional $4 million of gift exemption in 2011? Yes. The donor paid gift taxes on the excess of gifts over the $1 million exemption (or less) in prior years, and the donor can still take advantage of the additional $4 million of gift exemption. Under § 2505(a), the donor's gift tax unified credit amount would be the applicable credit amount on the $5 million basic exclusion less the "amounts allowable as a credit to the individual under this section for all preceding calendar periods" (which would reflect the credit amount on $1 million of gifts, so there would be lots of unified credit left).

Example ($5 million of Gifts in 2009). Assume Donor made $5 million of taxable gifts in 2009, and wishes to make an additional $4 million of gifts in 2011 (to make use of her additional $4 million of gift exemption.)

Gift tax in 2009 on $5 million gift:

Gift tax before credit (applying 45% rate)	$2,130,800
Gift tax credit on $1.0 million	- 345,800
Gift tax paid for 2009 gifts	1,785,000

Gift tax in 2011 on additional $4 million gift:

Gift tax on aggregate gifts of $9 million (applying 35% rate), § 2502(a)(1)(a)	$3,130,800
Less gift tax on prior $5 million gift (also applying 35% rate), § 2502(a)(1)(b)	- 1,730,800

Gift tax before credit		1,400,000
Less available gift unified credit (using 35% rate, even for determining amount of credit used in 2009 when the marginal rate was 45%, under § 2505(a), as amended by TRA 2010 § 302(d)(2))		
(1) Estate tax applicable credit amount on $5 million basic exclusion amount in 2011, § 2505(a)(1)	$1,730,800	
Less (2) Amounts allowable as credit for preceding years (on $1 million), using 35% highest marginal rate that applies in current year, rather than 39% highest rate that applied in 2009)	- 330,800	
Available gift credit for 2011	$1,400,000	
Gift tax for 2011 after credit		
Gift tax before credit (calculated above)		$1,400,000
Less gift unified credit		- 1,400,000
Gift tax payable for 2011		0

Practical Planning Pointer: If a donor previously made taxable gifts exceeding $1 million prior to 2011, the donor can make additional gifts of exactly $4,000,000 that will be covered by the $5 million gift exemption in 2011. Even though the gift credit on up to $1 million was previously calculated using 45% (or higher rates), in the current year calculation the amount of credit previously used is calculated using current year (35% rates) rather than the amount of credit actually applied at the higher rates.

4. Gift Tax Effects if Donor Previously Made Taxable Gifts In Excess of or Less Than $1 Million Prior to 2011. As illustrated by the preceding example, if the donor has previously made taxable gifts of at least $1 million prior to 2011, the client can make an additional taxable gift of exactly $4 million in 2011 without having to pay gift tax. Similarly, if the donor has made prior taxable gifts prior to 2011 of less than $1 million, the donor can make gifts of exactly $5 million less the amount of taxable gift made previously.

Example ($900,000 of Prior Gifts). Assume the donor made gifts of $900,000 in 2009.

Gift tax in 2009 on $900,000 gift:

Gift tax before credit (highest marginal rate is 39%)	$ 306,800
Gift tax credit on $900,000	- 306,800
Gift tax paid for 2009 gifts	0

Gift tax in 2011 on additional $4.1 million gift:

Gift tax on aggregate gifts of $5 million (applying 35% rate), § 2502(a)(1)(a)	$1,730,800
Less gift tax on prior $900,000 gift (also applying 35% rate), § 2502(a)(1)(b)	- 295,800
Gift tax on additional $4.1 million before credit	1,435,000

Credit on 2011 gift

Credit on $5.0 million applicable exclusion	$1,730,800	
Credit used on prior period gifts (35% rate)	- 295,800	
Credit left		$1,435,000
Gift tax payable on 2011 gift		$ 0

E. Change in Estate Tax Calculation Method Regarding Effects of Prior Gifts. The estate tax calculation method is changed to reflect the effects of changing gift tax rates. The calculation method under § 2001(b) is as follows:

- Step 1: calculate a tentative tax on the combined amount of (A) the taxable estate, and (B) the amount of adjusted taxable gifts (i.e., taxable gifts made after 1976 other than gifts that have been brought back into the gross estate — just the tax using the rate schedule is calculated, without subtracting any credits), I.R.C. § 2001(b)(1),
- Step 2: subtract the amount of gift tax that would have been payable with respect to gifts after 1976 if the rate schedule in effect at the decedent's death had been applicable at the time of the gifts, I.R.C. § 2001(b)(2). (The Form 706 instructions for the "Line 7 Worksheet" clarify that the gift unified credit attributable to the applicable credit amount available in each year that gifts were made is used in calculating the gift tax that would have been payable in that year. There is uncertainty as to how this will be applied if the estate tax applicable exclusion amount has decreased below the gift exemption amount utilized by lifetime gifts, particularly if there is a sunsetting of TRA 2010 to interpret the Code as if the $5 million gift tax exemption amount "had never been enacted." In that case, will the gift unified credit amount that is subtracted in determining the amount of the reduction under Step 2 be limited to the credit amount on a $1 million exclusion? This is discussed in detail below.)
- Step 3: Subtract the applicable credit amount.

TRA 2010 amends § 2001 to add new § 2001(g), which clarifies that in making the second calculation (under § 2001(b)(2)), the tax rates in effect at the date of death (rather than the rates at the time of each gift) are used to compute the gift tax imposed and the gift unified credit allowed in each year. The gift unified credit equals--

(1) the estate tax applicable credit amount for the year of the gift (§ 2505(a)(1)), less

(2) the aggregate gift unified credits for preceding years (§ 2505(a)(2)), and as discussed above in section IV.D.2 of this outline regarding the calculation of the gift tax, TRA 2010 amends § 2505(a) to provide that in calculating the aggregate gift unified credits used in prior years under § 2505(a)(2), rates in effect for the year of each current gift are used in lieu of the actual rates of tax in effect during the preceding years.

1. General Estate Tax Effects of Prior Gifts. Generally speaking, the estate tax calculation method of § 2001(b) is designed (1) to tax the estate at the highest estate tax rate brackets, taking into consideration prior gifts (by determining the tax on the combined taxable estate plus adjusted taxable gifts and subtracting the taxes on just the adjusted taxable gifts), and (2) to reflect that the individual has already utilized unified credit that would otherwise be available at death for any taxable gifts made previously (this is done by reducing the amount of tax that is subtracted attributable to just the adjusted taxable gifts by the amount of unified

credits attributable to those adjusted taxable gifts.) This is accomplished under the rather complicated estate tax computation procedures under § 2001. A brief refresher on the estate tax computation system, building on the description above, will assist in understanding the estate tax affects of large gifts.

Step 1: Calculate tentative tax on gross estate + adjusted taxable gifts

Step 2: Subtract from that the gift tax on just the adjusted taxable gifts that would have been paid, based on the rates in effect at the date of death. This gift tax amount is reduced by unified credit used in making the gift (again based on rates in effect at the date of death). Basic math principles tells us that the "negative of a negative is a positive." Reducing the amount of gift tax that is subtracted in Step 2 by the unified credit used in the gift in effect adds the gift unified credit to the tax calculation.

Step 3: The full estate unified credit amount is then subtracted at the end of the computation.

Therefore, if a $5 million gift has been made and the estate tax exclusion amount is $5 million, the calculation effectively adds $1,730,000 (the credit amount on $5 million with a 35% top rate) in Step 2 (i.e., there is no reduction in the amount of the tentative tax by the chapter 12 tax that would be paid on the adjusted taxable gifts) and subtracts $1,730,000 in Step 3. Thus, we get the generalization that the taxable gift "uses up" the estate tax exemption amount.

2. Controversial Calculation Issue: "Recapture" vs. "Clawback" If Estate Exemption Is Reduced in the Future ("Line 7 Issue"). If the estate tax exemption is decreased in the future, after the client has already made gifts covered by the $5 million gift exemption amount, it is not clear how Step 2 of the estate tax calculation described above will be interpreted. Following the Form 706 instructions, the hypothetical "chapter 12" offset amount (reported on Line 7 of the Form 706) is calculated using the applicable credit amount "in effect for the year the gift was made," (see the last two lines of the Form 706 Instructions, Line 7 Worksheet) which would be the credit amount for an applicable exclusion amount of $5 million. (Similarly, Letter Ruling 9250004 says that "the unified credit that would have been allowed to the decedent *in the year of the gift* is taken into account as a reduction of arriving at the gift tax payable.") That means that the gift unified credit amount would fully cover the gift and no gift tax calculated under chapter 12 would be reduced in calculating the tentative estate tax. In effect, the tentative tax (before applying the estate tax unified credit amount at death) would be the tax on the combined amount of the taxable estate plus the adjusted taxable gifts. This would result in estate tax being due with respect to the adjusted taxable gifts if the later estate tax unified credit is less than the gift tax unified credit that had applied previously.

The change under § 2001(g) says to use the date of death estate tax *rates* in calculating the gift credit amount for this hypothetical gift tax. This seems to connote that the Form 706 instructions approach would be applied by using the exclusion amount that was used in the *year of the gift* and determining a hypothetical gift credit amount using the date of death rate.

That situation, of the estate tax unified credit amount being lower than the gift unified credit amount for prior years, has never happened. It is not clear whether the Form 706 instructions would apply literally in that circumstance or not. On the other hand, if the amount of the chapter 12 tax on just the adjusted taxable gifts, to be subtracted from the tentative tax in Step 2 and reported on Line 7 of the Form 706, is calculated assuming the gift unified credit amount were determined on just the lower estate tax applicable exclusion amount, there would be chapter 12 tax that would be subtracted in Step 2, thus giving the estate the benefit of having removed the "excess" exclusion amount from the estate without gift or estate tax.

The listservs are full of comments about this issue. Some planners say that the additional estate tax is an appropriate "recapture" of using the excess exemption, and others take the position this is an unfair "clawback" of the tax benefits allowed in making gifts. The reasoning under the first position (that "recapture" should be appropriate with additional estate taxes at death on the prior gifts if the exemption amount is reduced in the future) is that this approach reflects the basic structure of the unified gift/estate tax system by adding back adjusted taxable gifts into the estate tax calculation and allowing one *unified* credit for estate tax purposes. Eric Viehman, attorney in Houston, Texas summarizes:

> "From a policy standpoint, it is hard to argue that two taxpayers dying in the same year who each made a total of $10 million of taxable transfers during lifetime and at death should pay dramatically different amounts in total tax simply because one made $5 million of lifetime gifts and the other made none... If new estate tax legislation is enacted but the post-2012 estate tax exemption is something less than $5 million, then Congress certainly might eliminate any recapture possibility, but it seems hard to make a persuasive policy argument for doing so."

The position of the unjust "clawback" group is that the taxable gifts are not part of the gross estate and are just part of the estate tax calculation procedure to tax the estate in the highest marginal brackets considering lifetime gifts.

Richard Franklin, an attorney in Washington D.C., summarizes:

> "Adjusted taxable gifts are not part of the taxable estate. Section 2001(a) imposes an estate tax on the taxable estate. Gifts are not part of the taxable estate. If the clawback analysis is correct, the total estate tax to be paid could exceed the maximum estate tax rate as a percentage of the taxable estate. I cannot think of another situation in which the total tax paid is over the maximum rate as a percentage of the taxable estate (even ignoring the applicable credit). Even the 5% surtax "bubble bracket" just took away the advantage of the lower brackets, but did not push the estate tax in excess of the maximum bracket as a percentage of the taxable estate. While I cannot say there is no risk of a clawback, the arguments against it are strong, it was not intended, it is beyond the purpose of the 2001(b) and I don't even believe the statute currently mandates that result. The 706 instructions lead to the clawback, but that arises out of the context of the IRS never envisioning the exemption upon gift being higher than at death."

Another argument of this group is that if TRA 2010 sunsets in two years and the EGTRRA/TRA sunset kicks in to apply the Code with respect to estate of persons dying after 2012 as if the EGTRRA and TRA provisions had never been enacted, then there would not have been a $5 million exemption for gift tax purposes, so the hypothetical gift tax on just the adjusted taxable gifts would be calculated assuming a gift exemption of only $1 million and there would be a big offset in the estate tax calculation. They argue that the "clawback" potential, while substantial or even likely, "doesn't 'feel right' or square with the original thought behind 'paid or payable' that actually benefitted taxpayers."

With respect to the sunsetting reasoning, keep in mind that there is the possibility that there may not be a general sunset of the EGTRRA and TRA provisions but, consistent with the sunsetting rule in TRA which leaves most of the estate and gift tax provisions of EGTRRA intact, future legislation may merely revise §2010(c)(2)(A) (as amended by TRA 2010) to say that the applicable exclusion amount is $3,500,000 (or whatever number is reached in the political discussions), and § 2505(a), which describes the gift tax unified credit amount, would continue simply to refer to § 2010(c) but without the parenthetical clause "(determined as if the applicable exclusion amount were $1,000,000)."

Here is a different way of stating the issue: One of the purposes of the estate tax calculation procedure is to reflect that using gift exemption also uses the estate exemption. Does that mean that it uses the estate exemption only to the extent of the estate exemption at death, or does it require a "recapture" to the extent that the gift exemption utilized exceeds the estate exemption?

There are indications from Congressional staffers that the "clawback" effect if the exclusion amount is reduced in future years was not intended and that there will be no clawback of the excess exemption.

In any event, the result is uncertain. One attorney has summarized it well: "One person's glitch is another's tax logic."

3. Impact of Gifts Utilizing $5 Million Gift Exemption on Later Estate Tax Calculation. In each of the following examples, the line of the calculation that is impacted by the "Line 7" issue of whether to determine the § 2001(b)(2) offset by using the gift credit amount based on the applicable exclusion amount for the year of the gift or for the year of death is italicized.

Example 1 (Gift of $5 Million; Death in 2012). Assume A has an estate of $15 million and makes a $5 million gift (ATG) in 2011, and dies in 2012 with a taxable estate (TE) of $10 million. (Because death occurs within three years, any gift tax paid would be brought back into the estate, but a gift of $5 million in 2011 will not require the payment of any gift tax.)

Gift Calculation. The gift is fully covered by the $5 million gift exemption, so no gift tax is due.

Estate Tax Calculation

(1) Tentative tax on TE + ATG ($15 million)		$5,230,800
(2) Less gift tax on ATGs using date of death rates Gift tax on $5 million (35% top rate)	1,730,800	

Less gift unified credit on $5M exclusion (35% rate)	*- 1,730,800*	
		- 0
(3) Estate tax before unified credit		5,230,800
(4) Less unified credit on $5 million exclusion		- 1,730,800
(5) Estate tax		3,500,000

Conclusion. The total gift tax and estate tax is $3,500,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been the same $3,500,000. Even though the gift is included in the estate tax calculation, making the gift did not cost any additional tax. The simple example neglects future appreciation and payments of income taxes. If the gift removed future appreciation or if the gift were made to a grantor trust and A paid income taxes on grantor trust income thus reducing her estate, the gift would have produced an overall savings — without having to pay a current gift tax.

If the decedent's estate is passing to a surviving spouse or charity, so that it qualifies fully for the marital or charitable deduction, the additional estate taxes would not qualify for the marital or charitable deduction, resulting in a circular calculation of the estate taxes. However, if the estate exemption remains at $5 million, there would be no estate tax payable at the donor's death. The tentative tax on the $5 million of adjusted taxable gifts would be completely offset by the estate tax unified credit on a $5 million applicable exclusion amount. The rest of the estate qualifies for the marital or charitable deduction. There is no added tax that begins a circular tax calculation.

Example 2 (Gift of $5 Million; Death in 2013 and Assume Applicable Exclusion Amount Has Been Reduced to $3.5 Million and Rate Has Been Increased to 45%; Follow Form 706 Instructions). Assume A makes a $5 million gift in 2011 and dies with a taxable estate of $10 million in 2013. Assume the law is changed for 2013 so that the applicable exclusion amount is reduced to $3.5 million and the rate is increased to 45% (the 2009 system). Assume the calculation follows the Form 706 instructions in calculating the § 2001(b)(2) "Line 7" offset for the gift taxes on adjusted taxable gifts by taking into consideration the amount of gift tax applicable credit amount in each year the gift was made but applying date of death rates (i.e., the gift credit amount using the 45% rate table on a $5 million applicable exclusion amount).

Gift Calculation. The gift is fully covered by the $5 million gift exemption, so no gift tax is due.

Estate Tax Calculation

(1) Tentative tax on TE + ATG ($15 million) (45% table rate)		$6,630,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $5 million (45% top rate)	2,130,800	
Less gift unified credit on $5M exclusion (45% table)	*- 2,130,800*	
		- 0
(3) Estate tax before unified credit		6,630,800
(4) Less unified credit on $3.5 million exclusion		- 1,455,800
(5) Estate tax		5,175,000

Conclusion. The total gift tax and estate tax is $5,175,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been the same $5,175,000. Despite the "clawback" effect, making the gift does not cost any additional tax, even if TRA sunsets and there is a later decrease in the applicable exclusion amount and increase in the gift tax rate. *Stated differently, the estate ultimately receives just the benefit of the applicable exclusion amount at the individual's death if the "clawback" applies.* However, future appreciation attributable to the gift or income taxes paid on gift assets in grantor trusts will reduce the gross estate that would otherwise be subject to estate taxes.

The estate tax on just the $10 million taxable estate would have been $2,925,000. Therefore, there is $2,250,000 ($5,175,000-$2,925,000) attributable to assets not in the taxable estate. (Check: The added $5 million x 45% = $2,250,000.) The recipients of the taxable estate will have to pay $2,250,000 of estate tax attributable to the $5 million of taxable gifts. If the taxable gifts were made to persons other than the recipients of the taxable estate, hard feelings may result (at the least). Tax apportionment issues are critically significant in light of the estate tax recapture for lifetime gifts, particularly this possible result if the estate tax exemption is decreased below the utilized gift tax exemptions. See section IV.E.4 of this outline.

If the decedent's estate is passing to a surviving spouse, so that it qualifies fully for the marital deduction, the additional estate taxes would not qualify for the marital deduction, resulting in a circular calculation of the estate taxes. The calculation results in a tax of $1,227,272.73. (Check it: The tentative tax on TE + ATG, or [$1,227,272.73 + $5 million] is $2,673,072.73. Subtracting the $1,455,800 unified credit leaves an estate tax of $1,227,272.73. More simply: [$1,500,000 + $1,227,272.73] x 45% = $1,227,272.73.)

Example 3 (Gift of $5 Million; Death in 2013 and Assume Applicable Exclusion Amount Has Been Reduced to $1 Million and Rate Has Been Increased to 55%; Follow Form 706 Instructions). Assume A makes a $5 million gift in 2011 and dies with a taxable estate of $10 million in 2013. Assume the law is changed for 2013 so that the applicable exclusion amount is reduced to $1 million and the rate is increased to 55% (the pre-2001 system). Assume the calculation follows the Form 706 instructions in calculating the § 2001(b)(2) offset for the gift taxes on adjusted taxable gifts by taking into consideration the amount of gift tax applicable credit amount in each year the gift was made but applying date of death rates (i.e., the gift credit amount using 55% rate table on a $5 million applicable exclusion amount).

Gift Calculation. The gift is fully covered by the $5 million gift exemption, so no gift tax is due.

Estate Tax Calculation

(1) Tentative tax on TE + ATG ($15 million) (55% table rate)		$7,890,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $5 million (55% top rate)	2,390,800	
Less gift unified credit on $5M exclusion (55% table)	- *2,390,800*	

	- 0
(3) Estate tax before unified credit	7,890,800
(4) Less unified credit on $1 million exclusion	- 345,800
(5) Estate tax	7,545,000

Conclusion. The total gift tax and estate tax is $7,545,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been the same $7,545,000. Making the gift did not cost any additional tax, even if EGTRRA and TRA sunset, resulting in a later dramatic decrease in the applicable exclusion amount and increase in the gift tax rate. The simple example neglects future appreciation and payments of income taxes. If the gift removed future appreciation or if the gift were made to a grantor trust and A paid income taxes on grantor trust income thus reducing her estate, the gift would have produced an overall savings — without having to pay a current gift tax.

The estate tax on just the $10 million taxable estate would have been $4,795,000. Therefore, there is $2,750,000 ($7,545,000-$4,795,000) of estate tax attributable to assets not in the gross estate. (Check: $5 million of ATGs x 55% = $2,750,000.)

