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U.S. MASTER™ ESTATE AND GIFT TAX GUIDE

Wolters Kluwer

2016
U.S. Master™
Estate and Gift
Tax Guide

Wolters Kluwer Editorial Staff Publication

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Preface

The *2016 U.S. Master™ Estate and Gift Tax Guide* is designed as a reference for tax advisors, estate representatives, and estate owners involved in federal estate and gift tax return preparation and tax payment. The explanations and filled-in forms (compiled in the Appendix for easy use) reflect major federal estate, gift, and generation-skipping transfer (GST) tax developments occurring up to the date of publication. Generally, the law applicable to decedents dying, and gifts made, in 2015 is discussed.

This book reproduces filled-in samples of all relevant estate, gift, and generation-skipping transfer tax forms. Unlike its practice in prior years, the IRS did not issue a new Form 706 for the estates of decedents dying in 2015. Instead, it indicated that Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) (Rev. August 2013), which had been used for 2013 decedents, is to be used for decedents dying in 2015. A sample filled-in Form 706 (Rev. August 2013) for a decedent dying in 2015 is reproduced in the *Guide*.

This book includes filled-in samples of *draft* Form 709 (2015), the federal gift tax return for reporting gifts made in 2015. The book also includes filled-in samples of Form 706-NA (Rev. August 2013), the federal estate and GST tax return for nonresidents not U.S. citizens and the following GST forms: Form 706-GS(D) (Rev. August 2013), Form 706-GS(D-1) (Rev. October 2008), and Form 706-GS(T) (Rev. November 2013).

Filled-in samples of Form 706-A (Rev. September 2013), the return for reporting the additional tax owing on recapture of the benefits of a special use valuation election and Form 706-QDT (Rev. August 2014), the estate tax return for qualified domestic trusts, are also reproduced.

Moving Beyond Tax Legislation

Although there has been no major estate and gift tax legislation since the enactment of the American Taxpayer Relief Act on January 2, 2013, there have been significant transfer tax cases and rulings. Chief among these continues to be the development of the rules relating to same-sex marriages. In the U.S. Supreme Court's landmark decision in *Windsor*, the Court, on Constitutional grounds, invalidated section 3 of the federal Defense of Marriage Act, which had defined marriage as a legal union between one man and one woman. Subsequent to *Windsor*, the Supreme Court held in *Obergefell* that the Fourteenth Amendment requires a state to license a marriage between two people of the same sex, to recognize same-sex marriages legally performed in other states, and to extend the right to marry in the remaining states that previously did not allow same-sex marriage. The IRS has since proposed regulations that would implement the holdings of these two decisions within the Internal Revenue Code.

For latest legislative updates and changes to the Guide, see www.CCHGroup.com/TaxUpdates.

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OVERVIEW; RATES AND CREDITS

¶ 3 "Permanent" Transfer Tax Rules

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (P.L. 112-240) (ATRA). In so doing, the President ended the uncertainty that had swirled around the estate and gift taxes since passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), by making many of EGTRRA's pro-taxpayer changes permanent. Within this context, "permanent," means that tax rates and exclusion/exemption amounts will no longer be subjected to statutory phase-ins (other than yearly inflation adjustments). Within the larger context, however, neither the Internal Revenue Code generally, nor the transfer tax provisions specifically, are ever permanent. The transfer tax provisions of the Code have been amended often, with no long-term end to this process likely in sight.

¶ 5 Estate and Gift Taxes

An estate tax is an excise tax levied on the right to pass property at death. Estate taxes, such as the federal estate tax and the estate taxes used by several states, generally do not alter tax rates, exemptions, or deductions based on familial relationship. (The federal marital deduction is a notable exception to this general rule.) Aside from its utility as a revenue raiser, the estate tax has been championed by some as a mechanism to avoid undue accumulation of wealth in the hands of a relatively few families.

An estate tax is fundamentally different from an inheritance tax, which is the type of death tax that is used by several states. An inheritance tax is levied on the right to receive property from a deceased person (the decedent). Because of this, an inheritance tax usually provides different tax rates, exemptions, or deductions based on the relationship between the decedent and the recipient of the decedent's property (such as husband/wife, parent/child, brother/sister).

