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Elaine Hightower Gagliardi on Treasury Transforms the Portability Election: Making the DSUE Amount a Reliable Planning Tool

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By Elaine Hightower Gagliardi*

§ 4.01 Introduction

With the issuance of temporary regulations, Treasury pulls back the cloak of uncertainty and reveals a portability election that proves to be relatively dependable and a useful planning tool. The temporary portability regulations,[1] issued June 15, 2012, remove the “now you see it, now you don’t”[2] quality of the deceased spousal unused exclusion (“DSUE”) amount as enacted by Congress. With a sleight of hand, Treasury rewrites the plain wording of the statute to eliminate uncertainty. The temporary regulations provide a clear path for avoiding loss of the DSUE amount on remarriage. The regulations allow donors to make gifts without fear of losing applicable exclusion amount, eliminate the possibility of the dreaded claw-back, and suggest the ability to use a QTIP election regardless of the value of decedent’s assets. This article discusses the impact of the temporary portability regulations, specifically noting the corrections and additions made to the statute as enacted by Congress. It also analyzes the planning considerations following from these changes.

The goal of portability is to simplify estate planning for married couples. As enacted by Congress, however, the statute falls short in its intent to provide an effective means for couples to avoid the necessity of making pre-death transfers and of using a credit shelter trust in order to ensure full use of the applicable exclusion amount by both spouses.[3] The plain wording of the statute creates an ambiguity as to calculation of the DSUE amount, which in turn leads to a number of questions as to whether the surviving spouse may effectively use the DSUE amount. If the surviving spouse makes a taxable gift does the DSUE amount shelter the gift or does the applicable exclusion amount of the surviving spouse shelter the gift? Can the surviving spouse make gifts triggering payment of estate tax without reducing the surviving spouse’s applicable exclusion amount? If the surviving spouse remarries after making gifts using the DSUE amount of the spouse from the prior marriage, can there be a claw back of transfer tax on the earlier gift? At what point does the surviving spouse become eligible to use the DSUE amount of a predeceased spouse? The temporary portability regulations answer each of these questions so as to allow the surviving spouse the ability to favorably plan for full use of the DSUE amount elected by the predeceased spouse’s estate, even in the event of remarriage.

The only uncertainty remaining and irresolvable by the temporary regulations is the possibility that the portability election will sunset at the end of 2012.[4] Congress must act to extend the portability

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[1] Treas Dec 9593, 2012 IRB LEXIS 333 (June 15, 2012).
[2] See Elaine Hightower Gagliardi on The Deceased Spousal Unused Exclusion Amount: Now You See It, Now You Don’t, 2012-03 Lexis® Federal Tax Journal Quarterly 2, § 2.01 *et seq*. (Matthew Bender).
[3] See Taxation of Wealth Transfers Within a Family: A Discussion of Selected Areas for Reform, JCX-23-08 at 10 (April 2, 2008).
[4] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, PL 111-312, 124 Stat 3296 § 303 (Dec 17, 2010).

election for it to be available after December 31, 2012. Understandably the temporary regulations do not discuss the ability to use a DSUE amount after the sunset occurs. The temporary portability regulations apply to estates of decedents dying and gifts made after 2010 and in a year when the applicable exclusion amount is determined by aggregating the basic exclusion amount and any DSUE amount. They expire by their terms on June 15, 2015. The effective date provisions of the temporary portability regulations, thus, recognize the portability statute is slated to sunset as of 2013.[5]

§ 4.02 Changes in Calculation of the DSUE Amount Made by the Temporary Regulations

Congress set the groundwork to achieve the purposes of the portability election by defining applicable exclusion amount to include the aggregate of the basic exclusion amount and the DSUE amount.[6] The unused basic exclusion amount of the predeceased spouse upon election by that spouse's executor becomes portable for use by the surviving spouse in the form of a DSUE amount. Thus, a married couple need no longer worry about losing the ability to use the basic exclusion amount of a spouse in the event that the spouse does not own sufficient assets to fully use the applicable exclusion amount prior to that spouse's death. Also, spouses need no longer include a credit shelter trust as part of their estate plan to fully use the basic exclusion amount of the predeceased spouse, but instead may transfer assets outright to the surviving spouse, who in turn can apply the predeceased spouse's unused basic exclusion amount. In order to encourage a couple to create an estate plan in reliance on the portability election, the temporary regulations recognize the need to ensure the surviving spouse can use the DSUE amount with some certainty as to it availability, and consequently provide clarifying rules increasing reliability of the portability election.

[1] Technical Correction Made by the Portability Regulations

Treasury corrects the ambiguous definition of DSUE amount set forth in the statute. The statute limits the DSUE amount to the lesser of the "basic exclusion amount" or "the basic exclusion amount of the last ... deceased spouse of [the] surviving spouse" less the "amount with respect to which the tentative tax is determined...on the estate of such deceased spouse."[7] The reference to "basic exclusion amount" in both limitations makes the first reference superfluous and raises a myriad of questions with regard to ordering and ability to use the DSUE amount. In fact, the Joint Committee on Taxation acknowledges a drafting error on the part of Congress in an Errata indicating: "A technical correction may be necessary to replace the reference to the basic exclusion amount of the last deceased spouse of the surviving spouse with a reference to the applicable exclusion amount of such last deceased spouse, so that the statute reflects intent."[8] If enacted as had been anticipated, the first limitation would have had meaning and effect as the second limitation in a second marriage situation could have exceeded the basic exclusion amount.

