John's will creates a credit shelter trust that equals the $1 million New York exclusion. He leaves the balance of his $10 million estate – or $9 million – to a trust for Abby that is eligible for the QTIP election (in other words, the qualified terminable interest trust is only for Abby, and she gets all the income; the election will postpone tax at John's death, and what remains of the trust at Abby's death will be taxable in her estate). John dies in 2013, and the New York credit shelter trust is created. His executor must decide whether to elect full, or only partial, QTIP treatment for Abby's $9 million trust.

Issue 1: If John's executor elects QTIP treatment for the full $9 million trust, no New York tax will be payable (a good thing)...but if he does so, he's wasting the remaining $4.25 million of John's $5.25 million exclusion AND he's choosing something that wasn't necessary to postpone federal estate tax. Can John's executor still elect portability in this case?

Issue 2: If John's executor makes a partial QTIP election of $4.75 million, he will shield the other part of the $9 million trust from federal estate tax using John's remaining $4.25 million of exclusion. Unfortunately, this $5.25 million taxable estate (John's $1 million New York credit shelter trust plus the $4.25 million non-QTIPPED portion of Abby's $9 million trust) will trigger at least $420,800 of New York tax, even though there's no federal estate tax. Not good.

If John's executor elects QTIP for the full $9 million trust, and thereby doesn't incur New York tax, why might portability *not* be available? Several thoughts come to mind: when the IRS issued temporary regulations on portability on June 18, 2012 (T.D. 9596 77 FR 36150-36163), those regulations offered examples where portability was used when the deceased spouse's estate was *under* the exclusion amount. These examples showed both a full and partial QTIP election – elections that were unnecessary to reduce the decedent's estate tax to zero, since none would have been payable anyway. The regs had no examples dealing with an estate that *exceeded* the exclusion amount and more QTIP treatment was elected than was necessary to protect the estate from tax. What to make of that?

Revenue Procedure 2001-38. Let us now look at Revenue Procedure 2001-38, issued on June 11, 2001. Here, the IRS addressed when it would allow an executor to "undo" an unnecessary QTIP election. The Service noted that taxpayers had previously requested relief when: 1) an executor elected QTIP treatment for a trust, but the estate wouldn't have been taxable anyway because it was under the exclusion amount; and 2) the executor accidentally elected QTIP treatment for both a credit shelter trust and a QTIP trust. The Rev. Proc. said that the Service would ignore the QTIP election and treat it as "null and void" if the QTIP election "was not necessary to reduce the estate tax liability to zero"; the Service would not do this, however, if the executor elected *more* QTIP than was necessary to reduce the estate tax liability to zero, or if the QTIP election was phrased as a formula "designed to reduce the estate tax to zero." In other words, the Rev. Proc. seems to say, if you didn't know what you were doing, we'll help you out; if you did know what you were doing, we're not going to play along.

How does that apply in the portability example above, where John's estate *exceeds* the exclusion amount, and his executor must decide whether to elect "excess" QTIP treatment for Abby's trust to avoid triggering New York estate tax? If the rationale of Rev. Proc. 2001-38 is applied, portability might not be permitted. Here's a possible reason why: suppose that John and Abby live in Florida, and no state estate dollars are at stake. An excess QTIP election presumably would have no other goal than ensuring that the full amount of Abby's trust was includible in her estate, and therefore eligible for a potential basis step-up that would eliminate the trust's built-in capital gains. This could be a real boon for the trust's ultimate takers, namely, John and Abby's children. In this circumstance, portability would ensure that John's exclusion is not wasted AND that potential capital gains are minimized...probably not what Congress had in mind.

The bottom line. Unless and until the IRS issues guidance on this, it is not clear that portability applies if a deceased spouse's estate exceeds the exclusion amount and more QTIP treatment is elected than is necessary to reduce the spouse's estate tax to zero. Although portability can work in "simple" situations,