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2014 Winter Series
Estate and Gift Tax Returns
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Estate Tax Returns

Table of Recent Federal Estate Tax Exclusion Amounts:

2011	$5,000,000
2012	$5,120,000
2013	$5,250,000
2014	$5,340,000
2015 and beyond	Adjusted annually

Table of Recent Illinois Estate Tax Exclusion Amounts:

2011	$2,000,000
2012	$3,500,000
2013	$4,000,000
2014	$4,000,000
2015 and beyond	$4,000,000 absent change in law

Estate Tax Returns/Portability of Deceased Spouse's Unused Exclusion Amount

"Portability" is a concept first introduced as part of the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010. Portability allows a surviving spouse to use a deceased spouse's unused estate tax exclusion. The 2010 Act made Portability effective for married

couples dying on or after January 1, 2011, but was set to expire on December 31, 2012. The American Taxpayer Relief Act of 2012 made Portability permanent.

In the past, estate tax planning attorneys have advised clients to attempt to equalize assets amongst themselves, or for high net worth clients, make sure each spouse owns at least as much as the amount of the estate tax exclusion at the time of his death. Traditionally, estate planning documents created a credit shelter trust (to hold the exclusion amount) and a Marital Trust (to hold the amount over the exclusion). Prior to the concept of Portability, clients who did not accomplish both of these goals were forced to pay higher taxes upon the death of the surviving spouse. Let's look at an example:

Example 1: Assume John and Jane (both U.S. citizens) are married and John dies in 2014, survived by Jane. John owns $3 million and Jane owns $15 million. John can leave up to $5.34 million in a credit shelter trust, which would be exempt from estate taxes at the death of both John and Jane. But John only has $3 million in assets, so the maximum amount he can leave in the trust is $3 million. Prior to the enactment of portability, $2.34 million of his exclusion would be wasted. The practical result is that at Jane's death, her entire estate ($15 million plus growth) is subject to estate tax. Had John and Jane done a better job of equalizing assets, the amount of her estate subject to tax would have been $2.34 million less!

Example 2: Same characters as Example 1. But John and Jane each owned $9 million at John's death in 2014. John should be able to use his $5.34 million exclusion, BUT, his estate planning documents provide that everything passes to Jane upon his death. Unrestricted transfers to spouses do not utilize the exclusion (they use the unlimited marital deduction). Therefore, John could not take advantage of any of the $5.34 million exclusion. His assets are transferred to Jane and, at Jane's death, the entire $18 million is includible in her estate. Had John used his federal estate tax exclusion, the amount of Jane's estate would have been $12.66 million instead of $18 million.

Deceased Spouse's Unused Exclusion Defined

Pursuant to Section 2010 of the Internal Revenue Code, the Deceased Spouse's Unused Exclusion (DSUE) is equal to the lesser of (1) the basic exclusion amount applicable to the estate of the

surviving spouse and (2) the excess of (i) the basic exclusion amount applicable to the surviving spouse's last deceased spouse estate over (ii)the amount of such deceased spouse's taxable estate plus adjusted taxable gifts.

Example 3:

John and Jane are married. John dies in 2014. John owns $2 million in his name at his death which passes to a credit shelter trust. John's estate makes a timely filed Portability election. The DSUE amount is $3.34 million ($5.34 million - $2 million). Jane dies later in 2014. The applicable exclusion amount for Jane is $8.68 million ($5.34 basic exclusion plus John's $3.34 DSUE).

Election Required

In order to elect Portability of the DSUE, a timely filed estate tax return Form 706 must be filed and the election must be made properly. (IRS Form 706, Page 4.) An estate tax return is generally required to be filed within 9 months after the death of the deceased spouse, unless an extension has been granted. Extensions are available by filing a Form 4768. Six month extensions are automatic upon the filing of Form 4768.

One of the main considerations when deciding whether or not to file an estate tax return (and elect Portability) is the cost of the return, including the cost of obtaining formal valuations for all of the assets. This can include expensive appraisals of real estate and businesses. The temporary regulations, 26 CFR 20.2010-2T(a)(7)(ii), provide that estates which would not otherwise be required to file an estate tax return do not have to report the value of certain property that qualified for the marital or charitable deduction. For those items, the executor will only have to report the description, ownership and/or beneficiary of the property, along with other information necessary to establish the right of the estate to the deduction. However, the rule does not apply if:

(1) The value of such property relates to, affects, or is needed to determine, the value passing from the decedent to another recipient;

(2) 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;

(3) 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

(4) 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.

