

# 2010 and Beyond: Estate Planning and Administration Issues

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Mickey R. Davis  
Bracewell & Giuliani LLP  
711 Louisiana, Suite 2300  
Houston, Texas 77002  
713.221.1154  
[mickey.davis@bgllp.com](mailto:mickey.davis@bgllp.com)

# Overview of 2010 Changes

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- The Estate Tax is "Repealed" for Decedents Dying in 2010
- The GST Tax is "Repealed" for 2010 Distributions and Terminations
- The Gift Tax Remains (but at a 35% Rate)
- Modified Carryover Basis Applies
- Other Weird Things Happen

# Carryover Basis Overview (§ 1022)

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- Basis is *Lesser* of Basis or FMV
- US Citizens/Residents Get \$1.3 Million Step-up (Plus Section 165 Unrealized Losses, NOL Carry-Forwards & Capital Loss Carry-Forwards)
- Nonresident Aliens Limited to \$60,000
- Additional \$3 Million for:
  1. Property Acquired from Decedent by Surviving Spouse
  2. Property Passing to QTIP Trust for Spouse
  3. Spouse's Half-Interest in Community Property

# Some of the Weird Things

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- The "Executor" Must Report Basis and FMV for All Estates Valued at \$1.3 Million or More (§ 6018)
- \$10,000 Failure-to-File Penalty (§ 6716)
- Despite Carryover Basis, Gain on Funding Pecuniary Bequests Only for Post-Death Appreciation (§ 1040)
- Inheritor of Decedent's House gets \$250,000 Gain Exclusion (§ 121(c)(11))
- Gain Recognized on Bequests of Property to Nonresident Aliens (IRC § 684(a))

# The Estate Tax Returns in 2011

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- The "Repeal" is Repealed
- \$1 Million Exemption with a 55% Top Rate
  - 60% for \$10,000,000 to \$17,184,000 Estates
- Carryover Basis is Repealed
- Thinking Back to 2001:
  - Deduction for QFOBIs Returns
  - 15 Shareholder Limit for § 6166 Deferral
  - The Texas Inheritance Tax Returns

# Repeal of the Repeal

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- EGTRRA Section 901(a):

"All provisions of, and amendments made by, this Act shall not apply . . . to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010."

- EGTRRA Section 901(b):

"The Internal Revenue Code of 1986 . . . shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a) had never been enacted."

# Congress Threatens Retroactive Re-enactment

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- It is "wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing." *Untermeyer v. Anderson* 276 U.S. 440 (1928).
- *Untermeyer*, which involved the Nation's first gift tax, essentially has been limited to situations involving "the creation of a wholly new tax," and its "authority is of limited value in assessing the constitutionality of subsequent amendments that bring about certain changes in operation of the tax laws." *U.S. v. Carlton*, 512 U.S. 26 (1994)

# What Are We Doing Now?

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- **Review Existing Documents**
  1. Marital Deduction/Bypass Formulas
  2. GST Split Formulas
  3. Blended Family Planning with Estate Tax Splits
  4. Charitable Bequest Language
- **Notify Clients and Former Clients**
  1. Legal Duty vs. Moral Duty vs. Marketing
  2. Re-establishing Attorney/Client Relationship?
  3. May Need Further Actions in 2011

# Planning for Deaths in 2010

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## 1. Formula Language Certainty

- Clarify What the Language in Existing Documents Means
- Consider State Death Tax Issues
- Beware of "Quick Fix" Issues

## 2. Spousal Basis Adjustment "Triage"

- Draft to Ensure Maximum Availability of Basis Increase

## 3. Executor Exoneration

- Limit Liability for Allocating to Probate and Non-probate Assets

# 1. Formula Language Certainty

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- **MUST Review Formula Language**
  - Current Language may Drive All Assets to Bypass (or QTIP) Trust
- **Especially Dangerous for "New Traditional Families"**
- **Other Code References (e.g., GST Splitting; Charitable Bequests)**
- **Consider the "Virginia Solution"**

## 2. Spousal Basis Adjustment "Triage"

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- **Planning to Get the Extra \$3 Million**
  - Only Married Couples
  - Not Couples Where Community Step-up is Less Than \$2.6 Million
  - Not Couples Where Community Step-up is more than \$6 Million
- **Available to Nonresident Alien Spouses**

# Where Should the \$3 Million Go?

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- **Outright to Surviving Spouse?**
  - May Cause Estate Tax Inclusion if Spouse Dies after 2010 (or if Congress Acts)
- **QTIP Trust?**
  - Allows for Full \$3 Million Step-up
  - No QTIP Election for 2010 Death, So No Later Inclusion under § 2044

# Bequests to QTIP

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- All Property (or All Step-up Property) to QTIP
  - Simple, but "Overfunds" QTIP
- Step-up Assets "As Selected by my Executor"
  - Flexible, but May Not Satisfy "Passing" Requirement
- Lowest FMV Step-Up Assets to QTIP
  - Minimizes QTIP Funding But May Not Maximize Tax Savings
- Most Income Tax Savings to QTIP
  - May "Overfund" QTIP to Save Income Tax

### 3. Executor Exoneration

- Authorize Executor to make allocation to adjust the federal income tax cost basis of assets passing as a result of death to the extent authorized by law, whether or not those assets pass under Will.
- No duty to allocate basis increase exclusively, primarily or at all to assets passing under the Will, or to allocate basis equally or pro rata among various recipients of those assets.
- Neither allocation nor failure to make allocation shall cause Executor to be liable.