A gift tax is a tax levied on the giver (donor) of property to the recipient (donee), where the property has been transferred for less than adequate consideration. Unlike a gift determined under old English common law, or the rules applicable in many states, a gift for federal gift tax purposes does not have to be traceable to a "donative intent" (see ¶ 2155). The gift tax was enacted to stop an otherwise easy way to avoid the estate tax: without the gift tax, a wealthy individual could make "death bed" gifts of property to his heirs that would escape the federal estate tax.

If a federal gift tax liability is created, it is generally payable by the donor. Although the tax rates that applied to the gift tax previously were less than those that applied to the estate tax, the rates for both of these taxes were unified into one rate schedule in 1976. Changes made by EGTRRA "de-coupled" these two taxes, providing separate exemption equivalents—and, therefore, separate effective tax rates—for each. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) (Tax Relief Act of 2010) and the American Taxpayer Relief Act of 2012 (P.L. 112-240) (ATRA) generally "re-coupled" the estate and gift taxes.

The generation-skipping transfer (GST) tax is another federal tax that exists primarily to keep extremely wealthy individuals from avoiding the estate tax by using "generation-skipping transfers," that is, passing their property at death (or during lifetime) to their grandchildren (or great-grandchildren), rather than to their children. How this strategy worked, and the method used by Congress to combat it, are illustrated in the following examples.

> ***Example 1:*** At his death, Alex Able bequeaths $20,000,000 to his son, Baker. At his later death, Baker bequeaths his $20,000,000 estate to his son, Charlie.

> ***Example 2:*** At his death, Alex Able bequeaths $5,000,000 to his son, Baker, and $15,000,000 to his grandson, Charlie.

In Example 1, Alex Able's estate will have estate tax liability on the $20,000,000 transferred to his son, Baker, at Able's death. Likewise, Baker's estate will have an estate tax liability on the $20,000,000 transferred to his son, Charlie, at Baker's death. This is how Congress envisioned that the estate tax would work. Each generation was expected to pass its property to the next generation (parent to child, child to grandchild, and so on). In this way, property would be taxed once per generation.

However, the situation in Example 2 demonstrates how extremely wealthy individuals could avoid property being taxed once per generation. Because Able concluded that Baker did not need more than a $5,000,000 bequest (he may have had other sources of wealth), Able could bequeath $15,000,000 to his grandson, Charlie. Although Able's estate will pay federal estate tax on $20,000,000 under the facts of either Example 1 or Example 2, this is not the case for Baker's estate. Under Example 1, Baker's estate will be taxed on the full $20,000,000, while under Example 2, his estate will be taxed only on $5,000,000. Under this scenario, $15,000,000 has "skipped" taxation in Baker's generation. To combat this, Congress enacted the generation-skipping transfer tax, which in broad terms attempts to approximate the tax result of property being taxed at each generation (see the discussion at ¶2430, and following).

Change has been the norm. The federal transfer taxes have been changed frequently (see the Transfer Tax Timeline at ¶2597). First, as the economy and federal spending change from year to year, the government's need for the tax monies that the transfer tax generates becomes relatively more, or less, acute. This affects the feasibility of making changes to the transfer tax law. Second, changes to the transfer tax structure sometimes need to be made to close or rein in perceived tax "loopholes," like generation-skipping transfers (discussed above), or "estate freezes" (which resulted in enactment of Chapter 14 of the Internal Revenue Code—see ¶2500, and following). Finally, there are ideological differences (usually falling along political party lines) regarding the nature and utility of the transfer taxes—particularly the estate tax. Proponents of the estate tax see it as a valuable revenue raiser, and, most importantly, as a tool to avoid the concentration of great wealth in the hands of a very few people. Opponents of the estate tax see it as unfair: a person's wealth was taxed once when earned (as income), and will be taxed a second time at that person's death (as part of his or her taxable estate). Opponents also argue that the estate tax operates to cause the break up or sale of family owned businesses. (See ¶2597 and ¶2600 for a discussion of selected major changes made by EGTRRA, the 2010 act, and ATRA).

Dealing with the changes. Change may be the lifeblood of tax preparers and tax planners, but it certainly is not easy to deal with. Not only does Congress periodically make changes to the estate, gift, and GST tax law, but the IRS and courts frequently hand down rulings and decisions. Preparers and planners will need to devote time, effort, and resources to keep abreast of all these new developments in the tax law.

