# YOU CAN'T TAKE IT WITH YOU... BUT YOUR SPOUSE CAN!: HOW PORTABILITY WORKS AND WHAT IT MEANS FOR YOU AND YOUR CLIENTS

Presented by

BRETT T. BERLY

Prepared by

BRETT T. BERLY
and
JULIE G. EDELMAN

CHAMBERLAIN, HRDLICKA, WHITE, WILLIAMS & AUGHTRY

email: brett.berly@chamberlainlaw.com

email: julie.edelman@chamberlainlaw.com

**HOUSTON**
1200 Smith Street, Suite 1400
Houston, Texas 77002
(713) 658-1818
(800) 342-5829

**ATLANTA** **PHILADELPHIA** **DENVER** **SAN ANTONIO**

# YOU CAN'T TAKE IT WITH YOU... BUT YOUR SPOUSE CAN!: HOW PORTABILITY WORKS AND WHAT IT MEANS FOR YOU AND YOUR CLIENTS

Presented by

BRETT T. BERLY

Prepared by

BRETT T. BERLY
and
JULIE G. EDELMAN

I. BACKGROUND AND INTRODUCTION. Portability allows a surviving spouse to utilize his or her deceased spouse's unused estate tax exclusion amount in addition to his or her individual exclusion amount.

A. Legislative History.

1. Portability first became effective in 2011 as part of the Tax Relief, Unemployment Insurance Reauthorization and Jobs Creation Act of 2010 (the "2010 Tax Act").

2. Portability was set to expire on December 31, 2012 but was made permanent by the American Taxpayer Relief Act of 2012 ("ATRA").

3. While the President's 2014 "Greenbook" budget proposals included provisions reducing the estate tax exclusion amount to $3.5 million, it did not include a proposal to eliminate portability. Thus, it appears that there is support for portability on both sides of the aisle and we should expect that it will be an important element in estate planning for the foreseeable future.

B. Purpose. Portability attempts to simplify estate planning and level the estate tax playing field between those who engage in sophisticated estate planning and those who do not.

1. Trust Planning. Portability allows spouses to fully utilize both spouses' exclusion amounts without the use of a "bypass" or "credit shelter" trust. Traditional planning techniques involve the funding of a bypass trust at the death of the first spouse to die in order to take advantage of his or her exclusion amount. At the death of the second spouse to die, the bypass trust is not subject to the estate tax.

a. Example. H and W have a combined estate of $8 million, comprised entirely of community property ("CP"). For purposes of this example, assume a $5 million exclusion amount.

i. Pre-Portability.

(a) Simple Wills. H dies, leaving his $4 million estate outright to W. No tax is due as a result of H's death. At W's subsequent death, her estate is $8 million, resulting in estate tax (the "estate-stacking" dilemma).

(b) Tax-Planned Wills. H dies, leaving his $4 million estate to a bypass trust for the benefit of W. No tax is due as a result of H's death. At W's subsequent death, the assets of the bypass trust are not included in her estate for estate tax purposes. W's gross estate for estate tax purposes totals only $4 million, so no tax is due as a result of her death.

ii. Post-Portability.

(a) Simple Wills. H dies, leaving his $4 million estate outright to W. No tax is due as a result of H's death. Because H's estate passes to W outright, qualifying for the marital deduction, H does not use any of his available exclusion amount. H's executor timely files an estate tax return electing spousal portability. At W's subsequent death, H's unused $5 million exclusion is available to W. W has a $10 million exclusion to fully shield her $8 million estate.

## II. DETERMINING THE AMOUNT OF A DECEDENT'S PORTABLE EXCLUSION.

A. Deceased Spousal Unused Exclusion Amount. Under the Internal Revenue Code (the "Code"), the amount of a decedent's unused exclusion is known as the "deceased spousal unused exclusion amount" (the "DSUE amount"). The DSUE amount is the lesser of:

1. The basic exclusion amount (in effect in the year of the deceased spouse's death); or

2. The excess of:

a. The applicable exclusion amount of the last such deceased spouse of such surviving spouse, over

b. The amount with respect to which the tentative tax is determined under Section 2001(b)(1) on the estate of such deceased spouse.[1]

3. Applicable Exclusion Amount. The "applicable exclusion amount" is the sum of:

a. The basic exclusion amount; and

b. In the case of a surviving spouse, the deceased spousal unused exclusion amount.[2]

4. Basic Exclusion Amount. The "basic exclusion amount" is $5,000,000, indexed for inflation.[3]

5. Estate and Gift Tax Exclusion. Portability applies to the decedent's unused estate and gift tax exclusion amount.

a. The GST tax exclusion is not portable.

6. Not Adjusted for Inflation. Although the basic exclusion is adjusted for inflation, the DSUE amount is not similarly adjusted and is therefore "set in stone" as of the decedent's date of death.

## III. ESTATES ELIGIBLE TO TRANSFER THE DSUE AMOUNT.

A. Decedents Who Died After 2010. A decedent's unused exclusion is only portable if the decedent died after December 31, 2010.[4]

B. Married Persons. A decedent's unused exclusion is only portable if he or she is survived by a spouse.

1. Surviving children will not be able to use a parent's unused exclusion for their own personal planning.

2. The Defense of Marriage Act defined marriage as the legal union of one man and one woman for federal purposes. After the decision in *Windsor v. United States*, however, portability may be available for same sex couples.

C. U.S. Citizens and Residents. Only deceased U.S. citizens and residents are able to transfer their unused exclusion.

---

1 I.R.C. § 2010(c)(4).
2 I.R.C. § 2010(c)(2).
3 I.R.C. § 2010(c)(3).
4 I.R.C. § 2010(c)(4).

1. Estates of deceased non-U.S. citizen/non-residents are not eligible to make a portability election.[5]

2. Estates of deceased U.S. citizens or residents married to non-U.S. citizens are eligible for a portability election, however, absent a treaty provision to the contrary, the use of a Qualified Domestic Trust (a "QDOT") is required and the DSUE amount may be subject to an adjustment upon the final distribution of the QDOT or the survivor's death.[6]

IV. MAKING THE ELECTION. An election is required in order to take advantage of a decedent's unused exclusion.

A. How Election Is Made. The portability election is made on a timely filed United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) for the deceased spouse's estate.[7] On the Form 706 for 2013, the election is made in Part 6 (page 4). *See Exhibit 1.*

1. Opting Out of Portability. The Executor may opt out of portability by checking the box in Section A of Part 6 of the Form 706. *See Exhibit 1.*

B. Who Makes the Election.

1. The portability election is made by the executor or administrator of the decedent's estate.[8]

a. If there are multiple executors or administrators, then they all must sign.[9]

2. If there is no appointed executor or administrator, any person in actual or constructive possession of any property of the decedent may file the estate tax return and make the election.[10]

C. Simplified Approach for Smaller Estates. For estates that do not meet the required filing threshold for Form 706, the value of property qualifying for the marital deduction or the charitable deduction can be estimated in certain circumstances.[11]

1. The executor can estimate the value of property qualifying for the marital and charitable deductions, rounded to the nearest $250,000.