Example 4 (Gift of $5 Million; Death in 2013 and Assume Applicable Exclusion Amount Has Been Reduced to $3.5 Million and Rate Has Been Increased to 45%; Limit § 2001(b)(2) Gift Tax Offset Based on Date of Death Applicable Exclusion Amount; Comparison to Example 2). Assume A makes a $5 million gift in 2011 and dies with a taxable estate of $10 million in 2013. Assume the law is changed for 2013 so that the applicable exclusion amount is reduced to $3.5 million and the rate is increased to 45% (the 2009 system). Assume in calculating the § 2001(b)(2) offset for the gift taxes on adjusted taxable gifts that the gift tax unified credit amount is calculated by applying the 45% rate table to the applicable exclusion amount for the date of death (i.e., $3.5 million) rather than in each year that gifts were made (i.e., $5 million).

Gift Calculation. The gift is fully covered by the $5 million gift exemption, so no gift tax is due.

Estate Tax Calculation

(1) Tentative tax on TE + ATG ($15 million) (45% table rate)		$6,630,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $5 million (45% top rate)	2,130,800	
Less gift unified credit on $3.5M exclusion (45%	*- 1,455,800*	
		- 675,000
(3) Estate tax before unified credit		5,955,800
(4) Less unified credit on $3.5 million exclusion		- 1,455,800
(5) Estate tax		4,500,000

Conclusion. The total gift tax and estate tax is $4,500,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been $5,175,000. Making the gift saved $675,000 of estate tax (even before considering the removal of future appreciation in the gift assets from the estate). *Stated differently, the estate ultimately receives the benefit of the applicable exclusion amount at the*

individual's death AND removes $1.5 million from the transfer tax base ($1.5 million x 45% = $675,000 savings).

The estate tax on just a $10 million estate would have been $2,925,000, so there is $1,575,000 of estate tax attributable to assets not in the taxable estate. (Compare this to Example 2 where there was an additional $2,250,000 of estate tax attributable to the adjusted taxable gifts. The difference is $675,000 — which is the amount attributable to the excess exemption used in taxable gifts times the estate tax rate ([$5 million - $3.5 million] x 45% = $675,000).)

If the entire estate passes to a surviving spouse that qualifies for the estate tax marital deduction, there would be no estate tax produced as a result of the $5 million of gifts under this "no clawback" approach for determining the "Line 7" offset amount.

Example 5 (Gift of $5 Million; Death in 2013 and Assume Applicable Exclusion Amount Has Been Reduced to $1 Million and Rate Has Been Increased to 55%; Limit § 2001(b)(2) Gift Tax Offset Based on Date of Death Applicable Exclusion Amount; Compare to Example 3). Assume A makes a $5 million gift in 2011 and dies with a taxable estate of $10 million in 2013. Assume the law is changed for 2013 so that the applicable exclusion amount is reduced to $1 million and the rate is increased to 55% (the pre-2001 system). Assume in calculating the § 2001(b)(2) "Line 7" offset for the gift taxes on adjusted taxable gifts that the gift tax unified credit amount is calculated by applying the 55% rate table to the applicable exclusion amount for the date of death (i.e., $1 million) rather than in each year that gifts were made (i.e., $5 million).

Gift Calculation. The gift is fully covered by the $5 million gift exemption, so no gift tax is due.

Estate Tax Calculation

(1) Tentative tax on TE + ATG ($15 million) (55% table rate)		$7,890,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $5 million (55% top rate)	2,390,800	
Less gift unified credit on $1M exclusion (55% rate)	*- 345,800*	
		- 2,045,000
(3) Estate tax before unified credit		5,845,800
(4) Less unified credit on $1 million exclusion		- 345,800
(5) Estate tax		5,500,000

Conclusion. The total gift tax and estate tax is $5,500,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been $7,545,000. Making the gift saved $2,045,000 of estate tax (even before considering the removal of future appreciation from the gift). *Stated differently, the estate ultimately receives the benefit of the applicable exclusion amount at the individual's death AND removes $4 million from the transfer tax base that would have been subject to estate tax at rates ranging from 41% to 55%.*

Practical Planning Pointer: Even if there is clawback of the excess gift exemption, if the estate tax is calculated under the Form 706 instructions approach, making a

taxable gift merely has the effect of excluding future appreciation of the gift property from the estate as well as income tax that the donor may pay on grantor trust income if the gift is made to a grantor trust. The estate ultimately receives just the benefit of the applicable exclusion amount at the individual's death. As illustrated in Examples 2-3, if an individual makes a $5 million gift in 2011 and the applicable exclusion amount is later reduced, the individual still has the benefit of making a $5 million gift (and shifting future appreciation and income payments attributable to a grantor trust) without taking away the estate's right to take advantage of the applicable exclusion amount at death, whatever amount that might be. If the donor has not paid gift taxes, the effect is that the estate is subject to estate tax (using rates in effect at the date of death) on the combined taxable estate plus adjusted taxable gifts, with the benefit of the unified credit that applies at the date of death.

However, if there is no clawback and the estate tax is calculated by determining the Line 7 gift tax offset from adjusted taxable gifts using the applicable exclusion amount at the date of death rather than in the year of the gift, substantial tax savings are generated. In effect, the difference between the $5 million exemption utilized in taxable gifts and the date of death applicable exclusion amount is removed from the tax base.

The next examples address the effects if gift taxes have been paid during life.

Example 6 (Gift of $10 million in 2011; Death in 2012 With Same Exclusion and Rate). Assume A makes a gift of $10 million in 2011 and dies in 2012 with a taxable estate of $5 million (including the gift tax paid, which is added to the gross estate because A did not live three years after making the gift).

Gift Calculation

Gift tax (before credit) on $10 million	$3,480,800
Less unified credit on $5 million exclusion amount	- 1,730,800
Gift tax payable for 2011 gift	1,750,000

Estate Tax Calculation

(1) Tentative tax on TE (incl Gift Tax) + ATG ($15 million)		$5,230,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $10 million (35% top rate)	3,480,800	
Less gift unified credit on $5M exclusion (35% table)	*- 1,730,800*	
		- 1,750,000
(3) Estate tax before unified credit		3,480,800
(4) Less unified credit on $5 million exclusion		- 1,730,800
(5) Estate tax		1,750,000

<u>Conclusion</u>. The total gift tax and estate tax is $1,750,000 gift tax plus $1,750,000 estate tax, or $3,500,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been the same $3,500,000. Making the gift did not cost any additional tax. The simple example neglects future appreciation and payments of income taxes. If the gift removed future appreciation

or if the gift were made to a grantor trust and A paid income taxes on grantor trust income thus reducing her estate, the gift would have produced an overall savings.

Example 7 (Gift of $10 Million in 2011; Death in 2013 With Exclusion of $3.5 Million and Top Rate of 45%; Follow Form 706 Instructions). Assume A makes a gift of $10 million in 2011 and dies in 2013 with a taxable estate of $5 million (including the gift tax paid, which is added to the gross estate because A did not live three years after making the gift). Assume that Congress has changed the applicable exclusion amount back to $3.5 million and has increased the top rate to 45% for 2013.

Gift Calculation

Gift tax (before credit) on $10 million	$3,480,800
Less unified credit on $5 million exclusion amt	- 1,730,800
Gift tax payable for 2011 gift	1,750,000

Estate Tax Calculation

(1) Tentative tax on TE (incl Gift Tax) + ATG ($15 million) (45% table) (at 45% top rate)		$6,630,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $10 million (45% top rate)	4,380,800	
Less gift unified credit on $5M exclusion (45% table)	*- 2,138,800*	
		- 2,250,000
(3) Estate tax before unified credit		4,380,800
(4) Less unified credit on $3.5 million exclusion		- 1,455,800
(5) Estate tax		2,925,000

Conclusion. The total gift tax and estate tax is $1,750,000 gift tax plus $2,925,000 estate tax, or $4,675,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been $5,175,000. Making the gift saved $500,000 of combined tax. (The $10 million gift had a 35% tax rate apply to $5 million — the amount of the gift not covered by the $5 million exemption. If the gift is not made, that $5 million would have been taxed at 45%. The additional 10% of the $5 million amount accounts for the additional $500,000 that would be paid if the gift were not made.)

Example 8 (Gift of $10 Million in 2011; Death in 2013 With Exclusion of $1 Million and Top Rate of 55%; Follow Form 706 Instructions). Assume A makes a gift of $10 million in 2011 and dies in 2013 with a taxable estate of $5 million (including the gift tax paid, which is added to the gross estate because A did not live three years after making the gift). Assume that Congress has changed the applicable exclusion amount back to $1 million and has increased the top rate to 55% for 2013.

Gift Calculation

Gift tax (before credit) on $10 million	$3,480,800
Less unified credit on $5 million exclusion amt	- 1,730,800
Gift tax payable for 2011 gift	1,750,000

Estate Tax Calculation

(1) Tentative tax on TE (incl Gift Tax) + ATG ($15 million) (45% table) (at 55% top rate)		$7,890,800
(2) Less gift tax on ATGs using DOD rates		
Gift tax on $10 million (55% top rate)	5,140,800	
Less gift unified credit on $5M exclusion (55% table)	*- 2,390,800*	
		- 2,750,000
(3) Estate tax before unified credit		5,140,800
(4) Less unified credit on $1 million exclusion (55% top rate)		- 345,800
(5) Estate tax		4,795,000

Conclusion. The total gift tax and estate tax is $1,750,000 gift tax plus $4,795,000 estate tax, or $6,545,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been 7,545,000. Making the gift saved $1 million of combined tax. (The $10 million gift had a 35% tax rate apply to $5 million — the amount of the gift not covered by the $5 million exemption. If the gift is not made, that $5 million would have been taxed at 55%. The additional 20% of the $5 million amount accounts for the additional $1 million that would be paid if the gift were not made.)

Practical Planning Pointer: As a general rule, if a gift over the $5 million exemption amount is made and if the estate/gift tax rate is later increased, there will be savings equal to the difference in rates times the excess gift over the gift exemption amount. A change in the estate tax applicable exclusion amount alone does not result in a change of the combined estate and gift tax (if the Form 706 instructions approach is used for "Line 7"). Also, this example is designed so that there is no benefit of savings attributable to having gift taxes removed from the estate tax if the donor lives at least three years after the gift; this is on purpose to more readily compare the tax effects of making gifts attributable to changing rates and exclusion amounts. However, the advantage of having gift taxes removed from the estate is more pronounced as larger gift taxes are paid. Furthermore, this simple example neglects future appreciation and payments of income taxes. If the gift removed future appreciation or if the gift were made to a grantor trust and A paid income taxes on grantor trust income thus reducing her estate, the gift would have produced an even greater overall savings.

4. Tax Apportionment Impact. The added estate taxes attributable to the prior gifts can be substantial. How are the additional estate taxes attributable to adjusted taxable gifts apportioned among the recipients under the will and the donees of the gifts? Howard Zaritsky provides this summary:

> "There are several cases that have examined this issue, and they are split on whether state law should apportion the taxes against the donees, versus against the residuary (marital) share. In re Metzler, 579 N.Y.S.2d 288, 290 (App. Div. 1992) and In re Estate of Coven, 559 N.Y.S.2d 798, 799-800 (Sur. Ct. 1990) (taxes not apportioned to donees); In re Estate of Finke, 508 N.E.2d 158, 162 (Ohio 1987) (taxes not apportioned to donees); Shepter v. Johns Hopkins University, 637 A.2d 1223 (Md. Ct. App. 1994) (taxes apportioned to donee); Bunting v. Bunting, 760 A.2d 989 (Conn.

App. Ct. 2000) (taxes apportioned to donee); Necaise v. Seay (In re Estate of Necaise), 915 So. 2d 449 (Miss. 2005) (taxes apportioned to donee).

Virginia directly permits apportionment to donees of tax increases caused by adjusted taxable gifts. Va. Code § §64.1-160 (stating that the decedent's gross estate, for apportionment purposes, "includes any property or interest which is required to be included in the gross estate of the decedent under the estate tax law of the United States, increased by any 'adjusted taxable gifts' as defined in § 2001(b) of the Internal Revenue Code."). The state apportionment statutes of Florida and Maryland also address adjusted taxable gifts but state that the provisions for apportioning taxes to nonprobate property do not include adjusted taxable gifts. See Fla. Stat. § 733.817(1)(d) (nonprobate property subject to apportionment "does not include interests or amounts that are not included in the gross estate but are included in the amount upon which the applicable tax is computed, such as adjusted taxable gifts"); Md. Code Tax-General § 7-308 (the legislative history states that nonprobate assets subject to apportionment "specifically do not include an adjusted taxable gift of the decedent as defined in § 2001 of the Internal Revenue Code", effectively reversing Shepter, cited above).

In states that have no express law, however, there is a question whether a will can even apportion estate taxes to people who are not beneficiaries of the estate. Therefore, I would recommend that, where large gifts are made in 2011 or 2012, and all or a major portion of the $5 million unified credit is used, the donor should both include an apportionment provision in his or her will, and have an agreement with the donee for the latter to bear the increased estate taxes."

What if the taxable gifts are so large that the remaining assets in the gross estate are not sufficient to pay all of the added estate tax? The entire probate estate would be applied to estate taxes (or other expenses that have priority over estate taxes), but there does not appear to be any way for the IRS to collect the remaining tax deficiency from the gift recipients except for gifts that have been made within three years of death. § 2035(c)(1)(C) (for purposes of estate tax liens the gross estate includes gifts made within three years of death). (If there is a state law apportionment statute that apportions estate taxes to donees of gifts or if there is an agreement of donees to reimburse the estate for added estate taxes, as addressed in the following paragraph, that obligation presumably would be an estate asset that the IRS could pursue for payment.)

One possible approach may be to have a net gift agreement with the donees of the gifts, so that they would agree to pay the estate tax attributable to the adjusted taxable gift inclusion in the event the exclusion amount is reduced in later years. Whether there would be any offset in determining the amount of net gift attributable to such agreement is not clear, because of the speculative nature of whether and by how much the estate exclusion might be reduced in future years. *See* McCord v. Commissioner, 461 F.3d 614 (5th Cir. 2006), rev'g, 120 T.C. 358 (2003). In McCord, the donees assumed all gift, GST and estate tax liability attributable to the transfer, specifically including potential estate tax liability under

the gift tax gross-up rule of § 2035(b) if the donor were to die within three years. The Tax Court viewed that potential liability as too speculative to consider as an offset to the gift value. The Fifth Circuit reversed, viewing it as even less speculative than the "built-in gains tax" discount that has been allowed in recent years. The Fifth Circuit distinguished Armstrong Trust v. United States, 132 F. Supp.2d 421 (W.D. Va. 2001), which dealt with the donees' general transferee liability under § 6324(a)(2) for additional estate taxes under § 2035(b) if the donor died within three years of the gift. That involves much more uncertainty, because not only must the donor die within three years, but the estate must be depleted to the point that it cannot pay the additional estate tax before the donees are liable under the transferee liability rule.

However, if a reduction in the exclusion amount did occur such that the donees had to reimburse the estate for the additional estate tax, that reimbursement right would likely be an estate asset subject to inclusion in the gross estate.

If there are other bequests being made to the donees under the donor's will, the tax apportionment clause may effectively charge the estate tax against the donees, by treating the tax as an advancement against their bequests.

5. Summary of Planning Conclusions; Practical Planning Pointers.

a. How Much Can the Donor Afford to or Want to Give? While substantial additional gifts can be made without having to pay gift taxes, the initial question is how much can the donor afford to or want to give? Spouses collectively could give up to $10 million without having to pay gift taxes. Few couples can afford to give $10 million without potentially impacting their lifestyle in later years. Furthermore, the increased estate exemption may mean that the donor is not as concerned about estate taxes as in the past. However, TRA 2010 only lasts for two years and the estate exemption could be decreased in future years; alternatively, the estate exemption could be increased or the estate tax could be repealed in future years in which event the donor may have preferred to retain the gift assets.

These questions inevitably will involve issues of whether the donor can make gifts in a way that the donor (or the donor's spouse) could retain some use of the assets in case needed as a "rainy day" fund. One possible approach would be to make gifts to a lifetime credit shelter trust for the donor's spouse (or even trusts created by each of the spouses for each other with enough differences so they are not treated as "reciprocal" trusts for tax purposes). Alternatively, self-settled trusts may be considered in jurisdictions that allow discretionary distributions to the settlor without subjecting the trust to claims of the settlor's creditors (and therefore estate inclusion). These issues are explored further in sections X.B and X.M of this outline.

b. Can Make Gifts of Full Additional Gift Exemption Amount. The amendments to § 2505 mean that a donor can make gifts equal to the difference between the current applicable exclusion amount for gift tax purposes and the amount of prior taxable gifts without having to pay gift tax.

c. Can Make Gifts of Full Additional Gift Exemption Amount Even If Made Prior Gifts Exceeding Gift Exemption Amount. If a donor previously made taxable gifts exceeding $1 million prior to 2011, the donor can make additional gifts of exactly $4,000,000 that will be covered by the $5 million gift exemption in 2011. Even though the gift credit on up to $1 million was previously calculated using 45% (or higher rates), in the current year calculation the amount of credit previously used is calculated using current year (35% rates) rather than the amount of credit actually applied at the higher rates.

d. Gift Does Not Remove Gift Assets From Base For Calculating Estate Tax. The adjusted taxable gifts are added to the taxable estate in making the estate tax calculation, with an offset for gift taxes that would be payable on just the adjusted taxable gifts. The gifts in effect are just an "advance" on distributions from the estate (without gift tax as long as the gifts do not exceed the exclusion amount), but the gifts are included in the transfer tax base. If there are other assets in the taxable estate utilizing all of the estate exclusion amount, the amount of the additional estate tax attributable to the taxable gifts is the amount of the taxable gifts times the estate tax rate. If there are $5 million of taxable gifts and the estate tax rate is 35%, the added estate tax is $1,750,000; if the estate tax rate is 45% the added estate tax would be $2,250,000. The total estate tax is the same whether or not the gifts are made. However, there will be estate taxes attributable to assets that have been given away and that are not in the probate estate (or in the federal gross estate) at the donor's death. Because of this effect, it is still preferable, to the extent possible, to shift value that would otherwise be in the taxable estate without making taxable gifts (e.g., using strategies such as GRATs, sales to grantor trusts, fractionalization discounts, paying income taxes on grantor trusts, etc.).

Making gifts never increases the total aggregate taxes as opposed to just retaining the assets and paying estate tax on the full amount (unless the gift assets were to depreciate, in which event it would have been better not to have made the gift or unless gift taxes are paid at a higher rate than the later estate tax rate).

e. Utilization of GST Exemption. Making current gifts and allocating GST exemption to the gifts means that future increases in value of the trust will also be GST exempt without having to allocate additional GST exemption. Even if there is a "clawback" for estate tax purposes if the estate tax exemption is later reduced below $5 million, there would be no clawback of the use of the $5 million GST exemption.

f. Use Exemptions Now in Case They Are Later Reduced. TRA 2010 affords what may eventually be a window of opportunity to make gifts of $5 million without paying current gift tax and to allocate $5 million of GST exemption. Those exemption amounts could be reduced in the future.

g. Gift Advantages and Disadvantages. Even though the overall transfer tax is generally the same whether or not gifts are made, other factors can make gifts advantageous from a tax perspective, including removal of

appreciation/income for gift assets from gross estate (generally resulting in an eventual tax savings equal to the appreciation/income removed times the estate tax rate), utilizing fractionalization discounts, and paying income taxes on income from grantor trusts that receive gifts. If GST exemption is allocated to the gift, these advantages also apply to increase the amount in the GST exempt trust compared to funding the GST exempt trust at the individual's death. Being able to make larger gifts without paying gift taxes increases these advantages.

In addition, if gift taxes are paid and the donor lives more than three years after making the gift, the gift tax amount is removed from the gross estate. Also, if the estate tax rate is later increased, there will be tax savings generally equal to the amount of the gift subject to payment of gift taxes times the amount of the percentage rate increase.

Those are tax advantages. Of course, the biggest advantage may be the ability to shift assets to other persons so they can enjoy, consume or otherwise use the assets currently.

Gifts can be disadvantageous from an overall tax cost perspective if a) the gift asset declines in value after making the gift (which uses up gift exclusion based on the date of gift value), or b) if the loss of a basis step-up more than offsets the estate tax savings as a result of removing appreciation/income from the asset and the other advantages of gifts listed above.

h. Possible Recapture/Clawback of Tax Attributable to Excess Exemption If Estate Tax Exemption Is Later Reduced. If the Form 706 instructions are followed, and the Line 7 gift tax offset amount is calculated using the applicable exclusion amount for the year of the gift, the estate will pay estate tax on all of the taxable gifts, including the excess of the exclusion utilized by gifts over the estate tax exclusion amount.

