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Portability: The Final Regulations

By Patrick J. Saccogna, Esq. [a0]

Introduction

Over five years have passed since President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act") on December 17, 2010. [1] The 2010 Act gave rise to the estate planning concept of *portability*, which is the subject of this article. [2]

In the face of the expiration of portability and many of the other provisions of the 2010 Act, President Obama signed into law the American Taxpayer Relief Act of 2012 (the "2012 Act") on January 2, 2013. [3] The 2012 Act made permanent the portability provisions of the 2010 Act (with one minor technical modification). [4] Finally, at the eleventh hour, the Department of the Treasury (the "Treasury Department") and the Internal Revenue Service (the "IRS") released final regulations on portability effective as of June 12, 2015, and removed the temporary regulations published on June 18, 2012. [5]

The final regulations on portability provide general guidance with respect to the applicable exclusion amount, as well as the requirements and rules with respect to portability. This article focuses on the key clarifications made by the final regulations, and identifies some important areas of concern that the final regulations failed to address.

The estate planning implications of portability and the profound changes that portability will continue to have in the estate planning for married couples are discussed in detail in Saccogna, *Portability: Estate Planning in the New Frontier*, 25 PLJO 6 (July/August 2015). [6] Additional information and numerous illustrative examples concerning (i) the concept of portability, (ii) the calculation of a surviving spouse's estate tax applicable exclusion amount under various scenarios applying portability, (iii) the application of portability for federal gift and generation-skipping transfer ("GST") tax purposes, and (iv) the requirements for making a valid portability election, are all outlined in Shearer and Saccogna, *Portability: Now It's For Real*, 23 PLJO 208 (May/June 2013).

The Final Portability Regulations: Key Clarifications and Notable Omissions

Availability of Extension of Time to Make Portability Election. Generally, a portability election is effective only if made by the executor of the deceased spouse's estate on a federal estate tax return that is filed within the time prescribed by law (including extensions) for filing such a return. [7] Prior to the issuance of the final portability regulations, there existed a question as to the extent to which, if any, an extension of time under Treasury Regulations Sections 301.9100-2 and 301.9100-3 (the so-called "9100 relief provisions") is available to make a portability election.

In the wake of the 2010 Act and the 2012 Act, the Treasury Department and the IRS published guidance regarding the availability of an *automatic* extension of time within which executors of certain estates under the filing threshold of IRC Section 6018(a) could file an estate tax return for the purpose of making a portability election. [8] This type of relief is *not* included in the final portability regulations.

Nevertheless, the final regulations do provide that an extension of time to elect portability may be granted under the rules set forth in Treasury Regulations Section 301.9100-3 to estates with a gross estate value less than the filing threshold amount (which estates are *not* otherwise required to file a federal estate tax return). [9] The rationale for this regulation is that the due date for the portability election in such a case is prescribed *by regulation*, and not by statute. [10]

The final regulations also provide that an extension of time to make the portability election will *not* be granted under Treasury Regulations Section 301.9100-3 to any estate that is *required* to file a federal estate tax return under IRC Section 6018(a) because the value of the gross estate equals or exceeds the filing threshold amount. [11] This is because, in such a case, the due date for the portability election is prescribed *by statute*, and the 9100 relief provisions only apply to an election the due date of which is prescribed by regulation. [12]

Effect of Portability Election In Case Where DSUE Amount Is Not Certain or Changes. As a result of the 2010 Act (as extended by the 2012 Act), Congress amended the Internal Revenue Code to allow for the portability of the deceased spouse's unused basic exclusion amount for a surviving spouse of a decedent who dies after 2010 if the executor of the deceased spouse's estate makes a proper election on a timely filed federal estate tax return that calculates the deceased spousal unused exclusion amount (the "DSUE amount"). [13]

A commentator suggested that the final regulations include language dealing with the issue of whether or not an estate can make a "protective" portability election if a DSUE amount is not reflected on an otherwise complete and properly prepared federal estate tax return at the time of its filing, but subsequent adjustments to the tax return would result in a DSUE amount of the decedent. An example of such an adjustment would be if the estate later became entitled to a deduction under IRC Section 2053 for a payment which reduces the estate tax and results in unused exemption of the decedent.

