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Opting out of the 2010 estate tax

We don't have a final version of Form 8939 as yet, but on August 5 the IRS released initial guidance regarding it [*IR-2011-83*]. Form 8939 will be used to choose to have the carryover basis rules apply to a 2010 decedent's estate instead of the retroactive estate tax enacted in December 2010. The Form will notify the IRS of the basis of all estate assets, as well as the executor's decisions regarding the allocation of \$1.3 million in basis step-ups. If there is a surviving spouse, the additional \$3 million in basis step-ups also will be reported with this Form.

Estates of less than \$5 million will doubtless prefer to accept the retroactive federal estate tax, as it is coupled with an adjustment of tax basis of inherited assets to fair market value. In some cases, the tax benefit of the basis step-up could be worth the payment of a modest estate tax, depending upon the composition of estate assets. The largest 2010 estates almost surely will be opting out of the estate tax.

The IRS also released *Rev. Proc. 2011-41* in August, regarding a number of technical issues associated with making the election. For example, the basis step-up will be allowed for spousal bequests that were sold prior to distribution to the surviving spouse. Depreciable property, loss property and community property are covered in *2011-41*. Guidance also is provided on what attachments will be needed for filing Form 8939.

Form 8939 for 2010 decedents *must* be filed on or before November 15, 2011. If it is filed early, a Form 8939 may be amended or revoked, but only through the filing of a subsequent Form 8939 before the November 15 cutoff. There will be no extensions of time for this filing. The election becomes irrevocable on November 15. **IMPORTANT:** Taxpayers are *not* permitted to file an estate tax return plus a conditional Form 8939, to take effect only in the event that an estate tax audit results in the value of a taxable estate going above the applicable exclusion amount.

How many estates are going to choose carryover basis? For how many taxpayers will we be maintaining this special tax regime? The Service expects 7,000 Forms 8939 to be filed.

Guidance priorities

Charles H. Egerton, Chair of the American Bar Association's Section of Taxation, sent the IRS the Section's summary of ideas on areas where new regulatory guidance is urgently needed. In the area of estate and gift taxes, the most important issue is the new portability of unused estate tax exemptions between spouses. The mechanics of making the election need to be explained, as well as the usage of the portable exemption in a gift tax context. Also, what happens if a widow or widower consumes the inherited exemption through major gifting, remarries and inherits another estate tax exemption upon being widowed a second time?

Another crucial area concerns the effects of a return to a \$1 million federal estate tax exemption in 2013. Most observers don't expect that to happen, but then few predicted what occurred in 2010. If the exemption is reduced,

what effect will that have on large gifts in 2011 and 2012 that were shielded from transfer tax by the larger \$5 million gift tax exemption? Will there be a “clawback” of that tax benefit? Similar difficult questions attend the generation-skipping transfer tax.

Gift taxes and free speech

Earlier this year, the IRS confirmed that it had begun gift tax audits of major donors to IRC §501(c)(4) organizations. The federal gift tax applies to transfers for no consideration, typically to family members. Contributions to 501(c)(4) organizations, in contrast, may be made for social welfare reasons, including advancing a political cause. Such organizations played a major role in the 2010 election.

Nearly 30 years ago, the IRS warned in *Rev. Rul. 82-216*, 1982-2 CB 220, that the gift tax could apply to transfers to 501(c) organizations that are not charities. The position has gone largely unenforced for the past 30 years, and some observers believed that sudden enforcement now, without warning to taxpayers, would violate fundamental fairness. The Republican members of the Senate Finance Committee protested the action in a May 18 letter to IRS Commissioner Douglas Shulman.

The Service has now reversed course. An internal IRS memo from Deputy Commissioner for Services and Enforcement Steven T. Miller, obtained by *Tax Notes*, suggests that further guidance is needed in this area, because of significant legal, administrative and policy implications. Until such guidance is developed, no further audits concerning contributions to 501(c)(4) will be undertaken, and the guidance itself will have only prospective effect, to put taxpayers on notice of the changes. Current audits in this area should be closed, the memo concludes.

More comments requested

In 2005 the IRS touched off a firestorm of criticism with *Rev. Proc. 2005-24*. The Service was concerned about a potential problem that many practitioners said didn't exist. What happens if an inter vivos charitable remainder annuity trust or unitrust is created, and at the grantor's later death a surviving spouse exercises her statutory rights to a portion of the estate? There is a possibility that the charitable trust might be invaded to satisfy the claim. Accordingly, to protect the trust, the revenue procedure required spouses to waive their elective share rights with respect to any such charitable trust. Some were concerned about a wave of charitable trusts being held unqualified for tax benefits because of failure to meet this technical requirement. Perhaps, some suggested, a wait-and-see approach might be preferable, recapturing tax benefits in the rare case of a spousal election, rather than putting all charitable trusts through these hoops?

Comments on the procedure and appropriate safe harbors have been requested before, and in July the Service made an additional such request [76 F.R. 40985]. All comments are due by September 12, 2011.

Tax strategies patent update

H.R. 1249, the Leahy-Smith America Invents Act, was passed in the House on a 304-117 vote on June 23, 2011. Among other elements, the bill would prospectively bar patents on tax strategies. The bill was presented to the Senate on August 2, just before the recess.

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