

ESTATE PLANNING FOR FINANCIAL PLANNERS 2010 SUPPLEMENT

2010 UPDATE FOR ESTATE, GIFTS, AND GST TAX

- As of the date of this material, there is no estate or generation skipping transfer (GST) tax for 2010.
- The new gift tax rate is 35%.
- The annual gift tax exclusion remains at \$13,000 per donee, per donor.
- The lifetime gift exemption is \$1,000,000.
- The credit equivalency for the gift exemption is \$330,800 (see schedule below).

If the amount with respect to which the tentative tax to be computed is	The tentative gift tax is:
Not over \$10,000	18% of such amount
Over \$10,000 but not over \$20,000	\$1,800, plus 20% of the excess over \$10,000
Over \$20,000 but not over \$40,000	\$3,800, plus 22% of the excess over \$20,000
Over \$40,000 but not over \$60,000	\$8,200 plus 24% of the excess over \$40,000
Over \$60,000 but not over \$80,000	\$13,000 plus 26% of the excess over \$60,000
Over \$80,000 but not over \$100,000	\$18,200 plus 28% of the excess over \$80,000
Over \$100,000 but not over \$150,000	\$23,800 plus 30% of the excess over \$100,000
Over \$150,000 but not over \$250,000	\$38,800 plus 32% of the excess over \$150,000
Over \$250,000 but not over \$500,000	\$70,800 plus 34% of the excess over \$250,000
Over \$500,000	\$155,800 plus 35% of the excess over \$500,000

- For 2010, while there is no estate tax, there is a change in the step to fair market value for basis of property inherited from a decedent dying in 2010. The changes are as follows:

2010 - Carryover Basis at Death

For property inherited from a decedent after December 31, 2009, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001) contains a provision that changes the basis of an heir's inherited property for decedents dying in 2010. The basis of the property will be treated as a transfer by gift, where the basis for the person inheriting is the lesser of, (1) the adjusted basis of the decedent or (2) the fair market value of the property as of the decedent's date of death.

In addition, the law provides for upward adjustments to the basis of estate assets of up to \$1,300,000 for nonspouse beneficiaries plus up to \$3,000,000 for the surviving spouse. The upward adjustment in carryover basis for 2010 may not increase the basis of inherited property above its fair market value as of the date of a decedent's death. Note that there is an additional adjustment for property in which the fair market value is less than the decedent's adjusted basis.

Qualified Spousal Property

The property inherited by a spouse that qualifies for the adjustment in basis includes:

1. outright transferred property, and
2. qualified terminable interest property.

Note that terminable interest property is considered as qualified spousal property available for the upward adjustment in basis. If the decedent's will has a provision for spouse survival as a condition of outright transfer property, the provision cannot require survival of the spouse for a period exceeding 6 months (in order for the inherited property to be considered as qualified spousal property available for the upward adjustment in carryover basis).

Property left to a spousal power of appointment trust apparently does not qualify for the basis adjustment.

For purposes of qualified property,

- If the decedent owned property as joint tenants with right of survivorship (JTWROS) or tenant by the entirety and the only other owner is the surviving spouse, then the decedent will be treated as the owner of 50 percent of the property.
- If the decedent did not own property JTWROS or tenant by the entirety, but otherwise was a co-owner, then the decedent will be treated as the owner of the property to the extent of the proportion of consideration made (actual contribution rule).
- If the decedent acquired the property by gift, bequest, devise or inheritance as JTWROS, then the decedent shall be treated as an owner according to the value of the fractional part calculated based on the number of joint tenants.
- For community property purposes, the one-half share of the surviving spouse's share of community property shall be treated as owned by and acquired from the decedent as qualified property if the decedent owns at least one-half of the whole of the community interest in the property. This will result in the availability of adjusted basis up to FMV for the entire property for a decedent dying in 2010.

Property Gifted to Decedent Within 3 Years of Death

Property that was acquired by the decedent by gift or by inter vivos transfer for less than adequate and full consideration within the 3-year period ending on the decedent's date of death will not be treated as qualified property available for the basis increase. This exception to qualified property however will not apply to property gifted to the decedent by the decedent's spouse within the 3-year period ending on decedent's date of death unless the decedent's spouse acquired the property by gift or by inter vivos transfer for less than adequate and full consideration.

