Death Is No Excuse: Use Postmortem Planning—Part 1

Valuation choices, portability, a tax deferral election, disclaimers, and estate and income tax deduction options are among the tools for minimizing estate tax.

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A client's death brings with it a host of planning and tax considerations. The practitioner should be mindful of these matters and the various tax planning opportunities and elections that may be available to minimize income and estate taxes for the decedent's estate.

Part 1 of this article explores matters related to federal estate taxes, including alternate valuation date issues, estate and income tax deductions, disclaimers, the Section 6166 election, and portability of the decedent's unused exemption amount. Part 2 of this article, which will be published in a subsequent issue of ESTATE PLANNING, will cover matters related to income taxes after death.

Alternate valuation

The decedent's executor must value the assets of the decedent's gross estate at their date-of-death value.[1] However, the executor may elect to value the assets as of a date six months after the date of death.[2]

The executor can make this "alternate valuation date" election only if it will decrease both of the following:

1. The value of the gross estate.
2. The sum of the federal estate tax and generation-skipping transfer tax.

The executor, therefore, cannot use the alternate valuation date values if no estate tax is due. The election applies to all of the property in the decedent's gross estate.[3] It cannot be made on an item-by-item basis.[4]

The executor may make the alternate valuation election to lower the value of the gross estate and thus the federal estate tax.

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However, even if the alternate valuation date election is available, it may be beneficial not to make the election (and use the higher date-of-death values), because the bases of the inherited property would be higher using the date-of-death values. In that case, not making the election would save income taxes for the heirs when they later depreciate or sell the inherited property. Because the current estate tax rates are higher than the long-term capital gains rates, however, it usually will be beneficial to select the lower alternate value.

The executor makes the alternate valuation date election by marking the appropriate box on line 1 of Part 3 of the Form 706 federal estate tax return. The executor must report on the return both the date-of-death and alternate-valuation-date values. This may require the executor to obtain two sets of appraisals (as of the date of death and the alternate valuation date) for assets included in the gross estate, or at least obtain updates of the date-of-death appraisals.

The election can be made on the last estate tax return filed by the executor on or before the due date of the return.[5] Once made, the election is irrevocable, except that the executor may revoke the election on a subsequent return filed on or before the due date of the return.

Any property that is not sold or distributed within the six-month period is valued as of six months after the date of the decedent's death. Property that is sold or distributed within the six-month alternate valuation period is valued on the date of sale or distribution. The executor must file supporting evidence with the return for statements made in the return regarding any distributions, sales, exchanges, or other dispositions of property during the six-month period following the decedent's death, including certified copies of court orders or decrees of distribution.[6] If there is no date in the sixth month following the decedent's date of death that corresponds numerically to the date of death, the alternate valuation date is the last day of the sixth month following the date of death.[7]

The value of certain property—such as copyrights, patents, and remainder interests—increases or decreases by the mere lapse of time. For purposes of alternate valuation, this type of property is valued on the date of death (not the alternate valuation date), and its value is then adjusted for changes that occurred in the six-month period that are not due to mere lapse of time.[8]

Debts and obligations are not affected by the alternate valuation election. However, the election may affect deductions (the value of which is determined by reference to an asset's value) and other options available to the estate.[9] For example, the election may affect the estate's options under Section 6166, discussed below, and it may reduce the marital and charitable deductions.[10] In addition, an actual sale or other disposition during the alternate valuation period of assets for which a valuation discount (blockage, minority, or marketability) was taken on the estate tax return will result in a loss of those discounts. The discounts reflect an effort to approximate what a willing buyer would pay; if an asset is sold, the actual sale price or other consideration is known and need not be discounted to reflect hypothetical factors.[11] Accordingly, before electing alternate valuation, the executor should consider what effect the election will have on the availability of the deductions and other options.

