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CARRYOVER BASIS AND THE 2010 ESTATE TAX SYSTEM

The current state and uncertainty of the estate tax system has been a widely discussed, blogged and dissected topic since it became clear, late last year, that 2010 would be a "year without an estate tax." There has been as much chatter, discussion and rumor mongering about what the estate tax system will look like in 2011; whether we will go back in time to the 2001 system, or forward to a new "2009 looking land" with a $3.5 million estate tax exemption and a 35% rate.

What has been little discussed, and has the potential to have a broader impact, is the modified carryover basis rule in place in 2010. Under the pre-2010 system, upon death, most assets received a stepped-up basis to their fair market value, often dramatically reducing or eliminating the post-death income tax consequences to beneficiaries. But in 2010, the beneficiaries will not get the benefit of a step-up, but will instead have the decedent's basis in those assets carryover to them.

There is some relief available. For transfers at death to non-spouses, $1.3 million of unrealized gain (or step-up) can be allocated to beneficiaries. Transfers to spouses or special Marital Trusts can have up to $3 million of step-up allocated to them. The personal representative has the discretion to determine which assets to allocate step-up to, and because there are planning opportunities and strategies, that allocation should be made with the advice and counsel of a team of experts, including the attorney, CPA and valuation expert.

The best thing about our current transfer tax system is it has created the impetus for planners to do what they should have always done: build plans flexible enough to deal with changing circumstances. Now is a great time for clients to insure their plans are sufficiently flexible; flexible enough to work under the law as written now, and flexible enough to deal with whatever Congress throws at them in the future. So buckle up, it's going to be a bumpy ride.