



# WRMarketplace

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## **TOPIC: Making Late Portability Elections for Non-Taxable Estates.**

**MARKET TREND:** The IRS continues to refine rules and procedures concerning how and when the portability election can be made to preserve a deceased spouse’s unused estate tax exclusion for the surviving spouse.

**SYNOPSIS:** Portability of a deceased spouse’s unused estate tax exclusion (“DSUE”) to the surviving spouse has increased estate planning options for moderately wealthy couples. The IRS recently adopted a simplified procedure for an estate not otherwise required to file an estate tax return to make a late election and capture the DSUE. Until the later of January 2, 2018 and the second anniversary of the decedent’s death, the new procedure is the exclusive method to make a late portability election.

**TAKE-AWAYS:** Portability can prevent the waste of the DSUE, and the new procedure for requesting a late portability election provides advisors and executors of eligible, non-taxable estates with a window of opportunity to make the election without the need for a private letter ruling. However, portability should still be viewed by advisors as an exception to traditional legacy planning, rather than the rule. It often serves better as a post-mortem “clean up tool” for non-existent or improperly implemented estate plans.

**PRIOR REPORTS:** 15-26; 15-18; 12-30; 11-101; 11-44; 10-135.

**MAJOR REFERENCE:** Rev. Proc. 2017-34.

Before 2011, traditional legacy plans for married couples were designed to maximize the use of the estate tax exclusion amount at each spouse's death. If a spouse did not use all of his or her estate tax exclusion amount, the unused portion was permanently lost - a use it or lose it approach. The introduction of portability in 2011 expanded the legacy planning options for many moderately wealthy couples by permitting the DSUE to be transferred to a surviving spouse, who could then use this amount in his or her own legacy planning.

### **HOW PORTABILITY HELPS**

Portability eliminates the need for spouses to create so-called "bypass" or "credit shelter" trusts at the first spouse's passing solely to take full advantage of both spouse's estate tax exclusions.

**Simple Example:** H and W are married with a total estate of \$10 million. They have no estate plan and have not made any lifetime gifts. H dies in 2017, when the federal estate tax exclusion is \$5.49 million. H's \$5 million estate passes outright to W. As these assets qualify for the federal estate tax marital deduction, H uses none of his federal estate tax exclusion. W dies after H later in 2017.

Before portability, all H's federal estate tax exclusion would have been wasted, leaving only W's \$5.49 million estate tax exclusion available at her death, resulting in a taxable estate of \$4.51 million (\$10 million total estate - \$5.49 million). Now, if H's executor made a portability election, W also could use H's DSUE of \$5.49 million, resulting in a \$0 taxable estate at W's death.

As discussed in *WRMarketplace No. 15-18*, portability often is not an ideal substitute to planning with a bypass or other trust on the death of the first spouse for numerous tax and non-tax reasons, including preserving the growth in trust assets, providing creditor protection, etc. Portability, however, offers a useful "clean-up tool" in post-mortem planning for an estate with no or improperly implemented planning.

### **PORTABILITY RULES**

Portability is **only available to married couples** and only if the **deceased spouse dies after December 31, 2010**. To transfer the DSUE to a surviving spouse, the executor of the deceased spouse's estate<sup>1</sup> must make a portability election by timely filing an estate tax return for the deceased spouse's estate.<sup>2</sup>

- Every estate making a portability election must file an estate tax return, **even if the estate would not otherwise be required to file** because its value falls under the filing threshold (for 2017, less than \$5,490,000 minus lifetime adjusted taxable gifts).<sup>3</sup>
- The estate tax return must be complete and properly prepared,<sup>4</sup> which typically requires valuation of all property held by the decedent as of the date of death.

- The estate tax return must include a computation of the DSUE.<sup>5</sup>
- The decedent must be a U.S. citizen or resident of the U.S.<sup>6</sup>
- Once made, the portability election is irrevocable.<sup>7</sup>

The due date to make the portability election is the same as the due date for filing the decedent's estate tax return, including extensions (i.e., nine months after the decedent's death plus extensions). If the deceased spouse's estate is required to file a return because it meets the filing threshold based on the value of the estate and prior lifetime taxable gifts, relief to file a late election will not be granted.<sup>8</sup>

### ***LATE ELECTION RELIEF FOR NON-TAXABLE ESTATES - REV. PROC. 2017-34***

While portability was implemented primarily to simplify estate planning for taxpayers, the rules regarding election procedures and due dates have been problematic, particularly for estates that are merely filing an estate tax return to make the portability election but otherwise fall below the filing threshold ("**non-taxable estates**"). Like larger, taxable estates, the due date for making a portability election for a non-taxable estate is nine months after the deceased spouse's death, plus extensions. However, the Treasury Regulations authorize the IRS to grant an additional extension of time to make a portability election to non-taxable estates.<sup>9</sup> Unfortunately, use of the relief available under the Treasury Regulations requires the estate to request a private letter ruling – a procedure that can be both time-consuming and expensive for a non-taxable estate (the filing fee alone is \$10,000).

The IRS had previously implemented a streamlined procedure for non-taxable estates to request an extension of time to make the election, but the procedure was only available until December 31, 2014. Since then, the IRS has been inundated with private letter ruling requests from executors of non-taxable estates seeking extensions of time to make the election, creating a significant burden on IRS resources. Recognizing the need for a permanent solution, on June 9, 2017, the IRS issued Rev. Proc. 2017-34, which sets out a simplified procedure for **non-taxable estates only** to obtain a time extension to make a portability election.