Decedent Nonresidents who are Noncitizens of the United States

The basis increase for property inherited from a nonresident who is not a citizen of the United States is limited to \$60,000 (not \$1,300,000).

2010 Estate Tax Return Filing Requirements

Even though there is no estate tax for 2010 estates (as of this publication), the special carryover basis rules may require an estate tax return filing. For 2010 decedents (U.S. citizens or residents) having gross estates that exceed \$1,300,000 plus unused built-in losses and loss carryovers require the filing of an estate tax return. In addition, non-citizen, non-residents whose gross estates contain U.S. property exceeding \$60,000 also require filing an estate tax return.

EFFECT OF NEW LAW FOR 2010 ON SELECTED EXAMPLES AND THE SOLUTIONS

Chapter 3

Example 3.8, Page 71

Ann and Bill have lived in a community property state all 32 years of their marriage. Ann and Bill purchased a home 20 years ago for \$120,000 (each would have deemed \$60,000 adjusted basis in the home). The value of their home has appreciated to \$2,000,000. When Bill dies in 2010, his executor will value the property at the lesser of the adjusted basis or the FMV of the property as of Bill's date of death. Assuming Bill bequeaths his interest in the home to Ann, his adjusted basis of \$60,000 would be Ann's carryover basis. The executor of Bill's estate can choose to assign available unallocated adjustments to the entire value of the community property home to increase the carryover basis for Ann up to the FMV of \$2,000,000 (EGTRRA 2001).

Example 3.9, Page 72

Assume Bill and Ann had lived in a common law (separate property) state and owned the property as tenants in common. If Bill's will does not transfer his interest to Ann, then only Bill's heirs would receive a new basis in $\frac{1}{2}$ of the home based on the lesser of Bill's adjusted basis (\$60,000) or the FMV at Bill's 2010 date of death. Bill's heirs could receive an upward adjustment in the \$60,000 basis if the executor of the estate applies unallocated adjustments up to the FMV of Bill's $\frac{1}{2}$ interest in the home. In this case, nonspouse beneficiaries have up to \$1,300,000 of upward adjustments available for 2010 to add to the carryover basis. The executor can assign \$940,000 (\$1,000,000 - \$60,000) to the heir's interest resulting in a \$1,000,000 carryover basis. Ann would continue to own her $\frac{1}{2}$ of the home with a tax basis equal to her original \$60,000 adjusted basis.

Example 3.10, Page 72

Jim and Carol lived in Illinois (a common law state) since their marriage in 1978. In 1982, Jim and Carol purchased a vacation home in California for \$50,000 and titled the property joint tenancy with right of survivorship. In 2001, Jim and Carol moved to California, but did not declare all property community property. When Jim died in 2010, Jim's executor valued $\frac{1}{2}$ of the California vacation home at the lesser of basis or FMV (\$300,000) as of Jim's date of death (lesser is basis of \$25,000). Because of the right of survivorship, Carol is the beneficiary and receives Jim's $\frac{1}{2}$ of the home with a tax basis of \$50,000 for her 100% ownership of the property. However, under EGTRRA 2001 the executor can assign unallocated adjustments up to the FMV of Jim's half ownership in the home of \$125,000 (\$150,000 - \$25,000 original basis) so that Carol's new carryover adjusted basis is \$175,000 (\$150,000 + \$25,000 - Carol's adjusted basis in her original half interest). Because the property is not community property, Carol does not receive a new tax basis for her original $\frac{1}{2}$ of the home, but keeps her old tax basis of \$25,000 (\$50,000 / 2). Had Carol and Jim declared all the property community property, Carol would have received a new tax basis on her $\frac{1}{2}$ of the home and would have a tax basis equal to \$300,000 in the property.

Example 3.11, Pages 77-79

Mandy and Steven had been married for six years. Three years ago, after having their only daughter, Carol, they bought their first home for \$250,000. In 2010, Steven was killed in a car accident. His will left everything to his daughter. The fair market value of the home at Steven's death was \$400,000.

