# PSST!

## Portability: Something Special to Try

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BACKGROUND

"Portability" allows a surviving spouse to "port" or use his or her deceased spouse's unused estate and gift tax exemption amount. The portability concept has been discussed for many years as being sound tax policy. It was recommended in 2004 by a task force comprised of representatives from the American Bar Association ("ABA") Section of Taxation, the ABA Section of Real Property, Probate and Trust Law, the American College of Tax Counsel, the American College of Trust and Estate Counsel ("ACTEC"), the American Bankers Association and the American Institute of Certified Public Accountants.[1] Although it appeared in several congressional bills subsequent to that time, portability was not available until 2011 with the enactment of the Tax Relief, Unemployment Insurance Reauthorization and Jobs Creation Act of 2010 (the "2010 Tax Act"). The provisions allowing portability were set to expire on December 31, 2012 under the 2010 Tax Act, however, they were permanently extended under the American Taxpayer Relief Act of 2012 ("ATRA").

In spite of the possible transitory nature of portability, the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") issued helpful guidance with respect to the application of portability prior to the passage of ATRA. On October 11, 2011, Notice 2011-82 was issued to alert executors (and their advisors) of the need to file a timely estate tax return to elect portability for decedents whose deaths occurred after December 31, 2010.[2] The provisions of Section 2010(c) require an "election" by the executor on a timely-filed estate tax return in order for portability to apply. The IRS recognizes that many estate tax returns will be filed for the sole purpose of electing portability. Notice 2011-82 clarifies that if portability is elected, the following requirements must be met:

- A complete and timely-filed estate tax return (including extensions) must be filed; and
- The "election" required by the statute will be deemed to have been made by the timely filing of a "complete and properly-prepared"[3] estate tax return until a revised estate tax return form that provides for making the election is released.

The notice goes on to state that an executor who does not want to make a portability election, but who otherwise timely files a complete return, must follow Form 706 instructions in order to make the opting-out election (even though no such instructions existed at the time). An executor who does not want to make a portability election and who otherwise is not obligated to file an estate tax return can simply not file a return to opt out of portability. In addition, the notice also clarifies that a portability election is not permitted for decedents whose death occurred on or before December 31, 2010. Comments were requested on several issues that were identified for consideration in the drafting of temporary regulations, including calculating the DSUE amount, ordering exemption usage and understanding the scope of the unlimited return review period allowed to assess additional tax.

Notice 2012-21,[4] issued on March 5, 2012, granted certain estates an additional six months to file an estate tax return to elect portability. The discussion portion of the Notice indicates that several comments received with respect to Notice 2011-82 raised concerns about estates of decedents who died early in 2011 whose executors did not have the benefit of any guidance regarding portability. Those executors may have not understood the need for filing a complete estate tax return, or may not have even been aware of a requirement for filing to preserve portability for the surviving spouse. In addition, in those cases the executor would also not have been aware of the need to file an extension to file a return. Accordingly, the IRS and Treasury used their powers under Section 6081(a) to grant a six-month extension of time to file to estates of decedents whose deaths were after December 31, 2010 and before July 1, 2011, so long as the fair market value of the estate did not exceed $5 million and the decedent was survived by a spouse. In order to receive this special extension, the executor was required to file Form 4768 with the proper IRS service center no later than 15 months from the decedent's death, with the notation "Notice 2012-21, Extension for Good Cause Shown" or other sufficient notice that the form was being filed in accordance with Notice 2012-21. If the executor of a qualifying

[1] 58 Tax Law. 93, 200 (Fall 2004).
[2] I.R.S. Notice 2011-82, 2011-42 I.R.B. 516.
[3] *Id*. at 517.
[4] I.R.S. Notice 2012-21, 2012-10 I.R.B. 450.

estate already filed a late-filed estate tax return in hopes of preserving portability and the return was filed within 15 months of the decedent's death, an extension filed in accordance with the requirements of this Notice will relate back to the previously-filed return. However, no additional extension of time to file can be obtained after the 6-month extension, except in the case of an executor abroad.[5]

In 2014, the Treasury Department and the IRS once again came to the rescue of floundering taxpayers and their advisors by issuing Revenue Procedure 2014-18. [6] This revenue procedure provided a simplified method for taxpayers to get an extension to file a portability election. This method was only made available to smaller estates that would not otherwise be required to file an estate tax return, for which the filing requirement to elect portability is prescribed by regulation. The IRS has the ability to grant extensions for due dates prescribed by regulation under Treasury Regulation Section 301.9100-3. However, in the case of larger estates that would be required to file an estate tax return regardless of whether or not a portability election was desired, the due date for the return is prescribed by statute and no Section 9100 relief is available. Consistent with the IRS's latitude in granting extensions to those "smaller" estates, the Rev. Proc. provided that executors of those estates could file a complete and properly-prepared return on or before December 31, 2014, even if it was late, indicating the filing was made pursuant to the Rev. Proc. This was an option in lieu of filing relief under Section 9100, which involves requesting a private letter ruling and paying the large fees associated with that process. In granting this relief, the IRS specifically prohibited estates that qualified for the relief from filing a PLR request. Unfortunately, this was a one-time opportunity that expired at the end of 2014. However, based on the history of the IRS of coming to the rescue of wayward taxpayers on the complications related to portability, it would not be surprising to see some sort of permanent relief to be issued at some point. The preamble to the final regulations indicates that the Treasury Department and the IRS are continuing to consider permanent extension options.[7]

Temporary regulations, [8] which also served as proposed regulations, were issued in 2012. The final regulations were issued on June 29, 2015.[9] Aside from a few clarifications, the final regulations are largely similar to the temporary and proposed regulations. These regulations address both the estate tax and the gift tax issues relating to portability. The regulations under Section 2010 are arranged so that Regulation Section 20.2010-1 provides definitions and applicable dates. Regulation Section 20.2010-2 addresses the portability issues as they apply to decedent's estates. Regulation Section 20.2010-3 discusses portability provisions that are applicable to the surviving spouse's estate. Regulation Section 25.2505-1 describes the general rule, special rules and applicable dates. Regulation Section 25.2505-2 explains the use of the DSUE amount by the surviving spouse for gift tax purposes.

Both the United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706)[10] and the United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709) include new sections to provide information on any DSUE amount the taxpayer may have.[11]

Let's take a look at the basics – the who, what, when, where and why – behind portability.

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[5] *See* § 6081. Unless otherwise indicated, all Section ("§") references are to the Internal Revenue Code of 1986, as amended (the "Code"), and all Regulation Section ("Reg. §") references are to the Treasury regulations promulgated thereunder.

[6] Rev. Proc 2014-18, 2014-7 I.R.B. 513.

[7] T.D. 9725, 2015-26 I.R.B. 1122, 1123.

[8] T.D. 9593, 2012-28 I.R.B. 54. Note that these temporary regulations were effective on June 15, 2012 and were set to expire on or before June 1, 2015. The temporary regulations also served as the text for the proposed regulations. Prop. Treas. Reg. §§ 20.2001-2; 20.2010-0 to -3; 25.2505-0 to -2, 77 Fed. Reg. 36229 (June 18, 2012).

[9] T.D. 9725, 2015-26 I.R.B. 1122. Note that the temporary regulations still apply to estates of decedents dying and for related gifts of DSUE amounts made on or after January 1, 2011 and before June 12, 2015, so be sure to hang on to those temporary regulations for a while longer!

[10] The current Form 706 can be found at http://www.irs.gov/pub/irs-pdf/f706.pdf. The instructions to Form 706 can be found at http://www.irs.gov/pub/irs-pdf/i706.pdf.

[11] The Form 709 can be found at http://www.irs.gov/pub/irs-pdf/f709.pdf and the instructions to the Form 709 can be found at http://www.irs.gov/pub/irs-pdf/i709.pdf.

