Estate & Succession Planning Corner

How a Spouse Who Is Not the Executor Can Cause a Portability Election to Be Made

By Lawrence I. Richman

The inclusion of portability legislation in Section 2010 of the Internal Revenue Code is among the most well-received additions to transfer tax law. Originally enacted in 2010, portability was made permanent in the American Taxpayer Relief Act of 2012.[1] The current provisions are relatively simple and straightforward. Code Sec. 2010 provides for the unified credit against estate tax and says each decedent is allowed a credit of the applicable credit amount. Subsection (c) of Code Sec. 2010 says that the applicable credit amount is to be computed in a manner so that it is equal to the applicable exclusion amount. The applicable exclusion amount is the basic exclusion amount and in addition, "in the case of a surviving spouse, the deceased spousal unused exclusion amount."[2] The Code recites the basic exclusion amount (which is now $5.49 million) is $5 million as adjusted for inflation post-2011. Code Sec. 2010(c)(4) explains that the deceased spousal unused exclusion (the DSUE) amount is the basic exclusion amount plus the portion of the applicable exclusion amount of the last deceased spouse of the surviving spouse that has not been applied against tax on that deceased spouse's estate tax return.

In order to make the DSUE an amount of record with the IRS, the Code establishes a process by which the IRS can know the amount available to the surviving spouse: Code Sec. 2010(c)(5) states that "a deceased spousal unused exclusion amount may not be taken into account by a surviving spouse … 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 so taken into account … " Thus, in order to compute and to elect a DSUE amount, there (1) must be an executor and (2) that executor must file a federal estate tax return on which the DSUE election is made. The Treasury has issued regulations interpreting these Code provisions and has generally been flexible in understanding and facilitating the policy goals reflected in the portability legislation.

However, the challenge and the tension in the law is that the person who has the greatest interest in portability and in seeing the DSUE election made, namely, the surviving spouse, is NOT the person who is identified under the Code as

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responsible for making that election. Code Sec. 2010(c)(5) expressly states that it is the executor who has that responsibility. If the surviving spouse is the executor, then the potential for conflict in the decision-making process should be absent. In many cases, though, and especially when the surviving spouse is the spouse of a second or later marriage and there are children of a prior marriage, conflict arises.

The forum for resolution of the conflict is not established by the IRS or by Treasury. Instead, the surviving spouse and the executor must look to state courts for what amounts to federal tax relief. Recent cases in jurisdictions as disparate as Oklahoma and Indiana represent the beginning of what will undoubtedly be many cases to come unless the IRS develops an alternative dispute resolution process for portability and the DSUE election.

The cases of Vose *and* Swisher *highlight two important approaches by which executors who are not surviving spouses are required to file an estate tax return so that a portability election may be made …*

In *The Matter of the Anne S. Vose Est., Deceased*,[3] the Oklahoma Supreme Court on January 17, 2017, ruled on the appeal of an interlocutory order of the district court compelling the administrator of the *Anne S. Vose Est.* to file a federal estate tax return for her estate and elect portability of the DSUE amount. *Vose* presents the prototypical situation: an administrator of an estate who is a child of the decedent's prior marriage and a surviving spouse who recognizes the financial worth of an asset of the decedent's estate that only has economic value to the surviving spouse. In *Vose*, the son/administrator objected to the surviving spouse's filing of an "Application to Compel Administrator to Timely Prepare and File a Federal Estate Tax Return for Purposes of Irrevocably Electing Portability of Decedent's Deceased Spousal Unused Exclusion Amount (DSUE)." Some of the aspects of the case reflect facts unique to it. However, in objecting to being required to file a return and make the portability election, the administrator argued that federal law preempts a state court from issuing such an order since the decision to file and make the election is by federal statute exclusively within the purview of the administrator/executor. The Oklahoma Supreme Court considered whether federal law completely preempts state law and concluded: "There is no indication in the federal law provisions concerning the DSUE that the Congress intended to leave no room for state law claims relating to the duties of the estate administrator, even if those duties involved a federal matter such as the election of the DSUE."[4] Since the determination and appointment of the person who is the executor/administrator of a decedent's estate is inherently a matter of state law and is subject to the jurisdiction of a state court, the Oklahoma Supreme Court concluded that the actions and duties of an executor/administrator which would be involved in the decision-making process of whether or not to make an estate tax filing and a portability election demonstrate that the complete federal preemption doctrine is inapplicable in a situation in which a state court is reviewing an exercise of discretion by the administrator of an estate. Thus, the court ordered the administrator to elect portability, thereby supporting the position of the surviving spouse that the administrator's fiduciary obligations under Oklahoma law compel him to do so notwithstanding the fact that the surviving spouse was not a beneficiary of the estate in the traditional sense.

In *Vose*, the surviving spouse had waived all rights under a premarital agreement to any interest in the deceased spouse's estate. The court found that *Vose* had standing by acknowledging that Code Sec. 2010 granted "Vose a potential interest in part of decedent's estate under the control of Lee as the administrator. [Thus] Vose may have a pecuniary interest as the surviving spouse in the portability of the DSUE, independent of his ability to take as an heir."[5]

The court notes that in *Vose* the surviving spouse had agreed to pay the cost of preparing the estate tax return, which probably was a wise tactical decision given the court's sensitivity to the equities of the situation. Interestingly, the surviving spouse's offer apparently did not include an offer to pay the cost of any audit nor was any mention made of possible tax issues relating to the deceased spouse that might have caused the administrator to prefer not filing an estate tax return.

The decision of the Court of Appeals in Indiana in *Walton v. Swisher Est.*[6] concerns the enforceability of a contract by a surviving spouse to pay $5,000 to the personal representative of his wife's estate "in exchange for which the Estate agrees to relinquish any and all claims to any tax benefits … received after date of death on any tax returns"[7] filed by the surviving spouse or the estate subsequent to the decedent's date of death. Once the personal representative realized the magnitude of the tax benefit

she was granting the surviving spouse of her mother's estate, she had seller's remorse claiming many things in an effort to set aside the contract, including claims that the agreement was ambiguous and constituted the unjust enrichment of the surviving spouse.

The Indiana Appellate Court treated the case as a simple matter regarding enforcement of a contract stating that the personal representative "agreed to relinquish her claims in exchange for consideration; she cannot now complain that she should have bargained for more."[8] For practitioners, the case provides insight into the marketplace the government has created for the right to benefit from a predeceased spouse's unused exclusion amount. Individuals may not be able to sell their body parts, but they can sell their tax benefits.

The development of the law regarding portability is in its early phases. The cases of *Vose* and *Swisher* highlight two important approaches by which executors who are not surviving spouses are required to file an estate tax return so that a portability election may be made: in *Vose*, the Court ultimately concluded it was an executor's fiduciary duty to file the return; in *Swisher*, the Court enforced a contract between an executor and the surviving spouse that required the filing of an estate tax return.

ENDNOTES

1. American Taxpayer Relief Act of 2012 (P.L. 112-240), 126 Stat. 2313 (2013).
2. Code Sec. 2010(c)(2)(B).
3. 2017 WL 167587, 2017 OK 3 (Jan. 17, 2017).
4. *Id.*
5. *Id.*
6. *Walton v. Swisher Est.*, 3 NE3d 1088 (Jan. 29, 2014).
7. *Id.*
8. *Id.*

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