PORTABILITY ELECTIONS IN POST-MORTEM PLANNING

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A. The 2012 Act Made Portability Permanent.

Section 101 of the “American Taxpayer Relief Act of 2012” (H.R. 8, Pub. L. 112-240) repealed two automatic sunset provisions that Congress had previously enacted: section 901 (Title IX) in EGTRRA 2001 (Pub. L. 107-16), and section 304 of TRUIRJCA (Pub. L. 111-312). By 2011, the automatic sunset date had been reset to January 1, 2013, and that sunset date applied to the portability election. Before the 2012 Act was enacted, portability elections were available with respect to married decedents dying after December 31, 2010, but the extended sunset date in TRUIRJCA meant that portability was available only if both spouses died in either 2011 or 2012.

With the 2012 Act’s complete repeal of the automatic sunset, portability is now available to married decedents dying after 2010, indefinitely into the future. There is no noticeable constituency or faction within the Congress or the Obama Treasury Department that has advocated the elimination of the portability election.

The 2012 Act made only one other change to the portability rules: a technical correction to Code § 2010(c)(4) as recommended by the Congress’s Joint Committee on Taxation in early 2011, so that Code section 2010(c) is now consistent with the IRS’s interpretation of Congressional intent in the temporary Treasury Regulations. The technical correction is explained on Page 6 below.

B. Nomenclature: “DSUEA,” “DSUE Amount,” and “Last Deceased Spouse”

In early guidance in 2011, the IRS referred to the “portable” exclusion amount — which was validly “transferred” to a surviving spouse — as the DSUEA [Deceased Spouse Unused Exclusion Amount]. Later, in the temporary regulations and in the August 2012 versions of Forms 706 and 709 and their accompanying instructions, the IRS changed the label to the “DSUE Amount.”

Various commentators have used other labels, such as “inheritable exemption” or “portable exemption.” This writer prefers and continues to use “DSUEA” because that acronym is short and can easily be pronounced as “d’S0O-yah.”

Another key concept for portability was introduced in Code § 2010(c)(4)(B) with the phrase “the last such deceased spouse of such surviving spouse.” From the legislative history, it was and is clear that the spouse who most recently predeceased the surviving spouse is the deceased spouse whose unused lifetime exclusion amount is “portable.” Initially, neither the Congress nor the Treasury Department invented a standard label for the concept of the last predeceased spouse. In early 2011, this writer came up with the acronym DIPS (Deceased Immediately Preceding Spouse). In the 2012 temporary regulations, Treasury has used “last deceased spouse.” See Temp. Reg. § 20.2010-1T(d)(5).
C. Available guidance and official instructions on portability

The primary current resources available on portability elections and the use of the portable exclusion amount (DSUEA or DSUE amount) are as follows:

- New Schedule C to the Form 709 for 2012, and the accompanying instructions (for use by a surviving spouse who has a portable exclusion amount from a deceased spouse and who made taxable gifts in 2012).  

- On the Form 706 for 2012 decedents, Line 9b on page 1; the note at the top of page 2 and new Line 3b (asking about the decedent’s prior marriages in Part 4); new Lines 10 and 23 in the Recapitulation on page 3; and new Sections C and D of Part 6 on page 4; plus pages 1, 2, 7, 8, and 16 through 18 in the accompanying instructions.


- Temporary gift tax regulations (Reg. §§ 25.2502-1T and 25.2502-2T), also effective June 15, 2012, and published at the same time as the temporary estate tax portability regulations.

- IRS Notices 2011-82 (September 29, 2011) and 2012-21 (February 17, 2012), which anticipated some of the issues covered the temporary regulations, and which have largely been superseded by those regulations.

All of the temporary regulations say that their applicability expires “on or before June 15, 2015.” This writer does not know whether Treasury will extend these temporary regulations or replace them with final regulations before mid-June of 2015.

D. The maximum portable “basic exclusion amount” is currently $5.25 million; “one-time” inflation indexing; no use for GST tax purposes

For a first-to-die married decedent who dies in 2013, the maximum amount of his or her unused lifetime exclusion amount that can be “transferred” to the surviving spouse via a portability election on a timely Form 706 return is $5.25 million — that is, the full basic maximum lifetime exclusion amount under Code section 2010(c), with “one-time”

1 In the Form 709 instructions, the worksheet for Schedule B (recalculation of the applicable credit amount used for prior years’ gifts) now has 14 columns (including Column H for the DSUEA from the predeceased spouse) and four examples with the worksheet filled in.

2 In the Form 706 instructions, page 7 consists of a 15-column worksheet for calculating the applicable credit amount used for prior periods and the gift tax (Line 7 on page 1 of the return) that is attributable to post-1976 taxable gifts.
indexing for inflation as of the year in which the deceased spouse dies. If the first-to-die spouse died in 2012, the maximum unused exclusion amount that could be portable is $5.12 million. See Code § 2010(c)(3) on Page 27 below.

Assuming that inflation-indexing of the basic lifetime exclusion amount remains in effect (in Code § 2010(c)(3)(B)) in future years, the maximum DSUEA that can be “transferred” to the surviving spouse by a timely portability election will be the basic exclusion amount, as indexed for inflation for the year in which the deceased spouse dies. Thus, the DSUEA will reflect inflation-indexing once and only once, frozen as of the year in which that deceased spouse dies, and assuming that he or she remains the Last Deceased Spouse.

In contrast, the basic lifetime exclusion amount of the surviving spouse will continue to receive inflation indexing in future years, through the year of his or her later death.

The surviving spouse can use the DSUEA to shelter what would otherwise be taxable inter vivos gifts from the gift tax, AND can use the DSUEA (or whatever is left of it) to shelter assets passing at her later death from the estate tax, subject to the Last Deceased Spouse restrictions explained in the next part below.

A surviving spouse’s use of the DSUEA from the deceased spouse is not elective. Because the DSUEA is a lifetime exclusion amount (and the source of a credit against gift or estate tax) under Code section 2010, the DSUEA is used automatically as and when the surviving spouse makes taxable gifts during her remaining lifetime, and if any of the DSUEA remains unused as of the date of the later death of the surviving spouse, the rest of the DSUEA is applied as part of the federal estate tax computation. The temporary regulations make it clear that the DSUEA is used before any of the surviving spouse’s own basic (inflation-indexed) exclusion amount is used.

A surviving spouse, or his or her estate, cannot use a DSUEA for generation-skipping transfer tax purposes. The unused lifetime GST exemption of a deceased spouse never was and still is not “portable.”

E. Who is and is not a “Last Deceased Spouse,” and the importance of the concept

A surviving spouse who has received a DSUEA from a predeceased spouse can only use, at any given time, the DSUEA (if any) from his or her immediately preceding deceased spouse (Last Deceased Spouse). See Temp. Reg. § 20.2010-1T(d)(5) and 20.2010-3T(a)(i).

For example, if a surviving spouse SS received a DSUEA in 2013 from her dead husband H1 who was, at that time, her Last Deceased Spouse, and if that surviving spouse later dies in 2017, the surviving spouse’s “estate” can still use that DSUEA (or whatever is left of it) to shelter assets passing at death from the federal estate tax in all of the following fact situations:

- The surviving spouse SS remained unmarried after H1’s death in 2013; or
• The surviving spouse married H2 and remained married to him, and H2 survived the death of the surviving spouse;\(^3\) or

• The surviving spouse married H2, but her marriage to H2 was dissolved before the surviving spouse’s death in 2017, and she did not marry anyone else before her death.\(^4\)

In each of the above situations, H1 remains the last spouse to have died before the death of surviving spouse SS, so H1’s unused exclusion or DSUEA, for which a timely election was made, remains the DSUEA that SS or her estate can continue to use.