The temporary regulations make the correction and define DSUE amount as "the unused portion of a decedent's applicable exclusion amount to the extent this amount does not exceed the basic

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[5] Temp Treas Regs §§ 20.2010-1T(e)(2011 date effective for sub-sections (a) - (c), and (d)(1)); 20.2010-2T(e); 20.2010-3T(f); 25.2505-1T(e); 25.2505-2T(g).
[6] IRC § 2010(c)(2).
[7] IRC § 2010(c)(4).
[8] Errata "General Explanation of Tax Legislation Enacted in the 111th Congress," JCS-2-11 (March 2011).

exclusion amount in effect in the year of the decedent's death."[9] The regulations ignore the wording of the statute and restate the determination of the DSUE amount generally as follows:

> [T]he DSUE amount of a decedent with a surviving spouse is the lesser of the following amounts-
>
> (i) The basic exclusion amount in effect in the year of the death of the decedent; or
> (ii) The excess of-
>
> (A) The decedent's applicable exclusion amount; over
> (B) The sum of the amount of the taxable estate and the amount of the adjusted taxable gifts of the decedent, which together is the amount on which the tentative tax on the decedent's estate is determined under section 2001(b)(1).[10]

This new formulation of the DSUE amount essentially replaces the language of the statute as the Errata suggests.[11] It also clarifies the basic exclusion amount at issue as the one effective on date of death, and the determination of the amount on which the tentative tax is imposed as the aggregate of the taxable estate and adjusted taxable gifts. Interestingly, in restating the second limitation, the temporary regulations eliminate the reference to "the last such deceased spouse" but nevertheless interpret use of the DSUE amount by the surviving spouse in relation to the last deceased spouse.

> The preamble to the temporary regulations justifies making this correction:
> Treasury and the IRS have carefully considered this issue. … Based on the principle that a statute should not be construed in a manner that renders a provision of that statute superfluous and consistent with the indicia of legislative intent reflected in the Technical Explanation and the General Explanation, and in the exercise of the express authority granted by Congress in sections 2010(c)(6) and 7805, Treasury and the IRS have determined that the reference in section 2010(c)(4)(B)(i) to the basic exclusion amount is properly interpreted to mean the applicable exclusion amount. Thus, the temporary regulations adopt this interpretation.[12]

The correction makes it unnecessary to wait for Congress to provide a technical correction.

By adopting these changes, the temporary regulations give credence to the example initially provided in the Conference Report issued by the Joint Committee on Taxation, but not supported by the plain wording of the statute. The regulations now make sense of the example which demonstrates determination of the DSUE amount as follows:

> Hal dies in 2011, having made taxable transfers of $3 million and leaving no taxable estate. Hal's executor makes a portability election. As a result the applicable exclusion

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[9] Temp Treas Reg § 20.2010-1T(d)(4).
[10] Temp. Treas. Reg. § 20.2010-2T(c)(1).
[11] IRC § 2010(c)(4)(B)(i). See Errata "General Explanation of Tax Legislation Enacted in the 111th Congress," JCS-2-11 (March 2011).
[12] Treas Dec 9593, 2012 IRB LEXIS 333 at 19-21.

> amount of Hal's surviving spouse Sara equals $7 million, the aggregate of her 2011 $5 million basic exclusion amount plus $2 million DSUE amount from Hal's estate. Sara remarries, but makes no taxable transfers and dies in 2011 with a taxable estate of $3 million. Assuming a DSUE election is made by Sara's executor, Sara's second spouse obtains a DSUE amount of $4 million from Sara's estate equal to her unused exclusion amount of $4 million (which is less than the basic exclusion amount at her death), calculated by subtracting her $3 million taxable estate from her $7 million applicable exclusion amount.[13]

This example reflects the formulation of the DSUE amount as now provided by the portability regulations.

[2] Rules Added to Address Computation of Adjusted Taxable Gifts

In order to provide the stability needed to ensure use of the portability election, Treasury supplements the technical correction redefining the DSUE amount with rules that change the meaning of adjusted taxable gifts for purposes of determining the DSUE amount. Key to making the computation of the DSUE amount work as anticipated by the Joint Committee on Taxation is the following adjustment made by the portability regulations:

> Solely for purposes of computing the decedent's DSUE amount, the amount of the adjusted taxable gifts of the decedent ... is reduced by the amount, if any, on which gift taxes were paid for the calendar year of the gift(s)."[14]

Absent this change in the determination of adjusted taxable gifts, a taxable gift triggering payment of estate tax could cause a donor to lose the benefit of the applicable exclusion amount. This change ensures that to the extent decedent paid tax on adjusted taxable gifts, those gifts will not reduce the applicable exclusion amount for purposes of determining the DSUE amount.

The temporary regulations highlight the impact of this important adjustment to the calculation of adjusted taxable gifts for purposes of the DSUE amount with examples similar to the following:

> **Example A:** In 2002, Herb makes a taxable gift of $1 million. He has not previously made any taxable gifts. Herb reports the gift on a timely filed gift tax return, and pays no tax on the gift because it falls within the applicable exclusion amount and the tax is fully offset by the unified credit. Herb dies on September 29, 2011, survived by his spouse Stella. Both Herb and Stella are U.S. citizens and neither has previously married. Herb's taxable estate is $1,000,000. His executor timely files the estate tax return and elects portability because Herb's estate did not fully use his applicable exclusion amount, thus, allowing Stella to benefit from Herb's DSUE amount computed by his executor to be $3 million. The $3

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[13] See Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," Scheduled for Reconsideration by the United States Senate, JCX-55-10 at 53 (Dec. 10, 2010); General Explanation of Tax Legislation Enacted in the 111th Congress, JCS-2-11 at 555 (March 2011).

