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- Tax planning for large estates
- Private letter rulings
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- Compliance – Forms 1041, 709, & 706

Portability: 4 Approaches Practitioners Need to Know

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Four Paths to Portability

1. Form 706 (& Buying Time with an Extension)
2. Portability Only Form 706
3. Late Filed Portability Only Form 706 Pursuant to Rev. Proc. 2022-32
4. 9100 Late Election Relief

Foundation Concepts

- Statistory Overview
  - Chapter 11: Estate Tax (§§ 2001–2210)
    - ➢Subchapter A: Estates of Citizens or Residents (§§ 2001–2058)
      - Part I: Tax Imposed (§§ 2001–2002)
      - Part II: Credits Against Tax (§§ 2010–2016)
      - Part III: Gross Estate (§§ 2031–2046)
      - Part IV: Taxable Estate (§§ 2051–2058)
    - Subchapter B—Estates of Nonresidents Not Citizens (§§ 2101–2108)
    - Subchapter C—Miscellaneous (§§ 2201–2210)

Foundation Concepts

- Chapter 12: Gift Tax (§§ 2501–2524)
- Chapter 13: Tax On Generation-skipping Transfers (§§ 2601–2664)
- Chapter 14: Special Valuation Rules (§§ 2701–2704)

Foundation Concepts

- Ownership of Property
  - Determined by state law
  - Community property
    - If in both names, report 50% of property
    - If in the name of decedent, list 100% of property and subtract 50%
  - Phantom assets

Foundation Concepts

- 706 Due Date
  - Normally nine months from date of death
  - Six-month extension available with Form 4768
  - The extension is merely for filing the return; the payment deadline remains

Form **4768**

(Rev. August 2012)
Department of the Treasury
Internal Revenue Service

Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes

OMB No. 1545-0181

Part I Identification

Decedent's first name and middle initial	Decedent's last name	Date of death
Name of executor	Name of application filer (if other than the executor)	**Decedent's social security number**
Address of executor (Number, street, and room or suite no.)		Estate tax return due date
City, state, and ZIP code	Domicile of decedent (county, state, and ZIP code)	Daytime telephone number

Part II Extension of Time To File Form 706, 706-A, 706-D, 706-NA, or 706-QDT (Section 6081)

Automatic Extension

If you are applying for an automatic 6-month extension of time to file:

- Form 706, check here . . . ▶ ☐
- Form 706-A, 706-D, 706-NA, or 706-QDT, indicate the form by checking the appropriate box below.
  ☐ Form 706-A ☐ Form 706-D ☐ Form 706-NA ☐ Form 706-QDT

Additional Extension

If you are an executor out of the country applying for an extension of time to file in excess of 6 months, check here . . . ▶ ☐

Also you **must** attach a statement explaining in detail why it is impossible or impractical to file Form 706 by the due date. See instructions.

Enter extension date requested

Part III Extension of Time To Pay (Section 6161)

You must attach your written statement to explain in detail why it is impossible or impractical to pay the full amount of the estate (or GST) tax by the return due date. If the taxes cannot be determined because the size of the gross estate is unascertainable, check here ▶ ☐ and enter "-0-" or other appropriate amount on Part IV, line 3. You must attach an explanation.

Enter extension date requested (Not more than 12 months)

- If this request is for the tax that will be or was due with the filing of Form 706, check here . . . ▶ ☐
- If this request is for the tax that will be due as a result of an amended or supplemental Form 706, check here . . . ▶ ☐
- If this request is for additional tax due as a result of an examination of your Form 706, check here . . . ▶ ☐
- If this request is for a section 6166 installment payment, check here . . . ▶ ☐

Part IV Payment To Accompany Extension Request

1	Amount of estate and GST taxes estimated to be due . . .	1	
2	Amount of cash shortage (complete Part III) . . .	2	
3	**Balance due** (subtract line 2 from line 1) (see instructions) . . .	3	

Signature and Verification

If filed by executor—Under penalties of perjury, I declare that I am an executor of the estate of the above-named decedent and that to the best of my knowledge and belief, the statements made herein and attached are true and correct.

Executor's signature | Title | Date

If filed by someone other than the executor—Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein and attached are true and correct, that I am authorized by an executor to file this application, and that I am (check box(es) that apply(ies)):

☐ A member in good standing of the bar of the highest court of (specify jurisdiction) ▶

☐ A certified public accountant duly qualified to practice in (specify jurisdiction) ▶

☐ A person enrolled to practice before the Internal Revenue Service.

☐ A duly authorized agent holding a power of attorney. (The power of attorney need not be submitted unless requested.)

Filer's signature (other than the executor) | Date

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 41984P Form **4768** (Rev. 8-2012)

Foundation Concepts

- Deductions - Both unlimited
  - Charitable deduction – IRC Sec. 2055
  - Marital deduction – IRC Sec. 2056

Foundation Concepts

- Amended Returns
  - No special form
  - Mark “supplemental information”
  - Attachment explaining changes

Foundation Concepts

- Statute of Limitations
  - Three years generally
  - Six years if:
    - taxpayer omits items that are properly includible in the gross estate from an estate tax return and
    - the amount of the omitted items exceeds 25 percent of the gross estate reported on the estate tax return.
  - The statute of limitations on assessment of estate tax cannot be extended. IRC 6501(c)(4)
  - No limit if:
    - a return is not filed or
    - a fraudulent return is filed

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Estate Planning After the 2010 Tax Act

Tax Act Dictionary

2010 TRA Dictionary

"Basic Exclusion Amount" (BEA)

2024 Basic Exclusion Amount	$13,990,000
Portable Amount	13,990,000
Applicable Exclusion Amount	$27,980,000

2010 TRA Dictionary

"Applicable Exclusion Amount"

- This term from prior law has been redefined to encompass the new estate tax concept of **portability** allowing the surviving spouse in certain situations to use the remaining basic exclusion amount from his or her previously deceased spouse
- [Your Basic Exclusion Amount + Portable Amount from your Last Deceased Spouse = New Applicable Exclusion Amount]

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2010 TRA Dictionary

"Deceased Spousal Unused Exclusion Amount" (DSUE)

