April 25, 2013

The Honorable Max Baucus, Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Dave Camp, Chairman
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Orrin G. Hatch
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sander M. Levin
Ranking Member
House Committee on Ways & Means
1236 Longworth House Office Building
Washington, DC 20515

RE: Request for Legislation Permitting Administrative Relief for Certain Late Lifetime Qualified Terminable Interest Property (QTIP) Elections; Certain Late Qualified Revocable Trust Elections and Certain Portability Elections

Dear Chairmen Baucus and Camp, and Ranking Members Hatch and Levin:

The following comments are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law (the “Section”). These comments have not been approved by the House of Delegates or Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

The Section respectfully requests that Congress consider enacting legislation which would remedy the disparate treatment of taxpayers under Treasury Regulations Section 301.9100-3 with regard to the Internal Revenue Service’s (the “IRS”) regulatory authority to grant administrative relief to taxpayers in the following three situations: (i) late or defective lifetime (i.e., inter vivos) QTIP elections (the “QTIP Election”); (ii) late or defective elections by certain qualified revocable trusts to be treated as part of a decedent’s estate for income
Treasury Regulations Section 301.9100-3 Relief - In General

Generally, Treasury Regulations § 301.9100-3 provides the procedure to follow in order to extend the time for making certain elections (e.g., the inter vivos QTIP Elections, the QRT Elections and the Portability Elections). Treasury Regulations § 301.9100-1(b) provides that elections are characterized as either “regulatory,” or “statutory”. An election is considered regulatory if the time for making such election is prescribed by a Treasury Regulation, Revenue Ruling, Revenue Procedure, IRS notice, or IRS announcement set forth in the Internal Revenue Bulletin. An election is considered statutory if the time for making such election is prescribed by statute. In other words, the statute actually prescribes the date for filing the election, and does not delegate regulatory authority to the Secretary of the Treasury. The distinction is significant because while the IRS is authorized, in its discretion, to grant relief under Treasury Regulations § 301.9100-3 ("Section 9100-3 Relief") for late or defective regulatory elections, it generally lacks any such authority to grant similar relief for statutory elections.1

A prerequisite of discretionary relief for regulatory elections, the taxpayer must show that the taxpayer acted reasonably and in good faith, and that the requested relief will not prejudice the interests of the Government.

Late or Defective Inter Vivos QTIP Elections

To avoid the imposition of estate and/or gift taxes on transfers of property between spouses, slightly more than thirty years ago, the Economic Recovery Tax Act of 1981 was passed and authorized the so-called “unlimited marital deduction” for certain transfers made between spouses. The unlimited marital deduction has certain limitations when property is transferred in trust to a spouse. Specifically, transfers of property interests to a QTIP trust (as such term is defined in Internal Revenue Code ("IRC") Section 2056(b)(7)) are eligible for the unlimited marital deduction for gift and estate tax purposes; provided, the QTIP election is timely and properly made.

For testamentary QTIP transfers (other than in the year 2010), the QTIP election must be made by the decedent’s executor on the decedent’s United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). Lifetime or inter vivos QTIP transfers require the donor to make the QTIP election on the United States Gift (and Generation-Skipping Transfer) Tax Return (Form 709) for the calendar year in which the interest is transferred. Once made, a QTIP Election is irrevocable.

1 There is a six month extension of time that is allowable under Treasury Regulations § 301.9100-2 for statutory elections. Relief is available solely in the case of regulatory elections beyond that six month period.
Section 9100-3 Relief has been available for failures to make a timely QTIP Election on a Form 706 for over two decades, since the deadline for making that election is deemed a regulatory election (Treas. Reg. § 20.2056(b)-7(b)(4)(i)).

Unlike the testamentary QTIP Election, where the regulations set the time for filing, the time for filing a lifetime or inter vivos QTIP Election is statutory (IRC § 2523(f)(4)(A)). IRC § 2523(f)(4)(A) provides that the QTIP Election shall be made on or before the date prescribed by IRC § 6075(b) for filing a gift tax return with respect to the transfer. Because the statutory language of the gift tax and estate tax QTIP provisions is different, the IRS has determined that the deadline for making the gift tax QTIP Election is statutory, and, therefore, Section 9100-3 Relief is not available.

The import of this difference is that it imposes a hardship on those taxpayers who fail to make a timely election having made a lifetime gift, where a similarly situated taxpayer making a testamentary gift is offered relief (albeit subject to the aforementioned prerequisite that the taxpayer acted reasonably and in good faith and that relief would not prejudice the Government). There appears to be no sound tax policy reason for this distinction, thus, we respectfully request that it be eliminated. Additionally, the interests of the federal government would not be prejudiced by this change because relief is not automatic but only within the discretion of the Service where circumstances justify it. Allowing the Service to grant relief would merely put taxpayers in the same position as they would have been had a timely election been made.

We note separately that a QTIP Election does not forgive estate or gift tax; the election simply defers imposition of the tax until the death of the donee / recipient spouse. Therefore, this provision would be of minimal cost (estimated in 2006 at $2 million over 10 years per the budget estimate in JCX-29-06).

QRT Election

2 Treas. Reg. §301.9100-3(a) provides that "[r]equests for relief subject to this section will be granted when the taxpayer provides the evidence (including affidavits . . .) to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government." In general, a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer--
   (i) Requests relief under this section before the failure to make the regulatory election is discovered by the Service;
   (ii) Failed to make the election because of intervening events beyond the taxpayer's control;
   (iii) Failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election;
   (iv) Reasonably relied on the written advice of the Service; or
   (v) Reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.
For estates of decedents who die after August 5, 1997, the QRT Election may be made to treat certain revocable trusts as part of the decedent’s probate estate, and taxed accordingly. The QRT Election is made on the first U.S. Income Tax Return for Estates and Trusts (Form 1041) that is required to be filed. If both the executor of a probate estate and the trustee of a QRT elect the treatment provided in IRC § 645 (originally enacted as IRC § 646), the trust is treated and taxed for income tax purposes as part of the estate (and not as a separate trust) during the election period.

