

December 2011

## TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

By: Victoria Tillman

As many of you know, on December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). Under the Act, the personal representative for a decedent dying in 2010 can elect to have the estate tax repeal and modified carry-over basis apply (the "opt out election") or to accept the default treatment which includes the application of the estate tax with a tax-free amount of \$5 million, tax rate of 35% and stepped-up basis.

If the opt-out election is made, the assets of the decedent receive modified carry-over treatment. This means \$1.3 million of basis may be allocated to the decedent's assets, regardless to whom they pass, and if the decedent was survived by a spouse, an additional \$3 million of basis may be allocated to those assets passing to the surviving spouse. The allocation of basis must be made on Form 8939, and although this Form was originally due on or before September 19, 2011, and then November 15, 2011, the Form 8939 is now due January 17, 2012.

For tax years, 2011 and 2012 (with adjustment for inflation), there is a federal estate tax on all estates over \$5 million, with a tax rate of 35%, and full stepped-up basis. The Act also provides for portability of the first spouse to die's unused tax-free amount beginning in 2011 and continuing through 2012. This means that if none of, or only some of, the first person's \$5 million tax-free amount is used when he or she dies, the surviving spouse can use the balance of the deceased spouse's tax-free amount. By electing portability the surviving spouse could potentially have a \$10 million tax-free amount when he or she later dies (if the first spouse to die did not use any of his or her tax-free amount).

The manner in which portability may be elected has just recently been formalized by the IRS (see, IRS Notice 2011-82). To preserve the option of portability for the surviving spouse, a timely and complete Form 706, the Federal Estate Tax Return, must be filed, even if the estate does not exceed \$5 million. If a Form 706 is not filed, and the surviving spouse exceeds the federal tax-free amount in the future, the deceased spouse's unused tax-free amount will be lost, and estate tax will be due.

While it may seem highly unlikely that the decedent's and his/her spouse's combined estate would exceed \$10 million, to fail to elect portability exposes the advising attorney to malpractice (perhaps) and questioning (for sure). An example of exposure occurs when portability is not elected, allowing the first spouse to die's tax-free amount to disappear, and the surviving spouse inherits assets causing his/her estate to exceed \$5 million or wins the Tennessee lottery, again pushing his/her estate over \$5 million. The loss of the first person to die's tax-free amount will result in a tax liability upon the surviving spouse's death - a tax liability that could have been avoided but for the "lost" portability. Still too far fetched? What if the tax-free amount is reduced to \$1 million in 2013 (as it is scheduled to do), but portability is extended, and your surviving spouse dies with over \$1 million in assets. Once again the beneficiaries will be looking to the advising attorney to explain why portability was not elected.

The draw back to electing portability of the first spouse to die's unused tax-free amount is the IRS's ability to go back and review that spouse's estate

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## Estate Planning Forum 2012

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Also, we are looking for sponsors for the forum. If your firm would be interested or if you know of any potential prospects, please let Kaisha Bond at the Tennessee Bar Association know. She can be reached via email at [kbond@tnbar.org](mailto:kbond@tnbar.org) or 615-383-7421.

## OnlineTNJustice.org

[OnlineTNJustice.org](http://OnlineTNJustice.org) is based on the walk-in clinic or dial-a-lawyer model where clients request brief advice and counsel about a specific civil legal issue from a volunteer lawyer. Lawyers provide information and basic legal advice without any expectation of long-term representation. The website was created in order to eliminate barriers to lawyer pro bono (such as geographic location, work schedule or family obligations), expand pro bono to the most rural areas of Tennessee and provide assistance to eligible Legal Aid clients who are turned away due to lack of resources (there are only 79 Legal Aid attorneys in the state). The online system screens potential clients for eligibility and, if qualified, allows them to post a legal question to a private messaging system. Clients have the ability to check the system for answers at any time. Only the name of the client is shared with the volunteer attorney. All other information is anonymous to ensure privacy. Lawyers have the ability to log into the site 24 hours a day and answer questions at a time that best suits their schedule. Lawyers receive CLE credit for the time they spend researching and answering questions and are covered by professional liability insurance maintained by the Tennessee Alliance for Legal Services. Currently, 285 lawyers have signed up to help 712 clients. New questions are posted every day, so check back often to see which ones you can answer.