---

5 Reg. § 20.2010-2T(a)(5).
6 Reg. § 20.2010-2T(c)(4).
7 Reg. § 20.2010-2T(a).
8 I.R.C. § 2010(c)(5).
9 Reg. § 20.6018-2.
10 Reg. § 20.2010-2T(a)(6)(ii).
11 Reg. § 20.2010-2T(a)(7)(ii).

a. The Instructions to the 2013 Form 706 provide that the estimated values are not required to be included on Schedules A – I next to the descriptions of such properties, however, their aggregate values are required to be included on the new line 10 of Part 5 - Recapitulation of the return. *See Exhibit 2.*

2. The executor must report the description, ownership and beneficiary of the property qualifying for the marital and charitable deductions. The executor must also include all information necessary to establish the right of the estate to such deductions.

3. The executor must exercise due diligence to estimate the fair market value of the gross estate that qualifies for the deductions.[12]

4. This exception does not apply to marital deduction property or charitable deduction property if:

a. The value of such property relates to, affects, or is needed to determine the value passing from decedent to another recipient;

b. The value of such property is needed to determine the estate's eligibility for 2032, 2032A, 6166 or another provision of the Code;

c. Less than the entire value of an interest in property is marital deduction property or charitable deduction property; or

d. A partial disclaimer or partial QTIP election is made with respect to a bequest, devise or transfer of property includible in the marital deduction property or charitable deduction property.[13]

5. Disadvantages to Using Simplified Approach.

a. The simplified approach may be a missed opportunity to establish the basis of property passing to surviving spouse.

b. For probate assets, the executor will still have to determine a value for purposes of the probate inventory.

D. Irrevocable. The portability election, once made, becomes irrevocable once the Form 706 due date, including extensions actually granted, has passed.[14]

1. However, an executor of the estate of a decedent who timely files an estate tax return may make and may supersede a portability election

12 Reg. § 20.2010-2T(a)(7)(ii)(B).
13 Reg. § 20.2010-2T(a)(7)(ii).
14 Reg. § 20.2010-2T(a)(1).

previously made, provided that the estate tax return reporting the decision not to make a portability election is filed on or before the due date of the return (including extensions).[15]

2. A portability election made by a non-appointed executor of a decedent's estate cannot be superseded by a contrary election made by another non-appointed executor of such decedent's estate (unless such other non-appointed executor is the successor of the non-appointed executor who made the election).[16]

E. Return Must Be Timely Filed (Including Extensions). The language of Section 2010 of the Code and the Regulations is clear that the portability election must be made on a timely filed Form 706.

1. Because the election is statutory in nature (and not merely created pursuant to regulations), the original position of the IRS had been that it is not authorized to grant relief for late elections under Reg. § 301.9100-3.

2. Rev. Proc. 2014-18 revised this position somewhat. In it the IRS (i) took the position that if a return was not required to be filed (i.e., the decedent's gross estate and adjusted taxable gifts were below the filing threshold), then the portability election became regulatory in nature and thus eligible for relief under Reg. § 301.9100-3 and (ii) granted an extension to file the Form 706 for portability purposes until December 31, 2014 for the estates of decedents falling in this category and who died between January 1, 2011 and December 31, 2013.

3. Reg. § 301.9100-2 only provides relief for failure to make a statutory election on a timely filed return if corrective action is taken within six months of the original due date.

## V. EXECUTOR'S CONSIDERATIONS REGARDING MAKING AN ELECTION.

A. Cost of Preparation of Form 706. The primary disadvantage of the portability election is the cost associated with the preparation of the Form 706.

B. Possible Conflicts of Interests.

1. The benefit of the portability election flows to the surviving spouse (who will have more exclusion available to make lifetime gifts) as well as the beneficiaries of the surviving spouse's estate. However, the cost of the preparation of the federal estate tax return is paid by the decedent's estate, and thereby reduces the benefit to the beneficiaries

---

15 *Id.*

16 Reg. § 20.2010-2T(a)(6)(ii).

of the decedent's estate. Where the beneficiaries of the two estates are different, or the surviving spouse is not named as executor, there could be some disagreement as to whether or not a return should be filed.

a. Example. H and W each have children from prior marriages. H dies with a $3 million estate, leaving $1 million outright to W and the residue of his estate to his children. W's children are the beneficiaries under her Will.

i. If W Is Named as Executor. She will likely want to file a Form 706 for H's estate, so that his unused $3 million exclusion is available to her. Depending on the expense apportionment provisions in H's Will, the costs of preparation of the 706 may come from the residue passing to H's children. If so, H's children bear the cost of the preparation of the Form 706, although they are not likely to benefit from the election.

ii. If H's Children Are Named as Executors. Depending on their relationship with W and W's children, H's children may decide not to file a Form 706, as the benefit would flow to W's children.

2. The potential conflict may be exacerbated where property is left to a trust for which a QTIP election may be made.

a. Example. H and W each have children from prior marriages. H has a $4 million estate. W has an $8 million estate. H dies, leaving his estate to a QTIP-able trust for W (H's children are remainder beneficiaries).

i. W Is Named as Executor of H's Estate. W files a Form 706 for the estate, electing both QTIP treatment for the trust and spousal portability. As a result, W is able to capture all of H's exclusion amount and she has $10 million exclusion amount available to her. At W's subsequent death, she leaves her estate to her children. Her $8 million estate is fully covered. However, only $2 million of the QTIP trust property is covered. The remaining $2 million is subject to estate tax, payable from the trust property if the provisions of Section 2207A of the Code are applicable. W's children have benefited from the QTIP and portability elections, while the elections caused H's children to incur estate tax that would not otherwise have been payable on a $4 million estate.

ii. H's Children Are Named as Executor of H's Estate. H's children may decide not to incur the costs of preparation of a Form 706 because the estate is below the filing requirement.

3. Some planners have suggested that in situations like the above examples, it may be advisable to include language in the Will which addresses this issue. For example:

a. The Will can include provisions that grant the executor discretion to make the election (and relieve them of liability for whatever decision they make) or it can mandate that an election be made.

b. Furthermore, the Will can address whether any costs of return preparation should be borne by the surviving spouse or the residue of the estate.

c. Finally, the Will can provide an alternative to Section 2207A for purposes of allocating the estate taxes due.

VI. CONCERNS FOR PRACTITIONERS. Practitioners must advise their client of the option to file a federal estate tax return to elect portability.

