Ladies and Gentlemen:

These comments, questions and recommendations pertaining to portability of transfer tax exemptions between spouses embodied in Internal Revenue Code Sections 2001, 2010(c)(2) – (6) and 2505 are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law Section (RPTE). These Comments represent the views of the RPTE Section only and have not been approved by the ABA’s House of Delegates or Board of Governors and therefore do not represent and should not be construed as representing the position of the ABA.

The attached submission was prepared by members of the Estate and Gift Tax Committee of the Income and Transfer Tax Planning Group of RPTE, Richard S. Franklin, Tracy Blake DeVlieger, Lester B. Law, Terence S. Nunan, and Carole M. Bass. These comments were reviewed by Jonathan G. Blattmachr on behalf of the Section’s Committee on Government Submissions.

Although the attorneys who participated in preparing these Comments have clients who may be affected by the legal issues addressed by the Comments, no such member (or firm or organization to which any such member belongs) has been engaged by a client to make a submission...
with respect to, or otherwise influence the development or outcome of, the specific subject matter of these Comments.

The Committee and the RPTE Section appreciate the opportunity to submit these Comments, and we respectfully request that the Service consider our recommendations. Members of the Committee are available to meet and discuss these matters with the Service and its staff and to respond to any questions. The principal contacts for discussion are listed below.

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Very truly yours,

/s/ Tina Portuondo

Tina Portuondo  
Chair, Section of Real Property, Trust and Estate Law

cc: Cara Lee T. Neville, Secretary, American Bar Association  
Thomas M. Susman, Governmental Affairs, American Bar Association
EXECUTIVE SUMMARY

I. GENESIS AND INTENT OF COMMENTS

The following comments, questions and recommendations pertaining to portability of transfer tax exemptions between spouses embodied in Internal Revenue Code Sections 2001, 2010(c)(2) – (6) and 2505 are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law. These questions and observations have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

The following submission was prepared by members of the Estate and Gift Tax Committee of the Income and Transfer Tax Planning Group of the Section of Real Property, Trust and Estate Law (the “Section”) of the American Bar Association, Richard S. Franklin, Tracy Blake DeVlieger, Lester B. Law, Terence S. Nunan, and Carole M. Bass. These comments were reviewed by Jonathan G. Blattmachr on behalf of the Section’s Committee on Government Submissions.

If you have any questions, please feel free to contact any of the persons listed below:

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<th>Contact persons</th>
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1 All references to the Internal Revenue Code shall be to the Internal Revenue Code of 1986, as amended through the date of these comments. Generally, references to “sections”, “§§”, “section”, or “§” shall be references to the particular section or sections of the Internal Revenue Code or the Treasury’s Regulations promulgated thereunder, unless otherwise provided in the context of the commentary. To distinguish between a reference to the Internal Revenue Code section and another provision, sometimes reference will be to “IRC §” or “Code §” as the case may be. IRC §§2010(c)(2) – (6) were recently enacted as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“TRA 2010”).
Although the members of the Section who prepared these comments have clients who would be affected by the Federal tax principles addressed, or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or the outcome of, the specific subject matter of these comments. Section members, including the authors, are interested in the way that these rules affect the way they manage their practices and business units.

The intent of this submission is to assist in the refinement of the temporary and proposed regulatory guidance issued June 18, 2012. We respectfully request Treasury to consider the following analysis and questions. We appreciate the opportunity to comment and would be happy to discuss our comments in any format you would find useful.

II. CONTEXT WITHIN WHICH PRESENT COMMENTS ARE OFFERED

A. Section 2010(c)(6)

Code § 2010(c)(6) provides a specific mandate to the Secretary of the Treasury (hereinafter “Treasury”) to “prescribe such regulations as may be necessary or appropriate to carry out this subsection.”

B. Notice 2011-82 - Guidance on Electing Portability of Deceased Spousal Unused Exclusion Amount

On September 29, 2011, the IRS issued Notice 2011-82. This Notice provided guidance on the portability election and identified four specific areas requiring clarification and requested public comments by October 31, 2011 (“2011-82 Comments”).

C. Notice 2012-21 - Extension of Time to File an Estate Tax Return Solely to Elect Portability of a Deceased Spousal Unused Exclusion Amount

On February 17, 2012, the Service issued Notice 2012-21 in response to several inquiries relating to allowance of late filed returns to elect portability for 2011 decedents where filing was not otherwise required.

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2 Specifically, the Notice requested comment on the following:

“The determination in various circumstances of the DSUE amount and the applicable exclusion amount;
The order in which exclusions are deemed to be used;
The effect of the last predeceased spouse limitation described in section 2010(c)(4)(B)(i);
The scope of the Service’s right to examine a return of the first spouse to die without regard to any period of limitation in section 6501; and
Any additional issues that should be considered for inclusion in the proposed regulations.”

3 For consistence in the term used in the new regulations, we refer to the Deceased Spousal Unused Exclusion Amount as “DSUE amount” herein.

