

The State of Estate Taxation

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Most financial advisors think that our tax system is (how can we put this delicately?) not the most streamlined or user-friendly document we've ever worked with. The U.S. Government Printing Office says that our current IRS Tax Code runs to 13,458 pages and roughly 5.8 million words. (A little longer than ten copies of the unabridged version of Tolstoy's *War and Peace*.)

Most of the language is less fun to read than you might imagine, with phrases like:

"If during any taxable year any building to which section [47\(d\)](#) applied ceases (by reason of sale or other disposition, cancellation or abandonment of contract, or otherwise) to

be, with respect to the taxpayer, property which, when placed in service, will be a qualified rehabilitated building, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section [38](#) for all prior taxable years which would have resulted solely from reducing to zero the credit determined under this subpart with respect to such building." (IRS Section 50, (a)(2)(A)).

But if you talk to professionals at industry conferences, they'll tell you that the messiest corner of the tax code involves the money you leave to your heirs.

For instance, there's a lot of discussion in professional journals these days about when and how it's beneficial to convert a traditional IRA to a Roth. One factor in the decision: the rules governing inherited Roth IRAs are very different from inherited traditional IRAs. Meanwhile, whoever is administering the money left to heirs often has the joy of calculating something called the "income in respect of a decedent." And, in the convoluted logic of U.S. taxes, there are different tax breaks on assets that have gone up in value depending on whether they were owned as community property or joint tenancy.

Of course, when you decide who should inherit your IRA (Roth or otherwise), you simply specify this important information in your last will & testament, right? Wrong! (MUCH too logical!) Under our tax code, it doesn't matter what you say about your IRA in your will. Instead, you have to specify who will receive your IRA assets with a "beneficiary designation form"--that fun and exciting document which usually assumes (for reasons nobody has ever convincingly explained) that you want to give your retirement assets to your brothers and sisters rather than your children and grandchildren. (A lot of times, professionals have to substitute a custom-made form for the standard one offered by the IRA account's custodian.

Not surprisingly, a lot of people forget to update these forms as their life circumstances change, as they divorce and/or remarry. Ed Slott, a noted specialist in IRA distributions, has famously

said that it is not uncommon for him to review beneficiary designations and find dead people listed as the inheritors. (This is not ideal from an estate planning perspective.)

A good financial planning professional can help you sort through these things, updating your beneficiary forms, helping you name contingent beneficiaries (who will receive your IRA if/when beneficiaries die), sorting through all the complicated issues surrounding Roth conversions and so forth. But lately, the most confusing part of the tax code has been the estate tax itself.

Why? If somebody had died last December 31, \$3.5 million worth of his or her assets would pass to heirs free of federal estate taxes, and for amounts above that, the federal estate tax rate maxed out at 45%. If that same person had managed to survive until January 1, 2010, the U.S. Tax Code assesses ZERO federal estate taxes--none whatsoever--even if the deceased happens to be a multi-billionaire like Bill Gates or Warren Buffett.

It gets better. As things stand now, if that same famous multi-billionaire were to die in January of 2011 or any time thereafter, only \$1 million of the ten-figure estate could be passed on estate-tax-free, and the tax rate is scheduled to go back up higher than it was last year, to a 55% maximum rate. Suddenly, a lot of people have to start thinking about estate taxes again. There is also a one-year change in how to calculate the capital gains tax on the sale of inherited assets, which will almost certainly affect many more people than the inheritance tax did (don't ask).



Congress is looking at ways to fix this situation, maybe retroactively. For now, we have to live with the complexity--which we should all be used to by now.