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Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1880
Date: 18-Oct-11
From: Steve Leimberg's Estate Planning Newsletter
Subject: Shenkman & Keebler: Ten Portability Malpractice Traps Practitioners Should Consider.

In their commentary, **Marty Shenkman** and **Bob Keebler** provide members with ten important examples of the malpractice risks confronting practitioners when dealing with the portability election that permits the surviving spouse to use decedent's unused exclusion amount. Their commentary is a more detailed follow-up to the recent **LISI** PodCast title "Portability Malpractice Alert."

Marty Shenkman is an attorney in private practice in Paramus, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. In addition to authoring his amazing Heckerling notes for **LISI**, he is a co-author with **Steve Akers** of Estate Planning After 2010 Tax Act - Tools, Tips, and Tactics.

Robert S. Keebler, CPA, MST, AEP (Distinguished) is a partner with **Keebler & Associates, LLP** and is a 2007 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Counsels. He has been named by CPA Magazine as one of the Top 100 Most Influential Practitioners in the United States and one of the Top 40 Tax Advisors to Know During a Recession. His practice includes family wealth transfer and preservation planning, charitable giving, retirement distribution planning, and estate administration. Mr. Keebler frequently represents clients before the National Office of the Internal Revenue Service (IRS) in the private letter ruling process and in estate, gift and income tax examinations and appeals, and he has received more than 150 favorable private letter rulings including several key rulings of "first impression". He is the author of over 100 articles and columns and is the editor, author or co-author of many books and treatises on wealth transfer and taxation. For information about Bob's tapes, seminars on tape, or speaking engagements, please contact Lisa Chapa at lisa.chapa@keeblerandassociates.com.

Before we get to their commentary, **LISI** would like to bring to the attention of members the fact that **LISI** commentator **Marty Shenkman** will be the featured presenter in a series of seminars as part of **National Estate Planning Awareness Week**.

It is estimated that over 120,000,000 Americans do not have up-to-date estate plans and long term financial strategies to protect themselves or their families in the event of sickness, accidents, or untimely death. The purpose of National Estate Planning Awareness Week is to encourage consumers to address these issues before they have a chance to negatively impact their daily lives.

RV4TheCause was founded by Marty and his wife **Patti**, who was diagnosed with Multiple Sclerosis in 2006. Their charity educates not only the individuals impacted by chronic illness or disability, but the attorneys, accountants, financial planners, and insurance professionals serving the 120 million Americans living with the challenges of disability and health issues.

Starting this week, the **National Multiple Sclerosis Society,** the **COPD Foundation,** the **Michael J. Fox Foundation for Parkinson's Research,** the **American Institute of Certified Public Accountants**, the **Alzheimer's Association,** the **American Bar Association**, and the **Ultimate Estate Planner, Inc.** will all sponsor webinars and teleconferences for clients and professionals where Marty will be the featured presenter. To learn more and to register, click the links below:

- Estate Planning Awareness Week1
- Estate Planning Awareness Week2

Now, here is their commentary.

EXECUTIVE SUMMARY:

Portability has been trumpeted by some in the media as one of the most significant estate planning benefits of The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("TRUIRJCA"), Sections 302(a)(1) and 303(a). Practitioners know otherwise. But knowing is not enough. Portability creates a number of significant malpractice risks which practitioners may be best advised to guard themselves against.

While most practitioners have focused on understanding the mechanics of portability, the first estate tax returns for 2011 decedents will be filed October 1, 2011 and the focus needs to shift to compliance and exposure issues. The IRS has issued recent guidance in the instructions to Form 709 and Notice 2011-82. While providing useful information, many questions and landmines remain.

FACTS:

Consider the following potential traps:

Portability Malpractice Risk No. 1 – Not Cautioning Clients about Limitations of Portability

Most practitioners have dismissed portability as an affirmatively planning option far preferring more tried and true planning. This is because portability does not apply to state estate tax, the GST tax, and does not address post death appreciation. Significantly, portability provides none of the asset protection a properly funded bypass trust will provide clients. However, merely relying on traditional bypass trust planning does not get practitioners out of the malpractice woods. Practitioners should communicate with clients the need to monitor title to assets, continue to use bypass trust and related planning, and not to dismiss estate planning merely because of the potential for using portability.

Further, for estates under $5,000,000 portability and the bypass are fully compatible; a decedent with an estate of $2,600,000 can fully fund the bypass trust and still "port" the remainder of the estate and gift tax exemption to his/her spouse.

Portability Malpractice Risk No. 2 – Not Filing to Preserve Portability

An executor can only elect to permit the surviving spouse to use decedent's unused exclusion amount by filing a "timely and complete" Form 706. Practitioners will need to assure that the deadline is not missed, or at least properly extended, so that the election is not inadvertently lost. IRC Sec. 2010(c)(5)(A). Both the CPA and lawyer have some responsibility here and communication will be critical.

