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She Updated Her Forms, and You Won't BELIEVE What Happens Next

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Find out the SEVEN things you NEED to add to your forms RIGHT now!

I. Introduction

If you have spent any time on social media, you know that headlines like this one are basically a desperate ploy to get your attention. You probably also suspect that this outline won't be nearly as interesting as the title suggests, it will be entirely believable, and it won't contain seven of anything. Also, the introduction is likely to be poorly written. So let's end this intro and get straight to the listicle...

II. Estate Tax Portability

A. The Setup

In 2010, Congress gave us estate tax portability. Everyone thought this would be simple: If the estate is not large enough to use up the exemption, the surviving spouse gets to use the unused exemption to make gifts or bequests.

But nothing in tax law is simple. The trouble started when Congress decided that the executor would have to file an estate tax return that calculates the size of the unused exemption and elects to let the surviving spouse use it. IRC § 2010(c)(5)(A).

At least one practitioner tried to warn the Treasury Department that this was a bad idea. But Treasury blew off those concerns. "A commenter responding to Notice 2011–82 suggested that the temporary regulations allow a *surviving spouse* to file an estate tax return on behalf of a decedent independently of a duly-appointed executor if the surviving spouse notifies the executor of the intention to file and the executor does not, in fact, file a return. Section 2010(c)(5), however, permits only the executor of the decedent's estate to file the estate tax return and make the portability election." Internal Revenue Bulletin 2012-28, p. 20, July 9, 2012 (emphasis added).

B. The Problem

It wasn't long before step-families found a way to weaponize the portability rules. In December of 2012, a lawyer posted to the NAELA listserv asking for advice about a case in which an executor was refusing to file an estate tax return to elect portability for the surviving spouse. *See* 12/31/12 thread on the Members listserv of the National Association of Elder Law Attorneys, subject "RE: Gift-splitting where the spouse is a beneficiary / reciprocal trusts," original post author Gregory Glenn (copy of post on file with the author).

The listserv post involved a Husband (I'm going to call him Mike) who was worth $7 million, and a Wife (I'll call her Carol) who had an estate of $800,000. Carol died, and her daughter (Marcia) was appointed as her executor. Although Carol's estate wasn't large enough to be required to file an estate tax return, Mike wanted the executor to file one so that he could get the unused $4,320,000 for use in his own estate. This unused exemption would be of no benefit to Marcia and her sisters, but it likely would save Mike's kids close to a million dollars in estate taxes.

Apparently, Marcia didn't like Mike, because she refused to file the return.

The consensus of the listserv was that nothing in federal law requires the executor to elect portability. Congress just assumed that the executor would always want to do so. Why would anyone destroy an asset solely to keep someone else from using it?

Which gets at an interesting underlying issue: Is the Deceased Spousal Unused Exclusion (DSUE) an asset of the estate? Or is it a right of the surviving spouse?

Surely it cannot be an asset, says the tax lawyer. If it were an asset, it would be subject to estate tax and would have to be reported on the estate tax return. How would it be valued? If we use face value, every estate that makes a marital or charitable bequest would be required to file an estate tax return, because the unused exemption would put the estate over the threshold. Maybe the value should be based on how much estate tax is saved by the DSUE in the surviving spouse's estate. But how can we predict that number at the time of the predeceasing spouse's death? The surviving spouse could live for many years, so any valuation would be an estimate at best. Surely Congress did not intend to create this circular valuation problem.

Furthermore, if the DSUE is an asset, and the executor voluntarily files an estate tax return that makes the DSUE election, has the executor made a taxable gift to the surviving spouse? It seems unlikely that Congress intended this result, either.

But if Congress meant for the DSUE to be a right, not an asset, they provided no mechanism for the surviving spouse to claim this right when the executor refuses to file a non-mandatory 706. Under the regulations, if no fiduciary is appointed by a court, "executor" can refer to whoever is in possession of the assets of the estate, so maybe the surviving spouse could file the return in that situation. But if an executor is appointed, no one else can file the return. And even if the executor files a return, no one can force the executor to make the DSUE election. The regulation specifically states that "an appointed executor also may elect not to have portability apply". Treas. Reg. § 20.2010-2(a)(6).

Several listserv members pointed out that if Mike is a beneficiary of Carol's estate, Marcia owes fiduciary duties to Mike. Depriving him of a right in connection with the estate would seem to be a violation of those duties. And if you subscribe to the asset theory, she's depriving him of an asset that he may be entitled to receive from the estate. If Mike's estate winds up owing $1 million in extra taxes because Marcia deprived Mike of the DSUE, Mike's executor might be able to sue Marcia for damages. Would Marcia be liable solely in her personal capacity, or her fiduciary capacity as well (since Marcia might personally be judgment proof)? If Carol's $800,000 estate is required to cover those damages, it would be wiped out. Marcia is taking a big risk in refusing to play ball.

Perhaps Marcia is taking the position that the DSUE is an asset that belongs to the estate, not to the surviving spouse. Perhaps she thinks that the surviving spouse should have to purchase this asset from the estate, at a price to be negotiated between the executor and the surviving spouse.

C. Estate Of Swisher

A couple years later, a step-child serving as an executor in Indiana took this position, and wound up losing. *Walton v. Estate of Swisher*, 3 N.E.3d 1088 (Ind. App. 2014) (affirming unpublished memorandum decision in Cause Number 49A02-1307-EU-626, found at https://www.in.gov/judiciary/opinions/pdf/01291409jgb.pdf).

In *Estate of Swisher*, the Wife died first with an estate that left exemption unused. Wife's Daughter was appointed as executor. Daughter and Husband signed a written agreement under which Husband agreed to pay all taxes owed by Wife's estate, and to pay for the preparation of all tax returns, and to further pay $5,000 to Wife's estate, in exchange for which the executor-daughter agreed "to relinquish any and all claims to any tax benefits or refunds."

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