WHO

Portability applies to the surviving spouse of a married couple.[12] A few definitions are important in determining the players involved.

"Last Deceased Spouse." The last deceased spouse means "the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse."[13] Even if the surviving spouse remarries after the death of her deceased spouse, as long as the surviving spouse predeceases the new spouse, the deceased spouse is considered to be the last deceased spouse.[14] The determination of the last deceased spouse is not affected by the amount of any unused exemption amount or portability elections.[15] It is simply based on the facts existing at the time with respect to the relationship of the parties.

"Other Deceased Spouse." Although the "other deceased spouse" is not a defined term in the regulations, that term is used to refer to a spouse who is not the last deceased spouse, but whose deceased spousal unused exclusion ("DSUE") amount was previously used by his or her surviving spouse for gifting purposes. A special rule applies in the case of multiple deceased spouses and such previously-applied DSUE amounts.[16] See the discussion of DSUE amount below.

"Non-US Citizens." Portability has limited availability to non-US citizens, depending on residency and citizenship.

If the deceased spouse is a nonresident, non-US citizen at the time of his or her death, a portability election is not available.[17] If the deceased spouse is a non-US citizen but is a resident at the time of his or her death, a portability election is available. However, the surviving spouse's use of that exemption may be limited or disallowed, depending on the surviving spouse's status.

For gift tax purposes, if, at the time of the gift, the surviving spouse is a nonresident, non-US citizen, he or she cannot utilize any of the deceased spouse's DSUE amount except to the extent allowed under an applicable treaty obligation of the United States.[18] For estate tax purposes, if, at the time of the surviving spouse's subsequent death, the surviving spouse is a nonresident, non-US citizen, he or she cannot utilize any of the deceased spouse's DSUE amount except to the extent allowed under an applicable treaty obligation of the United States.[19] Certain restrictions are imposed on qualified domestic trusts ("QDOTs") that are created on the deceased spouse's death for the benefit of a non-US citizen surviving spouse. See the discussion of special rules applicable to QDOTs below.

"Executor." Only the executor is able to make an election to take advantage of or opt out of portability.[20] Under the regulations, an executor is defined as an administrator or executor "that is appointed, qualified, and acting within the United States, within the meaning of section 2203…."[21] In addition, if there is no such appointed executor or administrator, the regulations provide that "any person in actual or constructive possession of any property of the decedent (a non-appointed executor) may timely file the estate tax return on behalf of the estate of the decedent"[22] to elect portability or to elect not to have portability apply. These regulations mirror the provisions of Section 2203. The final regulations include a clarification that if a non-appointed executor makes an election, a later appointed executor can

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[12] Under the Defense of Marriage Act (Pub. L. 104-199, 110 Stat. 2419, enacted September 21, 1996, 1 U.S.C. § 7 and 28 U.S.C. § 1738C), marriage was defined as the legal union of one man and one woman for federal and interstate purposes. Thus portability, initially, only applied to married spouses of the opposite sex. However, in the case of Windsor v. United States, 570 U.S. ___, 133 S.Ct. 2675 (2013), the Supreme Court held that this portion of DOMA is unconstitutional, resulting in the allowance of an estate tax marital deduction for a surviving same-sex spouse of a decedent and making portability available to all married couples. See Rev. Rul. 2013-17, 2013-38 I.R.B. 201, for the definition of "spouse" following the *Windsor* case.

[13] Reg. § 20.2010-1(d)(5).

[14] Reg. §§ 20.2010-3(a)(3); 20.2505-2(a)(3).

[15] Reg. §§ 20.2010-3(a)(2); 20.2505-2(a)(2).

[16] Reg. §§ 20.2010-3(b)(1)(ii); 20.2505-2(c)(1)(ii).

[17] Reg. § 20.2010-2(a)(5).

[18] *See* Reg. § 25.2505-2(f); § 2102(b)(3). The application and analysis of those rules and any related treaties are outside the scope of this paper. For a list of the current gift and estate tax treaties, see http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-&-Gift-Tax-Treaties-(International).

[19] *See* Reg. § 20.2010-3(e); § 2102(b)(3).

[20] § 2010(c)(5).

[21] Reg. § 20.2010-2(a)(6)(i).

[22] Reg. § 20.2010-2(a)(6)(ii).

make a subsequent timely election that will supersede the prior election.

WHAT

There are several defined terms used in the determination of the amount of the deceased spouse's exemption amount that is eligible for portability.

"Basic Exclusion Amount." The basic exclusion amount is $5 million beginning in 2011, and is subject to inflation adjustment thereafter.[23] The basic exclusion amounts for subsequent years are as follows:

2012 -- $5.12 million
2013 -- $5.25 million
2014 -- $5.34 million
2015 -- $5.43 million
2016 -- $5.45 million

"Applicable Exclusion Amount." The applicable exclusion amount is the sum of the basic exclusion amount and the deceased spousal unused exclusion amount (the DSUE amount).[24]

"Applicable Credit Amount." The applicable credit amount is the amount of tax that would be determined under section 2001(c) for estate or gift tax purposes on the applicable exclusion amount.[25] This amount is subject to reduction for certain pre-1977 gifts. The applicable exclusion amount is reduced by twenty percent of the total specific exemption amount that was allowed under section 2521 for gifts made after September 8, 1976 and before January 1, 1977.[26]

"Deceased Spousal Unused Exclusion (DSUE) Amount." The code defines the DSUE amount as:

> "DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT.—For purposes of this subsection, with respect to a surviving spouse of a deceased spouse dying after December 31, 2010, the term 'deceased spousal unused exclusion amount' means the lesser of—
>
> (A) the basic exclusion amount, or
>
> (B) the excess of—
>
> (i) the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over
>
> (ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse."[27]

Prior to the publication of the temporary regulations and the legislative fix under ATRA, there was quite a bit of controversy over how the DSUE amount was calculated.[28] The confusion arose from the reference in the statute to the "basic exclusion amount" in section 2010(c)(4)(B)(i) instead of to the "applicable exclusion amount." There is quite a bit of discussion about this in the temporary regulations. Example 1 in temporary Regulation Section 20.2010-2T(c)(5) provides an example of how to calculate the DSUE amount based on their interpretation of the statute prior to the correction made under ATRA.

The regulations also clarify that the basic exclusion amount referred to in Section 2010(c)(4)(A) means the amount in effect in the year of the decedent's death (as opposed to the year in which it is used).[29]

*Prior Taxable Gifts*. For purposes of computing the DSUE amount, the regulations provide that a special rule applies if the decedent made taxable gifts on which he or she paid gift tax. The amount of the adjusted taxable gifts of the deceased spouse is reduced by the amount of those gifts in making the DSUE amount calculation. This is an appropriate adjustment from a fairness standpoint. However, the statute does not provide for this adjustment. It appears that the Treasury and the Secretary are making this interpretation based on authority under Sections 2010(c)(6) and 7805. See Example 2 in Regulation Section 20.2010-2(c)(5) for an example of

[23] § 2010(c)(3); Reg. § 20.2010-1(d)(3).
[24] § 2010(c)(2); Reg. § 20.2010-1(d)(2).
[25] § 2010(c)(1); Reg. § 20.2010-1(d)(1).
[26] Reg. § 20.2010-1(b).
[27] § 2010(c)(4).
[28] For a brief summary of the issues, see T.D. 9593 at p. 20. For a more detailed discussion, see the American Bar Association's paper "Portability – Part One," prepared by the Estate and Gift Tax Committee of the ABA Tax Section (in coordination with other committees from the Real Property Trust and Estate Law Section), found at http://www.americanbar.org/content/dam/aba/events/real_property_trust_estate/heckerling/2012/heckerling_report_2012_portability_part_one.authcheckdam.pdf.
[29] Reg. § 20.2010-2(c)(1)(i).

how to calculate the DSUE amount where gift tax was previously paid by the deceased spouse.