A. Ultimately, the decision to file a Form 706 for portability purposes belongs to the executor. If the executor decides not to make the election, it is important to have something in writing indicating that the client was advised of the election, and they made the decision not to file. *See Exhibits 3 and 4 for examples of letters to spouse/executors and non-spouse/executors regarding the risks and rewards of filing a Form 706 for portability purposes.*

B. In certain circumstances, it may be wise to have the other beneficiaries sign a letter acknowledging that they have been informed of the executor's decision not to file a Form 706. *See sample letter to beneficiaries attached as Exhibit 5.*

VII. SURVIVING SPOUSE'S USE OF THE DSUE AMOUNT.

A. Limited to the Unused Exclusion Amount of the Last Deceased Spouse. In the event of remarriage, the benefit of the unused exclusion amount of the first spouse to die is lost only if a subsequent spouse also predeceases the surviving spouse. The identity of the "last deceased spouse" is unchanged by a subsequent marriage or divorce.[17]

1. Examples. H dies, leaving his estate outright to W, not using any of his $5 million exclusion amount. A portability election is made on a timely

[17] Reg. § 20.2010-3T(a)(3).

filed Form 706 for H's estate. As a result, W has a $5 million DSUE amount in addition to her individual exclusion amount. W marries H2.

a. W Predeceases H2. H1's DSUE amount is still available to W's estate.

i. Furthermore, any amounts not used by W will be available for H2 as DSUE (including the surplus from H1's DSUE). ATRA confirmed this result through a technical correction as the statute as originally written was not consistent with the Joint Committee on Taxation's report.

b. W and H2 Divorce. H1's DSUE amount is still available to W.

c. W Outlives H2. H1's DSUE amount is no longer available to W. Only H2's DSUE amount is available to W's estate.

i. In this scenario, it would have been advisable for W to use H1's DSUE amount to make lifetime gifts (to avoid the possibility of H2 predeceasing W and wiping out H1's DSUE amount).

B. Lifetime Gifts Made by Surviving Spouse. As indicated in the previous example, the DSUE amount can be applied to gifts made by the surviving spouse during his or her lifetime.

1. The DSUE amount is first applied to gifts made during surviving spouse's lifetime.

2. If surviving spouse has DSUE amount and is making lifetime gifts, DSUE amount will be used first before surviving spouse's individual exclusion amount.[18]

3. The DSUE amount must be reflected on Schedule C (page 4) of the 2013 United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709). *See attached Exhibit 6.* According to the instructions for the 2013 Form 709, a copy of the deceased spouse's 706 making the portability election must be attached. Additionally, all of the following information must be provided on Schedule C:

a. Name of deceased spouse (for dates of death after December 31, 2010 only);

b. Date of death;

c. Whether portability election was made;

[18] Reg. § 25.2505-2T(b).

i. If "yes," DSUE amount received;

d. DSUE amount applied by donor to lifetime gifts; and

e. Date of gifts.

C. Although the DSUE amount is limited to the last deceased spouse, it is possible to use the DSUE amount of more than one deceased spouse if lifetime gifts are made.

1. Example. H1 dies, survived by W. H1's unused exclusion amount is available to W. W makes lifetime gifts, applying the DSUE amount from H1. W marries H2 and continues making lifetime gifts using the DSUE amount from H1. H2 dies. While H1's exclusion amount is no longer available to W, H2's exclusion amount is now available to W. W can continue to make lifetime gifts using H2's exclusion amount.

D. Death of Surviving Spouse.

1. DSUE amount must be reflected on Schedule D (page 4) of the 2013 Form 706. *See attached Exhibit 1.* All of the following information must be provided:

a. Name of deceased spouse;

b. Date of death;

c. Whether portability election was made;

i. If "yes," DSUE amount received;

d. DSUE amount applied by decedent to lifetime gifts;

e. Year of Form 709 reporting use of DSUE amount; and

f. Remaining DSUE amount.

2. Multiple Deceased Spouses and Previously-Applied DSUE Amount. A special rule applies to compute the DSUE amount included in the applicable exclusion amount of a surviving spouse who previously has applied the DSUE amount of one or more deceased spouses to taxable gifts.[19]

a. If a surviving spouse has applied the DSUE amount of one or more last deceased spouses to lifetime gifts and if any of those last deceased spouses is different from the surviving spouse's last deceased spouse at the time of the surviving spouse's

[19] Reg. § 20.2010-3T(b)(1).

death, then the DSUE amount to be included in determining the applicable exclusion amount of the surviving spouse at the time of the surviving spouse's death is the sum of:

i. The DSUE amount of the surviving spouse's last deceased spouse; and

ii. The 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.[20]

E. Special Rule for Property Held in a QDOT. As discussed above, the DSUE amount may be adjusted from its original value if the deceased spouse was survived by a non-US citizen spouse and a QDOT was required to be used.[21]

1. The DSUE amount is initially computed on the decedent's Form 706 in the same manner discussed above.

2. The DSUE amount is redetermined, however, 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 the surviving spouse) on which estate tax is imposed under Section 2056A of the Code.[22]

3. The Regulations provide the following example:

a. Facts. During his lifetime, H makes gifts of $1,000,000. At his death in 2011, H has a gross estate of $2,000,000. H's wife, W, is a US resident, but not a citizen. H's Will makes a specific bequest of $1,500,000 to a QDOT for W's benefit and leaves the residue of his estate ($500,000) to his children from a previous marriage. A timely Form 706 is filed for H's estate and determines that the preliminary DSUE amount is $3,500,000. W dies in 2013 and the value of the assets in the QDOT are now $1,800,000.

b. Application. H's DSUE amount is redetermined to be $1,700,000 (the lesser of the basic exclusion in 2011, or the excess of H's $5,000,000 applicable exclusion over $3,300,000 (the sum of the taxable estate augmented by the $1,800,000 QDOT value and the $1,000,000 adjusted taxable gifts)).[23]

---

20 *Id.*

21 Reg. § 20.2010-2T(c)(4).

22 *Id*.

23 Reg. § 20.2010-2T(c)(5) *Example 3*; Reg. § 20.2010-3T(c)(2).

F. IRS' Authority to Examine Returns of Deceased Spouses.

1. For the purpose of determining the DSUE amount to be included in the applicable exclusion amount of the surviving spouse, the IRS may examine the returns of each of the surviving spouse's deceased spouses whose DSUE amount is claimed to be included, regardless of whether the period of limitations on assessment has expired for any such return.[24]

2. This does not affect the statute of limitations for tax on a deceased spouse's estate.[25]

3. If the surviving spouse applies the DSUE amount to lifetime gifts, what is the effect on the statute of limitations for gift tax?

VIII. PLANNING WITH PORTABILITY. Portability is a factor to be considered not only at the death of the first spouse to die, but also in the planning process.

A. Benefits. Portability may be a helpful tool in certain situations.

1. Significant Non-Probate Assets. Portability is helpful for married couples with significant non-probate assets. Traditionally, the only way to utilize a spouse's exclusion amount would be to name the testamentary Trustee as beneficiary of non-probate assets in order to make such assets available to fund the bypass trust. However, there are issues involved in naming a trust as the beneficiary of certain retirement plans. With portability, it is possible to leave a retirement plan outright to the surviving spouse (who can do a rollover) and the surviving spouse can still use the decedent's exclusion amount.

2. Low Basis Assets. Historically, the tradeoff with the funding of the bypass trust was that although the assets of the bypass trust (and any appreciation thereof) were exempt from estate tax at the death of the surviving spouse, they did not receive a second step-up in basis at the death of the surviving spouse. Now that the funding of a bypass trust is no longer the only way to take advantage of a decedent's exclusion amount, it may be possible to use both spouses' exclusion amounts and still get the second step-up in basis.

a. However, the appreciation in the property is now exposed to the estate tax, and the DSUE amount is not adjusted for inflation.

b. The estate tax on the assets of the deceased spouse's estate (and the appreciation thereof) must be weighed against the income tax on the gain from such assets.

