The DSUE Amount as an Estate Asset With Value

The enactment of portability is, perhaps, the most important recent change in the estate tax law. Under Section 2010(c), a decedent's executor can elect on a timely filed estate tax return to transfer the deceased spousal unused exclusion (DSUE) amount (the unused unified credit) to the surviving spouse. Portability has dramatically altered modern estate planning for many clients, allowing them to avoid the use of nonmarital trusts in a substantial number of instances.

Portability raises a substantial number of difficult estate planning problems. It forces practitioners to compare the potential estate tax savings of the traditional nonmarital trust with the potential income tax savings of portability, because portability gives the estate and beneficiaries of the surviving spouse a new basis in all of the couple's combined assets. Portability also forces practitioners to draft nonmarital trusts so that at least part of the trust assets can be included in the gross estate of the surviving spouse, if he or she has unused applicable exclusion amount.

The most complex aspect of portability, however, is balancing the surviving spouse's desire for the increased ability to transfer property without gift or estate tax afforded by the DSUE amount, with the desire of the fiduciary and beneficiaries of smaller estates to avoid the cost and work involved in filing a federal estate tax return to elect portability. In many estates of deceased spouses with harmonious families, the surviving spouse is both the primary beneficiary and the personal representative of the estate. In such cases, the surviving spouse merely decides whether the possible value of the DSUE amount exceeds the costs associated with filing an estate tax return.

In estates where the surviving spouse does not get along well with all of the decedent's children, however, and particularly if the surviving spouse is not the sole personal representative of the decedent's estate, a more difficult balancing act is required. In such situations, the personal representative must consider the cost to the estate of filing a federal estate tax return, and the value to the surviving spouse of the DSUE amount. One way of dealing with this problem is for the surviving spouse to pay the estate an amount for the estate's agreement to file a federal estate tax return electing portability, as was illustrated in *Walton v. Estate of Swisher.*[1]

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Background

Kathleen Walton was named personal representative of the estate of her deceased mother, Mary Cox Swisher. Mary[2] was survived by her husband, Glenn, as well as her daughter. Glenn and Kathleen met to discuss the benefits that Glenn would receive from the estate and the obligations that existed for the personal representative, and they executed a Letter of Understanding, stating that Glenn would pay certain financial obligations due to care facilities and nursing services for Mary's support and care, together with an additional payment to the estate of $5,000. Kathleen agreed that the estate would relinquish "any and all claims to any tax benefits or refunds" received after the date of death on any tax returns filed by Glenn and Mary or by the estate, whether before or after Mary's death.

After the Letter of Understanding was executed, Glenn asked his advisors to prepare Federal Form 706 for filing by Mary's estate, in order to obtain the benefit of Mary's DUSE amount. Mary's estate signed and filed the return. Mary's estate was only $100,000, and it was not subject to federal or state estate or inheritance taxes.

Glenn died in 2012, and Kathleen, as the personal representative of Mary's estate, filed two claims against Glenn's estate, asking that payment in the amount of $500,000 be applied to Mary's estate in compensation for Glenn's use of Mary's DSUE amount. Kathleen argued that, without compensation in addition to the $5,000 agreed to in their Letter of Understanding, Glenn's estate would be unjustly enriched, because it could reduce its tax obligations substantially by use of Mary's DSUE amount.[3]

Glenn's estate disallowed the claim, and filed a motion for summary judgment on the claim. Glenn's estate argued that, in part, the Letter of Understanding between Glenn and Kathleen was a binding contract. The probate court granted Glenn's estate the motion for summary judgment, stating that the Letter of Understanding was controlling as to the claims, that the Letter of Understanding was unambiguous, and that there was no unjust enrichment.

The court of appeals (Judge Baker) affirmed, holding that the Letter of Understanding was dispositive. The court noted that, in reviewing a contract, if the contract language is unambiguous, the intent of the parties is determined from its four corners. A contract is ambiguous only where a reasonable person could find its terms susceptible to more than one interpretation.[4] The Letter of Understanding clearly outlined the benefits due to and burdens placed on Mary's estate and Glenn, and all that Glenn was required to pay was $5,000. Kathleen, while represented by counsel, agreed to the Letter of Understanding, and promised to "relinquish any and all claims to any tax benefits or refunds received after date of death on any tax returns filed by [Glenn] and [Decendant] (or the [estate]) prior or subsequent to the date of death." The DSUE amount is such a tax benefit.

1 2014 WL 325666 (Ind. App., 2014) (slip copy).

2 References to parties by their first names are for convenience only, and are not to indicate either disrespect or a personal relationship between the party and the author.

3 Kathleen also argued that Glenn's representatives violated the state Rules of Professional Conduct by not explaining to her the tax consequences of signing the estate tax return for Mary's estate.

4 Zollman v. Geneva Leasing Associates Inc., 780 N.E.2d 387 (Ind. Ct. App., 2002).

Planning for the DSUE amount in a disharmonious estate

Practitioners should anticipate that, in a typical disharmonious family, there may be disputes between or among the family members about the advisability of filing an estate tax return to elect portability. One easy solution to this problem is for the will or revocable trust to direct that the executor file the estate tax return and elect portability. This relieves the personal representative of the estate of the task of deciding whether to file an estate tax return for an estate that is not required by the tax law to file a return, because the gross estate is under the available basic exclusion amount. Such a direction may be absolute, or it may provide that the personal representative should file a return not otherwise required by the federal tax law only if the surviving spouse agrees to pay the incremental costs incurred by the estate in filing the return.

A second approach is to allow the parties to negotiate a fair payment to the estate by the surviving spouse for filing a federal estate tax return and electing to transfer the DSUE amount to the surviving spouse. The maximum value of a $5.4 million DSUE amount (the highest possible DSUE amount in 2014) is $2,089,800. That figure is not indexed for inflation after the first spouse's death, and so represents the point at which a surviving spouse's payment would provide no net benefit to the spouse (and the detriment of a prepayment of the amount of future tax savings).

Arguably, the personal representative of an estate that does not pass entirely to the surviving spouse alone (outright, with no remainder or other beneficiaries) should decline to file a federal estate tax return solely to elect portability, absent some compensating payment from the surviving spouse. The personal representative owes a fiduciary duty to treat all of the estate beneficiaries fairly and equally; the cost of filing a federal estate tax return is a detriment to all of the beneficiaries, but the act of filing a return in such cases is a benefit only to the surviving spouse. It would be reasonable for such personal representatives to insist on some payment from the surviving spouse to cover the cost of preparing the return. In addition, the personal representative has a fiduciary duty to marshal and maximize the assets of the decedent's estate, and this duty may compel the personal representative to insist on some additional payment from the surviving spouse, beyond the cost of preparing the federal estate tax return.

Conclusion

As demonstrated in *Walton v. Estate of Swisher*, the interests of a surviving spouse with respect to an estate's election of portability may be contrary to the interests of the other beneficiaries of the estate. It is best to anticipate such conflicts and direct in the decedent's will whether to elect portability and whether the surviving spouse should be required to pay for the DSUE amount. In the absence of such directions, however, practitioners should anticipate that surviving spouses and personal representatives will be faced with a negotiation to determine the true value of the DSUE amount to the surviving spouse, and that the personal representative will seek to turn the DSUE amount into a true estate asset. ■

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