Surviving Spouse Wins the DSUE Lottery, But Must Pay for the Ticket

by:

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In what appears to be a case of first impression nationally, *In re Matter of the Estate of Anne S. Vose v. Lee*, ___ P.3d __, 2017 Ok. 3, 2017 WL 167587 (Ok. S. Ct. 2017), the Supreme Court of Oklahoma affirmed the District Court's decision to require the personal representative of a decedent's estate to make a portability election (on a timely filed Federal estate tax return (Form 706)), notwithstanding the fact that there was a prenuptial agreement; however, the surviving spouse was required to pay the costs of filing the Form 706 and was also required to provide any information the personal representative needed to properly prepare the return.

Background. On May 24, 2006, the decedent and her fiancé entered into an antenuptial agreement (the "Prenup"). Under the Prenup, the couple each waived his or her individual right to be the personal representative of the other's estate. It also appears that the fiancé, who became the surviving spouse, waived his right to any distributions of the decedent's estate (whether as a beneficiary under the decedent's Will, as an intestate heir, or by any spousal rights afforded under applicable state law (Oklahoma law)). Nine days later, the couple married.

Ten years later, the decedent died. Three days later, the decedent's son applied to the district court to admit the Decedent's 1995 will to probate (the "1995 Will"), and requested that he and his sister be appointed co-personal representatives of the decedent's estate. Four days later,

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the surviving spouse filed his own petition claiming that the decedent died intestate, seeking to be sole personal representative.

Not too long after the spouse's petition, the decedent's son withdrew his petition to be appointed the personal representative, based on the surviving spouse's representations that the 1995 Will had been revoked. Additionally, at the time of the withdrawal, the decedent's son apparently did not know the terms of the Prenup (i.e., the surviving spouse waived his right to be the personal representative of the decedent's estate).

Within a month, of the surviving spouse's petition, the Oklahoma District Court held a hearing and appointed him as personal representative of the decedent's estate. Apparently, the Prenup was not presented to the district court at that hearing. However, soon after the appointment, the Prenup was presented to the lower court, and an agreed upon order provided that the surviving spouse would be removed and the son became the new personal representative.

About 6 ½ months after the decedent's death, the surviving spouse filed "*Application to Compel Administrator to Timely Prepare and File Federal Estate Tax Return for the Purposes of Irrevocable Electing Portability of Decedent's Deceased Spousal Unused Exclusion Amount ('DSUE Application').*" 2017 WL 167587 at *1. Apparently, the surviving spouse believed that the son would not make a timely-filed portability election, and thus filed this application.

About 7 ½ months after the decedent's death, the district court heard the application, and two months later (about 9 ½ months after the decedent's death), the lower court entered its order "*effectively granting [the surviving spouse's] DSUE Application.*" 2017 WL 167587 at *2. Among other things, it appears that the district court:

(1) denied the surviving spouse's request for a special administrator to file the Form 706,

(2) ordered the decedent's son to provide the surviving spouse with a list of records that would be needed to prepare the Form 706 properly;

(3) ordered the surviving spouse to provide the records that the decedent's son was ordered to request;

(4) ordered that if the DSUE amount is available, that the decedent's son, as personal representative, would have to prepare a Form 706, where portability would be elected, and provide a draft to the surviving spouse at least 60 day before the Form 706 was required to be filed (for the surviving spouse's review); and

(5) ordered the surviving spouse to pay for "the filing" of the Form 706 if the DSUE was available. Presumably, the court meant that the surviving spouse would pay for all of the costs associated with the preparation and filing of the Form 706 (since there is no "filing fee" per se).

There are a couple of observations worth noting at this point in the case. First, it is unclear if the estate would have been required to file an estate tax return, absent portability. Second, it is unclear that an extension to file the Form 706 was timely filed on or before October 22, 2016 (i.e., nine months after the decedent's death). We presume that this was done, since it otherwise would be impossible to file a timely Form 706.

The next day, the decedent's son appealed the district court's decision. Under a number of motions and procedural issues, the appeal was taken up by the Oklahoma's Supreme Court to consider the following issues:

(1) the district court lacked subject matter jurisdiction;

(2) the order regarding the DSUE election is preempted by Federal law;

(3) the surviving spouse lacked standing; and

(4) the lower court's order violated the Prenup.

Oklahoma Supreme Court Agrees to Compel Portability Election

The Oklahoma Supreme Court (the "Court") began its opinion by discussing their standard of review, noting that probate proceedings are equitable in nature, and as a matter of law that the lower court's decision is presumed to be correct unless it is found to be clearly contrary to the weight of the evidence or some governing principle of law. Further, the lower court's equity decree may be affirmed if it is sustainable on "any rational theory" and the ultimate conclusion in the lower court is "legally correct." 2017 WL 167587 at *2.