Tax Preparers. Congressional amendment of estate, gift, and GST tax provisions require the IRS to make changes to its tax forms. Important court decisions, and IRS regulations and rulings can also lead to such changes. Even minor nonsubstantive changes (such as requiring information formerly included on one line of a form to be listed on two lines, instead) can lead to preparation errors. Accordingly, the *2016 U.S. Master™ Estate and Gift Tax Guide* reproduces the most currently available estate, gift and generation-skipping transfer tax forms, and gives helpful line-by-line guidance and filled-in form examples. The *2016 Guide* is generally geared to decedents dying, and gifts made, in 2015. Accordingly, this edition of the *Guide* includes (at ¶2910 of the Appendix) a filled-in Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return (Rev. Aug. 2013)) to be filed for the estates of decedents dying in 2015. A filled-in Form 709, U.S. Gift (and Generation-Skipping Transfer) Tax Return (Draft 2015), is also reproduced in the *2016 Guide* at ¶3280.

Tax and Estate Planners. Although planners generally will be less concerned with changes to the IRS forms than will tax preparers, planners have other challenges. Because tax and estate planning requires a forward-looking analysis of *future* conditions that may affect a client's financial well-being, the planner is put in the dubious position of having to be something of a seer. Some changes can be known, but may be "phased-in" or "phased-out" by way of a schedule of changes made by Congress (such as the phased-in increases in the estate tax applicable exclusion amount enacted by EGTRRA). Still other changes seemingly arise without warning, and are passed by Congress in response to political pressure or changed situations.

Regardless of how changes to federal tax law come about, planners will need to deal with them. This will mean not only keeping abreast of changes that have occurred, but also of those that are likely to occur. The *2016 Guide* can help with those changes that have occurred, but tracking impending changes will require a more planning-oriented product, such as *Financial and Estate Planning*, published by Wolters Kluwer, and the complete offering of Wolters Kluwer tax and estate planning products available on CCH® IntelliConnect®.

If the planner is also the drafter of documents implementing the tax or estate plan, existing documents (such as a will or trust) may be impacted by tax law changes. Assuming that these documents are not by their terms irrevocable (or made so because of the death of the grantor), the planner/drafter will want to consider amending the documents. Likewise, when drafting current documents, the drafter will want to consider the use of appropriate provisions that may give the executor or trustee the authority to exercise discretion when dealing with future law changes or other changed circumstances. Drafting document provisions that allow future fiduciary discretion, while not running afoul of state law or IRS attack is difficult and highly technical.

¶ 10 Unified Transfer Tax Rate Schedule and Unified Credit

The unified transfer tax that applies to estate and gift taxes is progressive and is based on cumulative lifetime and at-death transfers. The cumulated transfers to which the tentative tax applies are the sum of: (1) the amount of the taxable estate, and (2) the amount of taxable gifts made by the decedent after 1976, other than gifts includible in the gross estate. The tentative tax is then reduced by gift taxes payable on gifts made after December 31, 1976. For this purpose, the amount of the gift taxes paid by a decedent after 1976 is determined as if the rate schedule in effect in the year of death was in effect in the year of the gift. The result is the estate tax before credits.

The basic estate and gift tax rates with respect to which the tentative tax is computed are based on a rate schedule that, for decedents dying after 2012 provides 12 graduated rates, beginning with an 18-percent tax rate for amounts not over $10,000 and increasing to a 40-percent tax rate for amounts in excess of $5.0 million ($5.43 millions, as adjusted for inflation, for decedents dying in 2015). Despite there being 12 graduated rates, only the 40-percent rate applies with respect to the estate tax of decedents dying after 2012. This is because the operation of the applicable credit amount (unified credit; see ¶ 15).

The 2001 Act. The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) (EGTRRA) made significant changes to the transfer tax laws, the most notable being the gradual phase-out and ultimate repeal of the estate and generation-skipping transfer (GST) taxes in 2010. Prior to repeal of the estate and the GST taxes, a number of modifications are made to the maximum estate tax rate and applicable exclusion amount (see below).

Under EGTRRA, the top marginal rate for estate, gift, and GST taxes was reduced to 45 percent for decedents dying, and gifts made, in 2007 through 2009. In 2009, when the applicable credit amount was $3,500,000 (¶ 15), the effective minimum tax rate for the estate and GST taxes is also 45 percent.