4 Notice 2012-21 provided that in estates of married individuals who died in the first 6 months of 2011 with assets of $5 million or less, if the executor filed Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes (Form 4768), requesting an extension of time for filing within 15 months of the date of death and properly citing to Notice 2012-21, would be granted an automatic extension allowing the return to be filed within such 15-months period.
D. Issuance of Temporary Regulations and Notice of Proposed Rulemaking

Treasury issued temporary regulations and published a notice of proposed rulemaking in the Federal Register on June 15, 2012 including a request for comments by September 17, 2012. The comments in this submission are responsive to that request. The temporary and proposed regulations, which are identical, are collectively referred to as the “Portability Regulations,” and we believe that these comments should apply to both.

III. GENERAL INTRODUCTORY COMMENTS

The General Explanation of the Administration’s Fiscal Year 2012 Revenue Proposals issued by the Department of Treasury (commonly called the “2012 Greenbook”) states that, without portability, married couples would be required to retitle assets into each spouse’s separate name and use a trust structure in order to allow the first spouse to die to take full advantage of his or her exclusion while providing for the surviving spouse to benefit from all of the property of the spouse dying first. The 2012 Greenbook further states that portability is intended to “obviate the need for such burdensome planning.”

By its terms, TRA 2010 will sunset at the end of 2012, and with it portability will expire. In the 2013 Greenbook, President Obama proposes to make portability a permanent fixture of our transfer tax system. We continue to support portability as embodied in the legislation and the accompanying Portability Regulations, as well as the President’s proposal for permanence.

We applaud Treasury for these regulations, and support the overall approach of these regulations of making portability the middle class taxpayer-friendly provision Congress intended. We believe that portability is an important economic benefit and that in these regulations the Treasury has set forth a sound and thoughtful approach that recognizes portability’s value and promotes taxpayers’ ability to realize its benefits.

IV. ANALYSIS OF PORTABILITY REGULATIONS

A. Making or Declining to Make the Portability Election (Prop. Reg. §§ 20.2010-2T(a)(1); -2T(a)(2); -2T(a)(3); -2T(a)(6); and -2T(b))
   1. Gap Between Validity of Election and Return Requirements
      a. Making the Portability Election

Treasury clarified that an executor of an estate of a decedent makes a “portability election” by filing a timely, complete and properly-prepared United States Estate (and Generation-
Skipping Transfer) Tax Return (Form 706), sometimes also called an “estate tax return,” unless the executor chooses not to elect portability and complies with the requirements of Prop. Reg. § 20.2010-2T(a)(3)(i).\textsuperscript{10}

The portability election must always be made within nine months of the deceased spouse’s death, plus extension (if an extension has been timely obtained). The preamble noted that one commentator questioned what deadline existed under the “timely filing requirement” for an estate below the filing threshold set forth in Section 6018(a) (i.e., estates below the basic exclusion amount, less prior taxable gifts).\textsuperscript{12} In the preamble, the Treasury specifically answered this question, acknowledging that “the Code does not specify a due date” for estates below the filing threshold, but if such small estate wishes to take advantage of portability, it will be subject to the same time period for filing as those estates that have met the threshold for filing. Specifically, Prop. Reg. § 20.2010-2T(a)(1) deems that any estate making the election is required to file a return under Section 6018(a).

We believe this result is consistent with good administration practices and the Technical Explanations of the Joint Committee on Taxation.

Given that the new proposed regulations are setting the filing requirement for estates under the filing threshold, Treas. Reg. § 301.9100-3 discretionary relief should be available. We believe that it makes perfect sense that the Treasury should have the authority to grant this relief in appropriate circumstances. We respectfully request the Treasury to confirm this analysis. The portability election is new, coming at a time of great instability in the estate tax laws. As such, we believe that the Treasury should plainly state that Treas. Reg. § 301.9100-3 discretionary relief is available in this circumstance if the standards set forth therein are satisfied.

Furthermore, under Treas. Reg. § 301.9100-2(b), an automatic six month extension of time (from the due date of a return excluding extensions) to make a regulatory or statutory election such as the portability election is available if corrective action is taken within that six month period. This existing regulatory relief provision is applicable to the limitations period governed by statute. We believe that for estates under the filing threshold, the Treasury should consider setting forth some simple steps that the executor could take within the 6 month period that would constitute the corrective action as to making the portability election. Therefore, in the context of the portability election, if an estate tax return is not filed within 9 months of the decedent’s death and an extension request is not filed within that period, we suggest that the Treasury indicate that filing the estate tax return (complete and properly prepared) on which the portability election is made is sufficient corrective action to qualify under Treas. Reg. § 301.9100-2(b) if the action is taken during the following 6 month period (i.e., the 10th – 15th months).