To sign up to participate or for more information, visit us online at: [OnlineTNJustice.org](http://OnlineTNJustice.org)

## Law's Five Challenges to Thriving

tax return without any limitation as to time. This means that the typical statute of limitation of three years will not apply, giving the IRS the ability to go back and review what could be fairly old estates. Moreover, estates that normally do not file Form 706 will be required to file this federal return adding additional expense to the administration.

Despite the benefit of portability, there continues to be value to the old A/B plan: (1) portability does not apply for GST tax purposes; this (among other reasons) is why it's still a good idea to divide up a wealthy couple's assets in estate planning if they want to take advantage of a generation-skipping design; (2) at this point, portability applies only in 2011 and 2012; unless you are sure your clients are both going to die in 2011 and/or 2012, you will still need to use tax-planning techniques like the A/B plan; (3) without a credit shelter trust, with full use of portability, all appreciation in all assets of the couple will be taxed at the second spouse's death; (4) Tennessee doesn't have portability; non-use of the \$1 million at the first death could cost a couple \$83,400 or more in state tax; and (5) portability does not offer the asset protection benefits that the A/B plan offers, especially in second marriage situations.

Even if you don't represent "big" estates, you have the responsibility of advising your client about the opportunities that the Act provides, especially with regard to portability, and even if you don't do taxes you must be aware that there is potential for liability if you don't, at the very least, make your clients aware that there is an issue, and they need to seek the advice of a competent tax professional.

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## The Gift Tax Enforcer

By Donald J. Farinato, Esq.:

On December 27, 2010, an ex parte petition was filed on behalf of the IRS in the U.S. District Court for the Eastern District of California. (In The Matter of Tax Liabilities of John Does, E.D. Cal., No. 2:10-mc-00130-MCE-EFB.) The pleading was signed by Josephine Bonaffini, the Federal/State Coordinator for the IRS Estate and Gift Tax Program. Apparently, Ms. Bonaffini is the first person to hold this position, and she has been serving in this role since 2008. Among other duties, Ms. Bonaffini maintains communications with Government Liaisons ([www.irs.gov/govt/liasons/index.html](http://www.irs.gov/govt/liasons/index.html)) in furtherance of ensuring compliance with gift tax laws.

The petition sets forth some interesting facts with respect to one particular gift tax initiative: transfers of real property between family members where no gift tax return is filed. The IRS has communicated with numerous agencies at both the state and county level to obtain information pertaining to intra-family transfers of real property where there has been little or no consideration. Tennessee is among the various states that have provided information to the IRS. The pleading states that the failure to report rate is between 60% and 100%. Ms. Bonaffini notes that, in the "past two years, 323 taxpayers have been examined for failing to report transfers of real property to related parties for little or no consideration, another 217 taxpayers are currently under examination for failing to report transfers of real property to related parties for little or no consideration, and approximately another 250 cases are being researched to determine whether an examination should be opened." Clearly, the IRS has been busy with this initiative. And what is surprising to many practitioners is the level of information compiled by the IRS and the fact that this initiative has remained confidential.

While the IRS has been successful in obtaining information from many states, the State of California Board of Equalization ("BOE") stated that it could not provide the requested information unless compelled to do so via a summons. The BOE cited a California privacy law as the basis for not voluntarily complying with the IRS request. Through its petition, the IRS sought the issuance of a "John Doe Summons" to serve upon the BOE.

The request by the IRS was denied without prejudice through a Memorandum and Order issued by the California District Court on May 20, 2011. While the Court's response was somewhat sternly worded, it left the door open for the IRS to refile and seek the same relief again. It is not presently known whether the IRS will renew its pursuit for information through a California court or whether it will undertake other activities to

**Thriving:** Getting more of what you want in very challenging environments.

**Lawyers aren't thriving, it starts in law school, and it's not our fault.**

Substantial research over the last 30 years has established that shortly after starting law school, many law students see their levels of well-being drop severely and rates of depression, anxiety, and drinking as a coping behavior go sharply up. By the end of the first year in law school, as many as 30% of students are showing indications of clinical levels of depression. By the end of law school, it hits 40-50%. The rate of depression for practicing lawyers is 18 - 28%, which is 2-4 times the national average. However, none of this seems to be because of self-selection. Students entering law school are virtually indistinguishable from students entering other post-graduate programs.