Sunset provision. In order to comply with the Congressional Budget Act of 1974, EGTRRA provided that all provisions of, and amendments made by, the 2001 Act will not apply (that is, they *sunset*) to estates of decedents dying, gifts made, or generation-skipping transfers, after December 31, 2010. This sunset was extended by two years by the Tax Relief Act of 2010 (see the heading *"The 2010 Act"*, below), and repealed altogether by ATRA (see the heading *"The 2012 Act"*, below).

The 2010 Act. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) (the Tax Relief Act of 2010) reinstated the estate and GST tax for estates of decedents dying and GSTs made after December 31, 2009. The 2010 Act also made other substantial changes to the transfer tax system, including reducing the maximum unified rate to 35 percent effective for the estates of decedents dying and taxable transfers made after December 31, 2010 (see ¶ 11).

Election for decedents dying in 2010. The executors for estates of decedents dying after December 31, 2009, and before January 1, 2011, could elect to have the 2001 Act rules apply, with the result that such estates would be exempt from the estate tax, and the heirs would receive a carryover basis (rather than a stepped-up basis) in property received from the decedent (see ¶121).

Sunset extended, then repealed. The sunset of the transfer tax provisions pursuant to EGTRRA, scheduled to apply to the estates of decedents dying, gifts made, or generation-skipping transfers made after December 31, 2010, was extended to apply to estates of decedents dying, gifts made, or generation-skipping transfers made after December 31, 2012. As a result, the amendments made by EGTRRA and the new rules of the 2010 Act were scheduled to expire for the estates of decedents dying, gifts made, or generation-skipping transfers made after December 31, 2012. However, ATRA repealed the sunset provision, with the result that most of the changes made by EGTRRA, and extended by the Tax Relief Act of 2010, were made permanent (see the heading "*The 2012 Act*", below).

The 2012 Act. The changes made to the estate, gift and GST taxes made by EGTRRA (and extended through 2012 by the Tax Relief Act of 2010), were made permanent by ATRA, effective for the estates of decedents dying, gifts, and GSTs made after December 31, 2012. ATRA accomplished this by striking title IX (the sunset provision) of EGTRRA. Additionally, ATRA raised the maximum transfer tax rate to 40 percent (from 35 percent), and also made the portability of the deceased spousal unused exclusion (DSUE) election (portability election) permanent. The portability election is discussed at ¶16.

• *Rate Schedule After December 31, 2012*

The basic rate structure that applied to decedents dying and gifts made during 2010 through 2012, continued to apply to the estates of decedents dying and gifts made after December 31, 2012, with the exception of the rates applied to taxable estates in excess of $500,000.

The estate and gift tax rate schedule applicable to the estates of decedents dying and gifts made after December 31, 2012 is as follows:

Transfer Tax Rate Schedule: After December 31, 2012

(A) *Amount subject to tax more than—*	*(B)* *Amount subject to tax equal to or less than—*	*(C)* *Tax on amount in column (A)*	*(D)* *Rate of tax on excess over amount in column (A)* *Percent*
. . .	$10,000	. . .	18
$10,000	20,000	$1,800	20
20,000	40,000	3,800	22
40,000	60,000	8,200	24
60,000	80,000	13,000	26
80,000	100,000	18,200	28
100,000	150,000	23,800	30
150,000	250,000	38,800	32
250,000	500,000	70,800	34
500,000	750,000	155,800	37
750,000	1,000,000	248,300	39
1,000,000	. . .	345,800	40

See ¶2600 for the rate schedules applicable to decedents dying, and gifts made, before 2013.

• *Unified Credit*

The estate tax unified credit (applicable credit amount) and the applicable exclusion amount (exemption amount, for GSTs) for the years 2002 through 2016 are as follows:

Year	*Applicable Credit Amount*	*Applicable Exclusion Amount*
2002–2003	$345,800	$1,000,000
2004–2005	555,800	1,500,000
2006–2008	780,800	2,000,000
2009	1,455,800	3,500,000
2010*	1,730,800	5,000,000
2011	1,730,800	5,000,000
2012**	1,772,800	5,120,000
2013	2,045,800	5,250,000
2014	2,081,800	5,340,000
2015	2,117,800	5,430,000
2016	2,125,800	5,450,000

* The gift tax applicable exclusion amount remained at $1 million for gifts made in 2010 (see ¶2007). Beginning in 2011, the gift tax applicable exclusion was equal to the estate tax applicable exclusion (at $5 million) for the first time since 2003.