- TRA created a new concept called "**portability"** which endeavors to simplify the estate tax system by avoiding the need for families to undertake complex planning to maximize the use of both spouses' exclusions
- Under prior law, the couple would have divided assets 50/50, and had each will include a bypass trust to benefit the surviving spouse, to avoiding inclusion of those assets in the surviving spouse's estate, and thereby protect the 1st to die's exemption
- Under TRA, if your spouse dies with none of this planning on your later death, you **may** be able to utilize your prior deceased spouse's unused estate tax exemption (DSUE)
- **Portability** is not simple, nor does it assure the intended result

2010 TRA Dictionary

"Last Deceased Spouse"

- On your death, if your previously deceased spouse (the "last" spouse) had not used his or her estate tax exclusion, you may, under the new **portability** concept, be permitted to take advantage of that unused exemption
- To assure that your estate will only benefit from one such prior unused exclusion, and to provide clarity as to which exclusion can be utilized, it is the exclusion of your **last** deceased spouse that governs

Portability Issues

- The executor is considered to have elected to allow the surviving spouse to use the decedent's unused exclusion amount by filing a timely and complete form 706.

Portability Issues

- If the estate chooses NOT to allow the surviving spouse to take into account, for transfer tax purposes, the decedent’s unused exclusion amount, then check the box in Part 6, Section A and do not complete Section C.

Form 706 (Rev. 8-2019)

Estate of:	Decedent’s social security number

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

Portability Election

A decedent with a surviving spouse elects portability of the DSUE amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

Portability Issues

- Alternatively, if the filing of a Form 706 is not otherwise required for the decedent’s estate, not filing a timely and complete Form 706 will effectively prohibit the surviving spouse’s use of the decedent unused exemption.

Portability: Overview of Planning After 2010 Tax Act

Impact on Different types of Clients

Portability Planning for Moderate Wealth Clients

- What should moderate wealth taxpayers consider?
  - This will be the most complex and difficult strata of clients to plan for
  - State estate tax in decoupled states (e.g. only $4 million exemption in Illinois) will remain a substantial cost
  - Inflation may push their estates above the thresholds for taxation
  - “Wait and see” may translate into “Wait and pay”
  - Creative and flexible planning, with a more economical price tag will be the winning approach
  - Asset protection and related concerns for this wealth strata may be significant

Portability Planning for Modest Wealth Clients

- Moderate wealth clients are the main portability planning target:
  - Consider all the pros/cons of bypass versus portability planning
  - State estate tax in decoupled states, e.g. $1 million in exemptions
  - Client tolerance for planning cost and complexity will be lower

Portability Planning for Special Taxpayers

- **Asset Protection** – Physicians and other mid-wealth clients worried about asset protection have a historic opportunity to shift wealth into protective structures – Nike Just Do It! So portability planning will likely be obviated by current use of their gift exemption

- **No State Estate Tax** – Less concern about bypass trust planning if safely under federal exemption

- **Large IRA Accounts** – Portability will certainly help families with large IRAs. The spousal rollover will continue to be an option.

Portability Issues

- **Malpractice Traps**
  - Election to transfer the unused estate tax exemption amount must be made on a timely-filed estate tax return
  - Statute of limitations remains open for the decedent spouse's estate tax return until the statute of limitations has run on the surviving spouse's estate tax return
    - The "adequate disclosure" rules (applying to post-1997 gifts) ***does not apply***
    - Thus, the IRS can audit the deceased spouse's estate tax return (even after the normal statute of limitations has run) and add any increase in tax to the surviving spouse's estate tax return.
    - *See e.g. Sower,* 149 T.C. No. 11.

Portability Issues

- Utilizing the estate tax exemption at first spouse’s death vs. transferring the exemption to the surviving spouse
  - Size of combined estate
  - Anticipated growth of the surviving spouse’s estate
  - Changes in the future estate tax law
  - Asset protection issues
  - Additional basis step-up of property in surviving spouse’s taxable estate
  - Malpractice risks for advisors

New Generation-Skipping Transfer (GST) Tax Law

Unlike a surviving spouse's ability to utilize a predeceased spouse's unused unified credit, the new law *does **not** allow a surviving spouse to use the unused GST tax exemption* of a predeceased spouse.

Recordkeeping for Portability

- Estate tax returns making the portability election, along with all supporting documentation should be saved indefinitely because of the unlimited statute.
- Track any last deceased spouse’s unused exemption amount and its use to document how much was used and when. The “when” is vital in the event of the demise of a later spouse.
- Use of GST exemption will have to be monitored carefully since it will differ from the use of estate exemption since GST is not portable.
- When practitioners are preparing gift tax returns they should expressly inquire as to whether any DSUEAs exist and document the existence or lack of any.
- If ordering rules are created they will have to be monitored and tracked.
- There is a requirement related to what to attached when using DSUE on form 709 – see the 709 instructions

Portability Regulations

- Every estate electing portability, regardless of estate size, must file a Form 706 within nine months of death (or by extended due date).
- Executors of estates that are not otherwise required to file an estate tax return (because of the size of the estate) do not have to report the value of certain property that qualifies for the marital or charitable deduction.
- To use this exemption, the executor must exercise due diligence to estimate the FMV of the gross estate and report the values under penalty of perjury

Portability Regulations

- An appointed executor, not the surviving spouse, may file an estate tax return to elect portability or to opt to have the portability election not apply.
- If there is no appointed executor, any person in actual or constructive possession of any property of the decedent may file the estate tax return to elect into or out of portability.
- IRC § 2010(c)(5)(A)
- Treas. Reg. § 20.2010-2(a)(6)

REV. PROC. 2016-49

Rev. Proc. 2016-49

- After portability was enacted, it might be prudent to fund a QTIP even when it does not reduce or eliminate estate tax owed at the first death.
- However, before portability funding a QTIP was only prudent if it reduced or eliminated estate tax owed at the first death.
- Rev. Proc. 2001-38 sought to void such unnecessary QTIPs; it was a taxpayer friendly ruling.

Rev. Proc. 2016-49

- After portability was enacted, planners feared that Rev. Proc. 2001-38 could void now prudent QTIP elections.
- Rev. Proc. 2016-49 confirms that Rev. Proc. 2001-38 is not the position of the Service and will not be used to void such elections.