*Effect of Tax Credits*. The temporary regulations did not address the order in which available credits were to be applied in computing the DSUE amount. The final regulations provide that an estate's application of credits arising for gift taxes previously paid under Section 2012, taxes on prior transfers under Section 2013, foreign death taxes under Section 2014 and death taxes on remainders under Section 2015 do not affect the calculation of the DSUE Amount, as those credits are taken into account only after application of the Section 2010 credits. ACTEC's comments in response to Notice 2011-82 requested that the DSUE amount be calculated after taking into account any credits, so that the surviving spouse will receive the full benefit of the deceased spouse's unused exclusion amount.[30] Unfortunately, this position was not adopted by the Treasury and the IRS in the final regulations.[31]

Special Rules Applicable to Qualified Domestic Trusts (QDOTs). If the deceased spouse creates a QDOT for the surviving spouse, the DSUE amount is calculated as described above. However, the initial DSUE amount is subject to adjustment in the future and the surviving spouse's use of the DSUE amount is restricted. The regulations provide that the DSUE amount initially calculated at the deceased spouse's death is recalculated upon the final distribution or termination of the QDOT or the death of the surviving spouse who is the beneficiary of the QDOT.[32] This rule that suspends the surviving spouse's use of the deceased spouse's DSUE amount also applies to gifts, with one exception.[33] This exception allows the surviving spouse to apply the deceased spouse's DSUE amount to gifts made in the year of the surviving spouse's death or in the year that the terminating event occurs.[34] The final regulations added a provision to clarify that if the noncitizen surviving spouse later becomes a citizen and the requirements of the regulations under Section 2056A are met, then the estate tax will no longer apply to the trust distributions or the QDOT itself.[35] Similar clarifications were made with respect to the DSUE amount and gifts.[36] The regulations contain examples that explain how these provisions apply.[37]

## WHEN

In order to take advantage of portability, an election must be made on behalf of the decedent's estate. That election must be made on a timely-filed estate tax return (Form 706).[38] Although several advisors have requested that a "Form 706-EZ" be created if the sole purpose for filing the estate tax return is to elect portability, the Treasury Department and the IRS have declined to give in to this request. Their reasons are legitimate, but basically boil down to the fact that it would be too hard for them to create and administer.[39] The regulations make it clear that even though an estate tax return would not otherwise be required to be filed, if a portability election is desired, then the estate will be considered to be required to file a return under Section 6018(a).[40] The return will be considered timely-filed if it is filed within nine months after the decedent's death or within the amount of time provided in any extensions obtained from the IRS.[41] There are no provisions for a late-filed election.[42] If the estate cannot qualify for the automatic extensions permitted under the Notices and Rev. Proc. discussed above, there may still be relief available for the failure to timely file. The regulations clarify that although the general catch-all relief provisions under Regulation Section 301.9100-3 will not apply to estates otherwise required to file a return under Section 6018(a), those regulations will apply in the case of returns not required to file except as required under the portability regulations to elect portability. This is because the IRS is not authorized to offer relief under Regulation Section 301.9100-3 for statutory elections (even if the election is also a

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[30] *See* ACTEC letter to the IRS (Oct. 28, 2011), p. 17, which may be found at http://www.actec.org/Documents/misc/Radford_Comments_Notice_2011-82.pdf.
[31] Reg. § 20.2010-2(c)(3).
[32] Reg. § 20.2010-2(c)(4).
[33] Reg. § 25.2505-2(d)(2).
[34] *Id*.
[35] Reg. § 20.2010-2(c)(4)(ii).
[36] Reg. §§ 25.2505-2(d)(2), 2505-2(d)(3)(ii).
[37] *See* Reg. § 20.2010-2(c)(5), *Example 3*; Reg. § 25.2505-2(d)(2)(ii).
[38] § 2010(c)(5)(A); Reg. § 20.2010-2(a)(1).
[39] T.D. 9725 at p. 1125.
[40] Reg. § 20.2010-2(a)(1).
[41] *Id*.
[42] § 2010(c)(5)(A); Reg. § 20.2010-2(a)(1).

regulatory election).[43] However, the relief provisions under Regulation Section 301.9100-2 do allow extensions for certain statutory elections by allowing an automatic six-month extension from the original due date (without extensions) if the taxpayer timely filed its return but failed to make the election.[44] In the case of a portability election, the Treasury Department and the IRS have clarified in the final regulations that if the return is filed to elect portability and the return is not otherwise required to be filed under Section 6018(a), then this relief will be available.[45] Indeed, the IRS has granted several favorable rulings.[46] However, in cases where the return was timely filed and the executor affirmatively stated it was not electing portability, it may be difficult to later request an extension of time to affirmatively make the election. The IRS may interpret the affirmative opting-out of portability as an election for purposes of 9100 relief, particularly because Form 706 requires the executor to check a box to opt out of the portability election. In the preamble to the final regulations, the Treasury Department and the IRS indicated they are still considering options relating to permanent extension similar to Notice 2012-21.

After the return due date, any election made is irrevocable.[47] If the executor makes an election on a return filed before the due date, and then files a subsequent return that indicates no election is made, as long as the subsequently filed return is timely it will supersede the previously-filed return.[48] However, as discussed above, there may be several people who are eligible to make the election in the case of an estate with no appointed executor. In the case of multiple "non-appointed" executors, whose election takes effect? It appears that it is the election that is made first, with one exception. The regulations provide that a portability election made by a non-appointed executor cannot be superseded by a contrary election made by another non-appointed executor of that same decedent's estate (unless such other non-appointed executor is the successor of the non-appointed executor who made the election).[49] However, the final regulations also clarify that even if there is no executor appointed at the time a non-appointed executor makes an election, if a later appointed executor makes a timely election contrary to that of the non-appointed executor, then the appointed executor's election supersedes the prior election.[50] Challenges may arise for any non-appointed executors who wish to make this election. If a non-appointed executor desires to make a portability election, he or she will need to gather sufficient information about the entire estate in order to file a complete return. However, if a non-appointed executor desires to opt out of making a portability election, it is not entirely clear that the return be a complete and properly-prepared return. The regulations provide that an election will not be made if the executor either "…states affirmatively on a timely-filed estate tax return…that the estate is not electing portability…"[51] or fails to timely file an estate tax return.[52] Note that the words "complete and properly-prepared" are omitted from this section of the regulations. It could be argued that any return filed by a non-appointed executor to opt out of portability is sufficient for that purpose, even though it would not be considered sufficient to make the election.

The "complete and properly-prepared" requirement for the estate tax return is described in the regulations.[53] As a general rule, the return will be deemed complete and properly-prepared if it is prepared in accordance with Form 706 instructions and the regulations under Section 6018.[54] However, some relaxed reporting requirements are provided under the regulations if the return is not otherwise required to be filed, but is being filed to elect

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[43] *See* Priv. Ltr. Rul. 201109012 (Nov. 15, 2010) (revoking previously granted relief granted with respect to a qualified terminable interest election); Reg. § 301.9100-1.

[44] Reg. § 301.9100-2(b). If relief is granted, certain corrective action and procedures must be filed. *See* Reg. § 301.9100-2(c) and (d).

[45] Reg. § 20.2010-2(a)(1).

[46] *See* Priv. Ltr. Rul. 201407002 (Feb. 14, 2014); Priv. Ltr. Rul. 201406004 (Feb. 27, 2014); Priv. Ltr. Rul. 201421002 (May 23, 2014); Priv. Ltr. Rul. 201544003 (Oct. 30, 2015); Priv. Ltr. Rul. 201544001 (Oct. 30, 2015); Priv. Ltr. Rul. 201544017 (Oct. 30, 2015).

