Deceased Spousal Unused Exclusion

Cross References

- *Estate of Billy S. Rowland,* T.C. Memo. 2025-76

A decedent's estate is subject to estate tax under IRC section 2001(a). This tax is based on the sum of the taxable value of the estate plus the amount of taxable gifts made by the decedent during his or her lifetime. A decedent's taxable estate is determined by reducing the value of the gross estate by the values of permissible deductions. This amount is then reduced by the unified credit against estate tax under IRC section 2010. This credit is equal to the sum of the basic exclusion amount ($11,180,000 for 2018, the tax year at issue in this case), plus, in the case of a surviving spouse, the deceased spousal unused exclusion (DSUE) amount.

In general, estates of decedents survived by a spouse may elect to pass any of the decedent's unused estate tax exclusion to the surviving spouse. The DSUE amount is the lesser of the basic exclusion amount or the excess of:
- The applicable exclusion amount of the last such deceased spouse of such surviving spouse, over
- The amount with respect to which the tentative tax is determined on the estate of such deceased spouse.

The DSUE amount may not be claimed by a surviving spouse unless:
1) The executor of the estate of the deceased spouse files an estate tax return on which such amount is computed,
2) That executor makes an election on the deceased spouse's estate tax return, and
3) Such return is timely filed.

The decedent's spouse in this case, Fay Rowland (Fay's Estate) died on April 8, 2016. The executor of that estate received an automatic extension to file her estate tax return, which moved the due date of the return to July 8, 2017. The executor did not file the return by this extended deadline. He ultimately mailed the return to the IRS on December 29, 2017, which the IRS received on January 2, 2018.

The header of the first page of Fay's Estate return displayed the phrase "FILED PURSUANT TO REV PROC 2017-34 TO ELECT PORT SEC 2010(c)(5)(A)." The DSUE calculated on Fay's Estate return equals $3,712,562.

After the DSUE calculation, the Form 706 schedules listing various assets featured the same stock text that reads:

> *"Note. If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and the Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions and Reg. section 20.2010-2T(a)(7)(ii) for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns."*

Fay's Estate return (Form 706) listed assets including real property, shares of stock, a note receivable, and various bank accounts. The return did not include any information as to the fair market value of those assets but instead estimated the gross value of the estate.

On January 24, 2018, Billy Rowland died. His estate return (Billy's Estate) was timely filed which included the DSUE of $3,712,562 from Fay's Estate return. Billy's Estate return also included his basic exclusion amount of $11,180,000, resulting in an applicable exclusion of $14,892,562. Using this exclusion amount, his net estate tax equaled $4,477,555.

The IRS denied the DSUE claiming the portability election on Fay's Estate return was not timely filed. Nor did it satisfy the safe harbor set forth in Rev. Proc. 2017-34 because (1) it did not provide complete descriptions or valuation information for the property making up the estate return, and (2) it was ineligible to estimate the value of the property.

Specifically, the IRS claimed that Fay Rowland's will provided for certain non-marital bequests of property to various individuals and a trust, which should have been itemized and valued on her estate return. Because the return merely estimated the gross value of the estate, it did not comply with the regulations.

The tax court stated that the regulations for the valuation reporting requirements are relaxed, but with respect to only marital and charitable deduction property. The estate return may estimate the value of those assets but must provide detailed reporting for assets that did not pass to either the surviving spouse or to charity. Fay's Estate return made no attempt to identify and distinguish marital and charitable deduction property and instead incorrectly applied the relaxed treatment across the board.

Billy's Estate argued that Fay's Estate return substantially complied with the requirements to make a valid DSUE election by filing an estate tax return that reported the information necessary to determine that no estate tax is due and an estate tax exemption amount remains available. According to Billy's Estate, the regulations and the Form 706 instructions are unclear at best and that any errors on the return do not defeat the validity of the return or the DSUE election. Billy's Estate concluded that the IRS suffered no harm because Fay's Estate reported the DSUE amount, component gross estate, amount distributed to each beneficiary, and total deductions, which should have been sufficient for the IRS to verify the DSUE amount.

The tax court was unconvinced that Fay's Estate return did all that was reasonably possible to comply with the regulations. A DSUE election must satisfy the requirements of the Form 706 instructions, which direct an estate to list items of property by schedule and provide a fair market value of each item of property according to methodology provided in the instructions. The rigors of this reporting regime are only relaxed for marital and charitable deduction property (which would not be part of the taxable estate) and only where such property would not relate to, affect, or be needed to determine, the value of non-marital or charitable deduction property.

The court ruled that because Fay's Estate failed to make a timely DSUE election under Rev. Proc. 2017-34, Billy's Estate cannot use the DSUE amount to reduce its taxable estate.