Rev. Proc. 2016-49

- Example:
  - John & Jane have a $7,000,000 net worth. John has $5,000,000 of assets and Jane has $2,000,000.
  - John's estate funds a trust with the $5,000,000, makes a QTIP election, and elects portability for his remaining BEA.
    - John does not incur estate tax, lose his exclusion amount, or definitely create a future estate tax liability for Jane.
    - The QTIP also provides asset protection and dead-hand control.
    - A reverse QTIP election also preserves John's GST exemption.
  - Jane dies 5 years later. Her net worth has stayed about the same, however the assets in the QTIP are now worth $7,000,000.
  - By using the QTIP election to include the assets in Jane's estate any unrecognized appreciation in the trust is eliminated by the § 1014(a) basis adjustment.

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Portability Considerations after Rev. Proc. 2016-49

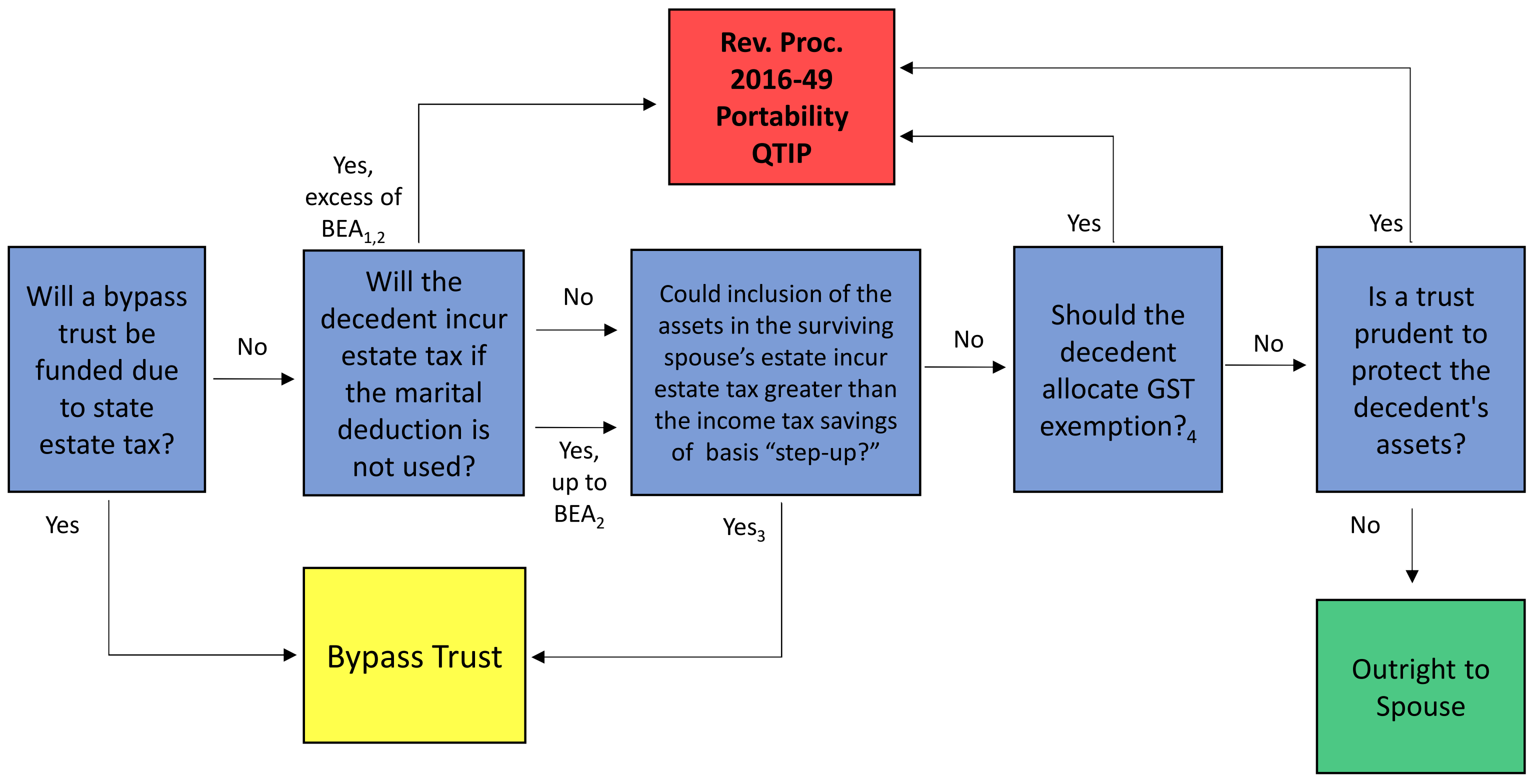
	Marital Deduction (U.S. Citizen Spouse)	Asset Protection	Estate Tax Inclusion at Second Death	GST Exempt at First Death	State Estate Tax Protection	Step-up in Basis at Second Death	Assets Available to Children- After First Death	Portability	IRA Rollover	Designated Beneficiary Trust
Spouse Outright	Yes	No	Yes	No	Generally No	Yes	Yes, via Gifts	Yes	Yes	N/A
Bypass Trust	No	Possible	No	Yes, with GST Exemption Allocation	Yes	No	Yes, if Trust Document Allows	Yes, Less Bypass Amount	No	Possible with Proper Drafting[4]
Bypass Trust with Formula GPA[5]	No	Varies by state	GPA Portion[1,5]	Yes, for Non-GPA Portion with Exemption Allocation	Yes, for Non-GPA Portion	Yes, for GPA Portion	Yes, if Trust Document Allows	Yes, Less Bypass Amount	No	Possible with Proper Drafting[4]
Portabilit y QTIP[6]	Yes	Possible	Yes[2]	Yes, via a "Reverse QTIP Election"[3]	Generally No	Yes	No	Yes	No	Possible with Proper Drafting[4]

This work is not intended to provide legal or accounting or any other professional advice.

1. IRC §2041
2. IRC §2044
3. IRC §2652(a)(3)
4. Treas. Reg. §1.401(a)(9)-4, Q&A 5
5. GPA limited to an amount which does not incur estate tax at the second death.
6. Requires elections reported on Form 706 at the first death.

The Portability QTIP

Rev. Proc. 2016-49



1. Basic Exclusion Amount (BEA)
2. Assumes asset protection is desirable.
3. May be prudent to elect portability, give assets to the surviving spouse and then fund the trust in order to allow for a grantor trust.
4. Note that the GST exemption cannot "port" to the surviving spouse, however a "reverse-QTIP" election is available.