Estate and income tax deductions

Although the income tax and estate tax are not *in pari materia*,[12] the estate's income tax return and the federal estate tax return should be prepared with the other in mind, because many post-mortem tax elections may affect the availability of other elections for a different type of tax (i.e., an income tax election may affect the estate tax, and vice versa). The nature of a particular expense or debt will determine on which return, and the extent to which, the expense or debt may be deducted. Unfortunately, these rules are not spelled out in one place in the Code, and practitioners must familiarize themselves with what is deductible where.

Deductible only on the decedent's final return. Only the taxpayer who sustains a loss is entitled to take a deduction for the loss.[13] Consequently, business losses and capital losses sustained by a decedent during his or her final tax year are deductible only on the decedent's final tax return (i.e., they die with the decedent). Similarly, expenses qualifying as itemized deductions paid prior to death can be deducted only on the decedent's final tax return.

Carryovers for net operating losses and capital losses incurred in a prior tax year also must be used on the decedent's final income tax return, or carried back to prior income tax returns of the decedent. However, carryforwards attributable to the surviving spouse can be carried forward by the surviving spouse, so the executor must allocate any carryforward items between the decedent and the surviving spouse.

Deductible on the decedent's final return, or on the estate tax return. If the decedent's estate pays the decedent's final medical expenses within one year of death, the expenses are treated as paid *by the decedent* at the time they were incurred (rather that at the time they were paid).[14] However, unpaid medical expenses are also a deductible claim against the estate. Accordingly, the executor can deduct the medical expenses either on the decedent's final income tax return or on the estate tax return.

1 Section 2031(a).
2 Section 2032.
3 Income accrued on gross estate property during the six-month period is not considered part of the gross estate, and is excluded in valuing the gross estate under the alternate valuation method. Reg. 20.2032-1(d).
4 Reg. 20.2032-1(b)(1).
5 It may be possible to make the election even on an estate tax return that is not timely filed. Section 2032(d)(2); Regs. 20.2032-1(b)(1) and -(b)(3).
6 Regs. 20.6018-3(c)(6) and 20.6018-4(e).
7 Rev. Rul. 74-260, 1974-1 CB 275.
8 The Regulations contain an example of this concept. See Reg. 20.2032-1(f)(2).
9 See GCM 35328, 5/4/1973.
10 See Reg. 20.2032-1(g).
11 See Estate of Sawade, TCM 1984-626, *aff'd* 795 F.2d 45, 58 AFTR2d 86-6330 (CA-8, 1986).
12 The income and estate tax are separate and distinct, and neither is dependent on the other as the basis for the imposition of a tax.
13 Rev. Rul. 74-175, 1974-1 CB 52.
14 Section 213(c)(1).

To deduct them on the decedent's final income tax return, the executor must file a statement confirming that the expenses were not deducted on the estate tax return, and waiving the right to deduct the expenses on the estate tax return.

The executor cannot deduct some of the medical expenses on each return, but instead must take the deduction on one return or the other.[15] The entire amount of the medical expense is deductible on the estate tax return. However, a portion may not be deductible on the income tax return if it does not exceed a certain percentage of the decedent's adjusted gross income.[16] If less than the entire amount of the medical expense is deductible on the income tax return, the balance of the expense cannot be deducted on the estate tax return and is, in effect, wasted.

Deductible only on the estate tax return. Some expenses—funeral expenses, certain claims against the estate, unpaid mortgages, federal income and gift taxes, and state death taxes—can be deducted only for federal estate tax purposes, and not income tax purposes, because they represent nondeductible personal expenses of the decedent, and have nothing to do with the determination of taxable income.[17]

Deductions for funeral expenses, claims against the estate and unpaid mortgages are allowed only if local law allows the expense to be paid out of the estate for probate purposes.[18] The total amount that may be deducted for these items is limited to the value of the decedent's probate property, plus amounts paid out of non-probate property within the filing period (including extensions) for the estate tax return.[19]

To be deductible, funeral expenses must be "reasonable," and may include the casket, burial vault, undertaker's fee, flowers, clothing purchased for burial, and similar expenses. The estate also may deduct the cost of transporting the person bringing the decedent's body to the place of burial and the cost of the perpetual care of a burial lot or mausoleum.[20]