** Beginning in 2012, the estate and gift tax, the applicable exclusion amounts and the GST exemption amount were subject to an inflation adjustment.

The applicable credit and exclusion amounts before the years 2002 are listed in the Appendix at ¶ 2600.

¶ 11 Unified Rate Schedule

A single unified transfer tax rate schedule applies to estate, gift, and generation-skipping transfer (GST) taxes, effective for the estates of decedents dying, and gifts and GSTs, made after December 31, 1976.[1] The rates are progressive on the basis of cumulative lifetime transfers and those transfers occurring at death. For estates of decedents dying, and gifts made in 2015, the unified transfer tax rates begin at 18 percent on cumulative transfers of $10,000 or less to a maximum rate of 40 percent, applicable to cumulative transfers over $5.43 million (see ¶10).[2]

Special generation-skipping transfer tax rate for 2010. Effective only for GSTs made in 2010, the tax rate applicable for such transfers was 0 percent (the GST exemption was $5,000,000 for 2010).[3] GSTs made in 2011 were taxed at 35 percent on transfers exceeding the $5,000,000 exemption amount; GSTs made in 2012 were taxed at 35 percent on transfers exceeding the $5,120,000 exemption amount; GSTs made in 2013 and beyond are taxed at 40 percent on transfers exceeding $5,250,000. GSTs in 2014 (on transfers over $5,340,000), in 2015 (on transfers over $5,430,000), and in 2016 (on transfers over $5,450,000), will also be taxed at 40 percent.[4]

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[1] Code Sec. 2001 and Code Sec. 2502; Reg. §20.0-2 and Reg. §25.2502-1.

[2] Code Sec. 2001(c)(1). See the Appendix at ¶2600 for the current unified transfer tax rate schedule, as well as the maximum rates that applied to pre-2013 decedents and transfers. See also ¶2640 and ¶2650 for the separate estate tax and gift tax rates that applied to pre-1977 decedents and transfers.

[3] Act Sec. 302(c), Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).

[4] Code Sec. 2001(c).

¶ 12 Application of Unified Rate Schedule

In computing the gift tax liability for any calendar year, the unified rate schedule is applied to the transferor's cumulative lifetime taxable gifts (see Chapter 34). The term "taxable gifts" means gross gifts, minus the annual exclusion (see Chapter 36) and any allowable charitable or marital deduction (see Chapter 37). Taxable gifts for the current period are aggregated with those for all prior periods (see ¶ 2355) and a tentative gift tax is computed. From this amount, a second tentative tax on the gifts from prior periods only is subtracted. In both cases, the current unified rate schedule is used to compute the tentative tax.[5] The applicable credit amount (see ¶ 15 and ¶ 2376) and the credit for foreign gift taxes, if any, are subtracted to arrive at the current year's gift tax liability.

In computing the estate tax liability under the unified transfer tax system, the unified rate schedule is applied to a decedent's cumulative transfers, both during life and at death. A tentative estate tax is computed on what is sometimes referred to as the "estate tax base," which is composed of the taxable estate (the gross estate minus allowable deductions (see Chapter 6 through Chapter 24)) plus all taxable gifts made after 1976, other than gifts includible in the gross estate (see Chapter 25).[6] The gross estate tax is then calculated by subtracting the gift tax payable on the post-1976 taxable gifts (using the current unified rate schedule).[7] The applicable credit amount (see ¶ 15) and additional allowable credits (see Chapters 26 and 27) are then applied against the gross estate tax liability to arrive at the net estate tax due.

Special phaseout rules applied with respect to both the gift tax and the estate tax for certain large transfers made before January 1, 2002 (see ¶ 18 and ¶ 2378).

The estate tax base does not include the value of lifetime transfers that are already included in the decedent's estate, such as transfers where the decedent retained certain interests, rights, or powers in the property (see ¶ 30). This precludes having the same lifetime transfers taken into account more than once for transfer tax purposes. The gift tax payable on these transfers is later subtracted in determining the correct estate tax.

Effective on and after June 17, 2008, a U.S. citizen or resident is subject to a special transfer tax upon receipt of property by gift or inheritance from an expatriate. This tax is equal to the value of the covered gift or estate multiplied by the highest rate in effect under Code Sec. 2001(c) (40 percent after 2012) or, if greater, the highest rate in effect under Code Sec. 2502(a) (also 40 percent after 2012). See ¶ 2593.