[47] § 2010(c)(5)(A); Reg. § 20.2010-2(a)(4).

[48] Reg. § 20.2010-2(a)(4).

[49] *Id*.

[50] Reg. § 20.2010-2(a)(6)(ii).

[51] Reg. § 20.2010-2(a)(3)(i).

[52] Reg. § 20.2010-2(a)(3)(ii).

[53] Reg. § 20.2010-2(a)(7).

[54] *Id*.; Reg. §§ 20.6018-2 (relating to persons required to file a return), 20.6018-3 (relating to required contents of the return), 20.6018-4 (relating to documents to accompany a filed return).

portability.[55] In these cases, there are special rules for valuing property that qualifies for the estate tax marital or charitable deduction. In most cases, the executor will only need to report the following information with respect to marital and charitable bequests, devises and transfers:

- Description, ownership and/or beneficiary of the qualifying property;
- Information necessary to establish that the property qualifies for the marital or charitable deduction; and
- An estimate of the total estate, including the qualifying property.[56]

The executor must include a best estimate of this property, rounded to the nearest $250,000.[57] The regulations remind the executor that this estimation is a part of the return that is signed under penalties of perjury.[58] The Form 706 provides that where this provision applies, the values for these estimated items are reported on a new line that is included in the recapitulation instead of being included on schedules A through I of the return, although a description of the property (without values) is still reported on the schedules. The examples in the regulations are helpful in understanding the application of this special rule.[59]

The relaxed reporting rules do not apply to marital or charitable deduction property if one of the following applies:

- The value of the property relates to the value of property passing to another beneficiary of the estate that is not the surviving spouse or a qualified charitable organization;
- The value of the property is needed to determine the estate's eligibility special treatment such as alternate valuation, special use valuation or for generation-skipping transfer tax calculation purposes;
- Only a portion of the property includable in the estate qualifies for the marital or charitable deduction; or
- A partial qualifying terminable interest property election or a partial disclaimer is made with respect to the property.[60]

In addition, note that the Treasury Department and the IRS have specifically reserved their rights to add other exceptions to these relaxed reporting rules.[61] This new section was presumably added to the final regulations to give flexibility in dealing with situations that could result in abuses that have not yet been identified.

Computation Required. The regulations require a computation of the DSUE amount to be made by the executor on the filed estate tax return.[62] Prior to the issuance of the new Form 706 in 2012, a complete and properly prepared estate tax return is deemed to be sufficient for this purpose.[63] The temporary regulations confirmed that this method of election was acceptable prior to the issuance of the new Form 706.[64] The temporary regulations also clarified that executors who filed returns before the new form was available were not required to file a supplemental estate tax return using the revised form.[65] Many practitioners believe that it was advisable to make the calculation and provide an affirmative election on the estate tax return although it was not required. This is a practical approach that will make it apparent that the election was made and will clarify the amount of the DSUE amount available for the surviving spouse's use. The new Form 706 simplifies this calculation by providing the new Part 6, Portability of Deceased Spousal Unused Exclusion (DSUE). Note, however, in cases where no portability amount is available, it may be prudent to ensure that at least a $0 amount is entered into Part 6 so that if there is a later adjustment to the estate tax return that reduces the value of the estate so that an amount does become available to be ported, that you have preserved your "election." The preamble to the final regulations imply that this would automatically be the case.[66]

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[55] Reg. § 20.2010-2(a)(7)(ii).
[56] *Id*.
[57] *See* Reg. § 20.2010-2(a)(7)(ii)(B), referring to the Form 706 Instructions. The current instructions provide the $250,000 valuation brackets and these amounts are no longer specifically set forth in the regulations.
[58] *Id*.
[59] *See* Reg. § 20.2010-2(a)(7)(ii)(A).
[60] Reg. § 20.2010-2(a)(7)(ii)(C).
[61] Reg. § 20.2010-2(a)(7)(ii)(A), T.D. 9725 at p. 1124.
[62] Reg. § 20.2010-2(b)(1).
[63] I.R.S. Notice 2011-82, 2011-42 I.R.B. 516, 517.
[64] Reg. § 20.2010-2T(b)(2).
[65] *Id*.
[66] T.D. 9725 at p. 1123.

Opting Out. Most of the emphasis in the regulations relates to the affirmative election to take advantage of portability. However, the regulations also clarify how to avoid or proactively opt out of the election. The simplest way to avoid a portability election is to not file an estate tax return, provided that a return is not otherwise required to be filed.[67] If a return must be filed for other reasons, the executor must state affirmatively on the return or on a statement attached to the return that the estate is not electing portability under Section 2010(c)(5).[68] Form 706 provides a check box in Part 6 for the executor to elect out of portability.

Authority to Examine Returns. As provided in Section 2010(c)(5)(B), the IRS can examine the deceased spouse's estate tax return at any time – *even after the expiration of the statute of limitations with respect to the return itself* – in order to determine the proper DSUE amount that the surviving spouse is entitled to have available for his or her own use. Any materials that may be relevant to the calculation of the DSUE amount, including the estate tax returns of each deceased spouse, can be examined by the IRS for these purposes.[69] However, any adjustments from such examination can only result in additional estate tax in cases in which the statute of limitations for such assessment has not yet expired.[70] Note that in addressing suggestions for the final regulations, the Treasury Department and the IRS took the position that an adjustment for DSUE purposes will not necessarily result in a basis adjustment of the asset in question.[71]

The IRS has indicated that an examination of an estate tax return will not be suspended merely because of a possible future review in connection with a portability election.[72] The IRS is currently issuing closing letters in estates in which a portability election has been made. These closing letters do not include any reference to the extended period of time allowed to review the return with respect to the portability election. These letters are also being issued fairly quickly – within three to four months after the estate tax return is filed. The IRS is also selecting estate tax returns that elect portability for audit as well, which may come as a surprise to some practitioners.

When the surviving spouse later dies, if he or she has a gross estate (increased by adjusted taxable gifts and the specific exemption amount) that is more than the basic exclusion amount, then the surviving spouse will have to file an estate tax return. This is true even if no tax will be due because of the use of the deceased spouse's DSUE amount. This will give the IRS the opportunity to review the valuations on the deceased spouse's estate tax return for purposes of challenging the DSUE amount calculated.

Attention should be given to this issue, particularly if there are previous spouses or blended families with respect to the estate. Those in control of the information with respect to the estate may not always be aligned or in communication with the surviving spouse. The surviving spouse will want to ensure that he or she has all of the relevant returns and documentation to support the DSUE amount from each predeceased spouse. Note that the regulations provide that it is the surviving spouse's responsibility to substantiate the DSUE amount claimed on his or her return.[73] The cost to do so, at least for estate tax purposes, may be deductible if the expenses otherwise qualify under Section 2053.[74]

Use of the DSUE Amount – Ordering. The regulations provide a very generous approach to the use of the DSUE amount by the surviving spouse. Although the surviving spouse is entitled to only the DSUE amount of the last deceased spouse, special rules apply in cases of multiple deceased spouses and previously used DSUE amounts.

