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COMPLIANCE INSIGHT BRIEF

Portability and Options for Using GST exemption

Why a Missed Form 706 Filing Can Permanently Eliminate Valuable Estate Tax Benefits for Surviving Spouses and Future Generations

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Executive Summary

The portability election allows a surviving spouse to preserve a deceased spouse's unused estate and gift tax exemption (DSUE), but only if **Form 706 is filed on time**. Many families mistakenly assume no filing is necessary when no estate tax is due, resulting in the permanent loss of valuable tax benefits. While limited late-filing relief may be available, the GST exemption is not portable and requires separate planning, including proper GST allocations and, where applicable, a Reverse QTIP election.

Key Takeaway: A timely Form 706 should be viewed as an essential estate planning tool, not just a tax return. Filing a 706 preserves the DSUE, protects future tax savings for the surviving spouse, and helps prevent the permanent loss of non-portable GST exemption benefits.

The "Accidental Waiver" Risk: Permanent Loss of the DSUE

Under **Internal Revenue Code** § 2010(c)(5), the estate of a deceased taxpayer can transfer its unused federal estate and gift tax exemption to a surviving spouse—a mechanism known as **portability**. The transferred amount, referred to as the **Deceased Spousal Unused Exclusion (DSUE)**, provides the surviving spouse with a significant tax shield against future lifetime gifts or their own ultimate estate tax bill.

However, portability is **never automatic**. Preserving this valuable tax credit requires an affirmative election that carries a steep trap for unwary executors and families.

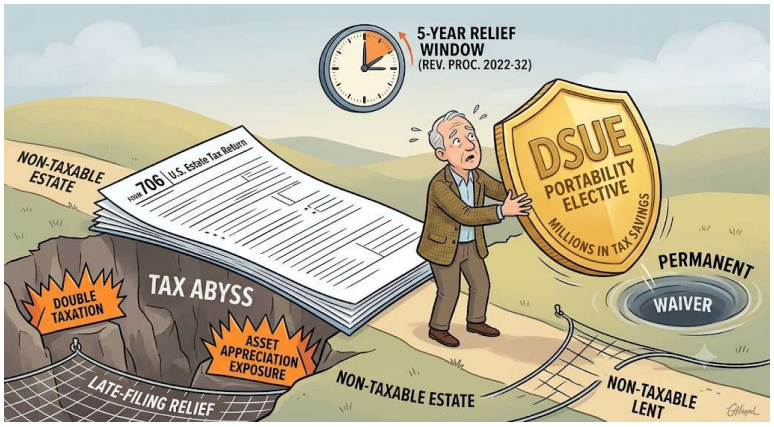
The Mechanism of Accidental Waiver

To elect portability, the executor of the deceased spouse's estate must file **Form 706 (U.S.**

Estate and Generation-Skipping Transfer Tax Return).

If the deceased spouse's gross estate falls below the statutory threshold requiring a return under IRC § 6018(a), there is **no statutory requirement** to file Form 706 for estate tax payment purposes. As a result, surviving spouses and family members frequently make a costly assumption: *"No estate tax is due, so we don't need to file anything."*

Failing to file Form 706 within the required filing window (including extensions) constitutes a **permanent waiver** of the DSUE. Once the deadline passes and statutory relief options expire, the unused exclusion vanishes—leaving the surviving spouse with only their individual basic exclusion amount.



The Long-Term Financial Impact

The loss of the DSUE often goes unnoticed at the first spouse's death because no tax is owed. The real financial damage materializes years or decades later upon the death of the surviving spouse:

- **Asset Appreciation Exposure:** Assets retained by the surviving spouse may grow significantly over time, pushing their total estate value past their individual exemption threshold.
- **Double Taxation Burden:** Without the DSUE shield, the appreciation—and the original transferred assets—become subject to federal estate tax at a flat rate of 40%.

Relief Windows (Rev. Proc. 2022-32)

Fortunately, for non-taxable estates that were not otherwise required to file Form 706 under § 6018(a), **Revenue Procedure 2022-32** offers a simplified, automatic extension. It allows qualifying estates to file a late Form 706 solely to elect portability **up to five years after the decedent's date of death** without paying a user fee.

Critical Warning: The GST Exemption Is NOT Portable

It is vital to distinguish between the basic estate tax exclusion and the Generation-Skipping Transfer (GST) tax exemption. **Unlike the DSUE, the GST tax exemption is strictly non-**

portable. Filing a Form 706 solely to elect DSUE portability does *not* transfer any unused GST exemption to the surviving spouse.

If the first spouse's GST exemption is not affirmatively allocated on a timely filed Form 706 (Schedule R), it cannot be saved for later use by the surviving spouse.

Preserving the First Spouse's GST Exemption via a "Reverse QTIP"

When assets pass to a surviving spouse via a Qualified Terminable Interest Property (QTIP) marital trust, the surviving spouse typically becomes the "transferor" for GST tax purposes upon their death, forcing the family to rely solely on the survivor's GST exemption.

To avoid forfeiting the deceased spouse's GST exemption:

- The executor must make a **Reverse QTIP Election** under IRC § 2652(a)(3) on Schedule R of Form 706.
- This election treats the *deceased spouse* as the transferor for GST tax purposes while retaining the marital deduction for estate tax purposes.
- The executor can then allocate the deceased spouse's non-portable GST exemption to the QTIP trust, sheltering multi-generational trust distributions from the flat 40% GST tax when the surviving spouse eventually passes away.

Without this deliberate coordination on Form 706, the deceased spouse's GST exemption is permanently lost—regardless of how much DSUE is successfully ported.

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