In response to this suggestion, the final regulations clarify that the portability election requirements, including the DSUE amount computation requirement, are satisfied by the timely filing of a complete and properly prepared estate tax return, as long as the executor has *not* elected out of portability. [14]

Thus, in the foregoing example, the recomputed DSUE amount would be available to the decedent's surviving spouse, and there is no need for a protective election. As a result of this clarification, it will be important for an executor in this situation *not* to elect out of portability even if the executor believes that, at the time of filing, the DSUE amount is zero. Notably, however, the Treasury Department and the IRS declined to include provisions in the final regulations outlining the facts and circumstances in which a timely filed federal estate tax return would be considered to be so deficient as to render it incomplete or not properly prepared for these purposes.

Persons Allowed to Make the Portability Election. Several commentators asked the Treasury Department and the IRS to issue final regulations that would permit a decedent's surviving spouse who is not the executor of the decedent's estate as defined in IRC Section 2203 to file a federal estate tax return and make the portability election for the estate under certain circumstances. [15]

The Treasury Department and the IRS flatly rejected this request, pointing out that the Internal Revenue Code allows only the executor of the decedent's estate to file the estate's estate tax return and make the portability election, and that the 2012 temporary regulations addressed the circumstances in which an appointed or non-appointed executor may file the return and elect portability. [16] Accordingly, the final regulations on this subject adopt the rules of the 2012 temporary regulations without change. [17]

Requirement of a "Complete and Properly Prepared" Estate Tax Return for Portability Election. On March 23, 2015, Troy Lewis, of the American Institute of Certified Public Accountants (AICPA), issued a letter to the IRS with several proposals with respect to the portability election. [18] One such proposal suggested that the IRS prepare a shortened, simplified estate tax

return, a "Form 706-EZ," to be used by estates that are not otherwise required to file an estate tax return but do so for the sole purpose of electing portability. [19] Mr. Lewis and the AICPA reasoned that this measure would make the portability election easier and less expensive to complete for small estates. [20]

The Treasury Department and the IRS chose not to adopt this suggestion in the final regulations, pointing out that (i) the legislative history of the 2010 Act suggests that estates making the portability election that are not otherwise required to file a federal estate tax return under IRC Section 6018(a) are intended to be subject to the same filing requirements that apply to estates that are required to file an estate tax return under IRC Section 6018(a), and (ii) the expected administrative burdens in administering the federal estate tax with an abbreviated estate tax return form far outweigh the purported benefits to taxpayers. [21]

Special Rules for Qualified Domestic Trusts (QDOTs). The 2012 temporary regulations provided that, with respect to a QDOT created for a decedent's surviving spouse who is not a U.S. citizen, the earliest date that such a decedent's DSUE amount may be included in determining the applicable exclusion amount of the surviving spouse or the surviving spouse's estate is the date of the event that triggers the final estate tax liability of the decedent under IRC Section 2056A. [22] A commentator challenged this delay in the surviving spouse's ability to use the decedent's DSUE amount in the case where the surviving spouse becomes a citizen of the United States after the decedent's estate tax return is filed and after property passes to a QDOT for such surviving spouse's benefit.

The final regulations make clarifying changes to the language of the 2012 temporary regulations regarding QDOTs, and state that, if the surviving spouse of the decedent becomes a United States citizen *and* the requirements under IRC Section 2056A(b)(12) and the corresponding regulations are met so that the tax imposed by IRC Section 2056A(b)(1) no longer applies, then the decedent's DSUE amount is no longer subject to any adjustment and thus will become available to the surviving spouse for transfers as of the date that the surviving spouse becomes a citizen of the United States. [23]

Availability of DSUE Amount to Surviving Spouse Who Becomes a United States Citizen. At the urging of commentary on the subject, the Treasury Department and the IRS have included a new rule in the final regulations making clear that a surviving spouse who becomes a citizen of the United States after the death of the deceased spouse is permitted to take into account the DSUE amount of the deceased spouse as of the date that such surviving spouse becomes a United States citizen, *so long as* the decedent's estate has made the portability election. [24] This rule, however, does not apply when the special rule regarding QDOTs in the final regulations, discussed above, applies. [25]

Accordingly, it will be essential in non-QDOT situations for the executor of the deceased spouse's estate to make a portability election, even though the surviving spouse is not expected to become a citizen of the United States, in order to allow the surviving spouse to use the DSUE amount of the deceased spouse if the surviving spouse ever later becomes a citizen of the United States. Of course, the surviving spouse could advise the executor not to make the portability election because the surviving spouse does not intend to become a United States citizen, and then later change course. Advisors thus ought to carefully document their files regarding these discussions and decisions.

