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October 31, 2011

New York City Bar Association
Joint Subcommittee of the Trusts, Estates and Surrogate's Courts Committee and the Estate and Gift Tax Committee

Via E-Mail to Notice.Comments@irscounsel.treas.gov
CC:PA:LPD:PR (Notice 2011-82)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments to Notice 2011-82

Dear Sir or Madam:

The New York City Bar Association, through a Joint Subcommittee of the Trusts, Estates and Surrogate's Courts Committee and the Estate and Gift Tax Committee, respectfully submits its comments to Notice 2011-82 (the "Notice"). Specifically, the Notice invited comments on the following issues which Treasury and the Internal Revenue Service (the "Service") have identified for consideration in proposed regulations under section 2010(c) of the Internal Revenue Code (the "Code"):

- The determination in various circumstances of the deceased spousal unused exclusion amount under section 2010(c)(4) (the "DSUEA") and the applicable exclusion amount under section 2010(c)(2);

- The order in which exclusions are deemed to be used;

- The effect of section 2010(c)(4)(B)(i), which limits the increase in the exemption available to a surviving spouse of a spouse who dies after December 31, 2010 to the exemption of “the last such deceased spouse of such surviving spouse”;

- The scope of the Service’s right to examine a return of the first spouse to die without regard to any period of limitation in section 6501; and

- Any additional issues that should be considered for inclusion in the proposed regulations.

Our comments are set forth below. Our primary objective is to enhance the attractiveness of the portability election relative to more complicated estate planning techniques, such as those that involve the creation of trusts upon the death of the first spouse to die. Accordingly, we are proposing solutions to eliminate the significant degree of uncertainty that a surviving spouse would otherwise face concerning the use of the DSUEA if he or she were to remarry after the executor of the deceased spouse’s estate has made a portability election under section 2010(c)(5)(A) (a “portability election”).

A. The Surviving Spouse[1] Should Be Treated as Using Her DSUEA First Before Using Her Basic Exclusion Amount

Once a surviving spouse inherits her predeceased spouse’s DSUEA, the surviving spouse can use the DSUEA to make lifetime gifts. It is unclear, however, whether in doing so the surviving spouse is treated as using her DSUEA first or her basic exclusion amount first. The distinction would be important in the remarriage context where a surviving spouse inherited a DSUEA from her predeceased husband, subsequently made lifetime gifts, and then remarried. If the surviving spouse’s second husband subsequently died, a question would arise whether the lifetime gifts she made prior to her remarriage were made using her own basic exclusion amount or the DSUEA she received from her first husband, because section 2010(c)(4)(B) indicates that, upon remarriage, the surviving spouse receives the benefit of the DSUEA only from the last spouse to die.

We believe the surviving spouse should be treated as using the DSUEA first before using her basic exclusion amount. This will encourage use of the portability election relative to other, more complicated, estate planning techniques by making it easier for a surviving spouse to make use of the DSUEA, and be more equitable to all taxpayers.

A surviving spouse who remarries may lose the DSUEA of Husband 1. One way to ensure that the DSUEA of Husband 1 is not lost would be for the surviving spouse to make lifetime taxable gifts of both the surviving spouse’s entire basic exclusion amount and Husband 1’s DSUEA. However, only the wealthiest individuals will be able to afford lifetime taxable gifts of this magnitude. The proposed regulations accordingly should facilitate the use of the DSEUA by the greatest number of taxpayers by having it deemed allocated to transfers before the basic exclusion amount.

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[1] For purposes of illustration, our examples assume that the wife will survive the first husband.

We believe this approach can be harmonized with the language of section 2010(c)(4)(B)(i) through the issuance of proposed regulations that focus on the exemption of the last deceased spouse at the time of a gift. Under this approach, the DSUEA available to a surviving spouse at the time of a gift would be calculated by reference to the exemption that was available to her most recent spouse to have died, reduced, but not to less than zero, by the DSUEA in respect of any deceased spouse that was previously used by the surviving spouse.

B. Guidance is Needed to Clarify That Neither Estate Tax Nor Gift Tax Can Result Through a "Clawback" of the DSUEA

There is also a potential recapture, or "clawback" issue, with respect to the DSUEA in the context of remarriage. By way of example, if a surviving spouse has an applicable exclusion amount of $7,000,000 (assume her basic exclusion amount is $5,000,000 and the DSUEA is $2,000,000) and she makes lifetime gifts of $6,000,000 and subsequently remarries, a "clawback" might be possible if her second husband predeceases her with less exclusion available than her first husband, because under section 2010(c)(4)(B) she can receive the DSUEA of only her *last* husband to die. When the surviving spouse subsequently dies, she would not have as much DSUEA as she did when she made the $6,000,000 in lifetime gifts, which may result in additional estate taxes being due.

In order to eliminate such uncertainty to the surviving spouse, the proposed regulations should clarify that neither estate tax nor gift tax can result through a clawback of the DSUEA.

Again, we believe this approach may be harmonized with the legislative intent of section 2010(c)(4)(B)(i) through the issuance of proposed regulations that reduce the DSUEA in respect of the last surviving spouse by the DSUEA in respect of any deceased spouse that was previously used by the surviving spouse claiming the exemption, but not to less than zero.

