The
Estate Analyst®

February 2014

Exploiting DSUE Portability
Revenue Procedure 2014-18
&
Mysteries of The Wang Estates

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Should a portability election be filed for the estate of every first spouse to die? What if the joint marital estates are relatively small?

Is there a downside to overreliance on portability?

Let's consider how the deceased spouse's unused exemption (DSUE) impacts planning in several different scenarios and consider the latest IRS guidance on extensions for filing the election from *Revenue Procedure 2014-18.*

Portability Arrives

It was the end of days, Tax-pocalypse, where space and time warped to form the end of the estate tax (and the beginning), a reversion to 2001, and a combination of the stepped-up basis and carryover basis for assets held at death. But then came 2011, and the estate tax was reinstated by Congress with a $5-million exemption and a brand-new portability provision to salvage the unused estate tax exemption of the first spouse to die.

The specific background of portability was recently summarized in Revenue Procedure 2014-18 as follows:

> "Sections 302(a)(1) and 303(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA), Pub. L. No. 111–312, 124 Stat. 3296, 3302 (2010), amended §2010(c) of the Code to allow the estate of a decedent who is survived by a spouse to make a portability election, which allows the surviving spouse to apply the decedent's DSUE amount to the surviving spouse's own transfers during life and at death. The portability election applies to estates of decedents dying after December 31, 2010, if such decedent was survived by a spouse. The portability provisions under § 2010(c) of the Code were scheduled to expire on January 1, 2013, pursuant to § 304 of TRUIRJCA. However, § 101(a) of the American Taxpayer Relief Act of 2012, Pub. L. No. 112–rev. 0, 126 Stat. 2313 (ATRA), made portability permanent."

Inside a Gift Horse's Mouth

The portability of the DSUE to a surviving spouse is a concept with multiple connotations, mostly positive. Deferring taxation is good. Exemptions from tax are even better. So preserving a deceased spouse's estate tax exemption is a useful tool. Thanks, Congress.

But is there a downside? Note: When one combines "deferred," "portable," and "exemption" into one portmanteau, the result is "deportation." Let this serve as a warning to look more closely but not necessarily to infer the same negativity as might apply to other notorious portmanteaus, such as "jeggings." Jeans + leggings = "jeggings," a garment that makes normal people look like ice-cream cones. But we digress.

The risk in estate planning for spouses is the simple assumption that the first spouse to die no longer needs to plan at all. The portability of the unused exemption ties right into the urge of spouses to write "I-love-you" Wills with everything left to the surviving spouse, even though it might result in unnecessary tax liability. With portability, spouses may be even more encouraged to postpone the decisions of planning or gifting until the death of the second spouse. However, this raises a number of issues.

Making the DSUE Election

Which estates need to make the §2010(c)(5) election to utilize the DSUE?

If the answer is the estate for every first spouse to die, a whole lot of estates would be affected and would have to start filing estate tax returns. Certainly, the estates of those spouses who are already filing an estate tax return can make the election with little extra effort. In fact, just filing a complete and properly prepared estate tax return constitutes the election, and one has to choose not to elect portability for the election not to apply; see Reg. §20.2010–2T(a)(2). But what about the 99% of estates that would not otherwise be required to file an estate tax return?

For example, septuagenarian spouses with a marital estate of $500,000 own all of their assets jointly. At the death of Husband, must Surviving Spouse file a Federal estate tax return for Husband for the sole purpose of preserving his unused exemption, even though she will have her own $5,340,000 exemption, plus inflation adjustments, plus annual gift exclusions?

What could beef up Surviving Spouse's estate or create a need for that unused exemption?

1) Surviving Spouse wins the lottery. Sure, it's obvious, it won't happen, but it has to be included on the list.

2) Surviving Spouse discovers that the ugly painting behind the dresser is a Rembrandt. This fits the same category of luck as winning the lottery but in a classier context and ends with drinking Champagne at Sotheby's.

3) Surviving Spouse inherits big money from her Dutch uncle. Sadly, few of us are of Dutch descent.

4) Surviving Spouse has a big salary and great investments, lives another 25 years, and dies at 99 with an estate of $6 million during the very year when Congress reverts back to a $3.5 million estate tax exemption…because Congress can't help exploring crazy options.

5) Surviving Spouse is given $10 million by one of her children so that she can set up a dynasty trust for the family or have assets receive a stepped-up basis for capital gains purposes at the Surviving Spouse's death.