Property Ownership Type	Amount Included in Gross Estate (Steven) for 2010?	Amount Included in Probate Estate (Steven)?	Who receives Steven's ownership interest in the home?	Mandy's income tax basis after Steven's death? Preallocation/Postallocation	Carol's income tax basis after Steven's death? Preallocation/Postallocation	Qualifies for Unlimited Marital Deduction?
Fee Simple*	N/A	Yes \$400,000	Carol	N/A	\$250,000/ \$400,000	No
Tenancy in Common**	N/A	Yes \$240,000	Carol	\$100,000	\$150,000/ \$240,000	No
JTWROS**	N/A	No \$0	Mandy	\$250,000/ \$325,000	N/A	Yes
Tenancy by the Entirety**	N/A	No \$0	Mandy	\$250,000/ \$325,000	N/A	Yes
Community Property***	N/A	Yes \$200,000	Carol	\$125,000/ \$200,000	\$125,000/ \$200,000	No

*Assume that Steven had purchased the home with his separate funds for \$250,000, and following EGTRRA 2001 provisions, the executor assigns the maximum allowed of unallocated adjustments to the adjusted basis.

**Assume, at the purchase of the home Steven contributed \$150,000 and Mandy contributed \$100,000 and held in corresponding percentages (EGTRRA 2001 provisions for 2010 applied). Also assume the executor assigns an upward adjustment of unallocated surviving spousal adjustments to the carryover basis in 2010 as allowed.

***Assume the home was purchased with community funds and also assume the executor assigns upward adjustment to the carryover basis of unallocated surviving spousal adjustments in 2010 as allowed (EGTRRA 2001).

Fee Simple: As of this publication there is no estate tax for 2010. The property is included in Steven's probate estate because fee simple ownership does not provide a right of survivorship and will transfer to Carol as directed by the will. A legatee receives fee simple property for 2010 at the lesser of adjusted basis or equal to the fair market value of the property at the decedent's date of death. Carryover basis would be \$250,000, but assuming the executor follows EGTRRA 2001 and applies unallocated adjustments (limited to \$1,300,000 for nonspouse heirs) of \$150,000, Carol's carryover basis will be \$400,000 (\$250,000 original basis + \$150,000 adjustment for EGTRRA 2001). Mandy does not receive any interest in the property, but may have a claim to continue living in the home or some other right granted by her state because she is a spouse.

Tenancy in Common: As of this publication there is no estate tax for 2010. Per the direction of the will, Steven's interest in the property will transfer through the probate process to Carol. Carol will receive the property with an adjusted basis equal to the lesser of adjusted basis or the FMV of the property at Steven's date of death. However, the executor of Steven's estate can apply EGTRRA 2001 and make a basis adjustment upward of unallocated adjustments (limited to \$1,300,000 for nonspouse heirs) of \$90,000 for an adjusted carryover basis of \$240,000 (\$150,000 +

\$90,000) for Carol. Mandy will retain her original adjusted basis, equal to her original cash contribution at the purchase date, or \$100,000.

Joint Tenancy with Rights of Survivorship (JTWROS): As of this publication there is no estate tax for 2010. When property is owned JTWROS between a husband and wife, each is assumed to have contributed 50 percent of the value of the property at the original purchase date. EGTRRA 2001 provides 2010 carryover basis that assumes 50 percent ownership by each spouse for property owned JTWROS. With the right of survivorship, the property automatically transfers to Mandy and does not transfer through the probate process. Accordingly, Carol does not receive any interest in the property. Mandy has an adjusted basis in the property equal to her original deemed contribution, \$125,000, plus the lesser of Steven's adjusted basis or the fair market value as of Steven's date of death. However, the executor of Steven's estate can apply EGTRRA 2001 and make a basis adjustment upward for unallocated adjustments (limited to \$3,000,000 for the surviving spouse), of \$75,000 for a total carryover basis on Steven's half of \$200,000. Mandy's total adjusted basis will be equal to \$325,000 (\$200,000 + \$125,000).

Tenancy by the Entirety: Property owned tenancy by the entirety is similar to property owned JTWROS between a husband and wife for all of the tax matters addressed. A key point to remember, however, is that property owned tenancy by the entirety requires the consent of both spouses to partition the interest, whereas property owned JTWROS, even between spouses, can be partitioned without the consent of the other spouse.