26 CFR 20.2010-2T(a)(7)(ii)(1-4).

While many practitioners were excited about the prospect of Portability simplifying estate planning for their client, the cost of preparing and filing an otherwise unrequired estate tax return must be considered. Arguably, every estate should be filing an estate tax return. It is impossible to predict the financial situation of a surviving spouse at her death. Some are more predictable (long term marriage, surviving spouse of very advanced age), many are less predictable (shorter marriage, surviving spouse of middle age). If no portability election is made for the estate of the deceased spouse, and if the surviving spouse has a taxable estate at death that could have been avoided, the executor, her attorney and her accountant could be liable.

PRACTICE POINTER: The takeaway from all of this is that you should immediately being advising clients of their options regarding filing an estate tax return to establish Portability. You should have documentation in your file demonstrating that you advised the executor about Portability and the executor chose not to make the election, if applicable. See Sample Letter

Statute of Limitations Change

The statute of limitations on the return filed for the deceased spouse is extended until expiration of the statute of limitations for the estate tax return filed for the surviving spouse. The reasoning is that the IRS can examine the return of the deceased spouse in order to determine the proper DSUE to apply at the death of the surviving spouse.

Multiple Spouses

Remarriage after the death of the spouse does not in and of itself change the DSUE that is available to a surviving spouse. However, the IRS will prevent those decedents with multiple spouses from essentially "stacking up" the DSUEs from previous spouses. Therefore, the DSUE is available to a surviving spouse as along as she dies and the DSUE being used is from their "last deceased spouse". If the second marriage ends in divorce or annulment, then the surviving spouse remains the surviving spouse of the deceased first spouse and is still, therefore, entitled to the DSUE from their first spouse.

If the surviving spouse remarries and survives that second spouse (i.e. now has two deceased spouses), there are different rules. Pursuant to 26 CFR 20.2010-3T, the amount of the DSUE is the sum of:

1. The DSUE amount of the surviving spouse's last deceased spouse as described in paragraph (a)(1) of this section (the most recently deceased spouse); and
2. The DSUE amount of each other deceased spouse of the surviving spouse, to the extent that such amount was applied to one or more taxable gifts of the surviving spouse.

Example 4: from 26 CFR 20.2010-3T): The following example, in which all described individuals are U.S. citizens, illustrates the application:

Facts. Husband 1 (H1) dies on January 15, 2011, survived by Wife (W). Neither has made any taxable gifts during H1's lifetime. H1's executor elects portability of H1's DSUE amount. The DSUE amount of H1 as computed on H1s estate tax return filed on behalf of H1's estate is $5,000,000 in 2011. On December 31, 2011, W makes taxable gifts to her children valued at $2,000,000. W reports the gifts on a timely-filed gift tax return. W is considered to have applied $2,000,000 of H1's DSUE amount to the amount of taxable gifts, in accordance with §25.2505-2T(c), and, therefore, W owes no gift tax. W has an applicable exclusion amount remaining in the amount of $8,000,000 ($3,000,000 of H1's remaining DSUE amount plus W's own $5,000,000 basic exclusion amount). After the death of H1, W marries Husband 2 (H2). H2 dies in June 2012.

H2's executor elects portability of H2's DSUE amount, which is properly computed on H2's estate tax return to be $2,000,000. W dies in October 2012. What is W's total exclusion amount?

Answer. The DSUE amount to be included in determining the applicable exclusion amount available to W's estate is $4,000,000, determined by adding the $2,000,000 DSUE amount of H2 and the $2,000,000 DSUE amount of H1 that was applied by W to W's 2011 taxable gifts. Thus, W's applicable exclusion amount is $9,000,000.

The practical takeaway from this is that a surviving spouse may use the DSUE from a "last deceased spouse" during her lifetime by making gifts, as long as at the time the gifts are made, the DSUE used is from the surviving spouse's "last deceased spouse." Thus, a spouse who has survived multiple spouses may use each "last deceased spouse's" DSUE amount by gift before the death of the next spouse, and can continue so long as there are multiple deceased spouses with DSUEs. However, the surviving spouse cannot "stack" all of the deceased spouse's DSUEs to use at her death.

Estate Tax Return

See Form 706, Part 6 (page 4) for Portability Election.

Gift Tax Returns

Annual exclusion for 2013 and 2014 is $14,000 per donee.

See Form 709, Schedule C (page 4) to use DSUE towards gifts.