

Cohen, Wolf buy
UI building for
new law offices



An Invitation

Cohen and Wolf, P.C.
 cordially invites you to celebrate
the Opening of its New Office
in the former United Illuminating Building
115 Broad Street, Bridgeport, Connecticut
Thursday, November 17, 1983 4:30 to 7:30 PM

Federal Estate Tax Rules fo 2010

02.16.2011

As widely reported, under a law adopted back in 2001, the federal estate tax was repealed for persons dying in 2010 (we will refer to this as the “2010 Law”). Everyone expected Congress to change the law long before we reached 2010; but due to the gridlock in Congress, the repeal still went into effect on January 1, 2010. Once it did, we waited to see whether Congress was going to do anything to undue the repeal. We did not know which tax rules would apply to estates for those who died in 2010, which has made it especially challenging to administer those estates.

To our relief, in December, 2010, Congress finally addressed the federal estate tax in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “Tax Relief Act” or “TRA”). By this bill, Congress reinstated the federal estate tax, but with a \$5 million exemption and a 35% tax rate. This new law applies until December 31, 2012. The new law sunsets on December 31, 2012, so Congress must address the estate tax once again before the end of 2012, otherwise the law will revert to a \$1 million exemption again.

The TRA changes were made retroactive to January 1, 2010. However, estates of persons dying in 2010 were given the choice of which law to apply: the 2010 Law or the new law as amended by the Tax Relief Act (we will refer to this as the “TRA Law”). Therefore, the executor of each estate will have to decide whether to be governed by the 2010 Law or the TRA Law, and will have to file the appropriate forms with the IRS.

2010 LAW

Under the 2010 Law, there is no federal estate tax. However, the rule that allows for step up in basis does not apply to estates electing the 2010 Law. The 2010 Law has a modified carryover basis rule.

Under the pre-2010 estate tax law and under the TRA Law, the assets of the decedent receive a tax basis for income tax purposes equal to the fair market value of the assets at the date of death. This is referred to as the “step-up” in basis. If those assets are sold soon after death, there is usually little or no gain or

loss for income tax purposes.

Under the 2010 Law, the estate and the beneficiaries take over the decedent's basis in his assets. However, the 2010 Law gives the executor the ability to step up the basis of assets to a limited extent. The executor can allocate \$1.3 million of basis increase to assets passing to persons other than a spouse, and \$3.0 million of basis increase to assets passing to a spouse. The form for making this basis election is Form 8939, which, as of February 1, 2011, had not been released in final form by the IRS.

TRA LAW

Under the TRA Law, the assets of the estate receive a basis equal to date of death value. Any assets passing outright to a surviving spouse or to a marital trust are not subject to tax due to the unlimited marital deduction. Assets passing to persons other than the spouse are subject to estate tax if they exceed the estate tax exemption, which is now \$5 million. The estate and gift tax exemptions are unified, so that if the decedent had used up his previous \$1 million gift tax exemption, his remaining estate tax exemption at death would be \$4 million.

The TRA Law will apply to estates of decedents who die in 2010 unless the executor makes an election to have 2010 Law apply. The TRA Law also made some other changes. With respect to 2010 estates, the TRA Law extends the due date for tax returns (regardless of which law is elected) until September 19, 2011. It also extends the period for making disclaimers (usually nine months from date of death) until nine months from the date of the adoption of the TRA (or until September 19, 2011). However, estates of Connecticut decedents should not rely on this unless the state law period for making disclaimers is also extended.

WHICH ELECTION SHOULD THE EXECUTOR OR ADMINISTRATOR MAKE?

The decision as to which law to apply will depend on the situation and we can discuss with you the facts of your particular situation and recommend which law you should choose. However, we can make some generalizations, based upon the size of the taxable estate (after reduction for amounts passing to the spouse).

If the taxable estate is less than \$5 million, it would likely be more beneficial to have the TRA Law apply, since there will be no federal estate tax and a full step up in basis.

If the taxable estate is greater than \$10 million, it will usually make more sense to opt for the 2010 Law.

If the taxable estate is between \$5-10 million, you will want to run the numbers. For example:

Assume that the Decedent died in 2010 with family vacation home worth \$3 million and securities worth \$3.5 million. Further assume that the basis of the vacation home is \$100,000 and the basis of the

securities is \$1,000,000. There is no surviving spouse. The children intend to sell the vacation home.

In this case the children would be better off electing the TRA Law, paying the estate tax and receiving the step up in tax basis. The estate tax would equal 35% of the excess over \$5 million or $\$1.5 \text{ million} \times 35\% = \$525,000$. Even after applying the \$1.3 million basis step up, the capital gain if the assets were all sold would be \$820,000, assuming a 20% combined federal and state income tax rate.

CONNECTICUT ESTATE TAX

Regardless of which law is chosen at the federal level, Connecticut has its own estate tax which was not affected by the TRA. Connecticut estate tax returns are still due within six months of the date of death. Taxable estates in excess of \$3.5 million with be subject to Connecticut estate.

PRACTICE AREAS

Tax

Trusts & Estates