Community Property: As of this publication there is no estate tax for 2010. Steven's interest would pass through probate to Carol per the direction of the will. Mandy would retain her 50 percent interest and would receive an increased adjusted basis equal to the fair market value of her interest at Steven's date of death, \$200,000 (per EGTRRA 2001 the executor can assign unallocated adjustments (limited to \$3,000,000 for the surviving spouse)). Carol's adjusted basis in her 50 percent interest would also be lesser of Steven's adjusted basis or the fair market value at Steven's date of death, \$200,000. Assuming the executor follows EGTRRA 2001 and applies unallocated adjustments (limited to \$1,300,000 for nonspouse heirs) then Carol's basis can be adjusted upwards to \$200,000 (\$125,000 + \$75,000).

Selected End of Chapter 3 Questions

Discussion Questions

8. Discuss the consequences of two people owning property as a tenancy in common with equal interests, but one contributes 70% to the initial purchase price.

For 2010, EGTRRA 2001 has the following provision: If the decedent did not own property JTWROS or tenant by the entirety, but otherwise was a co-owner, then the decedent will be treated as owner of the property to the extent of proportion of consideration made (actual contribution rule).

16. Discuss what happens at the death of the first spouse to die when property is held as community property.

For a decedent dying in 2010, EGTRRA 2001 provides that the one-half share of the surviving spouse's share of community property will be treated as owned by and acquired from the decedent as qualified property if the decedent owns at least one-half of the whole of the community interest in the property at decedent's date of death. An upward basis adjustment for unallocated adjustments (limited to \$3,000,000 for the surviving spouse) can be assigned by the executor to qualified property of the community up to the entire fair market value.

Multiple Choice

8. Kim and Tommy have lived in Arizona since their marriage. Kim received an inheritance from her father during their marriage. Kim and Tommy are moving to Massachusetts for a new job and have some questions regarding their move to a common law (separate property) state from a community-property state. Which of the following statements is correct?

- a. When a couple moves from a community-property state to a common law (separate property) state, separate property will generally remain separate property.
- b. When a couple moves from a common law (separate property) state to a community-property state, separate property will generally become community property.
- c. Community property avoids probate at the death of the first spouse and automatically passes to the surviving spouse by operation of law.
- d. To get the step-to fair market value in basis at the death of the first spouse, a couple who lives in a common law (separate property) state can elect to treat their separate property as community property.

The correct answer is a.

Answer a is the only correct statement. When a couple moves from a community property state to a common law (separate property) state, separate property will generally remain separate property. Answer b is incorrect because separate property does not generally become community property when a married couple moves from a common law state to a community property state. Answer c is incorrect because community property may be disposed of by will and does not automatically pass to the surviving spouse by operation of law. Finally, answer d is incorrect because couples living in common law states cannot elect community property treatment at the death of the first spouse in order to get a step-up in basis. Furthermore, for decedent's dying in 2010 EGTRRA 2001 provides for a carryover basis that is the lesser of adjusted basis or the fair market value of the property at decedent's date of death. Then, a basis adjustment upward for unallocated adjustments (limited to \$3,000,000 for the surviving spouse) can be assigned by the executor to qualified property up to the total fair market value of property owned as community property. For property owned as separate property, the basis adjustment upward would only apply to decedent's portion of property owned at death.

9. Dara has owned 100% of the stock of Dara's Baked Goods, a corporation, for 22 years. In the current year, she gifted 50% of the business to her daughter, Sheila, who lives in California. Sheila does not work at the business and reinvests any income in the company. With respect to the transfer of the business interest, which of the following statements is/are correct?

- a. Sheila's 50% interest in Dara's Baked Goods is community property, owned equally by Sheila and her husband.
- b. If Sheila's husband dies tomorrow, both his share of Dara's Baked Goods and Sheila's share of Dara's Baked Goods would receive a step-to fair market value in basis.
- c. Sheila owns 50% of Dara's Baked Goods outright, and the interest will not be considered community property.
- d. If Sheila dies tomorrow, the executor of her estate would include 25% of the value of Dara's Baked Goods in her gross estate.

The correct answer is c.

