IRS Provides Guidance on QTIP and Portability Elections

10.10.2016

The Treasury and the IRS can cross off another project from their **joint priority guidance plan**. IRS **Revenue Procedure 2016-49**, effective as of September 27, 2016, settles an issue arising when both QTIP and portability elections are made on a decedent?s estate tax return. According to Rev. Proc. 2016-49, a QTIP election can be made on a portability-only return. Consequently, property passing from a deceased spouse?s estate to a surviving spouse in trust may qualify for the marital deduction without using up the deceased spouse?s unused applicable exclusion amount (more commonly referred to as the ?DSUE amount?), even where the marital deduction is unnecessary to reduce the taxable estate to zero. To achieve this result, the executor of the deceased spouse?s estate must make a proper portability election.

QTIP and Portability Elections

The QTIP election is a common way to qualify property passing in trust from a decedent to a surviving spouse for the estate tax marital deduction. Generally, the value of property given to a surviving spouse is not deductible for estate tax purposes if the decedent gives the surviving spouse a ?terminable interest? in that property. Exception to this ?terminable interest rule? is made for qualified terminable interest property, or QTIP. QTIP is generally property in which the surviving spouse has a qualifying income interest for life. For marital deduction purposes, QTIP is deemed to pass to the surviving spouse and not to any other person. As a result, the property?s value can be deducted from the decedent?s gross estate. To take advantage of this treatment, the executor must affirmatively make a QTIP election with respect to the qualifying property on the decedent?s timely filed estate tax return.

Another important election available to the executor of a decedent?s estate has come about more recently. In 2010, Congress changed the Code to permit the executor of an estate to elect to transfer, or ?port,? the DSUE amount to the surviving spouse for his or her benefit. This so-called ?portability election? permits the surviving spouse to apply the DSUE amount of a deceased spouse when making transfers during life and at death. In this way, a surviving spouse?s applicable exclusion amount will equal his or her own applicable exclusion amount plus the remaining amount from his or her deceased spouse.

The Unnecessary QTIP Election and Revenue Procedure 2001-38

Many professionals have become concerned with the advent of portability that, in certain situations, making both elections might create an unnecessary QTIP election, thereby running afoul of prior IRS guidance in Rev. Proc. 2001-38. Under Rev. Proc. 2001-38, which was issued well before portability, the IRS stated that it would disregard and treat as a nullity for estate, gift, and GST tax purposes a QTIP election made in cases where the election was not necessary to reduce the estate tax liability to zero. This would be the case, for example, where the decedent?s total estate was worth less than his or her remaining applicable exclusion amount. In that case, the decedent?s remaining applicable exclusion amount would reduce any estate tax liability to zero. If the estate tax liability were zero, a QTIP election, used to qualify property for the marital deduction, would be unnecessary as it could not reduce the estate tax liability below zero.

Because Rev. Proc. 2001-38 was issued before, and clearly does not contemplate portability, the question many wrestled with was whether Rev. Proc. 2001-38 would block a QTIP election on a portability-only return. Rev. Proc. 2016-49 addresses this very question.

Applying Rev. Proc. 2016-49

In Rev. Proc. 2016-49, the Treasury and the IRS make clear that where the executor of a decedent?s estate makes the portability election, a simultaneous QTIP election with respect to the decedent?s property, including unnecessary QTIP elections, will not be treated as void, so long as such QTIP elections are properly made.

This now clarifies that QTIP elections will not be ignored for gift, estate, and GST tax purposes where: (i) a partial QTIP election was required with respect to a trust to reduce the estate tax liability, and the executor made the election with respect to more trust property than was necessary to reduce the estate tax liability to zero; (ii) the QTIP election that was stated in terms of a formula designed to reduce the estate tax to zero; (iii) a protective QTIP election under Reg. § 20.2056(b)-7(c) was properly made; (iv) the executor of the estate made a proper portability election; or (v) certain procedural requirements to affirmatively treat a QTIP election as void are not met.

Conversely, Rev. Proc. 2016-49 provides that certain QTIP elections will still be considered void, so long as **all** of the following are met: (i) the estate?s federal estate tax liability was zero, regardless of the QTIP election, making the QTIP election unnecessary; (ii) the executor of the estate neither made nor was considered as making the portability election; and (iii) certain procedural requirements set forth

in Rev. Proc. 2016-49 to affirmatively treat a QTIP election as void are met.

Conclusion

Rev. Proc. 2016-49 puts to rest a fear that certain QTIP elections would not be respected by the IRS, even though properly made. Instead, Rev. Proc. 2016-49 provides that the IRS will respect a QTIP election even if such election is unnecessary to reduce a decedent?s estate tax liability to zero.

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