**Law accomplishes hard, important tasks for society, and it is hard on practitioners.**

Why? Why should law school hit law students so hard? And why should lawyers show significantly lower levels of well-being and higher levels of psychological dysfunction than their peers in other professions? It's not us, it's because of what we do.

Law resolves the toughest disputes society creates, attempts to avoid those disputes, and manages policy resolutions to difficult decisions as enacted by the political realm. Working constantly within this system, lawyers are exposed to a unique configuration of five serious challenges to thriving:

**Values Conflicts** - Many legal matters involve situations where common values endorsed by societies around the world are in conflict. These disputes generally cannot be resolved without undercutting one or more of these values. These universal values are: Benevolence, Universalism, Self-Direction, Stimulation, Pleasure, Achievement, Power, Security, and Tradition-Conformity.

**Zero-Sum Conflicts** - Many legal matters also involve zero-sum or win-lose conflicts where any gain by one party is at the expense of another. These conflicts are often drenched in risk of loss and recriminations over past decisions. Anxiety, guilt, sadness, and other negative emotions are frequent and strong for clients, and often cross boundaries to impact their attorneys as well.

**Adversarial Skills** - Attorneys have highly developed adversarial skills and often employ them on each other and lay persons (including staff and family) in situations where those skills are not the only possible approach. This approach weakens relationships and generates more negative emotions, while making it hard to generate positive emotions that support collaboration, creativity, professionalism, performance, and thriving. In addition, possibly as a result of these skills, lawyers are prone to negative explanatory styles that tend to lead to feelings of helplessness in the face of even routine adversity. These thinking patterns have been shown to cause depression.

**Necessary Evils** - Lawyers are frequently required, in the service of a higher good, to employ their professional training and position in ways that cause physical or psychological pain to others. This repeated behavior creates a challenge to thriving for many professionals, but it is exacerbated for lawyers by the presence of a skilled advocate on the other side.

obtain the information from other sources, such as actual searches of the land records in California. Additionally, it is not currently known how states, such as Tennessee, might provide further assistance, if any, to the IRS.

What is also not known is how the information assembled by the State of Tennessee might be used for Tennessee gift tax reporting purposes. It would be easy enough for the Tennessee Department of Revenue to utilize the data that has already been assembled. Moreover, it would be just as simple to collect data on an ongoing basis through any number of procedures, including having county registers notify the Tennessee Department of Revenue whenever a deed is submitted with no consideration listed on the tax affidavit, a practice which is already in place in some counties. Additionally, the concept of reviewing intra-family transfers could be applied to assets other than real property, such as brokerage accounts.

The emergence of The Gift Tax Enforcer has lead some to ponder whether the voluntary disclosure of past unreported gifts might now be appropriate. (See: Scott D. Michel and Beth Shapiro Kaufmann: Unreported Gifts of Real Property: Time for a Voluntary Disclosure? Tax Notes (August 1, 2011), and the Internal Revenue Manual section 9.5.11.9 for more on the Voluntary Disclosure Program). Of course, unreported gifts can impact estate planning and estate administration, so addressing (or not addressing) this issue can have long-term implications for the client.

If nothing else, this gift tax initiative is something we need to be aware of so that we can continue to properly advise our clients.

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**Culture** - Law firms, the courts, and other legal organizations have strong cultures that have been shaped by the ad-hoc, often narrow adaptations that lawyers have made to these challenges over 800 years of development of western law.

**Narrow Adaptations** to law's challenges to thriving include adopting a "white hat" partisan view of your particular area, becoming a "Rambo" litigator or "scorched earth" negotiator, seeing every discussion or disagreement as an argument and judging your own and others' "smarts" by how the ability to argue, disconnecting from the pain suffered by participants in legal processes, and cultures focused on extrinsic incentives such as income.

**Broad Adaptations** include recognition and acceptance of values conflicts, practicing from your core character strengths, flexible and accurate thinking, avoiding needless negativity and looking for opportunities to bring warmth, humor, and respect even while focused on resolving zero-sum disputes, including appreciative approaches in our problem-solving toolkit, sensitivity and courtesy to others in all situations, and cultures built on strengths, relationships, and a respect for the priority of intrinsic motivations.

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