\textsuperscript{10} Prop. Reg. § 20.2010-2T(a).
\textsuperscript{12} Lester B. Law, LISI Estate Planning Newsletter #1885 (November 1, 2011).
b. Portability Election Not Made

Prop. Reg. § 20.2010-2T(a)(3) provides that a portability election is not made or not considered to be made, if either of the following applies:

“(i) The executor states affirmatively on a timely-filed estate tax return, or in an attachment to that estate tax return, that the estate is not electing portability under section 2010(c)(5) ... [or]

(ii) The executor does not timely file an estate tax return in accordance with paragraph (a)(1) of this section.”

The implication is that failing to meet this standard means the return is not sufficient to constitute a valid estate tax return and hence the portability election is not made. We request Treasury to elaborate on the circumstances under which an estate tax return filing is so deficient as to constitute a non-return and non-election of portability, and to provide illustrative examples.

c. Application of the Complete and Properly-Prepared Standard

Under the Portability Regulations, an estate tax return is complete and properly prepared if it is prepared in accordance with the instructions for the return and if the requirements of Treas. Reg. §§ 20.6018-2 (the person responsible for filing return), 20.6018-3 (the return must contain adequate information regarding assets, deductions and credits), and 20.6018-4 (the documents that must accompany return) are satisfied. The implication is that failing to meet this standard means the return is not sufficient to constitute a valid estate tax return and hence the portability election is not made. We request Treasury to elaborate on the circumstances under which an estate tax return filing is so deficient as to constitute a non-return and non-election of portability, and to provide illustrative examples.

d. Misidentification of Spouse

The Portability Regulations discussed above evidence a policy decision that the filing of an estate tax return showing a DSUE amount gives rise to a portability election, unless there is an affirmative election out of portability. Accordingly, we submit that the surviving spouse of a decedent should get the DSUE amount, even if he or she is unknown to the executor or is misidentified on the estate tax return. Confirmation of this point in the final regulations would be helpful.

2. Further Clarification

a. Protective Elections

Guidance on how to make a “protective” election also would be useful. By way of example, where the existence of a deceased spousal unused exclusion (“DSUE”) amount (and/or perhaps the identity of an executor) depends on the outcome of litigation, a protective election would preserve the portability election. If authorization to make a protective election is automatic and just to be assumed, then an example in illustration of the idea is requested.

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14 We note in Prop. Reg. § 20.2010-3T(c)(1)(ii) that the deceased spousal unused exclusion (“DSUE”) amount may be adjusted if there is a valuation adjustment or correction of an error in the calculation, and Prop. Reg. §20.2010-3T(d) contemplates that there may be adjustments made if there is an examination of the estate tax return. Accordingly, we believe that Treasury understands that mistakes may be made and adjustments would be needed, without having to forgo the entire portability election.
b. Marital Agreements - Who May Make the Election?

The Portability Regulations prescribe new rules under Prop. Reg. §20.2010-2T(a)(6) identifying the persons who are permitted to make the portability election. However, several of the 2011-82 Comments also requested guidance on the effect of spousal agreements specifying who is responsible for making the election and whether regulations might offer some level of protection to a surviving spouse relying on an enforceable agreement with the decedent that the election would be made.

Guidance would be useful as to any situations in which a marital agreement could provide a surviving spouse the right to file an estate tax return and make the portability election, if the surviving spouse is not the appointed executor. If, for example, a prenuptial agreement provides that the decedent’s executor shall make the portability election at the request of the surviving spouse and if the decedent’s estate is not otherwise required to file an estate tax return, we believe that the surviving spouse should have the ability to file an estate tax return and make the portability election if the executor (who is not the surviving spouse) refuses to comply.

Similarly, if there is litigation concerning the validity of the prenuptial agreement and, as a result, the executor refuses to file an estate tax return and make the portability election then we believe that the surviving spouse should be authorized to make a protective election.

We recognize that Code § 2010(c)(5) uses the term “executor” in reference to making the election. The Treasury may believe that it’s the role of the state courts to sort out any claims by the surviving spouse with regard to the executor failing or refusing to make the portability election. State court decisions, however, are time consuming and expensive. The portability election period will close quickly. At a minimum, perhaps the Treasury could give guidance on whether if a surviving spouse prevails in forcing an executor to file an estate tax return making the portability election, albeit late, that such state court action would constitute good cause under Treas. Reg. § 301.9100-3 (see section IV.1.a, above).

c. Liberalizing who can make the election.

The Portability Regulations provide that if an executor (or administrator) is appointed, qualified and acting, only that executor can file a return and make the portability election. If, for example, the appointed personal representative’s official authority has terminated by the time for filing the estate tax return, can someone else file the return and make the portability election? Would a surviving spouse with rights under a prenuptial agreement be deemed in constructive possession of property of the decedent, such that the spouse would be authorized to file a return to elect portability?

d. Surviving Spouse as Limited or Special Executor

The laws of some states permit a person to petition the applicable court for limited letters granting authority to such person to act in a fiduciary capacity for a limited or special purpose. If the surviving spouse has a pending application in the appropriate state court for such limited letters giving him or her the right to file the decedent’s estate tax return and to

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make a portability election, but such application will not be determined prior to the due date of the return we believe that the surviving spouse should be authorized to make a protective election. Furthermore, we request confirmation that a grant of such limited authority to the surviving spouse by a state court would authorize the surviving spouse to make the portability election even if another person is appointed, qualified and acting as executor (or administrator).

