Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2100

Date: 20-May-13
From: Steve Leimberg's Estate Planning Newsletter
Subject: **Bramwell, Dillon & Mullen: Relax, Rev. Proc. 2001-38 Cannot Be Used Against Taxpayers, Or Why QTIP Planning is Safer than Some Might Think**

"Revenue Procedure 2001-38 established a procedure whereby a surviving spouse or his or her estate may in some cases void a QTIP election made by the executors of the first spouse to die. Although it was intended to provide relief, many commentators have argued that the Procedure could instead be used against the taxpayer in ways that frustrate planning under the 'portability' provisions of the Internal Revenue Code.

A careful understanding of the Procedure, however, reveals that a valid QTIP election cannot be disregarded against a taxpayer's will. Taxpayers may take advantage of portability without fear that the Procedure will be used against them."

Now, **Austin Bramwell**, **Brad Dillon** and **Lisi Mullen** provide members with important commentary on why Revenue Procedure 2001-38 cannot be used against taxpayers in ways that frustrate planning under the portability provisions of the Code.

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Here is their commentary:

EXECUTIVE SUMMARY:

As described in the Technical Editor's comments further below, QTIP planning can be critically important in designing estate plans in light of portability. It might even be viewed as an essential part of planning if a taxpayer is domiciled or holds real estate in a state that imposes an estate tax and has a different estate tax exemption than the federal estate tax. Rev. Proc. 2001-38 is perceived by many to threaten those planning opportunities.

Rev. Proc. 2001-38 (the "Procedure") established a procedure whereby a surviving spouse or his or her estate may in some cases void a QTIP election made by the executors of the first spouse to die (the "first decedent"). Although it was intended to provide relief, many commentators have argued that the Procedure could instead be used against the taxpayer in ways that frustrate planning under the "portability" provisions of the Internal Revenue Code ("Code"). In their view, even if the surviving spouse or his or her estate wishes a prior QTIP election to be respected, the election could still be

nullified under the Procedure. This article argues that fears of the Procedure being used against taxpayers are unfounded. Contrary to surprisingly widespread perception, the IRS has not claimed and does not have the power on its own initiative to void a prior QTIP election.

FACTS:

At the time the Procedure was published, surviving spouses could not "inherit" the unused estate tax exemption of the first decedent. Thus, if the first decedent died with a taxable estate that was less than his or her estate tax exemption amount under section 2010 of the Internal Revenue Code (the "Code"), the exemption was lost or "wasted." To prevent that outcome, it was common practice for the first decedent's assets to be divided into two portions, one of which, known as the "credit shelter" portion, would be equal to the first decedent's remaining estate tax exemption amount and the other, known as the "marital" portion, would be equal to the balance of the first decedent's estate.

The credit shelter portion would pass to a trust for the benefit of the surviving spouse that would not qualify for the estate tax marital deduction but would pass outside of the surviving spouse's gross estate at his or her death. The marital portion (if any) would pass in a form that would qualify for the marital deduction. In this manner, at the first decedent's death, no estate tax would be due and all of the first decedent's assets would be held for the benefit of the surviving spouse, yet the first decedent's estate tax exemption could be fully used.

The credit shelter trust would often be in a form that could qualify for the marital deduction as qualified terminable interest property (or "QTIP") to the extent the first decedent's executors elected. Unfortunately, some executors (presumably, inadvertently) made the QTIP election over the credit shelter portion, thereby causing more property to qualify for the marital deduction than was necessary to reduce estate tax to zero. Sometimes, for example, as the Procedure notes, the first decedent's estate was not large enough to use up the first decedent's exemption amount, yet his or her executors still made a QTIP election. In other cases, the credit shelter portion was limited to the first decedent's exemption amount and so would not have caused estate tax to be due even without the benefit of a marital deduction. The consequence in both situations was that the survivor's gross estate was increased and his or her estate became liable for additional estate tax that could easily have been avoided had the first decedent's executors simply not made the QTIP election.

The Procedure, as it says in the first sentence, "provides relief" in such cases by allowing an "unnecessary" QTIP election to be disregarded. To obtain the relief described in the Procedure, "the taxpayer must produce sufficient evidence" that the QTIP election is within the scope of the Procedure. A QTIP election, subject to certain exceptions,[i] is within the scope of the Procedure if it was not necessary to reduce the estate tax liability to zero. An election within the scope of the procedure will be treated as if it had never been made and thus will not cause additional property to be included in the survivor's gross estate. In short, the Procedure permits a surviving spouse or his or her executors to undo a prior QTIP election even after the election was made.