A "complete" return may not be simple or inexpensive:

- Information regarding marital status of decedent should be entered on Part 4 Form 706 - General Information.
- If decedent had more than one marriage the return must provide name and Social Security Number of each former spouse, dates the marriages ended, and how the marriage ended by: annulment, divorce decree, or death of spouse. This data may not be easily available.
- If a prior marriage ended in death and the predeceased spouse died after 2010, the return should indicate on the explanation line whether the executor of the estate of the predeceased spouse elected to allow the decedent to use the deceased spouse's unused exclusion amount.
- It is not yet clear how the term "completed" will be defined. Might some level of disclosure of assets and corroboration of asset values be necessary to support the validity of the election?

Executors should be aware of the ability to request an automatic 6-month extension by filing Form 4768 before the due date for filing Form 706. See Treas. Reg. Sec. 20.6081-1(a) and (b).

Portability Malpractice Risk No. 3 – Not Addressing Executor Vindictiveness

In a typical blended family, children from a prior marriage might receive most assets on the first death. The surviving spouse from a second or later marriage might want to take advantage of portability (or perhaps should even if they don't understand it).

The children from the prior marriage may choose not to have portability elected out of spite if a return is filed. If the children who are the executors intentionally don't want portability to apply the practitioner must be proactive to assure that this is the case.

Will this create any exposure for the executor because of his or her fiduciary duty to the surviving spouse? Does the mere status as the one who can benefit from the portability election suffice to create a potential duty even if the surviving spouse is not otherwise a beneficiary? Is it worth the risk? Should executors generally be advised to inform the surviving spouse of the potential for portability in all cases? If the heirs won't benefit (i.e. the spouse is not an heir) perhaps offering the surviving spouse the opportunity to cover the cost of filing if the return otherwise does not have to be filed may suffice to protect the executor. However, does this create an ongoing liability for the executor since the statute never ends? A typical "Receipt and Release" does not address this exposure.

Portability Malpractice Risk No. 4 – Not Assuring Non-Election

In some situations the executor may not wish to keep the statute of limitations open on the return, even if it only pertains to the portability issue. How can the executor address the continuing liability of the open statute of limitations? What if the executor cannot justify (or the heirs object) to the costs of properly filing a "complete" return (e.g., the costs of appraisals) and the executor fears the open statute of limitations that might come back to haunt him or her?

The statute provides:

> "Examination of Prior Returns After Expiration of Period of Limitations With Respect to Deceased Spousal Unused Exclusion Amount.—Notwithstanding any period of limitation in section 6501, after the time has expired under section 6501 within which a tax may be assessed under chapter 11 or 12 with respect to a deceased spousal unused exclusion amount, the Secretary may examine a return of the deceased spouse to make determinations with respect to such amount for purposes of carrying out this subsection."

If the executor does not want portability to apply several options exist:

> Attach a statement to the Form 706 indicating that the estate is affirmatively not making election under Section 2010(c)(5) to have portability apply. Enter "No Election under Section 2010(c)(5)" on top of page 1 Form 706. Not filing "timely and complete" Form 706 will prohibit the surviving spouse's use of the decedent's unused exemption. However, if the executor feels strongly about not-electing perhaps one of the affirmative approaches should be used.

If a Form 706 is filed and portability is not intentionally chosen not to apply, it will be default.

Portability Malpractice Risk No. 5 – Not Maintaining Adequate Records

Estate tax returns making the portability election, along with all supporting documentation should be saved indefinitely because of the unlimited statute of limitations. IRC Sec. 2010(c)(5)(B).

The first to die spouse's filing to elect portability keeps the statute of limitations open as to that first spouse's return. Corroboration of asset values may be needed decades later to support the position taken on the first return. Practitioners should give copies of all relevant supporting documents to the appropriate clients and inform them of the obligation to retain those records. Importantly, the executor may not be the person needing these records in the future. Consider the situation of the typical blended family again. A child from the decedent's first marriage may be the executor but the new spouse will be the one to use portability. Does the practitioner have to receive approval or a waiver to provide that spouse with the records the surviving spouse, not the executor will actually need?

The surviving spouse's estate will have to attach the predeceased spouse's Form 706 and a calculation of the unused exclusion amount. Will this return be available? Perhaps, the surviving spouse should be provided with a complete copy of the estate tax return and attachments when the return is filed.

Portability Malpractice Risk No. 6 – DSUEA and Gift Tax Returns

It may be advisable for practitioners to attach a schedule to any gift tax return listing the source of all prior DSUEAs and their use to assure that the records are available and not lost.

If a client has DSUEA from a prior deceased spouse, should that be used prior to marriage to a new spouse? If the new spouse dies prior to the use of the prior DSUEA that prior DSUEA will be lost. Perhaps practitioners should document that they have advised clients with a DSUEA to use it for gift purposes before the new spouse dies.

The statute provides:

> "…deceased spousal unused exclusion amount" means the lesser of— (A) the basic exclusion amount, or (B) the excess of— (i) the basic exclusion amount of the last such deceased spouse of such 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."

