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TRUSTS AND ESTATES

A Second Chance to Elect Estate Tax Portability

In certain cases, a Form 706 can still be filed on or before Dec. 31, 2014

By Kevin R. Centurrino

On Jan. 2, 2013, the American Taxpayer Relief Act (ATRA) was signed into law and, in part, made permanent the concept of "portability," which was previously an option for the estates of certain decedents who died after Dec. 31, 2010. Portability allows the personal representative of an estate the opportunity to preserve a deceased spouse's unused federal estate and/or gift tax exemption amount for later use by the surviving spouse. The surviving spouse may retain the exemption of his or her "last deceased spouse."

Portability can potentially save a family millions of dollars. Although the federal estate and/or gift tax exemption amount is now $5.34 million per individual (and scheduled to be adjusted annually for inflation), portability can be a game-changer in those situations where the value of a married couple's assets exceeds the single exemption amount.

Take for example a married couple, Tom and Gina. Tom's assets are valued at $4 million, and Gina's are valued at $5 million. Assuming the couple wishes to leave the majority of their assets outright to the other, upon the second death the surviving spouse will potentially have an estate of approximately $9 million to $10 million. Assuming there is a federal estate tax rate of 40 percent, the surviving spouse's estate could face a federal estate tax bill of $1,864,000, inasmuch as his or her estate would be significantly greater than the available exemption ($10 million—$5.34 million x 40 percent). However, if portability was properly elected upon the first death, the survivor might have an available exemption of two times $5.34 million, effectively reducing the $1,864,000 estate tax bill to zero.

Electing portability is sensible even in those instances where it appears highly unlikely that the survivor will have an estate anywhere near the exemption amount upon death. Using the above example, now imagine that Tom's assets are valued at $500,000, and Gina's assets are valued at $750,000. Following Tom's death, the executor of his estate may think it is pointless to preserve portability, since Gina's and Tom's combined assets are significantly lower than the federal exemption amount. However, imagine if two years following Tom's death, Gina were to win a $10 million Powerball prize, or receive a significant inheritance or personal injury settlement. It is now entirely possible that a notable benefit (to the tune of several million dollars in estate tax savings) would exist upon Gina's death, had Tom's executor elected portability following his death. Gina will now likely want to elect portability; the problem is that now it *might* be too late.

In order to preserve portability, the executor is required to make an election on a timely filed IRS Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, following the death of the first spouse. It was previously believed among most tax practitioners that failure to file Form 706 within nine months of death (or within the extension period if an extension request was timely filed and subsequently granted) would result in the permanent loss of one's ability to preserve portability.

Recently, the Internal Revenue Service (IRS) published Rev. Proc. 2014-18, which states that with respect to the estates of decedents dying after Dec. 31, 2010, and on or before Dec. 31, 2013, where a Form 706 was not required pursuant to Section 6018(a) of the Internal Revenue Code, but there was a surviving spouse and Form 706 was not filed within nine months of death (or within the extension period if an extension was timely requested and granted) exclusively for purposes of preserving portability, a Form 706 can still be filed on or before Dec. 31, 2014, to preserve portability.

The IRS explains that because portability is actually prescribed by regula-

Centurrino is an associate with Witman Stadtmauer in Florham Park, focusing his practice on estate administration, trusts and Medicaid planning.

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tion, and not statute, the nine-month filing deadline only applies to those estates where a Form 706 is required under Section 6018(a) of the code, and not those being filed merely for purposes of preserving portability. Treasury Regulation 301.9100-3—which provides the standards that apply to determine whether to grant an extension of time to make an election whose due date is prescribed by regulation and not statute—offers relief if the taxpayer establishes to the satisfaction of the commissioner that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. The IRS reports that over the past several years it has issued several letter rulings granting an extension of time to elect portability pursuant to this standard, in situations where the decedent's estate was not required to otherwise file a return.

While there are numerous incidents where this extension might be useful, such as in those cases where an executor merely forgot to timely file or where, through good fortune or injury, a survivor's assets are now significantly higher than he or she ever expected, it is anticipated that, following *United States v. Windsor* and Rev. Rul. 2013-17, this might be particularly beneficial to the surviving spouse of a same-sex partner who died within the prescribed time frame. An executor who did not previously elect to preserve portability because there was no *federally* recognized surviving spouse, may now wish to preserve portability on behalf of the survivor. Because the federal government did not recognize these marriages prior to the decision in *Windsor*, it is plausible that many of the survivors have no idea that this simple election, which might result in millions of dollars of tax savings upon their demise, is now suddenly (and for a limited time only) available to them.

The IRS is explicit, however, that this extension only applies to those estates where Form 706 was not otherwise required pursuant to Section 6018(a) of the code (primarily where the gross estate, plus lifetime adjusted taxable gifts, did not exceed the exemption), and that the person filing the Form 706 on behalf of the decedent's estate: (a) files a complete and properly prepared Form 706 pursuant to Section 20.2010-2T(a)(7) of the code, on or before Dec, 31, 2014; and (b) states at the top of the Form 706 that the return is "Filed pursuant to Rev. Proc. 2014-18 to elect portability under Sec. 2010(c)(5)(A)." It is also explicit that it only applies to the estates of decedents who died after Dec. 31, 2010, and on or before Dec. 31, 2013. Although it is possible that a similar extension could be offered in the future for the estates of decedents dying on or after Jan. 1, 2014, Rev. Proc. 2014-18 does not guarantee any such extension, and it is therefore recommended that the executors of these estates still file within nine months of death, to be sure to preserve portability.

Regardless the reason a client did not file, it is recommended that the executors of any such estates be notified of this new deadline immediately. Even if it appeared that portability would be unnecessary based upon the size of a survivor's estate at the time of death, a small change in circumstances (or in the case of same-sex couples, a big change in the law) might give the surviving spouse reason for reconsideration this time around.■