# Overview of GST Issues

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1. Administration of Existing GST Trusts
2. Contributions to Existing GST Trusts
3. Creation of New GST Trusts
4. EGTRRA GST Allocations

# 1. Administration of Existing GST Trusts

- Fiduciary Duty to Consider Direct “Taxable Distributions” or “Taxable Terminations” From Non-Exempt Trusts?
- Consider Non-Tax Consequences (Loss of Creditor Protection, etc.)
- Consider Retroactive Re-enactment
- Retain Assets for Tuition and Medical Distributions

## 2. Contributions to Existing GST Trusts

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- No Exemption to Allocate for 2010 Gifts
  - Consider “Protective Allocation”
- Will This Result in Non-Zero Inclusion Ratio in 2011?
- Consider Late Allocation in 2011 if Retroactive or New GST Doesn't Resolve Doubts
- Consider "loans" or using internal assets to further purposes of trust

### 3. Creation of New GST Trusts

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- No GST Exemption to Allocate
  - Consider “Protective Allocation”
- Direct Skips Okay in 2010, but What About Taxable Distributions in 2011?
- Consider Trusts for Skip Persons Only
  - Gift Tax Still Applies (But At 35%)
  - “Drop-down” Rule of Section 2653(a) may Apply
- Even After 2010, can Distribute for Tuition and Medical

## 4. EGTRRA GST Allocations

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- EGTRRA Repeal is as if the provisions and amendments described in subsection (a) had never been enacted. Does this mean that:
  - Deemed Allocation of GST Exemption Never Happened?
  - Allocations of GST Exemption in Excess of \$1 Million (2004-2009) Never Happened?
  - IRS 9100 Relief Never Happened?

# Large Transfers at Death in 2010

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- Who Must File
  1. Estates with non-cash assets > \$1.3 Million (§ 6019(b)(1))
  2. Estates receiving taxable gifts within 3 years of death (§ 6019(b)(2))
  3. Estates of nonresident aliens with tangible US property + property passing to US persons > \$60,000 (§ 6019(b)(3))
  4. Returns by trustees and beneficiaries if no executor (§ 6019(4))
  5. All other estates? Basis must be allocated "on the return required by Section 6018" (§ 1022(d)(3))
- Must be filed "with decedent's final income tax return" on the due date (including extensions) for that return (§ 6075(a))

# Contents of Return

- **Large Transfers at Death return must report:**
  1. The name and TIN of the recipient
  2. An accurate description of the property
  3. The adjusted basis of the property in the hands of the decedent and its fair market value at the time of death
  4. The decedent's holding period for the property
  5. Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income
  6. The amount of basis increase allocated to the property under subsection (b) or (c) of section 1022; and
  7. Such other information as the Secretary may by regulations prescribe (§6018(c))
- **Must also provide this info to each beneficiary**  
(§6018(e))

# Penalties for Failure to File

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- Penalty for failure to file a “Large Transfers at Death” return is \$10,000 (§ 6716(a))
- Penalty for failure to report taxable gifts received within 3 years of death is \$500 (§ 6716(a))
- Penalty for failure to give information to beneficiaries is \$50 per failure (§ 6716(b))
- Penalty for *willful* failure is 5% of FMV of property (§ 6716(d))

# 2010 "Opportunities"

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- **Current Gift to Inter Vivos QTIP**
  - No Retroactivity: Trust Passes to Irrevocable Descendants' Trusts
  - Retroactivity: QTIP Election to Avoid Gift Tax
- **Formula Gifts**
  - “Maximum GST Exempt Amount to Trust”
  - Gift Over to Charity/GRAT/Spouse/QTIP/CLT
- **Disclaimer of Gift to Trust**
  - Reversion if Beneficiary or Trustee Disclaims

- Shift Wealth to Terminal Spouse?
  - Shift Step-up Assets to Use Full Allowance
  - Shift Other Assets to Maximize Bypass
- Shift Loss Assets to Healthy Spouse?
- Trustees Distribute Low Basis Assets to Terminal Beneficiaries?
- Buy Low Basis Assets from Grantor Trust?

# Conclusion

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- **Senator Max Baucus's Prediction has Come True: "Massive, Massive Confusion"**
- **Be Proactive**
  - Contact Clients and Former Clients
  - Know What to Say to Them When They Call
- **Stay Tuned for Further Developments**