The issue, stated briefly, is this: If gifts are made under a gift exclusion amount that exceeds the estate exclusion amount, does the excess amount pass free of gift or estate taxes? The amount of the potential clawback is the excess exemption times the estate tax rate. For example if a $5 million gift is made and if the estate exemption is later reduced to $3.5 million and the estate tax rate is increased to 45% (the 2009 system), the clawback would be the excess $1.5 million times 45%, or $675,000.

Legislative staffers have indicated that this "clawback" effect, if the exclusion amount is reduced in the future, was not intended and that there will be no clawback effect. One possible IRS guidance or legislative approach would be to make clear that the Line 7 gift tax offset amount is determined by applying a gift credit based on the amount of the lower estate tax exemption. This would effectively remove from the transfer tax base the difference between $5 million (if the $5 million gift exemption is used) and the estate tax exemption amount. (An alternate legislative approach would be to change the estate calculation so that it mirrors the gift tax calculation approach—determine a tentative tax on taxable estate plus adjusted taxable gifts, subtract the tentative tax on just adjusted

taxable gifts, and then subtract an estate tax unified credit that has been reduced by prior lifetime uses of the unified credit.)

If the residuary estate passes to different persons than the donees of the gifts, significant conflicts of interest may arise. The client may want to consider tax apportionment alternatives, as discussed in subparagraph 5.l below.

Clients should be aware of the possibility of the additional estate tax. But clients should also realize that the combined estate/gift tax would not be greater than if no gift were made in the first place. Even if the "clawback" applies, the estate will not pay more taxes as a result of making the gift than if the gift assets had been retained (unless the gift assets were to decline in value or unless gift taxes are actually paid at higher rates than the estate tax rate). In a marital/charitable plan, there may be estate taxes payable, but those same taxes would have been payable if the gift assets had been transferred to the gift donees at death.

i. Estate Tax Recapture With Marital/Charitable Estate Beneficiaries Results in Interrelated Calculation If Exemption Amount Decreases in the Future. If the estate would otherwise pass to a surviving spouse or charity, the additional tax is dramatic because the tax itself does not qualify for the marital/charitable deduction and an interrelated calculation dramatically increases the tax hit.

If there are $5 million of taxable gifts and if the estate tax exemption is also $5 million, there is no additional estate tax due at the donor's death if the estate passes entirely to a spouse or charity. Under the same $5 million gift with full marital/charitable estate beneficiaries scenario, if the estate tax exemption is reduced to $3.5 million and the rate is increased to 45%, the estate tax will be $1,227,272.73 if the Line 7 gift offset is determined under the Form 706 instructions approach (see Example 2). If Line 7 is determined by using the date of death exemption amount to calculate the gift credit in determining the hypothetical gift tax offset, there is no estate tax in a full marital/charitable deduction estate. In effect, the estate tax recapture is totally offset by the estate tax unified credit (see Example 4).

Carlyn McCaffrey points out that an approach to avoid this estate tax at the first spouse's death if clawback applies is to include provisions in the trust agreement of the trust that receives the gift (1) that give an independent party the right to grant the settlor a testamentary limited power of appointment over the trust (which would cause estate inclusion under § 2038, see section XI.N of this outline for a more detailed discussion of this strategy), and (2) that cause any trust property included in the settlor's gross estate to pass to a QTIPable trust if there is a surviving spouse at the settlor's death.

j. Recapture of Estate Tax If Portability Exclusion Is Utilized by Gifts. This recapture/clawback issue can also arise in the context of gifts using the surviving spouse's "deceased spousal unused exclusion" for making gifts. If the spouse later remarries and the subsequent spouse dies, with less exclusion, the spouse will not have as much deceased spousal unused

exclusion for estate tax purposes as when the gifts were made, so the exclusion amount for estate tax purposes will be less than for gift tax purposes when the gifts were made. Alternatively, if the surviving spouse makes gifts to utilize the unused exclusion from the deceased spouse and if portability is not extended in future legislation, the estate exemption available to the surviving spouse would be lower than the gift exemption utilized in lifetime gifts, raising the same "Line 7" issue. If the "Line 7" issue is resolved in favor in a taxpayer-friendly manner by allowing a gift tax offset based on the amount of estate exemption, rather than the larger amount of gift exemption at the time of the gift, and if this same approach is applied to gifts utilizing the deceased spousal unused exclusion amount, there would be substantial benefits of making lifetime gifts to utilize the amount of additional exclusion acquired from each prior deceased spouse.

k. Effects of Paying Gift Tax If Rates Stay the Same or the Rates Later Increase. If gifts are made requiring the payment of gift tax, if the donor dies within three years of the gift (so that the gift tax is brought back into the estate), and if the estate tax rate is the same as the gift tax rate, there is no reduction in the combined gift and estate tax. (See Example 6.) The gift tax merely "prepays" the transfer tax, but the advantages of making gifts described in subparagraph 5.g above would apply. By using the rates in effect at the date of death to calculate the gift tax that would have been payable on the adjusted taxable gifts, the system grants an advantage to making gifts at a lower rate than the ultimate estate tax rate. The amount of savings is generally equal to the amount of gifts in excess of the gift exclusion amount times a percentage equal to the difference between the marginal estate tax rate and the marginal gift tax rate. (See Examples 7-8.)

l. Consider Apportionment of Estate Tax Recapture. There are estate tax implications of gifts. All adjusted taxable gifts are brought into the estate tax base, and the donor may wish to have the donees pay a portion of the federal estate tax to the extent the donees have received the benefit of using up some of the donor's lifetime gift/estate exclusion amount (although that is rarely done). Furthermore, if the estate exemption is reduced below the gift exemption used in lifetime gifts, the excess exemption used by gifts over the eventual estate exemption amount may be subject to estate tax, depending on IRS interpretation of the estate tax calculation procedure.

The client could consider the taxes attributable to gifts in the tax allocation clause. Absent a state law providing for allocation of estate taxes to donees of gifts (Virginia may be the only state that does that), the testator may not be able to allocate taxes to a donee. However, if other assets are passing under the will to the donees of the gifts, the added estate taxes could be charged as an advancement against the bequest to the donees. Alternatively, a net gift type of arrangement could be used, with the donees agreeing to pay the added estate tax if there is clawback. These issues are explored further in Section IV.E.4 of this outline.

F. GST Tax — Overview of Changes. The general GST effects of the amendments in TRA 2010 are summarized below. A more detailed discussion of changes and planning implications is in section VIII of this outline.

1. GST Applicable Rate in 2010 is Zero. For all of 2010, the GST tax "applicable rate determined under section 2641(a)... is zero" for all generation-skipping transfers made in 2010. [TRA 2010 § 302(c).] This change in nomenclature makes clear that generation-skipping transfers may be made in further trust. This issue is discussed in sections VIII.B.1 and VIII.C.2 of this outline below.

2. GST Tax Applies After 2010. TRA § 301(a) in effect repeals § 2664 added by EGTRRA, which section provided that Chapter 13 would not apply to generation-skipping transfers after 2009. This change is made effective for transfers made after 2009. However, as discussed immediately above, TRA § 302(c) provides the special rule resulting in a zero GST tax rate for generation-skipping transfers in 2010.

3. GST Exemption of $5.0 Million for 2010. The GST exemption equals the estate tax "applicable exclusion amount under section 2010(c) for such calendar year." I.R.C. § 2631(c). Because the estate tax applicable exclusion amount is changed to $5.0 million for 2010 [TRA § 302(a)(1)], the GST exemption is $5.0 million for 2010. This is important, because it clarifies that there is up to $5.0 million of GST exemption that can be allocated on a timely basis to transfers to trusts in 2010. (See section VIII.H of this outline for a more detailed discussion of the applicability of the $5 million GST exemption in 2010 and planning implications in connection with that exemption.)

4. GST Exemption in Future Years. The GST exemption for 2011 will also be $5.0 million. The $5.0 million amount is indexed from 2010, beginning in 2012. (The GST exemption amount is the same as the estate tax applicable exclusion amount, and the estate tax exclusion amount is indexed from 2010 beginning in 2012. TRA 2010 § 302(a)(1).) If the GST exemption amount is not changed by future legislation, after the TRA sunsets following 2012, the GST exemption will be $1.0 million, indexed from 1997.

5. GST Tax Rate After 2010. The "applicable rate" for determining the GST tax is the maximum estate tax rate times the inclusion ratio of the trust. I.R.C. § 2641(a). Because the maximum estate tax rate is 35%, the GST rate is also 35% (except that the rate is zero for generation-skipping transfers in 2010).

G. Section 2511(c) Deleted. Section 2511(c), added by EGTRRA, provides that transfers to non-grantor trusts are treated as gifts. That section, which has raised considerable confusion, fortunately is deleted.

H. Sunset Provision of EGTRRA. Planners have been very concerned about the unintended possible effects of the sunset provision in EGTRRA following 2010. Section 901 of EGTRRA says that the Code will be interpreted as if the provisions of EGTRRA had never been enacted with respect to estates of decedents dying after, gift made after, and generation-skipping transfers after 2010. However, there are many taxpayer favorable provisions in EGTRRA that might conceivably expire under EGTRRA § 901.

Most of these uncertainties are resolved for 2011 and 2012. TRA 2010 § 301(a) says that each Code provision amended by subtitles A or E of title V of EGTRRA "is amended to

read as such provision would read if such subtitle had never been enacted." These subtitles only address the estate and GST tax repeal following 2009 and carryover basis. See section IV.B.1-2 of this outline.

All of the other provisions of EGTRRA would be given effect for 2011 and 2012, including the reduction of estate and gift tax rates (subtitle B), increase of unified credit exemption equivalent and GST exemption and setting the gift exemption at $1.0 million (except as further amended in TRA 2010) (subtitle C), replacing the state death tax credit with a state tax deduction (subtitle D), expansion of conservation easement rules for estate tax purposes (subtitle F), modifications of GST provisions, including automatic exemption allocations, retroactive allocations, qualified severances, modification of certain valuation rules, and the GST "9100 relief provisions"(subtitle G), and the relaxation of the requirements for deferred estate tax payments under § 6166 (subtitle H). This eliminates the concern about the effect of the sunset rule in EGTRRA on all of those other provisions for 2011 and 2012.

However, TRA 2010 provides for temporary tax relief (generally for just two years), and TRA 2010 § 101(a) states that Section 901 of EGTRRA is applied by replacing "December 31, 2010" with "December 31, 2012." This means that the sunset rule of EGTRRA is now delayed for two years, until following 2012. All of the uncertainties that we have had previously about the EGTRRA sunset provision remain, but are "punted forward" for two years to 2013.

V. Effective Dates

There are a variety of effective dates for the various provisions.

A. Applicable for 2010. Interestingly, some of the changes are effective retroactively for all of 2010, mainly the re-enactment of the estate tax with a $5 million exclusion amount and 35% rate (but subject to the election to have carryover basis apply instead of the estate tax), technical computational details for calculating estate and gift taxes, increasing the GST exemption to $5.0 million for 2010 with a zero rate for any generation-skipping transfers, and clarifying that direct skip transfers in trust in 2010 will not result in the application of GST taxes when distributions are later made to the beneficiaries (at least to the oldest generation of direct skip beneficiaries when the trust is created).

B. Applicable Beginning in 2011. Other changes are effective beginning in 2011. These include unification of the gift and estate exclusion amounts (by increasing the gift exemption to $5 million), and the portability of the unused estate tax exclusion amount.

C. Changes Effective For Decedents Dying Before and Generation-Skipping Transfers Before Date of Enactment. Several changes apply only to estates of decedents dying in 2010 prior to and generation-skipping transfers made in 2010 prior to the *date of enactment* (before December 17, 2010) — the provision allowing a delay in filing and paying tax until no earlier than nine months after the date of enactment. Similarly, the extended period for making disclaimers from transfers arising by the death of a decedent applies only to decedents who die in 2010 before the date of enactment.

D. No Changes Based on Date of Introduction of Bill. A very key change from the Baucus bill is that the changes to the gift tax in the Baucus bill (imposing a 45% rate) and reinstituting the GST tax on generation-skipping transfers applied to transfers after the *date of introduction* of that bill (December 2, 2010). That would have removed many

opportunities for year-end transfer planning in December. Fortunately, that issue did not arise under TRA 2010.

VI. What's Left Out?

Several provisions in the Baucus bill, including some provisions that have appeared in various bills in the last several years, are not included in TRA 2010. The following provisions in the Baucus bill and several other proposals that have received some attention over the last several years were not included.

A. Farmland. Estate taxes on farmland could have been be deferred under the Baucus bill until the farmland was sold or transferred outside the family or ceased to be used for farming. The executor would have had to make a special election to exclude the farmland from the gross estate, attach a qualified appraisal of the farmland to the estate tax return, and file an agreement that provided for a never-ending estate tax recapture provision when the farmland was later sold, transferred outside the family, ceased to be used as farmland, or was encumbered by a nonrecourse indebtedness secured in whole or in part by the farmland. (There were complex provisions regarding the amount of the recapture tax payable by intervening generations, taking into account subsequent appreciation in the farmland, and requiring that "qualified heirs" file annual information returns describing whether any of the recapture triggering events had occurred.)

B. Special Use Valuation. The Baucus bill would have increased the special use valuation adjustment amount from $750,000 (indexed to $1.0 million in 2010) under current law to $3.5 million (indexed from 2009 beginning in 2011). Therefore, up to a $3.5 million (indexed) reduction in value would have been allowed for farm or business property that satisfied the special use valuation requirements. This provision was effective for estates of decedents dying after and gifts made after 2009 (and therefore applied for 2010 decedents).

C. GRAT 10-Year Minimum Term. The Baucus bill included the proposal in the President's Budget Proposal for the last two years of a GRAT 10-year minimum term. Under the proposal, grantor retained annuity trusts must have a 10-year minimum term, the annuity amount cannot decrease in any year, and the remainder interest must have a value greater than zero determined at the time of the transfer to the trust. The Baucus bill would have applied this minimum 10-year GRAT provision to *transfers after the date of enactment.*

At this point, there has been no indication whether the deletion of this provision reflects Congressional policy not to impose a 10-year minimum term on GRATs, or whether the Congressional writers are just saving this revenue raising provision for subsequent legislation. The discussions surrounding the passage of TRA 2010 did not include any element of needing revenue offsets to "pay for" the changes. Indeed, the entire package is viewed as an economy and job creation stimulus. At some point in the future, the revenue impact of legislation will again matter, and revenue raisers, such as this one, may re-emerge.

This provision was again included in the Fiscal Year 2012 Revenue Proposals (released February 14, 2011), with an estimated 10-year revenue impact of $2.959 billion.

D. Consistency of Basis. The Baucus bill also included the consistency of basis proposal in the President's Budget Proposal for the last two years. The basis of property in the hands of heirs would be the same as its value as finally determined for estate tax purposes, and the

basis of property in the hands of donees for purposes of determining loss would be limited by the fair market value (under § 1015) as finally determined for gift tax purposes. (This provision in the Baucus bill was retroactive, applying to "transfers for which returns are filed after the date of enactment.")

As with GRATs, the deletion of this provision may just mean that it is being saved for future legislation when revenue offsets will be needed because this is a revenue raising provision.

This provision was again included in the Fiscal Year 2012 Revenue Proposals (released February 14, 2011), with an estimated 10-year revenue impact of $2.095 billion.

E. Gift Tax Separate Years for 2010 Gifts Before and After Date of Introduction. The Baucus bill would have resulted in different gift tax rates for gifts made in 2010 before and after December 2, 2010. A provision in the Baucus bill addressing the mechanics of reporting those gifts was not needed in TRA 2010.

F. Section 2704. TRA 2010 (as well as the Baucus bill) does not contain any provisions addressing § 2704 (as requested in the President's Budget Proposal the last two years). (This provision has not been included in *any* statutory proposal.)

This provision was again included in the Fiscal Year 2012 Revenue Proposals (released February 14, 2011), with an estimated 10-year revenue impact of $18.166 billion.

G. State Death Tax Deduction. The extension of the estate tax provisions of EGTRRA means that the state death tax credit did not get reinstituted in January 2011 (which would have caused the re-emergence of state death taxes in many states that just have a "federal credit pick-up system" and that therefore have no state estate taxes if there is not a federal death tax credit). Furthermore, some have speculated that as a revenue raiser, Congress may at some point delete the deduction for state death taxes that now exists under § 2058. That was not done in TRA 2010.

H. Limited Duration of GST Exemption. The Fiscal Year 2012 Revenue Proposals (released February 14, 2011) include a new proposal to limit the GST exemption to 90 years after a trust is created. This would be accomplished by increasing the inclusion ratio of any trust to one on the 90th anniversary of the creation of the trust. Contributions to a trust by separate grantors are treated as separate trusts for GST purposes. For each such separate trust, the 90-year period would be measured from the date of the first contribution by the grantor of that separate trust. If an existing trust pours over or is decanted into another trust, the 90-year period would be based on the creation date of the initial trust unless the assets pass to a single beneficiary-"vested" trust (this exception permits an incapacitated beneficiary's distribution to continue to be held in trust without incurring GST tax on distributions to the beneficiary). The proposal would apply to trusts created after the date of enactment and to the portion of preexisting trusts attributable to additions after that date. (Estimated 10-year revenue impact: Negligible)

VII. Effects on 2010 Year-End Planning

While 2010 year-end planning obviously is no longer possible, 2010 year-end planning concepts and issues are addressed because planners will be dealing with the effects of 2010 year-end transactions that were implemented to take advantage of special opportunities in the last few weeks of 2010 after TRA 2010 was passed.

A. Lack of Date of Introduction Effective Date Opened the Door to Year-End Planning. The Baucus bill would have had a major impact on year-end planning. Many individuals had been waiting until the end of 2010 to make 35% gifts, to make direct skip gifts, and to make distributions to skip persons from trusts that are non-exempt for GST tax purposes, in order to make sure that the 45% gift tax rate and GST tax were not applied retroactively. There had been no prior public discussion of making the gift and GST tax provisions effective on the date of INTRODUCTION of a bill, and the inclusion of the date of introduction effective date in the Baucus bill was quite surprising. Fortunately, TRA 2010 has no such early effective date, and year-end planning opportunities continued throughout the end of 2010.

The following is a general framework for year-end transfer planning strategies that existed in December 2010. The passage of TRA 2010 provided a substantial degree of certainty regarding various effects of year-end planning transfers for 2010.

B. No Gift Tax Advantage of Making Gifts in 2010 Unless Donor Was Willing to Pay Gift Tax. There was generally no advantage to making gifts in December 2010 rather than in 2011 if the donor did not want to pay gift tax. The rate would be the same (35%) if there is gift tax, and there is more gift exemption in 2011 to cover gift transfers in case the IRS argues for higher gift values on audit. (One exception to this general rule is deathbed planning for estates that would not owe federal estate taxes under the $5.0 million estate exemption in 2010 under TRA 2010, but would owe significant state estate taxes. In many states, pre-death gifts (even deathbed gifts) are excluded from the estate for state estate tax purposes.)

Furthermore, there could be long term benefits of making gifts in December 2010 rather than 2011 if (1) the donor had been willing to pay current gift taxes, and (2) if future legislation were to decrease the exemptions and increase the rates from the levels set in TRA 2010. There are several contributing factors to tax savings by making gifts in 2010 in order to pay larger current gift taxes than if the gift is made in January. (1) Gift taxes are removed from the gross estate if the donor lives at least three years, resulting in some of the estate being taxed on a "tax-exclusive" basis. Making the gift in December 2010 involved paying greater taxes, so this potential advantage would be larger. (2) Paying transfer taxes on a portion of the estate at rates below the ultimate estate tax rate can save overall combined transfer taxes. This would be important if the estate tax rates were to be increased in the future. Each of these factors is addressed below.

1. Taxing Portion of Estate on Tax-Exclusive Basis if Donor Lives Three Years (By Removing Gift Tax From Taxable Base). If a donor lives three years after making a gift, any gift taxes paid are removed from the gross estate. This can result in a significant overall tax savings. If a client was willing to entertain that planning strategy, making the gift in December 2010, when there was only a $1 million gift exemption rather than the $5 million gift exemption that applies in 2011, would result in a larger gift tax payment, which in turn results in a larger amount being removed from the gross estate if the donor lives at least three years after making the gift. Detailed calculations would be required to determine the overall effects of paying additional gift taxes (taking into account the assumed appreciation rate of the transferred assets, the time value of the tax payments, and the assumed future level of estate tax exemption amounts and rates).

