New IRS Guidance Extends the Retroactive Reach of the Windsor Case for Transfer Tax Purposes

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The extent to which the Supreme Court's decision in United States v. Windsor[2] applies retroactively is a question the Internal Revenue Service ("IRS") and the courts have struggled with since the Court announced its decision on June 26, 2013.[3] Because the Windsor case itself was applied to grant a marital deduction to the estate of a decedent who died more than four years earlier, the Court obviously intended some degree of retroactivity. In the transfer tax arena, one issue that remained to be resolved was the application of the decision to previously filed estate, gift and generation-skipping transfer tax returns that took positions consistent with the pre-Windsor definition of marriage.

The IRS's first response to the retroactivity issue appeared in Revenue Ruling 2013-17.[4] The ruling conceded, consistent with the Windsor decision, that the words "spouse," "husband" and "wife" when used in the Code[5] refer to an individual who is lawfully married under state law whether or not the individual is married to someone of the same sex. Although the ruling stated that it was to be applied prospectively from its issuance date, September 16, 2013, it also provided that taxpayers could rely on it "for the purpose of filing original returns, amended returns . . . or claims for credit or refund . . . provided the applicable limitations period for filing such claim under section 6511 has not expired."

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[2] 570 U.S. ___, 133 S. Ct. 2675 (2013).
[3] See, for example, last year's decision in Schuett v FedEx Corporation, 119 F.Supp. 3d 1155 (N.D. Cal. 2016), dealing with a surviving spouse's rights when her spouse died the day before the *Windsor* decision.
[4] 2013 I.R.B. 201. In September 2016, Treasury issued final regulations, Treasury Regulations Section 301.7701-18(b), that incorporated the holdings of Revenue Ruling 2013-17 under Code Section 7701.
[5] All references in this Article to the "Code" refer to the Internal Revenue Code of 1986, as amended (the "Code"), all references to "Code Section" refer to sections of the Code and all references to "Treasury Regulations Section" refer to sections of the U.S. Treasury Regulations promulgated under the Code.

The 2013 revenue ruling did not indicate whether it could be relied upon for prior estate, gift and generation-skipping transfer ("GST") tax returns if the applicable statute of limitations period had expired. It also did not clearly tell taxpayers whether they could, in reliance on Windsor, amend previously filed estate, gift and GST tax returns in a manner that would not result in immediate tax relief but would be likely to produce future tax savings. On January 17, 2017, the IRS offered some clarity as to these questions. It issued Notice 2017-15, which provides additional guidance on gifts, bequests and GST taxable transfers made between same-sex spouses prior to the Windsor decision. Specifically, Notice 2017-15 sets forth special administrative procedures allowing taxpayers to recalculate their remaining gift tax credit amounts and GST exemptions with respect to gifts and bequests made to or for the benefit of their same-sex spouses (and, in some cases, descendants of same-sex spouses) before Windsor, whether or not the statute of limitations period had expired.

Transfer Tax Law Pre-Windsor

Prior to Windsor, the federal Defense of Marriage Act ("DOMA") prohibited the IRS from recognizing same-sex marriages for federal tax purposes. This meant that taxpayers in legal, same-sex marriages were not treated as spouses for federal gift, estate and GST tax purposes. Several consequences resulted from this treatment. First, same-sex spouses were not entitled to claim the federal gift tax marital deduction or the federal estate tax marital deduction with respect to gifts and bequests made to each other, either outright or in trust. A gift or bequest to a same-sex spouse would be subject to gift or estate tax unless the transferor spouse had sufficient remaining applicable exclusion amount under Code Sections 2505 or 2010(c) (commonly referred to as the gift tax credit/estate tax credit) to protect the gift or bequest from

tax. Second, in determining whether to allocate GST exemption to a transfer to a same-sex spouse, taxpayers could not rely on the familial relationship to determine their spouse's generation assignment under Code Section 2651. This meant that same-sex spouses were not automatically assigned to the same generation and that transfers between them could result in GST tax if there was an age difference between the spouses of 37-1/2 years or more.

