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March 23, 2012

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Acting Assistant Secretary (Tax Policy)
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Re: Report on "Portability" of Unused Estate Tax Exclusion

Ladies and Gentlemen:

We write to submit comments on possible modifications to the "portability" of the first-to-die spouse's unused estate tax exclusion to the surviving spouse, both under current law and pending legislation.

By way of background, Congress amended section 2010 to increase the exemption of a surviving spouse by the unused portion (if any) of the

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exemption of the deceased spouse. Commonly known as the "portability" rule, the right of the surviving spouse to inherit the unused estate tax exclusion of the deceased spouse will sunset at the end of this year unless it is extended by future legislation. Bills have already been introduced in Congress to extend the portability rule. In addition, the Obama Administration's Fiscal Year 2013 budget proposes to make it permanent.

We express no view on whether the portability rules should be extended. If Congress chooses to do so, however, we recommend that it modify the current statutory language to better reflect the policy objectives it sought to achieve when it first amended Section 2010(c) in 2010.

As described in the report, current law permits the estate of an individual who has made no lifetime taxable gifts to avoid estate taxation on the first $5 million of assets, as adjusted for inflation. If the individual survived his or her spouse, the estate of the individual is also permitted to claim any unused portion of the spouse's $5 million exclusion. For example, if the first-to-die spouse had made no lifetime gifts and left the entire estate to the surviving spouse, all of the assets would pass tax free to the surviving spouse by reason of the marital deduction without any use of the available exclusion. Under these conditions, the estate of the surviving spouse would inherit the benefit of the $5 million of unused exclusion.

Couples who engage in basic estate planning may achieve the same benefit without relying on the portability rules. With the assistance of an estate planner, for example, they may bequeath the additional $5 million exclusion amount to a "by-pass" trust for the surviving spouse and children, leaving only the assets that remain to the surviving spouse. To do so, however, each spouse must have assets titled in his or her own name in an amount sufficient to fund the by-pass trust with the full exclusion amount. But many married couples do not wish to divide up the legal ownership of their assets during the marriage, often because they view themselves as a single economic unit.

The rationale for permitting such couples to "inherit" his or her deceased spouse's unused exclusion under the portability rules is to provide the same benefit enjoyed by more sophisticated couples who engage in basic estate planning, but without requiring them to retitle their assets and to create trust vehicles of this kind.

As described more fully in the report, if Congress chooses to extend the current portability statute, we recommend several changes to the existing statute, including changes that:

- clarify that an individual may *only* inherit the unused estate tax exclusion of his or her deceased spouse, not the unused exclusion of the former spouse of such deceased spouse; and

- clarify that a gift by an individual that is not subject to gift tax by virtue of an exclusion amount inherited from the individual's deceased spouse will not become subject to "retroactive" estate tax if the individual later remarries a second spouse with a smaller exclusion amount.

We also provide a number of other comments and technical recommendations.

We appreciate your consideration of our recommendations.

Respectfully submitted,

Andrew W. Needham
Chair

Enclosure

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