2. <u>Taxing Portion of Estate at Lower Rates In Case Estate Tax Rates Rise in the Future</u>. If gifts were made in December 2010 rather than 2011, savings would result from paying gift taxes on a portion of the estate at a 35% rate if later the estate tax rate were to be increased (for example, to 45% or 55%). (See the examples in section IV.E.3 of this outline for a general discussion of the impact of gifts on later estate tax determinations.) The following examples compare making gifts in December 2010 and in 2011, assuming that the estate tax rate at the date of death increases to 45%. The examples isolate the effect of the changing rates by not including the advantage of paying some of the tax on a tax-exclusive basis by removing the gift tax from the estate if the donor lives three years after making the gift. That factor would further increase the advantage of paying larger gift tax by making the gift in December 2010 (with a $1 million exemption) rather than in 2011 (with a $5 million exemption).

Example 1 (Gift of $10 million in January 2011; Death in 2013 With Exclusion of $3.5 Million and Top Rate of 45%). Assume A made a gift of $10 million in January 2011 and dies in 2013 with a taxable estate of $5 million (including the gift tax paid, which is added to the gross estate because A did not live three years after making the gift). Assume that Congress has changed the applicable exclusion amount back to $3.5 million and has increased the top rate to 45% for 2013. Assume the "Line 7" gift tax offset in the estate tax calculation is determined using the approach in the Form 706 instructions. (The "Line 7" issue is discussed in section IV.E.2-3 of this outline.)

Gift Calculation

Gift tax (before credit) on $10 million	$3,480,800
Less unified credit on $5 million exclusion amt	- 1,730,800
Gift tax payable for 2011 gift	1,750,000

Estate Tax Calculation

(1) Tentative tax on TE (incl Gift Tax) + ATG ($15 million) (at 45% top rate)		$6,630,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $10 million (45% top rate)	4,380,800	
Less gift unified credit on $5M exemption (using 45% rate)	- 2,130,800	
		- 2,250,000
(3) Estate tax before unified credit		4,380,800
(4) Less unified credit on $3.5 million exclusion (using 45% top rate)		- 1,730,800
(5) Estate tax		2,650,000

Example 2 (Gift of $10 million in December 2010; Death in 2013 With Exclusion of $3.5 Million and Top Rate of 45%). Assume A made a gift of $10 million in December 2010 and dies in 2013 with a taxable estate of $5 million (including the gift tax paid, which is added to the gross estate because A did not live three years after making the gift). Assume that Congress has changed the applicable exclusion amount back to $3.5 million and has increased the top rate to 45% for 2013. Assume the "Line 7" issue is resolved the same as in Example 1, above.

Gift Calculation

Gift tax (before credit) on $10 million	$3,480,800
Less unified credit on $1 million exclusion amt	- 330,800
Gift tax payable for 2011 gift	3,150,000

Estate Tax Calculation

(1) Tentative tax on TE (incl Gift Tax) + ATG ($15 million) (at 45% top rate)		$6,630,800
(2) Less gift tax on ATGs using date of death rates		
Gift tax on $10 million (45% top rate)	4,380,800	
Less gift unified credit on $1M exemption (45% rate)	- 345,800	
		- 4,035,000
(3) Estate tax before unified credit		2,595,800
(4) Less unified credit on $3.5 million exclusion (using 45% top rate)		- 1,455,800
(5) Estate tax		1,140,000

Observations Regarding Example 2. The total gift tax and estate tax is $3,150,000 gift tax plus $1,140,000 estate tax, or $4,290,000. If the gift had not been made, the estate tax on a $15 million taxable estate would have been 5,175,000. Making the gift saved $885,000 of combined tax. The $10 million gift had a 35% tax rate apply to $9 million — the amount of the gift not covered by the $1 million exemption. If the gift were not made, that $9 million would have been taxed at 45%. The additional 10% of the $9 million amount would represent $900,000 of savings. This is offset by $15,000 of reduced savings because the gift tax credit on the $1 million of gift exemption was only in the 39% bracket. To get to the 45% bracket of credit, there would be an additional 2% of $250,000 (the $1,000,000 to 1,250,000 bracket) and 4% of 250,000 (the $1,350,000 to 1,500,000 bracket), or $15,000.)

Comparison of Examples 1 and 2.

January 2011 Gift, combined gift and estate tax: $1,750,000 + 2,650,000 = $4,400,000

Dec. 2010 Gift, combined gift and estate tax: $3,150,000 + 1140,000 = $4,290,000

Savings by making gift in 2010 rather than 2011: $ 110,000

Observe, if the donor had lived for three years after making the gift, so that the gift tax was excluded from the gross estate, resulting in paying transfer tax on a tax-exclusive basis on $9 million rather than just $5 million of the estate, there would have been even greater savings by making the gift in December rather than in January.

Practical Planning Pointer: If a donor was willing and able to pay current gift taxes, making a large gift in December 2010 rather than in 2011 could result in significant overall tax savings attributable to (1) paying a portion of the transfer tax on a tax-exclusive basis if the donor lives three years after making the gift, and (2) paying a portion of the transfer tax at a lower rate if the estate tax rate increases above 35% by the time of the donor's death. These savings would have to be offset by the lost time value of the gift tax payment as compared to paying estate tax at a later time (but the growth attributable to the retained gift tax amount would have been subject to estate tax).

C. Significant GST Opportunities. The major year-end planning opportunities relate to GST planning. Opportunities to take advantage of the GST tax not applying to generation-skipping transfers in 2010 are significant. The GST planning opportunities included (1) direct skip gifts for grandchildren (or even for great-grandchildren), (2) making distributions from non-exempt trusts to remote beneficiaries (skip person beneficiaries) without the imposition of a GST tax, or (3) terminating non-exempt trusts in 2010 and distributing assets to younger generation beneficiaries without the imposition of a GST tax. Furthermore, TRA 2010 makes clear that generation-skipping transfers can be made in trust without risking having GST tax apply to later transfers to the oldest generation level skip person beneficiaries of the trust when the transfer was made in 2010.

This opportunity could also be applied to non-married partners where one partner was more than 37.5 years older than the younger partner; transfers could have been made in 2010 to the younger partner without the imposition of the GST tax. (The GST opportunities are discussed in more detail in section VIII of this outline.)

D. Retroactive Legislation Taxing Gifts and GST Transfers in 2010 is Extremely Remote. It seems extremely unlikely that the 2011 Congress will retroactively change the estate, gift and GST tax rules back into 2010, particularly changes that would adversely impact gifts and generation-skipping transfers made in 2010. The fact that Republicans control the House and have picked up more seats in the Senate in 2011 make the likelihood of such possible retroactive legislation, effective back into 2010, so remote as to be nonexistent.

VIII. GST Planning Issues

A. Sunset Rule Uncertainties. The sunset rule changes, discussed above in section IV.H of this outline, remove many of the uncertainties about the GST tax for 2010 and about whether and how the GST relief provisions in EGTRRA (increased GST exemptions, automatic allocation, qualified severances, "9100 relief" for late allocations, etc.) would still be given effect after 2010. Unfortunately, the relief under TRA 2010 only lasts for two years, and all the uncertainty will arise again following 2012. However, TRA 2010 shows how the EGTRRA adverse effects can easily be solved by a legislative change, and making that change is not controversial at all. The sunset as to those favorable provisions will likely be further extended following 2012, and the various estate, gift and GST changes in EGTRRA (other than the repeal of the estate tax with carryover basis and the repeal of GST tax) also will likely be extended permanently. But with Congress, nothing can be certain.

One planning pointer in light of this uncertainty is that planners should not rely on automatic GST exemption allocations under the automatic allocation provisions added in EGTRRA, but instead should file returns making affirmative exemption allocations until the sunset uncertainties of the EGTRRA provisions are resolved.

At the end of 2012, if it appears that the sunset uncertainties of EGTRRA and of TRA 2010 will not be resolved and that there is a possibility that GST exemption allocations in excess of those that would have been allowed under pre-EGTRRA law would no longer be respected so that the inclusion ratio of the trust would no longer be zero, Carlyn McCaffrey suggests the following. Consider decanting the trust assets to a trust that only benefits grandchildren. The decanting distribution would not be subject to GST tax in that year (assuming the inclusion ratio of the trust is still zero in late 2012), and the distribution would cause the move-down rule of § 2653 to apply so that later distributions

to grandchildren from the trust would not be subject to the GST tax. (This is similar to strategies that were used for non-exempt trusts in late 2010 to take advantage of the ability to make distributions from non-exempt trusts without paying GST taxes.)

B. GST Applicable Rate in 2010 is Zero. Chapter 13 applies in 2010 [TRA § 301(a)], but the GST tax "applicable rate determined under section 2641(a)... is zero" for all generation-skipping transfers made in 2010. [TRA 2010 § 302(c).]

1. Impact on Transfers in Trust. The change in nomenclature is particularly important because of its impact on direct skip gifts *in trust* for grandchildren (or more remote beneficiaries). This change clarifies that "direct skip" gifts for grandchildren *to trusts* that were made in 2010 will not result in having the GST tax apply when distributions are made from the trust to the grandchild in later years. This provision replaces § 2664 as added in EGTRRA, which section says that Chapter 13 "does not apply to generation-skipping transfers after December 31, 2009." While § 2664 resulted in a zero GST tax for direct skip gifts in 2010, saying that all of Chapter 13 does not apply raises the possibility that direct skip gifts in trusts may be subject to later GST taxation upon distribution to the beneficiary because the "move-down rule" in § 2653(a), which is in Chapter 13, would not apply. Under the new nomenclature, Chapter 13 (including the move-down rule as well as the rule in § 2642(c) saying that annual exclusion gifts to single-beneficiary vested trusts have an inclusion ratio of zero) does apply to generation-skipping transfers in 2010 (so the potential uncertainty about direct skip gifts to trusts is resolved).

The same issue applies regarding a taxable distribution or taxable termination in 2010 that results in the assets passing to another trust. The move-down rule will apply in that situation as well, because it applies whenever there is a generation-skipping transfer (even though the rate on the generation-skipping transfer in 2010 is zero). I.R.C. § 2653(a).

2. Inclusion Ratio Is Not Automatically Zero for Generation-Skipping Transfers in 2010. Under § 2641(a), the applicable rate is the "maximum Federal estate tax rate" times "the inclusion ratio with respect to the transfer." The statutory language of TRA 2010 § 302(c), that the "applicable rate determined under section 2641(a)" is zero, does not make totally clear whether the "maximum Federal estate tax rate" is deemed to be zero or whether "the inclusion ratio" is zero. The argument could be made that if the result of the multiplication of the maximum estate tax rate times the inclusion ratio is zero, and if the maximum estate tax rate is set by statute, the inclusion ratio must, by basic mathematical principles, be zero. If the inclusion rate is zero for any generation-skipping transfers made in 2010, direct skip gifts (which would be "generation-skipping transfers") would arguably result in a trust with an inclusion ratio of zero for generations to come. However, nothing in the statutory language suggests that is the intended result. Apparently the intent is just to provide that there is no GST tax in 2010 by saying that the applicable rate is zero, without a mathematical exercise of how that is achieved under the statutory formula. The more likely interpretation is that there is no GST tax on generation-skipping transfers in 2010, but transfers to trusts in 2010 do not automatically result in a zero inclusion ratio for the trust. GST exemption would have to be allocated to the transfer to result in a zero

inclusion ratio. The Joint Committee on Taxation Technical Explanation agrees that the inclusion ratio will not be zero, but that the amendment means that the highest estate tax rate that is used in the formula is zero in 2010:

> "...the generation skipping transfer tax rate for transfers made during 2010 is zero percent. The generation skipping transfer tax rate for transfers made after 2010 is equal to the highest estate and gift tax rate in effect for such year (35 percent for 2011 and 2012)." Joint Committee on Taxation Technical Explanation at 50.

In any event, the statute would have been clearer if it had stated that for purposes of § 2641(a), the "maximum Federal estate tax rate" would be deemed to be zero for generation-skipping transfers in 2010.

C. Direct Skip Gifts in Trust. Under TRA 2010, direct skip gifts made to trusts in 2010 do not risk having the GST tax apply when the trust later makes a distribution to a grandchild-beneficiary. Taking advantage of this opportunity required making a transfer that for sure was a direct skip.

1. Outright or Custodianship Gifts. A transfer directly to or to a custodianship for a grandchild (or more remote beneficiary) will clearly be a direct skip.

2. Gifts in Trust. For gifts in trust, the definitional provisions in the GST rules are important.

a. Move-Down Rule. The move-down rule of § 2653 applies if there is a generation-skipping transfer of property (a direct skip, taxable distribution or taxable termination, § 2611(a)) and the property is held in trust. The effect is that for purposes of applying the GST tax rules, the trust will be treated as if the transferor of such property were assigned to one generation above the highest generation of any person who has an "interest" in the trust immediately after the transfer. (If a grandchild has an interest in the trust, the transferor assignment level will be moved down to the child-level so that a subsequent distribution to a grandchild would not be a distribution to someone two or more generations below the transferor that would generate a GST tax.)

b. Skip Person Definition. The key is that for the move-down rule to apply, there must be a distribution to a skip person (whether it is a direct skip, taxable distribution or taxable termination). Skip persons are defined in § 2613. A trust is a skip person if (1) all "interests" in the trust are held by skip persons, or (2) if no person holds an "interest" in the trust and at no time may a distribution (including distributions on termination) be made to a non-skip person. I.R.C. § 2613(a)(2). As to item (2), the regulations add that if no one holds an immediate interest in the trust, for purposes of determining whether any distribution could be made to a non-skip person, a possible distribution that has a probability that is so remote as to be negligible (applying actuarial standards showing there is less than a 5% probability) is disregarded. Treas. Reg. § 26.2612-1(d)(2).

c. Interest Definition. An "interest" in a trust is defined in § 2652(c). A person holds an interest if, at the time the determination is made, the person (1) has a right (other than a future right) to receive income or

corpus from the trust, or (2) is a permissible current recipient of income or corpus. (There are other special rules if the trust is a charitable trust.) I.R.C. § 2652(c)(1). However, an interest that is used primarily to postpone or avoid any GST tax is disregarded. I.R.C. § 2652(c)(2). Also, the fact that a distribution may satisfy another person's support obligation is disregarded if such use is discretionary or is pursuant to a UGMA or UTMA transfer. I.R.C. § 2652(c)(3).

d. Application of Definitions to Trusts. Under these definitions, a trust will be a skip person (and therefore, result in application of the move-down rule) if a second generation below the transferor or more remote beneficiary has a right to receive current distributions or is a permissible current recipient of distributions and if there are no interests held by non-skip persons. If that is the case, it does not matter that non-skip persons may be contingent remaindermen or future beneficiaries. (The possibility that non-skip persons may receive benefits in the future applies under the statute and regulations only if there are no persons that hold interests in the trust when it is created (for example if no distributions can be made to anyone for a period of years).)

e. "Generation Jumping." If the distribution is made to a trust for great grandchildren only, the transferor will be moved down to the grandchild level, so that future distributions to the great grandchildren will not be generation-skipping transfers. Some planners have termed this "generation jumping.""

f. Addition of Upper Generation Beneficiaries at a Later Time. Some planners suggest that some independent party (an independent trust, a trust protector, or anyone other than the donor) could provide that upper level generations could later be added as beneficiaries without causing the trust to lose its status as a skip person trust (which is necessary for the move-down rule to apply). The older generation beneficiaries could only be added at a later time — long enough to provide comfort that such persons could not be viewed as having an interest in the trust currently. (Some planners, for example, suggest waiting five years before upper generation beneficiaries are added.) This would help to counter any argument that the non-skip person should be treated as an intended current beneficiary by implication or under some kind of application of a step transaction theory.

Another possible IRS argument is that nominally named beneficiaries can be ignored under § 2652(c)(2) if the interest is used primarily to postpone or avoid any GST tax. If the grandchild's interest in the trust at the outset is ignored, the trust would have no beneficiaries with current interests, and § 2613(a)(2) says that future contingent beneficiaries are then considered in determining whether the trust is a skip person (but the interest of any person to whom the likelihood of a distribution is so remote as to be negligible [applying actuarial standards showing there is less than a 5% probability] is disregarded, Reg. § 26.2612-1(d)(2)). The IRS may view the children as having contingent future interests, thus causing the trust not to be a skip person at the outset, which would mean that the move-down rule

would not apply, so subsequent distributions to grandchildren or more remote beneficiaries would be subject to the GST tax. There is not much guidance on how the nominal interest test is applied. In Letter Ruling 9109032 the IRS applied the statute to disregard temporary absence of an interest (for one year).

Some planners even suggest that the trust agreement could provide that older generation beneficiaries would automatically become discretionary beneficiaries after a stated period of time — such as five years.) However, other planners prefer a more conservative approach of not adding upper level beneficiaries at a later time.

g. No Current Grandchildren. If an individual has no current grandchildren but wanted to take advantage of the unique opportunity in 2010 to make transfers to direct skip trusts, perhaps the individual could have made transfers to a trust for grandnieces or grandnephews (if the individual had any), or other beneficiaries who are in a generation assignment two generations below the individual. The trust could provide that any future grandchildren would also be potential beneficiaries. However, to avoid the rule disregarding nominal interests, the trust agreement might have provided certain mandatory distributions to the existing grandnieces and grandnephews (or other designated second generation individuals) to avoid an argument that the trust was really just created for the benefit of non-existent grandchildren at the time it was created.

D. Move-Down of Transferor vs. Allocation of GST Exemption to Trust. If the move-down rule applies, the transferor generation assignment is merely moved to one generation above the oldest generation beneficiary of the trust, but the trust does not become fully exempt. For example, if a direct skip is made to a trust for a grandchild, the move-down rule treats the trust as if the transferor were in the child-generation, so that a future distribution to a grandchild (one generation down from the transferor) is not subject to the GST tax. However, a distribution to a more remote beneficiary (whether on termination of the trust or during the term of the trust) would generate a GST tax if no GST exemption has been allocated to the transfer.

On the other hand, if GST exemption is allocated to the transfer, so that the trust results in having a zero inclusion ratio, all future distributions from the trust to any generation levels of beneficiaries would be GST exempt.

Donors in 2010 had to decide whether (a) to make direct skip transfers in trust (which could be unlimited in amount) and forego using up any GST exemption to allocate to the transfer, or (b) to make transfers to GST exempt trusts, which could last for as many generations as would be allowed under the applicable rule against perpetuities, but which would be limited in amounts that be covered by the $5.0 million of GST exemption available in 2010.

E. Taxable Distributions or Taxable Terminations in 2010 Could Be Made Without GST Tax. The Baucus bill would have eliminated the ability to make GST tax-free taxable distributions or taxable terminations from trusts after December 2, 2010. Under TRA 2010, distribution opportunities from non-exempt trusts remain before the end of 2010. As with direct skips, if taxable distributions or taxable terminations result in the assets being held in further trust, the move-down rule applies. Before TRA 2010, it was not

clear that taxable distributions could be made in further trust for trust beneficiaries (for example under a decanting statute or pursuant to discretion granted to the trustee under the trust agreement) without the possible imposition of a GST tax when later distributions were made to those beneficiaries.

F. Timing of Actual Distribution. The direct skip or taxable distribution had to occur *during 2010* to take advantage of the special opportunity available only during 2010 to have a GST tax rate of zero. There is nothing in the statute or regulations about specifically when title must pass under state law to determine when the direct skip, taxable distribution or taxable termination occurs. However, transfers that are mandated under the instrument should be treated as occurring on that date, even if the trustee does not make the physical transfer until a later date. (Otherwise, planners could manipulate the timing of the payment of GST taxes by merely delaying mandated distributions until a later year or years.) Similarly, a specific bequest under a will of a person who dies in 2010, that is vested and is not subject to the discretion of an executor as to the amount of the bequest, should be treated as occurring as of the date of death, even if the executor delays for years in making the physical distribution of assets satisfying the bequest. However, in light of the very special treatment of generation-skipping transfers in 2010, some planners attempted to make physical distribution of the assets, if at all possible, in 2010 in order to avoid any possible argument that the direct skip did not occur in 2010.

Practical Planning Pointer: An important planning implication of the timing issue is that disclaimers in 2011 from 2010 estates that result in assets passing to grandchildren (or younger generation beneficiaries) should be treated as 2010 direct skips resulting in a zero GST tax.

Discretionary distributions, on the other hand, result in generation-skipping transfers occurring on the actual distribution date pursuant to the exercise of discretion.

