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Legacy Planning, Once Removed

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Once Removed: Making Use of the Deceased Spouse's Exemption Amount, and Lessons (and Warnings) from the Rowland Case

Episode 47 Summary

Under current law, individuals have a high estate tax exemption – but importantly, if one spouse dies without using all of his or her remaining exemption, steps can be taken to allow the surviving spouse to pick up and use a deceased spouse's exemption, or "Deceased Spouse's Unused Exclusion", or "DSUE", through a process call portability. This can result in significant tax savings upon the surviving spouse's death. But the election for "portability" is not automatic – there are various steps that must be taken, and other nuances to consider in electing portability. The recent case of *Rowland v. Commissioner* reminds us of the potential pitfalls, and of the importance of following the applicable requirements in order to take advantage of this important election. This case also serves as a reminder to review the estate plan to make sure that the plan properly takes advantage of portability and recognizes the limits of portability, and that processes are in place so that upon one spouse's death, due consideration is given to whether to elect portability.

Transcript:

(0:00):

Hello and welcome back. I'm Steve Murphy, a trust and estates attorney with McGuireWoods LLP. And this is Legacy Planning, Once Removed – my podcast on taxes, trusts, legacy, family, and everything else on my clients' minds.

For those of you who are returning again, welcome back. And for those of you who are new to the podcast, let me say again, welcome.

On this podcast, we try to help people with estate planning, but also with legacy planning generally, how to act and how to put in place structures and to create and solidify this legacy, both during life and after your passing.

And because we think so much about this approach to your legacy, we have a tagline here. We say: Walk like you leave footprints.

So, here's something that's been on my clients' minds and that's been in the news is state and gift tax exemption.

And there's another concept that's been in the news about how spouses can double up their exemptions after the death of one spouse.

It's a concept called portability, where a deceased spouse's exemption can be ported over to the surviving spouse.

And that deceased spouse's exemption is called the deceased spouse's unused exclusion or DSUE amount. I'm sorry, that's just another terrible acronym, but we've got to live with it.

We've talked a lot about that estate and gift tax exemption recently, and we've especially talked about that exemption related to updates in tax law.

Now, we hope that this concept of portability will be here to stay even if the law changes in the future.

But under current law, each individual has an estate and gift tax exemption of \$10 million index for inflation.

I'm recording this in 2025, so that amount is currently \$13.99 million, and as of 2026, it will be \$15 million per person.

(02:11):

And on other episodes I've talked about how that exemption works, and I've reminded you that that exemption is a starting point. If you make taxable gifts during life, then that applies towards that exemption and reduces the remaining exemption you would have upon death.

But as we talk about that exemption, we also talk about how spouses can double up and use their total estate tax exemptions.

Think about how powerful that can be.

This means that after one spouse's death, the surviving spouse can have his or her own exemption of let's say \$15 million as of 2026, but also the deceased spouse's remaining exemption—the DSUE amount—of maybe another \$15 million if the spouse died in 2026.

That means that this surviving spouse as of 2026, could pass \$30 million during life and upon death without any gift or estate tax.

Now, there are lots of nuances to this concept of portability; for example, of whether it's best for the deceased spouse's plan to use his or her exemption by funding trusts that won't be included in the surviving spouse's estate for state tax purposes.

But those strategic questions maybe are something for another episode.

We sometimes call this portability planning versus exemption or credit shelter planning.

And there are nuances too to this of how the DSU amount is applied to gifts made by the surviving spouse. As a reminder, GST tax exemption generation skipping transfer tax exemption is not portable between spouses.

So, if a client wants to make use of that GST tax exemption and shelter assets from a state tax, even at the death of their children or further descendants, then they should consider other planning.

And by the way, there are also some states that have a state estate tax, and so you might need to consider whether portability is available for that state too.

(04:22):

So again, lots of nuances to this concept of portability, but putting those nuances aside importantly, and here's the key issue for this episode, porting over the deceased spouse's exemption amount is not automatic. Steps have to be taken to get the benefit of this important tax election.

So, how is it done?

Well, it's done by filing an estate tax return.

That federal return is called Form 706 after the death of the first spouse. And that estate tax return would make the election for portability. And the person who files that return is the deceased spouse's executor or a similar person.

