**Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2161**

**Date:** 12-Nov-13
**From:** Steve Leimberg's Estate Planning Newsletter
**Subject:** **Alan Gassman & Jonathan G. Blattmachr: Stepping Up Efforts to Step-Up Basis for Married Couples**

*"The capital gains tax may be the most formidable tax challenge for surviving spouses who need to sell assets to support themselves. The increase in this tax from 15% to 20%, with the additional 3.8% Medicare tax for those with high income in the year of sale makes this a very important topic to cover with clients and their families.*

*The primary estate planning goal of most married couples is to provide as well as possible for the surviving spouse, but most of them do not recognize that 23.8% of the lifetime appreciation of family investments including in many cases on a large residence will have to be paid to the government in order to produce money for the surviving spouse.*

*For some survivors, this will be a devastating reality that must be faced when the cost of an adult congregate living facility and proper care is compared to the net proceeds that can be derived from the liquidation of assets. Even a modest investment portfolio owned by a retired married couple can be significantly impacted by these taxes, and the more modest the asset basis, the more crucial it is to protected against lost value due to capital gains taxes.*

*Why do so many planners fail to discuss this with clients, much less put mechanisms in place to assure a complete step-up in basis of all of a couple's assets on the first death? One reason is that the full impact of the large*

*capital gains tax increase has not yet been felt by many clients. Another is that the complexity of the recent estate tax changes, and especially the attention given to wealthy clients during 2012 to use their large gift and generation-skipping transfer tax exemptions.*

*Planners need to become accustomed to stepped-up basis planning being in the forefront of objectives and structuring. The Alaska community property trust is extremely under-utilized, and the JEST trust or stepped up basis power of appointment arrangements can be considered for those clients who for whatever reason would not prefer to use an Alaska community property trust. Now estate planners can get their eyes on the capital gains avoidance ball."*

**Alan Gassman** and **Jonathan G. Blattmachr** provide members with commentary that demonstrates the importance of stepped-up basis planning for married couples.

**Alan S. Gassman, J.D., LL.M.** practices law in Clearwater, Florida. Each year he publishes numerous articles in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, The Journal of Asset Protection, and Steve Leimberg's Asset Protection Planning Newsletters. Mr. Gassman is a fellow of the American Bar Foundation, a member of the Executive Council of the Tax Section of the Florida Bar, and has been quoted on many occasions in publications such as The Wall Street Journal, Forbes Magazine, Medical Economics, Modern Healthcare, and Florida Trend magazine. He is an author, along with **Kenneth Crotty** and **Christopher Denicolo**, of the BNA Tax & Accounting book Estate Tax Planning in 2011 and 2012. He is the senior partner at **Gassman Law Associates, P.A.** in Clearwater, Florida, which he founded in 1987. His email address is agassman@gassmanpa.com.

**Jonathan G. Blattmachr** is one of the country's most famous estate planning lawyers who has developed concepts and strategies from decanting to installment sales to grantor trusts to Domestic Asset Protection Trusts, which the profession uses every day. He was a practicing attorney for approximately 40 years at **Simpson Thacher & Bartlett** and **Milbank, Tweed, Hadley & McCloy**. Jonathan continues to be extremely active, being a director of **Pioneer Wealth Partners, LLC**, a boutique wealth advisor firm in New York, **Director of Estate Planning** for the **Alaska Trust Company**, co-developer with **Dallas Attorney Michael L. Graham of Wealth Transfer Planning**, a computerized drafting and advice system for lawyers, the author of many books (including Income Taxation of Estates and Trusts with Professor Ladson Boyle and The Circular 230 Deskbook with Professor Mitchell Gans, both published by the Practising Law Institute) and articles, trustee for many wealthy families and a frequent lecturer across the country.

Here is their commentary:

## EXECUTIVE SUMMARY:

The capital gains tax may be the most formidable tax challenge for surviving spouses who need to sell assets to support themselves. The increase in this tax from 15% to 20%, with the additional 3.8% Medicare tax for those with high income in the year of sale makes this a very important topic to cover with clients and their families.