A case that involved an agreement with the IRS regarding the timing of generation-skipping transfers, albeit in an unusual fact situation, is Robertson v. U.S., 97 A.F.T.R.2d 589 (N.D. Tex. 2006). That case involved a charitable lead annuity trust that passed to grandchildren at the end of the trust term. The trustee had total discretion as to what charities would receive distributions during the term of the trust, so no person held an "interest" in the trust during its stated term. The conclusion was that there was no taxable termination at the end of the stated term, because that required the termination "of an interest in property" and no person held an interest in the trust prior to the stated termination date. Therefore distributions from the trust were treated as taxable distributions. The IRS did not contest the position of the taxpayer that the taxable distributions occurred in the year following the stated termination date of the trust, and the parties stipulated that the date of actual distribution was the appropriate date for valuation of the GST amount and for applying the GST tax rate (the rate decreased in the year following the stated termination date of the CLAT). That stipulation seems to conflict with the generally accepted approach of treating transfers that are mandated in an instrument as occurring on the mandated vesting date.

G. Testamentary Transfers From 2010 Decedents. The possibility that 2010 testamentary transfers are forever exempt from the GST tax was eliminated under TRA 2010 because the estate tax would apply (or be deemed to apply) to 2010 decedents so the decedent would be a "transferor" under the GST definitions. TRA 2010 § 301(c)(last sentence). (Under the provisions of EGTRRA applicable in 2010, there was an argument that

testamentary trusts created by 2010 decedents were exempt from the GST tax, because under the GST rules the "transferor" is the last person subject to a transfer tax, and decedents who die in 2010 were not subject to estate tax [before TRA 2010]. The definitions of skip persons and non-skip persons are tied to the definition of "transferors." Non-skip persons are everyone other than skip persons (§ 2613(b)), and if skip persons cannot be identified because of the lack of a transferor, perhaps the whole world would constitute non-skip persons. If so, future transfers from the trust arguably would not be subject to GST tax.) TRA 2010 clearly removes that argument that had existed under EGTRRA.

H. <u>2010 GST Exemption of $5.0 Million</u>. Under TRA 2010, there is 2010 GST exemption of $5.0 million (because the estate tax exemption in 2010 is $5.0 million and the GST exemption is the same as the estate exemption, § 2631(c)). (Without this legislation, it appears that there was no GST exemption for 2010, because the GST exemption equals the estate tax applicable credit amount and in § 2010(c), as amended by EGTRRA, the table for the applicable credit amount ends with 2009; there is nothing listed for 2010 or beyond. While there was no GST exemption in 2010 under EGTRRA, in 2011 there may have been a GST exemption equal to $1.0 million, indexed for inflation since 1997, depending on how the "had never been enacted" rule was applied. <u>See</u> I.R.C. § 2631(c) (prior to amendment by the 2001 Act). That number was $1.34 million for 2010.

The literal wording of TRA § 301(a) leaves some ambiguity as to whether the $5 million GST exemption applies to estates that make the carryover basis election. The ambiguity arises because if the carryover basis election is made under TRA § 301(c), the "repeal of the repeal of the estate tax" under TRA § 301(a) does not apply, so literally chapter 11 does not apply to the estate. If chapter 11 does not apply, the amendment in TRA 2010 of § 2010 providing a $5.0 million applicable exclusion amount is irrelevant because § 2010 is in chapter 11 and it does not apply. An argument to the contrary is that the election for the estate tax not to apply under TRA § 301(c) applies only "with respect to chapter 11 of such Code and with respect to property acquired or passing from such decedent (within the meaning of section 1014(b) of such Code)," and therefore does not apply for GST purposes. Therefore, the reference in I.R.C. § 2631(c) to the "applicable exclusion amount under section 2010(c)" may continue to refer to the $5.0 million amount. The possibility of having no GST exemption for testamentary transfers in estates making the carryover basis election apparently is unintended (it certainly would be unjust to apply the GST tax scheme to testamentary transfers but not afford an opportunity to use GST exemptions). This result apparently is unintended, and the Joint Committee on Taxation Technical Explanation clearly takes the position that the $5 million GST exemption applies for 2010 decedents whether or not the carryover basis election is made:

> "The $5 million generation skipping transfer tax exemption is available in 2010 regardless of whether the executor of an estate of a decedent who dies in 2010 makes the election described below to apply the EGTRRA 2010 estate tax rules and section 1022 basis rules." Joint Committee on Taxation Technical Explanation at 50 n.53.

Having 2010 GST exemption of $5.0 million is very important for various reasons. First, consider electing out of automatic allocation of the 2010 GST exemption to direct skip gifts. Second, the $5.0 million of GST exemption can be allocated on timely filed returns, based on the values of gifts to trusts on the dates of the gifts in 2010.

1. Elect Out of Automatic Allocation for Direct Skip Transfers in 2010. The change in nomenclature in TRA 2010 to avoid saying that chapter 13 does not apply to GST transfers in 2010 has two important implications for direct skip gifts in trust: (1) Automatic allocation of GST exemption to the direct skip will occur under § 2632(b)(1) to the extent necessary to result in a zero inclusion ratio for the transfer unless there is an election out of such automatic allocation; and (2) the move-down rule of § 2653(a) will apply and the zero inclusion rule under § 2642(c) for single beneficiary-vested annual exclusion gifts in trust will apply, so that future distributions to the grandchild-beneficiary of the trust will not be subject to the GST tax. These effects are discussed below.

   There is generally automatic allocation of any unused GST exemption to direct skip gifts (whether or not in trust). I.R.C. § 2632(b)(1). Such automatic allocation to direct skip gifts can be avoided by electing out of automatic allocation on a timely filed gift tax return. I.R.C. § 2632(b)(3); Treas. Reg. § 26.2632-1(b)(1).

   Under TRA 2010, the nomenclature that chapter 13 does not apply has been dropped, so § 2632(b)(1) would apply to all direct skips, whether or not in trust, but only "to the extent necessary to make the inclusion ratio for such property zero." Therefore, automatic allocation will apply for direct skips generally (whether or not in trust), but will not apply to annual exclusion gifts to single beneficiary-vested trusts, because the inclusion ratio for such transfers is already zero under I.R.C. § 2642(c). (Under the law before TRA 2010, the same result may have occurred for direct skips in trust, though under a much more convoluted analysis. Under EGTRRA, chapter 13 does not apply to direct skips, so the automatic allocation rule of § 2632(b)(1) would not apply. However, under the sunset rule of EGTRRA (before it was amended by TRA 2010), the Code would be interpreted as if EGTRRA had never been enacted with respect to future generation-skipping transfers, so the chapter 13 rules would be applied to have allocated GST exemption automatically to direct skip trusts when a later taxable distribution or taxable termination occurs with respect to that trust.)

   TRA 2010 makes clear that the move-down rule of § 2653(a) would apply to direct skip gifts in trust in 2010. For example, if a direct skip gift is made in trust for the donor's grandchild, the move-down rule would cause the generation assignment of the transferor to be the grandchild's parent's generation, so that subsequent transfers to the grandchild-beneficiary would not cause a GST tax to apply. In that circumstance, GST exemption that is automatically allocated to the trust would have been wasted if it is likely that distributions from the trust will ultimately be made to the grandchild-beneficiary. (On the other hand, if the intent is to keep the trust intact for the grandchild's descendants, allocation of GST exemption to the trust may be appropriate and desirable.)

   Practical Planning Pointer: Planners must carefully examine all direct skip gifts in 2010 (whether or not in trust and whether inter vivos or by testamentary transfers) to determine whether a timely filed tax return should be filed electing out of automatic allocation.

2. Timely Allocation of 2010 GST Exemption. If a timely allocation is made, the GST exemption allocation is made effective as of the date of the gift using values on that date. § 2642(b)(1)(B). Late allocations are effective as of the date of the

allocation, § 2642(b)(3)(B), or as of the time the late allocation is made in 2011 (using values on that date, thus requiring allocation of GST exemption to the appreciation occurring up to that date). A late allocation cannot be filed until April 19, 2011 at the earliest (the due date is April 18). If the donor's income tax return is extended, that automatically extends the gift tax return as well to October 15 (or October 17 in 2011). In 2011, a late return for the October deadline could not be filed until October 18, 2011. Before TRA 2010, there was no GST exemption in 2010 and it was unclear under the sunset rule whether 2010 GST exemption would be deemed to have existed with respect to generation-skipping transfers occurring after 2010. If there was no 2010 GST exemption, there would be a necessity of waiting to file a late allocation of 2011 GST exemption, based on the appreciated values at the time of the allocation. Fortunately, that potential problem has been resolved by TRA 2010.

I. 2010 Transfers Not Grandfathered. Transfers to trusts in 2010 are not grandfathered or exempt from the GST tax. Trusts with contributions in 2010 will be GST exempt only if GST exemption is allocated to those transfers.

J. Provides Clarity Regarding ETIPs. GST exemption cannot be allocated to transfers subject to an "estate tax inclusion period" (or ETIP) during which the assets would be included in the gross estate of the transferor (or his or her spouse). § 2642(f). An example is a transfer to a GRAT, because some or all of the trust may be included in the transferor's gross estate if he or she dies during the GRAT term. GST exemption can be allocated at the end of the ETIP, and indeed there are rules for automatically allocating GST exemption at the end of the ETIP in certain situations. *See* Treas. Reg. § 2632-1(c). Various uncertainties about ETIPs arose in light of the repeal of the estate tax following 2009 under EGTRRA. Prior to TRA 2010, chapter 11 did not apply under EGTRRA after 2009 so arguably ETIPs ended as of January 1, 2010 because the trust assets would not have been included in the transferor's gross estate if he or she died after 2009. There were questions as to whether the ETIP would be reinstated at the end of 2010 when the EGTRRA sunset occurred and the estate tax would again apply. If the ETIP terminated on January 1, 2010, could GST be allocated when the ETIP terminated in 2010 — even though there was no GST exemption for 2010 before TRA 2010? TRA 2010 appears to remove many of the uncertainties, at least for two years. It provides that the estate tax did continue to apply after 2009 (subject to the election of carryover basis instead). Therefore, ETIPs did not end on January 1, 2010 but continue without interruption. This result apparently is not impacted by whether the carryover basis election is made for 2010 decedents. The Joint Committee on Taxation Technical Report states that making the carryover basis election "will have no effect on the continued applicability of the generation skipping transfer tax," and the ETIP rules are part of the generation-skipping transfer tax provisions. Because TRA 2010 only applies for two years (see section IV.H of this outline), uncertainty will exist again regarding ETIPs on January 1, 2013 absent further legislation.

IX. Construction Issues

A. Formula Bequests. The change in the law raises various potential construction issues in construing formula bequests. (For an excellent discussion of similar construction issues that arose during the 2010 estate tax hiatus, see Medlin, Zaritsky & Boyle, Construing Wills and Trusts During the Estate Tax Hiatus in 2010, 36 ACTEC L.J. 273 (2010).) For example, consider the effect of TRA 2010 in construing several possible types of formulas,

keeping in mind that the estate tax and the $5 million applicable exclusion amount apply from January 1, 2010.

- "Maximum amount that can pass free of estate tax" now appears to mean $5 million rather than the entire estate.
- "An amount equal to the federal estate tax applicable exclusion amount" now appears to mean $5 million rather than zero.

However, while the law seems to say that the amount passing under each of those formulas would be $5 million for decedents dying any time in 2010, there are various uncertainties. Observe that the resolution of each of these issues is a matter of state law, and as a practical matter will be determined in each separate case based on the equities of the case and what the parties can convince the court to be the testator's intent.

1. <u>Does Decision to Make Carryover Basis Election Change Construction</u>? Does the construction of the formula change if the executor makes the carryover basis election? In that event, TRA 2010 § 301(c) says that the "repeal" of § 2210 in TRA 2010 § 301(a) does not apply, so Chapter 11 does not apply, so the amended § 2010(c) changing the applicable exclusion amount to $5 million for 2010 does not apply. If making the carryover basis election changes the formula bequest, the executor not only has to make decisions of whether the overall tax result is better to apply carryover basis than the estate tax (which depends on a variety of factors, some of which are mentioned in section IV.B.2 of this outline) and how to treat beneficiaries fairly in implementing carryover basis and making the basis adjustments, but the executor also has to consider that the election may drastically change the amounts of the bequests passing under the will. A further complexity is that the due date of the carryover basis election is not described in the statute but will be provided in guidance from the IRS (see section IV.B.2 of this outline). It is possible the election will not be made until the fall of 2011, and the election could conceivably change the construction of the values of bequests assets passing under the will of a decedent who died perhaps over 20 months earlier.

   If there is any possibility that the election may impact the amounts of bequests under the will, attempt to get consents of all of the parties or court approval of the election decision. (Equitable adjustments among the parties may be appropriate.) One Wall Street Journal commentator observed: "There's another word for an executor who gets to choose how much money a beneficiary receives — defendant."

   Making the carryover basis election may also impact how assets pass under estate planning documents with formulas if the decedent lived in one of the twenty states with construction statutes giving guidance how to interpret formula distributions for 2010 decedents. See section IX.B of this outline for further discussion of how the election may have an impact under those statutes.

2. <u>Do Interests Passing Under Will Vest as of Date of Death Under State Law</u>? The change in the law could be almost twelve months after the date of death in 2010 and arguably should not change the amounts passing under the will. Some state laws provide that assets passing under a will vest as of the moment of death, subject to the administration of the estate.

3. What if Assets Have Been Distributed? Does it make a difference if bequests have already been funded? Changing the construction based on the new law, which is now effective as of January 1, 2010, may require that beneficiaries refund previously distributed amounts. Will that change the court's interpretation of the formula bequests?

4. Practical Scenario. Assume a fairly typical scenario of a situation in which the decedent's children are not children of the surviving spouse and are hostile to the surviving spouse. Assume the will provided that the formula "tax-free" amount passes directly to the children and that the balance of the estate passes to the spouse. Assume the local court determines that amounts passing under the formula bequest depend on the carryover basis election. This means that if the executor makes the carryover basis election, in which event chapter 11 does not apply, the entire estate would pass to the children, but if the executor does not make the carryover basis election, only $5 million passes to the children and the balance passes to the surviving spouse. Assume the executor does not make the carryover basis election, so most of the estate passes to the surviving spouse. Later the children sue, and assume the court construes the formula bequest to mean that all of the estate passed to the children. That state law ruling would mean that although the estate is subject to the estate tax, nothing qualifies for the marital deduction. Furthermore, it may be too late at that point (perhaps several years later) to change the decision not to make the carryover basis election. TRA 2010 § 301(c) states that the carryover basis election

> "shall be made at such time and in such manner as the Secretary of the Treasury or the Secretary's delegate shall provide. Such an election once made shall be revocable only with the consent of the Secretary..."

Perhaps that would be a situation in which the IRS would permit a change in the election. Does it make a difference that in this circumstance, the executor chose not to make the election so perhaps did not file anything making an affirmative election but merely filed a timely estate tax return? (The statute, quoted above, says that an election into carryover basis is revocable only with the Secretary's consent, and in this scenario there was never an election into carryover basis.)

B. Construction in States With Legislation Tying Formula Bequests to 2009 Law. Twenty states (including the District of Columbia) have statutes regarding the construction of formula "tax-free" bequest clauses for 2010. A number of those state statutes refer to estate tax rules on December 31, 2009. (Those states are Delaware, District of Columbia, Georgia, Idaho, Indiana, Maryland, Minnesota, Michigan, Nebraska, New York, North Carolina, Pennsylvania, South Dakota, Tennessee, Utah, Virginia, Washington, and Wisconsin. In addition Florida and South Carolina have "go-to-court" statutes that do not specifically apply 2009 law.) Will formula "tax-free" bequests in those states mean that $3.5 million continues to pass under the clause rather than $5 million that could pass without estate tax under TRA 2010? Most of those statue statutes say that the special construction applies only for 2010 decedents, but if the federal estate or generation-skipping transfer tax becomes effective before January 1, 2011, the statute will no longer apply as of the date the tax becomes legally effective. (A bill was introduced January 20, 2011 in Virginia providing that, among other things, [1] the formula in a will or trust would mean $5 million, whether or not the carryover basis election is made, [2] that

extrinsic evidence would be admissible for 2010 decedents to determine the testator's intent in a proceeding commenced any time before January 1, 2012, even if it contradicts the plain meaning of the document, and [3] that interested persons may enter a binding agreement regarding the construction of the instrument and may seek court approval of the agreement.)

Various uncertainties will apply in these states in light of the changes by TRA 2010.

- If the state has passed a statute providing that formula bequests are construed as if 2009 law applied, will the bequest of the tax-free amount be limited to $3.5 million even though $5.0 million could pass to the bypass trust without incurring estate tax?
- Will state legislatures change their construction statutes?
- Will courts construe the formula to mean $5.0 million despite the state statute?
- For purposes of the sunsetting provision in a state construction statute, does TRA 2010 cause the federal estate tax to be legally effective as of January 1, 2010 so that the sunsetting provision applies as of January 1, 2010, meaning that the state construction statute does not apply at all?
- Does the carryover basis election change the result? (For example, if the carryover basis election is made, the estate tax does not apply so the state statute says the tax-free amount means $3.5 million, but if there is no election, the estate tax does apply as of January 1, 2010 so the state construction state does not apply and the tax-free formula means $5 million.)
- Observe the difficulty the executor faces isn addressing this uncertainty. If the tax-free formula bequest is $5 million if the estate tax applies but $3.5 million if carryover basis applies, Howard Zaritsky concludes: "Would you want to be that executor?"
- Many of statutes allow estates to bring a legal proceeding to ascertain whether the decedent intended to apply 2009 law in determining the amount passing under the formula, but require that "such a proceeding shall be commenced within 12 months following the death of the testator or grantor" (quoting the Virginia statute). For decedents who died in early 2010, that one-year limit is fact approaching. (Some states, such as Virginia as discussed above, are considering amending their statutes to allow a longer time to bring such suits, such as through the end of 2011.)

C. Formula Bequests Equal to GST Exemption Amount. The specific language used in a GST formula transfer must be closely reviewed to determine the effect of TRA 2010 on the formula for 2010 transfers. For example, if the formula transfer applies "if Chapter 13 does not apply," that clause arguably is not triggered in light of TRA 2010, because it says that Chapter 13 *does* apply for all of 2010 (but the GST rate is zero). If the formula is an "amount that can pass free of GST tax," that might be everything passing under the instrument if the distribution is a direct skip in 2010. If the formula is an "amount equal to the GST exemption," that would be $5 million in 2010 under TRA 2010. That would be the starting point of the analysis, but this is still a state law construction issue, depending on the court's interpretation of the intent of the specific instrument and the donor.

X. Planning Strategies Going Forward Regarding Untimely 2010 Gifts

A donor who made gifts in 2010 and would pay a 35% gift tax may prefer to "undo" the 2010 transfer and instead make the transfer effective in 2011 when there is a $5 million gift exemption.

(If the client can afford to make gifts with other assets in 2011 to utilize the $5 million gift exemption amount, there is no real problem with having made gifts and paying gift tax in 2010. If the donor lives at least three years, there is the advantage of taxing the transfer on a tax exclusive basis.)

A. Decision Tree. A possible plan of attack is first to consider disclaimers, and if that is not available, consider rescission. Do not give up easily on "self-help" to undo the 2010 gift.

B. Disclaimers of 2010 Gifts. Is a disclaimer possible? (The extended time period for making disclaimers only applies to estates of decedents who died before December 17, 2010. It does not apply to disclaimers of gifts.)

Has the donee accepted the property so that a disclaimer is no longer available? The IRS may be more generous than in the past in determining what constitutes acceptance, in light of the totally unforeseen legislative change extending the time for the disclaimer. "Merely taking delivery of an instrument of title, without more, does not constitute acceptance." Treas. Reg. § 25.2518-2(d)(4). Perhaps depositing a check in one's account may be allowed, but receiving interest or dividends or selling the asset or spending the proceeds would not be. If the donee reverses the transfer, perhaps any purported acceptance would be negated. Look carefully at state law. File a Form 709 to report the disclaimer as a non-gift transaction. That starts the statute of limitations as to whether the transfer has gift consequences for that year. (One accountant reports that she always files Form 709s for disclaimers to report them as non-gift transactions.)

Determine where the disclaimed property will pass under local law. There may be a different result in different states. Look at all relevant states to see if there are differences of whether property would pass. If the assets do not pass back to the donor as a result of the disclaimer, a disclaimer will not "undo" the 2010 gift. Gifts to trusts are particularly suspect; the disclaimed assets may not return to the settlor but to other trust beneficiaries. *See generally* Handler & Chen, *Formula Disclaimers: Procter-Proofing Gifts Against Revaluations by Service,* 96 J. TAX'N 231 (April 2002).