Conversely, if SS survived H1’s death, if a timely portability election was made for H1’s DSUEA, \textbf{AND} if SS then married H2, \textbf{AND} if H2 died during the remaining lifetime of SS, who did not marry again, then H2 is the Last Deceased Spouse of SS. This means that from and after the death of H2, the only DSUEA that is “portable” and usable by SS is the DSUEA, if any, of the last husband, H2. \textit{See} Temp. Regs. §§ 20.2010-2T(a) and (b) and 25.2502-2T(a)(1)(i).

If a “second” portability election is made with respect to H2’s DSUEA, then H2’s DSUEA (whether it is larger or smaller than H1’s DSUEA) is the only DSUEA that SS can use with respect to subsequent taxable gifts or at her later death. And if no portability election is made with respect to H2’s DSUEA, then SS still cannot make any use of H1’s DSUEA — or what is left of it — after H2’s death, because from that time forward, H1 is no longer SS’s Last Deceased Spouse.

There is one technical exception to the principle that after a previously deceased spouse ceases to be the \textit{Last} Deceased Spouse, his or her DSUEA is no longer usable by the surviving spouse: If the surviving spouse SS used part of H1’s DSUEA for gift tax purposes while H1 remained the Last Deceased Spouse in order to shelter otherwise taxable gifts from the gift tax, then future gift tax calculations and the eventual estate tax calculation will still count (and give SS or her estate the benefit of) the part of H1’s DSUEA that was used for gift tax purposes at times when he was still the Last Deceased Spouse, even if H2 became the Last Deceased Spouse at a later time and remained the Last Deceased Spouse at the time of SS’s eventual death. This exception is made necessary by the cumulative nature of the gift tax calculation and the estate tax calculation, which take prior lifetime gifts into account. \textit{See} Temp. Reg. § 25.2502-2T(c)(1). Here is how the preamble to the Temporary Regulations explains this concept:

Under the rules in § 25.2505—2T, a surviving spouse may use the DSUE amount of a predeceased spouse as long as, for each transfer, such DSUE amount is from the surviving spouse’s last deceased spouse at the time of

\begin{footnotesize}
\begin{itemize}
\item \footnotesize Temp. Reg. § 20.2010-3T(a)(3).
\item \footnotesize Id.
\end{itemize}
\end{footnotesize}
that transfer. Thus, a spouse who has survived multiple spouses may use each last deceased spouse’s DSUE amount before the death of that spouse’s next spouse, and thereby may apply the DSUE amount of multiple deceased spouses in succession. However, this does not permit the surviving spouse to use the sum of the DSUE amounts of those deceased spouses at one time, and a surviving spouse may not use the remaining DSUE amount of a prior deceased spouse following the death of a subsequent spouse.


When a surviving spouse uses DSUEA amounts from multiple different predeceased spouses at different times, with respect to taxable gifts made by the surviving spouse, Temp. Reg. § 25.2505-2T(c) applies a special rule, which limits the usable applicable exclusion amount of the surviving spouse to the sum of (1) the DSUEA of the last deceased spouse plus (2) the part of the DSUEA of each other [previous] deceased spouse to the extent such DSUEA[s] were applied to one or more previous gifts by that surviving spouse. This makes perfect sense in light of the cumulative nature of the gift tax computation under Code § 2502(a). However, at any given time and with respect to a new gift during lifetime or transfers at death, this rule does not allow a surviving spouse to use the DSUEA from anyone except the Last Deceased Spouse.

Although Code section 2010(c) itself is silent on this issue, Temp. Reg. § 25.2502-2T(b) says that when a surviving spouse has a DSUEA from a predeceased spouse and makes a taxable gift, the DSUEA is treated as being used first, before applying the surviving spouse’s own applicable lifetime exclusion amount, in calculating the amount of the surviving spouse’s total exclusion amount (her own exclusion plus the DSUEA) that is used up in the form of a credit against the gross gift tax on the taxable gift. This rule produces a slight benefit to any surviving spouse who has a DSUEA and who makes taxable gifts, by leaving more of the spouse’s own exclusion “untouched” and available to be adjusted upward for inflation in later years.

The “Last Deceased Spouse” rules can create some hardship for a surviving spouse or for a surviving spouse’s estate, because once a predeceased spouse satisfies the criteria to be the Last Deceased Spouse, that spouse’s DSUEA is the only DSUEA that could be used for estate tax purposes after the surviving spouse’s later death — even if that predeceased spouse has NO DSUEA. See Temp. Reg.§ 20.2010-3T(a)(2).

F. The 2012 Act’s technical correction to Code section 2010(c)(4)(B) and the “tacking” of DSUEAs through multiple marriages

When the “portability” concept was added to Code § 2010(c) in December 2010, various Congressional staffers, expert commentators, and Treasury personnel could not agree about whether subsections 2010(c)(2) and 2010(c)(4)(B), as enacted, would allow a surviving spouse to marry multiple spouses, to survive all but one of them, and to pass
on to the last surviving spouse an exclusion amount that consisted of not only his or her own DSUEA, but at least a part of the DSUEA of the last deceased spouse.

This issue was presented squarely in “Example 3” in a December 2010 report of the Joint Committee on Taxation. That Example 3 has the same fact pattern as this writer’s Example 3 stated below. The consensus in late 2010 and early 2011 was that the Joint Committee had reached the result that Congress had intended, but that the wording of Code § 2010(c)(4)(B) was inconsistent with Congressional intent.

A technical correction to Code § 2010(c)(4)(B)(ii) — replacing the phrase “basic exclusion amount” with “applicable exclusion amount” was put into several estate tax reform bills that were stalled in the Congress in 2011 and 2012. The IRS’s Temporary Regulations interpreted Code § 2010(c)(4)(B) in a manner consistent with the technical correction. Ultimately, the correction was included in ATRA 2012 (see Pages 24 and 27 below).

One result of the technical correction is that if a surviving spouse SS receives a DSUEA from deceased spouse H1, and if SS then marries Last Spouse H2 and dies before H2, then a timely portability election on a Form 706 for SS will allow H2 to receive a DSUEA that includes not only the unused part of SS’s own lifetime exclusion, but also at least part of the DSUEA from first deceased Spouse H1, who was still the Last Deceased Spouse of SS at the time of her death.

As amended by the 2012 Act, subsection (c)(4) of Code § 2010 reads as follows (with the one-word change in bold):

(4) **DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT.** — For purposes of this subsection, with respect to a surviving spouse of a deceased spouse dying after December 31, 2010, the term “deceased spousal unused exclusion amount” means the lesser of —

(A) the basic exclusion amount, or

(B) the excess of —

(i) the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over

(ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse.

Code § 2010(c)(2) defines the “applicable exclusion amount” as the sum of the “basic exclusion amount” plus the DSUEA received from a deceased immediately preceding spouse, if the decedent or transferor (whose applicable exclusion amount is being determined or used) is a surviving spouse. And Code § 2010(c)(3) defines the “basic exclusion amount” as $5,000,000 plus the inflation adjustment for decedents dying after 2011.
As a result of the interplay between the defined terms in subsections (c)(2), (c)(3), and (c)(4), if a surviving spouse receives a DSUEA from a preceding deceased spouse, that DSUEA cannot be larger than the inflation-adjusted amount of that deceased spouse’s maximum applicable exclusion amount ($5,120,000 for 2012 decedents and $5,250,000 for 2013 decedents), because the “basic exclusion amount” of a deceased spouse includes the inflation adjustment for the year of death.

If a surviving spouse received a DSUEA from a previous spouse and then dies herself, leaving part or all of that DSUEA plus her own DSUEA, Code § 2010(c)(4)(A) will limit the combined DSUEA (which could be transferred to her own surviving spouse) to the amount of a single, inflation-adjusted lifetime exclusion amount (in 2013, $5,250,000).

G. What if the decedent or the surviving spouse is not a citizen of the United States?

According to Temp. Reg. § 20.2010-2T(a)(5), if the married decedent who dies first is not a U. S. citizen at the time of death and dies as a non-resident, a portability election is not available for that decedent’s estate. This is a natural result of Congress’s decision to make no portability amendment to Code section 2101, which imposes the federal estate tax on the U. S. assets of a non-U. S. citizen who is not a resident of the United States.