COMMENT

Advantages of Not Undoing an "Unnecessary" QTIP Election

Traditional planning for married couples has lately been upended by the permanent enactment of the new "portability" provisions and very high estate tax exemption amounts.[ii] Rather than have the first decedent use up his or her exemption amount at death, a couple will often benefit from having the surviving spouse "inherit" the first decedent's unused exemption amount.[iii] Combined with QTIP trusts, a portability election permits the surviving spouse to decide at any time after the first decedent's death whether to create the equivalent of a credit shelter trust or instead to allow assets passing from the

first decedent to be included in the survivor's gross estate and thereby qualify for a second change in basis under section 1014(a) of the Code.[iv] This type of planning is the only "flexibility" technique that always permits the first decedent's executors, if not otherwise required to file an estate tax return, to avoid having to report the fair market values of assets qualifying for the marital deduction.[v]

In light of the many advantages of portability, some couples who might otherwise have applied to have a QTIP election ignored under the Procedure will prefer to allow the election to stand. For example, a couple's combined wealth might be less than the sum of their exemption amounts. In that case, it may be better for all of the assets of the first decedent to be included in the survivor's gross estate, so that they will qualify for a second change of basis under section 1014(a) of the Code. The surviving spouse might also wish to trigger a deemed transfer of QTIP principal under section 2519 of the Code in order to "painlessly" remove assets passing from the first decedent from the survivor's gross estate for both federal and state death tax purposes.[vi]

The relief provided in the Procedure may also be undesirable if the first decedent's executors made the portability election and QTIP assets have declined in value. For example, suppose that a surviving spouse, who herself has $10.25 million of assets, inherited $5.25 million of "deceased spousal unused exemption" (or "DSUE") from her husband and that all of the husband's assets, worth $5.25 million at his death, passed to a QTIP trust for her benefit.

If the QTIP trust decreases in value to only $3.25 million by the time of the survivor's death, then only $13.5 million (i.e., her $10.25 million plus the $3.25 million QTIP trust) will be included in the her gross estate at death. However, she will have $10.5 million of exemption (i.e., her $5.25 million "basic" exemption amount plus her $5.25 million of DSUE), provided that the QTIP election is respected. Only $3 million will be subject to estate tax.

By contrast, if the QTIP election is ignored, then the husband will be deemed to have had a taxable estate of $5.25 million, which would effectively eliminate the DSUE amount. Consequently, the survivor will have a gross estate of $10.25 million but only $5.25 million of exemption. Now, $5 million of the survivor's gross estate – $2 million more than if the QTIP election had been respected – will be subject to estate tax.

Rev. Proc. 2001-38: Not a Relief but a Burden?

For reasons discussed above, a taxpayer will often not wish to have a QTIP election disregarded under the Procedure. Some planners have suggested, however, that even if a taxpayer does not seek to void a prior QTIP election, the IRS may impose the "relief" described in the Procedure whether the taxpayer likes it or not. The Procedure states that "[i]n the case of a QTIP election within the scope of this revenue procedure, the Service will disregard the election and treat it as null and void for purposes of §§ 2044(a), 2056(b)(7), 2519(a), and 2652." Under a literal reading of this statement, a QTIP election within the scope of the Procedure will always be ignored, even if the taxpayer prefers to have it respected.[vii] Some commentators have even gone so far as to ask the IRS to amend the Procedure to state that it does not apply if both a QTIP and a portability election have been made.[viii]

Fortunately, for the reasons discussed below, the IRS does not have and has not actually claimed the power to disregard a valid prior QTIP election. So long as the taxpayer does not seek the relief described in the Procedure, a prior QTIP election must be respected.

Rev. Proc. 2001-38 Does Not Have the Force of Law and Is Not Entitled To Judicial Deference

The first reason that the IRS may not use the Procedure against taxpayers is that the Procedure does not have the force of law and therefore cannot be relied

upon by the IRS as authority for disregarding a QTIP election.[ix] The IRS defines a revenue procedure as "a statement of procedure that affects the rights or duties of taxpayers or other members of the public under the Code and related statutes or information that, although not necessarily affecting the rights and duties of the public, should be a matter of public knowledge."[x] When the IRS established its policy of publishing revenue procedures, they did not "apply to . . . interpretations of substantive tax law."[xi] For the IRS's "official interpretation" of the tax laws, one must instead look to revenue rulings.[xii] To this day, the IRS continues to reserve "[r]ulings and other communications involving substantive tax law" for revenue rulings rather than revenue procedures.[xiii]

Given that the IRS publicly distinguishes between revenue rulings and revenue procedures, courts have viewed with skepticism the IRS's occasional claims that revenue procedures are entitled to as much judicial deference as revenue rulings.[xiv] In any case, even if certain revenue procedures might in theory be entitled to deference, no deference is warranted where a revenue procedure fails to provide a rationale for its conclusion. In *Federal Nat. Mortg. Ass'n ("Fannie Mae") v. United States*, 379 F. 3d 1303 (Fed. Cir. 2004), for example, the IRS argued that a revenue procedure was entitled to judicial deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc*., 467 U.S. 837 (1984). The court observed, however, that the procedure in question contained no "interpretative guidance" and "neither elucidates nor invokes support for its conclusion." Consequently, the court held that the procedure was ineligible for deference, because it was more in the nature of an "enforcement guideline" than an interpretation of the law.[xv]

Unlike the revenue procedure at issue in *Fannie Mae*, the Procedure methodically elucidates the requirements of a valid QTIP election as well as the election's tax consequences. However, that does not mean that the "conclusion" reached in the Procedure – namely, that a QTIP election within the scope of the Procedure will be treated as null and void – is entitled to deference. On the contrary, the Procedure correctly states the law as follows:

Under § 2056(b)(7)(B)(i), qualified terminable interest property is property which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7)(B)(v) applies. . . . This election, once made, is irrevocable. A QTIP election has transfer tax consequences for the surviving spouse. Section 2044(a) and (b) provides generally that the value of the gross estate includes the value of any property in which the decedent has a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under § 2056(b)(7). Under § 2519(a) and (b), any disposition of all or part of a qualifying income interest for life in any property with respect to which a deduction was allowed under § 2056(b)(7) is treated as a transfer of all interests in the property other than the qualifying income interest.

In other words, once the requirements of a valid QTIP election are satisfied, the election is irrevocable and the QTIP will ultimately be subject either to gift tax (under section 2519 of the Code) or estate tax (under section 2044 of the Code). The Procedure goes on to announce that, despite those clear statutory directions, the IRS will choose to ignore a QTIP election in some circumstances. Thus, the enforcement policy described in the Procedure is contrary to the very legal conclusions set forth in the Procedure.

To put it another way, the Procedure announces that the IRS is willing to disregard the law for the benefit of certain taxpayers. It does not purport to *interpret* the QTIP provisions of the Code but instead expresses willingness not to enforce them in some instances. As discussed, a revenue procedure is not entitled to deference if it does not analyze the law. *A fortiori*, if a procedure does analyze the law but adopts a policy unsupported by the procedure's own analysis, then the policy is not entitled to deference.[xvi] If anything in the Procedure is entitled to deference, it is not the Procedure's announcement that the IRS will treat a QTIP election as void but rather its legal analysis that a

QTIP election is irrevocable and will (if a deemed transfer under section 2519 of the Code does not occur) cause gross estate inclusion at the survivor's death. For authority for the view that the IRS cannot disregard a QTIP election, one need look no further than the Procedure itself.

Even If Rev. Proc. 2001-38's Policy Were Entitled To Deference, It Would Still Be Invalid

The second reason that the IRS cannot use the Procedure to void a QTIP election is that, even if the Procedure were construed as a "legislative-like interpretation," that interpretation would likely be rejected under any standard of deference. Suppose, for example, that the position that a QTIP election is void if it was not necessary to reduce estate tax to zero were entitled to *Chevron* deference.[xvii] Under the deferential *Chevron* standard, an interpretation will be upheld if both (1) the statute is ambiguous and (2) the agency in question reasonably resolves the ambiguity. There is no ambiguity, however, as to whether a QTIP election must be "necessary" in order to be valid.

On the contrary, as the Procedure itself states and cases uniformly attest,[xviii] section 2056(b)(7)(B)(i) of the Code imposes only three conditions for property to qualify as QTIP: (i) the property must pass from the decedent, (ii) the surviving spouse must have a qualifying income interest for life and (iii) an election must be made. Treasury Regulations, by referring the reader to "Section 2056(b)(7)(B)(i)" for the definition of QTIP, implicitly concede that there are no hidden additional requirements of the QTIP marital deduction. [xix] Proposed regulations under section 2010 of the Code likewise assume that a QTIP election is valid even if unnecessary to reduce the first decedent's estate tax to zero.[xx]

Nor is there any ambiguity as to whether there is an exception to the application of sections 2519 or 2044 of the Code for "unnecessary" QTIP trusts. On the contrary, as the Procedure correctly acknowledges, once property has qualified for the QTIP marital deduction, it will be included in the survivor's gross estate under section 2044 of the Code or will be subject to gift tax if the survivor's qualifying income interest for life is disposed of during lifetime. As courts have held, property for which a QTIP marital deduction was allowed is "required by statute" to be included in the survivor's gross estate (if not deemed to have been transferred under section 2519 of the Code). [xxi]

In sum, there is no ambiguity as to the requirements or consequences of a QTIP election. That does not mean that it is always clear when the three requirements of a QTIP marital deduction have been satisfied. Litigation has ensued, for example, over the meaning of "qualified income interest for life." Taxpayers and the IRS have argued over whether a QTIP election fails because income earned just prior to death was not required to be paid to the surviving spouse's estate[xxii] or because of "Clayton" provisions that convert a QTIP-type trust to a non-marital trust to the extent the QTIP election is not made. [xxiii] Both issues have since been resolved by regulation.[xxiv] By contrast, there is no ambiguity as to whether the surviving spouse having a "qualifying income interest for life" is one of only three requirements for property to qualify as QTIP.

