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# IRS May Audit Deceased Spouse's Estate Tax Return if Portability Elected

INTERNAL REVENUE SERVICE, 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 estate tax 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 \$5.49 million for decedents dying in 2017. 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.

Several months after filing a federal estate tax return, an executor may request the Internal Revenue Service (the “IRS”) to issue an estate tax closing letter. An estate tax closing letter is an acknowledgement by the IRS that a federal estate tax return has been reviewed and accepted. The closing letter is not binding on the IRS, and under certain circumstances, an assessment can be made even after a closing letter is issued. In *Estate of Sower v. Commissioner*, the Tax Court clarified that the issuance of an estate tax closing letter for the estate of a first spouse to die does not preclude the IRS from examining such return to determine whether the second spouse to die has correctly applied the deceased spousal unused estate tax exclusion amount (“DSUE”).

In the *Sower* case, the taxpayer and his wife made taxable lifetime gifts that were properly reported on federal gift tax returns. The husband died in 2012, and his executor elected portability on a timely filed federal estate tax return on which he failed to properly report the lifetime gifts. Some months later, the IRS issued an estate tax closing letter, stating that the husband’s estate tax return was accepted as filed. The wife passed away the following year, and her executor filed a timely estate tax return for her estate that also failed to report the lifetime gifts.

The IRS audited the wife’s return. In connection with the examination, the husband’s estate tax return was inspected for the purpose of determining whether the wife’s estate applied the proper DSUE amount. Upon discovery that the DSUE amount was

overstated due to the failure to report the lifetime gifts, the IRS increased the wife's taxable estate and assessed an estate tax deficiency.

The wife's estate filed a petition for redetermination of the deficiency. At trial, the estate argued that the estate tax closing letter issued to the husband's executor precluded the IRS from adjusting the DSUE amount. This argument was rejected. The court ruled that the estate tax closing letter was not a closing agreement. Only two IRS forms qualify as closing agreements, and an estate tax closing letter is not one of those forms. Furthermore, Section 2010(c)(5)(B) of the Internal Revenue Code expressly grants the IRS authority to examine the estate tax return of a predeceased spouse to determine the DSUE amount, regardless of whether the period of limitations on assessment has expired for the predeceased spouse's estate. Thus, the wife's estate was liable for the additional tax.

So, if an estate tax closing letter does not preclude the IRS from making an additional assessment, then why request the letter in the first place? Executors view receipt of a closing letter with no deficiency as a signal that it is reasonably safe to distribute assets to a beneficiary and close a probate estate. In some states, such as Florida and New York, an estate tax closing letter must be filed with the probate court before an estate can be officially closed. From a practitioner's perspective, obtaining closing letters for estates in which federal estate tax returns are filed is simply a matter of good practice. Nonetheless, it is important to remember that receipt of a federal estate tax closing letter may not be the end of the story. To learn more about estate taxes or The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, [contact us](#).

*Estate of Sower v. Commissioner*, 149 T.C. 11 (Sept. 11, 2017).

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