It's not necessarily the surviving spouse individually, although in many plans the surviving spouse is named as executor.

So, this issue is critical, this step, this filing of the estate tax return and this election must be taken in order to have the surviving spouse make use of that exemption.

Now another question is: When is this return due?

Generally, if the deceased spouse's assets were over the exemption amount and if an estate tax return is required for the deceased spouse, then that return must be filed within the normal due date for the return.

That's typically nine months of that person's death. And there's an automatic six-month extension available for filing if properly filed for.

But if the deceased spouse's assets were under the exemption amount and if no estate tax return is otherwise required, then this return can actually be filed up to five years after the deceased spouse's death.

(06:11):

And we'll come back to that issue of timing.

In this episode, I want to talk about a recent case that highlights some of these important factors.

It's called *Rowland v. Commissioner*.

And this case has been covered by the national media.

In that case, the wife died in 2016; the wife's executor filed an estate tax return.

The case talks more about the timing issue, but that return ostensibly would allow her surviving spouse to pick up and use her remaining estate tax exemption.

And then the husband died in 2018.

The problem though was that the IRS argued that the wife's estate tax return wasn't complete.

There are specific rules about how to report assets on that estate tax return, and the IRS argued that the wife's estate tax return didn't report the values properly and instead it provided general estimates.

Now, general estimates can often be used, but really only if the assets are passing directly to the surviving spouse or to charity or if you meet certain other exceptions.

But in this case, some assets of the wife's estate went to others.

And so, the IRS argued that information about the fair market value needed to be included.

And because it wasn't, the tax court concluded that this means that the wife's estate tax return wasn't complete, and so the husband didn't get to port over and use her remaining estate tax exemption.

And this costs the husband's estate significant estate tax.

(07:45):

You know, on these episodes, I like to leave with a few thought exercises or closing questions. And I think I've got a couple of comments here about portability and the *Roland* case.

You know, first there's this question after one spouse's death, should the deceased spouse's estate file for portability, it might require a filing that's not otherwise required.

And I think that the surviving spouse and other interested parties should consider various factors like, do we anticipate that the surviving spouse's assets would be over the exemption amount at the surviving spouse's death?

Are there any assets the surviving spouse might have that might spike in value?

Are we worried about the surviving spouse's exemption going down if law changes in the future?

And importantly, how much will this estate tax return cost?

Again, considering the lessons of *Roland* that if this return is to be filed properly, you have to follow very specific rules.

And then secondly, some clients sometimes ask if they could put off this question of filing for a few years. After all, in many cases, they might get five years before they have to file the return.

But generally, I don't like that approach. I don't like putting off this decision.

I worry that years might pass that a client might forget, or years later, filing this return might be much more complicated because we've got to go back and reconstruct what the assets look like now.

And there's a related question, should the clients include portability as part of their planning?

(09:21):

Should they deliberately choose a plan that's very flexible and passes all the assets to the surviving spouse and then hope that the surviving spouse will be able to use the deceased spouse's exemption amount?

And again, this might give us opportunities to really simplify the plan and that might even simplify the estate tax return. Again, see the lessons from *Roland*.

And lastly, I actually worry about a surprising and maybe ironic pitfall of relying on portability.

On this podcast, we talk a lot about opportunities to simplify the estate plan.

And way back in episode two, we talked about beneficiary designations and joint ownership.

And undercurrent tax laws, I've summarized spouses might be able to leave all their assets to the surviving spouse outright in a very simple way, and there might not be any tax sort of costs to that structure.

But here's the potential surprising or ironic pitfall.

That plan of passing all the assets to the surviving spouse might be so simple and so efficient there might not be any need to consult with any legal or tax advisors, but then in that case, there wouldn't be an opportunity for those legal and tax advisors to remind the surviving spouse and the family about things like portability.

So, perhaps the takeaway here is generally to consider how portability plays into your plan or into your client's plans, for the professionals who listen to this podcast.

And make sure that whatever the plan is, that the plan has considered this concept of portability and to make sure processes are in place to make sure that upon one spouse's death this important decision can be considered and made.

I'm Steve Murphy and this has been Legacy Planning, Once Removed my podcast on thoughtful estate planning.

Thanks for listening.

And until next time: Walk like you leave footprints.