Portability, Rev. Proc 2017-34 and Potential Estate Tax Legislation

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Recently widowed individuals whose deceased spouse's estate did not make a portability election by the due date for filing an estate tax return -- because the estate either was not aware a portability election was available or required, or determined that a portability election was not necessary under their facts – may, with the likelihood that the estate tax exemption will be reduced in the near term, suddenly find themselves needing their deceased spouse's unused exemption. There may be a window for some to file a late, but still timely, estate tax return to make the portability election.

Portability, enacted as part of the American Taxpayer Relief Act in 2013, allows a surviving spouse to use a deceased spouse's unused exemption. In order to have use of a deceased spouse's unused exemption, an estate tax return making a portability election must be filed for the deceased spouse. The due date for filing an estate tax return is nine months after the date of death, with an automatic six month extension if requested by the nine month due date.

Rev. Proc. 2017-34, extends the time under certain circumstances to file an estate tax return to make a portability election. Rev. Proc, 2017-34, issued in part due to the considerable number of taxpayer ruling requests for an extension of time to elect portability, provides that to make a portability election the decedent's estate "must file a complete and properly prepared Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, on or before … the second annual anniversary of the decedent's date of death."

Potential Estate Tax Legislation. As part of the Tax Cuts and Jobs Act of 2017 ("TCJA"), effective January 1, 2018 the estate and gift tax exemption (the applicable exclusion amount) was increased from $5,000,000 to $10,000,000, subject to a cost of living adjustment, resulting in an exemption of $11,700,000 in 2021. The TCJA was passed via the budget reconciliation process as it received only 51 votes in the Senate. As a result the increase in the estate and gift tax exemption to $10,000,000 is scheduled to sunset on December 31, 2025, at which time the exemption will return to $5,000,000 and, with the cost of living adjustment, is expected to be roughly $6,500,000.

The TCJA is different from the George Bush tax cuts enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, in that the TCJA's increased exemption can be used for both estate and gift purposes. Under the George Bush tax cuts, you had to die to take advantage of the increased exemption, you could not use the increased exemption for gift purposes.

There has been much speculation/expectation that if the Democrats win the White House (done), and the Senate (done) and keep the House of Representatives (done), that the exemption will be reduced sooner than the scheduled sunset on December 31, 2025. Possibilities are a reduction to $5,000,000 or $3,500,000, effective on date of enactment or maybe even retroactive to January 1, 2021.

A lot of gift planning has been undertaken in the last many months to use a person's exemption before it is reduced. A current gift will only use the current higher exemption if the gifted amount exceeds the new lower exemption – that is, if the new lower exemption is $5,000,000, a gift now of anything less than $5,000,000 will not result in using any of the current higher exemption (assuming no prior use of the exemption). To get full use of the $11,700,000 exemption requires a gift of $11,700,000 (assuming no prior use of the exemption).

If a person has say $20,000,000 or more, he/she may be comfortable making a current gift of $11,700,000, thus using his or her exemption before it is reduced (assuming the exemption is not retroactively reduced to January 1, 2021). However, as a practical matter, I'm finding that it takes a lot more that $20,000,000, for a person to be willing to give away $11,700,000. Regardless, a person with say $10,000,000 or less can't realistically make gifts to meaningfully take advantage of the current higher exemption.

Albeit only a small group will be eligible, keep in mind the extended deadline for making a portability election. There may be clients out there that are recently widowed that have an amount that, with some growth or investment in the next GameStop, could end up pushing them over $3,500,000, or $5,000,000. They may have missed the normal nine-month deadline to file the estate tax return -- either because they were not aware of the portability election, or they determined that a portability election was not necessary under their then facts. That client needs to be advised that, pursuant to Rev. Proc. 2017-34, they may still have an opportunity to file a late, but timely estate tax return to elect portability. [The next best alternative might well be to fall in love with and marry an older, less healthy individual that won't be using his/her exemption. But that's a discussion for another day.]