Windsor struck down DOMA because it rejected "the long-established precept that the incidents, benefits, and obligations of marriage are uniform for all married couples within each State."[6] The Supreme Court held that the federal government could not recognize certain marriages performed in a state, while rejecting others. Because the "avowed purpose and practical effect" of DOMA was to impose "a disadvantage, a separate status, and so a stigma upon all who enter into same-sex marriages made lawful by the unquestioned authority of the States," DOMA was found to be unconstitutional as a deprivation of the liberty of the person protected by the Fifth Amendment of the Constitution.[7]

Marital Deduction for Transfers to Same-Sex Spouses After Windsor

Under existing law, when a taxpayer makes a gift or bequest to a spouse, the taxpayer is entitled to claim a gift or estate tax marital deduction for the gift or bequest under Code section 2523 or Code Section 2056 if the gift or bequest satisfies the specific requirements set forth in these Code sections. As a result, the taxpayer can avoid transfer tax on the gift or bequest without having to use any portion of his or her applicable exclusion amount. As discussed above, prior to Windsor and Revenue Ruling 2013-17, these rules applied only to opposite-sex spouses; same-sex spouses could not claim the gift or estate tax marital deductions and would have paid gift or estate tax on spousal gifts and bequests unless they had sufficient remaining

[6] *Id.*
[7] *Id.*

credits. After Windsor and Revenue Ruling 2013-17, the gift and estate tax marital deduction rules under Code Section 2523 and Code Section 2056 were applied to gifts and bequests to same-sex spouses.

Notice 2017-15: New Procedures for Certain Pre-Windsor Gifts and Bequests

Under Revenue Ruling 2013-17, as long as the limitations period for filing claims of credits or refunds under Code Section 6511 has not expired,[8] a taxpayer who made a gift to a same-sex spouse prior to Windsor can file an amended gift or estate tax return to claim the marital deduction for a gift or bequest to a same-sex spouse, to restore any applicable exclusion amount the taxpayer used to shelter prior gifts to the same-sex spouse from tax and to obtain a refund or credit for prior gift or estate tax paid that is no longer payable.[9] But existing law did not offer any relief if the prior gift or bequest was made in a closed tax year. Fortunately, Notice 2017-15 partially fills in this gap.

Notice 2017-15 provides that even if the limitations period for filing claims of credits or refunds has expired, the taxpayer's remaining applicable exclusion amount may be recalculated to restore it to the amount it would have been if the taxpayer's marriage to his or her same-sex spouse had been recognized for federal tax purposes when the return was filed. To recalculate these amounts, the taxpayer should file the following form, as applicable:

- if the limitations period has expired, a Form 709, United States Gift (and Generation-Skipping Transfer Tax) Tax Return ("Form 709"), which preferably would be the first Form 709 required to be filed by the taxpayer after the issuance of the Notice.

- an amended Form 709, if the limitations period has not expired.

[8] Code Section 6511 provides that a claim for credit or refund of an overpayment of tax with respect to which the taxpayer is required to file a return must be filed within the earlier of three years from the time the return was filed, or two years from the time the tax was paid.

[9] See Revenue Ruling 2013-17, 2013 I.R.B. 201; IRS News Release (IR-2013-72).

- an amended or supplemental Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return ("Form 706"), with respect to bequests made by a deceased taxpayer not reported on a Form 709, although it is necessary to file an amended or supplemental Form 706 only if the taxpayer has predeceased Notice 2017-15.

The taxpayer should include a statement at the top of the form that the return is "FILED PURSUANT TO NOTICE 2017-15" and attach a statement supporting the claim for the marital deduction and illustrating the recalculation of the remaining applicable exclusion amount.

The Notice also permits a taxpayer's executors to recalculate any deceased spousal exclusion amount allowed to be added to the applicable exclusion amount of the taxpayer's surviving spouse under Code section 2010(c). It does not, however, offer any guidance as to how the election to permit a surviving spouse to use the deceased spouse's unused applicable exclusion amount is to be made if the due date for the deceased spouse's estate tax return has passed.[10] Presumably, the executor of the deceased spouse's estate will be able to seek 9100 relief[11] to obtain an extension of time to file the return if the estate was not required to file an estate tax return under Code Section 6018(a). It is unclear whether there is any path to relief if a return was required. The problem is that Code Section 2010(c)(5) imposes a time limit on making the election. The election may not be made if the estate tax return is filed after the time prescribed by the Code for filing the return. The IRS takes the position that it lacks the authority to extend the time to make an election when the time is prescribed by the Code rather than a regulation or ruling.[12]

Taxpayers who made gifts or bequests to a same-sex spouse in trust may be required to take additional steps to make those gifts eligible for the gift or estate tax marital deduction. If the limitations period has expired, the ruling permits the taxpayer to apply for 9100 relief to