The first piece of good news is that generally the deceased spouse's DSUE amount is considered "available for use" by the surviving spouse as of the date of the deceased spouse's death, presuming a valid portability election is made on the decedent's estate tax return.[75] This clarification makes planning much simpler for the most part, as the surviving spouse can rely on the availability of the DSUE amount of a deceased spouse to offset any taxable gifts before having to use his or her own exemption amount

[67] Reg. § 20.2010-2(a)(3)(ii).
[68] Reg. § 20.2010-2(a)(3)(i).
[69] T.D. 9593 at p. 22; Reg. § 20.2010-2(d).
[70] T.D. 9593 at p. 23; § 6501.
[71] T.D. 9725 at p. 1126.
[72] T.D. 9593 at p. 23.
[73] Reg. § 20.2010-3(c)(1)(iii).
[74] T.D. 9725 at p. 1126.
[75] Reg. § 20.2010-3(c)(1); Reg. § 25.2505-2(d)(1).

without having to wait until an estate tax return is filed for the deceased spouse. Special rules apply when property passes to the surviving spouse in a QDOT, as discussed above.

The second bit of good news is that the deceased spouse's DSUE amount is applied to gifts of the surviving spouse before his or her own remaining exemption is used.[76]

The remaining good news is that a surviving spouse can take advantage of the DSUE amounts of multiple predeceased spouses during the surviving spouse's lifetime.[77] Thus, to the extent a surviving spouse can use the full amount of each predeceased spouse's DSUE amount before the next spouse's death, he or she can make gifts far in excess of the exemption amount. The surviving spouse must use these exemptions through lifetime gifting. Upon the surviving spouse's death, he or she is limited to only the last deceased spouse's DSUE amount.

WHERE

The election for portability is made by filing IRS Form 706. For deaths in 2011, a timely-filed estate tax return (Form 706) is sufficient to elect portability. As discussed above, an attachment to the return reflecting an affirmative election may be prudent even though not required.

For deaths after 2011, Form 706 has provisions specifically relating to the portability election. A new Part 6 has been added to compute the DSUE amount. The amount calculated on this schedule is carried forward to page one, where new lines 9a, 9b and 9c are added to compute the combined basic exclusion amount and DSUE amount. In addition, a new line 3b has been added to Part 4 that requires information about all prior marriages of the decedent. The name and social security number of each former spouse must be included in this part. In addition, the date each prior marriage ended and a description of whether the marriage ended by death, divorce or annulment must be included in this part as well. Finally, the recapitulation in Part 5 includes two new lines to reflect the estimated value of the assets that qualify for the relaxed reporting rules discussed above with respect to marital or charitable deduction property.

Part 6 contains the bulk of the portability provisions. It includes a box for the executor to check to opt out of the portability election. In addition, section B of this part requires the preparer to indicate whether or not assets of the estate pass to a QDOT. Section C provides the method for calculating the DSUE amount portable to the surviving spouse of the decedent, while schedule D provides a chart for calculating the DSUE amount the decedent received from prior predeceased spouses.

When the 2012 From 706 draft form was issued, there was an error in the calculation of the DSUE amount passing to the surviving spouse in section C. The calculation did not work correctly in cases in which gift tax had previously been paid and the decedent had entirely exhausted his or her applicable exclusion amount. In these situations, the calculations provided on the draft form resulted in a DSUE amount being increased by the amount of prior gifts on which gift taxes were paid, regardless of the taxability of the estate at the decedent's death. This calculation error was corrected on the 2012 Form 706 before it was issued in final form.

The surviving spouse will report the use of the deceased spouse's DSUE amount on lifetime gifts on a timely-filed gift tax return (Form 709). Form 709 includes a box on line 19 in Part 1 for the donor to check if he or she has applied a DSUE amount to the current or any prior gift tax return. Schedule C is used to calculate the total available DSUE amount. The total calculated on schedule C carries forward to the tax computation in part 2. Note that schedule C on Form 709 requires the donor to state whether or not a portability election has been made. Recall that the DSUE amount is available for use by the surviving spouse right away. There is no requirement to wait until the estate tax return is filed for the deceased spouse before using the DSUE amount. In situations in which the donor is required to file his or her gift tax return prior to the due date of the estate tax return of the deceased spouse (with extensions), it is unclear how the donor should complete this schedule. One option would be to file the return indicating that an election has been made, under the assumption that it will be made. Another option would be for the surviving spouse to leave the box blank, attach a statement indicating that the election will be made and take the deduction for the DSUE amount as if the

[76] Reg. § 25.2505-2(b).
[77] Reg. § 25.2505-2(c).

election had already been made. Alternatively, a conservative approach would be for the surviving spouse file the return indicating that the election has not yet been made although it is anticipated to be made, pay gift tax on any amount taxable without the use of the DSUE amount, then later file an amended return seeking a refund once election is made.

WHY

Many practitioners believe that portability is a good safety net for those who have not done any estate planning, but is not something they would recommend to their clients. However, portability has really opened up the landscape of estate planning options for couples at all wealth levels. First, let's take a look at some of the pros and cons of recommending or relying on portability versus the use of traditional bypass or credit shelter trust planning.[78]

Pros: The main benefit of portability is its relative simplicity. It is also favorable in the following situations.

- Married couples who are not interested in spending money on comprehensive estate plans that include bypass trust planning may opt to rely on portability to shelter their combined estate from estate tax. In many cases, the average couple can title their probate assets as joint tenants with rights of survivorship or as pay on death accounts. This may avoid the need for probate on the first spouse's death. Although the estate tax return filing requirement may create some additional complexity, the relaxed reporting requirements of the regulations mitigate this burden to a certain degree.
- For married couples with one or more large qualified retirement accounts, relying on portability may be particularly desirable. Although a bypass trust that is drafted as a see-through trust can be named as the beneficiary of a retirement account without accelerating the income tax on the account, including the provisions necessary to meet this requirement is not consistent with the traditional purposes of the bypass trust.[79]
- Married couples with disparate wealth may prefer to rely on portability rather than be involved in complicated lifetime equalization planning between the spouses. If one spouse's estate is nontaxable and the other spouse's estate exceeds the taxable limits, bypass trust planning is not effective for the "poorer" spouse. If the nonwealthy spouse dies first, his or her estate tax exemption will be lost without portability, even with bypass trust planning because he or she simply does not have enough money to fund the bypass trust.
- If the marital assets consist of low basis assets, portability may be a better option than traditional bypass planning in order to take advantage of the step-up in basis in assets at death. With the increase in income tax rates on capital gains and the corresponding relatively low estate tax rate, this may be a good alternative in the right circumstances.

Cons: The most commonly discussed drawbacks include the following.

- Assets of the deceased spouse that pass outright to the surviving spouse are subject to creditors of surviving spouse, whereas if those same assets are transferred to a bypass trust they are more likely to be protected from creditors.
- Appreciation received from the deceased spouse's estate will be included in surviving

[78] A comprehensive review of the options relating to portability is beyond the scope of this outline. For some excellent materials on the planning options, see the materials included with the "Recipes for Income and Estate Planning in 2014" presentation at the Advanced Estate Planning Strategies Course, April 24-25, 2014, or Steve Aker's excellent summary at http://www.bessemertrust.com/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/Advisor/Presentation/Print%20PDFs/Hot%20Topics%20Current%20Developments%2006%2017%2014.pdf.

[79] For an excellent summary and discussion of the issues relating to naming trusts as beneficiaries of qualified retirement plans, see Karen S. Gerstner, "Current Issues Related to Estate Planning with Qualified Retirement Plans and IRAs," which was presented at the State Bar Advanced Estate Planning and Probate Course, June 28, 2012. It can be found at: http://www.texasbarcle.com/Materials/Events/9220/144091.pdf.

spouse's estate. If proper bypass trust planning is implemented on the death of the first spouse, all of the appreciation from the assets transferred to the bypass trust that are not distributed to the surviving spouse during his or her lifetime should not be subject to estate tax at the subsequent death of the surviving spouse.