The Procedure, therefore, even if treated as an IRS interpretation eligible for judicial deference, would fail the first step of the deferential *Chevron* standard. [xxv] The Procedure does not identify any legal issue that needs to be resolved. It confirms, on the contrary, that there is none but nevertheless goes on to announce a procedure whereby enforcement of the Code will be relaxed.

What Exactly Is the Status of Rev. Proc. 2001-38?

The enforcement policy announced in the Procedure, because it is contrary to the Code, is unlikely to be binding on the IRS. Although the IRS generally may not take a position contrary to a published ruling favorable to taxpayers,

[xxvi] the Supreme Court has indicated that such a ruling "may not be used to overturn the plain language of a statute."[xxvii] Taxpayer-friendly interpretations, Justice Scalia has reasoned, "cannot control the determination of whether the tax was due and owing according to Congress's command," for otherwise the Treasury Department "would effectively be empowered to repeal taxes that the Congress enacts."[xxviii] Thus, it seems that the IRS could, in litigation, choose to disavow the Procedure.[xxix]

Why, then, did the IRS choose to publish the Procedure at all? The answer is probably that the IRS did not anticipate that a taxpayer would ever want or even have standing to challenge it. The Procedure is not the only instance where the IRS has publicly announced an intention to relax enforcement of the Code. In Rev. Rul. 93-73, for example, the IRS cryptically ruled that Rev. Rul. 78-189, which had denied an income tax deduction for fees paid to Scientology "auditing" courses, was obsoleted. What Rev. Rul. 93-73 did not say was that the prior ruling had only recently been vindicated by the United States Supreme Court in *Hernandez v. Commissioner*, 490 U.S 680 (1989). The position being obsoleted, therefore, was manifestly good law. Indeed, as the Ninth Circuit later wrote,[xxx] the IRS's policy of permitting charitable income tax deductions for fees paid to the Church of Scientology "constitutes an unconstitutional denominational preference." Nevertheless, attempts by other taxpayers to challenge Rev. Rul. 93-73 have so far failed for lack of standing. [xxxi]

The Procedure, like Rev. Rul. 93-73, appears to have been written on the assumption that, although the relief it provides is contrary to the QTIP provisions of the Code, the IRS could nevertheless as a practical matter ignore "unnecessary" QTIP elections because no taxpayer would ever want or be able to challenge the Procedure. We now know that the assumption has turned out to be false: many taxpayers not only would not benefit but would be positively harmed by the "relief" described in the Procedure. As the Procedure was always contrary to law, however, it cannot be used against taxpayers. Whether it was ever wise for the IRS, through its enforcement powers, to have attempted to improve upon the enactments of Congress, the policy announced in the Procedure cannot have the force of law, because it not only never purported to be an interpretation of the Code but instead proposes that the Code simply be disregarded.

Rev. Proc. 2001-38 Does Not Imply That the IRS Has the Power to Disregard A QTIP Election

The final reason that the IRS may not use the Procedure against taxpayers is that, fairly interpreted, it does not actually imply that the IRS has the power to nullify a prior QTIP election. To be sure, the Procedure states flatly that "the Service will disregard" a QTIP election within the scope of the Procedure. The context, however, reveals that the Service will not disregard a QTIP election unless the taxpayer affirmatively seeks to have it disregarded. The Procedure begins with the statement that it "provides relief for surviving spouses and their estate." It goes on to inform the reader that the IRS "has received requests for relief" in cases where a QTIP election was made unnecessarily. "Relief" commonly means an "easing of burdens" – in this case, tax burdens. It would be contrary to the plain meaning of the Procedure to interpret it as threatening to increase rather than relieve a taxpayer's burdens.

Further, the Procedure effectively gives the taxpayer the choice whether or not to seek the relief provided. To obtain the relief, the taxpayer must "establish that [a QTIP] election is within the scope of this revenue procedure." The taxpayer, in other words, must make an effort to obtain the relief. If the taxpayer decides not to make the effort, then the relief is not available.

Granted, the Procedure does not say whether there are alternative mechanisms, in the absence of the taxpayer's request, for the relief to be made available (or imposed). The Procedure does not say, for example, whether the IRS may on its own initiative establish that the QTIP election was "unnecessary" and

therefore within the scope of the Procedure. That silence, however, does not imply that a power to disregard a QTIP election, even if the taxpayer wishes to have it respected, is lurking in the background.[xxxii] On the contrary, as discussed, the very legal analysis set forth in the Procedure belies the notion that the IRS has the power to nullify a QTIP election. The statement that the IRS will treat certain QTIP elections as null and void, therefore, should not be read as an attempt by the IRS to arrogate a power to itself but instead as an invitation to take advantage of a relaxed enforcement policy. Under the legal analysis section of the Procedure, the taxpayer always has the option of having the Code properly enforced.