Portability Malpractice Risk No. 7 – Not Obtaining Disclosures in Prenuptial Agreements

If a client is to marry the value of a portable exemption will depend on what actions the new spouse has previously taken with respect to lifetime gifts. Disclosure in a prenuptial agreement, or an acknowledgement that the disclosures are not being pursued may be critical for practitioners to obtain.

Portability Malpractice Risk No. 8 – Not Having Sign off of the Desire not to Elect

If the executor does not wish to elect portability practitioners should consider having the executor, and perhaps others, sign off affirmatively acknowledging that they do not wish to elect portability. To protect the executor it might be advisable to have a receipt and release from the beneficiaries or others who might benefit acknowledging that it is not being elected. This could be problematic if the new spouse is not a beneficiary. Another approach might be to suggest that the estate offer the new spouse, whether or not a beneficiary, the right to pay for the cost of the Form 706 if it is not otherwise required, so that an election may be made.

Portability Malpractice Risk No. 9 – Not Having Sufficient Corroboration

If the executor does not wish to incur the cost of formal appraisals since no tax is due practitioners should consider a warning letter to address the risk of an adjustment in the future on the amount that is portable. For example, if the decedent owned real estate and the estate was only worth approximately $2 million the executor might be willing to file a return to secure portability but not willing to justify the cost of a MAI appraisal of the real estate. If instead an appraisal from a website or local broker might be used to save costs. Practitioners should consider documenting that they have advised the executor of the potential liability that could occur decades later from such savings.

Portability Malpractice Risk No. 10 – Not Affirmatively Preserving a Prior Deceased Spouse's DESUA

Practitioners should also consider the "last deceased spouse" rule when drafting prenuptial agreements. Might there be an obligation to endeavor to preserve the bigger DESUA of a former last deceased spouse? Is this feasible? The law and guidance issued so far are not quite clear and practitioners' views do differ. Consider the following:

- Mr. Brown dies in 2012 and Mrs. Brown receives $5,000,000 of DESUA and her total amount exempt from estate tax is $10,000,000.
- Mrs. Brown marries Mr. Smith in 2016.
- Mr. Smith dies leaving $4,500,000 to his children and $500,000 of DESUA to his new bride Mrs. Brown-Smith.

- Mrs. Brown-Smith's exemption is now reduced to $5,500,000 under the "last deceased spouse" rule.

The law is not clear as to whether the $5,000,000 of DESUA could be protected if Mr. Brown's executor elected out of the portability rules. Perhaps a cautious approach would be to mandate this in the prenuptial agreement.

"If a surviving spouse is predeceased by more than one spouse, the amount of unused exclusion that is available for use by such surviving spouse is limited to the lesser of $5 million or the unused exclusion of the last such deceased spouse." Does affirmatively electing not to have DESUA apply negate Mr. Smith's (husband #2) status as the "last deceased spouse" thereby preserving the full exemption from Mr. Brown (husband #1)? This argument might be based on: "A deceased spousal unused exclusion amount is available to a surviving spouse only if an election is made on a timely filed estate tax return (including extensions) of the predeceased spouse on which such amount is computed, regardless of whether the estate of the predeceased spouse otherwise is required to file an estate tax return." So if no return is filed Mr. Smith's DESUA won't be available to Mrs. Brown-Smith that is clear. But will that suffice to retain the status of Mr. Brown's larger DESUA? See, Joint Committee Summary of P.L. 111-312 (Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010), Congress (United States).

Alas, while practitioners can debate how many DESUA's can dance on the head of a pin, opting out of Mr. Smith's DESUA might preserve Mr. Brown's much larger DESUA, or it might backfire. It could result in Mr. Brown losing his status as the "last deceased spouse" and preventing the use of Mr. Smith's smaller DESUA for failure to file Form 709.

In Notice 2011-82 the IRS stated: "…for the executor of the estate of a decedent to elect under section 2010(c)(5)(A) (a 'portability election') to allow the decedent's surviving spouse to use the decedent's unused exclusion amount, the executor is required to file a Form 706 for the decedent's estate, even if the executor is not otherwise obligated to file a Form 706." The IRS view appears to address the ability of Mrs. Brown-Smith to use Mr. Smith's DESUA, not the preservation of Mr. Brown's status as the last deceased spouse which is necessary to preserver Mrs. Brown-Smith's use of his DESUA.

The moral of this tale is that practitioners might prefer to recommend that Mrs. Brown-Smith make a completed gift of sufficient assets to utilize all of Mrs. Brown's DESUA to a domestic asset protection trust ("DAPT") of which she can benefit to lock in his DESUA and avoid the interpretive issues.

COMMENT:

Portability is not a tax strategy many advisers will commonly recommend be affirmatively pursued. However, the lack of recommendation does not mean practitioners won't face challenges for how they advise clients concerning portability. The new law, as new laws so often do, creates a host of intricate and complex traps for practitioners. For a law that was supposed to simplify planning, it has instead provided the entertainment value of a new Sudoku puzzle for practitioners.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Marty Shenkman
Bob Keebler

CITE AS: