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PORTABILITY: REPRIEVE FOR FAILURE TO FILE ON TIME

Bradford N. Dewan, J.D., MBA

On December 17, 2010, the US Congress amended Section 2010(c) of the Internal Revenue Code to allow for the transfer (commonly referred to as "portability") of a deceased spouse's unused applicable exclusion amount to the surviving spouse. Portability became effective for estates of decedents dying (and gifts made) after December 31, 2010.[i] However, portability does not apply automatically upon the death of the spouse. Rather, an estate tax return has to be filed. Importantly, an estate tax return has to be filed to claim portability even if the size of the estate of the deceased spouse is below the threshold for when an estate tax return must be filed. This requirement can certainly cause some confusion and uncertainty among the family members of the deceased spouse, as well as some advisors. If the assumption had been that the estate of either spouse was going to be below the filing threshold, then family members may assume that the benefits of portability could be realized without having to file an estate tax return.

A recent Private Letter Ruling[ii] involves this scenario of the failure to timely file an estate tax return and the subsequent need to file a request to the Internal Revenue Service for an extension of time to make the portability election by filing an estate tax return, even though the size of the estate did not require the filing of an estate tax return.

FACTS:

The facts presented were pretty straightforward. The decedent died on a date that was after the effective date of the amendment to Section 2010(c). To obtain the benefit of portability of the deceased spouse's unused exclusion amount, the decedent's estate was required to file Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, on or before the date that was 9 months after the decedent's date of death or the last day of the period covered by an extension. The estate did not timely file a Form 706 to make the portability election. The estate discovered its failure to elect portability after the due date for making the election.

The executor of the decedent's estate represented to the IRS that the value of the decedent's gross estate, including taxable gifts made during his lifetime, was less than the basic exclusion amount in the year of the decedent's death.

The executor requested an extension of time pursuant to Treas. Regs. 301.9100-3 to elect portability regarding the decedent's unused exclusion amount.

ANALYSIS

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

However, Section 2010(a) provides that a credit of the "applicable credit amount" will be allowed to the estate of every decedent against the tax imposed by Section 2001.

Section 2010(c)(1) provides that the applicable credit amount is the amount of the tentative tax that would be determined under Section 2001(c) if the amount with respect to which such tentative tax is to be computed was equal to the applicable exclusion amount.

Section 2010(c)(2) provides that the applicable exclusion amount is the sum of the basic exclusion amount and, in the case of a surviving spouse, the "deceased spousal unused exclusion amount" or "DSUE" amount.

Under Section 2010(c)(3), the basic exclusion amount is $5,000,000, but this amount is to be adjusted for inflation for years after 2011. With these inflation adjustments, in 2014 the basic exclusion amount is $5,340,000.

The DSUE amount is defined under Section 2010(c)(4) to mean the lesser of (A) the basic exclusion amount, or (B) the excess of (i) the applicable exclusion amount of the last deceased spouse of the surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under Section 2001(b)(1) on the estate of such deceased spouse.

Importantly for this private letter ruling and estate planning generally, Section 2010(c)(5)(A) states that a DSUE amount may not be taken into account by a surviving spouse (i.e. added to the basic exclusion amount of the surviving spouse) under Section 2010(c)(2) unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be taken into account. Under current regulations, the election is made by simply filing the return. The election, once made, is irrevocable. Moreover, to the point of the private letter ruling, no election may be made if the estate tax return for the deceased spouse is filed after the time prescribed by law (including extensions) for filing such return.

To clarify its basis for its response to the request for an extension to file the estate tax return, the IRS briefly reviewed the Code sections and regulations that applied to these facts.

The first reference was to Section 6075, which prescribes that returns made under Section 6018(a) (relating to estate taxes) must be filed within 9 months after the date of the decedent's death.

Section 6018(a)(1) provides that in all cases where the gross estate at the death of a citizen or resident exceeds the basic exclusion amount then in effect under Section 2010(c) for the calendar year which includes the date of death, the executor must file an estate tax return. (Note: As indicated above, the decedent's estate in the private letter ruling was less than the basic exclusion amount, and thus, initially, there was no requirement to file an estate tax return under Section 6018).

