

Trust & Estates

Taxes and Planning

TM Financial Services

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General Powers of Appointment

A power of appointment is the right to assign or specify who will be the owner of some property in the future. If the person (holder) has the ability to designate any of the following as owners of the property, the appointment is a general one:

- The holder
- Holder's estate
- Holder's creditors or
- Holder's estate's creditors

An exercise, lapse or release of a general power of appointment results during life in a gift and if held at death, inclusion in the holder's gross estate. Nevertheless, if the power to appropriate the property is limited to an ascertainable standard such as HEMS (health, education, maintenance or support), it will not be considered a general power.

Property over which a decedent possessed a general power of appointment must be included on Form 706 on Schedule H. Attached to the 706 should be copies of the instrument granting the power and asset-valuation documentation.

EDOTs

Many losses incurred during the period of administration of a trust or estate can be carried forward year to year and passed on to the beneficiaries in the year the trust or estate terminates. This can be done with both net capital losses (NCLs) and net operating losses (NOLs) under the provisions of §642(h)(1), (in contrast to the decedent's NOL or capital losses which cannot be carried from the final 1040 to the fiduciary 1041 return).

Non-business deductions (administrative expenses) in excess of income during interim years are lost and do not carry forward. However, in the estate's final year, the excess deductions on termination (EDOTs) can be distributed from the final fiduciary income tax return to the beneficiaries (§642(h)(2)). To avoid doubling the deductions, Regs. §1.642(h)-2(c) states that any item of income or expense used in determining an NOL or Capital loss carryover is not taken into account in determining the EDOTs.

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EDOTs (continued from page 1)

Charitable deductions allowable under §642(c) and the personal exemption under §642(b) are also ignored when computing the amount of excess deductions. AMT can reduce some of the EDOT tax benefits.

The beneficiaries who are entitled to the excess deductions are the "beneficiaries succeeding to the property of the estate or trust". The phrase "beneficiaries succeeding to the property of the estate or trust" means in the case of an intestate estate, the heirs and next of kin to whom the estate is distributed and in the case of a testate estate, it means the residuary beneficiaries. Reg. 1.642(h)-3(b) and (c).

The beneficiaries share in the excess deductions and unused loss carryovers distributed to them in accordance with their share of the estate. See generally Reg. 1.642(h)-3 and 4 for allocation of excess deductions and loss carryovers among the beneficiaries.

Planning for EDOTs

As the payment of bills controls the timing of deductions for a cash-basis entity, the fiduciary has a good degree of flexibility in determining the year of deductions and as the most common nonbusiness expenses are often legal, accounting and executor fees, the individuals producing these costs should collaborate to produce the maximum tax benefits for the beneficiaries. For example, one could delay the payment of expenses such as legal and executor's fees until the final year of the estate or trust. EDOT planning, therefore, should be considered as carefully as distributions to beneficiaries.

EDOT items need to be allocated between taxable and tax-exempt income. As deductions to tax-exempt income do not increase EDOT, consideration should be given to minimizing investments in tax exempt assets in the final year of the estate.

Another consideration is to distribute assets to beneficiaries instead of selling them as the increase in income from the gains will reduce or possibly eliminate any EDOT.

Finally, the creation of a short final year for the trust or estate may increase greatly the tax benefits to the beneficiaries.

Reporting for final year items:

	Estate <u>K-1</u>	Beneficiary <u>1040</u>
EDOTs	11.a	Schedule A, line 23
S/T CLCs	11.b	Schedule D, line 5
L/T CLCs	11.c	Schedule D, line 12
NCL c/o	11.d	Form 1040, Line 21
NCL c/o (AMT)	11.e	Form 6251, line 11

As the first line of the table indicates, EDOTs are reported by the beneficiary on Schedule A. Therefore if the beneficiary does not itemize on his personal return the tax benefits are lost. The beneficiaries can claim the deduction only for the tax year in which the estate terminates, whether the year of termination is a normal year or a short tax year. If the deductions exceed a beneficiary's other taxable income, it cannot be carried back or forward.

ESTATE & INHERITANCE TAXES BY STATE**2011 RATES & EXEMPTIONS**

	ESTATE <u>EXEMPTION</u>	INHERITANCE	ESTATE	INHERITANCE <u>TOP RATE</u>
Connecticut	3,500,000		12%	
Delaware	5,000,000		16%	
Hawaii	3,600,000		16%	
Illinois	2,000,000		16%	
Indiana		100		20%
Iowa		0		15%
Kentucky		500		16%
Maine	1,000,000		16%	
Maryland	1,000,000	0	15%	10%
Massachusetts	1,000,000		16%	
Minnesota	1,000,000		41%	
Nebraska		10,000		18%
New Jersey	675,000	0	16%	16%
New York	1,000,000		16%	
North Carolina	5,000,000		16%	
Ohio	338,333		16%	
Oregon	1,000,000		16%	
Pennsylvania		0		15%
Rhode Island	859,350		16%	
Tennessee		1,000,000		9.5%
Vermont	2,750,000		16%	
Washington	2,000,000		19%	
Washington DC	1,000,000		16%	

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Income tax election for decedent's medical expenses

§213(c) allows for expenses for the medical care of the taxpayer which are paid out of his estate during the 1-year period beginning with the day after the date of his death to be treated as paid by the taxpayer at the time incurred, thus allowing a deduction on the decedent's final 1040. This essentially puts medical expenses on an accrual basis for an otherwise cash basis taxpayer. The personal representative must make an election to waive the deduction allowed under §2053 on Form 706.

IRS	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
NJ	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
NY	General Information	518-457-5181
	Estate Tax	518-457-5387
CT	General Information	860-297-5962
PA	General Information	717-787-8201

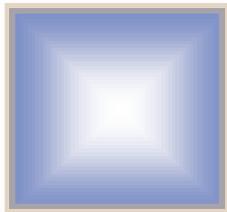
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Important Phone Numbers

With an exemption level of \$675,000 in 2001, the number of estates that paid any taxes was **51,700**. In 2009 at \$3,500,000 some **14,700** estates owed federal estate taxes and based on the new 2010 exemption of \$5,000,000 that number would have been **4,300**.

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