Effect of Portability Election on Application of Rev. Proc. 2001-38. Perhaps the most notable—and controversial—omission from the final regulations is the much sought-after guidance on the application of Rev. Proc. 2001-38 [26] ("Rev. Proc. 2001-38") when the executor of an estate makes a portability election under IRC Section 2010(c)(5)(A) and also makes a qualified terminable interest property ("QTIP") election under IRC Section 2057(b)(7).

Many advisors do not believe that Rev. Proc. 2001-38 poses any problems in this area. Some, however, remain concerned that the IRS may use Rev. Proc. 2001-38 to prevent the use of the "single QTIP-eligible trust" approach being employed by advisors today to plan for portability for married couples. [27] The idea behind this approach is for the first spouse to die to leave all of his or her assets to a single QTIP-eligible trust for the benefit of the surviving spouse; the executor of the deceased spouse's

estate would then (i) make an IRC Section 2056(b)(7) QTIP election over the entire trust, (ii) make a reverse QTIP election to utilize the deceased spouse's remaining GST tax exemption, [28] and (iii) make a portability election in order to port the deceased spouse's DSUE amount to the surviving spouse. [29] In this way, the planner seeks to solve all of the key estate, GST, and income tax problems by porting the DSUE amount of the deceased spouse to the surviving spouse, utilizing the remaining GST tax exemption of the deceased spouse, and achieving a second income tax basis step-up on the appreciated QTIP assets remaining in the trust at the surviving spouse's death. [30]

Some planners think that it is not entirely clear that this approach will succeed, though, at least in cases where a QTIP election is not necessary to reduce the estate tax liability of the estate of the first spouse to die to zero. [31] This is because Rev. Proc. 2001-38 provides that the IRS will ignore a QTIP election that is not necessary to reduce the estate tax liability of a decedent's estate to zero. [32] Accordingly, if the deceased spouse's estate is under the filing threshold, and if a portability election is made, then a QTIP election would not be needed to reduce the estate tax liability to zero (because such liability is already zero) and thus, Rev. Proc. 2001-38 could literally apply to preclude the QTIP election. Presumably, this result would *also* nullify the reverse QTIP election for GST tax purposes and thereby cause the waste of the unused GST tax exemption of the first spouse to die. [33]

Several reasons suggest that a valid QTIP election is possible even when a portability election is made. [34] First, the purpose of Rev. Proc. 2001-38 is to provide relief to a decedent's estate by preventing an inadvertent or erroneous QTIP election from undermining the proper creation and funding of a credit shelter trust designed to utilize the decedent's remaining estate tax exemption where a QTIP election was not necessary to zero out the estate tax. Second, it is doubtful whether the IRS may rely on a revenue procedure to invalidate a statutory election (*i.e.*, the QTIP election, and, correspondingly, the reverse QTIP election). [35] Third, the portability temporary regulations appeared to contemplate a QTIP election made on the same federal estate tax return on which a portability election is made where the return is not otherwise required to be filed. [36] The final portability regulations appear to also contemplate this, as the Treasury Department and the IRS did not modify the final portability regulations in this regard. [37]

A further reason is that Rev. Proc. 2001-38 does not operate automatically and the language of Rev. Proc. 2001-38 itself suggests that the estate, and *not* the IRS, is the proper party to trigger the application of the procedure by producing sufficient evidence showing that the estate is entitled to relief. This argument, however, is subject to debate given the estate inclusion battles between estates and the IRS over the jointly owned property rules and regulations under IRC Section 2040(a). The regulations under IRC Section 2040 provide that the entire value of jointly held property is included in a decedent's gross estate unless the executor submits facts sufficient to show that such property was not acquired entirely with consideration furnished by the decedent, or was acquired by the decedent and the other joint owner or owners by gift, bequest, devise, or inheritance. [38] Executors of the estates of joint owners who were the first joint owner to die argued that these regulations permitted them to decide whether to include the entire property in the gross estate of the decedent (and thereby obtain the IRC Section 1014 basis step-up) merely by declining to show any consideration provided by the surviving co-owner(s). The problem with this argument, though, is that IRC Section 2040(a) itself states that gross estate inclusion occurs except to the extent that the property may be shown to have originally belonged to the surviving co-owner. Some courts held favorably in this regard that the entire property was includible in the gross estate of the first joint owner to die, *unless* the executor of such estate provided sufficient evidence of the survivor's contributions. [39]