A liability imposed by law or arising out of a contract or tort is deductible if:

1. It represents a personal obligation of the decedent that existed at the time of his death.
2. Is a bona fide claim enforceable against the decedent's estate that is actually paid by the estate, or is not yet paid but the amount to be paid is ascertainable with reasonable certainty and will be paid.[21]

The executor may rely on a settlement to establish the amount of a claim or expense that is otherwise deductible, if the settlement resolves a bona fide issue in a genuine contest and is the product of arm's-length negotiations by parties having adverse interests with respect to the claim or expense.[22]

Interest on a deductible claim against the estate is itself deductible to the extent the interest had accrued at the date of the decedent's death (even if the executor makes an alternate valuation date election), but only to the extent the interest is actually paid or satisfies the requirements for deducting "ascertainable amounts."[23]

The decedent's unpaid federal gift taxes are deductible as claims against the estate, as are the decedent's unpaid income taxes, if those taxes are on income properly includable in an income tax return of the decedent for a period before his or her death.[24] Taxes on income of the decedent received after the date of death are not deductible. State death taxes paid also are deductible.[25]

Deductible only on the estate's income tax return. State and local taxes on estate income, and property taxes not accrued before death, are deductible only on the estate's income tax return.[26]

Deductible on either the estate's income tax return or the estate tax return. Administration expenses and casualty or theft losses can be deducted on either the estate's income tax return, or on its federal estate tax return, but cannot be deducted on both returns.[27] An administration expense is allowed as an estate tax deduction only if local law allows the expense to be paid out of the estate for probate purposes.

Administration expenses incurred in administering probate property are deductible under Section 2053(a)(2). Administration expenses incurred in administration of non-probate property (e.g., revocable trust assets, life insurance, joint property, etc.) that is included in the gross estate are deductible under Section 2053(b). These Section 2053(b) expenses are deductible if they meet the criteria for deductibility that apply to probate property (under Section 2053(a)) and are paid before the expiration of the period of limitation for assessment provided in Section 6501 (i.e., three years after the estate tax return is filed).[28]

15 Rev. Rul. 77-357, 1977-2 CB 328.
16 See Sections 213(a) and (f).
17 See Estate of Yetter, 35 TC 737 (1961).
18 Section 2053(a)(1); Reg. 20.2053-2.
19 Reg. 20.2053-1(c).
20 Reg. 20.2053-2.
21 Sections 2053(a)(3) and (4); Regs. 20.2053-4(a)(1) and 20.2053-1(d)(4).
22 Reg. 20.2053-1(b)(3)(iv).
23 Reg. 20.2053-4(e)(1). See also Reg. 20.2053-1(d)(4) (deduction of ascertainable amounts).
24 Regs. 20.2053-6(d) and (f).
25 Section 2058. See also Reg. 20.2053-6(c)(2).
26 Sections 2053(c)(1) and 164(a).
27 See Sections 165 (losses), 212 (expenses for production of income), and 642 (special rules). See also Reg. 1.2054-1 (no double deduction).
28 See Regs. 20.2053-1(a)(2) and 20.2053-8.

No statutory provision expressly grants the executor an option to deduct administration expenses and casualty losses either for estate or income tax purposes. The option arises from the operation of Section 642(g), which prohibits any income tax deduction for such expenses and losses unless the executor files a statement indicating that the expenses and losses have not been allowed as estate tax deductions and waiving all rights to have them allowed as estate tax deductions.[29] The executor may take the deduction on the estate tax return without filing a statement or waiver.

For this purpose, "administration expenses" are limited to expenses that are actually and necessarily incurred in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Examples of permitted administration expenses include legal and accounting fees, court fees, appraisal fees, fiduciary commissions, and expenses incurred in selling assets. Post-death accrued interest may be deductible in "appropriate circumstances" either as an estate tax administration expense under Section 2053 or as an income tax deduction.[30]

Losses are deductible if they arise from fires, storms, shipwrecks, or "other casualties," or from theft, if the losses are not compensated by insurance or from another source.[31] In order to be deductible, a loss must occur during the settlement of the estate. A loss with respect to an asset that occurs after its distribution may not be deducted.