[10] Code section 2010(c)(5).
[11] This relief generally is permitted under Treasury Regulations Section 301.9100-3.
[12] Treasury Regulations Section 301.9100-1; PLR 201109012; PLR 201316008.

obtain permission to make a late qualified terminable interest property ("QTIP") election or qualified domestic trust ("QDOT") election if required to obtain the marital deduction.[13] Of course, the trust instrument would need to include (and have included at the time of the gift) the appropriate provisions permitting eligibility for QTIP or QDOT treatment in order for the IRS to approve the marital deduction. This limits the applicability of Notice 2017-15 with respect to prior gifts to a same-sex spouse in trust because most of these trusts are unlikely to contain the necessary provisions. However, if the trust instrument does not include the necessary QTIP or QDOT provisions, the taxpayer could consider bringing a trust construction or reformation proceeding in state court, arguing that if the taxpayer had known that the marital deduction could have applied at the time of the gift, he would have included those provisions in the trust agreement when it was drafted.

Unfortunately, the Notice fails to provide complete relief for taxpayers who made gifts or bequests to same-sex spouses for the reasons discussed below.

1. Because of the manner in which a taxpayer's estate tax and gift tax is calculated, the restoration of a taxpayer's applicable exclusion amount will have no effect on future estate tax liability and will provide only incomplete relief in the case of future gift taxes. For estate tax purposes, every decedent is entitled to the applicable exclusion amount available at the time of death.[14] The amount of previously used credit is irrelevant.[15] The Notice should have permitted the taxpayer to reduce the amount of her taxable gift for preceding taxable years and a

[13] The willingness of the IRS to grant 9100 relief for this purpose is surprising. It has consistently taken the position that it lacks the authority to permit late QTIP elections because section 2523(f)(4) of the Code contains an express requirement for the time by which the election must be filed. See, for example, Private Letter Ruling 201109012 (March 4, 2011).
[14] Code Section 2010(c).
[15] It is unlikely that the IRS intended this consequence and future clarification by the IRS may be warranted to address this issue.

decedent's executor to reduce the amount of the decedent's adjusted taxable gifts in each case by the amount of his or her gifts that would have been protected from gift tax by the gift tax marital deduction if the spousal relationship had been recognized. In the case of the gift tax, the amount of previously used applicable exclusion amount is relevant but unless the taxpayer is also permitted to reduce the amount of taxable gifts for preceding taxable years, future gifts will be subject to gift tax at higher rates than would have been applicable if the gifts to the same-sex spouse had been eligible for the marital deduction.

2. Notice 2017-15 does not extend the statute of limitations with respect to elections to split gifts to third parties with a same-sex spouse under Code Section 2513.
3. Once the limitations period has expired, any claim for credit or refund of gift or estate tax paid with respect to a prior gift to a same-sex spouse will be denied. If the Notice is modified to solve the problem described in paragraph 1 to permit a taxpayer's executor to reduce the amount of his or her adjusted taxable gifts, the detriment caused by the failure to grant a refund will be a matter of timing only for those taxpayers who will be subject to the estate tax. If the gift on which the gift tax was paid is removed from the taxpayer's adjusted taxable gifts, the gift tax paid will serve as a credit against the taxpayer's future estate taxes.

Applying Notice 2017-15 to Lifetime Gifts

EXAMPLE A: Mark married his spouse William in New York in 2009. In 2010, prior to Windsor, Mark made an outright gift to William of $1 million. Mark filed a gift tax return in 2010 reporting the gift to William. In that gift tax return, the gift to William was protected from gift tax by Mark's remaining gift tax credit amount. As a result of Notice 2017-15, even though

the statute of limitations with respect to Mark's 2010 gift to William is now closed, Mark should recalculate his remaining gift tax exclusion amount and report this recalculated amount to the IRS on the next Form 709 Mark files after the issuance of the Notice.

EXAMPLE B: Assume the same facts as Example A, except at the time of the gift Mark had no remaining gift tax credit available and, therefore, paid gift tax on the gift to William. Under Notice 2017-15, because the statute of limitations on refunds and credits has expired, Mark cannot make a claim for a refund of gift tax. But the gift taxes paid will be creditable against future gift and estate taxes.

