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IRS Issues Final Estate Tax Portability Rules

ESTATE PLANNING, SD MEDALLION SERVICES, TAX
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The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 introduced a new concept known as “portability” to the American transfer tax system. Portability provides an additional layer of estate tax relief by allowing a surviving spouse to apply the unused portion of the deceased spouse’s exclusion amount to reduce his or her own estate tax liability. The concept of portability was originally intended to be temporary but was later made a permanent part of the tax code with the passage of the American Taxpayer Relief Act of 2012.

A surviving spouse does not automatically inherit a deceased spouse’s unused estate tax exemption. Portability can only be elected on a timely filed, complete and properly prepared federal estate tax return. Such return must be filed even if assets are below the filing threshold, currently \$5.43 million for decedents dying in 2015. The initial filing is due nine months from the date of death but may be extended for an additional six months by filing a request no later than the original due date of the return. The portability election may only be made by a decedent’s executor. A surviving spouse who is not the decedent’s executor has no authority to make the election if such executor neglects or refuses to file an estate tax return.

Concerns have been raised that executors of estates with assets below the filing threshold may be unaware of the need to file a federal estate tax return to elect portability. Earlier this year, the American Institute of Certified Public Accountants (the “AICPA”) wrote a letter to the Internal Revenue Service (the “IRS”) and the Department of the Treasury recommending that executors of estates with assets below the filing threshold be granted 15 months from the decedent’s date of death to elect portability. In addition, the AICPA suggested that the IRS provide a Short Form 706-EZ such that the portability election can be made in a cost-efficient manner. The letter further requested that the IRS grant surviving spouses the ability to make a portability election in the event the decedent’s executor fails to file the return.

On June 12, 2015, the IRS issued final regulations governing the portability election. The final regulations grant no automatic relief for untimely filed estate tax returns, regardless of size. If an estate’s assets do not exceed the filing threshold and an executor inadvertently fails to file a timely return, an extension may be granted on a case-by-case basis by applying for a private letter ruling and paying the applicable user fees. This procedure is not available for estates that exceed the filing threshold. No Short Form 706-EZ will be forthcoming, but if an estate tax return is not otherwise required, an executor need not obtain valuations for assets qualifying for the charitable or marital deduction but instead may use an estimated value. Surviving spouses who are not the deceased spouse’s personal representative may not make the portability election.

The final regulations take immediate effect and are not as taxpayer-friendly as the AICPA had requested. Taxpayers are thus well advised to carefully consider making a portability election before the window of opportunity is lost. Even if a surviving spouse's assets are currently insufficient to trigger estate taxes, future asset appreciation or a sudden windfall such as lottery winnings or an unexpected inheritance could quickly result in a taxable estate. Making a portability election now could result in significant tax savings for the surviving spouse's beneficiaries. Since every estate is unique, it is important to consult with an experienced estate planning professional to determine whether a portability election is appropriate in a given situation.

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