With respect to deductions that may be taken on either the federal estate tax return or the estate's income tax return, the executor must determine on which return to take the deductions, taking into consideration the applicable tax brackets and who will bear the burden of the expense (e.g., a spouse or child, or an income or residuary beneficiary).[32] The executor may choose to deduct certain expenses for income tax purposes and other expenses for estate tax purposes.[33] The executor also may elect to deduct part of an expense for income tax purposes, and part for estate tax purposes. If a deduction is allocated to more than one tax year of the estate, the executor can elect to deduct part of the expense in one year for estate tax purposes and another part of the expense in another year for income tax purposes, so long as a deduction for the same amount is not taken twice.[34]

Deductible on both the estate's income tax return and the estate tax return. The prohibition against double deductions does not apply to deductions in respect of decedents.[35] Accordingly, trade or business expenses, certain types of interest, certain types of taxes, and expenses for the production of income that were accrued as of the date of death can be deducted on both the estate's income tax return and the federal estate tax return.

Section 691(b) allows an estate to deduct amounts specified in:

- Section 162 (trade or business expenses).
- Section 163 (certain types of interest).
- Section 164 (state, local, and foreign income and real property taxes).
- Section 212 (expenses for production of income), for items accrued at the date of the decedent's death.

Arrearages of alimony due from the decedent at the date of death are deductible on the estate tax return as claims against the estate,[36] but do not qualify as deductions in respect of a decedent under Section 691. However, the alimony may be deductible by the estate for income tax purposes as distributions to a beneficiary under Section 661.[37]

Section 6166 election

Section 6166 allows an eligible estate to elect to defer the federal estate tax attributable to the estate's interest in a closely held business by paying the tax in as few as two and as many as ten annual installments,[38] beginning after a grace period in which only interest on the deferred tax is paid. The first tax payment must be made no later than five years and nine months after the date of the decedent's death. The election is made on a timely filed estate tax return.

For example, assume the decedent died on 11/1/2015. His or her federal estate tax return, and the Section 6166 election, is due on 8/1/2016. The executor must pay the non-deferred portion of the estate tax on 8/1/2016. For each of the next four years (8/1/2017 through 8/1/2020), the executor must pay interest on the deferred tax. For each of the following ten years (beginning on 8/1/2021), the executor must pay interest and a portion of the deferred

29 Section 642(g) does not grant an income tax deduction. It merely limits certain income tax deductions otherwise allowed to an estate. Reg. 1.642(g)-2 confirms that the impact of the disallowance for double deduction is only for administration expenses allowed under Section 2053(a)(2). See Regs. 1.2053-1(e) and 1.2054-1 (disallowance of double deduction).

30 Reg. 20.2053-4(e)(2).

31 See Section 2054.

32 The deduction of certain administration expenses on the estate tax return (rather than the estate's income tax return) may result in a reduction of the marital and charitable deductions available to the estate. See Regs. 20.2055-3(b) and 20.2056(b)-4(d).

33 Reg. 1.642(g)-2.

34 Rev. Rul. 70-361, 1970-2 CB 133.

35 Reg. 1.642(g)-2; Section 691(b).

36 Section 2053.

37 See Rev. Rul. 67-304, 1967-2 CB 224.

tax. The final tax payment will be due on 8/1/2030 (nearly 15 years after the date of death).

