

Estate Tax Audit... 30 years later?

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Since 2012, when Congress passed the American Taxpayer Relief Act, “portability” has been the heart of many estate plans for married couples. Portability allows a surviving spouse to use the deceased spouse’s unused estate tax exclusion (currently \$5.49 million).

A common estate planning goal of a married couple is to take full advantage of both spouses’ estate tax exclusions. Typically, this is done by funding a Family Trust (also sometimes called a Credit Shelter Trust or B Trust) at the death of the first-to-die with the exclusion amount and leaving the rest to one’s spouse (outright or in trust). It was common for a spouse’s exclusion to be wasted for one of two common reasons – unbalanced asset ownership or an inefficient estate plan.

With portability, if a first-to-die spouse has not fully used the estate tax exclusion, the unused portion, technically called the “Deceased Spousal Unused Exclusion Amount,” or “DSUE,” can be transferred or “ported” to the surviving spouse. In order to port the DSUE to the surviving spouse, the executor of the first-to-die’s estate must make an election on a timely-filed estate tax return. This could necessitate the preparation and filing of a return just to make this election when a return might not otherwise be needed.

In the *Estate of Minnie Lynn Sower v. Commissioner*, the Tax Court upheld an IRS audit of an estate tax return after the IRS sent a closing letter to the estate. The facts of the case were Minnie’s husband, Frank, died in 2012 and an estate tax return was filed showing no estate tax due and electing portability of Frank’s DSUE. Minnie passed away and her estate was large enough even with Frank’s DSUE to require the filing of an estate tax return. The IRS took a look at Frank’s estate tax return and determined that it was not filed correctly, thereby changing the amount of the DSUE on Minnie’s return resulting in an increase of estate tax due. The statute of limitations on an estate tax return is three years. The IRS audit of Frank’s return was after that three-year period. The Tax Court referenced the tax code, which explicitly gives the IRS the power to re-examine the DSUE without regard to any time limits.

The conclusion is with a portability election of a DSUE, the “real” statute of limitations is three years after the filing of the estate tax return on the second-to-die spouse. This could result in an IRS audit of the first-to-die spouse’s return 5, 10, 20, 30... years later.