Techniques for Avoiding the Threat of Rev. Proc. 2001-38

As discussed above, there are no grounds for believing that the IRS has or has even claimed the power to void a prior QTIP election. In any case, a taxpayer still worried about the safety of their QTIP elections can avoid the application of the Procedure, if a QTIP election of some amount is required to save estate tax. The Procedure does not apply where a partial QTIP election was needed in order to "zero out" the estate tax of the first decedent but the first decedent's executors made the election over more property than was necessary. A disposition to a single QTIP-type trust, so long as it exceeds the exemption amount, therefore, will not come within the scope of the Procedure. For example, if the first decedent wishes to give his or her executors flexibility over whether or not to use up his or her exemption at death, he or she could define the credit shelter portion to be equal to the remaining exemption amount plus $10. In that case, if the first decedent's executors do not qualify the credit shelter portion as QTIP, it will use up the first decedent's exemption amount and only a de minimis amount ($4) of estate tax will be due. If the first decedent's executors do make the QTIP election, then the QTIP trust will not come within the scope of the Procedure, as a fractional QTIP election was needed to reduce estate tax to zero but the first decedent's executors elected more property as QTIP than was necessary. In this manner, any remaining risk of the Procedure being used against taxpayers can be defeated.

Conclusion

Some practitioners have panicked over whether certain statements in the Procedure, when taken out of context, mean that the IRS can nullify a prior QTIP election. A careful understanding of the Procedure, however, reveals that a valid QTIP election cannot be disregarded against a taxpayer's will. Taxpayers may take advantage of portability without fear that the Procedure will be used against them.

TECHNICAL EDITOR'S REMARKS

I agree that the Procedure's own language strongly implies that the taxpayer must apply for relief and that the Procedure contradicts the law and would not withstand challenge by a taxpayer to whom the IRS applies it without such an application.

The practical implications of this conclusion are enormous, not only for portability planning but also for state death tax planning.

Consider three of the many important issues that portability raises: First, it involves a trade-off between basis step-up and possible estate tax exposure. If the spouses' assets are so much smaller than their combined estate tax exemption, then – from a tax perspective – a credit shelter trust generally will do more harm than good, because it saves no estate tax **and** a basis step-up is not available at the surviving spouse's death. In many cases, it is difficult to predict how much will remain at the surviving spouse's death, because that depends heavily on investment return and life expectancy, both of which involve significant uncertainty. When will clients have the best information available – when they sign their estate planning documents or when the first spouse dies? As Yogi Berra said, "It's hard to predict – especially the

future." In many cases, the most flexible estate plan is one that leaves the decedent's entire estate to a trust that is eligible for the QTIP election (a "one lung plan"). The surviving spouse can then decide how much to protect from future estate tax using the decedent's estate tax exemption and how much to expose to estate tax at the surviving spouse's death in order to obtain a potential basis step-up. We frequently extend the time to file the estate tax return and to pay federal estate tax (separate elections made on the same form) when the first spouse dies, allowing the return to be filed 15 months after the first spouse dies, giving us valuable planning time and a later snapshot of the family's situation.

Second, suppose the couple's combined estate is - and always will be - clearly below the estate tax exemption, so that a credit shelter trust is definitely undesirable. Yet, a trust might be very desirable – to protect from creditors, to shield the assets in the event of remarriage, or to make sure the assets pass to children from the decedent's prior marriage. Although the mandatory income requirement makes a QTIP trust less than ideal, in many cases it will be the ideal vehicle to secure estate inclusion at the surviving spouse's death while achieving a significant portion of these nontax objectives.

Third, portability applies to the decedent's gift/estate tax exemption but not the decedent's GST exemption. Again a QTIP trust can help, because it is includible in the surviving spouse's estate, but with a reverse-QTIP election under IRC section 2652(a)(3) will use the decedent's GST exemption to facilitate GST planning at the surviving spouse's death. This strategy can be useful for couples with combined assets that are - or might in the future be – greater than one estate tax exemption (whether or not above double the estate tax exemption.

Finally, consider that some states have death taxes with exemptions below the federal estate tax exemption. This concern applies to clients who live in or hold real estate in such a state. In those cases, one might need one trust that uses the federal and state exemptions (no QTIP election), one that uses the federal exemption that exceeds the state exemption (a state-only QTIP election), and one that uses the marital deduction for federal and state purposes. Portability complicates the decision even further. In many cases, a one-lung plan provides the ultimate flexibility for state death tax planning when the first spouse dies.