Conversely, if the surviving spouse is a non-resident and is not a citizen of the U. S. at the time of his or her death, that last-to-die spouse’s estate cannot take into account the DSUEA of the Last Deceased Spouse (even if a timely election was made), “except to the extent allowed under any applicable treaty obligation of the United States.” Temp. Reg. § 20.2010-3T(e) and Temp. Reg. § 25.2505-2T(f).

Suppose that H is a U. S. citizen and dies first, and suppose that surviving spouse SS is not a U. S. citizen and does not become a citizen on or before the filing deadline for H’s Form 706 return. Suppose further that H’s estate plan leaves assets to a qualified domestic trust (QDOT) under Code § 2056A for SS’s benefit, and that H’s executor makes a timely portability election. How is the calculation of H’s DSUEA affected by the existence of the QDOT? The June 2012 temporary regulations say that the amount of H’s DSUEA that is actually usable by non-citizen surviving spouse SS or her estate will be subject to redetermination at the time of the later death of SS or when the QDOT makes its final distribution of principal and terminates. See Temp. Reg. §§ 20.2010-2T(c)(4), 20.2010-3T(c)(2), and 25.2505-2T(d)(2).

In particular, the non-citizen surviving spouse SS cannot use the DSUEA from H as part of her own exclusion amount for inter vivos gifting purposes unless —

• The gift by SS is made in the year in which she dies, or

• The QDOT terminates in a year before the year in which SS dies.

If the QDOT terminates “early,” during the non-citizen spouse SS’s lifetime, then the DSUEA from H (as redetermined in light of the remaining QDOT principal that was
distributed after termination) can be used by SS for gift tax purposes, after that termination date and in subsequent years. See the Example at Temp. Reg. § 25.2505–2T(c)(2)(ii). See also Form 706, page 4, Part 6 Section B and p. 18 of the Form 706 instructions.

**H. Making a timely portability election on Form 706, and who the “executor” is**

Code section 2010(c)(5)(A) provides that a portability election can only be made by the “executor” of the deceased spouse’s estate, and only on a timely-filed Form 706 return, which means a Form 706 that is filed by the normal 9-month filing deadline or, if a timely filing extension is obtained with a Form 4768, within that extended filing period (9 months plus 6 months).

The Form 706 return that is timely filed also must be “complete and properly prepared.” See Temp. Reg. § 20.2010–2T(a)(7)(ii) and the further discussion on Pages 13 and 14 below.

As was the case in 2011 and 2012 under earlier guidance from Treasury, the filing of a timely Form 706 return for a married decedent will automatically make the portability election, unless the executor affirmatively “opts out” to avoid making the election. On the current (August 2012) version of Form 706, opting out, and preventing a portability election, must be done by checking the “opt out” box in Part 6, Section A on page 4 of Form 706.\(^5\)

Obviously, the only other ways to refrain from making a portability election for a married decedent are (a) to file no Form 706 return at all or (b) to file a Form 706 return late, after the 9-month deadline or after the expiration of any filing extension.

For portability election purposes, the general definition of “executor” in Code section 2203 applies: The “executor” who can make the portability election is the court-appointed executor, administrator, or personal representative who is acting, or, if there is no such fiduciary, “then any person in actual or constructive possession of any property of the decedent.”

If there is a court-appointed personal representative, that person has priority to make or to refrain from making a portability election. If there is no court-appointed fiduciary, then any person who is a “non-appointed executor” under Code section 2203 (who has possession of some of the decedent’s property) could make the portability election or opt out. See Temp. Reg. § 20.2010–2T(a)(6). If one non-appointed executor files a timely Form 706 return and opts out of portability, and if some time still remains

\(^5\) For a decedent dying before 2012 and for whom it is still possible to make a timely portability election (e.g., because multiple filing extensions have been obtained and have not run out), the executor can refrain from making a portability election by attaching an affirmative statement to the return, if the Form 706 used does not contain an explicit “opt-out” box to check. See Temp. Reg. § 20.2010–2T(a)(3)(i).
for the filing of a timely amended Form 706, a personal representative who is appointed by a court a little later could still timely file that amended Form 706, reverse the earlier decision by the non-appointed de facto executor, and make the portability election. However, according to Temp. Reg. § 20.2010-2T(a)(6)(ii), one non-appointed executor cannot reverse an earlier opt-out decision made by another non-appointed executor, unless the second non-appointed executor is the successor to the first (e.g., the later of two successors trustee of the decedent’s formerly revocable trust).

Code section 2010(c)(5)(A) says that once a valid and timely portability election is made, it is irrevocable. The temporary regulations create one exception to this rule: If a portability election is made on a Form 706 return that is filed well before the filing deadline, that executor can file an amended Form 706 return or before the deadline and reverse the earlier decision by “opting out” and undoing the portability election. See Temp Reg. § 20.2010-2T(a)(4). However, if a court-appointed executor made the portability election on the first Form 706 return, that election cannot be reversed by a non-appointed de facto executor on a subsequent Form 706 filed within the 9-month deadline plus extensions.

In summary, the first Form 706 filed (and the decision “on” that return to make or not make the portability election) has some practical priority and potential finality, and the priority and finality increase with the dwindling of the number of days left for timely filing of an amended Form 706. But so long as there is some time left for a court-appointed personal representative to file an amended Form 706 before the 9-month period plus extensions runs out, and so long as that fiduciary is willing to incur the expense and make the effort to prepare and file an amended return, the last-filed timely Form 706 will control.

A timely portability election relates back to the date of the decedent’s death. See Temp. Regs. §§ 20.2010-3T(c)(1) and 25.2505-2T(d)(1). This means that after the death of the first spouse to die, the surviving spouse could make significant taxable gifts in reliance on the portability election that she predicts will be made, even before the Form 706 return is filed, and without knowing the exact amount of the DSUEA that she will receive from the deceased spouse, or whether the IRS will redetermine the DSUEA later.

I. Affirmatively requiring the personal representative to make the portability election

The potential ability of a non-appointed executor to make an opt-out decision, at a time when there is no court-appointed fiduciary for the deceased spouse’s estate, could create some practical problems and, potentially, hardships for the surviving spouse who might otherwise have benefitted from the portability election.

And because the portability election is a post-mortem tax election, the decision to make or not make the election does expose the personal representative or successor trustee to some potential liability. The stakes are arguably somewhat lower than with
some other tax elections, because the portability election, by itself, does not change the disposition of property after the “first death,” and no non-spouse beneficiary is harmed by the decision to make or not to make a portability election, other than the cost of preparing a “no-tax-dued Form 706 return for the deceased spouse, if that return would be filed solely to make the portability election.

These considerations have led this writer, and some other lawyers, to draft standard provisions for married clients’ Wills and revocable trusts, to remind the personal representative or successor trustee of the availability of the portability election and (for some clients) to affirmatively require the fiduciary to make the portability election.

**Question:** When would it be essential for a married client to affirmatively require his or her personal representative or successor trustee to make the portability election?

**Suggested Answer:** When the married client is likely to die first with an unused lifetime exclusion amount AND when the personal representative or successor trustee is not the client’s spouse and may harbor some ill-will or resentment toward the spouse (e.g., the client’s adult child hates the second spouse of his or her parent).

It’s not difficult to imagine a situation in which an adult child fiduciary might dislike the surviving spouse / step-parent so much that the child fiduciary would intentionally “opt out” of the portability election, or intentionally delay filing a Form 706 until after the filing deadline, simply to punish the surviving spouse, *even though neither the adult child nor anyone else could personally benefit from not making the portability election*. The only person who can benefit economically from a timely portability election is the surviving spouse, and making the election could not harm any other heir or beneficiary, except for the cost of preparing and filing the Form 706 return.