---

[24] Reg. § 20.2010-3T(d).

[25] *Id.*

i. This is a very asset specific analysis.

ii. Factors to consider:

(a) Timing. Estate tax is payable nine months after death of the surviving spouse, while income tax recognition events may be deferred for years following a death.

(b) Trigger. Estate tax arises from a non-economic (and often unpredictable) occurrence rather than some type of recognition event under income tax law. Thus, estate tax may present a larger burden.

3. Disparate Wealth. Portability may simplify planning for married couples where one spouse has significant separate property and the other spouse's estate is well below the exclusion amount. Portability allows the spouses to utilize both spouses' exclusion amounts without having to transfer assets to the non-propertied spouse.

a. Example. W has $8 million SP estate. H and W have $2 million CP estate. For purposes of this example, assume a $5 million exclusion amount.

i. Pre-Portability.

(a) No Tax Planning. H dies first, leaving his estate to W. Although no tax is due at H's death because his estate is only his ½ of the $2 million CP, H and W are not using any of H's exclusion amount to shelter W's $8 million SP estate. Whether H's $1 million passed to W outright or in a bypass trust, at W's subsequent death, her estate totals at least $9 million, resulting in estate tax.

(b) Tax-Planned Wills. H and W engage in tax planning and W converts her SP assets to CP. H predeceases W, leaving his estate to a bypass trust for W. H now has sufficient assets to take advantage of his available exclusion amount. Again, no estate tax is due as a result of H's death. Upon W's subsequent death, only her one-half of the community ($5 million) is included in her estate for estate tax purposes, so no estate tax is due as a result of her death.

ii. Post-Portability.

(a) No Tax Planning. H dies, leaving his $1 million estate outright to W. A 706 is timely filed for H's estate. Upon W's subsequent death, she has H's unused $5 million exclusion amount available to her, as well as her $5 million individual exclusion amount. No estate tax is due as a result of W's death.

B. Drawbacks. The question is to what extent portability should be relied upon in estate planning. The following are some of the associated risks.

1. Dependent on Further Action. The DSUE amount is only available to the surviving spouse if the executor of the deceased spouse's estate timely files a Form 706.

a. As discussed above, one possible way to mitigate this risk is to include language in the Will directing that an election be made.

2. No Inflation Adjustment. The DSUE amount is not adjusted for inflation.

a. When a bypass trust is funded, both the trust property and any appreciation thereof is removed from the estate of the surviving spouse.

3. Remarriage. The DSUE amount of a deceased spouse is wiped out if surviving spouse remarries and is predeceased by his or her second spouse.

a. The DSUE amount of second deceased spouse then becomes available, but this may come with the complications and possible conflicts of interests where there are children from prior marriages.

4. GST Exclusion. GST exclusion amount is not portable. In order to utilize the deceased spouse's GST exclusion amount, it is necessary to create a trust at the death of the deceased spouse.

5. Legislative Uncertainty. The laws on portability could change.

C. The Portability Overlay on Common Estate Plans.

1. Traditional Bypass Trust Planning. At the death of the first spouse to die, his or her exclusion amount passes to a bypass trust for the benefit of the surviving spouse, and any amount in excess of the exclusion amount passes into a marital trust which qualifies for the marital deduction.

a. Advantages.

i. Estate Tax. Property held in the bypass trust (and appreciation thereof) is not subject to estate tax at the death of the surviving spouse.

ii. GST Tax. Utilizes deceased spouse's GST exclusion amount.

iii. Immediate Use of the DSUE Amount. Use of the DSUE amount of the deceased spouse is not dependent upon or affected by:

(a) Status of portability laws;

(b) The surviving spouse's decision to remarry and possibly be limited to the new spouse's DSUE amount; and

(c) The executor's decision of whether or not to file a Form 706.

iv. Standard Trust Protection.

(a) Creditors. Bypass trust assets are protected from creditors of the surviving spouse.

(b) Remarriage. Bypass trust assets are protected in the event the surviving spouse remarries and divorces. Assets in the bypass trust should not be characterized as community property and therefore are not on the table for a just and right division upon divorce.

(c) Disposition at Death of the Surviving Spouse. Deceased spouse can direct the disposition of the bypass trust assets at the death of the surviving spouse.

b. Disadvantages.

i. Income Tax.

(a) Bypass trust assets do not receive a second step-up in basis at the death of the surviving spouse.

(b) Trusts are subject to the highest tax brackets at much lower thresholds than individuals.

c. Fiduciary Duty. Trustees owe a fiduciary duty to all of the beneficiaries of the trust. This can create tension where the surviving spouse is named as Trustee but the deceased spouse's children from a prior marriage are the remainder beneficiaries.

d. Compliance Costs. Trust administration necessarily involves the compliance costs associated with a trust, including the annual filing of a Form 1041, attorney's fees and other expenses.

2. Outright to Surviving Spouse. At the death of the first spouse to die, his or her estate passes outright to the surviving spouse.

a. Advantages.

i. Simplicity. This avoids the hassle associated with trust administration.

ii. Income Tax. At the death of the surviving spouse, the entire estate will receive a second step-up in basis.

b. Disadvantages.

i. Estate Tax. The assets comprising the estate of the deceased spouse (and appreciation thereof) are included in the gross estate of the surviving spouse.

ii. GST Tax. The GST tax exclusion of the deceased spouse is lost.

iii. Cost of Preparation of a Form 706. The Executor must prepare and file a Form 706 in order to elect spousal portability, although assets of the estate may be well below the filing requirement.

(a) Simplified approach is available.

(b) Preparation of return is helpful to establish record of new basis of assets.

iv. Legislative Uncertainty. The availability of the deceased spouse's exclusion amount is dependent upon the status of portability laws. This plan presumes that portability will remain a part of the federal transfer tax system for the foreseeable future.

v. Risk that Executor Fails to Make Election. Executor must timely file a Form 706 in order to elect portability.

(a) As discussed above, clients can include language in their Wills which may mitigate the risk that the Executor fails to timely make the election.

vi. Risk of Remarriage. If the surviving spouse remarries and is subsequently predeceased by the second spouse, the DSUE amount of the first deceased spouse is lost.

(a) This risk may be mitigated if the surviving spouse makes lifetime gifts prior to the death of the second spouse utilizing the first deceased spouse's DSUE amount.

vii. No Trust Protection.

(a) Creditors. Assets passing outright to the surviving spouse are subject to the creditors of the surviving spouse.

(b) Remarriage. If the surviving spouse remarries, the assets could become commingled and therefore subject to just and right division in divorce proceedings.

(c) Disposition at Death of Surviving Spouse. The surviving spouse controls the disposition of assets at his or her death without limitation.