- There is a possibility that the deceased spouse's exemption amount could be lost entirely if the surviving spouse later remarries a new spouse and the new spouse predeceases the surviving spouse after using his or her entire exemption amount.
- Portability does not extend to the generation-skipping transfer ("GST") tax. Any amount of the GST tax exemption amount that was not used during the deceased spouse's life or through other planning at his or her death will be lost.
- Portability has not been adopted at the state level. Use of bypass planning may help mitigate state estate taxes that would be imposed on the presumably larger estate of the second spouse to die.

Aside from looking at just portability vs. bypass planning, practitioners also need to consider the broad planning opportunities and options available, taking into account the changes in the tax laws and each client's particular situation. There are a variety of options available in designing estate plans now that portability is a permanent feature of the Code. Some techniques may be more beneficial than traditional bypass planning, particularly if a client has assets than are anticipated to appreciate at a rapid rate even after the first spouse's death. Alternatives include transferring all assets to a qualified terminable interest ("QTIP") trust or leaving assets outright to the surviving spouse and providing for a "disclaimer" trust that can function as a bypass trust in the event the surviving spouse disclaims the outright ownership of the property at the first spouse's death but still wants to benefit from that property via trust distributions. If the QTIP trust is used, the executor can often be given the option to make a partial QTIP election or a special election called a "Clayton" election in order to use some or all of the deceased spouse's exemption amount. The benefit of this type of planning is that the decision about where the assets pass can be deferred until after the first spouse dies, instead of being locked into mandatory bypass trust funding at the date the planning documents are prepared. If the QTIP trust is used, a reverse QTIP election could be made to reduce the risk that the deceased spouse's GST tax exemption amount will be lost. It is important to keep in mind that if disclaimer planning is used, then the decision about funding will need to be made by the surviving spouse within nine months after the first spouse's death. However, with QTIP planning, the executor will have up to fifteen months to make a decision (nine months following the death, plus a six month extension if filed).

Some planners perceive that there is some risk in using QTIP planning with portability. This is because way back in 2001, the IRS issued Rev. Proc. 2001-38.[80] This revenue procedure was issued as a taxpayer-friendly ruling that provides if a testamentary QTIP election is made and the election was not necessary to reduce the estate tax payable to zero, then the QTIP election will be deemed void. Of course, this was issued to rescue taxpayers who inadvertently made such an election and was designed to be a tool that the taxpayer could use to correct an error in reporting after the fact. Many planners believe that the IRS will not use this "shield" given to taxpayers as a "sword" against them. Although the Treasury Department and the IRS have declined to clarify this issue in either the temporary or final regulations, they have signified their intent to do so sometime in the future.[81]

The best course will depend on a variety of factors that vary from client to client. Some of the factors to consider include asset composition, anticipated growth of assets, client age and health issues, blended family issues, desire for control, creditor issues, desire for simplicity/tolerance for complexity and income tax rates, among others. There will not be a "one-size-fits-all" solution for all clients. The one thing that does appear certain is that nearly all clients will benefit from a review of their estate plan.

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[80] Rev. Proc. 2001-38, 2001-1 C.B. 1335 (June 11, 2001).
[81] T.D. 9725 at p. 1127.

## CONFLICTS AMONG EXECUTORS AND BENEFICIARIES

The regulations make it clear that it is the executor who must make the election to take advantage of portability or to opt out of such election. Practitioners advising executors may find themselves in a dilemma if the deceased spouse's will does not address the issue (or if there is no will). In the typical long-term first marriage scenario in which all assets go to the surviving spouse and later pass to the couple's joint children, there may be no issues. However, a few scenarios come to mind that are not as simple. In situations where there are multiple beneficiaries with differing interests, the decision path may not be as clear.

Let's look at some examples.

*Example 1*. Suppose husband is married to his second wife and has two children from a prior marriage. Husband dies in 2015 with a taxable estate of $2 million. Husband's will provides that all of his assets pass to his children. No estate tax return is required to be filed, except to make the portability election.

Let's assume that the wife is named as executor. The wife will have access to the information necessary to file the estate tax return to elect portability and will have the power to do so. Who bears the cost of the filing is another matter. Is it a proper expense of the estate or should the wife pay for the expense from her own personal funds? In independent estate administration, the independent executor may pay expenses of the estate without court approval.[82] In dependent administration, the personal representative is entitled to all necessary and reasonable expenses incurred in the management of the estate on satisfactory proof to the court.[83] Wife could reasonably make a claim that preparation of the estate tax return is in connection with the proper management of the estate.

*Example 2*. Let's change the facts in Example 1 slightly, so that the children of the prior marriage are the executors. Let's first presume that they don't mind filing the return, but don't want to bear the expense for filing. If the wife pays for the return preparation and then later makes a claim against the estate to recover the expense, should the children be required to pay for this as an administrative expense of the estate? It is likely that a few probate judges will get to weigh in on this issue.

Alternatively, what will occur if the children have no interest in filing a return to elect portability, because in addition to the cost, they don't want the liability related to filing an estate tax return? Can the surviving spouse compel the executors to file a return? If the surviving spouse is able to characterize the deceased spouse's DSUE amount as an asset of the estate or as a claim against the estate, there may be judicial relief available to the surviving spouse.[84] When asked to weigh in on this issue, the Treasury Department and the IRS declined to do so.[85]

*Example 3*. Let's use the same facts as in Example 2, and add the fact that husband and second wife are in the process of divorce. Assume the divorce is pending and would have been final a day after husband's death. Also assume that the divorce was highly disputed and children (who are the executors) are strongly opposed to providing any tax benefit to the divorcing wife. They want to withhold the tax benefit purely out of spite. Wife is willing to pay for the preparation of an estate tax return, but children refuse. What is the recourse for wife? Is she somehow entitled to the use of husband's unused exemption amount? Can the children prevent her use of this exemption by filing an estate tax return to opt out? If so, does wife have a claim against the children for doing so and causing an economic loss to her?

Other circumstances may affect whether or not portability is elected. What happens in Example 3 if there is no executor appointed because there is no apparent need for a probate administration? Can the children, out of spite, apply to be appointed as executors even if an appointment is not strictly necessary, just to prevent surviving wife from being able to file an estate tax return to elect portability as a non-appointed executor? The children would have to show that a necessity exists for the administration of

[82] Tex. Prob. Code § 145B.
[83] Tex. Prob. Code § 242.

[84] A discussion of the available remedies, such as temporary restraining orders, removal of the executor and criminal sanctions, are beyond the scope of this paper. For additional information on these remedies, see Mary C. Burdette, "Enforcing Beneficiaries' Rights," found at http://ccba.willsandprobate.com/Handouts/3-11-11%20Burdette%20outline.pdf.
[85] T.D. 9725 at p. 1124.

the estate.[86] However, that should normally not be too difficult to do given the many aspects estate administration that rely on the powers granted to executors. Under the final regulations, their appointment will allow them to "trump" any return wife files as a non-appointed executor. If no executor is appointed, will there be a race between the surviving wife and the children to elect into or out of portability?

*Example 4.* Let's use the facts of Example 2 (children are the executors), but instead of the children being the beneficiaries of the estate, the sole beneficiaries are various charitable organizations. Should the charities bear the cost of the estate tax return preparation for the benefit of the surviving spouse?

ETHICAL CONCERNS

Taking a step back from the disputes among the parties, let's take a look at who is advising the executor. In many cases, the attorney who drafted the estate planning documents will be the attorney to represent the executor of the estate. The attorney will need to take care to ensure that he or she is not violating ethical rules. Below is Texas Disciplinary Rules of Professional Conduct Rule 1.06, Conflict of Interest: General Rule:

"(a) A lawyer shall not represent opposing parties to the same litigation.

"(b) In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:

"(1) involves a substantially related matter in which that person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyers firm; or

"(2) reasonably appears to be or become adversely limited by the lawyers or law firm's responsibilities to another client or to a third person or by the lawyers or law firm's own interests.