Answer c is correct because gifted property is generally considered separate property. Answer a is incorrect because gifted property is generally considered separate property unless Sheila elected to treat the property as community property, or commingled the assets. In this case, Sheila does not commingle the assets and the problem does not mention that she elected community property status over the assets. Answer b is incorrect because Sheila's interest in Dara's Baked Goods will not be included in her husband's gross estate. Separate property is only included in the gross estate of the separate property owner. Because the interest is not in her husband's gross estate, it does not receive a step-to fair market value (which is not available for decedent's dying in 2010 per EGTRRA 2001). Answer d is incorrect because if Sheila dies tomorrow she must include 100% of the value of all of her assets owned as separate property (thus 50% of Dara's Baked Goods). If Sheila dies in 2010, as of the date of this publication, there is no estate tax. For 2010, the entire interest Sheila owns in Dara's Baked Goods would be included in her probate estate and the value would be the lesser of adjusted basis or the fair market value at Sheila's date of death with the potential for an upward adjustment in basis (up to FMV) for unallocated adjustments (\$1,300,000 for nonspouse, \$3,000,000 for surviving spouse).

Quick Quiz 3.5, Page 71

1. Both halves of property owned tenancy by the entirety in a common law (separate property) state would receive a new basis at the death of one of the owners.

- a. True
- b. False

False. Under EGTRRA 2001 for a decedent dying in 2010, if the decedent owned property tenancy by the entirety and the only other owner is the surviving spouse, then the decedent will be treated as owner of 50 percent of the property. For a decedent dying in 2010, the portion of the property owned by decedent will have a basis of the lesser of the decedent's adjusted basis or the fair market value at the date of death with the potential for an upward adjustment in basis up to FMV for unallocated adjustments (up to \$3,000,000 for a surviving spouse). The surviving co-tenant's portion of the property will retain its original basis.

EXAMPLE OF 2010 CARRYOVER BASIS AT DEATH

Mike dies in 2010 with assets A-F as listed in the table below (assets do not include IRD property).

ASSET	FMV AT MIKE'S DEATH	MIKE'S ADJUSTED BASIS	< FMV OR MIKE'S BASIS
A	\$3,000,000	\$3,600,000	\$3,000,000
B	\$2,000,000	\$1,600,000	\$1,600,000
C	\$1,500,000	\$300,000	\$300,000
D	\$500,000	\$500,000	\$500,000
E	\$1,700,000	\$300,000	\$300,000
F	<u>\$1,300,000</u>	<u>\$200,000</u>	<u>\$200,000</u>
	\$10,000,000	N/A	\$5,900,000

ASSET	INITIAL BASIS TO SPOUSE	ADJUSTMENT TO SPOUSE BASIS	TOTAL SPOUSE ADJUSTED BASIS	INITIAL BASIS TO HEIR	ADJUSTMENTS TO HEIR BASIS	TOTAL HEIR ADJUSTED BASIS	TOTAL BASIS OF ALL ASSETS DISTRIBUTED
A	\$3,000,000	\$0	\$3,000,000				\$3,000,000
B				\$1,600,000	\$400,000	\$2,000,000	\$2,000,000
C				\$300,000	\$1,200,000	\$1,500,000	\$1,500,000
D	\$500,000	0	\$500,000				\$500,000
E	\$300,000	\$1,400,000	\$1,700,000				\$1,700,000
F	\$200,000	\$1,100,000	\$1,300,000				\$1,300,000
	<u>\$4,000,000</u>	<u>\$2,500,000</u>	<u>\$6,500,000</u>	<u>\$1,900,000</u>	<u>\$1,600,000*</u>	<u>\$3,500,000</u>	<u>\$10,000,000</u>
Total basis of all assets distributed (\$10,000,000 = \$6,500,000 + \$3,500,000) cannot exceed the fair market value at Mike's date of death.							
* Executor assigns additional adjustments of \$300,000 to heirs from underwater Asset A inherited by surviving spouse.							

EGTRRA 2001 Rules for 2010 Carryover Basis

- The adjusted basis of the asset inherited by an heir or legatee must be \leq fair market value.
- Up to \$3,000,000 of adjustments to basis is available for the surviving spouse.
- Up to \$1,300,000 of adjustments to basis is available for the other heirs.
- If the adjusted basis is less than the fair market value ("underwater"), then there is an additional adjustment available (Asset A).