Special rules apply in the case of nonresidents not citizens (see ¶ 1635) and for certain split gifts (see ¶ 1426). See also ¶ 2350.

¶ 15 Unified Credit

The unified credit, now referred to as the "applicable credit amount" in Code Sec. 2010, is a one-time credit in life and at death against taxes payable on certain transfers.[8] Although the credit must be used to offset gift taxes on lifetime transfers, regardless of the amount so used, the full credit is allowed against the tentative estate tax. The rationale for such full application is that, under Code Sec. 2001(b)(2), the estate tax payable is calculated using the cumulative transfers

[5] Code Sec. 2502(a).

[6] Code Sec. 2001(b).

[7] Code Sec. 2001(b)(2).

[8] Code Sec. 2010 and Code Sec. 2505. The unified credit replaced the pre-1977 $30,000 lifetime gift tax exemption and the $60,000 estate tax exemption.

at life and at death and is then reduced by the amount of gift tax paid by a decedent (computed using the current unified tax rates). If a portion of the unified credit was used to avoid the payment of gift taxes, the gift tax paid reflects the amount subtracted under Code Sec. 2001(b)(2). The estate tax payable is necessarily increased by the amount of the gift tax credit used. However, the credit for estate tax purposes cannot exceed the amount of the estate tax.

It should be noted that, because of the nature of the gift tax, the computation of the unified credit for gift tax purposes is different from that for estate tax purposes (see ¶ 2007 and ¶ 2376).

The *estate tax* applicable exclusion amount is determined according to the following schedule:

- For decedents dying in 2002 and 2003: $1 million;
- For decedents dying in 2004 and 2005: $1.5 million;
- For decedents dying in 2006, 2007, and 2008: $2 million;
- For decedents dying in 2009: $3.5 million;
- For decedents dying in 2010 and 2011: $5 million;
- For decedents dying in 2012: $5,120,000 (as adjusted for inflation); and
- For decedents dying in 2013: $5,250,000 (as adjusted for inflation).
- For decedents dying in 2014: $5,340,000 (as adjusted for inflation).
- For decedents dying in 2015: $5,430,000 (as adjusted for inflation).
- For decedents dying in 2016: $5,450,000 (as adjusted for inflation).

The *gift tax* applicable exclusion amount is $1 million for gifts made in 2002 through 2010. Thereafter, the gift tax and estate tax exclusion amounts are "re-unified," at $5 million for 2011. For 2012 and beyond, the unified credit amount is adjusted for inflation ($5,120,000 for 2012; $5,250,000 for 2013; $5,340,000 for 2014; $5,430,000 for 2015; and $5,450,000 for 2016).

Computation of the credit. For years 2002 through 2010, the amount of the gift tax applicable credit amount was equal to (1) the applicable credit amount in effect under Code Sec. 2010(c) for such calendar year, determined as if the applicable exclusion amount were $1 million, reduced by (2) the sum of the amounts allowable as a credit under Code Sec. 2505 for all preceding calendar periods[9] (see ¶ 2007).

For years 2011 and 2012, the amount of the gift tax applicable credit amount is equal to (1) the applicable credit amount in effect under Code Sec. 2010(c) which would apply if the donor died as of the end of the calendar year, reduced by (2) the sum of the amounts allowable as a credit to the individual under Code Sec. 2505 for all preceding calendar periods[10] (see ¶ 2007).

• ***Post-1997, Pre-2004 Unified Credit***

For the years 1998–2003, the unified credit was gradually increased to $345,800 and was determined by reference to the "applicable credit amount" and "the applicable exclusion amount" (formerly the exemption equivalent) ($1 million in 2002 and 2003). (See the table at ¶ 10.) For the years 2000 and 2001, the

[9] Code Sec. 2505(a), prior to amendment by P.L. 111-312.

[10] Code Sec. 2505(a), as amended by P.L. 111-312.

applicable exclusion amount was $675,000, resulting in an applicable credit amount of $220,550.

• *Pre-1998 Unified Credit*

The unified estate and gift tax credit was $192,800 for decedents dying after 1986 and before 1998. The exemption equivalent for these years was $600,000. The unified credit for previous years appears in the Appendix at ¶ 2600.

The estate tax and gift tax return filing requirements reflect the exemption equivalent (see ¶ 22 and ¶ 26).