3. Outright to Surviving Spouse with Disclaimer to Bypass Trust. At the death of the first spouse to die, his or her estate passes outright to the surviving spouse, with a provision in the Will that any part of this gift disclaimed by the surviving spouse will pass into a bypass trust.

a. Flexibility. The decision between options (i) and (ii) can be delayed until the death of the first spouse to die.

i. If (i) portability is in place at the death of the first spouse; and (ii) the benefits of a step-up in basis outweigh the cost of appreciation being included in the surviving spouse's estate → no disclaimer is filed and portability election is made → property passes outright to surviving spouse.

(a) The benefits and drawbacks of an outright disposition are those described in (ii) above.

ii. If (i) portability is not in place at the death of the surviving spouse; or (ii) portability is in place but the

executor determines that it would be better to have the appreciated assets out of the surviving spouse's estate → surviving spouse disclaims all or part of the outright gift and the bypass trust is funded.

(a) The benefits and drawbacks of funding the bypass trust are those described in (i) above, with a couple of additional drawbacks:

(1) The surviving spouse cannot hold a power of appointment over the bypass trust property.

(2) The plan is dependent upon the surviving spouse disclaiming.

4. All to a QTIP Trust. At the death of the first spouse to die, his or her estate passes to a QTIP-able marital trust. The executor can either: (i) make a partial or full QTIP election (qualifying the trust for the estate tax marital deduction); or (ii) refrain from making such an election, in which case the trust would function as a bypass trust.

a. Flexibility. This approach buys more time. The decision of whether to make the QTIP election or fund the bypass trust is delayed until the death of the first spouse to die.

i. If (i) portability is in place at the death of the first spouse; and (ii) the benefits of a step-up in basis outweigh the cost of appreciation being included in the surviving spouse's estate → the executor makes the QTIP election on a timely filed Form 706, also electing portability.

ii. If (i) portability is not in place at the death of the first spouse to die; or (ii) portability is in place and the executor determines that it would be better to have the appreciated assets out of the surviving spouse's estate → the executor declines to make the QTIP election (but still elects portability, if available).

(a) In this case, the trust would function as a bypass trust and the benefits and drawbacks are the same as those described in (i) above, with one additional drawback:

(1) Because the trust was structured to qualify for the marital deduction, there can be no other permissible beneficiaries of

the trust during the surviving spouse's lifetime.

b. Advantages of Executor Making a QTIP Election.

i. Income Tax. At the death of the surviving spouse, the assets of the QTIP trust will receive a second step-up in basis.

ii. GST Tax. Although the GST tax is not portable, in the case of a QTIP trust, it is possible to have the deceased spouse treated as the transferor for GST tax purposes by making a reverse QTIP election.

iii. Standard Trust Protection.

(a) Creditors. The trust assets are protected from creditors of the surviving spouse.

(b) Remarriage. The trust assets are protected in the event the surviving spouse remarries and divorces. The assets in the trust maintain their separate property character and therefore are not on the table for a just and right division.

(c) Disposition at Death of Surviving Spouse. The deceased spouse can direct the disposition of the trust assets at the death of the surviving spouse.

c. Disadvantages to Executor Making QTIP Election.

i. Estate Tax. The QTIP trust (and any appreciation thereof) is included in the gross estate of the surviving spouse for estate tax purposes.

ii. Legislative Uncertainty. Availability of the deceased spouse's exclusion amount is dependent upon the status of portability laws at the death of the surviving spouse.

iii. Risk of Remarriage. If the surviving spouse remarries and is subsequently predeceased by his or her second spouse, the DSUE amount from the first deceased spouse is lost. Furthermore, the property held in the QTIP trust generally will not be available for the surviving spouse to gift during his or her lifetime (absent 5 or 5 powers, etc.).

iv. Compliance Costs of Trusts. This involves the administrative costs associated with trust, including the annual filing of a Form 1041.

v. No Other Beneficiaries. In order to qualify for the marital deduction, during the surviving spouse's lifetime there can be no other permissible beneficiaries of the QTIP trust.

vi. Rev. Proc. 2001 – 38. In Rev. Proc. 2001-38, the IRS stated that QTIP elections on estate tax returns that are not necessary to eliminate estate tax liability are void for estate tax purposes. *See Exhibit 7 for copy of Rev. Proc. 2001-38*.

(a) Issued to avoid the need for private letter ruling requests where a QTIP election was mistakenly made.

(b) Some commentators have raised the concern that this precludes a full QTIP election being made for the purpose of a basis increase when a trust exists that would otherwise be a bypass trust.

5. QTIP Trust with Disclaimer to Bypass Trust. At the death of the first spouse to die, his or her estate passes to a QTIP-able marital trust. The Will provides that any amount of the residue which is disclaimed by the surviving spouse passes into a bypass trust.

a. This approach provides the same flexibility and involves the same analysis discussed in (iv) above, but there are a couple of important distinctions between the marital trust functioning as a bypass trust and the disclaimer into a separate bypass trust.

i. Benefit to Using the Disclaimer Approach.

(a) There can be other permissible beneficiaries of the bypass trust.

ii. Drawbacks to Using the Disclaimer Approach.

(a) Because the property passes by disclaimer, the surviving spouse cannot be given a power of appointment over the bypass trust.

(b) The plan is dependent upon the surviving spouse filing a disclaimer.

D. Advising Clients.

1. Planning approach will depend on a number of factors, including:

a. The size of the couple's estate;

b. The nature of the assets (high/low basis, highly appreciable, etc.);

c. Family dynamics; and

d. Age and health of the spouses.

2. It will be necessary to gather more information from a client in an initial planning meeting.

IX. CONCLUSION. Portability is a valuable tool for estate planners but has a lot of intricacies that must be fully understood and considered in order to best advise clients.

A. Estate Administration. At the estate administration level, planners must advise their clients of the option to elect spousal portability. If the client decides not to file a Form 706 to elect spousal portability, it is important that there be documentation in the file reflecting that the client was advised of portability and decided not to make the election.

B. Estate Planning. Although portability was intended to simplify, it is certainly a complicating factor at the planning level. While it may be appropriate in certain circumstances to plan with portability, there are many risks involved, including the risk that the portability laws change. For a client who is motivated by getting a second step-up in basis at the death of the surviving spouse, it may be best to take advantage of the planning techniques that delay the decision until the death of the first spouse to die. At that time, estate planners may have a better sense of whether portability really is "permanent."

Exhibit 1

Form 706 (Rev. 8-2013)

**Estate of:** | **Decedent's social security number**

## Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

### Portability Election

A decedent with a surviving spouse elects portability of the deceased spousal unused exclusion (DSUE) amount, if any, by completing and timely-filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

### Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

### Section B. QDOT

| | Yes | No |
|---|---|---|
| Are any assets of the estate being transferred to a qualified domestic trust (QDOT)? | | |

If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

### Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.)

