
IRS Guidance on Electing Out of the Estate Tax



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The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Tax Relief Act) reinstated the estate and generation-skipping transfer (GST) tax for decedents dying in 2010, but provided that the executor of an estate of a decedent who died in 2010 could elect not to have the estate tax apply, but instead, have carryover basis apply. In addition, the GST tax rate for all transfers in 2010 is zero. The reason for the allowing estates to elect out of the estate tax and the zero GST tax rate was to avoid Constitutional arguments about retroactive taxation. Under carryover basis, assets acquired from a decedent whose executor elected out of the estate tax would be treated as having been transferred by gift and the basis of such assets for income tax purposes would be equal to the lesser of the decedent's adjusted tax basis in the asset or its fair market value.

However, until August 5, 2011, it was unclear how and when the election out of the estate tax could be made, and how the carryover basis rules would be applied. On August 5, 2011, the Internal Revenue Service issued Notice 2011-66 and Revenue Procedure 2011-41 that provide guidance on these issues. Unfortunately, the final version Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent, was not issued. A draft of the form had been issued in December, 2010 before the enactment of the Tax Relief Act. The IRS indicated that the final form would be issued in early fall.

The Notice provides guidance with regard to the time and manner in which the executor of the estate of a decedent who died in 2010 elects to have the estate tax not to apply and to have the carryover rules apply to property transferred as a result of the decedent's death. The Notice also addresses various issues concerning the allocation of the transferor's GST tax exemption to transfers made during 2010. Most importantly, the Notice requires that the election out of the estate tax is made by filing a Form 8939 on or before November 15, 2011. The election is irrevocable unless one of four relief provisions described in the Notice applies. Therefore, it will be incumbent on executors of estates of decedents who died in 2010 to determine whether the election should be made as soon as possible. Completing the Form 8939 will also take some effort and time, including assembling information necessary in determining the basis and fair market value of the assets that would be included in the decedent's estate if the election out was not made and that would be treated as acquired from the decedent and that would be treated as owned by the decedent if the election was made.

Complicating the matter is the fact that the estate tax return of a decedent who died in 2010 before December 17, 2010 is required to be filed by September 19, 2011 and the return of those who died after December 16, 2010 is due nine months after the date of death. In many cases the executor who is not sure of whether to make the election will request an automatic extension of the estate tax return for six months, which is apparently permitted. However, if there would be an estate tax liability if the election out of the estate tax is not made, the tax must be paid by the due date of the return, not including extensions, unless an extension is granted for reasonable cause.

Revenue Procedure 2011-41 provides optional safe harbor guidance in determining a recipient's basis in property acquired from a decedent who died in 2010 whose executor makes the election out of the estate tax. It also provides guidance on the allocation of the Basis Increase. The Basis Increase allows the executor to increase the basis of assets acquired from such a decedent and that are treated as owned by the decedent. The Basis Increase consists of the General Basis Increase and the Spousal Property Basis Increase. The General Basis Increase is the sum of \$1,300,000 and certain loss carryovers and unrealized losses. The Spousal Property Basis Increase, which can only be allocated to property that passes outright to the surviving spouse or to a trust in which the spouse has an income interest (and certain other arrangements), is \$3 million.

It is estimated that approximately 7,000 executors will elect out of the estate tax. If you or your client may be eligible to make the election out, it will be necessary to review the Notice and Revenue Procedure and to make the necessary calculations to determine whether the election out will be beneficial, taking into account offsetting potential estate tax and income liabilities, and the effect of the election on the beneficiaries of the estate, which may be different depending on whether the election is made.