A special transitional rule applies to gifts made between September 9, 1976, and December 31, 1976.[11]

¶ 16 Portability of Deceased Spousal Unused Exclusion (DSUE) Amount

Effective for deaths occurring after December 31, 2010, the unused portion of a decedent's applicable exclusion amount[12] may be utilized by the estate of the decedent's surviving spouse at his or her later death. To take advantage of this provision, a special election must have been made by the predeceased spouse's estate[13]. This election is often referred to as the portability, or DSUE election.

With the U.S. Supreme Court's decision in *E. Windsor*,[14] the portability of a deceased spouse's unused exclusion amount is available to the surviving same-sex spouse as long as the couple is legally married. See, also, *J. Obergefell*, SCt, 2015-1 USTC ¶ 50,357, discussed at ¶ 1010.

According to the IRS[15], same-sex couples, legally married in jurisdictions that recognize their marriages, will be treated as married for federal tax purposes. These couples will be treated as married regardless of whether the couple lives in a jurisdiction that recognizes same-sex marriages. However, same-sex couples in domestic partnerships and civil unions will not be treated as legally married for federal tax purposes. In response to the holdings in *Windsor* and *Obergefell*, the IRS has proposed regulations dealing with the federal tax treatment of same-sex spouses (see ¶ 1010).

Computing exclusion amount of a surviving spouse. The applicable exclusion amount for a surviving spouse who dies after December 31, 2010, is the sum of:

• the basic exclusion amount ($5 million for 2011 and, as adjusted for inflation for deaths after December 31, 2011, $5,120,000 for 2012, $5,250,000 for 2013, $5,340,000 for 2014, $5,430,000 for 2015, and $5,450,000 for 2016); and

• the aggregate deceased spousal unused exclusion amount (discussed below).[16]

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[11] Code Sec. 2010(b); Code Sec. 2505(b).

[12] Although the DSUE provisions enacted by the Tax Relief Act of 2010 were applicable for decedents dying in 2011 and 2012, the American Taxpayer Relief Act of 2012 (P.L. 112-240) made these provisions permanent for decedents dying after December 31, 2012.

[13] Code Sec. 2010(c).

[14] *E. Windsor*, SCt, 2013-2 USTC ¶ 60,667, ruling section 3 of the Defense of Marriage Act (DOMA) (P.L. 104-199) was unconstitutional as applied to persons of the same sex who are legally married under the laws of their state because it violated the Equal Protection Clause of the Fifth Amendment to the U.S. Constitution.

[15] IRS News Release IR-2013-72, and Rev. Rul. 2013-17, IRB. 2013-38, 201.

[16] Code Sec. 2010(c)(2).

Any portion of the predeceased spouse's applicable exclusion amount that was used to reduce his or her estate tax liability may not be used to reduce the surviving spouse's estate tax liability under this new provision. The term "deceased spousal unused exclusion amount" (DSUE amount) is the lesser of:

- the basic exclusion amount, or
- the last deceased spouse's applicable exclusion amount, minus
- the amount with respect to which the tentative tax is determined under Code Sec. 2001(b)(1) on the estate of such deceased spouse.[17]

Example: Gina Parsons died in 2013 with a taxable estate of $3 million. An election is made on Gina's estate tax return to permit her husband, Henry, to use any of her unused exclusion amount. Henry, who had not made any lifetime taxable gifts, dies in 2015 with a taxable estate of $10 million. The executor of Henry's estate computes Henry's deceased spousal unused exclusion amount as the lesser of: (1) Henry's basic exclusion amount of $5.43 million or (2) Gina's basic exclusion amount ($5.25 million) minus (3) the amount of Gina's taxable estate ($3 million), or $2.25 million. Accordingly, the total applicable exclusion amount available to Henry's estate at his death is $7.68 million: his basic exclusion amount of $5.43 million, plus $2.25 million in deceased spousal unused exclusion from Gina's estate.

Reg. § 20.2010-2(c)(2) provides that amounts on which gift taxes were paid by a decedent are excluded from adjusted taxable gifts for purposes of computing that decedent's DSUE amount. This avoids the use of the exclusion on amounts if (1) gift tax was paid by the decedent on transfers that caused total taxable transfers to exceed the applicable exclusion amount at the time of the transfer and (2) the decedent's total adjusted taxable gifts are less than the applicable exclusion amount on the date of death.

