

# To Elect or Not Elect Out of Estate Tax: More Complicated Than You Think

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TO ELECT OR NOT ELECT OUT OF ESTATE TAX: MORE COMPLICATED THAN YOU THINK

## Introduction



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## The Basic Decision



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## Impact on the Beneficiaries

- Dollar Bequests
- Tax Driven Formula Provisions
- Actual Case



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## Running the Numbers: Not Always Easy

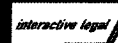
- Basis Higher Before Death for Non-Carryover Basis Property
  - QTIP Trust Described in Section 2041
  - General Power Appointment Property Described in Section 2041
  - Retained Income Property Described in Section 2036 (a)
  - Voting Stock Described in Section 2036 (b)
- Young Surviving Spouse or Charity
- Checking on State Death Tax Effects



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## Running the Numbers: Not Always Easy

- IRD Effects
- Determining When the Tax Will Be Due
- Negative Basis Property
  - Debt: \$10,000,000
  - Basis: \$1,000,000
  - Negative Basis: (\$9,000,000)
  - FMV: \$2,000,000/\$20,000,000



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## Fiduciary Duty



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## Apportionment of Estate Tax; Apportionment of Basis



### COMPARISON OF ESTATE TAX OPTIONS IN 2010

Gross estate $\leq$ \$5,000,000 (\$10,000,000 for married couples)	→	Elect into estate tax
Gross estate between \$5,000,000 and \$30,000,000 (\$10,000,000 and \$60,000,000 for married couples)	→	Need to analyze
Gross estate $>$ \$30,000,000	→	Elect out of estate tax

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### ELECTION OUT OF ESTATE TAX FOR 2010 DECEDENTS

- Time Extension
- Nine Months After December 17
- Payments of Estate Nine Months After December 17
- Qualified Disclaimer Nine Months After December 17, 2010



### FACTORS TO CONSIDER IN THE ELECTION BETWEEN THE ESTATE TAX REGIME AND THE CARRYOVER BASIS REGIME (CONT'D)

- Calculation and apportionment of estate tax burden.
- Impact of state death taxes, particularly in states with an exemption below \$5 million.
- Anticipated date of sale of each asset.
- Ability to allocate basis.
- Decedent's basis in each asset.
- Date of death value of each asset.



### FACTORS TO CONSIDER IN THE ELECTION BETWEEN THE ESTATE TAX REGIME AND THE CARRYOVER BASIS REGIME (CONT'D)

- Projected future value of each asset.
- Projected earnings from each asset.
- Tax character of any future gains or earnings on assets.
- Identity of the beneficiaries.
- Revenue needs of the beneficiaries.
- Future tax rates.



### FACTORS TO CONSIDER IN THE ELECTION BETWEEN THE ESTATE TAX REGIME AND THE CARRYOVER BASIS REGIME (CONT'D)

- Domicile of beneficiaries and personal income tax information. Can we "move" situs of taxpayer?
- Availability of asset-specific tax deductions and credits
- Impact of election on formula clauses
- Potential for disagreement among beneficiaries concerning the allocation of basis
- Conflicts of interest in making the election and allocating basis
- Aggressiveness of positions that will be taken if the estate tax return is filed.

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### FACTORS TO CONSIDER IN THE ELECTION BETWEEN THE ESTATE TAX REGIME AND THE CARRYOVER BASIS REGIME (CONT'D)

- The availability of binding consents or court approval
- Whether a compensating equitable adjustment is appropriate, and whether it should be approved by a court. Remember: equitable adjustments themselves are tax effects

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### ELECTING INTO OR OUT OF THE ESTATE TAX

Perhaps, the single most important issue in determining whether or not to elect into the estate tax will be the total tax incurred under each scenario

Need to compare estate tax rate vs. future ordinary income/capital gains tax rates

If estate tax elected out of, then the future ordinary income/capital gains tax to be incurred will need to be reduced to its present value

In most cases, the decision to elect into the estate tax can be made according to the following simple algebraic formula

Current estate tax liability = Present value of future income tax liability

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### MORE ON CARRYOVER BASIS

- ▶ Fundamental Rule: Basis Equals the Lesser of the Decedent's Basis and Fair Market Value at Death
- ▶ To Elect or Not Elect: That Is the Question
- ▶ No Automatic Long Term Holding Period
- ▶ Increases in Basis (allocation methods)
- ▶ Section 1022(b): \$1,300,000 + section 1212(b) losses + section 172 losses + section 165 inherent losses
- ▶ Section 1022(b) for NRA's limited to \$60,000
- ▶ Section 1022(c): \$3,000,000 for Qualified Spousal Property; Outright to Spouse and QTIP Trusts

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### MORE ON CARRYOVER BASIS (CONT'D)

- ▶ Property to Which the Basis Increases Apply
- ▶ Property "Owned by the Decedent" and "Acquired from the Decedent" (so QTIPs Are Apparently Excluded)
- ▶ Section 645 "Revocable" Trusts
- ▶ Trusts Over Which Control Was Held at Death and Transfers Taking Effect at Death Without Consideration (meets "acquired from" but maybe not "owned" test)
- ▶ Both Halves of Community Property
- ▶ Jointly Owned Property Rules
- ▶ No Power of Appointment Property (or IRD and Certain DISC, etc. stock)
- ▶ Property Received Within three Years by Gift

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### MORE ON CARRYOVER BASIS (CONT'D)

- ▶ Funding Pecuniary Legacies—Section 1040—IRD?
- ▶ Section 121 Carryover Exclusion for Principal Residence
- ▶ Negative Basis Property
- ▶ Passive Losses
- ▶ Transfer to Foreign Persons and Trusts: Section 684
- ▶ Carryover Basis Reporting Requirements
- ▶ Revised Section 6018: Information Required
- ▶ Valuation dilemmas—Go High or Go Low?
- ▶ Gift Tax Information (and New Gift Tax Rule)
- ▶ Duty to and of Others
- ▶ Section 6716: Penalties

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#### MORE ON CARRYOVER BASIS (CONT'D)

- ▶ How to Determine the Decedent's Basis
- ▶ Overview of Planning for Carryover Basis
- ▶ Reviewing the Impact of Dispositions: From Tax Apportionment to Inherent Gain Apportionment
- ▶ Carryover Basis and GST Terminations at Death
- ▶ The "Nature" of the Gain
- ▶ Allocation of \$3mm OSP Increase Before Funding
- ▶ Drafting to Obtain the Maximum Basis Increases
- ▶ Transferring Assets to Spouse Who Will Die This Year (Estate Tax and COB Considerations)

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### Summary and Conclusion

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