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

million DSUE amount is calculated as follows: The lesser of the $5 million basic exclusion amount in 2011, or the excess of Herb's $5 million applicable exclusion amount less $1 million taxable estate and less $1 million adjusted taxable gifts, which equals $3 million.[15]

Example B: Assume the same facts as in Example A above, except that Herb makes a $2 million gift in 2002 (instead of a $1 million gift). As a result of this gift Herb owes tax on the amount of the gift exceeding the then $1 million applicable exclusion amount, and pays the tax. On Herb's death, the executor of his estate computes the DSUE amount to be $ 3,000,000, the same as in Example A. The $3 million DSUE amount is calculated as follows: the lesser of the $ 5,000,000 basic exclusion amount in 2011, or the excess of Herb's $5,000,000 applicable exclusion amount less his $1,000,000 taxable estate and less only $ 1,000,000 of the adjusted taxable gifts. Herb's adjusted taxable gifts of $2,000,000 are reduced for purposes of this computation by $1,000,000, the amount of taxable gifts on which gift taxes were paid.[16]

Absent the special adjustment for adjusted taxable gifts on which the decedent paid tax, the DSUE amount elected by Herb's estate would only be $2 million (instead of the $3 million it should be), with the portion of the $2 million transfer triggering payment of gift tax inadvertently using up applicable exclusion amount meant to shelter assets from transfer tax. Given the special adjustment to adjusted taxable gifts, the portability election now works as intended.

[3] QDOT Adjustments Added by the Portability Regulations

The portability regulations provide special rules for determining the DSUE amount when property passes to a qualified domestic trust or QDOT for the benefit of a surviving spouse who is not a U.S. citizen. The special portability rules acknowledge the fact that tax will continue to be paid on certain distributions from the QDOT to the surviving spouse following the decedent's death. Adhering to the policy that the "DSUE amount first and foremost belongs to the decedent...,"[17] the adjustment for property passing to a QDOT requires that the DSUE amount be redetermined "upon the occurrence of the final distribution or other event (generally the death of the surviving spouse or the earlier termination of all QDOTs for that surviving spouse) on which estate tax is imposed…."[18] Thus, the DSUE amount of the decedent remains to offset transfers from the QDOT trust subject to estate tax under I.R.C. Section 2056A. When property passes to a QDOT, decedent's executor preliminarily computes the DSUE amount, with that amount being redetermined to reflect an appropriate reduction in the DSUE amount upon final distribution or other taxable event triggering estate tax under I.R.C. 2056A.[19] Consequently, the surviving spouse, who is beneficiary of a QDOT, may not use the DSUE amount until the final estate tax liability of the decedent pursuant to I.R.C. § 2056A comes due.[20] The preamble to the temporary regulations acknowledges that after reviewing proposals for determining the DSUE amount when a QDOT trust receives property from decedent's estate, "[e]ach of the proposals raises

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[15] See Temp Treas Reg § 20.2010-2T(c)(2), (c)(5) example 1.
[16] See Temp Treas Reg § 20.2010-2T(c)(2), (c)(5) example 2.
[17] Treas Dec 9593, 2012 IRB LEXIS 333 at 35.
[18] Temp Treas Reg § 20.2010-2T(c)(4).
[19] Temp Treas Reg § 20.2010-2T(c)(4).
[20] Temp Treas Reg § 20.2010-3T(c)(2).

issues of fairness, complexity, and administrability."[21] Treasury asks for further comment regarding the proposal chosen.

Given the limitations on using the DSUE amount when a QDOT is use, consideration should be given to using a traditional credit shelter-marital deduction plan to ensure immediate use of the decedent's applicable exclusion amount. Assuming the decedent owns assets less than the applicable exclusion amount available to the decedent's estate, use of a credit shelter trust avoids the more complicated reporting and redetermination of tax required with a QDOT. Likewise, if decedent owns assets in excess of the applicable exclusion amount, full use of the decedent's applicable exclusion amount by placing assets in a credit shelter trust protects the later appreciation of those assets from thereafter triggering estate tax on distribution to the surviving spouse from the QDOT.

[4] Interaction of the DSUE Amount with Other Estate Tax Credits

The portability regulations indicate that additional guidance is expected to address the interaction of the portability election with estate tax credits such as the tax on prior transfers credit. The preamble to the temporary regulations states: "The issue of the impact of the credits in sections 2013 to 2015 on computing the DSUE amount merits further consideration. The temporary regulations reserve [space] to provide future guidance on this issue."[22] The regulations do not provide any specific suggestion as to how future regulations might address this issue.

§ 4.03 Ability of the Surviving Spouse to Use the DSUE Amount

Just as changes prove necessary to clarify calculation of the DSUE amount available for use by the surviving spouse upon a valid portability election, further changes are required to protect the basic exclusion amount of the surviving spouse and to ensure against a clawback of gift tax in the event a surviving spouse makes a gift using the DSUE amount of a predeceased spouse. In response, the temporary portability regulations add an anti-clawback rule and an ordering rule.

Absent the addition of these rules, the "last deceased spouse" requirement of the statute as enacted raises the possibility that a DSUE amount previously available for use by the surviving spouse could vanish. Disappearance of the DSUE amount could lead to unexpected recovery or clawback of gift tax on a later transfer because the formula for calculating gift and estate tax requires determination of transfer tax based on aggregate lifetime transfers. Thus, a transfer previously sheltered by a formerly available DSUE amount would be added to determine later gifts, but the DSUE amount would no longer be available, and as a result the tax earlier sheltered by the DSUE amount would be clawed back in the calculation of the later gift tax. The anti-claw back rule of the temporary regulations prevents this from occurring. An additional ordering rule further protects the surviving spouse's basic exclusion amount by directing that an available DSUE amount is used first.

[1] The Last Deceased Spouse Requirement

The ability of the surviving spouse to use the DSUE amount of a predeceased spouse depends on whether the predeceased spouse is the surviving spouse's "last deceased spouse." The surviving

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[21] Treas Dec 9593, 2012 IRB LEXIS 333 at 35.
[22] Treas Dec 9593, 2012 IRB LEXIS 333 at 21.

spouse may only use the DSUE amount of a predeceased spouse if the DSUE amount is that of the "last deceased spouse" of the surviving spouse.[23] Remarriage by a surviving spouse may change the identity of the last deceased spouse.