EXAMPLE C: Assume the same facts as Example A, except that Mark made his gift to a trust for William rather than outright. At the time of the gift, the trust agreement contained the necessary QTIP provisions that would be required to qualify Mark's gift to the trust for the marital deduction. It did not give William a general power of appointment over the trust property. Even though the statute of limitations has expired, Mark can obtain more favorable tax treatment under Notice 2017-15, but first must submit a separate request under Treasury Regulations Section 301.9100-3 for permission to make a late election under Code section 2523(f) to have the gift to the trust be treated as qualified terminable interest property. Once that relief is obtained, Mark should then recalculate his remaining gift tax exclusion amount and report this recalculated amount to the IRS on a supplemental Form 709.

Notice 2017-15: New Rules Regarding GST Exemption and Generation Assignments

Under Code Section 2651(b), a transferee's generation assignment for purposes of the GST tax is based on the familial relationship to the transferor or the transferor's spouse. Spouses are always deemed to be in the same generation. A transferee who is descended from a grandparent of the transferor or the transferor's spouse is assigned to a generation based on his or

her position in the family line. A transferee who is not descended from one of these grandparents, will be assigned to a generation based on the age difference between the transferee and the transferor. An individual born not more than 12-1/2 years after the date of birth of the transferor is assigned to the transferor's generation. An individual born between 12-1/2 and 37-1/2 years after the transferor's date of birth is assigned to the generation immediately below that of the transferor. An age difference of more than 37-1/2 years results in a generation assignment that is two below the generation of the transferor.

Prior to Windsor, if a taxpayer made a gift to the taxpayer's same-sex spouse or to the lineal descendants of the taxpayer's same-sex spouse, because they had no familial relationship recognized under the Code, the spouse and the spouse's descendants would be assigned to a generation for GST tax purposes based on their ages. Depending on the ages of the transferor and the transferees, these generation assignments could have resulted in transfers to the taxpayer's spouse or spouse's descendants being subject to the GST tax (unless the GST exemption was allocated to the transfers). After Windsor and Revenue Ruling 2013-17, these generation assignments are now based on the familial relationships between same-sex spouses and their descendants. As a result, any transfers by a taxpayer to the taxpayer's same-sex spouse and the spouse's descendants that were subject to GST tax prior to Windsor and Revenue Ruling 2013-17, would not be so classified after Windsor.

Notice 2017-15 outlines several new rules dealing with the GST tax and the allocation of GST exemption to gifts to same-sex spouses and their lineal descendants. First, a transfer, either outright or in trust, to a same-sex spouse or the spouse's child cannot be subject to the GST tax because neither the same-sex spouse nor the spouse's children is a skip person as to the transferor regardless of their relative ages. Second, any allocation of GST exemption to a

transfer that is a direct skip, not in trust, to the taxpayer's same-sex spouse or such spouse's child or more remote lineal descendant (who is not otherwise a skip person with respect to the transferor) is void. Third, these rules apply to a taxpayer's allocations of GST exemption made prior to the date of issuance of Notice 2017-15, whether or not the limitations period on claims for credit or refunds under Code Section 6511 has expired. Fourth, the Notice permits a taxpayer to recalculate the amount of GST exemption allocated to a transfer, outright or in further trust, to or for the benefit of a same-sex spouse or the spouse's lineal descendants who were, prior to Windsor, deemed to be skip persons on the basis of the relative ages of the transferor and the transferee, but post-Windsor are determined to be non-skip persons on the basis of the familial relationship between the transferor and the transferee.

Interestingly, Notice 2017-15 does not apply in a way that would work to the detriment of a taxpayer. For example, there is no requirement that a taxpayer recalculate (i.e., reduce) the amount of his or her remaining GST exemption on account of a pre-Windsor gift made to an individual treated as assigned to the taxpayer's children's generation based on comparative ages but who is assigned to his or her grandchildren's generation post-Windsor because the taxpayer's marriage to the individual's grandparent is recognized.

Notice 2017-15 provides administrative procedures for recalculating the transferor's remaining GST exemption. The transferor should undertake this recalculation in accordance with IRS instructions to be provided online and in Forms 709 and 706 and report his or her recalculated remaining GST exemption to the IRS on the applicable form:

- a Form 709 (which preferably would be the first Form 709 required to be filed by the taxpayer after the issuance of the Notice), if the limitations period has expired.
- an amended Form 709, if the limitations period has not expired.

- a supplemental or amended Form 706 with respect to bequests made by a deceased taxpayer not reported on a Form 709, although it is necessary to file an amended or supplemental Form 706 only if the taxpayer has predeceased the Notice.