The following samples are the latest versions of two form provisions that this writer has been using in married clients’ Wills since early 2011. The first provision is intended for a married couple whose combined net worth and respective potential “gross estates” are definitely large enough to make it likely that a Form 706 return must be filed after the “first death”:

This subsection applies only if Code section 2010(c) (as amended by section 303 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312 and by section 101(c)(2) of the American Taxpayer Relief Act of 2012, Pub. L. 112-240) is in effect in the year of my death and if my spouse survives my death. If this subsection applies, then my Personal Representative must make the election permitted under Code section 2010(c)(5) (the “Portability Election”) so that my “deceased spousal unused exclusion amount” ("DSUE amount") will be available for use by my spouse during h___
remaining lifetime and upon h___ later death. If a federal estate tax return is filed for my estate solely for the purpose of making the Portability Election, then to the maximum extent permitted under applicable state and federal law, my Personal Representative may close my estate as promptly as is practical, without waiting for the Internal Revenue Service to issue an estate tax closing letter or to otherwise accept the Portability Election. Further, if the Internal Revenue Service acts, after the later death of my spouse, to audit or to contest the calculation of my DSUE amount under Code section 2010(c), neither my Personal Representative nor any Trustee under this Will will have any liability to any beneficiary or other person interested in a Trust created or funded under this Will, as a result of a change in the DSUE amount.

And for a couple with much smaller potential gross estates, where it is much less likely that a Form 706 return would be required after the first death, the following form provision would require (or at least strongly urge) the personal representative to make the portability election, unless he or she were to conclude that the extra cost of preparing and filing a “no-tax-due” Form 706 return, solely to make the election, would outweigh the likely benefit to the surviving spouse:

This subsection applies only if Code section 2010(c) (as amended by section 303 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312 and by section 101(c)(2) of the American Taxpayer Relief Act of 2012, Pub. L. 112-240) is in effect in the year of my death and if my spouse survives my death. If this subsection applies, then —

(a) My Personal Representative must make the election permitted under Code section 2010(c)(5) (the “Portability Election”) so that my “deceased spousal unused exclusion amount” (“DSUE amount”) will be available for use by my spouse during h___ remaining lifetime and upon h___ later death,

(b) Unless my Personal Representative determines, on the basis of competent professional advice, that the benefits from making the Portability Election (including the federal estate tax or gift tax savings that my spouse is likely to derive from using DSUE amount) would be outweighed by the cost (in time and money) and the audit risk with respect to the preparation and filing of a federal estate tax return my estate, where such a return would not be required if the Portability Election were not made.

If a federal estate tax return is filed for my estate solely for the purpose of making the Portability Election, then to the maximum extent permitted under applicable state and federal law, my Personal Representative may
close my estate as promptly as is practical, without waiting for the Internal Revenue Service to issue an estate tax closing letter or to otherwise accept the Portability Election. Further, if the Internal Revenue Service acts, after the later death of my spouse, to audit or to contest the calculation of my DSUEA under Code section 2010(c), neither my Personal Representative nor any Trustee under this Will will have any liability to any beneficiary or other person interested in a Trust created or funded under this Will, as a result of a change in the DSUE amount.

If the latter form provision were used, if the personal representative for the first-to-die spouse did not make the portability election, and if the surviving spouse were dissatisfied, the personal representative should be protected from liability if the Will also contains a general provision barring beneficiaries or other persons from basing claims or objections on the consequences of an available tax election that was made or not made.

If the first-to-die spouse’s estate is likely to be too small to require a Form 706 to be filed for estate tax purposes, and if a Form 706 would be filed only to make the portability election, should each spouse’s estate planning documents require the surviving spouse to bear and pay the cost of preparing and filing the “no-tax-due, portability-only” Form 706? In this writer’s opinion, that is a bad idea, because the IRS could reduce the amount of the estate tax marital deduction under Code § 2056(b)(4)(B), on the grounds that the cost-shifting to the surviving spouse represents an “encumbrance” on the assets passing to the surviving spouse.

Normally, a portability election, by itself, will have absolutely no impact on how and to whom property in the deceased spouse’s gross estate will pass: Those assets will pass to the transferees according to how they are titled (e.g., joint tenancy), who the named beneficiaries are (retirement assets, life insurance, annuities, and TOD assets), or how the substantive provisions in the Will or revocable trust are worded. The portability election normally just “transfers” to the surviving spouse the remaining lifetime exclusion (DSUEA) that the deceased spouse happens to leave on the table, in light of how those at-death transfers and lifetime gifts were structured.

The previous paragraph used the word normally, because some planners may be tempted to structure a married client’s estate planning documents more “cleverly,”6 so that actual post-death dispositions of property — for example, discretionary principal distributions to the surviving spouse from a marital trust or credit trust, or discretionary principal distributions from a credit trust to non-spouse beneficiaries — are either encouraged, discouraged, or prohibited, according to whether or not a portability election is made. This writer suggests that extreme caution should be used in

6 Here, a British colloquialism comes to mind: “Too clever by half.”
linking substantive provisions in clients’ documents to the making of a portability election, so that non-spouse beneficiaries’ interests could be affected. If such a linkage were to be created in the first-to-die spouse’s documents, the personal representative’s or successor trustee’s decision to make the portability election or not would become more complicated than estimating the cost of preparing and filing a Form 706 return (if a Form 706 would not otherwise be required). The fiduciary would be facing higher and more complicated risks of potential liability to beneficiaries whose substantive rights could be affected by a portability election, as a result of the linkage.

J. “Cutting corners” in asset reporting on a “no-tax-due, portability-only” Form 706 return

The IRS apparently has no plans to develop a “short-form” 706-EZ for decedents’ estates that will not owe any net federal estate tax and that are filing Form 706 solely to make the portability election. Notice 2011-82 stated that for the purpose of making a valid portability election, the Form 706 that is filed must be a “complete and properly prepared return.”

However, the temporary regulations and the Form 706 Instructions allow the executor to omit the actual date-of-death market values of all assets for which a 100-percent marital deduction or charitable deduction is available. For each such asset, the executor must come up with a good-faith estimate of the value, look up that value in a range-of-values table (Page 16 of the Instructions), and then use the “plugged” value that the table supplies for that range. See also Temp. Reg. § 20.2010-2T(a)(7)(ii) and 2012 Form 706, Recapitulation Lines 10 and 23.

If the executor uses this special rule and reports estimates of value instead of actual date-of-death values, the executor need not obtain appraisals for assets that qualify for the 100-percent marital or charitable deductions, but the executor is required to exercise “due diligence.” Temp Reg. § 20.2010–2T(a)(7)(ii)(B). This special rule cannot be used to avoid reporting of actual date-of-death values for assets for which any of the following conditions are present:

- The deceased spouse’s documents contain formula clauses or other provisions that cause the amount or value of marital deduction or charitable deduction transfers to vary according to the value of the gross estate as a whole;
- The value of the assets (for which the executor would like to use the special rule) is needed in order to determine the estate’s eligibility for special valuation or other relief under Code sections 2032, 2032A, 6166, etc.;
- Less than the entire value of an asset is marital deduction property or charitable deduction property (e.g., a CLAT, CLUT, CRAT, or CRUT); or
• Less than all of the value of an asset will qualify for the marital or charitable deductions as a result of a qualified *partial* disclaimer or *partial* QTIP election.⁷

For future income tax purposes (knowing the new cost basis for capital gain calculation purposes upon a future sale), a surviving spouse or the trustee of a marital trust would still benefit from knowing the actual (appraised) date-of-death fair market values of assets that are reportable on Form 706 but for which the 100-percent marital deduction is available. If there is time to obtain or determine actual market values, the fiduciary who signs and files a “no-tax-due” Form 706 return solely for portability purposes may still have an incentive to determine and report actual date-of-death values, instead of relying on the special rule described above.

**K. Some sample scenarios for calculating the DSUEA and the applicable exclusion amount of the surviving spouse at the “second death”**

The reader can verify the DSUEA computations in the following examples by using the gift tax or estate tax worksheets (as the case may be) for Sections C or D of Form 706 or for Schedule C of Form 709.