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

| | | | |
|---|---|---|---|
| 1 | Enter the amount from line 9c, Part 2—Tax Computation | 1 | |
| 2 | Reserved | 2 | |
| 3 | Enter the value of the cumulative lifetime gifts on which tax was paid or payable (see instructions) | 3 | |
| 4 | Add lines 1 and 3 | 4 | |
| 5 | Enter amount from line 10, Part 2—Tax Computation | 5 | |
| 6 | Divide amount on line 5 by 40% (0.40) (do not enter less than zero) | 6 | |
| 7 | Subtract line 6 from line 4 | 7 | |
| 8 | Enter the amount from line 5, Part 2– Tax Computation | 8 | |
| 9 | Subtract line 8 from line 7 (do not enter less than zero) | 9 | |
| 10 | DSUE amount portable to surviving spouse (Enter lesser of line 9 or line 9a, Part 2 – Tax Computation) | 10 | |

### Section D. DSUE Amount Received from Predeceased Spouse(s) (To be completed by the estate of a deceased surviving spouse with DSUE amount from predeceased spouse(s))

Provide the following information to determine the DSUE amount received from deceased spouses.

| A Name of Deceased Spouse (dates of death after December 31, 2010, only) | B Date of Death (enter as mm/dd/yy) | C Portability Election Made? Yes | C No | D If "Yes," DSUE Amount Received from Spouse | E DSUE Amount Applied by Decedent to Lifetime Gifts | F Year of Form 709 Reporting Use of DSUE Amount Listed in col E | G Remaining DSUE Amount, if any (subtract col. E from col. D) |
|---|---|---|---|---|---|---|---|
| **Part 1 — DSUE RECEIVED FROM LAST DECEASED SPOUSE** | | | | | | | |
| | | | | | | | |
| **Part 2 — DSUE RECEIVED FROM OTHER PREDECEASED SPOUSE(S) AND USED BY DECEDENT** | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| **Total** (for all DSUE amounts from predeceased spouse(s) applied) | | | | | | | |

Add the amount from Part 1, column D and the total from Part 2, column E. Enter the result on line 9b, Part 2—Tax Computation ▶

Exhibit 2

Form 706 (Rev. 8-2013)

**Estate of:** | **Decedent's social security number**

**Part 4—General Information** *(continued)*

| **If you answer "Yes" to any of the following questions, you must attach additional information as described.** | | **Yes** | **No** |
|---|---|---|---|
| **10** | Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which **(a)** one or more of the other joint tenants was someone other than the decedent's spouse, and **(b)** less than the full value of the property is included on the return as part of the gross estate? If "Yes," you must complete and attach Schedule E | | |
| **11a** | Did the decedent, at the time of death, own any interest in a partnership (for example, a family limited partnership), an unincorporated business, or a limited liability company; or own any stock in an inactive or closely held corporation? | | |
| **b** | If "Yes," was the value of **any** interest owned (from above) discounted on this estate tax return? If "Yes," see the instructions on reporting the total accumulated or effective discounts taken on Schedule F or G | | |
| **12** | Did the decedent make any transfer described in sections 2035, 2036, 2037, or 2038? (see instructions) If "Yes," you must complete and attach Schedule G | | |
| **13a** | Were there in existence at the time of the decedent's death any trusts created by the decedent during his or her lifetime? | | |
| **b** | Were there in existence at the time of the decedent's death any trusts not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship? | | |
| **c** | Was the decedent receiving income from a trust created after October 22, 1986, by a parent or grandparent? If "Yes," was there a GST taxable termination (under section 2612) on the death of the decedent? | | |
| **d** | If there was a GST taxable termination (under section 2612), attach a statement to explain. Provide a copy of the trust or will creating the trust, and give the name, address, and phone number of the current trustee(s). | | |
| **e** | Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in lines 13a or 13b? If "Yes," provide the EIN for this transferred/sold item. ▶ | | |
| **14** | Did the decedent ever possess, exercise, or release any general power of appointment? If "Yes," you must complete and attach Schedule H | | |
| **15** | Did the decedent have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? | | |
| **16** | Was the decedent, immediately before death, receiving an annuity described in the "General" paragraph of the instructions for Schedule I or a private annuity? If "Yes," you must complete and attach Schedule I | | |
| **17** | Was the decedent ever the beneficiary of a trust for which a deduction was claimed by the estate of a predeceased spouse under section 2056(b)(7) and which is not reported on this return? If "Yes," attach an explanation | | |

**Part 5—Recapitulation. Note.** If estimating the value of one or more assets pursuant to the special rule of Reg. section 20.2010-2T(a)(7)(ii), enter on both lines 10 and 23 the amount noted in the instructions for the corresponding range of values. (See instructions for details.)

| Item no. | Gross estate | | Alternate value | Value at date of death |
|---|---|---|---|---|
| 1 | Schedule A—Real Estate | 1 | | |
| 2 | Schedule B—Stocks and Bonds | 2 | | |
| 3 | Schedule C—Mortgages, Notes, and Cash | 3 | | |
| 4 | Schedule D—Insurance on the Decedent's Life (attach Form(s) 712) | 4 | | |
| 5 | Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance) | 5 | | |
| 6 | Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance) | 6 | | |
| 7 | Schedule G—Transfers During Decedent's Life (att. Form(s) 712 for life insurance) | 7 | | |
| 8 | Schedule H—Powers of Appointment | 8 | | |
| 9 | Schedule I—Annuities | 9 | | |
| 10 | Estimated value of assets subject to the special rule of Reg. section 20.2010-2T(a)(7)(ii) | 10 | | |
| 11 | Total gross estate (add items 1 through 10) | 11 | | |
| 12 | Schedule U—Qualified Conservation Easement Exclusion | 12 | | |
| 13 | Total gross estate less exclusion (subtract item 12 from item 11). Enter here and on line 1 of Part 2—Tax Computation | 13 | | |

| Item no. | Deductions | | Amount |
|---|---|---|---|
| 14 | Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims | 14 | |
| 15 | Schedule K—Debts of the Decedent | 15 | |
| 16 | Schedule K—Mortgages and Liens | 16 | |
| 17 | Total of items 14 through 16 | 17 | |
| 18 | Allowable amount of deductions from item 17 (see the instructions for item 18 of the Recapitulation) | 18 | |
| 19 | Schedule L—Net Losses During Administration | 19 | |
| 20 | Schedule L—Expenses Incurred in Administering Property Not Subject to Claims | 20 | |
| 21 | Schedule M—Bequests, etc., to Surviving Spouse | 21 | |
| 22 | Schedule O—Charitable, Public, and Similar Gifts and Bequests | 22 | |
| 23 | Estimated value of deductible assets subject to the special rule of Reg. section 20.2010-2T(a)(7)(ii) | 23 | |
| 24 | Tentative total allowable deductions (add items 18 through 23). Enter here and on line 2 of the Tax Computation | 24 | |

**Page 3**

Exhibit 3 – Sample Letter to Executor (Spouse)

Independent Executor

_____

_____

Re: Estate of _____, Deceased (the "Estate")
In Probate Court No. __ of Harris County, Texas
Cause No. _____

Dear Independent Executor:

As we have discussed, it does not appear that a U.S. Estate (and Generation-Skipping Transfer) Tax Return (Form 706) is required to be filed for the Estate, as the Estate did not exceed the $5,340,000 filing requirement for decedents who died in 2014. Nevertheless, you may still decide to file a Form 706 for the Estate in order to elect spousal portability. Such an election would allow you to use the unused portion of your husband/wife's $5,340,000 exclusion amount.