The regulations define "last deceased spouse" as "the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse."[24] The definition clarifies that remarriage in and of itself by the surviving spouse does not impact the identity of the "last deceased spouse." Only if, upon remarriage by the surviving spouse, the subsequent spouse dies does the identity of the last deceased spouse change in relation to the surviving spouse.[25] Also, if upon remarriage by the surviving spouse, the surviving spouse thereafter divorces, the temporary portability regulations explain that death of the divorced spouse will not impact the identity of the "last deceased spouse."[26]

The last deceased spouse limitation requires a surviving spouse on remarriage to affirmatively plan in order to ensure full use the DSUE amount from the estate of a former spouse. If a spouse remarries and does not fully use the DSUE amount of a former deceased spouse, that DSUE amount could be lost on the death of a subsequent spouse.

[2] The Anti-Clawback Rule

In the event of remarriage, the temporary portability regulations allow a surviving spouse to use the DSUE amount of a predeceased spouse by making a gift without fear of a later clawback or a loss of the surviving spouse's basic exclusion amount. The plain wording of the statute as enacted does not specifically address the issue of gifts by the surviving spouse on remarriage, but the regulations provide a special anti-clawback rule to allow for such planning. In the event that a surviving spouse applies the DSUE amount of one or more predeceased spouses to taxable gifts, the applicable exclusion amount of the surviving spouse as of death is increased by the amount so applied even if the identity of the last deceased spouse changes in the interim between making the taxable gift and the surviving spouse's death.[27] An ordering rule also applies so that the DSUE amount of the last deceased spouse is first applied toward sheltering any taxable gift made by the surviving spouse.[28] Similar rules apply in determining the applicable exclusion amount of the surviving spouse for purposes of subsequent taxable gifts by the surviving spouse.

The anti-clawback rule of the temporary portability regulations specifically provides that the surviving spouse's applicable exclusion at death or as of the date of a taxable gift is the surviving spouse's basic exclusion amount supplemented by a DSUE amount equal to the aggregate of the following two amounts:

(1) the DSUE amount of the surviving spouse's last deceased spouse; and,

[23] Temp Treas Reg § 20.2010-3T(a)(1); Temp Treas Reg § 25.2505-2T(a)(1).
[24] Temp Treas Reg § 20.2010-1T(d)(5).
[25] Temp Treas Reg § 20.2010-3T(a)(3); Temp Treas Reg § 25.2505-2T(a)(3).
[26] Temp Treas Reg § 20.2010-3T(a)(3); Temp Treas Reg § 25.2505-2T(a)(3).
[27] Temp Treas Reg § 20.2010-3T(b)(1); Temp Treas Reg § 25.2505-2T(c)(1).
[28] Temp Treas Reg. § 25.2505-2T(b).

(2) "[t]he DSUE amount of each other deceased spouse of the surviving spouse, to the extent that such amount was applied to one or more taxable gifts of the surviving spouse."[29]

This anti-clawback rule ensures the ability of a surviving spouse to effectively plan for full use of the DSUE amount elected by the estate of each spouse to whom the surviving spouse is married during his or her lifetime, and not just the DSUE amount of the last deceased spouse.

In its quest to make the portability election useable, Treasury essentially eliminates the last deceased spouse restriction for those surviving spouses who remarry and are willing to make gifts in an amount necessary to use the available DSUE amount. The impediment to making such a transfer rests in the fact that by making the gift the surviving spouse loses the ability to continue to use the gifted property. If the surviving spouse is concerned about not having sufficient funds upon making the gift, the surviving spouse should consider creation of an irrevocable trust not subject to creditor claims with terms allowing, but not requiring an unrelated trustee, to make distributions in the trustee's complete discretion to the surviving spouse. Such a transfer has been determined by the Service to be a completed gift[30] and not subject to estate tax in the grantor's estate.[31] The surviving spouse, however, makes such a gift at the expense of losing any control over the transferred property. Nevertheless, the trust terms allow the trustee to make distributions to the surviving spouse in the trustee's discretion.

Exceptions to the availability of the DSUE amount on the death of the predeceased spouse exist if (1) the executor of the decedent's estate supersedes the portability election by timely filing a subsequent estate tax return indicating it does not make a portability election; (2) the DSUE amount subsequently is reduced by a valuation adjustment or the correction of an error in calculation; or (3) the surviving spouse cannot substantiate the DSUE amount claimed on the surviving spouse's return.[32] This last exception places the burden for proving the DSUE amount on the surviving spouse, and suggests that documentation of value should be attached to the predeceased spouse's return to the extent feasible. In light of the uncertainty with respect to value of the DSUE amount, in making a gift for the purpose of fully using a former deceased spouse's DSUE amount consideration also should be given to using a defined value formula clause similar to those used in making gifts of family limited partnership interests so that if the DSUE amount is changed, the amount of any gift by the surviving spouse likewise changes.[33]

[3] The Ordering Rule

The temporary portability regulations clarify that any DSUE amount available to a surviving spouse will first be applied to any transfer made by that surviving spouse.[34] This ordering rule preserves the basic exclusion amount of the surviving spouse until such time as the surviving spouse fully exhausts any available DSUE amount. It is also necessary for the effective functioning of the anti-clawback rule. The plain wording of the statute as enacted by Congress neglects to clarify whether a gift by a surviving spouse uses an available DSUE amount first, last or proportionately. Treasury's choice of ordering rule

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[29] Temp Treas Reg § 20.2010-3T(b)(1); Temp Treas Reg § 25.2505-2T(c)(1).
[30] Treas Reg § 25.2511-2(b).
[31] PLR 200944002 (July 15, 2009).
[32] Temp Treas Reg § 20.2010-3T(c)(1).
[33] Wandry v Commr, TC Memo 2012-88 (Tax Court in a memorandum decisions approves use of a defined value formula clause even in the absence of a charitable beneficiary to take the spillover in the event of an increase in value).
[34] Temp Treas Reg § 25.2505-2T(b).

encourages use of the portability election. Without such a rule, the calculation of the DSUE amount, and as a result, the applicable exclusion amount of the surviving spouse, would either remain uncertain or make the ability to use the DSUE amount uncertain, both of which results would be opposed to the efforts of Treasury to make the portability election useable and reliable.