Distribution of Mike's \$10,000,000 of Assets

- The spouse assets were adjusted up to fair market value by using \$2,500,000 adjustments ($\$4,000,000 + \$2,500,000 = \$6,500,000$).
- The “other heir” assets were adjusted up to fair market value (\$3,500,000) by using \$1,300,000 (the adjustment limit for nonspouse heirs) plus an additional “borrowed” amount from Asset A (\$300,000 of \$600,000 underwater).
- The total basis of all assets distributed is equal to the fair market value of \$10,000,000 because the spouse’s initial basis of \$4,000,000 plus EGTRRA 2001 adjustments of \$2,500,000 equals \$6,500,000. In addition, the other heir has an initial basis of \$1,900,000 plus EGTRRA 2001 adjustments of \$1,600,000 equals \$3,500,000.
- Note that there remains unused EGTRRA 2001 adjustments of \$500,000 for surviving spouse and \$300,000 from Asset A being underwater.

We believe a reasonable forecast of CFP exam testing of EGTRRA 2001 application of 2010 carryover basis will be limited to the determination of allocated and unallocated adjustments (up to \$3,000,000 for a surviving spouse and up to \$1,300,000 for a nonspouse) and will not be as complex as this example.

STRATEGY / DECISION RULES FOR APPLYING EGTRRA 2001 CARRYOVER BASIS

It would seem that the executor would stratify the assets into six strata with the first strata (A) being those assets expected to be sold close to the death of the decedent.

- A. Use adjustments to increase basis to fair market value to avoid capital gains upon disposition.
- B. Assets that are depreciable (trade or business) and especially those that would qualify for any bonus depreciation should be adjusted to fair market value if possible to create an offset to future ordinary income.
- C. These are the assets that are not A, B, D, E, or F assets. Adjust these to make use of any excess adjustment amount available after A and B.
- D. Any asset that the family expects to hold until their death should only get an increase (adjustment) in basis if there is an excess.
- E. Any asset that is expected to be devoted to charity and is a long term asset should not get any adjustments.
- F. IRD assets cannot receive any adjustments but make excellent assets to fulfill the charitable intention of the decedent.

Chapter 5

Exhibit 5.1, Page 118, is revised as follows for 2010:

Tax Rate Schedule for Gifts (for 2010)

Over \$0 but not over \$10,000	18% of such amount.
Over \$10,000 but not over \$20,000	\$1,800 plus 20% of the excess of such amount over \$10,000
Over \$20,000 but not over \$40,000	\$3,800 plus 22% of the excess of such amount over \$20,000
Over \$40,000 but not over \$60,000	\$8,200 plus 24% of the excess of such amount over \$40,000
Over \$60,000 but not over \$80,000	\$13,000 plus 26% of the excess of such amount over \$60,000
Over \$80,000 but not over \$100,000	\$18,200 plus 28% of the excess of such amount over \$80,000
Over \$100,000 but not over \$150,000	\$23,800 plus 30% of the excess of such amount over \$100,000
Over \$150,000 but not over \$250,000	\$38,800 plus 32% of the excess of such amount over \$150,000
Over \$250,000 but not over \$500,000	\$70,800 plus 34% of the excess of such amount over \$250,000
Over \$500,000	\$155,800 plus 35% of the excess of such amount over \$500,000

Example 5.11, Page 124

Assume Brianna gifts property worth \$400,000 to Kenny in 2010 on the condition that Kenny pay the gift tax. Brianna's adjusted basis in the property is \$100,000. Because Kenny must pay the gift tax, the gift is considered a net gift, and the gift tax is calculated on \$400,000 less the gift tax that Kenny must pay, assumed to be \$103,703 ($\$400,000 - (\$400,000 / (1 + .35))$). In this example, Kenny would pay the gift tax of \$103,703, the taxable gift would be \$296,297 and Brianna would be required to recognize taxable income of \$3,703 ($\$103,703 - \$100,000$) on the gift because the gift tax was greater than the basis.

Key Concept #5, Page 125

5. What is the lifetime gift tax applicable exclusion amount?

In addition to the annual exclusion, each person has a \$1,000,000 lifetime applicable gift tax exclusion (resulting in a gift tax applicable credit of \$330,800 for 2010).