Eligibility requirements. The estate must meet a variety of requirements in order to qualify for deferral under Section 6166. In particular, the decedent must be a U.S. citizen or resident at the date of death, and the estate tax value of the interest in the closely held business must exceed 35% of the decedent's adjusted gross estate.[39]

In addition, the business must be engaged in an "active" trade or business at the time of the decedent's death, and must satisfy various criteria related to the number and nature of the business owners. In the case of a partnership or corporation, either: (1) 20% or more of the total capital interest, in the case of a partnership, or 20% or more of the value of the corporate voting stock, in the case of a corporation, must be included in the decedent's gross estate; or (2) there must be 45 or fewer partners or shareholders in the partnership or corporation.[40]

Interest charges. A portion of the deferred tax accrues interest at a rate of 2% per year. This "2% portion" is determined by a formula, which, for decedents dying in 2015, is computed as follows:[41]

Base amount	$1,000,000
Plus: Inflation adjustment (2015)	470,000
Plus: 2015 estate tax exclusion amount	5,430,000
Total	$6,900,000
Tentative tax on total	$2,705,800
Less: 2015 unified credit	$2,117,800
Portion taxed at 2%	$ 588,000

The balance of the deferred tax is subject to interest at a rate of 45% of the annual underpayment rate under Section 6621, as it is adjusted from time to time. Each tax payment results in a pro rata reduction of the 2% portion and the portion of the deferred tax subject to interest at 45% of the underpayment rate. No deduction is allowed for estate or income tax purposes for any interest paid on tax deferred under Section 6166.

Secured interest. The IRS can require a bond or lien to secure its interest in estate tax deferred under Section 6166.[42] Under Section 6324(a), a general federal estate tax lien arises on the decedent's date of death and attaches for ten years to all assets of the gross estate (except those used to pay certain expenses). This general federal estate tax lien may not be extended beyond the ten-year period following the date of death.

As a result, when an estate qualifies and elects under Section 6166 to pay estate tax over a period of up to 14 years, the government's interest in the deferred estate tax is secured by the general federal estate tax lien for only the first nine years and three months of the installment payment period. (Although the lien runs from the date of death, the installment payment period generally runs from the normal payment due date, nine months after the date of death, thus reducing the time the general lien protects the government to nine years and three months). During the final four years and nine months of the 14-year installment payment period, the government's interest is no longer secured by the general estate tax lien. In most cases, approximately one-half of the total deferred estate tax still remains to be paid during that final, unsecured portion of the deferral period.

Factors. The IRS determines on a case-by-case basis whether security will be required when a qualifying estate elects to pay all or a part of the estate tax in installments.[43] The IRS will consider the following factors in determining whether a sufficient credit risk exists that would justify the government's requirement of a bond or special lien (although other factors may be considered and no single factor will be determinative):

1. The duration and stability of the business.
2. The ability to pay the installments of tax and interest when they are due.
3. Compliance history.

Loss of deferral. The deferred estate tax may be accelerated if 50% or more of the value of the closely held business interest is distributed, sold, exchanged, or otherwise disposed of, or 50% or more of the value of the business is withdrawn from the business. Acceleration will not occur if the transaction is a mere change in form, or if a corporation redeems the decedent's stock (under Section 303) and the redemption proceeds are applied to the deferred estate tax within a certain time period.[44]

If the executor fails to make a required payment of tax or interest by its due date, the unpaid portion of the deferred tax must be paid upon notice and demand from the IRS, subject to one exception.

38 The executor elects the number of installments within these parameters. Section 6166(a)(1).

39 The "adjusted gross estate" means the value of the gross estate reduced by the sum of the deductions allowable under Sections 2053 and 2054. Section 6166(b)(6).

40 Section 6166(b)(1).

41 See Sections 6601(j)(2) and (3). For the 2015 inflation adjustment, see Rev. Proc. 2014-61, 2014-47 IRB 860, section 3.42. In 2016, the inflation adjustment for the 2% portion is $480,000; see Rev. Proc. 2015-53, 2015-44 IRB 615.