Apply relevant conflict of laws principles to determine which state's law applies. (For testamentary transfers, it may be more likely that the law of the transferor's domicile would apply than for inter vivos transfers. For gifts, the law of the donee's domicile may apply.)

C. Rescission. If a disclaimer will not work, consider rescission of the 2010 gift. If a gift is made under a mistake of a material fact, rescission may be possible under state law if the donees have not substantially changed their position in a way that would make the rescission unconscionable.

The question is whether a business judgment of what legislation may or may not pass in the future is a mistake of fact or just an error of judgment. The most recent rescission case, *Breakiron v. Guidonis*, 106 A.F.T.R.2d 2010-5999 (D. Mass. 2010). allowed rescission of a disclaimer from a QPRT on the basis of a mistake of law as to the effect of the untimely disclaimer. In *Neal v. United States*, 187 F.3d 626 (3rd Cir. 1999). the donor relinquished a retained power to avoid triggering the old § 2036(c), which was later repealed retroactively. *See also* Berger v. United States, 487 F. Supp. 49 (Pa. 1980) (rescinded gift not taxed); *cf.* Rev. Rul. 80-58, 1980-1 C.B. 181; Ltr. Ruls. 200613027, 200701019, 200911004 (income rulings relying on rescissions to undo transactions).

Rescissions have generally relied on a retroactive change in law or bad advice; no case has been located based on a wrong guess of what the law would be in the following year. Perhaps the mistake in *Neal* of not knowing that § 2036(c) would be repealed retroactively is analogous to not knowing that the gift exemption would be increased substantially for the following year.

The notion that rescissions are respected only if they occur in the same taxable year is an income tax concept. *See* Rev. Rul. 80-58, 1980-1 C.B. 181 (rescission occurring in same year as taxable event is respected if parties are returned to their original positions). Completing a rescission in 2011 of a 2010 transaction may still be recognized for transfer tax purposes.

XI. Estate Planning Strategies Going Forward To Utilize Increased $5 Million Gift Exemption in Light of Changed Planning Paradigm Under Under TRA 2010

The $5.0 million estate and gift exclusion amount (and GST exemption) beginning in 2011 will open up a new paradigm of thinking regarding estate planning and transfer planning strategies. The ability to make transfers of up to $10 million per couple without having to pay gift taxes paves the way for many transfer planning opportunities that, with leveraging strategies, can transfer vast amounts of wealth outside the gross estate. On the other hand, the increased estate exclusion amount may remove the motivation for many clients to do any transfer planning if their estates are lower than that amount.

A. Categorizing Client Situations. Planners will need to apply a triage approach to considering client situations. Taxpayers with estates well over $5 million ($10 million for couples) will probably continue to be interested in sophisticated transfer planning, and to take advantage of what may be just a window of opportunity to do transfer planning with a $5 million gift exclusion and $5 million GST exemption amount.

Married couples with estates approaching $10 million may feel that they no longer have estate tax concerns or need sophisticated estate planning. However, those clients should be cautioned that the $5 million exclusion was very contentious in this Congress and it make not be renewed in two years. Furthermore, future growth in the estate may take the client well above the estate tax threshold amount. These clients will likely be interested in transfer planning strategies but may be comfortable using simpler more straightforward strategies.

Couples with estates under $3-5 million or even more may feel comfortable that the combined exclusions of both spouses (perhaps using portability) takes them out of having estate tax concerns, particularly taking into account that the couple may anticipate depleting the estate through living expenses. They may have no interest in any transfer planning at this point. They may even decide to stop making annual exclusion gifts or to drop insurance that was acquired for paying estate taxes. They may want to "undo" prior transactions that may have the effect of creating valuation discounts because of the impact they may have on limiting a basis step-up at death. Again, those clients should be cautioned that the $5 million estate exclusion is not permanent.

Planners must counsel clients about the current law and possible changes in two years, and gauge the clients' appetite for further planning and the level of sophistication in planning that is acceptable. Clients should be advised of the extreme degree of uncertainty in our estate tax system. If Congress comes to loggerheads again in late 2012 (like it did at the end of 2009 regarding the estate tax), there is the possibility of returning to a $1 million

exemption system with a 55% rate. The next two years provide what may turn out to be a narrow window of opportunity.

B. Overview and Brief Summary of Tax Effects. The ability to move $5 million per individual ($10 million per couple) out of the gross estate opens up the possibility for many individuals to transfer as much as they would want to transfer to their descendants during life without any gift tax concerns.

The tax effects of gifts are summarized in sections IV.D-E of this outline. The following is a brief summary.

A donor can make gifts of the full additional gift exemption amount without paying gift tax. (See section IV.D.3-4 of this outline.) Gifts are not removed from the base for calculating estate tax, but making gifts does not result in increasing the aggregate combined transfer taxes. (See section IV.E.5.d of this outline.) Despite the fact that gifts are included in the base for calculating the estate tax, tax advantages of making gifts include removal of appreciation/income of gift assets from the gross estate, utilizing fractionalization discounts, paying income taxes on income from grantor trusts to further "burn" the donor's gross estate, removing gift taxes paid from the gross estate if the donor lives three years, and the ability to allocate GST exemption so that the same advantages apply for generation-skipping purposes as well. Those are tax advantages. Of course, the biggest advantage may be the ability to shift assets to other persons so they can enjoy, consume or otherwise use the assets currently. Gifts can be disadvantageous from an overall tax cost perspective if a) the gift asset declines in value after making the gift (which uses up gift exclusion based on the date of gift value), or b) if the loss of a basis step-up more than offsets the estate tax savings as a result of removing appreciation/income from the asset and the other advantages of gifts listed above. (See section IV.E.5.g of this outline.)

If the estate tax exemption amount is reduced below the current gift exemption amount, there is a possible "clawback" effect of having to pay estate tax on the excess gift exemption amount. (For example, if the estate tax rate increases to 45% and if the exemption decreases to $3.5 million, the tax exposure hinging on this issue is $675,000 (i.e., $1.5 million x 45%. See section IV.E.5.h of this outline.)

If the estate would otherwise pass to a surviving spouse or charity, the additional tax is dramatic because the tax itself does not qualify for the marital/charitable deduction and an interrelated calculation significantly increases the tax cost. For example if there is a $5 million gift in 2011 and the donor dies in a year in which the estate tax exemption is reduced to $3.5 million and the rate is increased to 45% and if the donor's will leave the entire estate to a surviving spouse or charity, the estate tax will be $1,227,272.73. (See sections IV.E.3.Ex.2 and IV.E.5.i of this outline.) (See section IV.E.5(i) of this outline, in conjunction with section XI.N of this outline, for a strategy to avoid this added estate tax at the first spouse's death if clawback were to apply.)

Even if the "clawback" applies, the estate will not pay more taxes as a result of making the gift than if the gift assets had been retained (unless the gift assets were to decline in value). In a marital/charitable plan, there may be estate taxes payable, but those same taxes would have been payable if the gift assets had been transferred to the gift donees at death. There is a general belief that the estate tax "clawback" will not occur. Congressional staffers have indicated that it is not intended, and IRS guidance or further

congressional technical corrections could make that clear. (See section IV.E.5.h of this outline.)

If a clawback of estate tax on the excess exemption amount should occur, the additional estate taxes probably cannot be apportioned against the donees, except in a state where the state apportionment statute allows apportionment against gift donees. (See sections IV.E.4 and IV.E.5.l of this outline.) If the donor dies within three years of making the gift, IRS liens can reach the gift property. § 2035(c)(1). The donees could contractually agree to pay the additional estate tax under an arrangement similar to a net gift agreement, but that contractual obligation would likely allow the IRS to pursue the estate's claim against the donees to collect the estate tax.

If the donor pays gift taxes, the gift taxes are included in the gross estate if the donor dies within three years. Even in that situation, the gift tax merely "prepays" the transfer tax. If the estate tax rate is later increased above the gift tax rate that applied at the time of the gift, there will be savings equal to the amount of the gifts in excess of the gift exclusion amount times a percentage equal to the difference between the marginal estate tax rate and the marginal gift tax rate. (See section IV.E.5.k of this outline.) If the donor lives at least three years after making a gift, any gift taxes paid on the gift will be removed from the gross estate for estate tax purposes.

C. How Much Can the Donor Afford or Want to Give? While substantial additional gifts can be made without having to pay gift taxes, the initial question is how much can the donor afford to or want to give? The increased estate exemption may mean that the donor is not as concerned about estate taxes as in the past. However, TRA 2010 only lasts for two years and the estate exemption could be decreased in future years; alternatively, the estate exemption could be increased or the estate tax could be repealed in future years in which event the donor may preferred to have retained the gift assets.

Spouses collectively could give up to $10 million without having to pay gift taxes. Few couples can afford to give $10 million without potentially impacting their lifestyle in later years. A primary concern will be "will I have enough left to live on?" How does one define what are "discretionary" assets? That is not for the planner to define. It is not the actual ability to make a gift that matters — it is the *perceived* ability to make a gift and maintain one's standard of living into the foreseeable future that matters. As a result, donors interested in making large additional gifts may want to consider the possibility of ways to preserve direct or indirect access to gift assets in the event of a "rainy day" financial reversal (strategies are discussed below).

D. Gift Splitting. If one spouse has most of the marital wealth, the couple can still take advantage of both spouses' $5 million gift exemptions by making the split gift election. § 2513. This can achieve the advantages of gifts with respect to $10 million worth of gifts instead of just $5 million.

A consenting spouse should be aware of possible effects of consenting to the election. Indeed, it may be appropriate to compensate the spouse for consenting to split gift treatment or it might be appropriate to amend a premarital agreement. For example, in return for agreeing to the split gift treatment, the donor spouse may agree that the consenting spouse can have the residence and leave it to anyone he or she wishes.

Fortunately, the election is just effective for gift and GST purposes (*see* § 2652(a)(2)), not for the purpose of treating the consenting spouse as the transferor for applying the estate

tax "string" statutes. *See, e.g.*, Rev. Rul. 82-198, 1982-2 C.B. 206; Rev. Rul. 74-556, 1074-2 C.B. 300. However, possible bad effects may result for the consenting spouse.

- At the consenting spouse's death, one-half of the gift assets will be added to the estate as adjusted taxable gifts, and the estate tax calculation operates in a manner that the consenting spouse's gift exclusion utilized in the split gift will effectively use up the consenting spouse's estate tax exclusion amount as well. (If the estate tax exclusion amount has decreased by the time the consenting spouse dies and if there is a "clawback" of the excess of the gift exemption used by the spouse over the estate exemption as discussed in sections IV.E.B and IV.E..5.h of this outline, this could result in additional estate taxes being payable by the consenting spouse's estate even if all of the estate is passing to a surviving spouse.)
- If the gift is included in the donor-spouse's gross estate under some section other than § 2035 (for example, a QPRT may be included under § 2036), both halves would be included in the donor-spouse's estate because the donor is treated as the transferor of both halves for estate tax purposes, but the consenting spouse's unified credit is not restored. If the assets are included in the donor spouse's gross estate under § 2035, the consenting spouse does not have to include one-half of the gift as an adjusted taxable gift under the estate tax computation, but that only applies if the asset is included in the estate under § 2035. I.R.C. § 2001(e).
- If the gift is included in the donor's gross estate under § 2035, the consenting spouse does not have to include one-half of the gift as an adjusted taxable gift under the estate tax computation, but the consenting spouse's gift tax unified credit is not restored for purposes of later gifts by the consenting spouse.

If there is any risk that the gift assets may be included in the donor spouse's estate under any of the string statutes, the spouse should be especially cautious about whether to consent to split-gift treatment. *See generally* Zeydel, *Gift-Splitting — A Bondage of a Bad Idea? A Comprehensive Look at the Rules*, J. Tax'n (June 2007). In light of these potential adverse affects for the consenting spouse, consider whether the consenting spouse should have separate counsel in considering whether to consent to split gift treatment.

E. "Rainy Day Fund" Considerations; Lifetime Credit Shelter Trust for Donor's Spouse. The donor may wish to make gifts in a way that the donor (or the donor's spouse) could retain some use of the assets in case needed as a "rainy day" fund. A popular way of using the increased gift exemption may be for a donor to make gifts to a "lifetime credit shelter trust" for the benefit of the donor's spouse. The trust would be for the benefit of the donor's spouse, containing very similar terms as in standard credit shelter trusts created in wills. In some ways, this is the ideal kind of trust for the spouse because the spouse is a discretionary beneficiary, can be the trustee, can have a limited power of appointment (exercisable at death or in life), and the trust may be protected against claims of both the donor's and spouse's creditors. The power of appointment could be broad enough to appoint the assets back to the donor. (Exercising the power of appointment in the donee-spouse's will to include the donor-spouse as a discretionary beneficiary should not cause inclusion in the donor-spouse's estate under § 2036(a)(1) if there was no pre-arrangement, but that might not prevent the donor's spouse's creditors from being able to reach the trust assets unless the trust is created in a self-settled trust jurisdiction, as discussed in section XI.F of this outline, below. Another way of addressing the donee-spouse predeceasing the donor would be to have some life insurance on the donee-spouse payable to the donor or a

trust for the donor-spouse that has substantially different terms than this trust, as discussed in section XI.F of this outline.) If the donor were concerned about how the donee-spouse might exercise the power of appointment, the instrument could provide that the power of appointment could be exercised by the spouse only with the consent of a non-adverse third party (such as the grantor's sibling), and the instrument could even provide that the third person's consent would be required in order for the donee-spouse to change an exercise of the power of appointment. The trust could define the "spouse" to be the person to whom the grantor is married to at the time without causing estate inclusion in the donor's estate so that the trust could also be available for the benefit of a new spouse. *See* Estate of Tully Jr. v. United States, 528 F.2d 1401 (Ct. Cl. 1976) (power to alter death benefit plan by terminating employment or divorcing wife not a §2038(a)(1) power); Rev. Rul. 80-255, 1980-2 C.B. 272 (including settlor's after-born and after-adopted children as additional beneficiaries is not the retention of a power to change beneficial interests under §§ 2036(a)(2) or 2038). With this approach, the trust could still be used for the "marital unit" if the client has concerns that large gifts may unduly impoverish the donor and his or her spouse, but the assets would not be included in the gross estates of the donor or the donor's spouse. Such a trust would likely be a grantor trust as to the spouse under § 677 (unless the consent of an adverse party were required for distributions to the spouse).

F. "Rainy Day Fund" Considerations; Lifetime Credit Shelter "Non-Reciprocal" Trusts. Some clients may want to go further and have each of the spouses create credit shelter trusts for the other spouse; the issue would be whether such trusts could be structured to avoid the reciprocal trust doctrine and therefore avoid estate inclusion in both spouses' estates.

If A creates a trust for B, and B creates a trust for A, and if the trusts have substantially identical terms and are "interrelated," the trusts will be "uncrossed," and each person will be treated as the grantor of the trust for his or her own benefit. In *United States v. Grace*, 395 U.S. 316 (1969), the trust terms were identical, the trusts were created at the same time, and the trusts were of equal value. The Supreme Court said that the primary factor in determining whether trusts are sufficiently interrelated is "whether the trusts created by the settlors placed each other in approximately the same objective economic position as they would have been in if each had created his own trust with himself, rather than the other, as life beneficiary." If the terms of the two trusts are not substantially identical, the reciprocal trust doctrine does not apply. *See* Estate of Levy v. Commissioner, 46 T.C.M. 910 (1983) (one trust gave broad inter vivos special power of appointment and other trust did not); Letter Ruling 200426008 (citation to and apparent acceptance of *Estate of Levy*; factual differences between the trusts included (a) power to withdraw specified amounts after one son's death, and (b) several powers of appointment, effective at specified times, to appoint trust principal among an identified class of beneficiaries). Another possible distinction would be for one trust to include the donor's spouse as a discretionary beneficiary but the other trust would merely give an independent party, perhaps after the passage of some specified time, the authority to add that donor's spouse as a discretionary beneficiary. For an extended discussion of the reciprocal trust doctrine in the context of spouses' creating lifetime QTIP trusts for each other, see Gans, Blattmachr & Zeydel, *Supercharged Credit Shelter Trust*, 21 PROB. & PROP. 52, 57-60 (July/August 2007).

The *Grace* case involved reciprocal interests rather than powers. Subsequent cases have differed as to whether the reciprocal trust doctrine also applies to powers that would cause

estate inclusion under section 2036(a)(2) or 2038. Estate of Bischoff v. Commissioner, 69 T.C. 32 (1977) (reciprocal trust doctrine applied to section 2036(a)(2) and 2038 powers); Exchange Bank & Trust Co. of Florida v. U.S., 694 F.2d 1261 (Fed. Cir. 1984); Tech. Adv. Memo. 8019041 (applied doctrine to trusts created by two brothers naming each other as trustee with broad distribution powers); *but see* Estate of Green v. Commissioner, 68 F.3d 151 (6th Cir. 1995) (reciprocal trust doctrine did not apply to powers).

If trusts of unequal value are reciprocal, the values to be included in either grantor's estate under the reciprocal trust doctrine cannot exceed the value of the smallest trust. Estate of Cole v. Commissioner, 140 F.2d 636 (8th Cir. 1944).

G. "Rainy Day Fund" Considerations; Discretionary Trusts in Self-Settled Trust States. Self-settled trusts may be considered in jurisdictions that allow distributions to the settlor in the discretion of an independent trustee without subjecting the trust to claims of the settlor's creditors (and therefore estate inclusion). This will raise the issue of whether a client can create a trust, with the possibility of it serving as a "rainy day fund" in the unlikely event that financial calamities occur, without triggering § 2036(a)(1) (a transfer with an implied agreement of retained enjoyment).

Twelve states have adopted varying approaches regarding "self-settled spendthrift trusts": Alaska, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, and Wyoming. Self-settled trusts, with the grantor as a discretionary beneficiary, can be used to overcome the concern of some clients that they will run out of money. Establish the trust in one of those states so that creditors do not have access to the trust. This will help alleviate concerns that § 2036 may apply to the trust. Furthermore, the trust could be structured to include only the settlor's spouse as beneficiary as long as the settlor is married — so that the settlor is not even a direct beneficiary as long as he or she is married. The potential § 2036 concern could be further ameliorated by giving someone the power to remove the settlor as a beneficiary, and that power could be exercised when the settlor is near death. Whether a retained enjoyment exists under § 2036 is tested at the moment of death, and § 2035 should not apply because the settlor has nothing to do with removing himself or herself as beneficiary (as long as there is no prearrangement). *See* Tech. Adv. Memo. 199935003 (§ 2035 will apply if pre-planned arrangement).

Private Letter Ruling 200944002 recognizes that transfers to the trust (apparently under Alaska law) are completed gifts, even though the grantor is a discretionary beneficiary, because he cannot revest beneficial title or change the beneficiaries. (Various cases have held that there is no completed gift if the settlor's creditors can reach the trust, but this Alaska trust was protected from the settlor's creditors.) The ruling also discussed § 2036. The "trustee's authority to distribute income and/or principal to Grantor, does not, by itself, cause the Trust corpus to be includible in Grantor's gross estate under § 2036" as long as state laws provide that including the grantor as a discretionary beneficiary does not cause the trust to be subject to claims of the grantor's creditors. However, the ruling expressly declined to give an unqualified ruling and noted that the discretionary authority to make distributions to the grantor "combined with other facts (such as, but not limited to an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust's assets in Grantor's gross estate for federal estate tax purposes under § 2036." While this is only a private letter ruling that cannot be relied on by other taxpayers, it is comforting that PLR 200944002

relied on a published ruling. Revenue Ruling 2004-64, 2004-2 C.B. 7, holds that a discretionary power of a trustee to reimburse a grantor for paying income taxes attributable to a grantor trust, whether or not exercised, would not cause inclusion in the gross estate under § 2036. However, Revenue Ruling 2004-64 observes (in Situation 3 of that ruling) that giving the trustee the discretion to reimburse the grantor for income taxes attributable to the grantor trust may risk estate inclusion if there were an understanding or pre-existing arrangement between the trustee and the grantor regarding reimbursement, or if the grantor could remove the trustee and appoint himself as successor trustee, or if such discretion permitted the grantor's creditors to reach the trust under applicable state law.