At this point the IRS then started referencing the Temporary Regulations under Section 2010(c).

The first reference was to Treas. Reg. 20.2010-2T(a), which provides that to allow a decedent's surviving spouse to take into account that decedent's DSUE amount, the executor of the decedent's estate must elect portability of the DSUE amount on a timely filed Form 706.

Then, importantly, Treas. Reg. 20.2010-2T(a)(1) provides that an estate that elects portability <u>will be considered to be required to file a return under Section 6018(a)</u>. This reflects the requirement that a return must be filed even if the estate of the decedent is less than the basic exclusion amount. Accordingly, the due date of an estate tax return required to elect portability is 9 months after the decedent's date of death or the last day of the period covered by an extension (if an extension of time for filing had been obtained).

Treas. Reg. 20.2010-2T(a)(2) resolved the issue as to how the election was actually to be made. Under this regulation, upon the timely filing of a complete and properly-prepared estate tax return, an executor of an estate of decedent who is survived by a spouse will have elected portability of the decedent's DSUE amount unless the executor chooses not to elect portability and satisfies the requirements for the election not to apply as set forth in Treas. Reg. 20.2010-2T(a)(3)(i). Thus, there is no "box" on a Form 706 that needs to be checked. Simply filing the Form 706 constitutes making the election for portability.

The IRS then presented its analysis of the regulations that provide the standards it will use to determine whether to grant an extension of time to make various elections.

Treas. Reg. section 301.9100-1(c) provides that the IRS may grant a reasonable extension of time under the rules set forth in Treas. Reg. 301.9100-2 and 301.9100-3 to make a "regulatory election" or a "statutory election" under most of the subtitles of the Internal Revenue Code.

Because of the importance of the distinction between a "statutory election" and a "regulatory election" with respect to this extension request, the IRS provided the definitions for the two types of elections.

A "statutory election" under Treas. Reg. 301.9100-1(b) means an election whose due date is prescribed by statute. The term "regulatory election" means an election whose due date is prescribed by a regulation, revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Treas. Regs. 301.9100-2 and 301.9100-3 set forth the standards that the IRS will use to determine whether to grant an extension of time to make an election.

The IRS noted that Treas. Reg. 301.9100-2 provides for <u>automatic extensions</u> of time for making certain statutory and regulatory elections. Very importantly, however, Treas. Reg. 301.9100-3 provides for an extension of time only for making <u>regulatory elections</u> that do not meet the requirements for an <u>automatic extension</u> of time under Treas. Reg. 301.9100-2.

The IRS then stated that a request for relief under Treas. Reg. 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the IRS that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the US government.

The IRS pointed to Treas. Reg. 301.9100-3(b)(1)(v), which provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make or failed to advise the taxpayer to make the election.

The IRS then provided an important analysis of why the election that the executor failed to make for the estate was a "regulatory election" and not a "statutory election," which thus allowed the IRS to grant an extension under Treas. Reg. 301.9100-3.

Sections 2010(c)(5)(A), 6075(a) and 6018(a), when construed jointly, prescribe a due date for electing portability for those estates <u>required to file an estate tax return</u> under Section 6018. Accordingly, the IRS states, with respect to those estates, the portability election is a <u>statutory election</u> as defined in Treas. Reg. 301.9100-1(b). However, the IRS explained, when an executor is <u>not required</u> to file an estate tax return under Section 6018, the Internal Revenue Code does <u>not specify a due date for an estate tax return filed for the purpose</u>

of making a portability election. Rather, the regulations under Treas. Reg. 20.2010-2T(a), which are applicable to all estates electing portability, specify that the portability election must be made on a timely-filed Form 706. Consequently, the IRS concludes, with respect to estates not required to file an estate tax return under Section 6018, the portability election will be deemed to be a regulatory election. Because the election is treated as a regulatory election for estates not required to file an estate tax return, the IRS can apply the rules under Treas. Reg. 310.9100-3 for granting an extension.

The executor of the estate, the IRS noted, represented that, based on the value of the gross estate and taking into account any taxable gifts, the Decedent's estate was not required to file an estate tax return under Section 6018(a). As a result, under these facts, the IRS determined that it had the discretionary authority under Treas. Reg. 301.9100-3 to grant to Decedent's estate an extension of time to elect portability.