B. What Constitutes a “Complete and Properly Prepared Return” -- Determination of Value by Executors of Smaller Estates (Prop. Reg. § 20.2010-2T(a)(4); and -2T(a)(7))

1. Return Requirements

For smaller estates in which an estate tax return would not be required to be filed (other than to make the portability election), Prop. Reg. § 20.2010-2T(a)(7)(ii)(A) provides a very helpful rule that the value of certain property which would qualify for the marital and/or charitable deductions under Code §§ 2056 and 2055, respectively, does not need to be reported.\(^\text{16}\)

2. Exceptions to Special Valuation Rule

Prop. Reg. § 20.2010-2T(a)(7)(ii)(A) provides four exceptions\(^\text{17}\) to the rule avoiding valuation in smaller estates and defines situations in which marital deduction or charitable deduction property in estates below the filing threshold must be valued and reported by the executor.

a. Prop. Reg. § 20.2010-2T(a)(7)(ii)(A)(1) – Where the value of marital or charitable deduction property relates to or affects the value passing from the decedent to another person

\textit{Problem:} Assume that H’s estate is comprised entirely of one privately held business with an estimated value of $1,000,000. H owned all 100

\textit{... However, this rule does not apply to marital deduction property or charitable deduction property if _}

\begin{enumerate}
\item of such property relates to, affects, or is needed to determine, the value passing from the decedent to another recipient;
\item The value of such property is needed to determine the estate’s eligibility for the provisions of sections 2032, 2032A, 6166, or another provision of the Code;
\item Less than the entire value of an interest in property includible in the decedent’s gross estate is marital deduction property or charitable deduction property; or
\item A partial disclaimer or partial qualified terminable interest property (QTIP) election is made with respect to a bequest, devise, or transfer of property includible in the gross estate, part of which is marital deduction property or charitable deduction property.”
\end{enumerate}

\(^{16}\) We note that Prop. Reg. §20.2010-2T(a)(7)(ii)(B) provides that Prop. Reg. § 20.2010-2T(a)(7)(ii)(A) applies only if the executor exercises due diligence to estimate the fair market value of the gross estate. Thus, there will be a reporting of value, albeit without the rigors and expense typically associated with filing a regular estate tax return.

\(^{17}\) Prop. Reg. § 20.2010-2T(a)(7)(ii)(A)(1) – (4) provide in part as follows:
shares of the company’s stock. H could divide the stock between his surviving spouse and child in a number of ways, having different implications under Prop. Reg. § 20.2010-2T(a)(7)(ii)(A). Consider these scenarios:

A. H devises 10 shares to the child and 90 shares to the surviving spouse.

B. H’s will devises the number of shares to the child needed to give him $100,000 and the balance to the surviving spouse.

C. H’s will divides the stock on a fractional basis leaving 90% to his surviving spouse, W, and 10% to a child.

In each of the scenarios, the value of the estate is under the filing threshold. But for the portability election, no return would likely be filed. For purposes of the discussion below, assume if the stock passing to the surviving spouse needs to be valued, it is solely as a consequence of filing an estate tax return making the portability election.

In scenario A, under Prop. Reg. § 20.2010-2T(a)(7)(ii)(A), only the 10 shares passing to the child need to be appraised. In scenarios B and C, all of the stock would need to be valued under the exceptions of Prop. Reg. § 20.2010-2T(a)(7)(ii)(A)(1) and (3). In some cases, perhaps only be a small additional expense would be involved in appraising the remaining 90 shares in scenario A, as well as the remaining interests in scenarios B and C. In some cases, the valuation concepts applicable to the remaining interests passing to the marital deduction share could be different.

In this example, the amount of stock passing to the surviving spouse would be a majority block. Many of the valuation firms would charge more to value the other stock or interest in the same property passing to the surviving spouse. Just preparing another valuation report could result in additional expense. We respectfully request the Treasury to consider reducing the circumstances in which an additional more complicated appraisal must be obtained in order to make the portability election.

The question is whether the expense of engaging a business valuation firm to value the share passing to the surviving spouse is justified in any of these scenarios to protect the interests of the government when a return is being filed merely to enable the executor to make the portability election. In particular, we think that the need for the exception in Prop. Reg. § 20.2010-2T(a)(7)(ii)(A) to protect the interests of the government should be unnecessary, as long as the value of the non-spousal or non-charitable property is being properly determined. Under Prop. Reg. § 20.2010-2T(d), the IRS may examine the returns of the decedent for purposes of determining the decedent’s DSUE notwithstanding the normal statute of limitations. We believe that the government’s interests are sufficiently protected by this rule.