The Mathematics of Portability

Portability Basics

DSUE is limited to the lessor of:

A. The basic exclusion amount (BEA):

____

$13.61 M in 2024

B. The excess of:

(i) the BEA of the last deceased spouse of the surviving spouse over

(ii) The taxable estate of the last deceased spouse

____

Example:

- BEA = $13.61M
- Deceased's estate = $3.40 M
- $13.61 M – $3.40 M = $10.21M

Portability Basics

<u>Indexing for Inflation</u>

- The basic exclusion amount (BEA) is indexed for inflation
- DSUE ***<u>is not indexed</u>*** for inflation
- Consider the following example if the first death occurred in 2023:

	BEA	DSUE
2023	$ 12,920,000	$ 12,920,000
2024	$ 13,610,000	$ 12,920,000
2025	$ 13,990,000	$ 12,920,000

Portability Basics

However, under current law DSUE will survive the scheduled "sunset" of the double estate tax exemption on 12/31/2025:

	BEA	DSUE
2024	$ 13,610,000	$ 13,610,000
2025	$ 13,990,000	$ 13,610,000
2026	$ 7,135,000	$ 13,610,000
2027	$ 7,280,000	$ 13,610,000
2028	$ 7,430,000	$ 13,610,000
2029	$ 7,580,000	$ 13,610,000
2030	$ 7,730,000	$ 13,610,000
2031	$ 7,880,000	$ 13,610,000

Mathematics of Portability

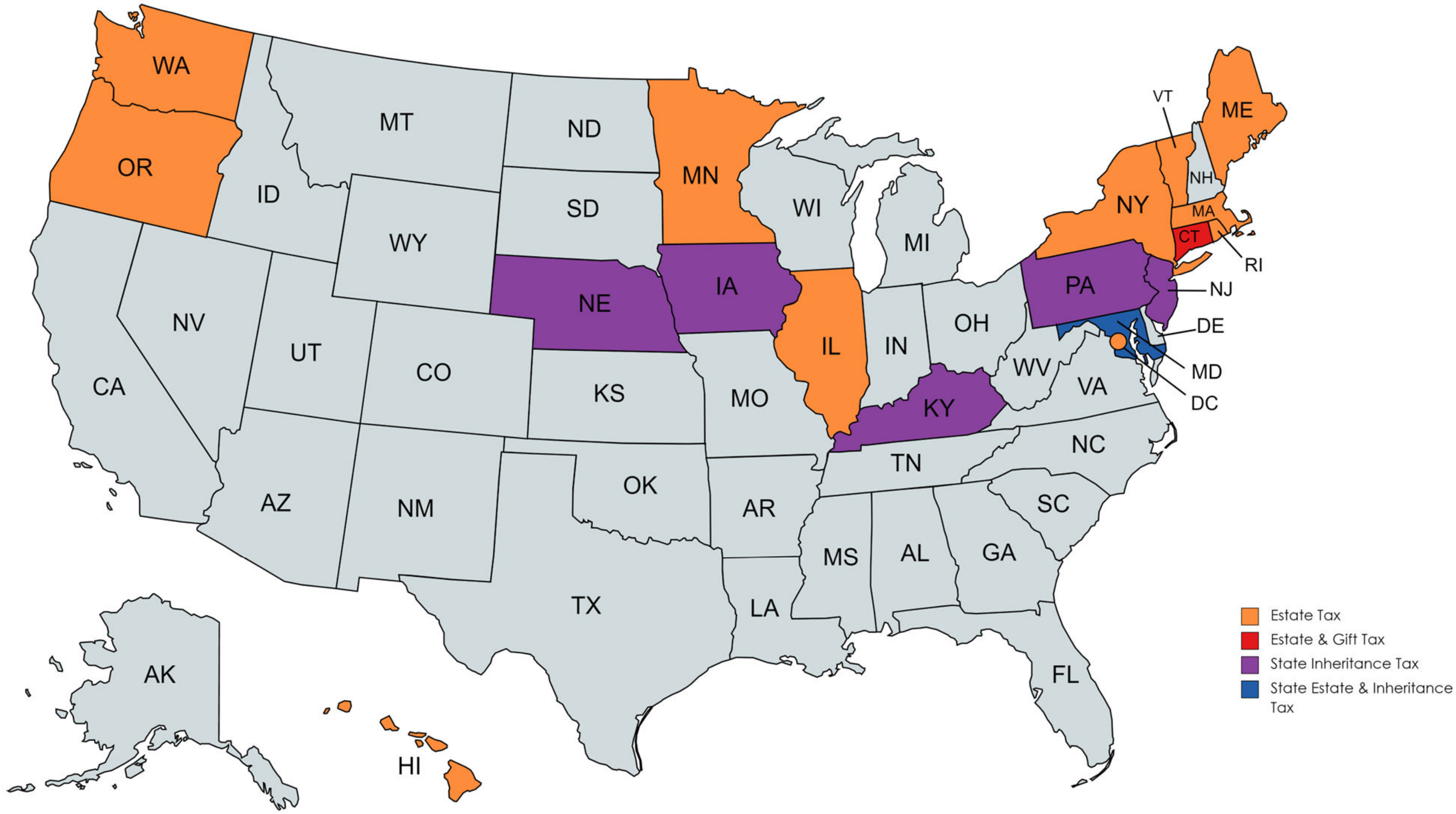
"It's a balancing Act"

Estate Tax

Income Tax

Mathematics of Portability

- Core Concepts – Saving Transfer Tax
  - Estate Tax: 40%
  - GST Tax: 40%
  - Gift Tax: 40%
  - State Estate/Inheritance Tax: 0% - 20%
  - State Gift Tax: 0% - 12%



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CT
RI
NJ
DE
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DC
AK
HI
Estate Tax
Estate & Gift Tax
State Inheritance Tax
State Estate & Inheritance Tax

Mathematics of Portability

- Core Concepts – Protecting Property
  - Asset Protection
  - Bloodline Protection
  - Spendthrift Protection
  - Power of Appointment