C. Guidance is Required Where the Husband's Estate Does Not Intend to Make a Portability Election

A question also arises where the Husband's estate does not make a portability election because the total value of the estate is less than the estate tax exemption and therefore no estate tax return is required to be filed. This may be particularly likely in a second marriage situation.

For example, suppose Wife marries Husband 1, and after his death marries Husband 2. Suppose further that Husband 2's estate is smaller than the basic exclusion amount so that no Federal estate tax return is required to be filed, and passes under his estate planning documents solely to the children of Husband 2's first marriage. Such an estate plan will often be enacted pursuant to a prenuptial agreement. Suppose further that Husband 2's executor is a child of Husband 2 who does not want to incur the time and expense of preparing and filing a Federal estate tax return that would not otherwise be required solely to benefit the surviving spouse by making a portability election. Moreover, under state fiduciary law principles, a strong argument could be made that, under these circumstances, the executor of Husband 2's estate should not be

incurring professional fees to prepare and file a Federal estate tax return for the sole purpose of benefiting the surviving spouse who is not a beneficiary of Husband 2's estate.

While the Wife in the above example might be able to protect herself by negotiating a provision in a prenuptial agreement that requires Husband 2's executor to file the required estate tax return and make the necessary election, we believe that the correct policy result should be to encourage the use of the portability election in lieu of more complicated estate planning alternatives. Accordingly, we believe that Wife should be given the authority to prepare and file an estate tax return for Husband's estate in order to make the portability election. To minimize any potential confusion, we would propose allowing Wife to file a return if the Wife notifies the executor of her intention to file a return and the executor does not in fact file a return. Under those circumstances, the Wife could be treated in a manner similar to that of a statutory executor under section 2203. In the event that a Wife and an executor file competing returns, the return filed by the duly appointed executor should control.

In making this recommendation, we note that permitting a surviving spouse to file an estate tax return independently of a duly appointed executor could result in additional complications in coordinating certain tax elections, such as an election to treat an estate administration expense as an income tax deduction or an estate tax deduction, and there may be situations in which the surviving spouse does not have adequate information to prepare the return or there are confidentiality issues associated with providing the surviving spouse sufficient information to file the return. However, we believe that these complications would be minimal if the spouse's authority to file a return were limited to situations in which the surviving spouse is required to notify the duly appointed executor of that spouse's intention to file a return, and the duly appointed executor does not in fact file a return. We would also hope that in most situations an executor would be willing to file a return or provide the spouse with any needed information, provided that the return is being prepared and filed at the spouse's expense.

D. The Proposed Regulations Should Clarify the Scope of Section 2010(c)(5)(B)

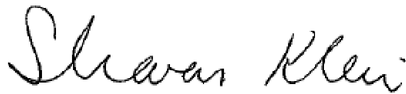
Under section 2010(c)(5)(B), after the time has expired under section 6501 within which a tax may be assessed under Chapters 11 and 12 of the Code (the estate and gift tax provisions respectively) with respect to a DSUEA, the Secretary may nevertheless examine a return of the deceased spouse to make determinations with respect to the DSUEA.

We believe that uncertainty regarding statute of limitations issues could detract from the attractiveness of the portability election relative to other estate planning alternatives. It would therefore be helpful if the proposed regulations were to expressly provide that the scope of the examination authorized under section 2010(c)(5)(B) is limited to determining the amount of the DSUEA available to the surviving spouse for purposes of determining taxes imposed under Chapter 11 or 12 of the Code with respect to a gift by, or the gross estate of, the surviving spouse, and not for any other purpose. Correspondingly, we suggest that the proposed regulations clearly provide that the extension of the statute of limitations under section 2010(c)(5)(B) will not apply (i) to any tax imposed upon or with respect to a gift by, or the gross estate of, the deceased spouse, or (ii) to any income taxes (including to " income in respect of a

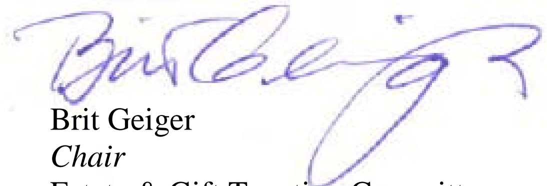
decedent" under section 691), the generation-skipping transfer tax, or to any other tax imposed by the Code other than under Chapter 11 or 12.

In addition, to provide finality in connection with ongoing estate planning for the surviving spouse, we believe that the proposed regulations should provide for finality with respect to a DSUEA in a manner similar to that provided under Treas. Reg. § 26.2642-5(b)(1) for determining the finality of inclusion ratios with respect to taxable distributions and taxable terminations following the death of a transferor (with the deceased spouse being treated similarly to the transferor). More specifically, under this approach, the amount of a DSUEA with respect to a particular deceased spouse would become final upon the expiration of the period for assessment with respect to the first gift or estate tax return filed by the surviving spouse, or the surviving spouse's executor, using that DSUEA.

Sincerely yours,



Sharon Klein
Chair
Trusts, Estates & Surrogate's Courts Committee



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