The ruling does not address the result if the grantor is not a resident of Alaska. There is authority supporting the view of various commentators that the analysis applies even if the grantor does not reside in the state in which the trust is created. *See* Letter Rulings 9332006 (U.S. grantors created self settled spendthrift trusts under the laws of a foreign country and IRS held no estate inclusion) & 8037116; Estate of German v. United States, 7 Ct. Cl. 341 (1985) (Maryland trust created by Florida grantor). However several bankruptcy cases have denied a discharge to grantors of a foreign situs self-settled spendthrift apparently because the law of the grantor's domicile did not permit such trusts.

The position that the self-settled trust will not be included in the gross estate of the grantor may be the strongest for self-settled trusts created in Alaska and Nevada. In all of the other self-settled trusts states, some creditors can reach the trust assets (for example, for certain family obligations such as for alimony or child support), and that may jeopardize the "no inclusion" argument. *See* Rothschild, Blattmachr, Gans & Blattmachr, *IRS Rules Self-Settled Alaska Trust Will Not Be In Grantor's Estate*, 37 EST. PL. 3, 11-12 (Jan. 2010).

PLR 200944002 is consistent with prior cases that have analyzed gross estate inclusion under § 2036 in part based on whether trust assets can be reached by any of the grantor's creditors. Estate of Uhl v. Commissioner, 241 F.2d 867 (7th Cir. 1957)(donor to receive $100 per month and also to receive additional payments in discretion of trustee; only trust assets needed to produce $100 per month included in estate under § 2036(a)(1) and not excess because of creditors' lack of rights over other trust assets under Indiana law); Estate of Paxton v. Commissioner, 86 T.C. 785, 818 (1986)(self-settled trust assets included under § 2036 because grantor's creditors could reach income and corpus); Outwin v. Commissioner, 76 T.C. 153 (1981) (trustee could make distributions to grantor in its absolute and uncontrolled discretion, but only with consent of grantor's spouse; gift incomplete because grantor's creditors could reach trust assets, and dictum that grantor's ability to secure the economic benefit of the trust assets by borrowing and relegating creditors to those assets for repayment may well trigger inclusion of the property in the grantor's gross estate under §§ 2036(a)(1) or 2038(a)(1)); Estate of German v. U.S., 7 Cl. Ct. 641 (1985) (denied IRS's motion for summary judgment, apparently based on § 2036(a)(1), because grantor's creditors could not reach trust assets where trustee could distribute assets to grantor in trustee's uncontrolled discretion, but only with the consent of the remainder beneficiary of the trust and a committee of non-beneficiaries). Interestingly, the PLR does not cite any of the case law in support of its conclusion, but relies on Revenue Ruling 2004-64.

H. Taking Advantage of $5 Million GST Exemption. There are no assurances that the GST exemption will remain at $5 million. Making a $5 million gift and allocating the $5

million of GST exemption that is currently available is one way of assuring that the full $5 million GST exemption can be used. The safest way of utilizing the $5 million GST exemption would be to make direct skip gifts, to as low a generation as is practicable. Even if the TRA 2010 provisions sunset at the end of 2012, and the Code is interpreted as to future generation-skipping transfers as if the provisions of TRA 2010 (or EGTRRA) "had never been enacted" (see section IV.H of this outline), there would be no ability to impose a GST tax retroactively on the direct skip that occurred in 2011 or 2012 when the direct skip gift was made to the trust. On the other hand, if a gift is made to a dynasty trust and $5 million of GST exemption is allocated to the trust and if TRA 2010 sunsets, it is not clear that for purposes of determining the inclusion ratio of the trust as to a generation-skipping transfer that occurs after the sunset date whether the full $5 million of GST exemption could be considered.

I. Forgiveness of Outstanding Loans to Children. Many clients will be interested in forgiving existing loans to children as an easy way of utilizing the $5 million gift exemption. A possible concern exists if there has been a repeated pattern of forgiving loan payments. If the IRS can establish an intention from the outset that the entire loan would be forgiven eventually, the IRS may treat the gift as occurring all in the year of the initial advance. *E.g.,* Letter Ruling 200603002; Field Service Advice 1999-837. Utilizing the newly granted increased gift exemption may help rebut the "original intent" implication. Typically, the forgiveness will not result in discharge of indebtedness income. Rev. Rul. 2004-37, 2004-1 C.B. 583 ("debt discharge that is only a medium for some other form of payment, such as a gift or salary, is treated as that form of payment, rather than under the debt discharge rules").

J. Gifts to Grantor Trusts. Making transfers to grantor trusts, where the donor continues to pay income taxes on the trust income, has a huge impact on the amounts that can be transferred over time. The trust assets compound free of income tax, and the payment of income taxes by the donor further depletes his or her estate (substantially over time). Simple $5 million (or $10 million for couples) gifts to grantor trusts can move huge amounts of value out of the donor(s)' gross estates over time.

K. Gifts to Grantor Trusts Leveraged With Loans. A very simple additional strategy would be to make a $5 million (or $10 million for couples) gift to a grantor trust and then loan up to nine times that with a very low interest AFR note to the trust, substantially leveraging the amount of future income and appreciation that could be shifted to the trust.

L. Gifts and Sales to Grantor Trusts; "Rainy Day Fund" Considerations By Using Sale or Private Annuity With Grantor Trust. Sales to grantor trust transactions traditionally are often complicated by the difficulty of transferring sufficient equity to the trust (typically by gifts) to justify selling large values to the trust for installment notes from the trust. The $5 million gift exemption ($10 million for couples) relieves many of those difficulties. For example, a couple could give $10 million to grantor trusts, and sell $90 million of assets to the trusts with extremely low interest rate notes. The couple would continue to pay all of the income taxes on the grantor trusts, further depleting their estates and allowing the trusts to compound tax-free. Huge estate tax savings could result over time from freezing future appreciation from coming into the estate and from "burning" the estate by making the income tax payments. The grantor trust status could be left intact until the grantor had depleted the estate as much as he or she was willing to deplete it.

If prior sale to grantor trust transactions have been structured using guarantees to provide "seed" equity to justify the sale, the clients might make additional gifts to the trust and terminate the guarantee agreements.

The sale transaction is a "leaky" freeze, but may leave the client in a much more comfortable position than making gifts of $5 million (or $10 million for couples). For example, a client may make a smaller gift, but make a sale of $10 million. The client continues to have access to principal and interest on the $10 million note, as compared to a $10 million outright gift where there is no retained benefit. A "leaky" freeze may not be perfect from an estate planning perspective, but the client may be much more comfortable. "Don't let the perfect get in the way of the good if the only way to get anything done is a leaky freeze." (Mil Hatcher, Atlanta, Georgia, addressed this advantage of a "leaky" freeze over a large gift in a panel discussion at the 45th University of Miami School of Law Heckerling Institute on Estate Planning.)

If a client has long ago made transfers to a grantor trust, the client might consider selling substantial assets to the trust in return for a lifetime annuity. An "old and cold" trust should be used to build the best arguing position that the transfer is made for full consideration so that § 2036 should not apply. The trust would have to contain sufficient assets to satisfy the "exhaustion" test described in Reg. §§ 25.7520-3(b)(2)(i), 20.7520-3(b)(2)(i) and 1.7520-3(b)(2)(i), which assumes that the measuring life will live to age 110. If the trust does not have sufficient assets to cover all of the exhaustion test, it may be possible for individuals to guarantee the annuity to avoid the impact of the exhaustion test.

M. Highly Volatile Assets; GRATs or Gift/Sales Transactions With Minimal "Seed" Gift. For highly volatile assets, a preferable approach may be to use GRATs rather than gift/sale transactions to avoid the possibility of wasting the client's gift exemption if the volatile asset becomes worthless. For highly volatile assets, the gift element in the gift/sale transaction should be minimized. This minimizes the risk of the highly volatile asset declining in value substantially, which may eliminate the value of the trust, and result in having wasted the client's gift exemption. For example, if a couple might be interested in selling $30 million of assets to a grantor trust, do not fund that trust with a $10 million gift, but only fund it with a gift of $3,333,000. Using a 9 to 1 ratio, that would still justify a sale of assets for $30 million. If the couple wants to utilize the full $10 million gift exemptions, give the remaining $6,667,000 to another trust. This approach does not expose the other $6,667,000 to the sale transaction in case the assets decline in value. (Mil Hatcher, Atlanta, Georgia, discussed this example in a panel discussion at the 45th University of Miami School of Law Heckerling Institute on Estate Planning.) (Alternatively, one grantor trust could be used, but the $3,333,000 amount needed to support the sale would be contributed to an LLC, the member interests in the LLC would be given to the trust, and the sale would be made to the LLC, thus not putting at risk the other $6,667,000 assets given to the trust.) A problem in the past was not coming up with enough seed money. In the future, the problem may be having too much seed money.

N. Basis Step-Up Flexibility; Repurchase of Assets by Grantor, Triggering "String" Provision. Consider steps to build in flexibility for achieving a basis step-up at the death of a transferor. Key to this flexibility will be making the gift to a trust rather than an outright gift.

One traditionally used method to achieve a basis step-up is for the grantor to repurchase appreciated assets from a grantor trust recipient.

Another approach is to draft the trust to give an independent trustee or other independent party the power to grant a testamentary limited power of appointment to the grantor. The limited power of appointment could be as broad or narrow as desired, as long as it allowed the possibility of shifting benefits from beneficiary to another. If so granted, this would cause inclusion under § 2038 (and that section is based on powers that the grantor actually holds at death and not on the retention of interests at the time of the original transfer). To protect the independent third party, the instrument might exonerate the independent party from liability with respect to the decision to grant the power of appointment regardless of whether it is exercised. The instrument could provide that the independent third party has no obligation to inquire as to whether the authority should be exercised. Another approach would be to provide that the independent party has no authority to grant the power of appointment until requested in writing to do so by a designated class of persons.

The grant of the testamentary power of appointment to the grantor could conceivably be by a formula. The trust instrument could give the donor a formula testamentary power of appointment to the extent that an amount equal to 35% of the excess of the date of death value over the date of gift value is less than amount equal to 15% of the excess of the date of death value over the basis of the property (substituting the current tax rates). The disadvantage of the formula approach, if it operates immediately after the creation of the trust, is that it creates an ETIP, which would preclude immediate allocation of GST exemption to the trust.

Another possible approach would be to take steps to trigger the "string" provisions of §§ 2036-2038. For example, the parent may continue living in the house in a QPRT without paying rent to trigger § 2036(a)(1). However, the IRS conceivably may not take the position in that type of circumstance that the failure to pay rent, based on the changed circumstances, reflects an implied agreement to retain the interest at the outset (which is a requirement under § 2036(a)(1)). As another example, if a parent has given undivided interests in a vacation home to children, the parent may start using the vacation home exclusively without paying rent in a similar attempt to trigger an implied agreement of retained enjoyment under § 2036(a)(1).

A further extension of this planning would be to leave the flexibility of causing the trust assets to be included in the donee-spouse's estate for estate tax purposes if there are no estate tax concerns for the donee-spouse and if a basis step-up at his or her death would be desirable. These are the same strategies that could be used in creating trusts for a spouse in the testamentary context. See section XII.B.5-7 of this outline for a discussion of specific strategies.

O. GRATs. GRATs may not be as favored when clients can make gifts of up to $5 million without paying gift taxes and without using sophisticated planning strategies. However, GRATs have the advantage of allowing transfers of future appreciation without incurring gift taxes *or utilizing any gift exemption.* Everything else begin equal, it would be advantageous to transfer the desired amount to family members via a GRAT without making any taxable gifts, if possible.

Furthermore, for transferring hard to value assets, GRATs offer a unique significant advantage of being able to use a built-in valuation savings clause approach that is

recognized in the GRAT regulations for the initial transfer to the GRAT. *See* Treas. Reg. § 25.2702-3(b)(1)(ii)(B). (However, the valuation uncertainties would exist for in-kind payments of the annual annuity amounts if the annuity amounts cannot be made in cash.)

The $5 million gift exemption opens up the possibility of another strategy that would minimize the valuation risks in making annuity payments. For example, a client might give some of the $5 million gift exemption amount to the grantor trust that will be the remainder beneficiary of a GRAT. When the annuity payment is due, the grantor trust might loan funds to the GRAT which it could use to make the annuity payment, without having to make an in-kind distribution. There would be no gift valuation risk with respect to annuity payments that could be funded with such loan proceeds.

The 10-year minimum term provision is not included in TRA 2010. Does that mean that rolling two-year GRATs can be created within the next two years before TRA 20120 sunsets? We cannot be sure. Congressmen may have simply wanted to save the GRAT 10-year minimum term revenue raising provision for some subsequent bill in 2011 that needs a revenue raiser to offset the cost of some new bill.

P. Life Insurance Transfers. A limit on the amount of life insurance that can be acquired by an irrevocable life insurance trust is the amount that the insured can give to the trust to make future premium payments. Having $5 million ($10 million per couple) of gift exemptions to cover life insurance premium payments can buy a very large amount of life insurance coverage that can pass free of transfer tax to younger generations. For example, a $2 million premium can often purchase $20 million of second-to-die life insurance coverage.

Split dollar agreements have often been used in the past to help finance the payment of large premiums by an irrevocable life insurance trust where the insured could not make gifts to the trust large enough to cover the premiums without having to pay current gift taxes. If split dollar arrangements have been used in the past, large gifts (within the $5 million gift exclusion amount) could be made to the trust to roll out of the split dollar arrangement and simplify the planning.

Q. Deemed § 2519 Gifts from QTIP Trusts. One way to make use of the $5 million gift exemption is triggering § 2519 with QTIP trusts. A gift of the income interest will result in a deemed gift of the remainder interest of the QTIP under § 2519. This may be a way for a surviving spouse who is a beneficiary of a QTIP trust to make use of the $5 million gift exemption if the QTIP trust is no longer needed. A gift of a small portion of the income interest in a QTIP trust can also result in a gift of the entire remainder interest under § 2519. However, it is likely that § 2036(a)(1) would cause inclusion of the trust assets attributable to the portion of the income interest that was retained. *See* Read Moore, Neil Kawashima & Joy Miyasaki, *Estate Planning for QTIP Trust Assets*, 44th U. MIAMI HECKERLING ON EST. PLAN. ch. 12 ¶ 1202.3 (2010). For example, if the spouse makes a gift of 0.1% of the income interest, retaining the other 99.9%, it is likely that 99.9% of the trust assets would be included in the spouse's estate under § 2036(a)(1). A possible planning approach would be for the spouse to sell the income interest, rather than making a gift of it, to avoid § 2036(a)(1) inclusion. The spouse would continue to receive payments on that note (rather than a fluctuating income entitlement). That could result in freezing the value of the QTIP trust assets for transfer tax purposes. This was the fact situation in Letter Ruling 201024008, but a ruling on the § 2036(a)(1) issue was not requested or given. (A sale of the income interest may result in the spouse having a zero

basis in the income interest under § 1001(e)(1) for purposes of determining how much gain is recognized on the sale transaction. Section 1001(e)(1) should not be triggered by a gift of some or all of the income interest.)

R. Qualified Personal Residence Trusts. One of the disadvantages of a qualified personal residence trust (QPRT) is that there is a significant (though highly discounted) gift element. The $5 million ($10 million for a couple) gift exemption may permit the transfer of even very valuable residences to a QPRT while still allowing the gift element to be covered by the gift exclusion to avoid having to pay gift taxes when the QPRT is created. (Of course, QPRTs are not as favorable in the current very low AFR environment as they are with a higher AFR.)

S. Same-Sex Couples Planning. Planning for same-sex couples is difficult because of the lack of a gift or estate tax marital deduction. The increased $5 million gift tax exclusion opens up significant possibilities for transferring assets between the partners without current gift tax consequences.

T. Equalizing Gifts to Children or Grandchildren. A frequently recurring request is to make gifts to equalize gifts to all of the children or grandchildren. The extra $4 million of gift exclusion may permit some donors to equalize gifts when they have not had enough gift exclusion to do so in the past.

U. Gifts to Save State Estate Taxes. Only several states (Connecticut and Tennessee) have state gift taxes. Maine requires that gifts made within one year of death be added to the gross estate for state estate tax purposes. In other states, gifts within the $5 million gift exemption would be free of federal and state gift taxes. However, the gift assets would no longer be subject to state estate taxes (as long as there were no retained interests in or powers over the gift assets that would cause estate inclusion for state estate tax purposes). Even deathbed gifts could result in substantial state estate tax savings. See section XII.B.4 of this outline. A disadvantage is that the gift assets will not be eligible for a step-up in basis at the donor's death, but that would not be a disadvantage for a gift of high basis assets.

V. Transfers May Impact § 6166 Deferral. Closely held business interests often represent highly appreciating-high income producing assets that can be the perfect vehicle for gifts. Making $5 million ($10 million for a couple) of gifts in a closely held business may take the business interest in the estate below the 35% of adjusted gross estate level needed to qualify for § 6166 estate tax deferral.

W. Leveraging Transfers Through Valuation Discounts. If the transferred assets are discounted to reflect lack of control or marketability, the value that can be transferred via the $5 million gift exemption is further expanded. On the other hand, clients who think the estate tax will no longer apply to them (because of the $5 million estate exclusion amount) may wish to avoid transactions that will have the effect of creating valuation discounts. They may even want to dissolve partnerships, despite the non-tax advantages of the partnerships, if the loss of basis step-up for assets in the partnership is critical.

XII. Testamentary Planning Strategies Going Forward in Light of Changed Planning Paradigm Under TRA 2010

A key to testamentary planning going forward is the extreme instability and unpredictability in the transfer tax system. Over the last 10 years, exemptions and rates changed in a stable progressive way. Exemptions have exploded from $2 to $3.5 to $5 million in the last several

years. How can we advise clients going forward? It is extremely difficult to predict what will happen in 2013. At some point, will Congress began worrying how to pay for tax relief? Will China stop buying US bonds, so that Congress becomes worried about deficits and deadlock occurs with nothing happening in 2012 and the estate tax returning to a $1 million exemption 55% rate system in 2013? It is hard to handicap whether there will be small exemptions, large exemptions, or estate tax repeal following 2012. We can learn from what happened at the end of 2009. We don't know what Congress will do from moment to moment, let alone in two years. This time, at least we know to warn clients that there is a tremendous amount of uncertainty, and we cannot predict exactly what will happen.

A. Increased Focus on Client's Individual Goals and Customized Drafting to Meet Those Goals in Light of Inherent Uncertainty While Leaving Flexibility to Accelerate or Defer Estate Taxes at the First Spouse's Death. Previously, planners could ask clients about their goals, and then structure those goals into a fairly standardized credit shelter trust /marital share planning approach. In the future, it will be imperative to focus on client goals in light of very unpredictable tax changes, rather than just tweaking the standard tax planning structure around the client's goals.

Planners for their entire careers have used instruments driven by standard formula clauses. The academic debate has been over issues such as whether to use pecuniary versus fractional formulas, or pre-residuary versus residuary bequests of the credit shelter or marital bequests. Standardized formula clauses could be used in the past because of stability in the estate tax system. That is no longer the case. Why draft documents to leave a formula amount, which will be based upon what a small group of people in Washington decide? What client in his or her right mind will want a document with that kind of uncertainty?

The standard formula driven approach can still work in a truly harmonious family situation. The maximum exemption amount can pass to the credit shelter trust and the balance to the surviving spouse, without concern for what Congress does to the formulas. Even then, what if Congress repeals the estate tax — what will the formulas mean then? In addition, for really wealthy clients, standard formula drafting will be sufficient. The exemption amount is just a nuisance anyway for them.

For other clients, documents will have to be customized to meet the detailed goals. The document does not necessarily have to address what happens if the exemption is $1 million, $2 million, $3.5 million, $5 million, or $10 million, but the core principles of the distribution plan must be identified to customize the plan in light of uncertain tax laws.

Planners should keep detailed notes of the client's goals in light of a variety of possible future tax law situations. Include statements of intent in estate planning documents regarding the core goals, making them sound as much like the client as possible. They will help if the court needs assistance in interpreting the document, rather than just having the sterile words of a formula.

Consider the following as an example of the type of customization using "floors and ceilings" that will be needed in the new paradigm of uncertainty. (This example was discussed by Bruce Stone, Coral Gables, Florida, in a panel discussion at the 45th University of Miami School of Law Heckerling Institute on Estate Planning.) A client with a $6 million estate has a spouse and two children by a prior marriage. The client wants to leave at least $3 million for supporting the spouse, but wants the overall estate divided so that it ultimately passes one-third to the spouse and two-thirds to the two children.