The Court went on to explain the history of portability (i.e., its enactment), and the details about the DSUE amount and other aspects of the election, including who is required to make the election under the Code and the Treasury Regulations, and when the election is to be made. The Court reviewed the Preamble of the final Portability Regulations (80 Fed Reg 34,379-01 (June 16, 2015)) that summarized some of the comments and explanations of revisions regarding why an executor and not a surviving spouse can make the election.

The Court addressed the son's arguments that the district court did not have subject matter jurisdiction and because of the preemption doctrine the district court's decision is not binding. With regard to the first issue, the Court held that the district court had subject matter jurisdiction. The Court explained that under Oklahoma statutes, "*[t]he district court sitting in probate has the power to order and regulate all distribution of property or estates of deceased persons*[,] *... has the power to cause estate taxes to be equitably apportioned and collected*[,] *... has authority to make all such orders as may be necessary to exercise the powers conferred upon it*[,] *... and further authority to determine rights as to estate property as to all persons and entities.*" 2017 WL 167587 at *5. The Court concluded that, based on such authority, the district court could "*determine the applicability of federal estate tax provisions to Decedent's estate and determine what interest, if any, [the surviving spouse] may have in the DSUE* [amount]." 2017 WL 167587 at *5.

With regard to the preemption issue, the Oklahoma Court analyzed the preemption doctrine and the Federal cases that were pertinent to the issue. The Court focused on the son's assertion that because he is forced to make the election by a state court, where the election is discretionary under the Federal statute (i.e., IRC § 2010(c)(5)(A)), that such state courts actions "*thwart the objectives and purposes of Congress.*" 2017 WL 167587 at *7. The Court cited to Justice Sotomayor's concurring opinion in *Williamson v. Mazda Motor of America, Inc,*, 562 U.S. 323, 336, 131 S.Ct. 1131, 1139, 179 L.ed.2d 75 (2011), reasoning as follows:

> *Absent an expressed Congressional purpose served by the DSUE election choice, the fact that the choice may be restricted on state law grounds does not implicate*

preemption. An examination of the relevant provisions does not reveal such a purpose.

2017 WL 167587 at *8.

The Court continued its reasoning stating that,

In fact, the IRS leaves open the possibility that a state court could appoint the surviving spouse as the administrator for the limited purpose of making the election, thereby depriving the primary administrator of the ability to make the election, either to comply with an antenuptial agreement or on some other grounds.

2017 WL 167587 at *8.

Having disposed of the subject matter jurisdiction and preemption arguments, the Court then addressed the son's objection that the surviving spouse lacked standing. Analyzing Oklahoma's probate statute and case law, the Court noted, *"[s]tanding in a probate proceeding generally requires a pecuniary interest in the estate of the deceased*." 2017 WL 167587 at *8. The son argued that since the surviving spouse had waived his rights to "a distributive share under Paragraph 6.1(H) of the antenuptial agreement," he has no interest in the estate; therefore, he could have no standing. 2017 WL 167587 at *8

Paragraph 6.1H of the Prenup provided specifically that:

6.1 Waiver: Except as otherwise specifically provided in this Agreement, [the fiancé] and [Decedent] mutually waive, discharge, and release each other to the fullest extent lawfully possible from any and all claims and rights, actual, inchoate, vested, or contingent, in law or equity, which he or she may aquire [sic] in or to the separate property, income, assets and liabilities of the other by reason of their marriage, under the laws of any state or the United States, including but not limited to:

* * *

H. The right to a distributive share in the estate of the other should he or she die intestate pursuant to Title 84 Okla. Stat., 213, or otherwise.

2017 WL 167587 at *10, note 9.

The Court acknowledges that the surviving spouse did not have a stake in the estate or a right to an intestate share under the Prenup, but it then stated that,

Title 26 U.S.C.A. 2010 grants [the surviving spouse] ***a potential interest in a part of Decedent's estate*** *under the control of [the son] as the administrator.* [emphasis added]

2017 WL 167587 at *9.

Analysis of Standing Issue

It is unclear how the Court concluded that making the election creates a "potential interest in [the decedent's] probate estate." The Court may have adopted a novel legal theory that the portability election does not create an asset in the decedent's estate, but rather, that it allows an amount equivalent to a tax credit (that would otherwise be unused or wasted by the decedent), to be used only by the surviving spouse; thus, creating a "pecuniary interest". But, recall, the tax credit equivalent amount (i.e., the DSUE amount) has no value to the decedent's estate, *per se*. Prior to the enactment of portability, if the decedent did not fully use her applicable credit, then the otherwise unused equivalent amount was lost (i.e., it was a "use it, or lose it proposition"). Since portability's inception, the DSUE amount has yet to be recognized as an asset of the probate estate of any state (to the best of the authors' knowledge). For state law purposes, one does not have to report this otherwise wasted tax credit as an asset of the estate, in fact, it does not appear under Oklahoma law that the DSUE amount is an asset of the estate (prior to the issuance of this opinion).