A similar circumstance arises when a surviving spouse elects against the Will, with the result that she or he is entitled to a percentage of the estate. Regardless of
whether the elective share is satisfied by agreement and the expense of appraisal avoided, this exception would require that all of the assets be appraised and a report of value filed.

Similarly, where there is a class gift and the surviving spouse is a member of the class, all of the properties which could be used to fund the class gift would have to all be valued.

We believe that the application of the exceptions Prop. Reg. § 20.2010-2T(a)(7)(ii)(A)(1) and (3) may be overly broad. Accordingly, we respectfully request Treasury reconsider the rationale for the exceptions and determine if they could be more narrowly tailored. While we acknowledge that the problem presented above is akin to Example 3 in Prop. Reg. §20.2010-2T(a)(7)(ii)(C), we respectfully request re-consideration to alleviate the need to value all of the assets.


Prop. Reg. § 20.2010-2T(a)(7)(ii)(2) provides the exception to non-reporting of value if the value of the property (that may pass to the surviving spouse or to charity) is needed to “determine the estate's eligibility for the provisions of sections 2032, 2032A, 6166, or another provision of the Code [emphasis added].” We question whether the clause “another provision of the Code” is overly broad in this context. For instance, the adjusted basis of property acquired by the surviving spouse at the death of the decedent is the property’s fair market value at the decedent’s date of death under Code §1014. Is this language intended to include Code §1014? If so, it applies to virtually all assets. We do not believe that Treasury intended this result. We respectfully request that Treasury re-consider the catch-all phrase “another provision of the Code” and enumerate the code provisions intended. Perhaps, limiting the provision to situations where the estate must make an affirmative election (such as that under Code 6166) would be sufficient.

c. Prop. Reg. § 20.2010-2T(a)(7)(ii)(4) – Where there is a partial disclaimer or partial QTIP election relating to marital deduction or charitable deduction property

Consider the slightly different situations in which the surviving spouse was entitled to 100% of a family business estimated to be worth $1,000,000 (the only asset) but disclaims 10%, which passes to child, or perhaps she disclaims 50% with the result that it passes to a trust which qualifies for the marital deduction. In either event, it appears that a valuation of all interests in the business would be required under the 4th exception. We offer the same comment here respectfully requesting Treasury’s review of this exception under Prop. Reg. § 20.2010-2T(a)(7)(ii)(4), to determine if the exception can be narrowed.

C. Remarriage Situations (Prop. Reg. §§ 20.2010-3T and 25.2505-2T))

The Portability Regulations now address the situation where a surviving spouse is the surviving spouse of multiple marriages.

1. Possible typographical error in Examples

The regulations provide examples of how one calculates the DSUE amount available to a surviving spouse. It appears that there was a typographical error in Prop. Reg. § 20.2010-
3T(b)(2)(Example) and Prop. Reg § 25.2505-2T(c)(2)(Example 1). In those examples, they conclude that W’s applicable exclusion amount is $9 million. W’s applicable exclusion amount should be $9.12 million, since W dies in 2012 when her basic exclusion amount would be $5.12 million (and not $5 million).

D. Non-residents who are Not Citizens

Comments noted that it was unclear from the statutory language whether a Non-Resident Alien (“NRA”) could create a DSUE amount and the effect of treaty provisions. Prop. Reg. § 20.2010-3T(e), and Prop. Reg. § 25.2505-2T(f), provide that a non-resident surviving spouse who is not a US citizen at the time the DSUE amount is to be used cannot use any DSUE amount of a deceased spouse, except as allowed under any treaty. We believe that it would be helpful for the Portability Regulations to provide examples confirming that if the non-resident surviving spouse does become a US citizen prior to making a transfer subject to gift or estate taxes, the DSUE amount would be available for use.

It is unlikely that any current treaty provision would specifically allow use of the DSUE amount given the recent enactment of TRA 2010. It would be helpful to have clarification whether the proposed regulations contemplates an express reference to DSUE amounts or an interpretation of the treaty to the effect that DSUE amounts are within the contemplated application.

E. QDOTs

Prop. Reg. §§ 20.2010-3T(c)(2) and 25.2505-2T(d)(2) provide that when property from a deceased spouse’s estate passes to a Qualified Domestic Trust (“QDOT”), the surviving spouse’s ability to use DSUE amount is suspended until the occurrence of the final QDOT distribution or other final event on which tax under Code § 2056A is imposed (e.g., the surviving spouse’s death or earlier termination of all QDOTs for that surviving spouse). At that point, the DSUE amount is re-determined.18 The Portability Regulations provide an example of how this would work.19

1. Possible waste of DSUE amount while waiting

Prop. Reg. § 25.2505-2T(d)(2) provides that the DSUE amount is suspended, and included into the computation of a surviving spouse’s applicable exclusion amount, with respect to property that passed from the decedent to a QDOT for such surviving spouse. The suspended DSUE amount becomes available to the surviving spouse upon the date of distribution or final event which would cause the imposition of the tax under Code § 2050A (the “termination date”). The Portability Regulations provide the following example:

(ii) Example. The following example illustrates the application of this paragraph (d)(2):

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18 The Preamble of the Regulations indicate that there were several possibilities on how to approach the use of the DSUE amount in the Portability Regulations, and that the approach taken was to preserves the DSUE amount first for use against this QDOT tax liability — making the DSUE amount available to the surviving spouse if and only if there is excess exclusion remaining after the final redetermination.