42 Notice 2007-90, 2007-2 IRB 1003.

43 See *id.*

44 Section 6166(g)(1)(B).

45 Section 6166(g)(3)(B).

46 Reg. 25.2512(d)(2).

47 Section 2518(b)(4); Reg. 25.2518-2(e)(1).

48 Reg. 25.2518-2(e)(5), Example 6

49 See Estate of Lassiter, TCM 2000-324.

50 Reg. 25.2518-3(d), Example 20.

If the executor misses a payment, but then makes the payment within six months of its due date, the deferred portion of the tax will not be accelerated, but will lose the benefit of the 2% interest rate with respect to the late payment, and must pay a penalty equal to 5% of the amount of the late payment, multiplied by the number of months that the payment was overdue.[45]

Disclaimers

A disclaimer is a refusal by someone (the "disclaimant") to accept property that was given to him or her by another, either during the donor's life (a gift) or at death (a bequest). In the estate tax context, disclaimers may be used to solve tax and drafting problems after the donor's death. For example, disclaimers may be used to avoid generation-skipping transfer tax problems, remedy the decedent's failure to use all of his or her estate tax exemption, adjust between the marital and credit shelter portions of a revocable trust, and prevent the acceptance of problem assets, such as environmentally contaminated real property.

Eligibility requirements. "Qualified" disclaimers satisfy the criteria of Section 2518. Property that is the subject of a qualified disclaimer is treated as never having been transferred to the disclaimant for tax purposes, and the property passes to the next beneficiary without any gift tax consequences to the disclaimant (i.e., if the disclaimer is qualified, the disclaimant does not gift the disclaimed property to the next beneficiary). In order to be qualified under Section 2518, the disclaimer must be:

1. In writing.
2. Delivered to the transferor of the disclaimed interest or the holder of the legal title to the property to which the disclaimed interest relates.
3. Delivered within nine months of the date on which the transfer creating the interest in the disclaimant is made.

The disclaimant cannot accept the disclaimed interest or any of its benefits before making the disclaimer.[46] A disclaimant is not considered to have accepted property merely because under applicable local law title to the property vests immediately in the disclaimant on the death of a decedent.

Special rules for spouses. If the disclaimant is not the transferor's spouse, the disclaimed interest must pass without direction by, and to someone other than, the disclaimant.[47] If the disclaimant is the transferor's spouse, the disclaimer is qualified if the interest passes as a result of the disclaimer without direction on the part of the surviving spouse to either the surviving spouse or to another person.

In order to satisfy this "no passage" requirement, the disclaimer also must be effective under applicable state law. State law creates and determines legal rights and interests in property, and transfers thereof, but federal law governs the manner in which the interests are to be taxed. Consequently, an interest must validly pass without the disclaimant's direction under state law before it will be deemed to have done so for federal tax purposes.

If the surviving spouse retains the right to direct the beneficial enjoyment of the disclaimed property in a transfer that is *not* subject to federal estate or gift tax (whether as trustee or otherwise), the spouse's disclaimer will not be qualified unless the power is limited by an ascertainable standard. For example, if, the spouse is a trustee of the trust that receives property as the result of the spouse's disclaimer, and the spouse, as trustee, can distribute trust property to herself or any other beneficiary according to an ascertainable standard, then the disclaimer will be qualified.[48] The disclaimer would not be qualified, however, if the spouse had a limited power of appointment over the trust property.

If as a result of a spouse's disclaimer, the disclaimed property passes to a QTIP trust for the spouse's benefit, the disclaimer will be qualified, even if the spouse has the power to direct where the trust property passes upon her death (i.e., she has a testamentary power of appointment over the marital trust assets). This is because the QTIP trust property will be includable in the spouse's estate upon her later death.[49]

Formula disclaimer. A qualified disclaimer can be made by a formula.[50] When making a formula disclaimer, the amount disclaimed, and any income attributable to that amount, must be segregated based on the fair market value of the assets on the date of the disclaimer, or on a basis that is fairly representative of value changes. Formula disclaimers are useful when a surviving spouse wants to disclaim only an amount equal to the deceased spouse's unused estate tax exemption amount. The surviving spouse can disclaim a fraction of an asset, the numerator of which is the amount that can be sheltered by the estate tax exemption amount, and the denominator of which is the value of the estate's assets, as finally determined for estate tax purposes.