The Court continued,

> *[The surviving spouse] may have a pecuniary interest as the surviving spouse in the portability of the DSUE, independent of his ability to take as an heir. The portability election would result in an increase to [the surviving spouse's] own applicable exclusion amount pursuant to 26 U.S.C.A. 2010(c)(2).*

2017 WL 167587 at *9.

The Court appears to make the DSUE amount the equivalent of an asset – a pecuniary interest – based on the impact that the ported exemption would have on the surviving spouse, but not considering whether the DSUE amount is truly an asset of the decedent's estate. In this regard, the Court stated:

> *If reliance is not placed on any specific statute authorizing invocation of the judicial process, the question of standing depends upon whether the party has alleged a personal stake in the outcome. Ind. School Dist. No. 9 of Tulsa County v. Glass, 1982 OK 2, 8, 639 P.2d 1233. [The surviving spouse] has an obvious interest in the portability of the DSUE. The determinative question, then, is not whether the antenuptial agreement between [the surviving spouse] and Decedent bars him from being a legal heir, but whether the agreement bars him from claiming any interest in the portability of the DSUE.*

2017 WL 167587 at *9.

Perhaps it is the Court's earlier language in *Glass* that led it to hold that the surviving spouse has standing. If the standard is whether the surviving spouse has a personal stake in the outcome, then certainly the surviving spouse had standing, because without the election, he would lose the potential benefit of the DSUE amount.

Had the Court stopped there, one could argue that they had good reasoning and made a good argument. But, they did not … they went on, stating as follows:

> *The determinative question, then, is not whether the antenuptial agreement between [the surviving spouse] and Decedent bars him from being a legal heir, but whether the agreement bars him from claiming any interest in the portability of the DSUE.*

2017 WL 167587 at *9. The Court then, under the caption, "***B. [Surviving Spouse's] Interest in the DSUE is not barred by the antenuptial agreement he entered into with Decedent***", stated that antenuptial agreements are contracts where parties can waive rights to property or in other ways alter right related to marriage, statutory or otherwise. Contractual modification of applicable law is ineffective unless the power to do so is expressly exercised. An adjustment of rights contrary to law must be clearly expressed in the agreement, and the person waiving a right must know (actually or constructively) of the right he or she intends to waive and in fact waives such right.

The Court may have struggled with the following emphasized language quoted earlier from Section 6.1 of the Prenup:

> *Except as otherwise specifically provided in this Agreement, [the surviving spouse] and [Decedent] mutually waive, discharge, and release each other to the fullest extent lawfully possible from any and all claims and rights, actual, inchoate, vested, or contingent, in law or equity,* ***which he or she may aquire [sic] in or to the separate property, income, assets and liabilities of the other by reason of their marriage****, under the laws of any state or the United States, …*

2017 WL 167587 at *10, note 9. Arguably, the waiver language deals with assets that could possibly come into existence in the future, akin to one spouse buying a winning lottery ticket. The Prenup language means that the other spouse would have not any have any interest in the lottery winnings, because it is anticipated that future assets are excluded. The Court, however, wants to distinguish this particular pecuniary interest, from lottery winnings, by example.

The Court stated that "[t]*he portable DSUE is not simple property acquired by one party over the course of the marriage according to existing laws in effect when the agreement was made.*" 2017 WL 167587 at *9. Using the term "simple property", the Court states implicitly that the DSUE amount is special. The Court stated that, because portability did not come to the Code before the Prenup existed, covering it by the waiver was impossible.

The Court then stated in a rather cursory manner that the parties intended to waive all of their "*martial rights under the law as it existed at the time*." 2017 WL 167587 at *9. The Court goes on to state that, "[*h*]*owever, the agreement is silent as to portability because the change in law was* ***unforeseeable*** *to the parties when the contract was made*." [emphasis added] 2017 WL 167587 at *9.

