# THE LENZI LAW FIRM, PLLC

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Friday, October 29, 2010

**Don't Think You Should Basis Plan For Your Clients Death?**

Clients become advocates when they realize that your advice helped save them hundreds of thousands of dollars. Unfortunately the incoming 2011 basis rules have radically changed the game. The older basis rules that once saved our clients hundreds of thousands of dollars are no more.

Under the current scheme (*applies today*), our clients need to make certain of two things. First, the asset should qualify for a basis increase under the new rules. Second, a plan needs to be implemented to promote the maximum effectiveness of the basis increase allocations. This requires both an asset by asset analysis and a practical analysis of the family dynamics. Financial advisors and attorneys should collaborate together to serve the client in this area.

The new basis rules don't depend on whether your client's property was subject to the estate tax. The new complex and radically different rules can burn your clients. However, complexity brings with it opportunity. Consider the following:

*No Basis Increase Allowed Unless:*

1) The beneficiary inherited the asset from the decedent, AND

2) The decedent owned the asset at the time of death

*No Basis Increase Property:*

- gifted property
- passing by power of appointment (treated as not being owned by the decedent)
- passing to the decedent's estate as a contingent interest
- any lifetime transfer with retained beneficial enjoyment (e.g., vacation home put in trust and retained the right to use it for a term of years)

- passing by revocable trust (must be a qualified revocable trust under §645(b)(1)
- irrevocable trusts (must meet more specific requirements)
- passing in life, or at death, to the extent it is received with some consideration attached
- acquired by decedent within 3 years of death
- that is IRD
- that is a Foreign Personal Holding Company
- that is stock of a Foreign Investment Company
- that is stock of a Passive Foreign Investment Company (unless 1295 qualified)

*Common Pre-2010 Transfer Methods That Don't Work!*

- A lifetime power of appointment trust
- An accumulation estate trust
- No certainty as to whether a Life Estate will qualify for carry over basis, and generally should be avoided
- Clayton Election QTIPS should generally be avoided in 2010
- QTIPS should compel annual distributions instead of merely providing the spouse with a withdrawal right (this is because the carry over basis rules are separate from the estate tax marital deduction rules. Unfortunately many QTIPS were skillfully drafted under the prior law to provide a withdrawal right, as opposed to a compelled distribution)
- Doesn't apply to terminable interests (e.g., patents, copyrights, terms of years) although it can be allocated to a bond, note, or similar contractual obligation

**You Are Not Finished By Merely Insuring Assets Qualify For Basis Increase**

*How Should The Executor Allocate The Basis Increase?*
**Common Issues:**

- Should the spouse receive any of the 1.3 million aggregate basis allocations, or will that result in litigation? (e.g., child from a prior marriage alleges misconduct)
- What beneficiaries should benefit from the allocations (and who shouldn't)?
- With the heightened risk of litigation, should a no-contest clause be included?
- How should assets that are subject to a short-term capital gains, long-term capital gains, and ordinary income rules be treated differently? (or should they)
- Is it generally true that a client would want to allocate a basis increase to assets that have massive equity built in? (what if the beneficiary doesn't sell during life, the asset passes via a power of appointment, or there is a risk of litigation)
- Will failing to pick an impartial executor result in wasting the maximum benefit of the carry over basis because disgruntled beneficiaries threaten litigation?

## POTENTIAL ESTATE PLANNING FIXES

Your client should consider naming an impartial person to allocate his or her spousal and aggregate basis increases so that there is no conflict of interest. Otherwise the client may be inviting estate litigation and disgruntled family members may strain their relationships irreparably.

The client should have language that directs the executor as to the proper allocation of the basis increase and coordinates that allocation with other non-probate assets (i.e., trust, beneficiary designations)

If your client is nominated to be someone's fiduciary under a will, then your client should strongly consider demanding that the testator or testatrix insert provisions to clarify their basis allocation desires. Otherwise, litigation, stress, and confrontation may likely result.

## A SPECIAL ISSUE FOR FOREIGN CLIENTS

Your foreign client's estate may be unnecessarily wasted by delays, courts costs, and litigation fees if they don't have a document that nominates an executor. It may be necessary to consolidate all of your client's properties, and designate a single executor, to avoid protracted litigation.

*Reason*: All non-residents aliens who have >60,000 in U.S. assets + foreign assets that will be acquired by a U.S. person must file a Large Transfer at Death Return. IRC § 6018(b)(3). If the probate court nominates an executor who has insufficient information about their assets, or there are multiple persons deemed to be executor for tax purposes, then it is likely that a return will not be filed or there will be litigation regarding the proper allocation of the basis increases.

**Advanced Practice Tip**: It may be favorable to seek Resident Alien Status for your Non-Resident Alien Clients, under the "substantial presence test", if they spend some time in the U.S.

*Reason*: An alien who has very few assets situated in the U.S. may receive a far more favorable income tax treatment under the carry over basis rules if they are deemed a resident alien

If you have any questions about the foregoing, or are totally confused with the language used above, feel welcome to contact me at the office. I am happy to discuss the topic with you.

Sincerely,
THE LENZI LAW FIRM, PLLC
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This information isn't intended, and shouldn't be construed, as legal advice. Nor does this document create an attorney-client relationship with you or any third party. The following is for general educational purposes only. It is based on assumptions, incomplete information, and is intrinsically unreliable. If you have any legal questions, please contact our firm and schedule an appointment. Please note that no attorney-client relationship will exist with our firm unless a written fee agreement has been signed by the parties.

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**Please complete this form if you have an asset that is worth many thousands of dollars**

1. Is the asset worth many thousands of dollars more than the purchase price you paid for it?
   ☐YES or ☐NO

2. Was the asset gifted to you (*not inherited*)?
   ☐YES or ☐NO

3. Is the property in a Trust and subject to a power of appointment?
   ☐YES or ☐NO

4. Will the asset pass through a living or testamentary trust instrument that grants powers of appointment to beneficiaries?
   ☐YES or ☐NO

5. Is your estimated estate greater than 1.3 million dollars (including life insurance and the combined value of both spouses)?
   ☐YES or ☐NO

**Please Note:**

If you have answered "☒ YES" to any of the questions located above, then you should consider consulting an attorney to maximize if not eliminate the total capital gains tax liability of your surviving spouse or other beneficiaries.

With proper planning, you may be able to eliminate capital gains taxes on 4.3 million dollars worth of asset appreciation.

Consider the following. If you inherited land with a basis of $50,000 and sold it for $500,000, assuming a 15% capital gains tax, your tax liability may be $67,500. However, if the inheritance of the asset was structured correctly, your tax liability may have been $0.

If you are interested in learning more, we strongly suggest you contact a firm experienced in estate planning.