Mathematics of Portability

- Core Concepts – Saving Income Tax
  - Carryover basis – IRC §1015
  - Step-up in basis – IRC §1014
  - Federal Capital Gains Tax
  - State Capital Gains Tax
  - Taxation of Trusts and Estates
- State Estate Tax
  - State Portability
  - State Exemption

Mathematics of Portability

Core Concepts:

- BEA
- DSUE
- GST Exemption
- Basis reset to FMV at Death
- Capital Gains Rates (including state rates)
- Tax characteristics of assets (tax deferred, tax free, depreciable, etc…)

Mathematics of Portability

Seven Strategies

1. 100% to Spouse
2. 100% to Bypass Trust
3. 100% to Bypass Trust with formula contingent general power of appointment
4. 100% to QTIP Trust
5. 100% to Clayton QTIP Trust
6. 100% to Spouse followed by a large gift
7. Combined Approach

Algebra to Chart Portability

$$A_1 = A_i \times (R_1 + 1)^y$$
$$A_2 = A_i \times (R_2 + 1)^y$$
$$A_3 = A_i \times (R_3 + 1)^y$$

$$B_2 = B_1 \times (R_i + 1)^y$$
$$D = B_1$$
$$C = B_2 + D$$

Where:

- y equals years
- A_1, A_2, and A_3 equal the future value of the estate assuming different growth rates as defined by R_1, R_2, and R_3
- B_1 equals the deceased spouse's BEA
- B_2 equals the surviving spouse's BEA
- R_i equals the assumed inflation rate of the BEA
- D equals DSUE
- C equals the combined exemption (BEA+DSUE)

Consider a couple with a combined estate of $10,000,000 and note the effect of a long life expectancy and or a high rate of return.

Algebra to Compare Portability to the Bypass Trust

$$A_{1y} = A_{1i} \times (R_1 + 1)^y$$
$$A_{2y} = A_{2i} \times (R_2 + 1)^y$$
$$B_1 = T_i$$

$$T_y = T_i \times (R_1 + 1)^y \times (1 - I)^y$$
$$B_2 = B_1 \times (R_i + 1)^y$$
$$D = B_1$$
$$C = B_2 + D$$

Where:

- y equals years
- A_{1i} equals the deceased spouse's estate
- A_{1y} equals the deceased spouse's estate at time y
- A_{2i} equals the surviving spouse's assets at the first death
- A_{2y} equals the surviving spouse's estate at time y
- B_1 equals the deceased spouse's BEA
- B_2 equals the surviving spouse's BEA
- T_i equals amount contributed to trust
- T_y equals the value of the trust at time y
- I equal the marginal income tax rate
- R_i equals the assumed inflation rate of the BEA
- D equals DSUE
- C equals the combined exemption (BEA+DSUE)

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Mathematics of Portability

In Florida

Income Tax		Estate Tax
23.8%	vs.	40.0%

Mathematics of Portability

In California

Income Tax		Estate Tax
37.1%	vs.	40.0%

* 20% + 3.8% + 13.3% = 37.1% (assumes no SALT deduction)

100% to Spouse

Advantages	Disadvantages
• Step-up at second death • Spouse controls property • IRA Rollover Available • Spousal Rollover/EDB stretch IRA possible	• First spouse's DSUE is "frozen" at DOD value, while assets appreciate • GST exemption cannot "port"

OFTEN IMPRACTICAL IN SECOND MARRIAGES

QTIP TRUST CAN ACHIEVE MOST OF THE SAME GOALS

100% to Bypass Trust

Advantages	Disadvantages
• Growth is exempt from estate tax • GST Exemption Preserved ______________________________ Non-Mathematical Advantages • Asset, bloodline, & spendthrift protection	• No step-up in basis at the second death • Annual Income taxation at the trust level • At best, the 10-year IRA rule likely applies at the first death

What is the Value of a Step-up?

Tax savings

- Federal Capital Gains Tax
- Federal Net Investment Income Tax
- State Capital Gains Tax

What is the Value of a Step-up?

Example:

- Tom, a Florida Resident, purchased an apartment building for $900,000. Later, the fair market value of the property increases to $2,200,000. If he were to sell the property at $2,200,000, he incurs income tax.

Basis	$900,000
Fair Market Value	$2,200,000
Gain	$1,300,000
Tax Rate	23.8%
Tax	$309,400

- Alternatively, if Tom dies before the apartment is sold, the original basis would “step-up” to reflect the current fair market value. Tom is therefore able to pass more property to his heirs.

Basis	$2,200,000
Fair Market Value	$2,200,000
Gain	$0
Tax Rate	23.8%
Tax	$0

What is the Value of a Step-up?

The higher the tax rate the greater the value of any step-up in basis

What is the Value of a Step-up?

Example:

The value of a step-up varies by state. For example, if Tom from the previous example was subject to a 23.8% tax. However, if he were in California, however, the combined rate might be 37.1%

	Florida	California
Basis	$900,000	$900,000
Fair Market Value	$2,200,000	$2,200,000
Gain	$1,300,000	$1,300,000
Tax Rate	23.8%	37.1%
Tax	**$309,400**	**$482,300**

What is the Value of a Step-up?

<u>Summary</u>: Managing Highly Taxed Capital Assets

- Option 1 – pass assets to surviving spouse
  - Basis follows the assets
  - Appreciated assets incur tax if disposed of prior to the second death
  - Opportunity for a larger step-up in basis if assets appreciate between the first and second death
- Option 2 – fund bypass trust
  - Basis is reset to FMV at the first death
  - Any income (yield) from assets is subject to higher trust tax brackets
  - No opportunity for step-up at the second death, but step-up “locked-in” at first death

General Power of Appointment

IRC § 2041 – General Powers of Appointment (“GPA”)

- A GPA grants the authority to designate the recipients of property held by an estate or trust.
- The GPA is a broad power which allows the beneficiary to allocate the estate/trust property to any individual or organization.

General Power of Appointment

IRC § 1014 – Basis of Property Acquired From a Decedent includes property subject to GPA

- The holder of a GPA over trust property will be subject to estate tax on that property whether or not the GPA is exercised

General Power of Appointment

- **§2041** – Requires the holder of a power appointment to choose assets to include in the taxable estate

- **§1014** – If property is included in one's taxable estate, the basis of the asset is adjusted to FMV

The flexibility of a GPA therefore can be used to funnel the maximum amount of built-in gain to the taxable estate to receive a tax-free step-up.