A request for relief under Treasury Regulations Section 301.9100-3 is not necessary. The transferor should include a statement on the top of the form that the return is "FILED PURSUANT TO NOTICE 2017-15," and should attach a statement that the transferor's prior allocation of GST exemption is void as a result of Notice 2017-15 and include a copy of the computation of the taxpayer's revised GST exemption allocation and the taxpayer's remaining GST exemption amount. Notice 2017-15 clarifies that (i) Chapter 13 of the Code and the Treasury Regulations promulgated under Chapter 13 apply to the newly recalculated GST exemption amount, and (ii) as is the case with the gift tax, as described above, if the statute of limitations period on claiming refunds or credits under Code Section 6511 has expired, the taxpayer will not be able to make a claim for a refund or credit of any prior GST tax paid by the taxpayer.

Applying the GST Exemption Allocations Rules under Notice 2017-15

EXAMPLE A: Mark is 65 years old. In 2009, he married William in New York when William was 50 years old. In 2010 (i.e. prior to the Windsor decision), Mark made a $500,000 gift to William. Because William was 15 years younger than Mark at the time of the gift, for GST purposes, William was assigned to the generation directly below Mark. As a result, Mark's gift to William was not subject to the GST tax.

EXAMPLE B: Mark is 75 years old. In 2009, he married William in New York when William was 35 years old. In 2010, Mark made a $500,000 gift to William. Because at the time of the gift William was 40 years younger than Mark, for GST tax purposes William was assigned to the generation that is two generations below Mark's generation. As a result, William was

treated as a skip person as to Mark, and Mark's gift to William was subject to the GST tax. Because Mark did not elect on his 2010 gift tax return to have the automatic GST exemption rule of Code section 2632(b) not apply to his gift, $500,000 of his GST exemption was automatically allocated to the gift to William, to protect the gift from GST tax. As a result of Notice 2017-15, Mark and William are now subject to generation assignment based on their familial relationship as spouses and deemed to be in the same generation. Mark's 2010 deemed allocation of GST exemption in 2010 is now void. Even though the statute of limitations with respect to Mark's 2010 gift to William has closed, Mark should recalculate his remaining GST exemption and report to the IRS the recalculated remaining GST exemption amount on the next Form 709 Mark files after the issuance of the Notice.

EXAMPLE C: Assume the same facts as Example B, except that Mark did not have any remaining GST exemption at the time of his gift to William in 2010 and, therefore, paid a GST tax on his gift to William. Under Notice 2017-15, because the statute of limitations on refunds and credits has expired, Mark cannot make a claim for a refund of GST tax.

EXAMPLE D: Assume the same facts as Example A, except that Mark also made a $500,000 gift in trust in 2010 to William's 30-year old daughter Jane from a prior relationship. Because Jane was 35 years younger than Mark at the time of the gift, she was deemed to be in the generation that is one generation below Mark's generation. As a result, Mark's gift to Jane was not subject to the GST tax.

EXAMPLE E: Assume the same facts as Example B, except that Mark also made a $500,000 gift in trust in 2010 to William's 5-year old daughter Jane from a prior relationship. Because Jane was more than 37-1/2 years younger than Mark, Mark's gift to Jane is subject to the GST tax. Mark did not elect to have the automatic GST exemption allocation rule not apply

to his transfer to Jane's trust on his 2010 gift tax return, and $500,000 of Mark's GST exemption was automatically allocated to this transfer. As a result of Notice 2017-15, due to their familial relationship as spouses, William's daughter Jane is now deemed to be in the same generation and Mark's children and his prior deemed allocation of GST exemption in 2010 to his transfer to Jane's trust is now void. Even though the statute of limitations with respect to Mark's 2010 gift to William has closed, Mark now should recalculate his remaining GST exemption and report to the IRS the recalculated remaining GST exemption amount on the next Form 709 Mark files after the issuance of the Notice.

Conclusion

Advisors should keep Notice 2017-15 in mind when reviewing the estate plans of married same-sex clients and give particular attention to prior gifts, bequests and generation-skipping transfers. When applicable, clients should be advised to file supplemental or amended Forms 706 or 709 to recalculate their remaining applicable exclusion amounts and GST exemptions. Though Notice 2017-15 is fairly narrow in scope, certain taxpayers may benefit greatly from this relief.