The latter scenario may seem wild, but it is seriously entertained by those estates where the surviving spouse, children, and grandchildren live in jurisdictions where such arrangements can be carried out and where the parties involved have assets, tax rates and circumstances where sending money back "upstream" can actually make sense. In a recent blog by Kevin A. Pollock, JD, LLM, the pros and cons of this strategy are weighed. See *"Gifting to Parents to Save on Capital Gains Taxes," http://willstrustsestates.blogspot.com.*

On the other hand, despite the unlikelihood of needing the unused exemption for many estates, no attorney or accountant wants to be in the position of having overlooked the DSUE exemption and having a client's family on the receiving end of a tax liability that could have been avoided.

Portability Elections Extended

Previously, any estate that made the portability election under §2010(c)(5) was treated under Reg. §20.2010-2T(a)(1) as if it were required to file an estate tax return under §6018(a). As a result, such estates were required to file Form 709 by nine months after the decedent's date of death or the last day of any extension that was obtained.

Estates for which no estate tax return was required but which now have remorse about not making a portability election may be in luck as a result of an extension that was provided by Revenue Procedure 2014-18, which was published on February 10, 2014, with an effective date of January 27, 2014.

Under *Rev. Proc. 2014-18*, estates of decedents dying after 2010 and before 2014 who did not file Form 706 and were not required to do so under Section 6018(a) will now have until December 31, 2014, to file Form 706 and make the DSUE election.

"The Service believes that, in such circumstances, it is appropriate to provide a simplified method to obtain an extension of time to elect portability under §2010(c)(5)(A), provided that certain requirements (set forth in sections 3 and 4 of this revenue procedure) are met," states *Rev. Proc. 2014-18.*

Gimme Credit Shelter

Is it truly safe to rely on portability of the DSUE and do without the traditional credit shelter trust? For a generation, the Federal estate tax exemption of the first spouse to die was fully exploited by transferring a portion of the estate into a credit shelter trust, as opposed to relying exclusively on the unlimited marital deduction. Now that the estate tax exemption is generous, those estates that are in jurisdictions with state death taxes still need to carve out a credit shelter trust to fully exploit the small but valuable state exemptions, such as $1 million for New York.

But even an estate in a tax haven like Florida may not be safe enough to forego a credit shelter trust. Any state may adopt state death taxes in the future. And assets in a credit shelter trust can appreciate outside of the surviving spouse's estate. Trusts also enjoy asset protection advantages.

And look at the typical scenario provided by attorney Kevin A. Pollock:

"Let's say mom and dad live down in Florida, a jurisdiction that does not have state estate tax. Mom and dad are worth $8,000,000 and have simple Wills leaving everything to the surviving spouse and then equally to the children. For Federal estate tax purposes in Florida, there is no 'need' to set up a credit shelter trust for the surviving spouse. When the first spouse dies, everything goes to the urvivor, free of estate tax. Additionally, on the first to die, the surviving spouse receives the unused estate tax exemption of the deceased spouse. So, when the survivor dies, over $10,000,000 can pass to the children free of Federal estate tax... if the surviving spouse stays in Florida. What happens if the surviving spouse wants to move to New Jersey to be closer to her children? Upon her death, there will be a New Jersey state estate tax of over $1,000,000. If dad had set up a trust for mom, this could have been completely avoided."

Additional Pitfalls

As noted in the February 2011 issue of The Estate Analyst entitled The Perils of Portability, several potential pitfalls of portability must be contemplated:

No GST Portability: Rocky leaves his $10 million estate to his wife, Ramona, and Rocky's timely estate tax return elects to transfer his unused estate tax exclusion to Ramona. At Ramona's death, she has her full $5 million exclusion available, as well as the $5 million from Rocky. Ramona leaves $10 million to her grandson. Her $10 million of exclusion shields her estate from estate tax on that transfer, but only $5 million of the transfer is exempt for generation-skipping transfer tax purposes.

Remarriages: The surviving spouse will have his or her own exclusion, plus the exclusion of the most recently predeceased spouse. Thus, Ramona may have a total of $10 million of exclusion based on her own exclusion and the exclusion that was carried over from Rocky. This would continue to apply even if Ramona was remarried to Rafael. But if Rafael then died and had already used up $4 million of his own exclusions on lifetime gifts, Ramona would be limited to $6 million of total exclusions—the $5 million of her own exclusion, plus the $1 million that was carried over from Rafael, the most recently predeceased spouse. However, if Rafael's estate made no election to transfer the unused exclusion to Ramona, then it appears that she would be left with just her own exclusion and would not get to use the exclusions of Rocky or Rafael.