General Power of Appointment

Example:

- At David's death in 2014, 100% of his $3,000,000 estate passes to a bypass trust and $2,340,000 of DSUE "ports" to his wife Viola.
- Viola has assets of $5,000,000 at her death in 2017. Her total BEA + DSUE equals $7,830,000 ($2,340,000 + $5,490,000).

General Power of Appointment

Example:

Total Estate	$5,000,000
Total Exemption	$7,830,000
Excess Exemption	$2,830,000

Viola will therefore have a GPA over $2,830,000 at her death – this property now receives a STEP-UP at the second death!

General Power of Appointment

- Excellent strategy for an estate below the combined exemption
- Does not work for items of IRD (IRC §691(a))
- Does not work for IRA assets – must be a restricted limited power of appointment
- May raise asset protection concerns

Formula Contingent General Power of Appointment

"At the death of my spouse she shall have a general power of appointment to the extent it will not result in a higher federal estate tax."*

*This language is merely to illustrate the concept. DO NOT use this language in a trust document. It is insufficient.

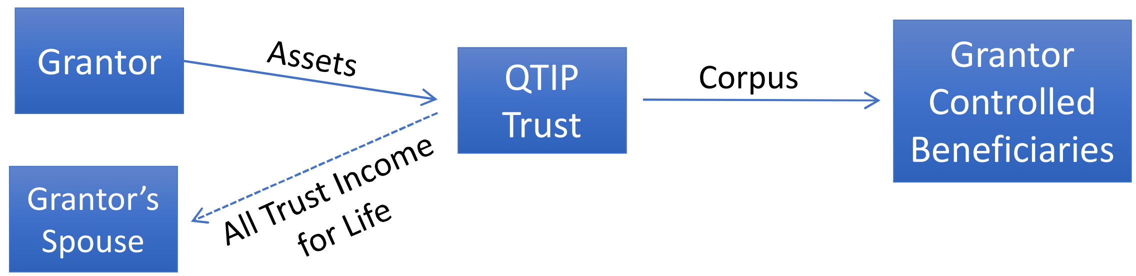
QTIP Trust

- The corpus of a QTIP trust is not subject to estate tax at the grantor's death
- Instead, the corpus passes tax-free to the surviving spouse via the martial deduction
- The surviving spouse is entitled for life to all income from the trust
- At the surviving spouse's death, the corpus of the trust passes to beneficiaries controlled by the grantor's wishes

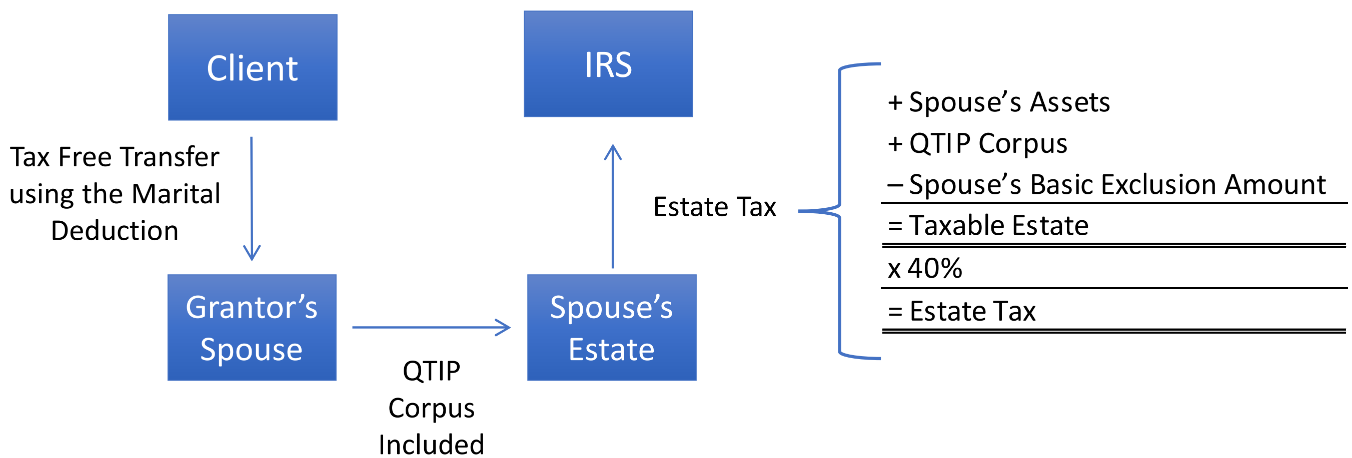
See 26 USC § 2056(b)(7).

QTIP Trust

Follow the Money:



Follow the Estate Tax:



QTIP Trust

Example – Estate Tax Calculation with QTIP

+ Spouse's Assets	$4,500,000
+ QTIP Corpus	$2,000,000
– Spouse's Basic Exclusion Amount	$5,340,000
= Taxable Estate	$1,160,000
x 40%	40%
= Estate Tax	$464,000

100% to QTIP Trust

Advantages

- Step-up at second death
- GST protection with "REVERSE QTIP" election (Treas. Reg. 26.2652-2)
- 15 months to make a QTIP election (with a 706 extension)

___

Non-Mathematical Reasons

- Asset & bloodline protection

Disadvantages

- Property taxable at death of surviving spouse (IRC § 2044)
- Estate tax exposure for FMV of property at second death
- Difficult to "QTIP" an IRA

Clayton QTIP

- A Clayton QTIP is merely a regular QTIP with an additional clause in the trust document
- This provision allows the trustee to elect, at the time of the grantor’s death, that some or all the corpus of the QTIP trust is distributed per the grantor’s instructions (can be outright or in further trust)
- Named after *Clayton v. Comm’r,* 976 F.2d 1486 (1992)

100% to Clayton QTIP

- Excellent strategy for estates below the combined exemption
- An election on the estate tax return divides the QTIP into marital and family shares

100% to Clayton QTIP Trust

Advantages	Disadvantages
• Family trust is very efficient • 15 months to make a QTIP election (with a 706 extension) • QTIP can be included in grantor's or surviving spouse's taxable estate	• No step-up at second death for "family share" • Spouse loses degree of control

100% to Spouse followed by a Gift to a Grantor Trust

Strategy Explained:

- At first death, 100% of property passes to the surviving spouse
- Spouse then gifts DSUE amount to "Grantor Trust" for family
- Spouse pays income tax until death
- "Tax-burn" creates tax-free wealth transfer

  (*See* Rev. Rul. 2004-64)

100% to Spouse followed by a Gift to a Grantor Trust

Unique Advantages

- “Tax burn” associated with a grantor trust (might be an excellent strategy for income producing assets)
- “Locks in” the value of the deceased spouse’s estate tax exemption which prevents erosion of its value if assets appreciate faster than inflation

Unique Disadvantages

- GST does not “port” to spouse; Trust is a one generation trust

100% to Spouse followed by a Gift to a Grantor Trust

Example

The spouse who is expected to pass first (spouse 1) has an estate of $11,000,000 while other spouse (spouse 2) has an estate of $1,000,000.