Example. (i) Facts. Husband (H), a US citizen, dies in January 2011 having made no taxable gifts during his lifetime. H's gross estate is $3,000,000. H's wife (W) is a US resident but not a citizen of the United States and, under H's will, a pecuniary bequest of $2,000,000 passes to a QDOT for the benefit of W. H's executor timely files an estate tax return and makes the QDOT election for the property passing to the QDOT, and H's estate is allowed a marital deduction of $2,000,000 under section 2056(d) for the value of that property. H's taxable estate is $1,000,000. On H's estate tax return, H's executor computes H's preliminary DSUE amount to be $4,000,000. No taxable events within the meaning of section 2056A occur during W's lifetime with respect to the QDOT. W makes a taxable gift of $1,000,000 to X in December 2011 and a taxable gift of $1,000,000 to Y in January 2012. W dies in September 2012, not having married again, when the value of the assets of the QDOT is $2,200,000.

(ii) Application. H's DSUE amount is redetermined to be $1,800,000 (the lesser of the $5,000,000 basic exclusion amount in 2011, or the excess of H's $5,000,000 applicable exclusion amount over $3,200,000 (the sum of the $1,000,000 taxable estate augmented by the $2,200,000 of QDOT assets)). On W's gift tax return filed for 2011, W cannot apply any DSUE amount to the gift made to X. However, because W's gift to Y was made in the year that W died, W's executor will apply $1,000,000 of H's redetermined DSUE amount to the gift on W's gift tax return filed for 2012. The remaining $800,000 of H's redetermined DSUE amount is included in W's applicable exclusion amount to be used in computing W's estate tax liability.

Although the foregoing example covers the usual situation where the surviving spouse dies and QDOT triggers Code § 2056A, there may be situations where the U.S. resident surviving spouse becomes a U.S. citizen during life. See e.g., Treas. Reg. § 20.2056A-10. Assume the same facts as Prop. Reg. § 25.2505-2T(d)(2)(ii)(Example), except that W's taxable gift was $6 million in 2011 (using up her applicable exclusion amount and paying a gift tax of $350,000 on the $1 million in excess of her $5 million applicable exclusion amount) and then W becomes a U.S. citizen in January 2012. Also assume that in February 2012 W makes a taxable gift of $4 million. What are W's gift tax implications for 2011 and 2012?

We also question how Prop. Reg. § 25.2505-2T(b)(i.e., the ordering rule) and Prop. Reg. §25.2505-2T(c)(1)(i.e., the special rule in the case of multiple deceased spouses and previously applied amounts) apply in the case of a QDOT.
F. Scope of Review of Predeceased Spouse’s Return (Section 20-2020-3T(d))

Prop. Reg. §§ 20.2010-2T(d), 20.2010-3T(d), and Prop. Reg. § 20.2505-2T(e) provide that the IRS can examine the returns of any deceased spouse of a surviving spouse whose DSUE amount is claimed to be included in the applicable exclusion amount of the surviving spouse, regardless of the normal statute of limitations applicable to such returns of such deceased spouse(s) and may adjust the DSUE amount(s) as calculated on such return(s). This authority applies to each transfer by a surviving spouse using a ported DSUE amount. However, the IRS’s authority to assess additional taxes is limited to the normal statute of limitations applicable to the particular deceased spouse’s return. We request clarification on the operation of this rule as follows:

1. Issues Open Upon Examination

In the event of an examination of the previously filed estate tax return of a deceased spouse pursuant to section 20.2010-3T(d), we presume the surviving spouse is entitled to claim additional deductions, including the fees incurred in such examination, and to seek to reduce the value of assets reported on the estate tax return. We request clarification of this issue.

2. Effect of Examination

The examination of returns specifically authorized by these sections is intended to ascertain the appropriate DSUE amount and not to assess additional tax in the predeceased spouse’s estate if the statute of limitations has run. We request clarification that an adjustment to DSUE based on examination of a return of a predeceased spouse outside the limitations period will not affect the basis of such assets for income tax purposes.

3. Participation in Examination Process

If a subsection (d) examination takes place prior to the expiration of the applicable statute of limitations, will the executor of the deceased spouse and the executor of the estate of the surviving spouse each have independent standing to participate in the examination? If the subsection (d) examination takes place after the applicable statute of limitations has expired in the predeceased spouse’s estate, will the executor of the deceased spouse be permitted to participate in the examination?