Based on the facts submitted and the representations made by the executor of the estate, the IRS concluded that the requirements of Treas. Reg. 301.9100-3 had been satisfied. Consequently, the IRS granted the executor an extension of 120 days from the date of the letter sent to the executor to elect portability under Section 2010(c)(5).

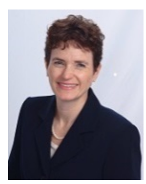
SUMMARY

This Private Letter Ruling may well present a scenario that may be commonly seen in the future. With the Applicable Exclusion Amount likely to continue to increase as a result of the inflation adjustments, executors and other parties with an interest in the estate may initially decide that an estate tax return need not be filed since the estate was below the then Applicable Exclusion Amount. Subsequently, analysis may show that the surviving spouse (and later heirs) would benefit from portability. This PLR provides a good description of the available remedy by filing for an extension with the IRS and the criteria the IRS will use in determining whether to grant an extension under such facts.

NOTE: The IRS recently issued Revenue Procedure 2014-18 that provides for an extension of time to elect portability for some estates. Under this Revenue Procedure, the IRS has granted an extension of time until December 31, 2014 to elect portability to all estates of United States citizens or residents who died in 2011, 2012 and 2013 and which did not timely file a Federal estate tax return. This extension, however, only applies to an estate that is too small to be required to file a Federal estate tax return. Consequently, the PLR discussed above is most relevant for the estates of decedents who die in 2014 and later years. However, it may also be helpful for those estates of decedents who qualify for the extension but fail to make the appropriate filing by December 31, 2014.

[1] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L.No. 111-312, section 303

[2] PLR 201421002



FIRE SEASON IS EARLY AGAIN: ARE YOU FINANCIALLY PREPARED?

DeEtte L. Loeffler, J.D., LL.M. Taxation

Fire season has started early again this year, and given the number of years since the last big burn, you may be concerned about whether or not you are prepared in the event of a disaster. This article is intended to remind you of the steps you should take to be personally and financially ready for whatever the 2014 fire season brings you.

Not all of these steps concern "legal matters," but taking time this year to ensure you have addressed each of these issues can save you time, money and heartache down the line.

1. Update Your Homeowner or Renter's Insurance.

If it has been a while since you looked at your homeowner or renter's insurance policy, now would be a good time to review your policy's terms. If you have added assets or improved your home, you might not be carrying enough coverage to rebuild and/or refurnish in the event of a loss. In addition, you should consider whether some of your assets are worth insuring using a "rider." Riders, which provide additional insurance for high value items, can often be obtained for electronic equipment (computers, TV's, sound systems, etc.), jewelry, art and silver. You may need to obtain an appraisal to support the addition of such riders to your policy.

Trustees should also review policies for any real properties held in a trust. The trustee is responsible for safeguarding assets, which includes ensuring the assets are adequately insured against loss by natural disasters. **Trustees should be particularly careful, as some homeowner policies do not cover a house that is vacant**.

2. Secure Important Information.

You should always store your important documents in a place unlikely to burn. While a "fire proof" safe is good to have, safes will actually melt in a fire hot enough to destroy a house (as happened in the Cedar Fire in 2003). It is better to store these documents in a safe deposit box or in an office or other place that is located in an area that has a low risk of burning. Some professionals may also provide a safe place to store records. For example, some estate planning attorneys provide their clients with storage for original estate planning documents.

You should also make digital copies of these important documents, as well as your family photographs. In all probability, your computer stores a significant portion of your financial and personal information. We recommend that you periodically back up that information to storage on the internet ("in the cloud"). There are now many businesses that provide reasonably priced and secure cloud based document storage. One major advantage of internet storage is that documents stored on the cloud can be retrieved at any time from any location. If you are not comfortable with cloud based storage, an alternative would be to back up the data to a DVD or CD ROM and send a copy to be stored with a friend or relative out of the state. **If you encrypt your data, be sure to provide someone with the information needed to access that encrypted data in the event you are unable to retrieve it yourself.**