The regulations include the following explanatory example of the interaction of the anti-clawback and ordering rules:

> **Example:** Henry, Sally's first husband, passed away on January 15, 2011, survived by Sally. Neither Henry nor Sally made any taxable gifts during Henry's life. Henry's executor elects portability of his DSUE amount, and computes Henry's DSUE amount on the estate tax return as $5,000,000. On December 31, 2011, Sally makes taxable gifts to her children valued at $2,000,000, and reports those gifts on a timely-filed gift tax return. Sally is considered under the regulations to have applied $2,000,000 of Henry's DSUE amount to the taxable gift as reported, and no gift tax is owed. After the gift, Sally has a remaining applicable exclusion amount of $8,000,000 ($3,000,000 of Henry's remaining DSUE amount plus Sally's own $ 5,000,000 basic exclusion amount because the ordering rules deem Henry's DSUE amount to be used first by Sally). After Henry's death, Sally remarries Robert II. Sally and Robert's marriage is short lived, and Robert II dies in June 2012. Robert's executor elects portability of Robert II's DSUE amount of $2,000,000 as computed on Robert II's estate tax return. Sally then dies in October of 2012. Sally's applicable exclusion amount as of her death is $9,120,000, which equals Sally's basic exclusion amount of $5,120,000 plus an aggregate DSUE amount equal to the $2,000,000 DSUE amount of Robert II, her last deceased spouse, and the $2,000,000 DSUE amount of Henry that was applied by Sally to her 2011 taxable gifts.[35] The regulations further clarify that if Sally wanted to make an additional taxable gift after Robert II's death and prior to her own death, that following Robert II's death, she would be able to use the $9,120,000 applicable exclusion amount as calculated above.[36]

This example demonstrates the importance of the ordering and anti-clawback rules. The special anti-clawback rule, in conjunction with the ordering rule, allows more certainty in using the DSUE amount in a client's estate plan.[37] Without these rules clarifying application of the statutory language as passed by Congress, it would not be possible to plan with any certainty for use of the DSUE amount. These rules allow the surviving spouse to avoid any issue of loss of the surviving spouse's applicable exclusion amount on remarriage by offering the surviving spouse the opportunity to make a taxable gift using the predeceased spouse's DSUE amount without concern that a tax could later be "clawed-back" due to a reduction in the applicable exclusion amount on a later transfer by the surviving spouse.

[4] Time When a DSUE Amount May Be Used

The temporary portability regulations clarify that the surviving spouse generally may use the DSUE amount of a predeceased spouse as of the date of death of that spouse without the necessity of

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[35] Temp Treas Reg § 20.2010-3T(b)(2). (The example indicates Sally's applicable exclusion amount is only $9,000,000, but that amount does not take into account the inflation indexing of the 2011 basic exclusion amount to yield a 2012 basic exclusion amount of $5,120,000.) See also, Temp Treas Reg § 25.2505-2T(c)(2).
[36] Temp Treas Reg § 25.25050-2T(c)(2).
[37] Temp Treas Reg § 20.2010-3T(b); Temp Treas Reg § 25.2505-2T(b).

waiting until the predeceased spouse's estate makes a portability election.[38] The regulations state as a general rule that the predeceased spouse's DSUE amount increases the surviving spouse's applicable exclusion amount and applies to transfers after the death of the predeceased spouse.[39] The regulations, however, provide for specific exceptions to this rule as previously noted with respect to use of a QDOT, and in the event the portability election is not made, its value is adjusted by the Service, or the surviving spouse is unable to substantiate its amount.[40]

§ 4.04 Requirements of the Portability Election

In order for a surviving spouse to use the DSUE amount of a predeceased spouse, the estate of a predeceased spouse must make a portability election. An effective portability election requires the estate of the predeceased spouse to comply with the following:

(1) The predeceased spouse's executor must timely file a federal estate tax return.
(2) The federal estate tax return must be complete and properly-prepared pursuant to regulations.
(3) At such time as required by Instructions to Form 706, the estate tax return must include a calculation of the DSUE amount.

The temporary portability regulations make clear that the portability election is available only to a U.S. citizen or resident decedent. A nonresident alien's estate may not make the election.[41]

[1] Estate Tax Return Filing Requirement

In order to preserve a decedent's unused exclusion amount for use by that decedent's surviving spouse or the surviving spouse's estate, the decedent's estate must timely file an estate tax return.[42] An estate tax return is required to make the portability election even if such a return would not otherwise be required because decedent's assets do not exceed the filing requirement. Recognizing that the Code does not provide any filing deadline for estates not required to file, the temporary portability regulations fill this gap by coordinating the time for filing the return by those estates that would not otherwise be required to file with the date applicable to those estates required to file a return. The time for filing the return required to make the portability election, thus, is the date nine months from the date of decedent's death, or if an extension is obtained, the last day for timely filing under the extension.[43]

Other than timely filing a complete and properly prepared estate tax return calculating the DSUE amount, nothing more need be done to make the portability election.[44] No box need be checked. No notice need be given the surviving spouse's estate. The choice by Treasury to make the election automatic upon timely filing of the estate tax return reflects Treasury's attempt to make the election as uncomplicated as possible based on the assumption that most decedents' estates will want to make the election.

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[38] Temp Treas Reg § 20.2010-3T(c)(2).
[39] Temp Treas Reg § 20.2010-3T(c)(1).
[40] Temp Treas Reg § 20.2010-2T(c)(4); Temp Treas Reg § 20.2010-3T(c)(1).
[41] Temp Treas Reg § 20.2010-2T(a)(5); Temp Treas Reg § 25.25050-2T(f).
[42] IRC §2010(c)(5); Temp Treas Reg § 20.2010-2T(a).
[43] Temp Treas Reg § 20.2010-2T(a)(1).
[44] IRC §2010(c)(5); Temp Treas Reg § 20.2010-2T(a).