4. Examination Limited to Valuation Issues

We request confirmation that a subsection (d) examination after the limitations period is limited to determination of DSUE amount from a reporting of assets and valuation standpoint and may not extend into distinct issues such as the validity of the marriage of the spouses.

G. What happens if the portability provisions end in 2012, and a surviving spouse made a taxable gift using some of the ported DSUE amount?

In light of the fact that taxpayers may use DSUE in 2012 (and may have used DSUE in 2011) for gifts, it is unclear what will happen if portability is no longer in existence in 2013 and the taxpayers die. We request Treasury’s clarification that the DSUE amount actually
used in a year when portability was available will be recognized in future years so that there will be no “recapture” or “clawback” of the DSUE amount actually used.

H. Rev. Proc. 2001-38

We request that the Treasury re-examine Revenue Procedure 2001-38\(^{20}\) in the context of portability planning and amend this ruling to permit intentional estate tax QTIP elections in estates having less value than the deceased spouse’s available applicable exclusion amount under Section 2010. The IRS issued this revenue procedure in response to numerous requests for relief in situations in which the estate made an unnecessary QTIP election. For example, the procedure is designed to provide relief if a QTIP election is made for an estate having a value less than the applicable exclusion amount under Section 2010. In such as case, the election is unnecessary because no estate tax would be imposed without the election. The procedure notes that in some cases QTIP elections were mistakenly made for by-pass trusts.\(^{21}\)

The revenue procedure applies to QTIP elections under Section 2056(b)(7) where the election was not necessary to reduce the estate tax liability to zero, based on final estate tax values. Rev. Proc. 2001-38 specifically does not apply to protective elections; or to situations where a partial QTIP election was needed to reduce estate tax liability to zero and the executor made the election with respect to more property than was necessary; or to elections that are stated in terms of a formula designed to reduce the estate tax to zero. For example, if the executor made 50% QTIP election, when a 35% election would have zeroed out estate taxes, the procedure offers no relief.

QTIP elections within the scope of the procedure will be ignored for federal estate, gift and GST tax purposes, and the property that was the subject of the election will not be taxed in the surviving spouse’s estate. The revenue procedure makes a blanket statement that “In the case of a QTIP election within the scope of this revenue procedure, the Service will disregard the election and treat it as null and void for purposes of sections 2044(a), 2056(b)(7), 2519(a), and 2652.” Then the Service sets forth a procedure to follow in establishing whether an election is within the scope of the revenue procedure:

\[
\text{To establish that an election is within the scope of this revenue procedure, the taxpayer must produce sufficient evidence to that effect. For example, the taxpayer may produce a copy of the estate tax return filed by the predeceased spouse’s estate establishing that the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes. Such information, including an explanation of why the election should be treated as void under this revenue procedure, should be submitted either with the Form 706 filed for the surviving spouse’s estate, or with a request for a}\]


Rev. Proc. 2001-38 does not state whether the Service could ignore any “unnecessary” QTIP election on its own accord or whether this procedure’s relief is solely within the control of the taxpayer.

After the advent of portability, a taxpayer in planning his or her estate may wish to establish a QTIP trust and have his or her executor make the QTIP election (i.e., within the scope of Rev. Proc. 2001-38) to enable his or her estate tax exclusion to pass to his or her spouse via portability. In simple terms, with portability a married couple can pass $10.24 million of assets in 2012 without any estate taxes and with a full step-up in basis under Code § 1014 upon the surviving spouse’s death. Relying upon a traditional by-pass trust may not achieve that result. In planning his or her estate, however, the first spouse to die may desire to use a QTIP trust for passing her or his property to surviving spouse (i.e., for which a QTIP election would be made thereby permitting portability of his or her applicable exclusion amount), rather than an outright disposition of the property to the surviving spouse, for one of more of the following reasons:

1. To enable the deceased spouse to maintain control of the ultimate disposition of the QTIP following the surviving spouse’s death;
2. To enable the executor for the deceased spouse to make a reverse QTIP election and thereby not waste the deceased spouse’s GST exemption;
3. To enable the deceased spouse to create a spendthrift trust for the surviving spouse and thereby provide some degree of creditor protection for these trust assets; and
4. To avoid paying state estate taxes on any difference between the state estate tax exclusion amount and the Federal exclusion amount.