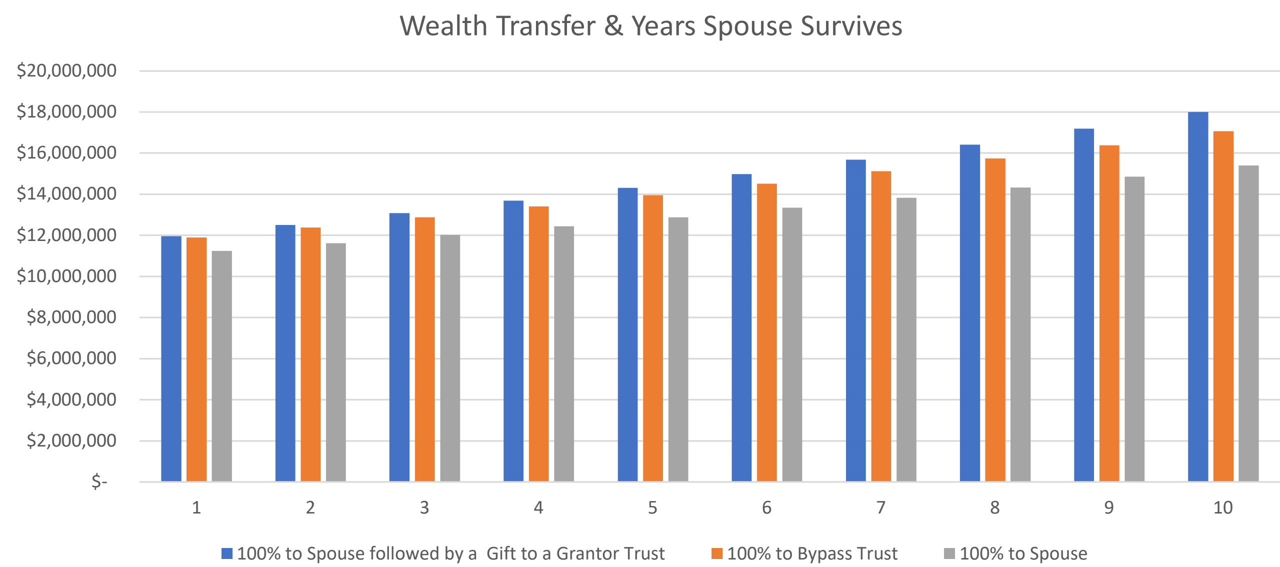
	1	2
Estate @ 1st Death	$ 11,000,000	$ 1,000,000
Gift to Spouse	(11,000,000)	11,000,000
Gift to Grantor Trust	N/A	(5,340,000)
Net Estate	$ 0	$ 6,660,000

Note: *The surviving spouse uses DSUE to fund the trust & retains their BEA.*

100% to Spouse followed by a Gift to a Grantor Trust

Example (cont.)

Assumptions: 7% Growth Rate, 30% Effective Tax Rate for Surviving Spouse, 40% Effective Tax Rate for Trust, 2% Inflation Rate for BEA



Mathematics of Portability & IRAs

IRAs represent a substantial portion of many client's wealth.

Due to the income tax advantages, preserving IRAs is a MUST.

Stretch IRA / “Inherited” IRA – Foundation Concepts

Options after Account Owner’s Death

- Immediate distribution
- IRA payable to non-qualified beneficiary (five-year rule)
- IRA payable to surviving spouse (no spousal rollover)
- IRA payable to surviving spouse (spousal rollover)
- IRA payable to child, grandchild, etc…

Portability Path #1

Timely Filed Form 706

Form 706

- Decedent has a taxable estate and owes estate tax
- Requires filing a full return, with detailed appraisals

Form 706 (Rev. 8-2019)

Estate of:	Decedent's social security number

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

Portability Election

A decedent with a surviving spouse elects portability of the DSUE amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount. ☐

Section B. Qualified Domestic Trust (QDOT)

	Yes	No
Are any assets of the estate being transferred to a QDOT?	☐	☐

If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.)

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

1	Enter the amount from line 9d, Part 2—Tax Computation	1	
2	Reserved	2	
3	Enter the value of the cumulative lifetime gifts on which tax was paid or payable. See instructions	3	
4	Add lines 1 and 3	4	
5	Enter amount from line 10, Part 2—Tax Computation	5	
6	Divide amount on line 5 by 40% (0.40) (do not enter less than zero)	6	
7	Subtract line 6 from line 4	7	
8	Enter the amount from line 5, Part 2—Tax Computation	8	
9	Subtract line 8 from line 7 (do not enter less than zero)	9	
10	DSUE amount portable to surviving spouse (Enter lesser of line 9 or line 9a, Part 2—Tax Computation)	10	

Section D. DSUE Amount Received From Predeceased Spouse(s) (To be completed by the estate of a deceased surviving spouse with DSUE amount from predeceased spouse(s))

Provide the following information to determine the DSUE amount received from deceased spouses.