Special provision is made for certain estates of decedent's dying in the first half of 2011. Estates of 2011 decedents, who die prior to July 1, survived by a spouse, and with an estate not exceeding the $5 million basic exclusion amount, may file the estate tax return without incurring a late filing penalty so long as the return is filed within 15 months of decedent's date of death accompanied by a Form 4768 requesting an extension of time to file.[45] The Service essentially eliminates the need to timely obtain an extension, and simply grants an extension to all qualifying estates provided the Form 4768 accompanies the return when filed within the 15 month period. The Service gives the reason for this exception: "[C]ommentators noted that the executors of estates of decedents dying in 2011, particularly during the early part of 2011, did not have the benefit of guidance on electing portability of the decedent's DSUE amount and, further, that executors of estates having assets with a value not in excess of $5,000,000 might not have known about the requirement to file Form 706 to make the portability election at all."[46]

[2] Person Entitled to Make Portability Election

The "executor" makes the portability election.[47] The simplicity of this rule belies its complexity. The term executor may include an executor appointed by a court or a beneficiary of decedent's assets. Recognizing the need to provide clarity, the temporary portability regulations address the possibility of multiple elections, and set forth an order of priority. Prioritizing who is finally deemed to make the election proves important because the portability election becomes irrevocable as of the due date for filing the return, including extensions, and up until that time a prior election may be superseded.[48] The last timely filed return controls whether or not a portability election has been made.[49]

For purposes of the portability election, treasury regulations categorize persons who may file as an executor into two categories: (1) appointed executors, and (2) non-appointed executors. An appointed executor is one appointed by a court, and an appointed executor has priority over a non-appointed executor. An appointed executor may file a portability election or may elect not to make the portability election.[50] In contrast, a non-appointed executor is one who is in "actual or constructive possession" of decedent's property if "there is no appointed executor."[51] A non-appointed executor may also make a portability election or elect not to make the election, however, once the portability election is made by a non-appointed executor, it "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)."[52] This implies that a later appointed executor, prior to the due date of the return, including extension, may supercede the election of a non-appointed executor.

If any concern exists regarding multiple elections on the part of the person entitled to be appointed executor pursuant to state law, that person should apply for appointment as executor of decedent's estate by an appropriate court. Once appointed no one else may make the decision as to

[45] Notice 2012-1, 2012-10 IRB 450.
[46] *Id*.
[47] IRC § 2010(c)(5)(A). See IRC § 2203; Treas Reg § 20.2203-1.
[48] Temp Treas Reg § 20.2010-2T(a)(4).
[49] Treas Dec 9593, 2012 IRB LEXIS 333; Temp Treas Reg § 20.2010-2T(a)(4).
[50] Temp Treas Reg § 20.2010-2T(a)(6)(i).
[51] Temp Treas Reg § 20.2010-2T(a)(6)(ii).
[52] *Id*.

whether to make the portability election because a non-appointed executor by definition can act only when there is no appointed executor. As between potential non-appointed executors the regulations also indicate the first one to file gets to control whether or not a portability election is made, so timing for a non-appointed executor is key. If a person in receipt of decedent's property wishes to control the decision to make a portability election in absence of a formal court appointment, the regulations indicate that person needs to be the first to file.

[3] Choosing Not to Make the Portability Election

If an estate not otherwise required to file decides against making the portability election, the estate simply should not file any return.[53] If on the other hand, an estate must file a return, but does not want to make the portability election, the return should so indicate. Specifically the executor must state either on a statement attached to the return or at the top of the first page of the return: "[T]he estate is not electing portability under section 2010(c)(5)."[54] Although the bulk of estates would want to make the portability election to preserve the decedent's unused applicable exclusion amount, some would not.

An estate may choose not to make a portability election in order to limit the ability of the Service to audit the decedent's estate tax return to the applicable period of limitations. If a portability election is made, the Service may "examine a return of the deceased spouse to make determinations with respect to" the DSUE amount available to the surviving spouse even after the period of limitations has expired.[55] Upon examination, the Service may decrease or eliminate the DSUE amount available to the surviving spouse.[56] It, however, may not assess additional tax on the estate of the predeceased spouse if the statute of limitations for redetermination of tax has run on the predeceased spouse's return.[57] In order to foreclose the opportunity of the Service to audit the predeceased spouse's estate tax return for purposes of determining the DSUE amount available to a surviving spouse, a portability election should not be made.

An estate which includes hard to value assets, especially when a discount or other valuation adjustment is taken, should carefully consider whether drafting to use a credit shelter/marital deduction plan or a partial QTIP election is preferable to making the portability election. Use of a formula marital deduction typically results in a zero estate tax even on revaluation of assets. As a consequence, it is unlikely the Service would choose to audit a return if revaluation would not increase estate tax owed. By fully funding the credit shelter trust, a portability election becomes unnecessary and the likelihood of the Service auditing the predeceased spouse's return remains exceedingly low. To the extent of the decedent's basic exclusion amount discount planning in this situation likely would escape the scrutiny of the Service if the surviving spouse lived beyond the period of limitations applicable to the predeceased spouse's return. Use of a credit shelter trust also provides the added advantage of sheltering appreciation occurring after the decedent's death from taxation in the surviving spouse's estate that would occur if a portability election had been made, and allows full use of a predeceased spouse's unused generation skipping tax exemption as portability does not apply to the GST exemption.

[53] Temp Treas Reg § 20.2010-2T(a)(3)(ii).
[54] Temp Treas Reg § 20.2010-2T(a)(3)(i).
[55] IRC § 2010(c)(5)(B).
[56] Temp Treas Reg § 20.2010-3T(d); Temp Treas Reg § 25.2505-2T(e).
[57] *Id*.