Portability

Portability of a decedent's unused estate tax exemption was made permanent by the American Taxpayer Relief Act of 2012[51] and is available to married decedents[52] dying after 2010. The amount of the decedent's exemption that can be transferred to the surviving spouse is referred to as the "deceased spousal unused exclusion amount," or the "DSUE amount." The spouse who most recently predeceased the surviving spouse is the deceased spouse whose unused lifetime exclusion amount is "portable."

On 6/15/2015, the IRS issued final portability regulations. The temporary regulations still apply to taxable gifts made, and estates of decedents dying, after 1/1/2010 and before 6/12/2015.[53] The final regulations apply to gifts made, and to the estates of decedents dying, on or after 6/12/2015.

Balancing upended. The portability election can eliminate the risk that the amount of a married couple's total federal estate tax liability depends on whether the value of the spouses' estates are "unbalanced." Prior to portability, the estate tax on the surviving spouse's death could differ if each spouse did not own assets at least equal to the exemption amount. Portability essentially allows spouses to be treated as a unit for purposes of the federal estate tax. However, the portability rules do not apply to the GST tax, and a decedent's unused GST exemption cannot be transferred to a surviving spouse.

Portability considerations. Making a portability election, and transferring the entire estate of the decedent spouse outright to the surviving spouse, is very simple, and may be appropriate where the surviving spouse may need all of the assets to live on. It also permits all of the couple's assets to receive a step-up in basis on the surviving spouse's death, which would not be the case if a traditional credit shelter trust is created and funded on the first spouse's death. However, couples with wealth sufficient to create transfer tax and asset protection concerns should address these issues through affirmative estate planning, rather than relying on portability.

The alternate valuation election may affect the estate's options under Section 6166, and it may reduce the marital and charitable deductions.

In 2016, $5.45 million is the maximum amount of a married decedent's unused estate tax exemption that can be "transferred" to the surviving spouse via a portability election on a federal estate tax return.[54] Although the federal estate tax exemption is indexed for inflation, the amount of unused exclusion transferred to the surviving spouse equals only the amount of the decedent spouse's unused exclusion in the year of death, and is not increased in later years to reflect inflation-related increases to the federal estate tax exemption in those later years. The surviving spouse's own lifetime exemption amount will continue to receive inflation indexing in future years, through the year of that spouse's later death.

The surviving spouse can apply the DSUE amount to lifetime taxable gifts and to assets included in the spouse's estate for federal estate tax purposes, subject to certain restrictions. The surviving spouse's use of the DSUE amount received from the deceased spouse is not elective. Rather, that amount is applied automatically when the surviving spouse makes taxable gifts during his or her remaining lifetime, and if any of the DSUE amount remains unused as of the date of the spouse's death, that amount is used when calculating the surviving spouse's estate tax liability. The DSUE amount is used before any of the surviving spouse's own exclusion amount is used.

Election mechanics. A portability election must be made by the executor[55] of the deceased spouse's estate, on a timely filed federal estate tax return (Form 706). The filing of a timely Form 706 return for a married decedent will automatically make the portability election, unless

51 Portability was first introduced as part of the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010, and became effective for married individuals dying after 2010. Portability was scheduled to "sunset" on 12/31/2012, but the 2012 Act made portability permanent.

52 After Windsor, 111 AFTR2d 2013-2385 (2013), the IRS issued Rev. Rul. 2013-17, 2013-38 IRB 201, which treats a same-sex spouse as a spouse for tax purposes if the marriage was valid in the state where the parties were married. In June 2015, the United States Supreme Court ruled that same sex marriage is legal and valid in all fifty states. See Obergefell v. Hodges, 115 AFTR2d 2015-2309 (2015). Same sex spouses can elect portability, and can file claims if gifts to spouses resulted in gift tax, or assets passing to spouses resulted in estate tax.