Limited State Exclusion: Rocky and Ramona live in a state with its own estate tax and a $1.5 million exclusion. The state estate tax exclusion is not portable. By relying entirely on the Federal portability provision, Rocky's $1.5 million state estate tax exclusion is wasted.

Income Taxation: Now that income tax rates have crept higher and there are Medicare surtaxes, consolidation of assets in the estate of the surviving spouse may have a negative income tax result over time as well.

So portability is a great new tool in context, but conventional planning is still of paramount importance.

Mysteries of the Wang Estates

Proving once again that life is stranger than fiction, that planning can't anticipate everything, and that even sophisticated businesspeople are not immune to bizarre twists of fate, we return to the incredible tale of Teddy and Nina Wang.

The Wangs were childhood sweethearts who married in 1955 and built Chinachem into one of the most powerful pharmaceutical companies in Asia.

In 1983, Teddy Wang was kidnapped, and Nina Wang paid a $33 million ransom to rescue him. But paying ransoms can encourage terrorism; in 1990, Teddy Wang was kidnapped again. After the second abduction, he was seen no more.

Nina Wang, known as "Little Sweetie" because of her two pigtails, branched the company into property development and grew it into a multi-billion-dollar empire.

Surely a billionaire could...make arrangements to have two neutral witnesses and a notary?

In 1999, Teddy Wang was declared dead. This set the stage for the presentation of three atrocious Wills.

A 1960 Will divided Mr. Wang's estate between his wife and his father, Wang-Din-Shin. This Will was from early in the marriage, before there were significant assets.

A 1968 Will with disputed authenticity was allegedly written after Teddy Wang discovered his wife's infidelity. This Will left the entire estate to Wang-Din-Shin.

And a 1990 Will, executed one month before his second abduction, contained the phrase "one life, one love" in English, expressed disappointment in the Wang family, and left the entire estate to his wife, Nina Wang. This Will was witnessed by the family's butler.

So the alternatives are a Will written 30 years before he disappeared, a forgery, or another possible forgery written a month before Mr. Wang disappeared. Surely a billionaire could avoid the cliché of the butler being the witness (and punch line) and make arrangements to have two neutral witnesses and a notary?

In 2002, Hong Kong's High Court held a 171-day trial and concluded that the 1990 Will was a forgery and awarded Teddy Wang's estate to Wang-Din-Shin. In 2004, Nina Wang lost an appeal by a 2-1 vote, and her husband's assets were actually transferred to her father-in-law. In 2005, she was formally charged with forgery.

But, later that year, the Court of Final Appeal reversed the lower courts, and control of Chinachem was restored to Nina Wang. There was not, however, a happy ending.

The battle over the estate is said to have taken a toll on Nina Wang. In 2007, Little Sweetie succumbed to cancer. At the time of her death, she was worth $4.3 billion, making her the wealthiest woman in Asia (and, according to Wikipedia and Forbes rankings of the wealthy, on a par with Oprah Winfrey). Since her death, the fortune may have grown to $10 billion.

Nina Wang's estate, like her late husband's, was the subject of litigation over dubious Wills. A 2006 Will purporting to leave her entire estate to her lover, a 53-year-old feng shui master (and former bartender) named Tony Chan, was rejected as a forgery. This Will contradicted a 2002 Will that left the estate to a family-run foundation.

In 2011, Hong Kong's High Court confirmed that the 2006 Will was a forgery. Tony Chan then converted to Christianity and changed his name to Peter. However, this did not prevent the Court from convicting him of forgery in 2013 and denouncing him for his "shameless and unparalleled greed."

This begs the question: Why forge a Will that so conspicuously departed from Nina Wang's long-time goals, i.e., the pursuit of her family-run charitable foundation? Why didn't he insert a more plausible bequest of $10 million—or even $100 million—instead of claiming the whole estate? What self-respecting feng shui master goes for the whole Pu Pu Platter of $10 billion? That is so not feng shui. In fact, it started a shui storm that put Tony/Peter in jail for 12 years. And worse, Chan was also charged with back taxes for payments received from Wang.

How could Nina Wang's estate be drawn into forgery litigation just like that of her husband? Are Wills so easy to forge in Hong Kong? Had no one the foresight to move assets into trusts and foundations prior to death? Let's hope that Nina Wang was sophisticated enough to transfer some non-probate funds prior to her death in a variety of sensible arrangements. But some mysteries of the Wang estates will endure forever.