

June 27, 2012

**IRS CLARIFIES SPOUSAL PORTABILITY OF THE ESTATE AND GIFT TAX EXEMPTION  
WITH NEW REGULATIONS**

The IRS issued temporary regulations effective June 15, 2012 addressing the portability of the estate and gift tax exemption between spouses, a matter covered in detail in our February 8, 2011 memorandum.

“Portability” refers to the ability of a surviving spouse to apply his or her deceased spouse’s unused Federal estate and gift tax exemption to gifts or bequests made by the survivor, thereby sheltering them from tax. Portability (available only to United States citizens) is not automatic but must be affirmatively elected by the estate of the deceased spouse by the timely filing of a Federal estate tax return.

The regulations clarify the application of the portability rules. Below is a summary of key questions raised by the law that have now been answered:

- Filing – The regulations confirm earlier IRS guidance that a “complete and properly-prepared” estate tax return must be filed by an estate, regardless of size, if portability is desired. The regulations do appear to simplify the return preparation process for estates that would not have otherwise been required to file (i.e., generally estates under \$5.12 million, including lifetime taxable gifts, for a decedent dying in 2012) by permitting estimated values, within certain ranges, to be provided for estate assets, in lieu of more costly and time-consuming appraisals. However, this exception is limited to assets that pass entirely to a surviving spouse or to charity.
- Who makes the election – From the language of the portability statute it appeared that only a duly appointed executor could elect portability. The regulations clarify that when there is a duly appointed executor of an estate, only the executor is authorized to make the election. However, in the event that there is no such executor, the portability election can be made by anyone in possession of estate assets, and if there is more than one such individual, any one of them can make the election. These rules suggest that it may be prudent to appoint an executor (even where the disposition of one’s assets can

be accomplished without a Will) and to choose carefully the identity of the executor in order to protect the interests of a surviving spouse where his or her desire for portability may not be agreed to by other beneficiaries of the estate.

- Gifts by the survivor – The regulations provide that if portability is elected, the deceased spouse’s unused exemption is applied to gifts made by the survivor before the surviving spouse’s own exemption in “last-in-first-out” fashion. This allows the deceased spouse’s exemption to be used up first. In addition, a properly made portability election is retroactive to the deceased spouse’s date of death, which means that the survivor can begin using the deceased spouse’s exemption for lifetime gifts even prior to filing an estate tax return, provided a return ultimately is timely filed.
- Remarriage – Portability applies only to the unused exemption of an individual’s last deceased spouse. Thus, if a surviving spouse remarries and also survives his or her second spouse, the surviving spouse is limited to the second spouse’s unused exemption, irrespective of whether it is larger or smaller than the first deceased spouse’s unused exemption. However, during the lifetime of the second spouse, the surviving spouse can still use the prior spouse’s exemption, since that spouse technically remains his or her “last deceased” spouse. Coupled with the last-in-first-out rule described above, this offers the surviving spouse favorable lifetime estate planning opportunities to make gifts during the second spouse’s lifetime using the deceased spouse’s exemption, while also using the second spouse’s exemption by traditional “gift-splitting” between spouses. Use of the deceased spouse’s exemption does not foreclose the later portability of the second spouse’s remaining exemption if the surviving spouse also survives the second spouse.

Absent Congressional action, portability is set to expire on December 31, 2012. However, the new regulations provide helpful guidance for clients wishing to take advantage of portability now and in the likely event that the law is extended.

We are available to advise our clients in determining what portability means for their particular situation, or to discuss any other estate planning matter.

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