"(c) A lawyer may represent a client in the circumstances described in (b) if:

"(1) the lawyer reasonably believes the representation of each client will not be materially affected; and

"(2) each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible adverse consequences of the common representation and the advantages involved, if any.

"(d) A lawyer who has represented multiple parties in a matter shall not thereafter represent any of such parties in a dispute among the parties arising out of the matter, unless prior consent is obtained from all such parties to the dispute.

"(e) If a lawyer has accepted representation in violation of this Rule, or if multiple representation properly accepted becomes improper under this Rule, the lawyer shall promptly withdraw from one or more representations to the extent necessary for any remaining representation not to be in violation of these Rules.

"(f) If a lawyer would be prohibited by this Rule from engaging in particular conduct, no other lawyer while a member or associated with that lawyer's firm may engage in that conduct."

Most careful planners make it clear in their engagement letter for an estate that they are representing the executor. Some attorneys take the extra step to affirmatively state that they do not represent the beneficiaries. The comments to Rule 1.06 specifically state that with respect to estate administration, the lawyer should make it clear to the parties involved whether the fiduciaries or the beneficiaries are the clients.[87] This will become more important in estates in which election or nonelection of portability may become an issue. If the lawyer believes that a conflict may arise regarding the steps necessary to make the portability election (i.e., filing an estate tax return), the lawyer should be proactive in reminding the parties who he or she represents and who he or she does not represent with respect to the estate. In cases in which the lawyer has represented the entire family over a number of years, the beneficiaries may believe that the lawyer is still representing their interests even though the engagement letter states he or she is representing the executor. In these cases, an affirmative statement that the beneficiaries are not represented by executor's counsel and should seek their own counsel for

[86] Tex. Prob. Code § 82(h).

[87] Texas Disciplinary Rules of Professional Conduct, Comment 15 to Rule 1.06.

assistance should be made. In addition, consideration should be given as to whether any waivers should be obtained where multiple parties are represented.

## ADVISING ISSUES

It is difficult to know how to advise those clients who forego the more complex bypass trust planning in favor of simplicity. It comes up often in estate planning for the wealthy. While a complex estate plan may make sense from tax savings perspective, clients often forgo planning opportunities that they perceive to be too complicated or outside the boundaries of their risk tolerance. When this happens, some practitioners may think "I don't want to be hit with the '*Belt*'." "*Belt*" in this instance refers to the *Belt* case, [88] which received much publicity in estate planning circles. In *Belt*, the Texas Supreme Court held that the executors of an estate could maintain a legal malpractice claim against the decedent's lawyers on behalf of the estate. Although the court did not find the lawyers liable for malpractice, the *Belt* case had many practitioners worried about future claims from heirs of clients who thought more aggressive planning could have been done to reduce estate tax liability. With the star witness to what was discussed no longer around to help out (due to his or her death), estate planning attorneys began preparing lengthy memos summarizing conversations with clients and letters to clients confirming that certain planning techniques were discussed and rejected by the client. Attorneys who prepare such memos and letters (and even ones who don't) should consider adding a new section about portability or creating a separate advisory memo.

Several other potential malpractice risks arise with portability. Advising clients whether it is prudent to forgo tax-planned wills in favor of relying on portability is one issue. Others include advising clients about requirements to make the election (timely filing of an estate tax return), requirements to keep documentation to support valuations until the second spouse's death and advising clients about the effects of subsequent marriages.

Changes in the law can certainly make the current ideal plan turn out to be not the best solution for the clients in the future. Although ATRA made the current estate, gift and GST tax exemption amounts (with inflation adjustments) and the tax rates permanent, the current administration's fiscal year end 2016 revenue proposals (as explained by the Treasury in what is popularly referred to as the "Green Book") includes a provision that would reduce the estate and GST tax exemption amount to $3.5 million (without increases for inflation adjustments in future years) and the gift tax exemption amount to $1 million beginning in 2016.[89] The proposal also includes an increase in the gift, estate and GST tax rate from 40% to 45%. Although the Green Book is just the President's "wish list" of fiscal policies that he would like to implement in the upcoming fiscal year, it is an indication that estate and gift taxes are still on the table for certain politicians in their quest to raise revenue.

In light of this uncertainty, some practitioners are taking steps to ensure their clients do not miss out on exemption in portability situations by failing to file a return. One way to influence clients whose spouses have died to file an estate tax return where there is any DSUE amount remaining is to explain that the cost of preparing the estate tax return is equivalent to the cost of purchasing an insurance policy against future estate taxes on the DSUE amount. The cost of preparing the return is your one-time premium payment for the policy. Another way to encourage clients to file an estate tax return to elect portability is to remind the surviving spouse that the detailed information that is included in the estate tax return, such as basis information, will be needed by the surviving spouse for his or her own tax reporting purposes.

## DRAFTING ISSUES

*Estate Planning Documents*. Practitioners may want to consider adding specific language in their wills with respect to the portability. Most lawyers will prefer to give broad discretion to the executor to elect or not elect portability. However, some thought should be given in directing how the incremental cost

[88] *Belt v. Oppenheimer, Blend, Harrison & Tate, Inc.*, 192 S.W.3d 780 (Tex. 2006). Also available on line from the Supreme Court of Texas website at http://www.supreme.courts.state.tx.us/historical/2006/may/040681.htm. An attorney who worked on this case indicated that it later settled.

[89] See the Department of Treasury's General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals at p. 193. The Green Book can be located at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf.

of making the election will be paid. A default provision could require that the election be paid for as an expense of the administration of the estate. However, in the second family situation, that might not be the best solution or one that your client would want. For those who have client questionnaires or a checklist of items to discuss with the client at the initial meeting, this should be one more item added to those lists. Exhibit A includes some sample language to include in wills.

*Premarital Agreements*. Practitioners should consider elections with respect to portability in marital property agreements. Particularly with respect to spouses with disparity in their wealth, the wealthier spouse may want to negotiate use of the poorer spouse's exemption amount should he or she predecease the wealthier spouse. It may be prudent to include each party's remaining exemption amount in the disclosure of assets. While it may be a good idea to require a portability election to be made if the survivor requests it, practitioners may want to include a provision that confirms that neither party has a duty to preserve his or her exemption amount. See Exhibit B for a drafting example.

*Family Settlements/Will Contests*. Inevitably, there will be legal disputes over the portability of a deceased spouse's DSUE amount. Several of those scenarios are discussed above. Negotiating the use of a decedent's DSUE amount will likely be a negotiation factor in will contests as well. It will be important in those cases to keep in mind that the election must be made on a timely-filed return. That could be a challenge in litigation situations.

## CONCLUSION

Just a few years ago, the idea of portability seemed like a good way to allow married couples to enjoy the benefits of more complicated estate planning to preserve exemption without actually having to do the planning. Most practitioners agreed that it would be a good addition to current law. However, now that portability is available, it is not as simple as it once seemed. In reality, with the decisions that are required to be made and the technical requirements necessary to make the portability election, it appears that portability has created more work for attorneys rather than less. Taxpayers who otherwise would not have considered filing estate tax returns before portability now have to consider that option, and their advisors need to take the extra steps to ensure they fully understand those options. Perhaps ATRA could stand for "Attorney's Tactical Retirement Arrangement" as well! These are indeed exciting times to be an estate planning attorney.[90]

[90] Reader, if you have made it all the way to the end and are still reading footnotes, then I feel confident that you can be categorized as a detail-oriented person! Any suggestions for improvement to this outline or corrections are always greatly appreciated.

