

Legal Alert

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IRS ISSUES TEMPORARY AND PROPOSED REGULATIONS ON ESTATE AND GIFT TAX PORTABILITY

Under the Tax Relief, Unemployment Insurance and Reauthorization Act of 2010 ("2010 Tax Act"), in addition to increasing the lifetime exemption for gift and estate tax purposes to \$5 million, the 2010 Tax Act introduced the concept of portability. For decedents and surviving spouses dying after January 1, 2011, the exemption amount of a surviving spouse included not only his or her lifetime exclusion amount, but allowed the unused portion of a previously deceased spouse's lifetime exclusion as well, i.e., the Deceased Spouse's Unused Exclusion Amount or "DSUEA." Thus, as much as \$10 million could be passed by a surviving spouse to other family members without the need for a credit shelter trust, which had heretofore been the only way to shelter such sums.

The portability provisions are scheduled to expire at the end of 2012. However, there is the common belief that the concept will be continued, either because of legislation passed in an expected lame-duck session of Congress at the end of year or in retroactively effective legislation enacted in 2013.

Apparently, the IRS believes that it is likely that portability will continue because it has now issued Temporary and Proposed Regulations to implement the portability provisions of the 2010 Act ("Temp. Regs."). The Temp. Regs. are effective June 15, 2012. They supersede the prior guidance of Notice 2011-18 and Notice 20-21.

The Temp. Regs. confirm that in order to use the portability provisions, the deceased spouse's estate must file a federal estate tax return. However, the Temp. Regs. presume that the deceased spouse wanted the surviving spouse to be able to use his DSUEA. This reverses the requirement in the 2010 Tax Act that require that the deceased spouse's personal representative make an affirmative election to allow the surviving spouse to use his or her DSUEA. Now, the DSUEA will be available absent a clear showing the deceased spouse did not intend for it to be available.

The Temp. Regs. acknowledge the hardship of having to file a return in order to avail oneself of the DSUEA. The Temp. Regs. allow estates that did not otherwise have to file returns to estimate values of assets of the deceased spouse's estate, rather than securing appraisals that would have otherwise been required.

The Temp. Regs. Also address a problem that was caused by the 2010 Tax Act's use of the term "Basic Exclusion Amount" rather than the term "Applicable Exclusion Amount" in the calculation of the DSUEA. The original term suggested that the amount of the DSUEA could be understated in some situations.

The DSUEA's purpose is to simplify estate planning. However, it is simple in only the most straight-forward of situations and there can be unforeseen complications where there are serial marriages, especially where the surviving spouse remarries and the second spouse predeceases, in which case the DSUEA of the first spouse is lost to the surviving spouse.

Despite its facial attractiveness, portability is not a panacea. Even in situations where portability might otherwise "shelter" an estate from tax, there are valid reasons to continue with credit shelter trust planning. For example, where there are issues of blended families and the desire to ensure that assets will pass as both spouses wish; or issues of management of asset; or issues of deferred distributions to children and grandchildren, these situations militate towards credit shelter planning notwithstanding the availability of a full tax shelter through use of the portability provisions.