The primary estate planning goal of most married couples is to provide as well as possible for the surviving spouse, but most of them do not recognize that 23.8% of the lifetime appreciation of family investments including in many cases on a large residence will have to be paid to the government in order to produce money for the surviving spouse.

For some survivors, this will be a devastating reality that must be faced when the cost of an adult congregate living facility and proper care is compared to the net proceeds that can be derived from the liquidation of assets. Even a modest investment portfolio owned by a retired married couple can be significantly impacted by these taxes, and the more modest the asset basis, the more crucial it is to protected against lost value due to capital gains taxes.

## FACTS:

There are three primary ways that the typical non-community property state couple can attain a full step-up in basis for assets on the first death (understanding that some assets, such as those in pension plans or IRAs never receive a step up when the owner dies):

1. Have the assets owned by the first dying spouse more than one (1) year before he or she dies, or if the one (1) year period cannot

be met, have the spouse leave the assets to a trust that may benefit the surviving spouse and not trigger the one (1) year rule under Internal Revenue Code Section 1014(e), which denies a step up in basis with respect to assets the spouse dying first received by gift from the survivor within a year of death and that are re-inherited

back by the spouse who made the gift. Trying to guess who dies first and even having to talk about this can be a difficult and risky proposition.

2. The couple can amend their estate planning documents to either provide that each of them will have a testamentary power of appointment over assets held in on another's separate revocable trusts or form one joint JEST (Joint Estate Step-up Trust), in which event Private Letter Rulings 200101021, 200210051, and 200403094 and TAM 9308002 support the proposition that assets owned jointly under a JEST Trust or under the revocable trust of a surviving spouse may be considered to have passed through the taxable estate of the first dying spouse, although there are Section 1014(e) one (1) year rule and fundamental issues associated with this (such as whether the private letter rulings and the technical advice memorandum are correct). These issues and possible drafting solutions are discussed at length in **LISI** Estate Planning Newsletter No. 2086 and the October and November 2013 issues of Estate Planning Magazine that were co-written by **Alan S. Gassman**, **Tom Ellwanger**, **Christopher J. Denicolo**, and **Kacie Hohnadell**.

This technique has its downsides, as described in the chart below but the JEST Trust itself has no annual cost associated with it unless there are changes in the client's estate plan. Many clients prefer to have their assets under a single trust created by and for both of them, and preexisting separate trusts can be amended and restated to be considered a part of the single JEST Trust so that re-titling of assets is not required. It will take the planner a few hours to draft and thoroughly review their initial trust draft. See Estate Planning Newsletter No. 2086 for a discussion of some of the provisions **Alan Gassman** includes in his documents.

3. The most reliable way to achieve a full step up on the first death, with potential incidental asset protection features is to establish a conventional Alaska Community Property Trust with an Alaskan Co-Trustee. The Alaskan community property statute was enacted in 1998 to allow both Alaskan couples and non-Alaskan couples to form trusts there to comply with Internal Revenue Code Section 1014(b)(6), which provides that community property will receive a full step up on the death of one spouse. This technique has been endorsed by not only **Jonathan Blattmachr**, who originated the concept, but also by **Howard Zartisky** and a number of other well respected experts. It is essentially a joint revocable trust which will be used as the principal estate planning document as the spouses die. The Alaska Trust Company provides the trust form to professionals who use these, and an Alaskan lawyer is available to review and approve the trust document for only about $1000.

## COMMENT:

Assume that a married couple in their late sixties has $500,000 of investments with a cost basis of $100,000, and their home's worth is $100,000.

If one spouse dies owning one-half (2) of the assets or the assets are jointly owned in a non-community property state and one of them dies, his or her half of the assets will receive an automatic change in income tax basis to its estate tax value (even if no estate tax is due) and the inherent gain in those assets are forgiven. That result is known as the income tax free "step up in basis" at death. But the inherent gain in the survivor's half of their wealth will not be stepped up. That means then that there is $200,000 worth of untaxed gain that will cost, depending upon several factors including whether the couple lives in a jurisdiction with state and local taxes of, perhaps, over $50,000 in capital gains tax in order to liquidate their wealth to provide cash to support the surviving spouse or to buy into a retirement center unit.

