# M.C.L.E.

# Introduction and Overview of the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" (2010 Act)

by

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March 25, 2011

## I. <u>Introduction and Overview of The 2010 Act</u>:

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (hereinafter "2010 Act"). Among many income tax provisions, the 2010 Act primarily served to extend and increase certain estate tax, gift and generation skipping transfer tax exemptions, at least until 2013, at which point the 2010 Act will sunset. Among the changes made are the following:

- A $5,000,000 estate tax and GST tax exemption was retroactively reinstated for 2010, but taxpayers were given an election to have either a $5,000,000 estate and GST tax exemption with a full step up in basis or apply a modified carryover basis with no estate tax applied for deaths occurring in 2010. ACT Section 301(a)(c)

- Any estate, gift or GST tax return, payment or disclaimer for federal purposes will be due no sooner than nine months after the date of enactment. (There is no extension for Massachusetts estate tax purposes.) ACT Section 301(d)

- The estate tax exemption, or more appropriately, the applicable exclusion amount, is increased to $5,000,000 per person for deaths occurring in 2011 and 2012, but will return to $1,000,000 in 2013. ACT Section 302(a)(1)

- The estate tax exemption (but not the GST exemption) is portable. (Portability of the gift tax exemption is uncertain insofar as the actual statute is concerned, but the Committee Reports indicate that gift tax portability was intended.) A spouse can only use the unused exclusion amount for the immediately predeceased spouse. Example: Surviving spouse remarries and new spouse dies before surviving spouse. The surviving spouse can use only the unused exclusion amount of his second spouse.

- The applicable exclusion amount for both estate, gift, and GST tax purposes (but not the portable portion of the exclusion amount) will be indexed for inflation beginning in 2012.

- Generation skipping tax exemption is set at $5,000,000 for 2011 and 2012 (as adjusted for inflation).

- The gift tax exemption is raised from $1,000,000 per person to $5,000,000 per person for gifts made in 2011 and 2012 (but scheduled to return to $1,000,000 in 2013).

- The maximum tax rate for gifts, estates and GST will be 35% in 2011 and 2012.

- The GST tax rate for 2010 is zero.

## II. **<u>Getting Familiar With the New Terms</u>:**

The computation of the estate tax payable, if any, remains the same. First, the amount of the tax is determined without regard to any exclusion amount and then the "applicable credit amount" is subtracted to determine the actual tax due. In this regard, the "applicable credit amount" is the amount of the tentative tax, which would be determined under IRC § 2001(c) if the amount with respect to which such tentative tax is to be computed or equal to the "applicable exclusion amount." ACT Section 302(a).

- Basic Exclusion Amount:

  This is the $5,000,000 exclusion amount for estate tax as increased by a cost of living adjustment beginning in 2012.

- Deceased Spouse's Unused Exclusion Amount:

  This is the amount of the decedent's most recently deceased spouse basic exclusion amount not used by him or her, assuming that the first spouse to die dies after December 31, 2010 (This is not automatic and will require an estate tax filing upon the death of the first spouse to die and that estate will remain open for examination at least until the death of the survivor).

- Applicable Exclusion Amount:

  This is the sum of the (1) basic exclusion amount plus (2) the deceased spousal unused exclusion amount.

- Portability:

  Portability is the ability of the surviving spouse to use the "deceased spousal unused exclusion amount."

## III. Uncertainty Remains:

- Claw-Back Issue:

  A claw-back issue arises if a taxpayer makes a gift in excess of $1,000,000 in 2011 or 2012 and dies in 2013 with no taxable estate. If the estate tax return is followed literally, the taxpayer would wind up owing estate taxes even though the decedent did not have any assets as of the date of death. This problem arises from the way the estate tax is computed, which requires that gifts in excess of the annual exclusion amount made after 1976 must be added back to the decedent's taxable estate (primarily to determine the applicable rate).

  If we assume a 35% bracket, this would give rise to an estate tax of $1,750,000. In connection with the actual tax computation, however, a credit is allowed based upon the estate tax applicable to the exclusion amount in effect in the year of death (presumably $1,000,000). This would give an estate tax credit of $350,000 with a tax due of approximately $1,400,000. This was clearly not intended by Congress, depending upon which commentator is read, and may or may not be a legitimate problem.