**Requirements for Relief.** For a non-taxable estate to request a time extension to make the portability election, the executor must:

- File a complete and properly prepared estate tax return on or before the later of (i) January 2, 2018, or (ii) the second anniversary of the decedent's date of death.<sup>10</sup>
- State the following at the top of the estate tax return: "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)."<sup>11</sup>

Satisfaction of these requirements is deemed to fulfill the requirements for relief under Treas. Reg. § 301.9100-3 and, upon such satisfaction, the executor is granted an

extension of time to elect portability. The estate tax return filed as part of the procedure will be considered to have been timely filed for purposes of the election. However, ***if it is later determined that the estate was required to file an estate tax return based on the value of the estate, the grant of an extension under the new simplified procedure will be deemed null and void.***<sup>12</sup>

**Impact of Late Election on Surviving Spouse.** If an estate is granted an extension of time to make the portability election pursuant to Rev. Proc. 2017-34, the decedent's DSUE is available for use retroactive to the decedent's date of death. However, if the surviving spouse paid gift tax or his or her estate paid estate tax before the election was made, and application of the decedent's DSUE results in an overpayment of gift or estate tax, then a claim for a refund of the overpayment may only be made if the limitations period for claiming a refund has not expired.<sup>13</sup>

*Example:* H died on January 1, 2014, when the federal estate tax exclusion was \$5.34 million. His \$2 million estate passed to W, his surviving spouse. H did not make any lifetime taxable gifts. Because the value of H's estate was below the filing threshold, the executor of H's estate was not required to file an estate tax return, and no return was filed.

W passed away on January 30, 2014 with an estate valued at \$9 million. W also did not make any lifetime taxable gifts. The executor of W's estate filed an estate tax return claiming W's federal estate tax exclusion amount of \$5.34 million and paid the estate tax due on October 30, 2014.

On December 1, 2017, the executor of H's estate files for relief to make a late portability election under Rev. Proc. 2017-34, meeting all the requirements for such relief. The IRS accepts the estate tax return filed without changes.

To recover the overpayment of estate taxes made for W's estate, a claim for refund would need to be filed by October 30, 2017 (within 3 years after W's estate tax return was filed). If W's estate files a claim for refund by that date ***in anticipation of the late portability election*** by H's estate, the IRS can consider and process the claim once the portability election is valid. W's executor will need to notify the IRS that the claim for refund can be considered once the election is valid.

**Impact of Rev. Proc. 2017-34 on Existing Letter Ruling Requests.** For a non-taxable estate, Rev. Proc. 2017-34 provides the only available procedure to obtain an extension of time to make a portability election until the later of January 2, 2018 or the second anniversary of the decedent's death. A ***pending letter ruling request*** filed with the IRS by an estate that meets the eligibility requirements for the new procedure ***will be closed*** (the user fee will be refunded) and ***the executor will be required to request an extension by using the new procedure.***<sup>14</sup> Any non-taxable estate that does not meet the requirements for using the new procedure may still submit a letter ruling request under Treas. Regs. § 301-9100-3.<sup>15</sup>

## TAKE AWAYS

Portability can prevent the waste of the DSUE, and the new procedure for requesting a late portability election provides advisors and executors of eligible, non-taxable estates with a window of opportunity to make the election without the need for a private letter ruling. However, portability should still be viewed by advisors as an exception to traditional legacy planning, rather than the rule. It often serves better as a post-mortem “clean up tool” for non-existent or improperly implemented estate plans.

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## NOTES

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<sup>1</sup> If no executor is appointed, qualified, and acting within the U.S., then the election may be made by any person in actual or constructive possession of any property of the decedent. Treas. Regs. § 20.2010-2(a)(6)(i)-(ii).

<sup>2</sup> Code § 2010(c)(5)(A); Treas. Regs. § 20.2010-2(a)(1). Conversely, if an estate must otherwise file an estate tax return (e.g., because the value of the estate meets the filing threshold) but does not wish to make the portability election, the executor must make an affirmative statement that the estate is not electing portability. Non-taxable estates may opt out by not filing an estate tax return. Treas. Regs. § 20.2010-2(3).

<sup>3</sup> Treas. Regs. § 20.2010-2(a).

<sup>4</sup> Treas. Regs. § 20.2010-2(a)(7).

<sup>5</sup> Treas. Regs. § 20.2010-2(b).

<sup>6</sup> Treas. Regs. § 20.2010-2(a)(5).

<sup>7</sup> Treas. Regs. § 20.2010-2(a)(4).

<sup>8</sup> Treas. Regs. § 20.2010-2(a)(1).

<sup>9</sup> See, Treas. Reg. § 20.2010-2(a)(1) and Treas. Reg. § 301.9100-3.

<sup>10</sup> If the executor previously filed an estate tax return, the estate cannot use the new procedure – the election will already have been made on the filed return or the estate will have affirmatively elected out of portability. See, Rev. Proc. 2017-34 Section 3.03.

<sup>11</sup> Rev. Proc. 2017-34 Section 4.01(1).

<sup>12</sup> Rev. Proc. 2017-34 Section 4.03.

<sup>13</sup> Rev. Proc. 2017-34 Sections 5.01 and 5.02.

<sup>14</sup> Rev. Proc. 2017-34 Section 7.02.

<sup>15</sup> Rev. Proc. 2017-34 Section 3.03.