

BERWITZ & DiTATA LLP

Attorneys and Counselors at Law

310 Old Country Road Suite 101
Garden City, New York 11530
Telephone (516) 747-3200 • Facsimile (516) 747-3727

Lawrence N. Berwitz

Maureen R. DiTata

Economic Growth and Tax Relief Reconciliation Act of 2001 Revisited

At present, assets which are includable in a decedent's gross estate receive a basis adjustment to fair market value as of the date of death. This step-up or step-down in basis provides the beneficiaries with a significant tax benefit by eliminating the recognition of the appreciation in value of assets during the life of the decedent.

While there is currently an unlimited step-up in basis, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) repeals this basis step-up system commencing in 2010 and replaces it with a modified carry-over basis system.

Under EGTRRA, property acquired from a decedent who dies after December 31, 2009 will be treated, for income tax purposes, as a gift. As a result, the basis of the property received will be the lower of (1) the decedent's adjusted basis in the property or (2) the property's fair market value as of the date of the decedent's death. This could cause the basis in such property to step-down, but not step-up. Whether, upon the sale or disposition of the property, the recipient will report ordinary income or a capital gain will also be determined by the decedents basis.

Beginning in 2010, a decedents property that, under the prior law, was not subject to estate tax because it was valued below the applicable unified credit amount at death, will be subject to capital gains tax when sold by the recipient.

The EGTRRA reduces the tax burden on smaller estates with the implementation of a new section in the Internal Revenue Code, Section 1022. This new section permits the executor of a decedent's estate to increase the basis of the estate's assets, asset-by-asset, by an aggregate of \$1.3 million, plus the sum of the decedent's unused capital losses and certain other tax losses. It also enables the executor to increase the basis of assets passing to the surviving spouse, whether outright or in a QTIP trust, by up to \$3 million. In no circumstance, however, can an assets basis be increased above its fair market value at date of death or the alternative valuation date.

This change poses significant planning challenges. Absent any further legislation, the new law contains a sunset provision which, by its terms, repeals the new law and reinstates the prior law on December 31, 2010. Thus, it is conceivable that the modified carry-over basis rules will only be in effect for one year. Because the new Section 1022 excludes property received from an irrevocable trust, whether or not a life estate or a power of appointment has been retained, recipients of such property

from decedents who die in 2010 will retain the basis of the donor. This will significantly impact clients who have implemented lifetime Medicaid planning and who make the mistake of dying in 2010.

A more practical problem has to do with record-keeping. How many of our clients retain sufficient records to enable the calculation of the basis of their appreciated assets? In the case of lifetime gifts, the lack of records establishing the basis of the gifts often creates difficulties for the recipient. Under the prior law, this problem did not exist for property which was includable in the decedents estate since the step-up in basis at the decedents death, which is easily ascertainable, rendered the decedents basis moot.

Under the new law, the recipient of a decedents asset receives it at the decedents basis unless the executor chooses to allocate a portion of the \$1.3 million basis increase to such asset. Thus it will be necessary to advise clients to maintain sufficient records to calculate the basis of all appreciated assets, those which will pass through their estates as well as those which will be gifted outright or transferred to an irrevocable trust. Moreover, as 2010 approaches, it may be advisable to assist clients in specifying which assets are to receive the step-up in basis.

Certainly, few if any practitioners believe that EGTRRA will wholly disappear into the sunset. Notwithstanding the present uncertainty, it behooves us all to alert our clients to the dangers that are lurking in the Bush.

Editors Note: The author's are with Berwitz & DiTata LLP, a Garden City based Elder Law firm. This firm concentrates in Estate and Retirement Distribution Planning; Estate Administration and Elder Law.