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**Example 1. No Remarriage by Surviving Spouse.** Ginger died in February 2011 with a $3 million gross estate, all of which passed under her Will outright to her daughter Frieda. Her husband Fred was independently wealthy and did not elect to take against Ginger’s Will. Ginger and Fred made no taxable gifts during their lifetimes, and so Ginger had a full $5 million lifetime exclusion available at her death in 2011. Ginger’s taxable estate and transfer tax base was $3 million. Ginger therefore left $2 million of her $5 million exclusion unused and “on the table.” Ginger’s “deceased spouse unused exclusion amount” or DSUEA was $2 million.

Fred, as executor of the estate of his deceased spouse Ginger, filed a timely Form 706 for Ginger, which constituted a timely election under Code §2010(c)(5) to add Ginger’s unused exclusion or DSUEA of $2 million to Fred’s own $5 million lifetime exclusion amount. Fred then became able to use the combined exclusion amount of $7 million to shelter lifetime gifts from the gift tax. Fred’s combined exclusion amount increased to $7,120,000 in 2012 because of the 2012 inflation adjustment to Fred’s own $5 million exclusion. Fred made no taxable gifts in 2011 or 2012.

Fred died in December 2012 without having remarried. Because Fred used none of the $7.12 million combined exclusion to shelter 2011 or 2012 gifts from the gift tax, Fred’s executor can use a total lifetime applicable exclusion of $7.12 million to reduce the estate tax on Fred’s Form 706. The $7.12 million comprises Fred’s own basic exclusion amount of $5,120,000 plus the $2 million DSUEA “transferred” from Ginger.

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Example 2. New Last Deceased Spouse. Assume the same facts as in the previous example, except that late in 2011, surviving spouse Fred married Wilma. Wilma was an heiress who had children and grandchildren from her previous marriage and who made extensive lifetime taxable gifts. Wilma died early in 2012. Wilma’s projected federal estate tax computation showed that none of her lifetime applicable exclusion amount (maximum $5.12 million) would go unused, so Wilma’s DSUEA is zero. When Fred died later in December 2012, the portability election made by the executor for Fred’s first spouse Ginger is no longer beneficial to Fred, because Ginger is not the “last such deceased spouse” of Fred (Wilma is the last deceased spouse). Fred will have only his own lifetime exclusion amount ($5,120,000) usable on Fred’s Form 706.

Example 3. Serial Remarriage and “Tacking.” Heathcliff made $3 million in taxable gifts during his lifetime and died in 2011 with no taxable estate and an unused lifetime exclusion of $2 million. Heathcliff’s estate made a timely portability election to permit his surviving spouse, Catherine, to use Heathcliff’s unused exclusion.

Catherine had not made any taxable gifts during her lifetime, and so immediately after Heathcliff’s death in 2011, Catherine had a total available lifetime exclusion of $7 million, comprising her own $5 million “basic exclusion amount” plus the $2 million DSUEA that was “transferred” from Heathcliff.

Late in 2011, Catherine remarried, to Edgar, and Catherine died in 2012, leaving Edgar as her surviving spouse. Catherine made no lifetime taxable gifts in 2011 or 2012 and had a taxable estate of $3.12 million. Catherine’s estate made a timely portability election to permit Edgar to receive and use Catherine’s unused exclusion amount.

Catherine’s DSUEA is computed as follows under Code § 2010(c)(4), reflecting the technical correction, which was made retroactive in ATRA 2012:

\[
\text{DSUEA from Heathcliff in 2011} \hspace{2cm} 2,000,000 \\
\text{plus Catherine’s own lifetime exclusion amount} \hspace{2cm} + 5,120,000 \\
\text{at the time of her death in 2012} \hspace{2cm} \text{total} \\
\text{Catherine’s “applicable exclusion amount” at her death as defined in Code § 2010(c)(2)} \hspace{2cm} 7,120,000 \\
\text{minus Catherine’s transfer tax base under § 2001} \hspace{2cm} - 3,120,000 \\
\text{Catherine’s tentative DSUEA transferable to surviving spouse Edgar if a timely election is made} \hspace{2cm} 4,000,000 \\
\text{Catherine’s actual DSUEA transferable to Edgar (lesser of $5.12 million or $4 million)} \hspace{2cm} \text{final value} \\
\]

On the next page, Example 4 illustrates the rule that if a deceased spouse made taxable gifts earlier in his lifetime, paid a net gift tax on some of those gifts, and later
died, leaving a surviving spouse, then for the purpose of computing that deceased spouse’s DSUEA, the amount of his lifetime taxable gifts (which ordinarily would be included in his transfer tax base under Code § 2001 and used in the DSUEA calculation under Code § 2010(c)(4)(B)), will be reduced by the amount of the gifts on which gift tax was paid for the year(s) in which those taxable gifts were made. See Temp. Reg. § 20.2010-2T(c)(2). This rule is intuitively “fair,” because if the deceased spouse paid gift tax from his own funds on a lifetime taxable gift, that part of the gift should not be subtracted in determining his tentative DSUEA amount after his later death.

### Example 4. First-to-Die Spouse Made Taxable Gifts and Paid Gift Tax.

Vic made his first lifetime taxable gift in 2002, in the amount of $2 million. Vic’s gift tax lifetime exclusion amount was $1 million in 2002, so $1 million of the $2 million gift was taxable, and Vic used his own funds to pay the gift tax on the $1 million taxable portion. Vic made no other taxable gifts after the 2002 gift.

In 2004, Vic married Sadie. Vic died in 2011 with a federal taxable estate of $1 million, and Sadie survived him. If a Form 706 were required to be filed for Vic, the estate tax computation would look like this:

- Vic’s federal taxable estate .......................................................... $1,000,000
- plus Vic’s lifetime taxable gifts .................................................. + 2,000,000
- Vic’s transfer tax base on Form 706 (Line 5) .............................. $3,000,000
- Tentative tax on Line 5 amount ................................................ $890,800

- minus Line 7 gift tax on lifetime taxable gifts, computed at 2011 rates (35% flat) ................................................................. – 350,000
- Gross estate tax before credit (Line 8) ........................................ $540,800

- minus full applicable credit amount ......................................... – 1,730,800
- Net federal estate tax due ......................................................... 0

Because $1 million of Vic’s 2002 taxable gift (the part of the gift on which Vic paid gift tax) must be excluded from the DSUEA calculation, Vic’s DSUEA is calculated as follows:

- Vic’s applicable exclusion amount in year of death (2011) ........... $5,000,000
- minus Vic’s taxable estate .......................................................... – 1,000,000
- minus Vic’s lifetime taxable gifts on which Vic did NOT pay gift tax ($2 million minus $1 million) .......................... – 1,000,000
- Vic’s tentative DSUEA under Code § 2010(c)(4)(B) ....................... $3,000,000
- Vic’s actual DSUEA transferable to Sadie with a timely election on Form 706 (lesser of $3 million or $5 million applicable exclusion) ............... $3,000,000
The last example below illustrates the use of the DSUEAs from more than one spouse where a surviving spouse remarries twice and uses the DSUEA from the first predeceased spouse to make *inter vivos* taxable gifts, plus the DSUEA from the second and last predeceased spouse to reduce the federal estate tax.

**Example 5** is adapted from the Example in Temp. Reg. § 25.2505-2T(c)(2).

### Example 5. Serial Remarriage with *Inter Vivos* Gifts

Mike (Husband 1) dies on January 15, 2011, and was survived by Wife Liz. Neither Mike nor Liz had made any taxable gifts during Mike’s lifetime. Liz, as Mike’s executor, made a timely portability election on Mike’s Form 706. Mike’s Will left all assets outright to Liz, and so Mike’s taxable estate and transfer tax base was zero. Therefore, Mike’s DSUEA was $5,000,000.

On December 24, 2011, Liz made completed taxable gifts to her children in the total amount (minus annual exclusions) of $2,000,000. Liz filed a timely Form 709 for those 2011 gifts. Liz is treated as using up $2 million of Mike’s DSUEA first, so Liz owed no net gift tax for 2011. At the end of 2011, Liz had a remaining applicable exclusion amount of $8 million (the remaining $3 million of Mike’s DSUEA, plus Liz’s own “untouched” $5 million exclusion amount).