Example: Assume the same facts as in the Example above, except that after Gina's death in 2013, Henry married a second spouse, Rita, who died in 2014, leaving a taxable estate of $4 million. An election was made on Rita's estate tax return to permit Henry to use any of her unused exclusion amount. Although the combined unused applicable exclusion amounts of Gina and Rita is $3.50 million (Gina's $2.25 million and Rita's $1.25 million), only $1.25 million is available for use by Henry's estate because Henry's deceased spousal unused exclusion amount is the lesser of: (1) Henry's basic exclusion amount of $5.43 million or (2) Rita's basic exclusion amount ($5.34 million) minus (3) the amount of Rita's taxable estate ($4 million), or: $1.25 million. Accordingly, the total applicable exclusion amount available to Henry's estate at his death is $6.68 million, composed of his basic exclusion amount of $5.43 million, plus $1.25 million in deceased spousal unused exclusion from Rita's estate.

Reg. § 20.2010-3(a) and § 25.2505-2(a) explain that, if the decedent is the last deceased spouse of a surviving spouse on the date of a transfer by the surviving spouse that is subject to estate or gift tax, the surviving spouse (or the estate) may take into account the decedent's DSUE amount in determining the surviving spouse's applicable exclusion amount when computing the surviving spouse's estate or gift tax liability on that transfer. The portability election by the decedent's estate is effective as of the decedent's date of death. Accordingly, it is not

[17] Code Sec. 2010(c)(4).

possible for individuals who have been married multiple times to tack on multiple applicable exclusion amounts of their predeceased spouses.

Reg. § 20.2010-3(a)(3) and § 25.2505-2(a)(3) clarify the scope of the "last deceased spouse" limitation. Remarriage does not affect the identity of the last deceased spouse and does not prevent the surviving spouse from including in the surviving spouse's applicable exclusion amount the DSUE amount of the deceased spouse who most recently preceded the surviving spouse in death. The identity of the last deceased spouse for purposes of portability is not affected by whether the executor of the decedent's estate elected portability of the deceased spouse's DSUE amount or the decedent had any DSUE amount available. For purposes of determining a surviving spouse's applicable exclusion amount when the surviving spouse makes a taxable gift, the last deceased spouse is identified as of the date of the taxable gift.

Generation-skipping transfer tax exemption. A surviving spouse is not allowed to use the unused GST tax exemption of a predeceased spouse.[18]

Portability election. In order for a decedent's estate to take advantage of the unused exclusion amount of the decedent's predeceased spouse, the executor of the predeceased spouse's estate must:

- file an estate tax return on which the amount of the deceased unused exclusion is computed, and
- elect on the return that such amount may be taken into account by the surviving spouse's estate (this election is deemed made if the decedent spouse's estate does not mark the checkbox denying portability on Part 6, Section A.—Opting Out of Portability, of Form 706 (Rev. August 2013)).

Preparation Tip: Once made, the portability election is irrevocable. No election will be allowed if the deadline for filing the predeceased spouse's estate tax return (including extensions) had not been met.[19] In order for Form 706 to be considered timely filed, executors must file it nine months after a decedent's date of death. Executors may request an automatic six-month extension of time to file by filing Form 4768 before the due date of Form 706. The IRS may examine the estate tax return of a predeceased spouse to make a determination of the predeceased spouse's unused exclusion amount, even after the period of limitations under Code Sec. 6501 has closed.[20] A decedent's estate wanting to opt out of the portability election should mark the checkbox in Form 706 (Rev. August 2013), Part 6, Section A.—Opting Out of Portability. Instructions for preparing Form 706, Part 6, Section A, appear at ¶ 1210. A filled-in Part 6, Section A, is reproduced at ¶ 2942.

Discussion of Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return (2014), Schedule C—Deceased Spousal Unused Exclusion (DSUE) Amount, appears at ¶ 2007). A filled-in Form 709, Schedule C is reproduced at ¶ 3280.

Simplified procedure for requesting relief. The IRS has issued a simplified procedure for the estates of decedents dying after December 31, 2010, and on or

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[18] The JCT Report (Footnote 56), Committee on Taxation, Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (JCX-55-10) (December 10, 2010).

[19] Code Sec. 2010(c)(5)(A).

[20] Notice 2011-82, IRB 2011-42, October 18, 2011.