An estate that would not otherwise be required to file an estate tax return may choose not to make the portability election in order to avoid the added costs and fees of preparing a return. This would likely be the choice if the couple anticipates their combined estate would never exceed twice the basic exclusion amount available to the couple. Given uncertainty as to whether the basic exclusion amount will in fact remain at $5 million or at such time when Congress acts (or does not act) will be reduced, couples whose combined assets will likely exceed the $1 million applicable exclusion amount for 2013 in the event Congress fails to extend the 2010 amendments, should strongly consider making the portability election if one of the spouses dies in 2012. The temporary portability regulations provide some relief as to valuation costs for estates that would not otherwise be required to file an estate tax return.

[4] Complete and Properly Prepared Return Requirement

An effective portability election not only requires timely filing of an estate tax return after taking into account extensions granted, it also requires the return be "complete and properly-prepared."[58] Subject to an exception in the event of certain marital and charitable deductions, the temporary portability regulations indicate a return meets this standard only if it complies with the Instructions to the Form 706 for preparation of an estate tax return.[59] As a result, unless the exception applies, the estate must report and value each asset.

A special reporting exception, however, applies to estates that would not otherwise be required to file a return but for the decision to make a portability election.[60] Those estates may take advantage of relaxed reporting requirements for certain property passing pursuant to a marital or charitable deduction. Specifically, those estates may file the estate tax return without obtaining sometimes costly date of death appraisals for property passing pursuant to the marital deduction or the charitable deduction provided that none of the following four circumstances exist:[61]

(1) The value of the property subject to the marital or charitable deduction "affects, or is needed to determine, the value passing from the decedent to another recipient."[62]

(2) The value of the property subject to the marital or charitable deduction is needed in order to determine eligibility for alternate valuation, special use valuation, or payment of estate tax in installments on closely held business interests pursuant to IRC Section 6166.[63]

(3) Less than the entire value of a property interest includible in the gross estate is subject to the marital or charitable deduction.[64]

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

[59] Temp Treas Reg §20.2010-2T(a)(7)(i) citing compliance with Treas Reg §§ 20.6018-2, 20.6018-3, 20.6018-4.

[60] Temp Treas Reg §20.2010-2T(a)(7)(ii). It should be noted that the temporary regulations, § 20.2010-2T(a)(7)(ii)(A) specifically applies the special reporting rule to "estates in which the executor is not required to file an estate tax return under section 6018(a)." Under IRC § 6018(a) estates not required to file are those that do not exceed "the *basic exclusion* amount in effect … for … date of death" reduced by adjusted taxable gifts and any "aggregate amount allowed as a specific exemption under section 2521[prior to its repeal]." The examples provided by the temporary, however, apply the special reporting rule to those estates not exceeding "the excess of the *applicable exclusion* amount for the year of his death over the total amount of H's adjusted taxable gifts and any specific exemption under section 2521." Temp Treas Reg § 20.2010-2T(a)(7)(ii)(C). Thus, there is an ambiguity with respect to the application of the special reporting rule.

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

[62] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(A).

[63] *Id*.

(4) "A partial disclaimer or partial qualified terminable interest property (QTIP) election is made with respect to a bequest, devise, or transfer of property includible in the gross estate, part of which is marital deduction property or charitable deduction property..."[65]

If the estate qualifies for the special exception allowing it to file a complete and properly-prepared return without valuing the assets passing pursuant to the marital or charitable deduction, then for each asset the estate need report only the property description, ownership, and/or beneficiary, and all other information necessary to establish allowance of the marital or charitable deduction with respect to the property.[66] In lieu of appraisals, the executor need only provide an estimate of the value of the total gross estate rounded to the nearest $250,000 in accordance with return instructions.[67] In making the estimate of value, the executor must exercise due diligence to make its best estimate of the value of the total gross estate.[68]

The following example illustrates the parameters for filing a complete and properly-prepared return:

> **Example:** Holly dies in 2011, and is survived by her spouse Wyatt. Both are United States citizens. Holly's gross estate does not exceed the excess of the applicable exclusion amount for the year of her death over the total amount of adjusted taxable gifts and any specific exemption under section 2521, in other words her estate would fall within the requirements for applicability of the special reporting rule.[69] Holly's uncontested will passes her entire estate to a QTIP trust for Wyatt's benefit. In addition to probate assets passing to the QTIP trust, Holly's gross estate includes a life insurance policy payable to her children of a prior marriage. Holly's executor files the estate tax return identifying all assets included in the gross estate on the proper schedule, but does not include the date of death value of assets passing to the QTIP trust. The executor makes a QTIP election and attaches Holly's will to the return. The return, thus, describes each asset and its ownership to establish the estate's entitlement to the marital deduction. The life insurance policy payable to children is reported on the return as generally required with a Form 712 establishing fair market value. Holly's executor exercises due diligence to arrive at a best estimate of the fair market value of the total gross estate, and certifies the amount on the return. Holly's executor has filed a complete and properly-prepared return, and has elected portability.[70]

Further examples provided by the Service stress that in the event a decedent's estate makes a partial QTIP election, the estate will not be able to take advantage of the special exception allowing the estate to save the cost of valuing the assets as of date of death.[71] Also, in the event a decedent's estate uses a formula clause to divide decedent's assets as between a QTIP trust and a credit shelter trust or other recipient, the estate will not be able to take advantage of the special exemption and thereby avoid

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[64] *Id*.
[65] *Id*.
[66] *Id*.
[67] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(B).
[68] *Id*.
[69] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(C) suggests that the applicable exclusion amount, as opposed to the basic exclusion amount, should be the beginning point for applying the special reporting rule. But see, Temp Treas Reg § 20.2010-2T(a)(7)(ii)(A).
[70] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(C) example 2.
[71] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(C) example 2(iii).

reporting the date of death value of the assets.[72] This results because the value of the property passing to the marital trust relates to or affects the value passing to the credit shelter trust or other beneficiary.[73]

An estate should carefully consider the appropriateness of not obtaining a date of death appraisal of certain assets. For example, it would be important to obtain an appraisal for depreciable property passing on decedent's death. Pursuant to I.R.C. Section 1014 property receives a step up in basis at date of death, and the increased depreciation deductions for purposes of income tax can be very valuable. Also, if it is anticipated it will be difficult to later obtain a date of death value of assets passing to the surviving spouse, the estate should consider obtaining a current appraisal because the temporary portability regulations place the burden for substantiating the DSUE amount on the surviving spouse's estate.[74]