In January 2012, Liz married Eddie (Husband 2). Before Liz could make any further taxable gifts, Eddie died in an accident on June 30, 2012. Eddie’s DSUEA amount was $2 million, and Liz, as Eddie’s executor, made a timely portability election on Eddie’s Form 706.

In the second half of 2012, after Eddie’s death, Liz made another taxable gift of $4 million to her children. For 2012 gift tax reporting purposes, the DSUEA that Liz can use with respect to her 2012 gift is $4 million, consisting of the $2 million DSUEA from Eddie (Husband 2) plus the $2 million of Mike’s DSUEA that was applied to Liz’s 2011 taxable gifts. Therefore, by the end of 2012, Liz has her own $5.12 million lifetime exclusion amount left, but she has no DSUEA left from Mike (Husband 1), because he ceased to be Liz’s last deceased spouse or DIPS. And Liz has no DSUEA left from Eddie, because his entire $2 million DSUEA was used up.

Therefore, if Liz dies in 2013 without remarrying again and without making any further taxable gifts, her applicable exclusion amount at the time of her death, and usable on her federal estate tax return will be $5,250,000, consisting of her own exclusion amount, adjusted for inflation.

### L. General advantages of the portability election as a post-mortem planning device, and general implications for pre-mortem planning

The availability of a portability election after the death of the “first-to-die” spouse has given married couples the chance to avoid wasting the deceased spouse’s unused lifetime exclusion amount even though the deceased spouse’s Will or trust documents reflect poor, outdated, or non-existent death tax planning. This displeases a few estate
planning professionals, who apparently would prefer that such inattentive couples be punished, or at least denied a reward, for failing to do basic or updated planning to minimize death taxes.

The main advantages of portability elections are undeniable. A timely-made portability election will avoid the wasting of the deceased spouse’s unused lifetime exclusion —

- No matter how the couple’s estate planning documents are structured,
- No matter which spouse dies first, and
- No matter how the couple’s assets are titled or how their beneficiary designations are worded.

In addition, to the extent that the estate plan puts more assets and more asset value into the potential gross estate of the surviving spouse, those assets will receive a second step-up (or step-down) to fair market value at the surviving spouse’s later death.

**Presumptions of Survivorship.** “Rationally paranoid” couples who want to preserve the availability of a portability election by first-to-die spouse’s personal representative should prefer not to rely on the state simultaneous death statute (Indiana’s is IC 29-2-14) if the statute does not trigger or state a presumption that one of them died first with respect to assets in general. Instead, these couples will include a definite presumption in each spouse’s documents.

**Combining Portability Elections with Credit Shelter Planning.** Suppose that a married couple has a combined net worth in a range that would make it possible, but not likely, that federal estate tax would be owed after the “second death” if all assets in the gross estate of the first-to-die spouse were to pass outright to the surviving spouse. Suppose, further, that both spouses’ existing estate planning documents contain either (a) a fairly typical marital deduction formula clause that would trigger the funding of a marital trust (or marital share) and a credit trust after the “first death,” or (b) an equally typical QTIP-eligible credit trust that would be funded only if the surviving spouse disclaimed assets.

Would the use of portability elections be superfluous for such a couple? Not necessarily. Depending on how well-drafted the formula clause is and how well the deceased spouse’s fiduciary follows the instructions, the formula clause might cause the credit trust to be funded with slightly less than the optimum amount to make maximum use of the deceased spouse’s unused lifetime exclusion. Or, if the deceased spouse’s documents included a disclaimer-funded credit trust, the surviving spouse might choose to disclaim less than the optimum amount of asset value, resulting in a credit trust that doesn’t use up the deceased spouse’s unused lifetime exclusion. In either case, a portability election could be used to avoid leaving too much (or any) of the deceased spouse’s unused exclusion “on the table” to be wasted.
**Requiring a Portability Election under a Prenuptial Agreement.** The possibility of a portability election (following the death of the spouse who is most likely to die first) has already become a relevant issue in the negotiation and drafting of prenuptial agreements. The party who believes he or she is most likely to die last may be well-motivated to bargain for a provision in the prenuptial agreement that would require the other party’s personal representative to make the portability election.

**Surviving Spouse Uses Assets Transferred Outright to Make Tax-Efficient Gifts.** If the members of a married couple have a long, stable marriage and shared objectives for making gifts to non-spouse beneficiaries (children, grandchildren, etc.) over a period of years or decades, then leaving assets outright to the surviving spouse at after the “first death,” combined with a portability election and future annual gifting by the surviving spouse, could be a more tax-efficient way to transfer wealth to those beneficiaries than making a one-time disposition to a credit shelter trust at the first death, because the surviving spouse can use the exclusions from taxable gifts under Code sections 2503 and 2642(c), and those exclusions will reduce the amounts of taxable transfers before the DSUEA from the deceased spouse is applied. Obviously, this works if the surviving spouse can be counted upon to proceed with that program of annual gifts.

**Requiring Surviving Spouse to Make Gifts as Quid Pro Quo for Portability Election.** What if the couple’s marriage is shorter and the level of mutual trust between the spouses is somewhat lower? Can the spouse who feels he or she is most likely to die first make an enforceable agreement with the spouse who seems most likely to die last, under which the surviving spouse is contractually obligated to make certain specified inter vivos taxable gifts after the first death, so that the surviving spouse’s annual exclusions and the DSUEA amount from the deceased spouse will be automatically used to shelter those gifts from the gift tax?

It may well be possible to structure such agreements (for the surviving spouse to continue to make inter vivos gifts) so that they are supported by adequate consideration. But if the spouse who feels he or she is likely to die first wants the DSUEA to be used by the surviving spouse to shelter future taxable gifts from the gift tax and does not have high confidence that the surviving spouse will actually make those gifts as “agreed,” it would be easier for the first spouse to simply make those gifts during his or her lifetime or at death in his or her Will or revocable trust, leaving a smaller unused exclusion amount (or none) after death.

**Discouraging Surviving Spouse from Remarrying.** If the ultimate beneficiaries under a couple’s estate plan are their own children and grandchildren, both members of the couple may want to structure their documents so that after one of them dies and after a portability election is made, the survivor will be given a disincentive to remarry, in order to prevent the loss of the estate tax savings from the portability election. It seems to this writer that this would be a tricky objective to accomplish with a portability election. Suppose that the spouse who feels more likely to die first is concerned that the
surviving spouse would use the DSUEA amount in ways that the first spouse would dislike — such as to remarry and leave the unused portion of the DSUEA to a subsequent surviving spouse. Wouldn’t it be easier for the spouse with the heightened sense of mortality to make the other spouse the beneficiary of a marital QTIP trust or credit trust or both, and to leave virtually none of his or her lifetime exclusion amount “on the table” after death?

The Black Widow Side Effect. The ability of a healthy surviving spouse to remarry multiple times, to survive the death of each successive spouse, and to receive and use a DSUEA from each deceased spouse for inter vivos gifting might be called the “Black Widow Side Effect” of portability. Jeffrey Pennell has called it “serial skid row monogamy,” because the wealthier the conniving or predatory spouse is, and the poorer and sicker (or enfeebled) each “victim” spouse is, the more likely it is that the poorer spouse will die first and leave his or her entire lifetime exclusion amount unused. The predatory surviving spouse then uses the DSUEA to fund additional inter vivos gifts and moves on to court and to wed the next patsy.

M. Disadvantages of relying primarily on portability, compared to “traditional” A-B credit shelter planning

Beyond the advantages of portability that were discussed above, standard or traditional death tax planning using credit trusts has several advantages, compared to reliance on the portability election alone:

1. The portability election is “all or nothing.” Once the first-to-die spouse has died, there is no way to make the election with respect to less than all of his or her DSUEA. The first-to-die spouse can influence the DSUEA only by structuring his or her post-mortem estate plan or inter vivos gifts in order to reduce his or her projected unused exclusion amount to a chosen size.

