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Temporary Regulations Issued on Portability of the Estate Tax Exclusion and Related Issues

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Overview

On June 15, the IRS issued temporary regulations concerning portability of the amount of the unused federal estate tax exemption at the death of the first spouse – known as the "deceased spousal unused exclusion amount" (DSUEA).[1] Portability is in play, by election, for individuals who die in either 2011 or 2012 *and* their spouse also dies by the end of 2012.

Portability allows the full federal estate exemption of both a husband and wife to be utilized without the need for any detailed marital deduction estate planning to be engaged in. But, the portability provision raised numerous questions. In the temporary regulations, IRS has attempted to answer those questions.

The Portability Election

While many initially thought that portability was automatic, it is not. Instead, an election must be made for a surviving spouse to be able to use the unused amount of the federal estate tax exclusion at the death of the first spouse. That election is made by filing a "timely filed" estate tax return (IRS Form 706) in the estate of the first spouse.[2] But, statutorily, "timely filed" only has meaning if Form 706 is required.[3] Form 706 is required if the estate value is not covered by the available exclusion amount at the time of death. So, in the case of portability of an unused exclusion amount, a Form 706 would not be required to be filed in the first spouse's estate (because the estate is not large enough to use up the exclusion amount). Thus, "timely filed" has no meaning in the context of portability and can lead to the conclusion that no "election" is necessary in the first spouse's estate. According to that theory, a practitioner could adopt a "wait-and-see" approach. Simply wait to see if the surviving spouse dies by the end of 2012 and, if so, whether any unused exclusion from the first spouse's estate is necessary to be added to the surviving spouse's exclusion to cover potential estate tax.

In the temporary regulations, the IRS has stated that every estate electing portability of a decedent's DSUE must file an estate tax return within 9 months of the decedent's date of death, unless an extension of time for filing has been granted, regardless of the size of the gross estate.[4] The regulations fail to cite any basis in the statute for this position. Instead, the regulations state that "the rule will benefit the IRS and taxpayers choosing because the records required to compute and verify the DSUE amount are more likely to be available at the time of the death of the first deceased spouse than at the time of a subsequent transfer by the surviving spouse by gift or at death, which could occur many years later."

> **Note:** The Treasury's rationale makes little sense. Unless present law is extended, portability has no application beyond 2012. Thus, records that are available on June 15, 2012 (the date of the temporary regulations were issues) are just as likely to be available if the surviving spouse dies on the latest possible date to utilize the portability provision – December 31, 2012.

Details of the "Election" on Form 706

Required information. The regulations specify that the portability election is to be made on a "complete and properly prepared" estate tax return.[5] But, what does that mean when the only reason the return is filed is to make the portability election? The regulations specify that the estate's executor (the party responsible for making the portability election) need not report the value of property that qualifies for either the marital or charitable deduction, but must estimate the total value of the decedent's gross estate on line 1, part 2 of the return. In addition, the regulations specify that a "complete and properly-prepared return" contains the information required to compute a decedent's DSUE amount.[6] The temporary regulations go on to state that "once the IRS revises the prescribed form for the estate tax return expressly to include the computation of the DSUE amount, executors that previously filed an estate tax return pursuant to the transitional rule will not be required to file a supplemental estate tax return using the revised form."

By statute, the DSUE amount as the lesser of (A) the basic exclusion amount, or (B) the excess of (i) the basic exclusion amount of the last deceased spouse of the surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under I.R.C. §2001(b)(1) on the estate of such deceased spouse.[7] The temporary regulations confirm that the term "basic exclusion amount" referred to in section 2010(c)(4)(A) means the basic exclusion amount in effect in the year of the death of the decedent whose DSUE amount is being computed.[8]

> **Note:** The temporary regulations provide that for purposes of determining a surviving spouse's applicable exclusion amount when the surviving spouse makes a taxable gift, the surviving spouse's last deceased spouse is identified as of the date of the taxable gift.[9] The same rule applies on the estate tax side. The identification of the decedent's "last deceased spouse" is made at the time of the death of the decedent.[10]

The temporary regulations provide that amounts on which gift taxes were paid by a decedent are excluded from adjusted taxable gifts for the purpose of computing that decedent's DSUE amount.[11]

On the issue of whether the DSUE amount is determined before or after the application of other available credits, the temporary regulations did not provide any guidance. Further guidance on this issue is expected in the future.

Electing out of portability. For the estate of the first spouse to die where an estate tax return is required to be filed, but for which the surviving spouse does not wish to have available any unused exclusion in the surviving spouse's estate, the temporary regulations require that the executor of the first deceased spouse's estate affirmatively state on the estate tax return that the portability election does not apply.[12] For estates where an estate tax return need not be filed, not filing one means that portability has not been elected.

Examination of Returns

The regulations point out that the IRS can examine returns of each deceased spouse of the surviving spouse (in reality only the estate tax return of the decedent's last deceased spouse would be relevant) to determine the allowable DSUE amount even if the period of limitations on assessment under section 6501 has expired.[13] But, the statute is not extended for purposes of assessing additional tax on such a return.

Nonresident, Non-Citizen Surviving Spouses

The temporary regulations clarify that nonresident, non-citizen surviving spouses are not eligible to utilize the DSUEA from their last surviving spouse.[14] The temporary regulations did not address the applicability of the DSUEA to a Qualified Domestic Trust created for a surviving spouse that is not a U.S. citizen.

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[1] T.D. 9593, effective upon publication in the Federal Register. I.R.C. §2010(c)(4).

[2] I.R.C. §2010(c)(5)(A).

[3] I.R.C. §6018(a).

[4] Temp. Treas. Reg. §20.2010-2T(a)(1).

[5] Temp. Treas. Reg. §20.2010-2T(a)(7)(i).

[6] Temp. Treas. Reg. §20.2010-2T(b)(1)-(2).

[7] I.R.C. §2010(c)(4)(A).

[8] Temp. Treas. Reg. §20.2010-2T(c)(1)(i).

[9] Temp. Treas. Reg. §§20.2010-3T(a).

[10] Temp. Treas. Reg. §5.2505-2T(a).

[11] Temp. Treas. Reg. §20.2010-2T(c)(2).

[12] Temp. Treas. Reg. §20.2010-2T(a)(3).

[13] I.R.C. §2010(c)(5)(B); Temp. Treas. Regs. §§20.2001-2T(a); 20.2010-2T(d); 20.2010-3T(d); 25.2505-2T(e).

[14] Temp. Treas. Reg. §20.2010-2T(a)(5); 20.2010-3T(e); 25.2505-2T(f). Whether a surviving spouse is a nonresident who is not a citizen is to be determined at the time of the surviving spouse's death.