§ 4.05 Planning for Portability with a QTIP Trust

The temporary portability regulations provide welcomed examples that appear to confirm the ability to use a QTIP trust in conjunction with a portability election even when an estate would not otherwise need to make a QTIP election in order to avoid estate tax because the assets of the decedent do not exceed the basic exclusion amount available to shelter assets at death.[75] Revenue Procedure 2001-38[76], issued many years prior to the advent of the portability election, initially raised an issue as to whether it was possible for an estate to make a QTIP election if it would not otherwise incur estate tax. The revenue procedure indicates that to the extent a QTIP election is unnecessary to avoid payment of estate tax it is null and void if the decedent's assets do not exceed the available applicable exclusion amount. This ruling was a taxpayer friendly ruling at the time it was issued allowing estates to avoid inclusion of QTIP assets in the survivor's gross estate if a QTIP election was inadvertently made in the predeceased spouse's estate under certain circumstances. The ruling does not apply if estate assets exceed the applicable exclusion amount and a partial QTIP election is unnecessarily made or a formula marital deduction clause is used.[77] The example in the temporary portability regulations appropriately indicates that taxable and non-taxable estates will be able to take advantage of QTIP trusts in conjunction with a portability election on the same footing. Application of the revenue procedure by the Service in a manner that would preclude a nontaxable estate from taking advantage of the QTIP election makes little sense as it would put those estates to a difficult choice.

A QTIP trust provides flexibility to determine at decedent's death whether or not to make a portability election. If a decedent's estate plan passes decedent's assets to a QTIP trust, the executor may choose whether or not to make the QTIP election for all assets or for only a portion of the assets held by the trust.[78] To the extent the executor makes a partial QTIP election, the assets in the QTIP trust for which a QTIP election is not made will typically be sheltered by the applicable exclusion amount, which if fully used, negates the need for a portability election. On the other hand, to the extent that the executor makes the QTIP election and the decedent's applicable exclusion amount is not fully used, the executor likely would make a portability election. Just as QTIP trusts have always provided flexibility

[72] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(C) example 3.
[73] *Id*.
[74] Temp Treas Reg § 20.2010-3T(c)(1).
[75] Temp Treas Reg § 20.2010-2T(a)(7)(ii)(C) example 2. See also Temp Treas Reg § 20.2010-2T(a)(7)(ii)(A)(4).
[76] Rev Proc 2001-38, 2001-2 CB 124.
[77] *Id*.
[78] Treas Reg § 20.2056(b)-7(b)(2)(i).

to make post mortem planning decisions as to use of the unified credit, they do so again with regard to the portability election.

For couples who have children from prior marriages, the QTIP trust proves an invaluable estate planning tool if the couple wishes to obtain a marital deduction and at the same time ensure that on the death of the surviving spouse the remaining assets held in trust will pass to the transferor spouse's descendants or as the transferor otherwise chooses. For the same reason, it proves an important planning tool for a couple concerned that the surviving spouse will later remarry. Absent the interpretation provided in the temporary portability regulations acknowledging that a QTIP trust can be used to allow a nontaxable estate to make a portability election, the QTIP trust would not be a clearly viable option for clients who wish to use a QTIP trust when the decedent's assets do not exceed the available applicable exclusion amount given the holding of Revenue Procedure 2001-38.[79] Without the QTIP option as provided in the temporary regulations, a credit shelter trust would be the remaining option for client's with assets less than the applicable exclusion amount who wish to ultimately protect assets for distribution to descendants on the death of the surviving spouse.

The QTIP trust allows the added advantage of an additional step up in basis for appreciation occurring from the date of death of the predeceased spouse to the date of death of the surviving spouse.[80] The ability to obtain the step up in basis as of the surviving spouse's death encourages use of the QTIP trust as opposed to a credit shelter trust for those client's who anticipate the couple's assets will not exceed the applicable exclusion amount available, including the DSUE amount, as of the survivor's death. For couples that can fully shelter assets of both spouse's by use of the applicable exclusion amount, the QTIP trust will provide an added income tax advantage of the step up in basis with no offsetting estate tax cost. If client's anticipate combined assets will result in a taxable estate on the death of the survivor after taking anticipated appreciation into account, client's likely would be better off choosing to use a credit shelter trust or making a partial QTIP election as opposed to making the portability election in order to avoid payment of estate tax on appreciation of the sheltered assets as of the survivor's death. The trade off, of course, is the income tax benefits of a step up in basis on the appreciation as balanced against an increase in estate tax.

In addition, couples who wish to make generation skipping transfers should consider the importance of being able to fully use the GST exemption available to both spouses. A QTIP trust may provide advantages for achieving generation skipping transfer tax objectives that an outright gift to a spouse would not achieve in light of the ability to make the reverse QTIP election. Use of the GST exemption of both spouses is an important consideration and provides another reason for welcoming the acknowledgement in the temporary portability regulations that a decedent whose estate does not exceed the applicable exclusion amount may still use the QTIP trust in conjunction with the portability election.

§ 4.06 Conclusion

The temporary portability regulations provide certainty when using the portability election, and minimize potential concerns arising from the plain wording of the statute. The temporary regulations make technical corrections to the plain wording of the statute, provide rules allowing decedent and decedent's spouse to make taxable gifts without causing a loss of basic exclusion amount available to

[79] See Rev Proc 2001-38, 2001-2 CB 124.
[80] IRC § 1014(b)(10).

the donor spouse, and eliminate the possibility of a claw back causing a potential tax on phantom property. In addition the regulations ensure that both taxable and nontaxable estates can take advantage of the estate, income and generation skipping transfer tax benefits associated with the QTIP election. The portability election is now a viable planning option.