2. The portability election alone does not remove asset value from the potential gross estate of the surviving spouse, and also does not protect future appreciation in assets’ value from estate tax at the time of the surviving spouse’s later death.

3. The portability election achieves only one goal (allowing the surviving spouse to receive the deceased spouse’s unused exclusion amount or DSUEA) and does nothing to prevent the surviving spouse from mismanaging or making unwise dispositions of assets that he or she inherits outright. In contrast, a credit trust’s assets can be professionally (or at least independently) managed for the benefit of the surviving spouse and eventually for the benefit of the remainder beneficiaries.

4. Although the maximum DSUEA that can pass from a deceased spouse to a surviving spouse will always include or reflect the inflation adjustment under Code § 2010(c)(3)(B) for the year in which that spouse dies, the inflation
adjustment’s “benefit” to the surviving spouse is frozen as of the year of death. If a married decedent dies in 2013 with a Will that passes her entire residuary estate to an outright marital share or to a section 2056(b)(5) marital trust, the DSUEA will be $5,250,000, and the surviving spouse can add that $5.25 million to his own lifetime exclusion. But the growth in value of the marital share or marital trust will not be protected by the DSUEA at the time of the surviving spouse’s later death unless his total estate is less than his total applicable exclusion amount (including the remaining DSUEA, if any). The surviving spouse’s own exclusion amount will receive inflation adjustments; the DSUEA from the first spouse will receive no further inflation adjustment after the year of the first death. The flip side of these observations is that if there is a significant period after the “first death” during which assets held by the surviving spouse depreciate in value, the portability election, with its one-time inflation adjustment after the first death, would work just as well as, or better than, credit shelter planning.

5. The DSUEA amount could be wasted or disappear altogether if the surviving spouse does not make lifetime taxable gifts or if he or she remarries and survives the death of someone with a lower (or non-existent) potential DSUEA.

6. A portability election does not allow the first-to-die spouse’s unused lifetime GST exemption to be “transferred” to the surviving spouse.

7. Credit shelter planning for a deceased spouse with gross estate smaller than $5.25 million will “work” even though no Form 706 is required or filed. In contrast, for that same deceased spouse, a portability election can be made only by filing a timely Form 706, with the corresponding preparation time and cost.

8. If the “executor” of the first-to-die spouse’s estate — the person who has the authority to make the portability election — harbors some resentment, spitefulness, or ill-will toward the surviving spouse, the executor may refuse to file a Form 706 (or will not make the portability election), even though making the election would do no harm to the executor or to other surviving family members.

9. If a deceased spouse’s estate plan relied on credit shelter planning and if no portability election is made, the statute of limitations for IRS examination of the Form 706 return and for assessment of federal estate tax runs 3 years after the later of the filing date or the filing deadline (Code §§ 6501(a), 6501(b)(1), and 6501(c)(4)). But if a portability election is made, the IRS’s authority to examine the deceased spouse’s gift tax returns and estate tax return continues on an open-ended basis — and potentially until after the surviving spouse’s later death — for the limited purpose of determining the correct amount of the last deceased spouse’s DSUEA. Code § 2010(c)(5)(B).
10. If a portability election is made, the surviving spouse will be entitled to receive disclosure of information from the IRS about the deceased spouse’s estate tax return, and this entitlement to disclosure will continue for as long as the IRS is able to revisit the issue of the correct value of the DSUEA. See Temp. Reg. § 20.2010-3T(d).

N. Worrying or not worrying about future “claw-back”

In 2011 and 2012, many estate planners and commentators were worried about “claw-back,” because of the prospect of automatic sunsetting of estate and gift tax relief on January 1, 2013 — and the unpleasant possibility of a decrease in the lifetime exclusion amount to $1 million and/or an increase in the section 2001 top marginal tax rate to 55 percent, effective January 1, 2013. “Claw-back” was the label chosen for the perceived automatic “punishment” of donors who used the higher lifetime exclusion amount ($3.5 million to $5.12 million in 2009-2012) to make large taxable gifts and who later died in a post-2012 year when the lifetime exclusion amount would be lower.

If claw-back were to be considered a post-mortem “punishment” of earlier aggressive inter vivos gifting, the “punishment” would result from the combined effect of Code subsections 2001(b) and 2001(g). As part of the familiar cumulative estate tax computation, Code § 2001(b)(2) would (and still will) give a decedent credit for the gift tax calculated at year-of-death rates on all post-1976 taxable gifts. If claw-back occurred, it could be regarded as an unexpected increase in the estate tax imposed on the assets that the decedent had left at death, and not as an ex post facto punishment for having made large taxable gifts in earlier years with no out-of-pocket gift tax cost.

It is clear that no claw-back can occur with respect to a portability election and the DSUEA that is “transferred” to the surviving spouse after the first death: The DSUEA amount is based on the applicable exclusion amount as in effect in the year of the first death and will not be decreased if Congress subsequently reduces the amount of the basic exclusion under Code section 2010. See Temp. Reg. § 20.2010-2T(c)(1)(i) and the Preamble, Section 4 b (77 Fed. Reg. 36,153).

Recently, Jeffrey Pennell described what he called “reverse claw-back,” in a situation in which a donor (married or unmarried) made a large taxable gift in a prior year, used up his entire lifetime gift exclusion (e.g., $1 million), paid the net gift tax out-of-pocket, and then died in a later year when the lifetime exclusion is much higher (e.g., $5.25 million in 2013). If that donor had waited to make the large transfer in the later year or at death when the exclusion amount was higher, he would have paid less gift tax, or no gift tax. But the estate tax computation under Code §§ 2001(b)(2) and 2001(g) will give this deceased donor credit only for gift tax computed at the rates in effect in the year of death; the previously-used credit amount will also be calculated using the rates in effect at death. A donor in this situation who is still alive, and notices that his basic exclusion amount has increased since he made that large taxable gift and wrote that large check to the Treasury, can ameliorate the “reverse claw-back” problem by making additional
inter vivos taxable gifts to use up the additional basic exclusion before he dies. Prof. Pennell correctly points out that there are relatively few high-net worth clients who would suffer the effects of “reverse claw-back.”

If claw-back ever becomes a real problem for significant numbers of taxpayers, it will affect high-net-worth clients regardless of marital status, and whether they rely on traditional transfer tax planning (lifetime taxable gifts, credit shelter trusts, etc.) or portability or a mixture of both.

Fortunately, because Congress would have to take direct action to decrease the lifetime exclusion amount or to increase the section 2001 marginal tax rate(s) again, the problem of claw-back has now receded far into the background. In 2011 and 2012, there seemed to be majority support in Congress to address claw-back with a technical correction.⁸

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⁸ For example, see Sen. Harry Reid’s mid-2012 bill, S. 3393, which would have added a new subsection 2001(h) and a new subsection 2502(d), to explicitly deal with a decrease in the applicable exclusion amount by adding adjustments to the estate tax and gift tax computations.
Appendix


Sec. 2001. Imposition and rate of tax

(a) Imposition. A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

(b) Computation of tax. The tax imposed by this section shall be the amount equal to the excess (if any) of -

(1) a tentative tax computed under subsection (c) on the sum of -
   (A) the amount of the taxable estate, and
   (B) the amount of the adjusted taxable gifts, over

(2) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the modifications described in subsection (g) had been applicable at the time of such gifts.

For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

(c) Rate schedule.

