

Fall 2022 Newsletter

More Families Can Now Take Advantage Of A \$24.12 Million "Portable" Estate Tax Exemption:

For families with significant wealth, a new IRS procedure could result in millions of dollars in tax savings. The new procedure allows for more flexible estate planning by making the Deceased Spouse Unused Exclusion available up to five years after the death of the first spouse of a married couple.

Under current law, an individual may give away \$12.06 million to beneficiaries during life or at death (other than the individual's U.S. citizen spouse for whom such gifts or bequests are not taxable) without incurring federal gift or estate tax. This \$12.06 million amount is the unified estate and gift tax credit (for ease of reference this amount is referred to as the "exemption" below) for the year 2022. Gifts in excess of this exemption are subject to estate or gift tax at a 40% rate. This means that a married couple should be able to collectively gift \$24.12 million, during life or at death, to their children or other intended non-spousal beneficiaries without incurring estate or gift tax.

Prior to 2011, it was necessary for the first-to-die spouse to use such spouse's exemption in its entirety during life or at death to ensure it was not wasted. This exemption was often used by fully funding a "credit shelter" trust (also known as a "bypass trust," "B trust," or "family trust") under the first-to-die spouse's Will or Revocable Trust. Since 2011, however, the tax code has allowed for the "portability" of a deceased spouse's unused estate tax exemption to the surviving spouse. Portability has allowed for more flexible estate planning in which the first-to-die spouse's exemption is not necessarily "wasted," even if all or most assets are passed outright to the surviving spouse (or in a marital trust) without using any exemption, rather than establishing a credit shelter trust to use the first-to-die spouse's exemption. Portability also allows for potentially better income tax planning due to the step-up in tax basis for assets included in the surviving spouse's taxable estate at death. (It's important to note that a credit shelter trust or other trust planning is still often advisable for large estates because of the additional estate and generation-skipping transfer tax savings it can provide. Trusts can also have numerous non-tax advantages such as asset protection for family members.)

The caveat to the helpful portability rule is that a Form 706 federal estate tax return must be filed for the deceased spouse in order for the surviving spouse to inherit the "Deceased Spouse Unused Exclusion" (DSUE) through a portability election on that return. Without regard to taking advantage of the DSUE, only estates with gross assets in excess of the decedent's available exemption at the time of death are legally required to file an estate tax return. For example, if a spouse died this year passing \$12 million of assets to the surviving spouse (with no prior gifts), no estate tax return would be legally required. Unfortunately, however, if no estate tax return is filed, the surviving spouse does not get to use the DSUE, meaning there is potential for the surviving spouse's estate to pay nearly \$5 million in taxes it could otherwise have avoided.

The IRS recognized that the required filing of an estate tax return solely for the purpose of making the portability election to use the DSUE of the first-to-die spouse, without the legal

requirement to do so in an estate that has gross assets less than the decedent's exemption, has left many surviving spouses, and, often, their advisors, confused about appropriate steps.

The estate tax return is due nine months after the decedent's death (with an automatic six-month extension available if requested prior to the due date). If the return is not required by statute (because the gross estate assets are less than the decedent's available exemption), the IRS has the discretion to grant a retroactive extension of the time for filing. Generally, requesting this extension required the deceased spouse's estate to file a private letter ruling request under Treasury Regulations Section 301.9100-3, an expensive and time-consuming process requiring evidence of reasonable cause for failure to timely file the estate tax return. Recognizing that numerous families are affected by failure to timely file an estate tax return solely for the purpose of electing portability, the IRS in 2017 created a streamlined filing process without a private letter ruling request, provided that (i) the estate tax return was filed within two years of the decedent's death, and (ii) the return was not required by statute (because the gross estate assets were less than the decedent's available exemption). Even with the streamlined procedure, numerous families missed the two-year deadline and were required to file expensive requests for private letter rulings.

For families with significant wealth, the ability to claim the DSUE through a late filing could result in millions of dollars in tax savings. This is particularly true with the very high current exemptions (\$12.06 million per person with inflation adjustments through 2025 under current law). These high current exemptions will reduce by half for any individual dying in 2026 or later. Many families may not have an estate tax problem under current law with the high exemptions, but very well could pay estate tax if the second spouse dies after the exemptions are cut in half. In those circumstances, claiming the first-to-die spouse's DSUE could ensure that no estate tax is owed, or, at a minimum, provide significant estate tax savings.

The following example highlights the potential tax savings available under the new Revenue Procedure by showing the estate tax owed at the second spouse's death with \$24.12 million of taxable assets (assuming transfer of all assets outright to second spouse upon death of first spouse in 2022).

Second Death: Date and Portability Variables	Estate Tax Owed
Second death in 2022 <i>with</i> portability election	\$0
Second death in 2026 <i>with</i> portability election	\$2,412,000
Second death in 2022 <i>without</i> portability election	\$4,824,000
Second death in 2026 <i>without</i> portability election	\$7,236,000

For simplicity, the amounts above are expressed in 2022 real dollars and assume all future values grow only with inflation (\$12.06 million estate tax exemption per person in 2022, \$24.12 million taxable estate, and \$6.03 million estate tax exemption per person in 2026). The \$6.03 million

estate tax exemption per person in 2026 assumes that the estate tax exemption is halved in 2026 as provided under current law.

Fall Office Hours:

Our office hours are from 9:00 a.m. to 4:00 pm. Masks for appointments, at the moment, are optional.

Sincerely,
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