Example 5.17, Page 130

Celeste transfers a present interest in property with a fair market value of \$32,000 to Raymond in 2009. This transfer is the only gift that Celeste has ever made and the only gift made to Raymond for the year. It qualifies for the annual exclusion because it is a gift of a present interest. \$13,000 of the \$32,000 is excluded under the annual exclusion and the tax on the remaining \$19,000 reduces Celeste's available applicable credit (\$345,800 for 2009; \$330,800 for 2010) resulting in no gift tax payable.

Example 5.18, Page 130

Zeke gifts a total of \$2,052,000 (\$1,026,000 to each of his two children). Zeke is married to Debbie. Debbie allows Zeke to use her annual exclusion and her lifetime applicable gift tax credit by signing a split gift election. Assuming no previous taxable gifts, there would be no gift tax payable. The couple would use their annual exclusions for the year for these donees and would have exhausted each of their applicable gift tax credits (\$345,800 or \$1,000,000 credit equivalency for 2009; \$330,800 for 2010).

Exhibit 5.4, Page 131

Year of Death	Applicable Estate Tax Credit	Applicable Estate Tax Credit Equivalency	Applicable Gift Tax Credit	Applicable Gift Tax Credit Equivalency
1997	\$192,800	\$600,000	\$192,800	\$600,000
1998	\$202,050	\$625,000	\$202,050	\$625,000
1999	\$211,300	\$650,000	\$211,300	\$650,000
2000	\$220,550	\$675,000	\$220,550	\$675,000
2001	\$220,550	\$675,000	\$220,550	\$675,000
2002	\$345,800	\$1,000,000	\$345,800	\$1,000,000
2003	\$345,800	\$1,000,000	\$345,800	\$1,000,000
2004	\$555,800	\$1,500,000	\$345,800	\$1,000,000
2005	\$555,800	\$1,500,000	\$345,800	\$1,000,000
2006 - 2008	\$780,800	\$2,000,000	\$345,800	\$1,000,000
2009	\$1,455,800	\$3,500,000	\$345,800	\$1,000,000
2010	REPEALED	REPEALED	\$330,800	\$1,000,000

Note: Under EGTRRA 2001, the applicable gift and estate tax credits and exclusion amounts will revert to the law in effect in 2001 in 2011.

Example 5.30, Pages 140-141

Tracy gave his daughter Skylar outright \$611,000 in 2005, \$712,000 in 2006 and \$813,000 in 2010. An abbreviated schedule detailing the gift tax due each year is shown below. (Note: the schedule provided has been simplified to ease illustration. Form 709 is more extensive.) The annual exclusion is \$11,000 for 2005, \$12,000 for 2006, and \$13,000 for 2010.

YEAR 2005 GIFT TAX CALCULATION		
Total Gifts	\$611,000	
Less Annual Exclusion	(\$11,000)	
Taxable Gifts	\$600,000	
Plus Previous Taxable Gifts	\$0	
Total Taxable Gifts	\$600,000	
Tax	\$192,800	(\$155,800 + (37% x \$100,000))
Less Gift Tax Previously Paid	\$0	
Less Applicable Credit Previously Used	\$0	
Less Applicable Credit Remaining*	(\$192,800)**	
Gift Tax Due	\$0	
*Credit remaining before transfer for 2005 = \$345,800		
**Do not exceed the tax due		

YEAR 2006 GIFT TAX CALCULATION		
Total Gifts	\$712,000	
Less Annual Exclusion	(\$12,000)	
Taxable Gifts	\$700,000	
Plus Previous Taxable Gifts	\$600,000	
Total Taxable Gifts	\$1,300,000	
Tax	\$469,800	(\$448,300 + (43% x \$50,000))
Less Gift Tax Previously Paid	\$0	
Less Applicable Credit Previously Used	(\$192,800)	
Less Applicable Credit Remaining*	(\$153,000)**	
Gift Tax Due	\$124,000	
*Credit remaining before transfer for 2006 = \$153,000 (\$345,800 - \$192,800).		

YEAR 2010 GIFT TAX CALCULATION		
Total Gifts	\$813,000	
Less Annual Exclusion	(\$13,000)	
Taxable Gifts	\$800,000	
Plus Previous Taxable Gifts	\$1,300,000	(\$600k in 2005 and \$700k in 2006)
Total Taxable Gifts	\$2,100,000	
Tax	\$715,800	(\$330,800 + (35% x \$1,100,000))
Less Gift Tax Previously Paid	\$124,000	
Less Applicable Credit Previously Used	(\$330,800)	
Less Applicable Credit Remaining*	\$0**	
Gift Tax Due	\$261,000	
*Credit remaining before transfer for 2010 = \$0.		