If the Procedure were to make uncertain the viability of one-lung or other QTIP planning, it would undermine many very helpful strategies. Fortunately, the Procedure can be a shield for certain taxpayers but is not – and never will be – a sword for the IRS.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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CITES:

Code §§ 2044(a), 2056(b)(7), 2519(a), 2652; Treas. Reg. §§ 20.2056(b)-7(b)(1), 20.2056(b)-7(d)(3)-(4), 601.601(d)(2)(i)(b); Prop. Treas. Reg. §20.2010-2T(a)(7)(ii)(C); Rev. Procs. 68-44, 89-14, 2001-38; PLR 201131011; *U.S. v. Burke*, 504 U.S. 299, 246 (1992), *Federal Nat. Mortg. Ass'n v. United States*, 379 F. 3d 1303 (Fed. Cir. 2004), *Kornman & Associates Inc v. U.S.*, 527 F.3d 443 (5th Cir. 2008), *Mayo Foundation v. United States*, 131 S. Ct. 7 (2011), *Schleier v. Comm'r*, 515 U.S. 323, n.9 (1995), *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), *Sklar v. Comm'r*, 282 F.3d 610, 618-19 (9th Cir. 2002), *Warner v. United States*, 98 AFTR2d 2006-6136 (C.D. Calif. 2006); *Estate of Clayton v. Comm'r*, 976 F.2d 1486 (5th Cir. 1992), *Exxon Mobil Corp. and Affiliated Cos. V. Comm'r*, 136 T.C. No. 5 (U.S. Tax Court 2011), *Estate of Shelfer v. Comm'r*, 86 F.3d 1045 (11th Cir. 1996); Blattmachr, Gans and Rios, Circular 230 Deskbook (P.L.I. 2006) (supplement April 2013); Gans and Soled, A New Model for Identifying Basis in Life Insurance Policies: Implementation and Deference, 7 Fla. Tax. Rev. 569 at 595 (2006), Bramwell, "How to Use Portability to Avoid (Not Just Defer) State Death Taxes," LISI Estate Planning Newsletter #1991 (July 24, 2012), Blattmachr, Bramwell and Zeydel, "Portability or No: The Death of the Credit Shelter Trust?," Journal of Taxation (forthcoming May 2013), Bramwell and Kanaga, "The Section 2519 Portability Solution," Trusts & Estates (June 2012).

CITATIONS:

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[i] The QTIP election cannot have been a formula election or a protective election. In addition, a QTIP election is not within the scope of the Procedure if a partial election was necessary to reduce estate tax to zero and the first decedent's executors made the election over more property than was necessary to reduce estate tax to zero.

[ii] *See generally* Bramwell and Kanaga, "The Section 2519 Portability Solution," Trusts & Estates (June 2012).

[iii] For a discussion of the many reasons why portability may outperform traditional planning, see Blattmachr, Bramwell and Zeydel, "Portability or No: The Death of the Credit Shelter Trust?," Journal of Taxation (forthcoming May 2013).

[iv] *See* Bramwell and Kanaga, "The Section 2519 Portability Solution," Trusts & Estates (June 2012).

[v] Alternative techniques, such as partial QTIP elections and fractional disclaimers, may cause the first decedent's executors to have to report the value of the property qualifying for the marital deduction in order to make the portability election. Prop. Reg. § 20.2010-2T(a)(7)(ii)(A)(4).

[vi] *See* Bramwell, "How to Use Portability to Avoid (Not Just Defer) State Death Taxes," LISI Estate Planning Newsletter #1991 (July 24, 2012).

[vii] *See also* PLR 201131011 ("In general, under Rev. Proc. 2001-38, 2001-1 C.B. 1335, a QTIP election under § 2056(b)(7) will be treated as null and void for purposes of §§ 2044 (a), 2056(b)(7), 2519(a), and 2652, where the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax

purposes.").

[viii] *See, e.g.,* ABA Section of Real Property, Trust and Estate Law, Income and Transfer Tax Group, Estate and Gift Committee, Comments on Proposed Regulations and Temporary Regulations under IRC Sections 2001, 2010 and 2505.

[ix] For a thorough discussion of judicial deference in the tax context, see chapter 1 of Blattmachr, Gans and Rios, Circular 230 Deskbook (P.L.I.) (supplement April 2013).

[x] Treas. Reg. § 601.601(d)(2)(i)(b).

[xi] Rev. Proc. 1955-1, 1955-2 C.B. 897, superseded by Rev. Proc. 68-44.

[xii] Treas. Reg. § 601.601(d)(2)(i)(a); Rev. Proc. 89-14.

[xiii] Rev. Proc. 89-14.