The Tax Court, however, later adopted the IRS' position that *either* the joint owner's estate *or* the IRS could prove the surviving joint owner's contribution to the joint property. [40] The Tax Court's adoption of the views of the IRS in these cases shows that, despite the language of Rev. Proc. 2001-38 that appears to trigger the procedure's application only upon the affirmative action of the executor of the estate, the IRS may nevertheless be able to invoke Rev. Proc. 2001-38 itself to void an attempted QTIP election in the case where an estate tax return is filed solely to make the portability election and where the QTIP election is not necessary to zero out the federal estate tax.

Thus, advisors eagerly anticipated that the Treasury Department and the IRS would provide guidance on this important question in the final portability regulations. But alack and alas, the Treasury Department and the IRS chose *not* to do so, stating instead that they intend to provide future guidance, by publication to the Internal Revenue Bulletin, to clarify whether a QTIP election made under IRC Section 2056 (b)(7) may be disregarded and treated as null and void when an executor has elected portability of the DSUE amount under IRC Section 2010(c)(5)(A). [41] The timing and substance of any such future guidance remain a mystery.

Until the Treasury Department and the IRS act on this issue, then, caution would appear to be the proper course in planning for the use of the single QTIP-eligible trust approach. Trust and estate attorneys ought to counsel their clients to go ahead and use this approach and plan to make the QTIP, reverse QTIP, and portability elections, but only if the clients are willing to assume the risk that the IRS may ultimately issue negative guidance that would prevent this approach from working as intended. Of course, alternate planning options should always be considered as well.

As a final thought on this issue, planners working with this type of estate plan for clients should consider including language in the IRS Form 706 of the deceased spouse's estate indicating the intention to make the QTIP election in order to establish the deceased spouse's DSUE amount and port that amount to the surviving spouse via the portability election, *even though* the QTIP election is not needed or effective to reduce the federal estate tax liability of the deceased spouse's estate.

Order of Credits. One commentator suggested a rule to apply in computing the DSUE amount that would provide that the tentative tax is equal to the net estate tax after the application of all available credits. [42] The commentator argued that the applicable credit amount of the deceased spouse should not be applied to the extent that one or more of the estate tax credits under IRC Sections 2012 through 2015 are available to reduce the estate tax of such deceased spouse's estate. [43]

Because the amount of each allowable credit under IRC Sections 2012 through 2015 can be determined only after subtracting the applicable credit amount determined under IRC Section 2010 from the tax imposed by IRC Section 2001, the amount of any credits under IRC Sections 2012 through 2015 are not available, or remain unused, to the extent that the applicable credit amount is applied to reduce the tax imposed by IRC Section 2001 to zero. [44] Accordingly, the commentator's proposal would, if accepted, have the effect of increasing the DSUE amount to be ported to the surviving spouse in these cases.

The Treasury Department and the IRS pointed out, however, that the rules set forth in IRC Section 2010(c)(4) for calculating the DSUE amount do not take into account any of the unused credits arising under IRC Sections 2012 through 2015. [45] Thus, the Treasury Department and the IRS concluded that no adjustment to the calculation of the DSUE amount on account of any unused credits is warranted, and issued clarifying final regulations providing that a deceased spouse's estate's eligibility under IRC Sections 2012 through 2015 for credits against the estate tax does *not* impact the computation of the DSUE amount. [46]

Conclusion

Portability and the many complicated estate planning and estate administration issues it carries with it are a reality. Estate planners should make portability a point of discussion with virtually all of their married clients in addition to those of their clients who are executors of estates involving a surviving spouse. Planners, however, need to fully understand and inform their clients about portability's rules of the road, including those set forth in the final regulations, in order to best advise their clients. Likewise, planners need to keep abreast of future developments involving portability, particularly given the important questions that remain unanswered, such as the applicability of Rev. Proc. 2001-38.

Footnotes

a0 Thompson Hine LLP
Cleveland, Ohio

1 Pub. L. 111-312, H.R. 4853, 124 Stat. 3296.

2 Id. at §§ 301 et seq.

3 Pub. L. 112-240, H.R. 8, 126 Stat. 2313.

4 Id. at §§ 101(a)(2), 101(c)(2).

5 T.D. 9725, 80 Fed. Reg. 34279 (June 16, 2015).

6 In Obergefell v. Hodges, 576 U.S. _____ (2015), decided on June 26, 2015, the United States Supreme Court held that the Fourteenth Amendment to the United States Constitution guarantees a fundamental right to the recognition and provision of same-sex marriage. The case requires all states to (i) issue a marriage license between people of the same gender, and (ii) recognize same-sex marriages that are validly performed in other jurisdictions.