**Form 706 & 709**

**Sample Computations of Gift & Estate Tax Computations to Show Potential Claw-Back**

**Form 709 (Gift)**

| | |
|---|---|
| Amount of Gift | $5,000,000 |
| Tax on Gift (35%) | $1,750,000 |
| Unified Credit | |
| (Gift Tax on $5,000,000) | $1,750,000 |
| Gift Tax Due | – $0 – |

**706 Computation (Using 706, 9/09)**

| | | |
|---|---|---|
| Line 3(a) | Total Assets at Death | – $0 – |
| Line 3(b) | State Death Tax Deduction | – $0 – |
| Line 3(c) | Taxable Estate | – $0 – |
| Line 4 | Adjusted Taxable Gifts Made After December 31, 1976 (Other than Gifts that are Includible in the Decedent's Gross Estate) | $5,000,000 |

| | | |
|---|---|---|
| Line 5 | Total | $5,000,000 |
| Line 6 | Tentative Tax (Assume 35%) | $1,750,000 |
| Line 7 | Total Gift Tax Paid | – $0 – |
| Line 8 | Gross Estate Tax | $1,750,000 |
| Line 9 | Maximum Unified Credit ($1,000,000 x 35%) | $350,000 |
| Line 11 | Allowable Unified Credit | $350,000 |
| Line 16 | Tax Due (Line 8 minus Line 11) | $1,400,000 |

- Portability of Gift Tax Exemption:

  While it is clear that the estate tax exemption is portable, it may be less clear that the gift tax exemption is portable. This means that, while a surviving spouse would be permitted to die with up to $10,000,000, $500,000 applicable to the decedent's basic exemption amount, plus the $5,000,000 attributable to the unused exemption amount from the predeceasing spouse, it is less clear that the surviving spouse can give away $10,000,000. In this regard, an analysis of the statutory provisions is necessary.

  In general, it appears that portability applies for the gift exemption since the 2010 Act, Section 303(b)(1), amends IRC § 2505(a)(1), which describes the applicable credit amount (for gift tax purposes) as the applicable credit amount under 2010(c), which "would apply if the donor died as of the end of the calendar year.

  The applicable credit amount under IRC § 2010(c) includes the deceased spousal unused exclusion amount, so, in theory, that amount is also included in the gift tax exemption. It should be noted that the applicable Joint Committee on Taxation report specifically provides that a surviving spouse may use his or her DSUEA "for life time gifts or for transfers at death."

- Massachusetts basis is uncertain:

  The basis of property for Massachusetts income tax purposes is determined by M.G.L. c.62, § 6F. Pursuant to Section 6F(b)(2)(C), the step-up in basis rules of IRC § 1014(b) apply to property acquired from a decedent so that there should be no difference between federal basis and Massachusetts basis.

  The problem lies in IRC § 1014(f) enacted in 2001 under EGTRRA, which provides that Section 1014 shall not apply to decedents dying after December 31, 2009. While the 2010 Act did repeal IRC § 1014(f), for Massachusetts purposes, the applicable Code for purposes of Chapter 62 refers to the Internal Revenue Code as amended on January 1, 2005, and in effect for the taxable year. As a result, the Internal Revenue Code including Section 1014(f)'s repeal of Section 1014, will govern Massachusetts basis.

## IV. **Planning Suggestions**:

(1) An aggressive lifetime giving program should take place over the next two years, remembering there is no Massachusetts gift tax. A transfer of $5,000,000 by a single person, even shortly before death, will result in a savings of $391,600 for Massachusetts estate tax purposes.

(2) Massachusetts estate taxes should be eliminated upon the death of the first spouse to die either using a QTIP trust or an outright gift to the surviving spouse, who then would be in a position to gift assets away free of both federal and Massachusetts gift tax purposes.

(3) Some effort should be made to try to cause estate tax includibility in the estate of the first spouse to die, at least up to the $5,000,000 exemption amount since the estate tax law sunsets in 2013. See, PLR 200604028; PLR 200403094 (Using General Powers of Appointment); PLR 200101021; PLR 200210051 (Using Joint Trusts).

(4) Consider disclaimer trusts and/or Clayton provisions in light of portability, (but it is unlikely that, at least in Massachusetts, planning would shift from its traditional three-trust format).

(5) Be sure to include the ability to pay principal to or for the benefit of the surviving spouse in both the Massachusetts QTIP share and any by-pass share in order to take full advantage of the possibility of a step-up in basis upon the death of the second spouse to die.