Contrast that couple's situation with one if they live in a community property state, such as Texas or California. For that couple, all of the inherent gain is "forgiven" when the first spouse dies. Therefore, the survivor would face no capital gains tax in liquidating the couple's wealth.

A couple with $2,000,000 of assets and a $500,000 home with the same ratios of growth face a much larger tax which could be $450,000 or more. The above assumes that tax rates will not rise and that there will be no state income tax to be paid.

Why do so many planners fail to discuss this with clients, much less put mechanisms in place to assure a complete step-up in basis of all of a couple's assets on the first death? One reason is that the full impact of the large capital gains tax increase has not yet been felt by many clients. Another is that the complexity of the recent estate tax changes, and especially the attention given to wealthy clients during 2012 to use their large gift and generation-skipping transfer tax exemptions. Now estate planners can get their eyes on the capital gains avoidance ball.

**Conclusion:**

Planners need to become accustomed to stepped-up basis planning being in the forefront of objectives and structuring. The Alaska community property trust is extremely under-utilized, and the JEST trust or stepped-up basis power of appointment arrangements can be considered for those clients who for whatever reason would not prefer to use an Alaska community property trust.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

*Alan Gassman*

*Jonathan G. Blattmachr*

## CITE AS:

1 Comment Posted re. *Alan Gassman & Jonathan G. Blattmachr: Stepping Up Efforts to Step-Up Basis for Married Couples*

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Rod Goodwin 12-Nov-13 10:52 PM

I do not think the comments are correct, see the following:

ESTATE PLANNING ADVISOR VOL. 2013-6

DOUBLE STEP UP IN BASIS AT THE DEATH OF THE FIRST DECEASED SPOUSE'S DEATH AND A GIFT TAX MARITAL DEDUCTION

This Advisor discusses the planning technique known as Crossed General Powers of Appointment, such that, H and W provide the other with a general power of appointment over the other's property held in a revocable trust. The theory is that when one spouse dies, the property of the survivor is transferred to the decedent, and that this transfer qualifies for the gift tax marital deduction. The result is that the property of each spouse obtains a date of death value at the date of the death of the first spouse to die.

I. Conclusions:

a. Application of 1014(e) to the surviving spouse's share – There is no double date of death basis.

b. Gift tax marital deduction under Code Section 2523 on the survivor's property passing to the deceased spouse – No marital gift tax deduction is allowed.

II. Introduction

The issues involved in this Advisor are parsed from 5 private letter rulings and the opinions of the Internal Revenue Service, with respect to a question posed by a taxpayer. The specific issues to be dealt with are: (i) allowance of a gift tax marital deduction and (ii) date of death basis for gifts due to the lapse of a general power of appointment.

A. Gift Tax Marital Deduction–

a. Allowance of the Unlimited Gift Tax Marital Deduction - Whether a gift by a surviving spouse to a deceased spouse qualifies for the unlimited gift tax marital deduction?

Assume that H has granted, in H's revocable trust, to W, a testamentary general power of appointment to appoint a portion of the property in H's trust.

i. Example of Language in the RLT – I provide my spouse a testamentary general power of appointment over the previously stated portion of my trust corpus.

ii. Death of W -

1. Gift Tax Marital Deduction - When W dies, some proponents claim that the transfer of H's property pursuant to the lapse of the GPOA over H's property due to W's death constitutes a gift by H to W that qualifies for the gift tax marital deduction provided by Code Section 2523(a).

2. No Gift Tax Marital Deduction – When W dies, some proponents claim that no marital deduction is allowed because H's transfer, by the grant of the testamentary general power of appointment to W, constitutes a taxable gift that does not qualify for the gift tax marital deduction under Code Section 2523(a),because W is deceased.