3. Inventory Your Assets.

Do you remember what you have in the third drawer down in the kitchen cabinet? While it may not be necessary to have a detailed list of every butter knife, it is important to inventory the items in your home that you would want to be insured in case of a fire because insurance companies often require homeowners to provide a detailed list of the assets lost. One way to simplify this process is to prepare an inventory now, which you could scan and store with your important papers. If you lack time to do a thorough written inventory of your home, taking a video of your property, to include the contents of your closets, cupboards and drawers, could provide useful information if it is ever needed. This will help you not only to prepare a list the assets lost, but also help to prove their existence and condition. Smart phones make this process much easier than it used to be. Another option is to hire a company to do the inventory for you. Several such inventory companies came into existence after the last fires and still provide these services. Finally, if you made a video in the past, consider whether it is still current enough to be useful. If not, you may want to make a new video.

You may also want to consider having your home reappraised. With home values on the rise again, you may want to discuss the value with your insurance company now, rather than argue its proper replacement value after a loss.

4. Have An Exit Strategy.

In addition to the emergency survival kit you should keep by the door or in your car, you should keep a binder or box ready to go with your important assets and information. Be sure to include the CD of the data from your computer.

While we hope this year will not be a bad one for fires, it is better to be prepared. Taking these steps now can prevent heartache and extra work in the future.

STATE TAX NEWS

DeEtte L. Loeffler, J.D., LL.M. Taxation

Taxpayers who received a reduction in their property taxes during the Great Recession can expect much higher property tax bills this summer. In California, property tax increases are generally limited under Prop 13 to a maximum of 2% a year. However, that limit does not apply when property taxes have been artificially depressed. During the Great Recession, some taxpayers requested reductions in their property taxes because of depressed home values, while others received reductions when country assessors unilaterally reduced the tax roles. Under state law, however, these reductions were only temporary.

With property values rising in many areas of California, Counties are again increasing taxes to those levels that would have been in effect if the recession had not occurred. Under state law, counties may increase property taxes to the lesser of (1) current tax levels, or (2) what taxes would have been under Prop 13 if the reductions had not been granted. The state estimates that for some, property tax rates may increase as much as 20% in 2014, and may increase another 10% per year thereafter until the maximum permitted rates are reached.

FEDERAL TAX NEWS

DeEtte L. Loeffler, J.D., LL.M. Taxation

Agents Must Also File an FBAR

If you are an agent under a power of attorney, and the maker of that power owns a financial account outside the US, we recommend you file a FinCENT Form 114 (Report of Foreign Bank and Financial Accounts, or FBAR) no later than June 30, 2014. You should file the form even if you have never exercised any authority over a foreign account, and/or did not even know of the existence of such account before you read this article.

As you may know, taxpayers who own foreign accounts are required to file FinCENT Form 114 annually, as well as to report such accounts on Schedule "B" of their federal income tax returns (Form 1040), and on IRS Form 8938 (Statement of Specified Foreign Financial Assets (Form 8938)) if they have over $10,000 in such accounts. Failure to file can subject the taxpayer to significant fines. Until now, however, agents for such taxpayers did not face any reporting requirements.

Under recent IRS FBAR Guidelines, however, **not only the account's owner, but ANYONE with "signature authority" over a foreign account, must file a FinCEN Form 114.** "Signature authority" is defined broadly to mean "the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account." *Please note that these rules have not yet been tested.*

Most estate plans include, as a standard document, a financial power of attorney that is immediately effective in order to permit the named agent to act quickly if the maker becomes disabled. These broad powers may now pose a specific liability problem for agents. We recommend agents review any power of attorney in their possession and ask the maker if he or she has a foreign financial account. If so, the agent should file an FBAR for the current year. We also recommend, going forward, that agents consider obtaining a new power of attorney that specifically denies the agent power over such foreign accounts. You can find and complete the FINCEN Form 114 online here.

IRS UPDATES IRA ROLLOVER CHART

The IRS has recently released its updated IRA Rollover Chart, a one-page PDF table, to explain the newest interpretation of the one-rollover-per-year-rule. The table lists the types of plans and IRAs that are eligible to make rollover distributions and the corresponding plans to which such distributions can be rolled over. The updated IRA Rollover Chart can be found here.

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[i] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L.No. 111-312, section 303
[ii] PLR 201421002