7 I.R.C. § 2010(c)(5)(A).

8 See Notice 2012-21, 2012-10 IRB 450; Rev. Proc. 2014-18, 2014-7 IRB 513.

9 See Treas. Regs. § 20.2010-2(a)(1).

10 See Rev. Proc. 2014-18, 2014-7 IRB 513, Section 2.03.

11 See Treas. Regs. § 20.2010-2(a)(1).

12 See I.R.C. §§ 2010(c)(5)(A), 6075(a), 6018(a); Treas. Regs. § 301.9100-1(b).

13 I.R.C. §§ 2010(c), 2505(a).

14 See Treas. Regs. §§ 20.2010-2(b), 20.2010-2(a)(7), 20.2010-2(a)(3)(i).

15 See 2015 Tax Notes Today 56-13 (March 24, 2015).

16 T.D. 9725, 80 Fed. Reg. 34279 (June 16, 2015), at Section 3 of Supplemental Information; See I.R.C. § 2010(c)(5), Temporary Regulation § 20.2010-1T.

17 See Treas. Regs. §§ 20.2010-2(a)(6)(i), 20.2010-2(a)(6)(ii).

18 See 2015 Tax Notes Today 56-13 (March 24, 2015).

19 Id.

20 Id.

21 See T.D. 9725, 80 Fed. Reg. 34279 (June 16, 2015), at Section 4 of Supplemental Information; "Technical Explanation of the Revenue Provisions Contained in the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010' Scheduled for Consideration by the United States Senate," J. Comm. on Tax'n, 111th Cong., JCX-55-10 (December 10, 2010).

22 See Temporary Regulation § 20.2010-3T(c)(2).

23 See Treas. Regs. §§ 20.2010-2(c)(4), 20.2010-3(c)(3), 25.2505-2(d)(3).

24 See Treas. Regs. §§ 20.2010-3(c)(2), 25.2505-2(d)(2).

25 Id. See also Treas. Regs. §§ 20.2010-3(c)(3), 25.2505-2(d)(3).

26 Rev. Proc. 2001-38, 2001-1 C.B. 1335.

27 See Saccogna, Portability: Estate Planning in the New Frontier, 25 PLJO 6 (July/August 2015).

28 I.R.C. § 2652(a)(3).

29 See Saccogna, Portability: Estate Planning in the New Frontier, 25 PLJO 6 (July/August 2015).

30 Id.

31 See Rev. Proc. 2001-38, 2001-1 C.B. 1335.

32 Id.

33 I.R.C. § 2652(a)(3); Treas. Regs. §§ 26.2652-2(a), 26.2652-2(b).

34 See Franklin, Law & Karibjanian, Portability - The Game Changer (American Bar Association Real Property, Trust & Estate Law, January 2013).

35 See Aucutt, ACTEC Capital Letter No. 34, Priority Guidance Plan Published, Commissioner Nominated (Aug. 12, 2013).

36 See Temporary Regulation § 20.2010-2T(a)(7)(ii)(A)(4).

37 See Treas. Regs. § 20.2010-2(a)(7)(ii)(A)(4).

38 See Treas. Regs. § 20.2040-1(a)(2).

39 See Tuck v. United States, 282 F.2d 405 (9th Cir. 1960); English v. United States, 270 F.2d 876 (7th Cir. 1959); Estate of Saunders v. Comm., 14 T.C. 534 (1950); and Rule v. United States, 105 Ct. Cl. 176, 63 F. Supp. 351 (1945).

40 See Madden v. Comm., 52 T.C. 845 (1969); and Estate of Fleming v. Comm., T.C. Memo. 1974-377.

41 T.D. 9725, 80 Fed. Reg. 34279 (June 16, 2015), at Section 8 of Supplemental Information.

42 T.D. 9725, 80 Fed. Reg. 34279 (June 16, 2015), at Section 10 of Supplemental Information.

43 Id.
44 Id.
45 Id.
46 See Treas. Regs. § 20.2010-2(c)(3).

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