Analysis

One could as easily view the Prenup as waiving all future rights, as well as all rights then in existence. The Premup did state that it covered all rights "*which [a party] may aquire* [sic] *in or to separate property … of the other. . . ., including but not limited to …*" 2017 WL 167587 at *10. The words "may acquire" and the nonexclusive language "*including but not limited to …*" seems intended to incorporate future, unknown, and arguably, unforeseeable interests. This Court,

however, says that this was not a simple interest, but rather a special unforeseeable Federal interest. Thus, the Court held that it would have been impossible for one to know what the parties were waiving when they signed the contract.

One may note that portability was first discussed in a Congressional publication in 2004 and the first bill proposed it in in 2006. Thus, the Court is wrong to conclude that portability was unforeseeable in 2006. If such future laws cannot be covered in a premarital agreement, one should plan on amending such agreements after marriage to address new rights, such as portability. This sounds easy, but most practitioners who have experience in drafting pre-marital and post-marital agreements would suggest that such amendments are often simply not practical and revising the existing agreement may raise more problems than it solves.

It is difficult to determine how *Estate of Vose* would apply to a premarital agreement entered into after 2010, when portability first came into the law, and before 2012, when it was made permanent. It is not certain that similar waiver language in a later premarital agreement would preclude the surviving spouse having standing to force a portability election.

The Court's decision leaves much to be considered. First, it may have opened a Pandora's box for those pre-marital agreements that wish to cover potentially unforeseen events, where the parties are willing to risk that unforeseen events may be contrary to their best future interests. Addressing future changes in circumstances is one of the things a pre-marital agreement is supposed to do. Pre-marital agreements are supposed to establish rights of parties for unforeseen events in the future.

Second, the Court held that the lower court did not err when it ordered the decedent's son to file an estate tax return and elect portability. The Court emphasized that the personal

representative has the duty to "*preserve the estate … from damage waste and injury.*" 2017 WL 167587 at *10. This is the rule generally, and it seems appropriate for the Court, recognizing that the DSUE amount is valuable only to the surviving spouse, to recognize that the personal representative "s*hould be allowed to demand consideration from [the surviving spouse] in exchange for making the election."* 2017 WL 167587 at *10.

Third, one may disagree that the DSUE amount is really an "asset of the estate." It does not benefit the estate, but it is certainly a commodity for which someone will be willing to pay. Remunerating the estate for expenditures to make the election cannot realistically be viewed as an asset, because the estate's net value did not increase whether an election was made, or not.

The surviving spouse's agreement to pay any costs associated with preparing the necessary return appears to have helped persuade the Court to require that the election be made. Effectively, the estate was not harmed, because the surviving spouse paid the costs to make the election, and without the election, the surviving spouse would otherwise lose a benefit.

In the last paragraph of the Court's opinion, it noted that the district court "*evidently determined that any risk to the estate was outweighed by [the son's] fiduciary obligation to preserve assets of the estate and safeguard [the surviving spouse's] interest in the DSUE*." 2017 WL 167587 at *10. The Court apparently felt that the lower court's decision was not contrary to the clear weight of the evidence or law.

The Court reached a conclusion and made some statements that may be of concern for the future. The Court appears to believe that the DSUE amount is an estate asset. It also appears to believe that, because it is an asset, the personal representative has the duty to preserve it. Implicitly, if the surviving spouse agrees to pay for the costs associated with making the election,

that should leave the personal representative with no choice but to file a timely return and make the election. If the personal representative refuses to make the election, he or she may be in breach of fiduciary duty.

This case may not have resolved many of the questions that we face when examining the right to a portability election that is not expressly addressed in the governing instruments.[2] In fact, one wonders whether this case may have actually created new law.

Other courts reading this decision may not understand that the DSUE amount is really not an asset of the decedent's estate, but rather is a potential benefit that the surviving spouse (and only the surviving spouse) can obtain, and then only if the election is made. If courts view the DSUE amount as an asset, then the personal representative should be able to negotiate for compensation from the surviving spouse in an amount more equal to the value of the asset, rather than the mere cost of making the election. Moreover, this opinion renders existing premarital agreements that appear to waive all rights uncertain with respect to portability, unless the agreement was entered into after portability was made permanent in 2012.

One also hopes that a personal representative who declines to make the portability election, because he or she does not believe that it is beneficial to the estate and its beneficiaries, will not be in breach of a fiduciary duty to a surviving spouse who may not be a beneficiary of the estate. Until the courts make a clearer rule on this type of situation, it remains important to deal with these issues in the planning phase, to avoid waste, both financial and emotional.

[2] For a good article on planning for portability and marital agreements, *see*, Karibjanian and Law, *Portability and Prenuptials, A Plethora of Preventative, Progressive, and Precautionary Provisions*, Tax Management, Estate, Gift and Trusts Journal, Vol. 38., No. 2.., March-April 2013.