IRC § 645(c) provides that a QRT Election shall be made not later than the time prescribed for filing the return of tax imposed for the first taxable year of the estate (determined with regard to extensions). The time for making the election to treat the QRT as part of the estate is prescribed by statute. Because of such statutory prescription, we believe that the IRS would take the position that it does not have the authority to grant Section 9100-3 Relief for late QRT Elections. Decedent's estates that do not make the election timely have no recourse to cure the problem and may be unnecessarily disadvantaged, in some instances because of the errors committed by their tax advisors.

Portability Election

Effective with respect to estates of decedents who die after December 31, 2010, the Portability Election can be made by the executor to transfer (or “port”) any of the decedent’s unused applicable exclusion amount (also known as the Deceased Spousal Unused Exclusion Amount (or DSUE amount)) to the surviving spouse. The election to port the DSUE amount to the surviving spouse appears to be both statutory (for larger estates) and regulatory (for smaller estates). Specifically, the time for filing the Portability Election is statutory for those “estates that are required to file a return.” (IRC § 2010(c)(5)). Under IRC § 6075, “estates that are required to file a return” are those estates with a gross estate, as adjusted by prior taxable gifts, that exceed the basic exclusion amount (“BEA”) in the year of the decedent spouse’s death.

In 2011, the BEA was $5 million. The BEA is adjusted for inflation; thus, in 2012, it was $5.12 million, and in 2013, it is $5.25 million.

Interestingly, the time for filing the Portability Election for estates that are not otherwise required to file an estate tax return (i.e., estates where the gross estate, as adjusted for taxable gifts, is less than the BEA at the time of the decedent’s death) is set forth in the current proposed and temporary regulations (Prop. Regs. §20.2010-2T(a)). Thus, the election is regulatory for smaller estates (i.e., estates where the gross estate, as adjusted for taxable gifts is less than the BEA at the time of the decedent's death).

To demonstrate the difference, assume that Taxpayer X dies in 2013 with a gross estate and adjusted taxable gifts of $5.24 million (i.e., $10,000 under the filing threshold for 2013). If X’s executor did not timely file the Portability Election, he
could request discretionary Section 9100-3 Relief, since the time to file would have been regulatory (because the estate is a smaller estate). Now, assume that another person, Taxpayer Y, dies with a gross estate and adjusted taxable gifts of $20,000 more than taxpayer X (i.e., Y has a gross estate of $5.26 million). If Taxpayer Y’s executor fails to file timely, it appears that there would be no Section 9100-3 Relief available, because the time for filing would be statutory since Y had a gross estate and adjusted taxable gifts of an amount in excess of the filing threshold of $5.25 million (albeit just $10,000 over the threshold in this example).

Details of the QTIP, QRT and Portability Election Proposals

The problems for late QTIP, QRT and Portability Elections are similar to the problem that existed with the allocation of GST exemption prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). There, the time for making an allocation of GST exemption was fixed by statute, and numerous taxpayers were being penalized for the failures of their lawyers and accountants to properly make the allocation. EGTRRA added IRC § 2642(g)(1)(B), which states in pertinent part, as follows: “[f]or purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.” That language opened up the possibility of Section 9100-3 Relief for failed allocations of GST exemption. Given that statutory authority, the IRS has granted Section 9100-3 Relief in hundreds of cases.

The Section respectfully requests that Congress consider enacting legislation similar to that in IRC § 2642(g)(1)(B), quoted above that clearly provides the due date for inter vivos QTIP Elections, QRT Elections, and a Portability Elections are treated as if not prescribed by statute. These proposals would bring IRC § 2523(f)(4), §645(c) and §2010(c)(5), respectively, in line with the methodology of IRC § 2642(g)(1)(B), thereby allowing taxpayers to request relief to file such a late elections, and in appropriate cases not be penalized for what are frequently inadvertent errors of their lawyers or accountants in failing to make these elections. The provisions would apply to requests for relief pending on or filed after the date of enactment with respect to elections due before, on, or after such date. These proposed prospective effective dates are similar to the prospective effective date provision applicable to the GST exemption relief in EGTRRA.

Our comments are consistent with the comments submitted by the American Institute of Certified Public Accountants (AICPA) dated November 16, 2010, which cover the first two subjects (i.e., the QTIP Election and the QRT Election). The comments regarding portability are new, and have not yet been addressed by the AICPA.

The above comments were prepared by Lester B. Law, Kevin Matz, and Thomas M. Sheehan who are the contact persons for these comments. Lester Law can be reached at (239)254-3206 or lester.law@ustrust.com; Kevin Matz can be reached at (914)682-6884 or kmatz@kmatzlaw.com, and Thomas M. Sheehan can be reached at 617-330-7000 or tsheehan@rubinrudman.com. These comments were reviewed
by Ellen K. Harrison (who can be reached at (202)663-8316 or ellen.harrison@pillsburylaw.com) on behalf of the Section’s Committee on Government Submissions. Although they have clients who would be affected by the Federal tax principles addressed, or have advised clients on the application of such principles, neither they (nor the firms to which they belong) have been engaged by a client to make a submission with respect to, or otherwise influence the development of the outcome of, the specific subject matter of these comments.

Sincerely,

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

Enclosure

cc: Steven B. Gorin, ABA Section of Real Property, Trust & Estate Law
Cara Lee T. Neville, Secretary, American Bar Association
Thomas M. Susman, Director, Government Affairs Office, American Bar Association