Notice that each year the previous taxable gifts are added to the taxable gifts and the tax is recalculated. This is to prevent individuals from escaping the progressive increase in the gift tax rate schedule by gifting in multiple years. Therefore, over the years Tracy paid a total of \$385,000 (\$124,000 + \$261,000) in tax and gave \$2,100,000 (\$600,000 + \$700,000 + \$800,000) in taxable gifts and \$2,136,000 (\$611,000 + \$712,000 + \$813,000) in total gifts including those subject to the annual exclusion.

Example 5.31, Pages 141-142

Assume instead that Tracy gave his daughter Skylar \$2,113,000 in 2010 and had not made any previous taxable gifts. Notice that the total taxable gifts is equal to the total taxable gifts over the three years given by Tracy in the previous example. In addition, the total tax paid equals the total tax Tracy paid over the years in the example above. The only difference between the examples is that Tracy was only able to use one annual exclusion rather than three in the previous example.

YEAR 2010 GIFT TAX CALCULATION - SAME TAXABLE GIFTS AS PREVIOUS EXAMPLE		
Total Gifts	\$2,113,000	
Less Annual Exclusion	(\$13,000)	
Taxable Gifts	\$2,100,000	
Plus Previous Taxable Gifts	\$0	
Total Taxable Gifts	\$2,100,000	
Tax	\$715,800	(\$330,800 + (35% x \$1,100,000))
Less Gift Tax Previously Paid	\$0	
Less Applicable Credit Previously Used	\$0	
Less Applicable Credit Remaining*	(\$330,800)**	
Gift Tax Due	\$385,000	
*Credit remaining before transfer for 2010 = \$330,800.		

If Tracy gave the same amount of total gifts, \$2,136,000, as he had given over the three years but within 2010, then he would have paid \$8,050 more transfer tax because of his failure to use the annual exclusion for the previous two years. Note, however, that the planner must consider the potential appreciation in the property to determine if making a gift in one installment (and foregoing some annual exclusions) makes sense. If the appreciation over the proposed transfer period exceeds the additional gift tax that is incurred by making the transfer in one year, it may make sense to incur the additional tax if the client is engaging in long-term planning.

YEAR 2010 GIFT TAX CALCULATION - SAME TOTAL GIFTS AS PREVIOUS EXAMPLE		
Total Gifts	\$2,136,000	
Less Annual Exclusion	(\$13,000)	
Taxable Gifts	\$2,123,000	
Plus Previous Taxable Gifts	\$0	
Total Taxable Gifts	\$2,123,000	
Tax	\$723,850	(\$330,800 + (35% x \$1,123,000))
Less Gift Tax Previously Paid	\$0	
Less Applicable Credit Previously Used	\$0	
Less Applicable Credit Remaining*	(\$330,800)	
Gift Tax Due	\$393,050	(\$8,050 greater than before)**

*Credit remaining before transfer for 2010 = \$330,800.
 ** The \$8,050 is equal to 35% of the \$23,000 annual exclusion that was not used because of the gift being delayed to 2010.

SUMMARY	
Total Paid if all gifts made in 2010	\$385,000
If alternatively, gifts made:	
2005, 2006, and 2010 (\$124,000 + \$261,000)	\$385,000
No Difference	\$0

Multiple Choice

5. Mary and Emile would like to give the maximum possible gift that they can to their son without having to pay gift tax. Mary and Emile have never filed a gift tax return and live in a community-property state. How much can they transfer in 2010 to their son free of gift tax?

- \$26,000.
- \$330,800.
- \$1,013,000.
- \$2,026,000.

The correct answer is d.

Mary and Emile can each transfer \$1,000,000 tax free during their lifetimes. Mary and Emile can also make a gift of \$13,000 each during the year to qualify under the annual exclusion. In total to their son, Mary and Emile can transfer \$2,026,000 $((\$1,000,000 \times 2) + (\$13,000 \times 2) = \$2,026,000$.

Chapter 6 – Estate Tax Repealed for 2010.

Chapter 13 – General Skipping Transfer Tax Repealed for 2010.