The significance of the portability election is that at your death, you can use your personal exemption amount (currently $5,340,000 for decedents dying in 2014[1]) as well as your husband/wife's unused exclusion amount to shelter assets from taxation. Your husband/wife's unused exclusion amount can also be applied to gifts that you make during your lifetime. Taking advantage of this election would be a benefit to the beneficiaries of your estate, as a greater portion of your estate would be exempt from the Federal estate tax.

The primary disadvantage to filing a Form 706 is the cost of preparation. We estimate that the cost of preparing a Form 706 for your husband/wife's Estate would be between $_____ and $_____.

The Form 706 for your husband/wife's Estate is currently due on _____; however, we can obtain an automatic six-month extension to allow more time for you to decide whether you wish to file the Form 706 and to compile the necessary information. Filing an extension request does not obligate you to file a Form 706.

If you are interested in filing a Form 706 for the Estate or would like to discuss this in further detail, please contact us as soon as possible. If we do not hear from you

[1] Although the current estate tax exclusion amount is at a historical high, there is no guarantee that it will remain at this level. In fact, the President's most recent budget proposal calls for a reduction in the estate tax exclusion amount to $3,500,000.

by _____, we will assume that you do not wish for us to begin the process of preparing the Form 706.

Sincerely,

Christie P. Accountant

Exhibit 4 – Sample Letter to Executor (Non-Spouse)

Independent Executor

_____

_____

Re: Estate of _____, Deceased (the "Estate")
In Probate Court No. __ of Harris County, Texas
Cause No. _____

Dear Independent Executor:

As we have discussed, it does not appear that a U.S. Estate (and Generation-Skipping Transfer) Tax Return (Form 706) is required to be filed for the Estate, as the Estate did not exceed the $5,340,000 filing requirement for decedents who died in 2014. Nevertheless, you may still decide to file a Form 706 for the Estate in order to elect spousal portability. Such an election would allow the Decedent's surviving spouse to use the unused portion of the Decedent's $5,340,000 exclusion amount.

The significance of the portability election is that at the death of the Decedent's surviving spouse, he/she can use his/her individual exemption amount (currently $5,340,000 for decedents dying in 2014[1]) as well as the Decedent's unused exclusion amount to shelter assets from taxation. The Decedent's unused exclusion amount can also be applied to gifts that the Decedent's surviving spouse makes during his/her lifetime. Taking advantage of this election would be a benefit to the beneficiaries of the estate of the Decedent's surviving spouse, as a greater portion of his/her estate would be exempt from the Federal estate tax.

The primary disadvantage to filing a Form 706 is the cost of preparation. We estimate that the cost of preparing a Form 706 for the Estate would be between $_____ and $_____.

One factor to remember is that you are not only a beneficiary of this Estate, but you are also serving in a fiduciary capacity as Independent Executor. As such, you have a responsibility to look after the best interests of all of the beneficiaries. Some commentators have expressed concern that when an Executor fails to file a Form 706 for portability purposes, the Executor may be exposed to potential claims by the beneficiaries of the surviving spouse's estate if estate tax is ultimately due and could

[1] Although the current estate tax exclusion amount is at a historical high, there is no guarantee that it will remain at this level. In fact, the President's most recent budget proposal calls for a reduction in the estate tax exclusion amount to $3,500,000.

have been avoided by electing portability. If you decline to file a Form 706 for the Estate, we would advise you to inform the other beneficiaries of this decision and obtain their consent to same in writing. Please let us know if you would like us to prepare a document for their review and signature.

The Form 706 for the Estate is currently due on _____; however, we can obtain an automatic six-month extension to allow more time for you to decide whether you wish to file the Form 706 and to compile the necessary information. Filing an extension request does not obligate you to file a Form 706.

If you are interested in filing a Form 706 for the Estate or would like to discuss this in further detail, please contact us as soon as possible. If we do not hear from you by _____, we will assume that you do not wish for us to begin the process of preparing the Form 706.

Sincerely,

Christie P. Accountant

Exhibit 5 – Letter to Beneficiary

Independent Executor
_____
_____

Beneficiary
_____
_____

Re: Estate of _____, Deceased
In Probate Court No. __ of Harris County, Texas
Cause No. _____

Dear Beneficiary:

I am writing you this letter in my capacity as Independent Executor of the Estate of _____ (the "Estate"). Based on the size of the Estate, I have determined that a U.S. Estate (and Generation-Skipping Transfer) Tax Return (Form 706) is not required to be filed for the Estate, as the Estate did not exceed the $5,340,000 filing requirement for decedents who died in 2014. Nevertheless, I have been advised that I may still decide to file a Form 706 for the Estate in order to elect spousal portability. Such an election would allow Decedent's surviving spouse to use the unused portion of Decedent's $5,340,000 exclusion amount.

The significance of the portability election is that at Decedent's surviving spouse's subsequent death, Decedent's surviving spouse can use his/her personal exclusion amount (currently $5,340,000 for decedents dying in 2014[1]) as well as Decedent's unused exclusion amount to shelter assets from taxation at his/her death. Decedent's unused exclusion amount can also be applied to gifts that Decedent's surviving spouse makes during his/her lifetime. Taking advantage of this election would be a benefit to the beneficiaries of Decedent's surviving spouse's estate, as a greater portion of his/her estate would be exempt from the Federal estate tax.

The primary disadvantage to filing a Form 706 is the cost of preparation. I have been advised that the cost of preparing a Form 706 for the Estate is estimated to be between $_____ and $_____.

[1] Although the current estate tax exclusion amount is at a historical high, there is no guarantee that it will remain at this level. In fact, the President's most recent budget proposal calls for a reduction in the estate tax exclusion amount to $3,500,000.

At this time, I have determined that that it is in the best interest of the beneficiaries of the Estate not to file a Form 706 for the Estate, based on the size of the Estate and the costs associated with the preparation of a Form 706.

I am writing this letter to notify you of my decision. If you believe that it would be in your best interest to file a Form 706 for the Estate to elect spousal portability, please contact me no later than _____. Any Form 706 filed for the Estate is currently due on _____.

If you agree with my decision to refrain from filing a Form 706 for the Estate, please sign where indicated below and return this signed letter to me.

Sincerely,

Independent Executor

I have received and read this letter. I understand the portability election discussed in this letter and I consent to Executor's decision to refrain from filing a Form 706 in order to elect spousal portability for the Estate.