Leaving $3 million outright to the spouse would leave $1 million short of the desired amount to pass eventually to the two children. The plan would be drafted to shift some of the spousal bequest to a QTIPable trust so that at least $4 million would eventually pass to the two children. The remaining $3 million would pass to the children, but not in excess of the federal estate exemption amount. If the federal exemption is less than $3 million, the difference would pass to a QTIPable trust. If there is a state estate tax with a state-only QTIP election, there could be further limits on the bequest to the children to utilize a separate QTIP trust to avoid state estate taxes at the client's death. It will no longer be possible to just explain a standard credit shelter trust and sell a document based on that model.

As another example, assume wife has a $15 million estate that she wants to leave one-third to her husband and two-thirds to children by prior marriage. If she leaves $10 million directly to the children, that would cost approximately $2.4 million in federal and state estate taxes, but if the children receive $5 million currently, and receive the second $5 million when the husband subsequently died, the taxes payable at her death would drop to about $400,000 (the state estate taxes on the $5 million bequest to the children).

In this situation, the will might make a formula bequest to the children equal to the lesser of the estate tax exemption amount or two-thirds of the estate, and provide that if two-thirds of the estate exceeds the estate tax exemption amount, the difference passes to a QTIPable trust that would eventually pass to the two children. The other one-third of the estate would pass directly to the surviving spouse or to a QTIP trust for the spouse.

Carlyn McCaffrey has suggested ways to provide flexibility as to whether estate taxes would be paid at the first spouse's death or deferred until the surviving husband's death. One possibility is that the clause could give the surviving husband the right to disclaim his interest in the QTIP trust, (and provide in the trust that any disclaimed assets would pass directly to the children or to trusts for them). The surviving husband might disclaim, for example, if the transfer tax rates were expected to increase in subsequent years.

Another alternative would be to leave the flexibility of whether to defer estate tax until the surviving husband's death in the hands of the children. For example, there might be a formula bequest to a trust for each of the children equal to one-half of an amount equal to the difference between two-thirds of the residuary estate and the applicable exclusion amount. The terms of each trust would give the child the right to receive income from the trust for the surviving spouse's lifetime, with remainder to a discretionary trust for the child and his or her descendents. If the child thought that deferring estate taxes would be preferable, the child could disclaim the income interest, and the trust would provide that if the income interest is disclaimed by the child, it would pass to the surviving husband in a QTIPable format. (The disclaimer of the income interest by the children should be a qualified disclaimer, because the income interest was a severable interest created in the original document.)

Yet another alternative is to give an independent advisor or trustee the flexibility to make the choice of whether to defer estate tax until the surviving husband's death. Under this approach, there would be a formula bequest to a trust for the benefit of the surviving husband and children that would convert into a QTIP trust just for the surviving husband if the independent party (who would be the executor) made a QTIP election (the so-called Clayton election). If the QTIP election were not made, the trust would be a discretionary trust for the benefit of the surviving husband and children, but estate taxes would be due

at the wife's death. The independent advisor and the family could make that decision at the time of the wife's death, with greater knowledge of the estate tax exemption amount at the time of the wife's death, and perhaps with better knowledge of what the law might look like when the husband subsequently dies than the parties know at the time the document is drafted.

B. Testamentary Drafting Patterns for Building Flexibility. In this world of tremendous uncertainty regarding future tax systems, there is tension among (i) planning for federal estate tax savings, both at the first spouse's and second spouse's deaths, (ii) planning for state estate tax savings, and (ii) planning for basis step up if there are no estate tax concerns.

1. General Planning Strategy. First, make sure the federal marital deduction is available at the first spouse's death whether by an outright bequest, QTIP trust, or general power of appointment trust (state estate tax planning flexibility is increased by using "QTIPable" trusts).

   Second, make sure the surviving spouse has the flexibility to shelter the assets from estate tax at his or her subsequent death. For example, an outright bequest to the spouse with credit shelter trust provisions in the event of a disclaimer can work in a homogeneous family situation, but a QTIP trust may be needed for other situations (the portion for which no QTIP election is made is not includable in the surviving spouse's estate under §2044).

   Third, following the first spouse's death, leave the flexibility for causing assets to be included in the surviving spouse's estate to obtain a basis step up at his or her death if there are no estate tax concerns (generally by permitting distributions to the spouse under a very broad distribution standard or by granting someone the power to cause the spouse to have a general power of appointment). (Dennis Belcher, Richmond, Virginia, suggested this general planning structure in a panel discussion at the 45th University of Miami School of Law Heckerling Institute on Estate Planning.)

2. Disclaimer Approach. The simplest approach is to leave the entire estate to the surviving spouse, but provide that any disclaimed assets would pass into a trust having the spouse and/or other family members as beneficiaries. The disclaimer approach has the advantage of simplicity in a homogeneous family situation. It may become the preferred approach for "low net worth clients." If there are state estate tax concerns, the disclaimed assets should pass into a QTIPable trust if the state recognizes a state-only QTIP election. If there are no state estate tax concerns or if the state does not recognize a QTIP election, the disclaimed assets will likely pass to a trust similar to standard credit shelter trusts.

   Is a disclaimer by a surviving spouse invalidated by subsequent grant of a general power of appointment to the spouse? A possible analogy is that the IRS has approved "reverse QPRTs" where the children later decide to give the parent the right to live in the house for a period of time, if the children's decision was an independent action that was not pre-planned. However, subsequently granting the disclaimant-surviving spouse a general power of appointment over the disclaimed assets would raise the question of whether the disclaimer satisfies the "pass without direction of the disclaimant" requirement.

3. QTIP Trust Approach. An alternative approach is to leave the entire estate into a trust for which a QTIP election could be made. Marital deduction qualification at the first spouse's death is available by making the QTIP election. To the extent the election is not made, assets would not be included in the surviving spouse's gross estate under § 2044. State estate tax planning is flexible with QTIPable trusts, particularly if the state recognizes a "state-only" QTIP election. "Clayton QTIP" provisions could be included to provide that the assets would pass to a different type of trust to the extent that the federal QTIP election is not made.

4. State Estate Tax Planning. While state estate taxes are considerably lower than federal estate taxes, they are still significant. Planning for domicile of the client will still be important. Formula clauses should be reviewed in light of the increased federal exclusion amount. Some clients may have opted previously to fully fund a bypass trust even though doing so would generate some state estate tax at the first spouse's death. The client may have been willing to do that with a $3.5 million federal exclusion but may not be willing to do that with a $5 million federal exclusion. For example, if the state has a $1 million exemption (which is the case for most of the states that have state estate taxes), paying state estate tax on the excess $4 million would incur $391,600 of state estate taxes in some states if the state tax is charged against the bypass trust (leaving a net funding of $4,608,400) and would incur $444,091 of state tax if the state tax is not paid out of the bypass trust. A possible strategy to avoid paying this state tax is to fund the bypass trust with only the state exemption amount and rely on portability to take advantage of the balance of the first deceased spouse's federal exemption amount. However, as discussed in section IV.C of this outline, there are a variety of uncertainties in relying on portability (not the least of which is that the portability provisions expire in two years unless renewed by Congress).

   In states that allow a state-only QTIP election, planning to accommodate the increased federal exemption amount is more flexible. For example, in states with a $1 million state exemption, the bypass trust could be funded with the state exemption amount ($1 million), and a "QTIPable" trust could be funded with the remainder of the federal exemption amount (the remaining $4 million). A state-only QTIP election would be made for the $4 million trust. In this manner, the full $5 million federal exemption is utilized without incurring state estate taxes at the first spouse's death.

   Gift planning may also save significant state estate taxes, because gifts are not included in the state gross estate base. The ability to make a $5 million gift without federal gift tax means that very substantial state estate taxes may be saved via gift planning. This is particularly important for deathbed planning.

   While either of the disclaimer or QTIP approaches can be used to afford flexibility in addressing federal and state estate tax planning issues at the deaths of either of the spouses, further planning is needed to afford the flexibility of basis step-up planning at the surviving spouse's subsequent death.

5. Basis Step-Up Flexibility; Broad Distribution Powers. One method of causing estate inclusion if the surviving spouse has no estate tax concerns is to give the independent trustee broad authority to make distributions to the surviving spouse, in the absolute discretion of the trustee. (Even a "best interests" standard for a

particular beneficiary might limit distributions for the purpose of allowing the beneficiary to make gifts.) An advantage of this approach is its simplicity, but possible disadvantages are discussed below.

6. Basis Step-Up Flexibility; Independent Party With Power to Grant General Power of Appointment. The trust agreement could give an independent party the power to grant a testamentary general power of appointment to the surviving spouse. It could be a power exercisable only with the consent of a non-adverse party if the settlor wishes to place some controls over the surviving spouse's unbridled ability to redirect where the assets will pass. The power could be limited to the ability to appoint the assets to the surviving spouse's creditors. There are several advantages to this approach over the broad distribution authority approach. (Howard Zaritsky, Rapidan, Virginia, discussed these advantages at the 45th University of Miami School of Law Heckerling Institute on Estate Planning. He prefers this approach to the broad distribution powers approach. His new book, *Practical Estate Planning in 2011 and 2012* (Thomson-Reuters/WG&L 2011), discusses the basis flexibility alternatives in detail with sample form language. The new book will be published in March 2011.) Distributing asset outright increases the surviving spouse's probate estate. Making physical distributions to the spouse may be mechanically cumbersome, particularly in a deathbed situation. The mechanics may be much easier by merely having the independent party sign a one-page document granting the spouse a general power of appointment. The surviving spouse may be elderly and have management issues with respect to outright ownership of the assets, or may be susceptible to pressure to make transfer to related family members or caregivers. The distributed assets can be left by the spouse to whomever he or she chooses, whereas a granted general power of appointment can be conditioned upon the consent of a nonadverse third-party to any exercise in favor of the spouse's estate or its creditors. (Howard Zaritsky suggests that the nonadverse party who can consent to the exercise of a power should be someone other than the person who grants the power because a power is not a general power of appointment if it can be exercised only in conjunction with the "creator of the power." The IRS might assert [incorrectly] that the person who granted the power was the "creator" of the power.)

7. Basis Step-Up Flexibility; Formula General Power of Appointment. One possible approach is to use formula general powers of appointment, granted to the extent that the power would not result in the payment of estate taxes. There is concern that the beneficiary could have indirect control over all of the trust assets as a result of the formula grant of the power, meaning that the beneficiary would have a general power over all of the trust assets for tax purposes. If the formula operates without regard to the availability of a marital or charitable deduction, the formula no longer accurately grants a general power to cause basis step-up even though there would be no estate tax.

8. Basis Step-Up Flexibility; Delaware Tax Trap. Another alternative to leave the flexibility to cause inclusion in the beneficiary's estate is to use the "Delaware tax trap." Delaware law at one time (perhaps still) provided that if someone exercises a power of appointment to grant a presently exercisable power of appointment to another person, even a *limited* power of appointment, that grant of the new power is treated as a vesting of property for purposes of the rule against perpetuities. The

original power could be exercised to appoint the assets in further trust, with a new perpetuities period running from the date of exercise, which means that the trust could be extended indefinitely without having the assets subjected to estate tax. Sections 2041(a)(3) and 2514(d) were enacted to prevent avoiding the estate tax indefinitely by successive exercises of limited powers of appointment and creating new powers in other persons of new presently exercisable limited powers of appointment. Section 2041(a)(3) provides that property subject to a nongeneral power of appointment (which would generally not cause inclusion under § 2041) will cause estate inclusion under that section if the power holder exercises the power of appointment "by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power."

Under the law of most states, exercising a power of appointment by creating a new presently exercisable *general* power of appointment in another person is treating as vesting the property in the new power holder because he or she could exercise the power to appoint the property immediately to him or herself. If the new powerholder were to appoint the property in further trust, the perpetuities period on the new trust would run from the time of the exercise creating the new trust. Therefore, at the time the original power holder granted a new presently exercisable general power of appointment, § 2041(a)(3) would be triggered because the new power could be exercised in a way that the vesting of the property in anyone else could be postponed for a period longer than the perpetuities period that applied originally (i.e., "for a period ascertainable without regard to the date of the creation of the first power."). For an excellent discussion of the Delaware tax trap and ways of using the concept to cause estate inclusion in a trust beneficiary (in order to avoid the GST tax), see Jonathan Blattmachr and Jeffrey Pennell, *Using "Delaware Tax Trap" to Avoid Generation-Skipping Taxes*, 68 J. TAX'N 242 (April 1988).

Accordingly, using the Delaware tax trap is one way to cause inclusion in the surviving spouse's (or any other beneficiary's) gross estate, if the beneficiary would not owe estate tax in any event because of the estate tax exemption and the beneficiary would like to obtain a step-up in basis on the trust assets at his or her death. All that must be done to leave open the flexibility of using the Delaware tax trap is for the trust to give the beneficiary a limited power of appointment that includes the power to grant new presently exercisable powers of appointment. (The power to appointment in further trust would generally include this authority.) The decision of whether to trigger estate inclusion in the beneficiary's gross estate is then totally up to the beneficiary. If the beneficiary wants to trigger estate inclusion, the beneficiary would exercise the original power to create a presently exercisable general power of appointment in someone else. That would cause estate inclusion in the original powerholder's gross estate under § 2041(a)(3).

Under that approach, a negative aspect of causing estate inclusion in that manner is that the assets would also have to be included in the successor powerholder's gross estate as well (because the second powerholder would hold a general power of appointment).

Being able to use the Delaware tax trap in statues that have abolished their rule against perpetuities is more complicated. In that situation, a possible strategy suggested by some planners is to provide that the original trust lasts for 1,000 years, but that the power can be exercised to create a trust that could last for 1,000 years after the power is exercised. In this manner, the vesting of the property could be postponed for a period "ascertainable without regard to the date of the creation of the first power." As an example, Steve Gorin, an attorney in St. Louis, Missouri, suggests using the following clause in a state that has abolished its rule against perpetuities:

> "Notwithstanding the foregoing, if a power of to Appoint that is not a general power of appointment (within the meaning of Code section 20141) is exercised by creating another power of appointment which under the applicable local law could be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, then any trust created by such exercise shall terminate no later than one thousand (1,000) years after this Agreement becomes irrevocable; provided however, that the limitations of this sentence shall not apply if the exercise specifically states an intent to create a general power of appointment or specifically refers to Code section 2041(a)(3) in a manner which demonstrates such an intent."

To exercise the Delaware tax trap under that clause, the surviving spouse would "create another power of appointment that postpones the vesting of any estate or interest in such property, or suspends the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the first spouse's death (or creation of an inter vivos irrevocable trust) that also happens to be more than 1,000 years after the first spouse's death" (quoting Steve Gorin). Steve cautions that the use of this approach would depend on particular state law, and there may be limitations if a state has a 360- or 1,000-year rule against perpetuities.

9. Basis Step-Up Flexibility; Triggering "String" Provision. To build in flexibility for achieving a basis step-up at the death of a transferor, consider purchasing appreciated assets from a grantor trust prior to the transferor's death or taking steps to trigger the "string" provisions of §§ 2036-2038. Planning flexibilities in the analogous gift situation for achieving estate inclusion in the original donor's estate are discussed in section XI.M of this outline.

XIII. GST Planning Issues Going Forward in Light of Changes in TRA 2010

A. GST Exemption Allocations; Opting Out of Automatic Allocations. There is now 2010 GST exemption ($5 million) that can be allocated on a timely basis to transfers that were made in trust during 2010. It is very important to "opt out" of automatic allocations to direct skip gifts in 2010 that are intended to pass to the current beneficiary rather than to future generations. Because the GST tax rate is zero on direct skip gifts in 2010, allocating GST exemption to the transfer would waste the exemption (unless a direct skip trust will remain in existence for the life of the current beneficiary and then pass to younger generations).

While TRA 2010 provides an extended due date (to no earlier than September 19, 2011) for reporting direct skip transfers, there is no extension of time for allocating GST exemption or opting out of automatic allocation for "indirect skip" transfers to trusts (i.e., transfers to trusts that are not direct skips). (See section IV.C.4 of this outline.) If an individual has made both direct skip gifts as well as indirect skip gifts, as a practical matter both should be reported, making GST exemption allocations or opting out of automatic allocations, on the same tax return under the normal filing cycle (April 18, 2011 or October 17, 2011 if the return is extended).

B. Reporting 2010 Generation-Skipping Transfers. Should returns be filed to report 2010 generation-skipping transfers? Even though there is a zero GST rate, a return is still technically required. However, the issue of generation-skipping transfers with a zero rate has been around for twenty-five years; trusts with a zero inclusion ratio are not *exempt* from the GST tax — they just have a zero tax rate. However, as a practical matter few planners filed tax returns for zero inclusion ratio trusts, unless they were worried about what the inclusion ratio was. For direct skip gifts (or other generation-skipping transfers) in 2010, there is no uncertainty. The only purpose for filing a return would be to get the statute of limitations running, but with a zero tax rate, that does not matter. There are no penalties where no GST tax is due, because there are no information reporting penalties for GST tax returns.

C. Adding Non-Skip Beneficiaries of Direct Skip Trusts. Some planners have suggested adding non-skip beneficiaries to direct skip trusts after the lapse of some period of time (such as five years). Amounts transferred to a direct skip trust in 2010 incurred no GST tax. If non-skip persons (for example, beneficiaries at the children level) could be added at a later time, in effect, the trust could benefit children and grandchildren without any GST tax being due when distributions are made to grandchildren during the trust term or upon termination. There is some concern, however, that a court might ultimately find that to be an abusive "end-run" around taking advantage of the zero tax rate on direct skips in 2010. A key factor would seem to be whether there was an intention subsequently to add children as beneficiaries when the transfer was made to the direct skip trust. See section VIII.C.2.f of this outline.

D. Disclaimers. Disclaimers in 2011 may result in direct skips having been made in 2010 with a zero GST tax rate. For testamentary transfers, the general thinking is that direct bequests under the will are deemed to have occurred at the time of death for GST purposes. (Otherwise there would be too much possibility for manipulation of the GST tax system by indefinitely delaying the funding of bequests.) A corollary is that disclaimers also operate as of the date of death for testamentary transfers. Under this reasoning, disclaimers made in 2011 (and there is an extended period for disclaimers from estates up to September 19, 2011, see section IV.B.3.c of this outline) may result in transfers for younger generation beneficiaries that are treated as 2010 direct skips, thus qualifying for the zero GST tax rate. See section VIII.F of this outline.

XIV. Other Estate Planning Strategies Going Forward in Light of Changed Planning Paradigm Under TRA 2010

A. Roth Conversions. TRA 2010 may impact Roth conversions in several ways. First, some taxpayers who made Roth conversions in 2010 have planned not to use the special exception allowing income taxes on the Roth conversion to be paid in the 2011 and 2012 tax years, for fear that the income tax rates would be higher than in 2010. That is now not

the case, and in most situations the two-year deferral approach will now be advantageous. Second, a possible advantage of a Roth conversion is that the income tax payment is removed from the taxpayer's gross estate and can result in estate tax savings. If the increased $5 million exclusion means that the taxpayer will not pay estate tax, this is no longer a relevant factor.

B. Graegin Loans Not as Favorable. Graegin loans are not as advantageous as under prior law. The income tax rate may approach or even exceed the estate tax rate. Trading income inclusion (from the interest on the note) for an estate tax deduction may not be favorable. However, there is still the significant present value advantage of benefiting from the estate tax deduction effective as of the estate tax payment due date even though some of the income recognition may not occur for years later.

C. Powers of Attorney and Revocable Trusts. In drafting powers of attorney, explore the principal's intent regarding the ability of the agent to make gifts in light of the greatly increased gift exemption amount. Does the principal want to allow $5 million in gifts, or does the principal want to place an upper ceiling on gifts that may be made under the power of attorney? Perhaps the client has no estate tax concerns under a $5 million estate tax exclusion amount and would want to severely restrict the power of the agent to make gifts as long as the estate tax exclusion remains above a certain amount.

On the other hand, some clients will want to broaden and reinforce the ability to make gifts in order to provide flexibility to take advantage of planning opportunities in case the principal becomes incompetent or to make adjustments in case of future law changes. Indeed, for those clients, the increased gift exclusion and the inherent estate tax uncertainty that we face may be a factor favoring revocable trusts in light of the increased flexibility that the trustee could have to consider changing circumstances.

D. Non-Tax Planning Issues. A $5 million estate exclusion amount means that very few families will pay estate taxes. Planners must keep in mind the myriad other nontax issues that must be addressed in estate planning. Some of these include asset protection, special needs planning, disability planning, elder financial planning, marital planning, planning for management for beneficiaries, planning for appropriate disposition among beneficiaries, planning for disabled beneficiaries, and charitable planning.

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