[xiv] *See Federal Nat. Mortg. Ass'n v. United States*, 379 F. 3d 1303 (Fed. Cir. 2004) (noting, but without deciding whether "there is any distinction of significance between revenue rulings and revenue procedures," that the distinction is of the IRS's own making). A consensus appears to be emerging that revenue rulings are generally entitled to deference under the standard set forth in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). *See, e.g., Kornman & Associates Inc v. U.S., 527 F.3d 443 (5th Cir. 2008) ("[T]he various circuit courts addressing this issue have held that revenue rulings are entitled to Skidmore* deference. . . . and we apply that standard today."); *Taproot Administrative Services, Inc. V. Comm'r*, 679 F.3d 1109 (9th Cir. 2012) ("As both parties concede, I.R.S. revenue rulings are entitled to the degree of deference articulated by the Supreme Court in *Skidmore* . . . ."). *Skidmore* deference may not amount to much in practice. *U.S. v. Mead*, 533 U.S. 218 at 295 (2001) ("[T]he rule of *Skidmore* deference is an empty truism and a trifling statement of the obvious: A judge should take into account the well-considered views of expert observers.") (Scalia, J. dissenting).

[xv] *See also Exxon Mobil Corp. and Affiliated Cos. V. Comm'r*, 136 T.C. No. 5 (U.S. Tax Court 2011), where the court refused to give deference to a pronouncement in a Revenue Procedure that was not supported by any analysis of text or legislative history or any other relevant guidance.

[xvi] *Cf. McGee v. Comm'r*, 123 T.C. 314 (2004) (rejecting the IRS's proposed application of a revenue procedure in a manner that "causes a result that is inconsistent with the statutory scheme").

[xvii] In *Mayo Foundation v. United States*, 131 S. Ct. 7 (2011), the Supreme Court held that all treasury regulations, whether or not "legislative," were entitled to *Chevron* deference.

[xviii] *See, e.g., Davis v. Comm'r*, 394 F.3d 1294 at 1298 (9th Cir. 2005); *Patterson v. U.S.*, 181 F.3d 927 at 930 (8th Cir. 1999); *Estate of Shelfer v. Comm'r*, 86 F.3d 1045 at 1047 (11th Cir. 1996); *Estate of Cavenaugh v. Comm'r*, 51 F.3d 597 at 599 (5th Cir. 1995); *Estate of Spencer v. Comm'r*, 43 F.3d 226 at 229-30 (6th Cir. 1995).

[xix] Treas. Reg. 20.2056(b)-7(b)(1).

[xx] *See* Prop. Reg. § 20.2010-2T(a)(7)(ii)(C) Example 2 (concluding that a portability election can be made even though the first decedent's gross estate is less than the exemption amount and the first decedent's executors make a QTIP over all probate assets).

[xxi] *Warner v. United States*, 98 AFTR2d 2006-6136 (C.D. Calif. 2006); *see also, e.g., Estate of Shelfer v. Comm'r*, 86 F.3d 1045, n.1 (11th Cir. 1996) ("[Section 2044] provides for the inclusion of the QTIP assets in the estate tax return of the surviving spouse"); *Estate of Cavenaugh v. Comm'r*, 51 F.3d 597 at 600 (5th Cir. 1995) ("[Section 2044] requires the inclusion of the property in [the decedent's] gross estate if the 'decedent had a qualifying income interest for life' when 'a deduction was allowed with respect to the transfer of such property to the decedent'"); *Estate of Spencer v. Comm'r*, 43 F.3d 226 at 230 (6th Cir. 1995) ("Since [the trust] property in the instant case qualifies as QTIP, it will be included in the

surviving spouse's estate upon her death under § 2044.").

[xxii] *See, e.g., Estate of Shelfer v. Comm'r*, 86 F.3d 1045 (11th Cir. 1996), *rev'g Estate of Shelfer v. Comm'r*, 103 T.C. No. 2 (U.S. Tax Court 1994); *Estate of Howard v. Comm'r*, 910 F2d 633 (9th Cir. 1990); *rev'g Estate of Howard v. Comm'r*, 91 TC 329 (1988).

[xxiii] *See, e.g., Estate of Spencer v. Comm'r*, 43 F.3d 226 (6th Cir. 1994), *rev'g* 64 TCM 937 (1992); *Estate of Clayton, Jr. v. Comm'r*, 976 F.2d 1486 (5th Cir. 1992), *rev'g* 97 T.C. 327 (1991); *Estate of Robertson v. Comm'r*, 15 F.3d 779 (8th Cir. 1994), *rev'g* 98 T.C. 678 (1992).

[xxiv] Treas. Reg. 20.2056(b)-7(d)(3)-(4).

[xxv] *Cf. Finfrock v. U.S., 860 F.Supp.2d 651 (2012) (invalidating, under "step one" of Chevron*, a regulation under section 2032A of the Code).

[xxvi] *See, e.g., Rauenhorst v. Comm'r*, 119 T.C. 157 (2002).

[xxvii] *Schleier v. Comm'r*, 515 U.S. 323, n.9 (1995).

[xxviii] *U.S. v. Burke*, 504 U.S. 299, 246 (1992) (Scalia, J. concurring). *See generally* Gans and Soled, A New Model for Identifying Basis in Life Insurance Policies: Implementation and Deference, 7 Fla. Tax. Rev. 569 at 595 (2006).