## EXHIBIT A – WILL SAMPLE LANGUAGE

Executor Discretion to Make Election – Estate Bears Filing Expenses

Should there be any unused exclusion amount (as defined in Code Section 2010(c)(4)) after satisfying the devises and bequests in Section I and Section II of this will, I hereby authorize, but do not require, my executor, in my executor's sole and absolute discretion, to elect that any amount of such unused exclusion amount be available for use by my [wife/husband] by making an election on a timely-filed estate tax return, and my [wife/husband] shall be entitled to the benefits of such election. Should such election by my executor result in the filing of a federal estate tax return where my executor has determined that no such return would otherwise be required to be filed, I direct my executor to pay any and all costs incurred by reason of such filing as an administration expense of my estate. The decision of my executor in the exercise of this discretion shall be final, binding and conclusive upon all parties ever interested in this will.

Executor Discretion to Make Election – Surviving Spouse Bears Related Expenses

Should there be any unused exclusion amount (as defined in Code Section 2010(c)(4)) after satisfying the devises and bequests in Section I and Section II of this will, I hereby authorize, but do not require, my executor, in my executor's sole and absolute discretion, to elect that any amount of such unused exclusion amount be available for use by my [wife/husband] by making an election on a timely-filed estate tax return, and my [wife/husband] shall be entitled to the benefits, and bear the burdens, of such election. Without limiting the generality of the foregoing, should such election by my executor result in the filing of a federal estate tax return where my executor has determined that no such return would otherwise be required to be filed, my [wife/husband] shall bear any and all costs incurred by reason of such filing. The decision of my executor in the exercise of this discretion shall be final, binding and conclusive upon all parties ever interested in this will.

Executor Directed to Make Election – Estate Bears Filing Expenses

Should there be any unused exclusion amount (as defined in Code Section 2010(c)(4)) after satisfying the devises and bequests in Section I and Section II of this will, my executor shall elect that such amount of my unused exclusion amount be available for use by my [wife/husband] by making an election on a timely-filed estate tax return and shall pay any and all costs incurred by reason of such filing as an administration expense of my estate, and my [wife/husband] shall be entitled to the benefits of such election.

Executor Directed to Make Election – Surviving Spouse Bears Related Expenses

Should there be any unused exclusion amount (as defined in Code Section 2010(c)(4)) after satisfying the devises and bequests in Section I and Section II of this will, my executor shall elect that such amount of my unused exclusion amount be available for use by my [wife/husband] by making an election on a timely-filed estate tax return, and my [wife/husband] shall be entitled to the benefits, and bear the burdens, of such election. Without limiting the generality of the foregoing, should such election by my executor result in the filing of a federal estate tax return where my executor has determined that no such return would otherwise be required to be filed, my [wife/husband] shall bear any and all costs incurred by reason of such filing.

**Note: In blended families, specific thought should be given as to the allocation of taxes due on the surviving spouse's death if a QTIP Trust is included in the planning. For an excellent summary of this issue and sample language, see Granstaff, Portability + QTIP: A Happy Couple of a Recipe for Family Discord, reproduced in the Real Estate, Probate, and Trust Law Reporter at http://www.reptl.org/Private/Content/Reporter/Reporter_Vol53_No1/12_PORTABILITY.pdf.**

***NOTE: THE SAMPLE PROVISIONS INCLUDED IN THIS OUTLINE ARE INTENDED ONLY TO PROVIDE GUIDANCE TO A PRACTITIONER IN DRAFTING TO ACCOMPLISH THE INDICATED OBJECTIVE(S) AND ARE NOT TO BE RELIED UPON BY ANY PRACTITIONER FOR ANY OTHER PURPOSE. ADDITIONALLY, THE AUTHOR WISHES TO REMIND ANY PRACTITIONER USING THE SAMPLE PROVISIONS OF THIS OUTLINE FOR GUIDANCE PURPOSES OF THE NEED TO CONSIDER ALL OTHER PROVISIONS OF THE GOVERNING INSTRUMENT THAT MAY BE AFFECTED BY OR HAVE ANY EFFECT ON THE PROVISIONS PRODUCED FROM SUCH GUIDANCE SO THAT ALL PROVISIONS OF THE GOVERNING INSTRUMENT MAY BE TAILORED AS APPROPRIATE TO FULFILL THE CLIENT'S INTENDED OBJECTIVES.***

## EXHIBIT B - PREMARITAL AGREEMENT SAMPLE LANGUAGE

Portability of Deceased Party's Unused Exclusion Amount.

A. Conditions of Porting Deceased Party's Unused Exclusion Amount. If the first Party to die (the "Deceased Party") has any estate tax exclusion that is unused at the time of the Deceased Party's death (after taking into account all testamentary transfers provided for by the Deceased Party and all debts, expenses, taxes, and charges occasioned by his or her death) and the Parties are then married (regardless of whether dissolution, annulment or legal separation proceedings are pending), the Parties agree that the survivor of the Parties (the "Surviving Party") should have the right to use such unused exclusion amount as he or she sees fit, subject to the provisions set forth below:

(i) If an Estate Tax Return is Required. If a federal estate tax return for the Deceased Party's estate is required pursuant without regard to the portability election, the personal representative of the Deceased Party's estate will make the portability election on such return to allow any deceased spousal unused exclusion amount with respect to his or her estate to be taken into account by the Surviving Party or the Surviving Party's estate without any reimbursement from the Surviving Party for the costs of such filing and election (including but not limited to all accounting, appraisal, and legal costs incurred in connection with such filing and election); or

(ii) If No Estate Tax Return Is Required. If a federal estate tax return for the Deceased Party's estate is not required, upon request of the Surviving Party, the personal representative of the Deceased Party's estate will file a federal estate tax return and make the portability election, and the Surviving Party shall reimburse the Deceased Party's estate for the costs of such filing and portability election (including but not limited to all accounting, appraisal, and legal costs incurred in connection with such filing and portability election). Such reimbursement shall be made within thirty (30) days of written request of the Deceased Party's personal representative for such reimbursement. Within sixty (60) days of the Deceased Party's death, his or her personal representative shall notify the Surviving Party of the Surviving Party's discretion to request that the portability election be made, and the Surviving Party shall have thirty (30) days after such notice is received to request that such election be made in a written instrument delivered to the Deceased Party's personal representative.

(iii) Information Provided to Surviving Party. If the portability election is made, the personal representative for the Deceased Party's estate shall provide to the Surviving Party a complete copy of the Deceased Party's estate tax return (including any exhibits thereto) and all correspondence transmitted to or received from the Internal Revenue Service by the Deceased Party's personal representative relating thereto, including but not limited to a closing letter or a notice of selection of such estate tax return for examination by the Internal Revenue Service. Upon request from the Surviving Party, the Deceased Party's personal representative shall also provide the Surviving Party with copies of any and all other documentation that supports the filing of the Deceased Party's estate tax return. The Surviving Party shall reimburse the Deceased Party's personal representative for the costs incurred in supplying the requested documentation.

(iv) Limited Duties Owed to Surviving Party by Deceased Party's Personal Representative. Other than as previously provided, the personal representative of the Deceased Party's estate shall have no obligation to the Surviving Party or his or her estate, heirs, beneficiaries, or assigns, to maintain records or provide documentation or other information to substantiate the portability election or exclusion amount ported. The Surviving Party, on his or her own behalf and that of his or her estate, heirs, beneficiaries, or assigns, agrees that, if for whatever reason, the portability election is not properly made (e.g., because it was not timely, accurate, etc.), so long as the personal representative of the Deceased Party's estate did not act with gross negligence or with willful neglect, the Deceased Party's personal representative shall be held harmless.

(v) Parties' Agreement to Maintain Accommodating Testamentary Documents. Each Party agrees to maintain a Will or other testamentary document that directs such party's personal representative (if such party is the first of the parties to die) to make the portability election as provided in this section ___ and provide the Surviving Party with such documentation as is required pursuant to this section.

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