SPOUSAL PORTABILITY: ANOTHER TRAP FOR THE UNWARY (OR UNINFORMED) PRACTITIONER

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Section 303 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("TRUIRJCA") brought into the Tax Code an idea that had been discussed for many years, but had never previously been enacted: the ability of a surviving spouse to use the unused portion of a deceased spouse's "applicable exclusion amount", commonly referred to as "spousal portability."

This provision defines the "applicable exclusion amount" as the sum of: (A) the basic exclusion amount [$5 million, as adjusted for inflation after 2011]; and (B) in the case of a surviving spouse, the "deceased spousal unused exclusion amount." The "deceased spousal unused exclusion amount" is (with respect to a deceased spouse dying after December 31, 2010) the lesser of: (A) the basic exclusion amount, OR (B) the excess of (i) the basic 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." An election is required; the Section provides that a deceased spousal unused exclusion amount may not be taken into account 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 to take into account the deceased spouse's unused exclusion amount.

The "deceased spousal unused exclusion amount" only applies to decedents dying on or after January 1, 2011. The entire provision (and therefore spousal portability) expires on December 31, 2012 (the "sunset date"), unless extended by Congress.

The IRS issued Notice 2011-82 on September 29, 2011, reiterating that in order to use the deceased spouse's unused exclusion amount, an executor is required to file a Form 706 for the decedent's estate, even if the executor is not otherwise obligated to file a Form 706. This is a trap for the unwary (or uninformed) practitioner who assumes that if a decedent's estate is not worth $5 million (or the applicable exclusion amount at the time of death), a Form 706 need not be filed. The Notice provides that the timely filing of a Form 706 (including extensions) "prepared in accordance with the instructions for that form" will constitute the making of a portability election. There is no need to make an affirmative statement, or to check a box. Indeed, there is no box to check on the recently issued Form 706 for 2011. In addition, until the IRS revises the Form 706 to expressly contain the computation of the deceased spousal unused exclusion amount, a timely-filed and "complete" Form 706 that is "prepared in accordance with the instructions for that form" (whatever that may mean—presumably, that all appropriate schedules are attached, and all required attachments (appraisals, for example) are appended) will be deemed to contain the computation of the deceased spousal unused exclusion amount. If, on the other hand, an executor wishes to elect out of portability, in a case in which a Form 706 is not otherwise required to be filed, the executor need simply not file a Form 706, which will "prevent" the making of the election. It is unclear how an executor of an estate that is *required* to file a Form 706 will opt out of the election. The Notice states that the executor must follow the instructions for Form 706 that will describe the necessary steps to avoid making the election. To date, neither the instructions for the 2011 Form 706 nor the Form itself provide for a way to elect out of portability. (The creators of GEMS software have stated that the Form 706 generated by their software will print "No Election Under Section 2010(c)(5)" at the top of page one of the Form 706 if the executor chooses to elect out of portability.) It is difficult to envision a scenario under which one would want to opt out of portability, in any event. But it is important to note that once made, the election is irrevocable; and that once the time for filing a Form 706 (including extensions) has passed, there is no way to make a "late" election. One can only imagine the number of malpractice claims that may result from the failure to advise clients of the need to file a federal estate tax return in a small or moderate estate in order to elect spousal portability, or to obtain an executor's written and informed decision not to do so. An election to use a deceased spouse's unused exclusion amount permits the Service to examine the return of the deceased spouse without regard to the applicable limitations pe-

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riod under Code Section 6501.

The Notice makes the following statement about the new legislation: "Thus, sections 302(a)(1) and 303(a) of TRUIR-JCA eliminate the need for spouse to re-title property and create trusts solely to take full advantage of each spouse's basic exclusion amount." "Solely" is the operative word here. Spousal portability does not permit use of the deceased spouse's generation-skipping transfer tax exemption. If a client is inclined to make gifts to grandchildren, or create GST trusts, a traditional credit shelter trust should be used. If portability does not become a permanent feature of the tax law, one shouldn't rely on its availability in estate planning. At this time, it would only apply if both spouses die between January 1, 2011 and December 31, 2012, an unlikely occurrence. In addition, the deceased spouse's unused exclusion amount is not adjusted for inflation. A credit shelter trust will be exempt from tax in the survivor's estate regardless of how much the assets may appreciate. And, of course, there are non-tax reasons for using trusts, such as to protect property from a spendthrift spouse, to provide asset management and investment for a spouse, and to preserve property for children of a prior marriage.

A deceased spouse's unused exclusion amount can be used to make lifetime gifts as well as transfers at death. Due to the sunset provision (and the possibility that the basic exclusion amount may be reduced in the future), it may be prudent for a surviving spouse to make large gifts prior to 2013, although it is unclear whether the survivor's exclusion amount or that of a deceased spouse will be deemed to be used first. (The IRS welcomes comments on the order in which exclusions are deemed to be used, per Notice 2011-82).

Questions remain about the "last" deceased spouse limitation. Does a surviving spouse of a decedent who elected to use his or her prior spouse's unused exclusion amount get to use both the deceased spouse's unused exclusion amount and that of the deceased spouse's predeceased spouse? It appears so, under Example 3 of the Committee Reports. What if a surviving spouse re-marries and then divorces? Is the unused exclusion amount of the deceased spouse re-instated? The Service intends to issue Regulations to Code section 2010(c) to address issues arising with respect to the portability election. So stay tuned!