A Name of Deceased Spouse (dates of death after December 31, 2010, only)	B Date of Death (enter as mm/dd/yy)	C Portability Election Made? Yes	C No	D If "Yes," DSUE Amount Received From Spouse	E DSUE Amount Applied by Decedent to Lifetime Gifts	F Year of Form 709 Reporting Use of DSUE Amount Listed in col. E	G Remaining DSUE Amount, if any (subtract col. E from col. D)
Part 1 — DSUE RECEIVED FROM LAST DECEASED SPOUSE							
		☐	☐				
Part 2 — DSUE RECEIVED FROM OTHER PREDECEASED SPOUSE(S) AND USED BY DECEDENT							
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
		☐	☐				
Total (for all DSUE amounts from predeceased spouse(s) applied)							

Add the amount from Part 1, column D, and the total from Part 2, column E. Enter the result on line 9b, Part 2—Tax Computation ▶

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Filing Deadline Extension

- The 706 must generally be filed within 9-months of death.
  - Form 4768 provides for an automatic six-month extension to file.
  - Tax must still be paid by the deadline.

- Filing an extension is often prudent:
  - Portability elections often require balancing income and estate tax consequences.
  - Often a surviving spouse will die within 15-months of death.
  - The ability to modify funding and elections can create significant value.

Filing Deadline Extension

- Example:
  - Larry died December 15, 2022 at age 91.
  - Assets totaled about $10,000,000 with no prior gifts
  - The 706 is due September 15, 2023; or March 15, 2024 if extended.
  - If wife Lisa (90 years old) dies before the return is filed, Larry's executor can choose to not elect portability
    - ➢ Larry's estate tax can be calculated using older valuations, without any appreciation which may have occurred between the two deaths
    - ➢ Lisa will be entitled to a credit for estate tax paid so recently by Larry on her estate tax return

Portability Path #2

Portability Only Form 706

Portability Only Form 706

- Decedent's who aren't required to file an estate tax return, *but want to file to elect portability*, are allowed to estimate certain asset values
- Required to report only the description, ownership, and/or beneficiary of such property, along with all other information necessary to establish the right of the estate to the deduction
- Executor's best estimate of value; must exercise due diligence and perjury penalties apply
- This applies to property eligible for the:
  - Marital deduction - § 2056
  - Charitable deduction - § 2055

Estimated values cannot be used for:
- Alternative valuation - § 2032
- Farm/real property valuation reduction - § 2032A
- QTIP disclaimer - §2652(a)(3)
- Extension of time for payment - § 6166

Portability Only Form 706

- Estimate value – example:
  - Herald dies with 3-million-dollars of property:
    - ➢ Real estate, JTWROS with his wife Wilma;
    - ➢ Bank accounts, JTWROS with W;
    - ➢ Life insurance, payable to W;
    - ➢ Survivor annuity payable to W
  - Executor reports on the 706:
    - ➢ Evidence of title and policy/annuity beneficiary
    - ➢ Best estimate of the fair market value of the gross estate, determined by exercising due diligence
  - This is sufficient to make the portability election

Treas. Reg. § 20.2010-2

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Portability Path #3

Rev. Proc. 2022-32

Rev. Proc. 2022-32

<u>Rev. Proc. 2022-32:</u> Provides a simplified method to make a late portability election.

It is available to the executor if:

1. The decedent:
   a. Was survived by a spouse
   b. Died after 12/31/10, and
   c. Was a citizen or resident on the DoD
2. The executor was not required to file based on the value of the gross estate and prior gifts
3. The executor did not file a timely estate tax return, and
4. Meets the following requirements for relief:
   a. The executor files a complete and properly prepared estate tax return on or before the fifth anniversary of death
   b. The top of the 706 states: "FILED PURSUANT TO REV. PROC. 2022-32 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)."

Rev. Proc. 2022-32

Rev. Proc. 2022-32:

- If the requirements of this revenue procedure are met, the return – and election – will be considered timely filed.
- If the Service later determines that based on the value of the gross estate and prior gifts, the executor was required to file an estate tax return, the extension granted by this revenue procedure is void ab initio.
- Importantly, this extension of time to file for portability DOES NOT grant an extension of time for a surviving spouse's estate to make a claim for credit or refund.
- However, an estate of a surviving spouse can file a protective claim in anticipation of filing for a portability election under this revenue procedure.

Portability Path #4

9100 Late Election Relief

9100 Late Election Relief

- Requests for relief to make late regulatory elections is allowed under 26 CFR § 301.9100-3

- Requests will be granted if the taxpayer can establish
  - that they acted reasonably and in good faith, and
  - the grant of relief will not prejudice the interests of the Government

9100 Late Election Relief

- Factors Demonstrating Reasonable Action and Good Faith:
  - Request for relief is made before the failure is discovered by the IRS
  - Failure is due to intervening events beyond the taxpayer's control
  - Taxpayer was unaware of the necessity of the election despite exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the issue)
  - Reliance on written advice of the IRS
  - Reasonable reliance on a qualified tax professional who failed to make or advise the taxpayer to make the election

9100 Late Election Relief

- Reasonable Reliance on a Tax Professional
  - Taxpayer must believe the professional was competent
  - Taxpayer will not be considered to reasonably rely on the advice if the they knew or should have known the professional not:
    - Competent to render advice on the regulatory election; or
    - Aware of all relevant facts

9100 Late Election Relief

- Prejudice to the Interests of the Government
  - Extensions of time to make a regulation election are granted only when the interests of the government won't be prejudiced
  - Lower Tax Liability – retroactive relief results in a lower aggregate tax liability than if the election had been made timely
  - Closed Years – the late election affects closed tax years (can be overcome)

9100 Late Election Relief

- Ruling process and cost
  - Complicated process for the novice, but relatively straightforward for the experienced
  - Requires payment of significant user fees to the government (2023 figures):
    - ➢ Generally: **$12,600**
    - ➢ For those with income under $250,000: **$3,000**
    - ➢ For those with income under $1,000,000: **$8,500**

However, the tax savings if successful are huge:
Example: $11,400,000 x 40% = $4,560,000

9100 Late Election Relief

- Specific to late portability elections:
  - Administrative relief must be time barred (i.e. beyond the 5-year period provided for in Rev. Proc. 2022-32)
  - Relief is only available if the estate did not have filing obligation (i.e. there was no return filed because the first death estate was below the exclusion)
  - Relief generally must be requested before the surviving spouse's death
  - Must be able to identify what went wrong:
    - ➢ Tax professional mistake?
    - ➢ Client mistake? or trustee/executor?
    - ➢ Unbearable grief
    - ➢ Other intervening events

Examples of 9100 Relief Rulings

https://www.irs.gov/written-determinations

Simply search for: “portability”

CONCLUSION