53 See Regs. 20.2010-1(e), -2(e) and -3(f) (estates), and Reg. 25.2505-2(g) (gifts).

54 See Section 2010(c). If the decedent spouse had received a DSUE amount from a prior spouse, any remaining DSUE amount cannot be transferred to the surviving spouse.

55 The "executor" who can make the portability election is the court-appointed executor, administrator, or personal representative who is acting, or, if there is no such fiduciary, "then any person in actual or constructive possession of any property of the decedent." See Section 2203.

56 Rev. Proc. 2014-18, 2014-7 IRB 513, provided a simplified method to obtain an extension of time to elect portability, but the availability of this method expired on 12/31/2014.

57 For an in-depth discussion of this issue, see Schiller, "Estate Planning at the Movies: Pleasantville and Portability Elections" (10/29/2014), LISI Estate Planning Newsletter #2253, at http://www.LeimbergServices.com. Note that the simplified regime cannot be used in certain circumstances, which are described in Reg. 20.2010-2(a)(7)(ii)(A).

58 The table of estimated values requires the executor to include his best estimate, rounded to the nearest $250,000, on lines 10 and 23 of "Part 5—Recapitulation" of the Form 706 and sign the estimate under penalties of perjury. Reg. 20.2010-2(a)(7)(ii)(B). The final regulations include examples illustrating the special rule. See Reg. 20.2010-2(a)(7)(ii)(C).

59 Reg. 20.2010-3(c)(1)(iii).

60 Reg. 20.2010-3(d).

the executor affirmatively "opts out" of the election by checking the "opt out" box in Part 6, Section A on page 4 of Form 706. The only other ways to avoid making a portability election for a married decedent are by:

1. Not filing any federal estate tax return (assuming a return is not otherwise required).
2. Filing the federal estate tax return late.[56]

Once a valid and timely portability election is made, it is irrevocable, and relates back to the date of the decedent's death. However, if the executor makes a portability election on a federal estate tax return that is filed before the filing deadline, the executor can file an amended 706 on or before the deadline, and reverse the earlier decision by "opting out" of portability.

An estate that files an estate tax return solely to make the portability election (i.e., the executor is not otherwise required to file an estate tax return) has two choices:

1. Report valuations in the traditional manner.
2. Report valuations in the "simplified regime" for assets in the gross estate that qualify for the estate tax marital deduction or charitable deduction.[57]

To use the simplified regime, the executor must determine a good-faith estimate of the value of each asset, look up that value in a range-of-values table (page 17 of the Form 706 instructions), and then use the "plugged" value that the table supplies for that range.[58] The executor does not include the estimated value on the line corresponding to the schedule of the Form 706 on which the property is reported. Instead, the executor enters the total of the estimated value of the assets subject to this special valuation rule on line 10 of the "Recapitulation" section of the estate tax return (page 3).

Limitations period. The time for determining the finality of the DSUE amount is not limited to the usual statute of limitations. The decedent's DSUE amount will not be included in the surviving spouse's exclusion amount, even if the surviving spouse made a transfer in reliance on the availability or computation of the decedent's DSUE amount, if, among other things, the surviving spouse cannot substantiate the DSUE amount on the surviving spouse's return.[59] Because the surviving spouse may not know the exact DSUE amount when making gifts, the spouse must assume the risk of incurring gift tax liability if he or she makes gifts that consume all of his or her remaining exemption (including the DSUE), and all or a portion of the DSUE amount is later disallowed.

The executor can deduct the medical expenses either on the decedent's final income tax or on the estate tax return.

The IRS can examine the return of a deceased spouse whose DSUE amount is claimed to be included in the surviving spouse's exclusion amount, even if the limitations period has expired on the deceased spouse's Form 706.[60] Upon examination, the IRS can adjust or eliminate the DSUE amount, but cannot assess additional tax on the return if the limitations period has expired.

Conclusion

A client's death does not end the tax planning process. Regardless of the size or complexity of an estate, postmortem planning can be used to minimize the total tax obligation and maximize the net value passing to the beneficiaries. ■