<table>
<thead>
<tr>
<th>If the amount with respect to which the tentative tax to be computed is:</th>
<th>The tentative tax is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $10,000</td>
<td>18 percent of such amount.</td>
</tr>
<tr>
<td>Over $10,000 but not over $20,000</td>
<td>$1,800, plus 20 percent of the excess of such amount over $10,000.</td>
</tr>
<tr>
<td>Over $20,000 but not over $40,000</td>
<td>$3,800, plus 22 percent of the excess of such amount over $20,000.</td>
</tr>
<tr>
<td>Over $40,000 but not over $60,000</td>
<td>$8,200 plus 24 percent of the excess of such amount over $40,000.</td>
</tr>
<tr>
<td>Over $60,000 but not over $80,000</td>
<td>$13,000, plus 26 percent of the excess of such amount over $60,000.</td>
</tr>
<tr>
<td>Over $80,000 but not over $100,000</td>
<td>$18,200, plus 28 percent of the excess of such amount over $80,000.</td>
</tr>
</tbody>
</table>
If the amount with respect to which the tentative tax to be computed is:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Tentative Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over $100,000 but not over $150,000</td>
<td>$23,800, plus 30 percent of the excess of such amount over $100,000.</td>
</tr>
<tr>
<td>Over $150,000 but not over $250,000</td>
<td>$38,800, plus 32 percent of the excess of such amount over $150,000.</td>
</tr>
<tr>
<td>Over $250,000 but not over $500,000</td>
<td>$70,800, plus 34 percent of the excess of such amount over $250,000.</td>
</tr>
<tr>
<td>Over $500,000 but not over $750,000</td>
<td>$155,800, plus 35 percent of the excess of such amount over $500,000.</td>
</tr>
<tr>
<td>Over $750,000 but not over $1,000,000</td>
<td>$248,300 plus 39 percent of the excess of such amount over $750,000.</td>
</tr>
<tr>
<td>Over $1,000,000</td>
<td>$345,800, plus 40 percent of the excess of such amount over $1,000,000.</td>
</tr>
</tbody>
</table>

(d) **ADJUSTMENT FOR GIFT TAX PAID BY SPOUSE.** For purposes of subsection (b)(2), if –

1. the decedent was the donor of any gift one-half of which was considered under section 2513 as made by the decedent's spouse, and

2. the amount of such gift is includible in the gross estate of the decedent, any tax payable by the spouse under chapter 12 on such gift (as determined under section 2012(d)) shall be treated as a tax payable with respect to a gift made by the decedent.

(e) **COORDINATION OF SECTIONS 2513 AND 2035.** If –

1. the decedent's spouse was the donor of any gift one-half of which was considered under section 2513 as made by the decedent, and

2. the amount of such gift is includible in the gross estate of the decedent's spouse by reason of section 2035, such gift shall not be included in the adjusted taxable gifts of the decedent for purposes of subsection (b)(1)(B), and the aggregate amount determined under subsection (b)(2) shall be reduced by the amount (if any) determined under subsection (d) which was treated as a tax payable by the decedent's spouse with respect to such gift.
(f) **Valuation of Gifts.**

(1) **In General.** If the time has expired under section 6501 within which a tax may be assessed under chapter 12 (or under corresponding provisions of prior laws) on –

(A) the transfer of property by gift made during a preceding calendar period (as defined in section 2502(b)); or

(B) an increase in taxable gifts required under section 2701(d), the value thereof shall, for purposes of computing the tax under this chapter, be the value as finally determined for purposes of chapter 12.

(2) **Final Determination.** For purposes of paragraph (1), a value shall be treated as finally determined for purposes of chapter 12 if –

(A) the value is shown on a return under such chapter and such value is not contested by the Secretary before the expiration of the time referred to in paragraph (1) with respect to such return;

(B) in a case not described in subparagraph (A), the value is specified by the Secretary and such value is not timely contested by the taxpayer; or

(C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

For purposes of subparagraph (A), the value of an item shall be treated as shown on a return if the item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.

(g) **Modifications to Gift Tax Payable to Reflect Different Tax Rates.** – For purposes of applying subsection (b)(2) with respect to 1 or more gifts, the rates of tax under subsection (c) in effect at the decedent's death shall, in lieu of the rates of tax in effect at the time of such gifts, be used both to compute –

(1) the tax imposed by chapter 12 with respect to such gifts, and

(2) the credit allowed against such tax under section 2505, including in computing –

(A) the applicable credit amount under section 2505(a)(1), and

(B) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2).

-SOURCE-

Sec. 2010. Unified credit against estate tax

(a) General Rule. A credit of the applicable credit amount shall be allowed to the estate of every decedent against the tax imposed by section 2001.

(b) Adjustment to Credit for Certain Gifts Made Before 1977. The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

(c) Applicable Credit Amount. –

(1) In General. – For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under section 2001(c) if the amount with respect to which such tentative tax is to be computed were equal to the applicable exclusion amount.

(2) Applicable Exclusion Amount. – For purposes of this subsection, 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.

(3) Basic Exclusion Amount. –

(A) In General. – For purposes of this subsection, the applicable exclusion amount is $5,000,000.

(B) Inflation Adjustment. – In the case of any decedent dying in a calendar year after 2011, the dollar amount in subparagraph (A) shall be increased by an amount equal to –

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting “calendar year 2010” for “calendar year 1992” in subparagraph (B) thereof.
If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

(4) **DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT.** – For purposes of this subsection, with respect to a surviving spouse of a deceased spouse dying after December 31, 2010, the term “deceased spousal unused exclusion amount” means the lesser of –

(A) the basic exclusion amount, or

(B) the excess of –

(i) the basic applicable exclusion amount of the last such deceased spouse of such surviving spouse, over

(ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse.

(5) **SPECIAL RULES.** –

(A) **Election Required.** – A deceased spousal unused exclusion amount may not be taken into account by a surviving spouse under paragraph (2) unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account. Such election, once made, shall be irrevocable. No election may be made under this subparagraph if such return is filed after the time prescribed by law (including extensions) for filing such return.

(B) **EXAMINATION OF PRIOR RETURNS AFTER EXPIRATION OF PERIOD OF LIMITATIONS WITH RESPECT TO DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT.** – Notwithstanding any period of limitation in section 6501, after the time has expired under section 6501 within which a tax may be assessed under chapter 11 or 12 with respect to a deceased spousal unused exclusion amount, the Secretary may examine a return of the deceased spouse to make determinations with respect to such amount for purposes of carrying out this subsection.

(6) **REGULATIONS.** – The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this subsection.

(d) **LIMITATION BASED ON AMOUNT OF TAX.** The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.
Sec. 2502. Rate of tax

(a) COMPUTATION OF TAX. – The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of –

(1) a tentative tax, computed under section 2001(c), on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

(2) a tentative tax, computed under such section, on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

(b) PRECEDING CALENDAR PERIOD. Whenever used in this title in connection with the gift tax imposed by this chapter, the term "preceding calendar period" means –

(1) calendar years 1932 and 1970 and all calendar years intervening between calendar year 1932 and calendar year 1970,

(2) the first calendar quarter of calendar year 1971 and all calendar quarters intervening between such calendar quarter and the first calendar quarter of calendar year 1982, and

(3) all calendar years after 1981 and before the calendar year for which the tax is being computed.

For purposes of paragraph (1), the term "calendar year 1932" includes only that portion of such year after June 6, 1932.

(c) TAX TO BE PAID BY DONOR. The tax imposed by section 2501 shall be paid by the donor.

-SOURCE-

Sec. 2505.  Unified credit against gift tax

(a)  GENERAL RULE.  In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar year an amount equal to –

(1)  the applicable credit amount in effect under section 2010(c) which would apply if the donor died as of the end of the calendar year, reduced by

(2)  the sum of the amounts allowable as a credit to the individual under this section for all preceding calendar periods.

For purposes of applying paragraph (2) for any calendar year, the rates of tax in effect under section 2502(a)(2) for such calendar year shall, in lieu of the rates of tax in effect for preceding calendar periods, be used in determining the amounts allowable as a credit under this section for all preceding calendar periods.

(b)  ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1977.  The amount allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the individual after September 8, 1976.

(c)  LIMITATION BASED ON AMOUNT OF TAX.  The amount of the credit allowed under subsection (a) for any calendar year shall not exceed the amount of the tax imposed by section 2501 for such calendar year.

-SOURCE-