[xxix] Indeed, the Procedure inevitably will be revoked, modified or disavowed, for, as currently written, it would permit a couple the benefit of three exemption amounts. *See* Bramwell and Kanaga, "The Section 2519 Portability Solution," Trusts & Estates at 24 (June 2012).

[xxx] *Sklar v. Comm'r*, 282 F.3d 610, 618-19 (9th Cir. 2002).

[xxxi] *Henson v. Internal Revenue Service*, 238 F.3d 428 (9th Cir. 2000) (unpublished decision). Attempts to secure similar privileges for members of other denominations have also failed. *Sklar v. Comm'r*, 549 F.3d 1252 (9th Cir. 2008).

[xxxii] *But cf. Madden v. Comm'r*, 52 T.C. 845 (1969) (discussed in detail in the postscript below).

Postscript: Rev. Proc. 2001-38 vs. Treas. Reg. § 20.2041-1(a)(2)

Some, including the great **Howard Zaritsky**, have compared the Procedure to Treas. Reg. § 20.2041-1(a)(2). *See* American Bar Association Estate and Gift Tax Committee, Portability – Part One at 45-46. By way of background, section 2040(a) of the Code provides that the gross estate of a decedent includes the value of all property held with another as joint tenants with rights of survivorship, "except such part thereof as may be shown to have originally belonged" to the other owner(s). Treas. Reg. § 20.2041-1(a)(2) goes on to impose on the executor the burden of showing the extent to which the other owners(s) furnished the consideration for property owned jointly with the decedent. In other words, the value of the decedent's jointly held property (other than property held jointly with a spouse, one-half of which is generally included under section 2040(b) of the Code) is included in the gross estate except to the extent that the executor can show that it was paid for by the other owner.

In *Madden v. Comm'r*, 52 T.C. 845 (1969), however, the surviving spouse of the decedent attempted to use Treas. Reg. § 20.2041-1(a)(2) against the IRS. He took the position that, because the decedent's estate had made no showing that the surviving owner furnished any of the consideration for the decedent's jointly held property, the property was included in the decedent's gross estate and, therefore, should receive a "step up" in basis under section 1014 (b)(9) of the Code. The court disagreed and held that section 1014(b)(9) of the Code does not give taxpayers the option of obtaining an increase in basis by including more joint property in the gross estate than necessary. *See also Estate of Fleming v. Comm'r*, T.C. Memo. 1974-377 (permitting the IRS to establish the portion of jointly held property included in the gross estate where the taxpayer's proposed method of determining the portion included had no basis in the law).

While there are interesting similarities between Treas. Reg. § 20.2041-1(a)(2) and the Procedure, the differences are more significant. First, a close reading of *Madden* reveals that the court did not reject (or affirm) the taxpayer's position that the executor could artificially increase the gross estate under Treas. Reg. § 20.2041-1(a)(2). Rather, the court held that, regardless of how much of the joint property in question was properly included in the gross estate for estate tax purposes, it was not "required" to be included in the gross estate for *income* tax purposes within the meaning of section 1014(b)(9) of the Code. *Madden* is not inconsistent, therefore, with the view that Treas. Reg. § 20.2041-1(a)(2) in

effect enables estates to increase the size of their gross estates if they wish. The court merely denied that there is an income tax benefit of doing so. *But cf.* General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals ("Greenbook") (April 2013) at 140-41 (proposing to require income and estate tax valuation consistency).

Second, it is at best unclear whether Treas. Reg. § 20.2041-1(a)(2) does create the equivalent of an estate tax election. The QTIP election, by contrast, is a statutorily-created tax election that can be used to increase or decrease the gross estate. Indeed, Treasury Regulations have long recognized the validity of partial QTIP elections for that very purpose. Thus, while the IRS had strong grounds for rejecting the existence of the apparent tax option in *Madden*, it would have no grounds for denying taxpayers the option of making a QTIP election.

Finally, regardless of who has the burden of establishing the extent to which jointly held property is excluded from the gross estate, section 2040 of the Code clearly provides that it can be so excluded. To the extent the IRS takes it upon itself to show that joint property should be excluded from the gross estate, therefore, the IRS is at least, as *Madden* held, carrying out a mandate from Congress. The enforcement policy announced in the Procedure, by contrast, goes against the Code's QTIP provisions. Unlike the IRS's efforts in *Madden* to show that joint property was not properly included in the gross estate, therefore, any effort by the IRS to show that property is within the scope of the Procedure would be legally meaningless. The IRS, as discussed, may adopt a policy of disregarding the Code, but if a taxpayer wants the Code to be properly applied, he or she can have it properly applied.

0 Comments Posted re. *Bramwell, Dillon & Mullen: Relax, Rev. Proc. 2001-38 Cannot Be Used Against Taxpayers, Or Why QTIP Planning is Safer than Some Might Think*

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