Whether the lapse of the general power of appointment does or does not qualify for the gift tax marital deduction is discussed later. b. Application of Code Section 1014(e) to the transfer of H's Property, through W, to H or a Credit Shelter Trust for H's Benefit

i. Code Section 1014(e) – prevents a healthy spouse from transferring property to an ill spouse such that when the ill spouse dies, the property passes to(directly or indirectly) the donor/surviving spouse and the donor/surviving spouse does not attain a date of death basis. If the ill spouse survives a year after the gift, the date of death basis is allowed upon the death of the ill spouse.

ii. Passing to the Donor Spouse or to the Donor's Trust –

1. Passing directly to the Donor Spouse – Some believe the 1 year survival rule only applies to donated property that is left directly to the donor spouse, and if the property passes to a trust for the benefit of the donor spouse it is not covered by the 1 year rule.

2. Passing to a Trust for the Benefit of the Donor Spouse – Some believe the 1 year survival rule also applies to a trust for the benefit of the donor/surviving spouse.

III. Relevant Authorities –

a. Code Section 1014(e) – Applying Code Section 1014(e) to our Crossed General Powers of Appointment circumstance, the Code Section deals with the ability of H, the surviving spouse, to grant W, the deceased spouse, a GPOA in H's property that passes, at W's death either to H, or a trust for H's benefit.

i. Property to H – PLR 9308002 - Section 1014(a) of the Code provides that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from the decedent is the fair market value of the property at the date of the decedent's death (or the alternate valuation date). . . Under section 1014(e), if appreciated property was acquired by the decedent by gift during the one-year period ending on the date of the decedent's death and the property is acquired from the decedent by, or passes from the decedent to, the donor of such property, the basis of such property in the hands of the donor is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent. . . Thus, in enacting, which disallows a step-up in basis for transfers made within one year of death, Congress clearly contemplated that a donor must relinquish actual dominion and control over the property for a full year prior to death. (Emphasis supplied) An analysis of the legislative history of the enactment of Code Section 1014(e) makes clear that if the survivor, H, holds dominion and control over the property until the death of W, H's property returning to H due to the death of the power holder causes the basis rules of Code Section 1014(e) to apply, and there is no date of death basis. ii. Property Left to a Trust for H – Some contend that 1014(e) only applies to property left directly to the donor spouse, H, in our facts. That contention is incorrect. In PLR 200101021, the survivor's property was left to a trust for the benefit of the survivor, and Code Section 1014(e) was held to apply. PLR 200101021 - Further, on the death of the first deceasing Grantor, the surviving Grantor is treated as relinquishing his or her dominion and control over the surviving Grantor's one-half interest in Trust. Accordingly, on the death of the first deceasing Grantor, the surviving Grantor will make a completed gift under section 2501 of the surviving Grantor's entire interest in Trust. . . In addition, §1014(e) will apply to any Trust property includible in the deceased Grantor's gross estate that is attributable to the surviving Grantor's contribution to Trust and that is acquired by the surviving Grantor, either directly or indirectly, pursuant to the deceased Grantor's exercise, or failure to exercise, the general power of appointment. See, H.R. Rept. 97-201, 97th Cong., 1st Sess. (July 24, 1981). (Emphasis added) b. Allowance of the Gift Tax Marital Deduction – This portion of the analysis first requires a definition of terms.

i. Statements in the PLRs - Proponents of the allowance of a gift tax deduction rely on the statements in the PLRs referenced earlier. However, those PLRs provide no analysis; merely a statement that the gift tax marital deduction is allowed. As an example, PLR 200604028 makes a summary statement: Section 2523 provides that where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value. . .

If Husband predeceases Wife and Husband exercises his testamentary general power of appointment to the fullest extent possible, Wife will be treated as making a completed gift to Husband of the appointed assets and Husband will be treated as the owner of those assets. Let's suspend our preconceived view regarding the allowance of a gift tax marital deduction for a moment, and consider the language actually used to justify the allowance of a gift tax marital deduction in 200604028: If Husband predeceases Wife A reasonable reading of the phrase clearly shows that the H has died prior to W. The statute provides that W may only make a marital deduction gift if, at the time of the gift, H is a spouse. While logic would seem to require that H be alive upon the receipt of the gift, the fact, as stated in the PLR, is that H has predeceased W. How does one resolve this seeming inconsistency in the requirement of a spouse to whom a gift is made, when H has predeceased the donor W?