_____

Beneficiary

Exhibit 6



## SCHEDULE C Deceased Spousal Unused Exclusion (DSUE) Amount

Provide the following information to determine the DSUE amount and applicable credit received from prior spouses. Complete Schedule A before beginning Schedule C.

| A Name of Deceased Spouse (dates of death after December 31, 2010 only) | B Date of Death | C Portability Election Made? Yes | C No | D If "Yes," DSUE Amount Received from Spouse | E DSUE Amount Applied by Donor to Lifetime Gifts (list current and prior gifts) | F Date of Gift(s) (enter as mm/dd/yy for Part 1 and as yyyy for Part 2) |
|---|---|---|---|---|---|---|
| **Part 1—DSUE RECEIVED FROM LAST DECEASED SPOUSE** | | | | | | |
| **Part 2—DSUE RECEIVED FROM PREDECEASED SPOUSE(S)** | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |
| **TOTAL** (for all DSUE amounts applied for Part 1 and Part 2) | | | | | | |

| | | | |
|---|---|---|---|
| 1 | Donor's basic exclusion amount (see instructions) | 1 | |
| 2 | Total from column E, Parts 1 and 2 | 2 | |
| 3 | Add lines 1 and 2 | 3 | |
| 4 | Applicable credit on amount in line 3 (See *Table for Computing Gift Tax* in the instructions). Enter here and on line 7, Part 2—Tax Computation | 4 | |

## SCHEDULE D Computation of Generation-Skipping Transfer Tax

**Note.** Inter vivos direct skips that are completely excluded by the GST exemption must still be fully reported (including value and exemptions claimed) on Schedule D.

**Part 1—Generation-Skipping Transfers**

| A Item No. (from Schedule A, Part 2, col. A) | B Value (from Schedule A, Part 2, col. H) | C Nontaxable Portion of Transfer | D Net Transfer (subtract col. C from col. B) |
|---|---|---|---|
| 1 | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| Gifts made by spouse (for gift splitting only) | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |

*(If more space is needed, attach additional statements.)*

Exhibit 7

*26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, §§ 2044, 2056, 2519, 2652; 20.2044–1, 20.2056(b)–7, 25.2519–1, 26.2652–1.)*

## Rev. Proc. 2001–38

SECTION 1. PURPOSE

This revenue procedure provides relief for surviving spouses and their estates in situations where a predeceased spouse's estate made an unnecessary qualified terminable interest property (QTIP) election under § 2056(b)(7) of the Internal Revenue Code that did not reduce the estate tax liability of the estate. This revenue procedure describes the circumstances in which these QTIP elections will be treated as a nullity for federal estate, gift, and generation-skipping transfer tax purposes, so that the property will not be subject to transfer tax with respect to the surviving spouse.

SECTION 2. BACKGROUND

Section 2056(a) provides that, except as limited by § 2056(b), the value of a taxable estate is determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the surviving spouse. Section 2056(b)(1) denies a marital deduction for an interest passing to the surviving spouse that is a "terminable interest." An interest is a terminable interest if the interest passing to the surviving spouse will terminate or fail on the lapse of time or on the occurrence of an event or contingency or on the failure of an event or contingency to occur, and on termination, an interest in the property passes to someone other than the surviving spouse.

Section 2056(b)(7)(A) provides an exception to this terminable interest rule in the case of qualified terminable interest property. For purposes of § 2056(a), qualified terminable interest property is treated as passing to the surviving spouse, and no part of the property is treated as passing to any person other than the surviving spouse. Under § 2056(b)(7)(B)(i), qualified terminable interest property is property which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(v) provides that the election to treat property as QTIP under § 2056(b)(7) is made by the executor on the return of tax imposed by § 2001. This election, once made, is irrevocable.

Section 20.2056(b)–7(b)(4)(i) of the Estate Tax Regulations provides that the QTIP election is made on the return of tax imposed by § 2001 (or § 2101). The term "return of tax imposed by § 2001" means the last estate tax return (*Form 706–United States Estate (and Generation-Skipping Transfer) Tax Return*) filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed after the due date. Section 20.2056(b)–7(b)(4)(ii) provides that the election, once made, is irrevocable.

A QTIP election has transfer tax consequences for the surviving spouse. Section 2044(a) and (b) provides generally that the value of the gross estate includes the value of any property in which the decedent has a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under § 2056(b)(7). Under § 2519(a) and (b), any disposition of all or part of a qualifying income interest for life in any property with respect to which a deduction was allowed under § 2056(b)(7) is treated as a transfer of all interests in the property other than the qualifying income interest. Further, the surviving spouse will, in the absence of a "reverse QTIP" election under § 2652(a)(3), be treated as the transferor of the property for generation-skipping transfer tax purposes under § 2652(a).

The Internal Revenue Service has received requests for relief in situations where an estate made an unnecessary QTIP election. In some cases, a QTIP election was made when the taxable estate (before allowance of the marital deduction) was less than the applicable exclusion amount under § 2010(c). The QTIP election was not necessary, because no estate tax would have been imposed whether or not the QTIP election was made. In other cases, the decedent's will provided for a "credit shelter trust" to be funded with an amount equal to the applicable exclusion amount under § 2010(c), with the balance of the estate passing to a marital trust intended to qualify under § 2056(b)(7). The estate made QTIP elections for both the credit shelter trust and the marital trust. The QTIP election for the credit shelter trust was not necessary, because no estate tax would have been imposed whether or not the QTIP election was made for that trust. In these situations, as a consequence of the unnecessary QTIP election, the property subject to the election would be included in the surviving spouse's gross estate under § 2044(a), or if that spouse disposes of the income interest, would be subject to gift tax under § 2519. Further, the surviving spouse would, in the absence of a "reverse QTIP" election under § 2652(a)(3), be treated as the transferor of the property for generation-skipping transfer tax purposes under § 2652(a).

SECTION 3. SCOPE

This revenue procedure applies to elections under § 2056(b)(7) to treat property as qualified terminable interest property where the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes. This revenue procedure does not apply in situations where a partial QTIP election was required with respect to a trust to reduce the estate tax liability and the executor made the election with respect to more trust property than was necessary to reduce the estate tax liability to zero. This revenue procedure also does not apply to elections that are stated in terms of a formula designed to reduce the estate tax to zero. *See*, for example, § 20.2056(b)–7(h), *Examples 7 and 8*. In addition, this revenue procedure does not apply to protective elections under § 20.2056(b)–7(c).

SECTION 4. PROCEDURE

In the case of a QTIP election within the scope of this revenue procedure, the Service will disregard the election and treat it as null and void for purposes of §§ 2044(a), 2056(b)(7), 2519(a), and 2652. The property for which the election is disregarded under this procedure will not be includible in the gross estate of the surviving spouse under § 2044, and the spouse will not be treated as making a gift under § 2519 if the spouse disposes of the income interest with respect to the property. Further, the surviving spouse will

Exhibit 7

not be treated as the transferor of the property for generation-skipping transfer tax purposes under § 2652(a). To establish that an election is within the scope of this revenue procedure, the taxpayer must produce sufficient evidence to that effect. For example, the taxpayer may produce a copy of the estate tax return filed by the predeceased spouse's estate establishing that the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes. Such information, including an explanation of why the election should be treated as void under this revenue procedure, should be submitted either with the Form 706 filed for the surviving spouse's estate, or with a request for a private letter ruling submitted at any time prior to filing that Form 706.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective as of June 4, 2001, and applies to elections within the scope of this revenue procedure, whenever made. If prior to June 4, 2001, property subject to an election within the scope of this revenue procedure was subject to transfer tax (for example, because the surviving spouse has died or disposed of all or part of an income interest), the taxpayer may file a claim for refund provided the time prescribed by § 6511 for filing the claim has not expired.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Scott S. Landes of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Landes at (202) 622-3090 (not a toll-free call).