For example, H and W are domiciled in the District of Columbia, each has $4 million of assets, no debts, have been previously married, and have made no taxable gifts. The District of Columbia, which has an estate tax, provides an estate tax exemption amount of $1 million. If H dies first and funds a traditional by-pass trust with his $4 million estate, it would require a payment of $280,400 in District of Columbia death taxes if the state death tax is charged to the by-pass trust (i.e., resulting in a net funding of $3,719,600). The payment of the District of Columbia estate taxes could be avoided upon H’s death if H’s assets are qualified for the Federal estate tax marital deduction. Using portability, H’s applicable exclusion could be transferred to W by making the portability election. If H’s assets appreciate in value during the period between the time of his death and W’s death, having the assets included for Federal estate tax purposes in W’s estate may result in lower income taxes as a result of there being a step-up in basis as to all of their aggregate assets. But for Rev. Proc. 2001-38, H and W could achieve these results by utilizing a QTIP trust that would receive all of H’s assets upon his death. The QTIP trust would provide the

22 See e.g., Franklin & Walls, State Death Tax Planning, Trusts & Estates (September 2011).
advantages of enabling the use of $4 million of H’s GST exemption by making the reverse QTIP election, allowing H to control the ultimate disposition of the QTIP assets upon W’s death, and enabling H’s assets to be owned in a spendthrift trust for W’s benefit. These latter benefits are those typically associated with a traditional by-pass trust.

Additionally, the Treasury seems to contemplate that a QTIP election could be made (i.e., within the scope of Rev. Proc. 2001-38) to enable portability of the deceased spouse’s applicable exclusion amount in Prop. Reg. § 20.2010-2T(a)(7)(ii)(C), which concerns the special rules for not reporting the value of certain marital or charitable deduction property:

(C) Examples. The following examples illustrate the application of paragraph (a)(7)(ii) of this section. In each example, assume that Husband (H) dies in 2011, survived by his wife (W), that both H and W are US citizens, that H’s gross estate does not exceed the excess of the applicable exclusion amount for the year of his death over the total amount of H’s adjusted taxable gifts and any specific exemption under section 2521, and that H’s executor (E) timely files Form 706 solely to make the portability election.

Example (2). (i) Facts. H’s will, duly admitted to probate and not subject to any proceeding to challenge its validity, provides that H’s entire estate is to be distributed to a QTIP trust for W. The non-probate assets includible in H’s gross estate consist of a life insurance policy payable to H’s children from a prior marriage, and H’s individual retirement account (IRA) payable to W. H made no taxable gifts during his lifetime.

(ii) Application. E files an estate tax return on which all of the assets includible in the gross estate are identified on the proper schedule. In the case of the probate assets and the IRA, no information is provided with regard to date of death value in accordance with paragraph (a)(7)(ii)(A) of this section. However, E makes a QTIP election and attaches a copy of H’s will creating the QTIP, and describes each such asset and its ownership to establish the estate’s entitlement to the marital deduction in accordance with the instructions for the estate tax return and §20.2056(a)-1(b) (except with regard to establishing the value of the property). In the case of the life insurance policy payable to H’s children, all of the regular return requirements, including reporting and establishing the fair market value of such asset, apply. Finally, E certifies on the estate return E’s best estimate, determined by exercising due diligence, of the fair market value of the gross estate in accordance with paragraph
We realize that the above example is in the new regulations to illustrate the special rules for not reporting the value of certain marital or charitable deduction property, and that the Treasury probably did knowingly mean to overrule or contradict Rev. Proc. 2001-38. Even if the Treasury inadvertently provided this example within the scope of Rev. Proc. 2001-38, it illustrates a plan that many families may wish to utilize.

It is also worth noting that Example 3 of Prop. Reg. § 20.2010-2T(b)(5) illustrating the special QDOT rule in Prop. Reg. § 20.2010-2T(b)(4) is also a situation in which QDOT election is being made for a QDOT that is less in value than the remaining applicable exclusion amount upon the deceased spouse’s death, which enables a portability election and tentative DSUE to be determined based on a marital deduction being allowed. To our knowledge there is not a companion ruling like Rev. Proc. 2001-38 applicable to QDOT elections. If Rev. Proc. 2001-38 is not amended or clarified, given the advent of portability, the planning for a non-U.S. citizen spouse would have a significant option that is not allowed for citizens.

We believe that Rev. Proc. 2001-38 was meant to provide relief from QTIP elections that were not beneficial to taxpayers (and in circumstances where the government’s interests were not prejudiced). Now with portability, unwinding some QTIP elections within the scope of that ruling would be harmful and unwanted. The executor making the QTIP election ought to be able to make the QTIP election in a manner that forestalls any later attempt to void the election.

We propose that Schedule M of Form 706 be revised to add a check box (which could relate to an item number on the Schedule M corresponding to QTIP) that would enable the executor to indicate that the QTIP election is intentionally being made and that the executor is foregoing the possibility of requesting relief under Rev. Proc. 2001-38. Alternatively, we propose that Rev. Proc. 2001-38 be amended to indicate that relief will not be available to the extent that both a QTIP election and a portability election are made on the deceased spouse’s estate tax return resulting in DSUE being available to the surviving spouse. This would enable the executor to qualify for the marital deduction by using a QTIP trust, allow portability of the deceased spouse’s remaining applicable exclusion amount and protect the government’s interests in the fair administration of the tax.

CONCLUSION

We appreciate the opportunity of providing these comments. We would be happy to continue to work together to address new issues which will develop as we deal with the implementation of portability.