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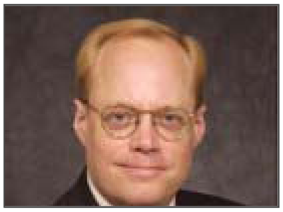

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THE TAX LAWYER

Nov. 22 2010 — 11:23 am |

Ghoulish Estate Planning Before New Year's?

Halloween may be over, but that doesn't mean no one is thinking ghoulish thoughts. Understandably, you may want to put a hex on Congress for failing to come to terms with the Bush tax cuts and the tax rates we'll all face in little more than a month. See Tea Leaves And Tax Moves In 2010 and Making Tax Decisions In Limbo. Even more deserving of a hex or voodoo spell is what Congress did to estate planning, which is worthy of Mary Shelley. See See Your Estate Lawyer Now-If You Are Rich Or Frying A Turkey. It's not hyperbole to say it was downright irresponsible to let the estate tax expire for calendar year 2010, not to mention the bizarre boomerang to 2001 estate tax law scheduled to kick in on January 1, 2011. What a Frankensteinian mess! See Estate Tax Steps For This Year.

But if hexing Congress doesn't satisfy all your ghoulish hankerings, just consider some of the bizarre incentives currently swirling ghost-like around estate planners these days. See Some Contemplate Dying In 2010 To Avoid Paying Estate Tax. Toward the end of 2009, there was an extra incentive to cling to life, since it then looked like death in 2009 would trigger estate tax but dying in 2010 would not. Hanging on to life seemed noble, and if there were tax savings, then so much the better.

Even Law & Order had an episode about it! See "The Taxman Cometh" Recap & Review. Hanging onto life to avoid taxes turned out to be prophetic. While most tax lawyers and observers assumed Congress would re-enact the estate tax in 2009 or at least in early 2010(!), they didn't. With a number of multimillionaires and billionaires dying in 2010, it looked like Congress would try to tax them retroactively. See [Federal estate tax quagmire more complex as 2011 nears]. But now that 2010 is all but over, most consider that grave-grab unlikely. And the incentives from the end of 2009 have taken a decidedly grave turn.

2010 Swan Song. So if you weren't "tax-wise fortunate" to die in 2010, what do you do? Lawyers have an obligation not to encourage unethical or unlawful behavior, but one also must tell clients the truth. It now looks like a death in 2010 won't face estate tax but one in 2011 will. That can make for some even-worse-than-normal estate planning conversations, especially with ill and infirm clients with family businesses, ranches or farms. These individuals may be a lot more worried about their children and the heritage they want to pass on than they are about their long-term survival.

Still, few are talking about basis and capital gain tax, and that's a huge omission that can change the debate entirely. With no estate tax on a 2010 death, there's no automatic adjustment of basis to the fair market value at the time of death. Instead, there is a limited $1.3 million step-up in basis for income tax purposes, plus $3 million for bequests to a surviving spouse. But continue to watch out for assets that have declined in value! Under either regime, basis for these assets can be no higher than their fair market values.

> Example: Claude dies in 2010 with a family business worth $5 million in which his basis is $200,000. His estate pays no tax, but when his son and daughter take over ownership of the business, their basis is $200,000, plus $1.3 million. If they sell it, they have a $3.5 million gain.
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> Example: Arthur's business hit hard times last year, so that it is worth only $1 million upon his death in 2010. His basis is $2 million. But when his son and daughter take over ownership of the business, basis is reduced from $2 million to $1 million. If they sell it, they cannot claim a loss for the $1 million in disappearing basis.

When Congress does resume the protracted estate tax debate, one possibility is that they will allow the estates of 2010 decedents to apply

2010 or 2011 law, even though the death occurred in 2010. That way families can elect the better alternative. If the estate tax exemption is high enough, many may actually opt for being subject to estate tax to get a more favorable adjustment in basis.

But it's all about the numbers. No matter what you do, if this situation is affecting you and your family, sit down with someone qualified and talk it over. Do nothing rash.

Gifts. Apart from the unfortunately ghoulish discussions about 2010 versus 2011 deaths, gifts should certainly be considered before year end. The unlimited $13,000 per person annual exclusion gifts still make sense, especially for outright gifts to grandchildren. Keep in mind there's no generation skipping tax in 2010, but there is still a gift tax. See Estate Tax Steps For This Year.

Beyond these $13,000 gifts, there's still a $1 million lifetime exemption from the gift tax. But even if you go beyond this and actually have to write a check for gift tax, 2010 may be the cheapest year to do it. With a top gift tax rate of 35%, the rate is at a real low and must be seen as a bargain. It will climb to 55% in 2011. Even if Congress acts to change the 2011 law as seems likely, it's highly unlikely 2011 gifts will be taxed less.

Insist on *Individualized* Advice. It's always dangerous to follow general or canned advice that doesn't take your facts and circumstances into account. That's true with this column too! There's lots of speculation and advice floating around. You are better off not implementing anything without having a qualified professional consider your facts and circumstances.

For more, see:

Estate Taxes: How to Beat The Levy That Won't Die

Why No Estate Tax Could Be a Killer

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