

Changes in Portability, Should You Revise Your Estate Plan?

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A recent change in US law provides estate tax, income tax and other benefits you should know about and may want to take action on.

Portability became permanent under the American Taxpayer Relief Act of 2012, which raises the question whether you should revise your estate plan to take advantage of portability.

What is "Portability?"

There is an estate tax at death on the value of a deceased individual's estate in excess of the exemption amount. The estate tax exemption amount is \$5 million, indexed for inflation; for 2013, the estate tax exemption amount is \$5.25 million. In addition, there is a separate generation skipping transfer (GST) tax on the value of transfers to grandchildren, persons in the same generation as grandchildren and/or persons in lower generations in excess of the GST exemption, which is \$5 million, indexed for inflation; for 2013, the GST exemption is \$5.25 million.

Prior to the enactment of portability, the estate tax exemption and the GST exemption not used at death is each permanently lost. Portability was first enacted in 2010 and originally applied only to individuals dying in 2011 and 2012. Subsequently, the 2012 Tax Relief Act made portability permanent.

Portability allows a deceased spouse's unused estate exemption amount (the Deceased Spousal Unused Exclusion Amount, or DSUEA) to be transferred or "ported" to his or her surviving spouse, thereby increasing the estate tax exemption available to the surviving spouse during the surviving spouse's lifetime or at his or her death. Thus, if an individual dies in 2013 without effectively using his or her \$5.25 million exemption, this amount (the DSUEA) is added to the surviving spouse's \$5.25 million exemption (referred to as the survivor's Basic Exclusion Amount, or BEA) and the surviving spouse's exemption becomes \$10.5 million (referred to as the survivor's Applicable Exclusion Amount, or AEA).

Note, portability applies only to married couples and the estate tax exemption. There is no portability for the GST exemption, so any GST exemption not used at death remains permanently lost.

Requirements for Using a Deceased Spouse's Unused Exclusion Amount

It needs to be noted that in order to use a DSUEA, an estate tax return needs to be filed for the deceased spouse and an election made in the estate tax return. If this is not done, then the surviving spouse will have no DSUEA.

Therefore, provision should be made to allow the surviving spouse to file or cause to be filed an estate tax return for

the deceased spouse.

How Does Portability Affect Your Estate Planning?

Prior to portability, traditional estate planning used a Bypass Trust to make use of the first deceased spouse's exemption as follows: The Bypass Trust is funded with the first deceased spouse's exemption amount and is not taxable in the surviving spouse's estate. The Bypass Trust may provide for distribution to the surviving spouse of income and principal for support, health and maintenance. The negative to traditional planning is that at the death of the surviving spouse, the appreciation of the assets in the Bypass Trust do not receive a step up in basis, so upon sale of the assets the appreciation or unrealized gain is taxed.

Planning with portability does not use a Bypass Trust, but rather distributes the deceased spouse's assets to the surviving spouse or a marital trust for the benefit of the surviving spouse. Upon the death of the surviving spouse, the value of the surviving spouse's estate is more than the value would be using a Bypass Trust, but the *estate tax* on the increased value of the surviving spouse's *estate is reduced and under some circumstances totally eliminated* by the DSUEA. The benefit of planning with portability rather than using a Bypass Trust is that upon the second death, the assets receive a step up in basis and there is no appreciation subject to income tax.

In a situation where the value of the survivor's estate is less than the survivor's Applicable Exclusion Amount (e.g., the surviving spouse exclusion amount plus the deceased spouse's unused exclusion amount), portability planning provides overall tax savings (the sum of estate tax and income taxes).

In the situation where the value of the surviving spouse's estate is more than the surviving spouse's Applicable Exclusion Amount, portability may (but not always) provide a tax savings.

Under Portability Planning, What Are the Differences Between Leaving Assets Outright to the Surviving Spouse and to a Marital Trust?

Leaving the deceased spouse's estate outright to the survivor is less complex than leaving the assets to a marital trust for the benefit of the survivor. However, leaving assets to a marital trust for the benefit of the surviving spouse offers the following benefits: (i) asset protection; (ii) control by the first deceased spouse upon the death of the surviving spouse; (iii) asset protection via spendthrift trust protection; (iv) use of the deceased spouse's generation skipping transfer tax exemption (GST exemption).

However, the following needs to be noted: An election needs to be made on the deceased spouse's estate tax return in order to create a marital trust and to use the deceased spouse's GST exemption. *Furthermore, based on an existing revenue procedure, there is the possibility the Internal Revenue Service will not recognize the above elections if the value of the deceased spouse's estate does not exceed the deceased spouse's exemption amount (\$5.25 million).* The uncertainty created by this possibility is likely to be resolved in the near future, but until it is resolved, one should consult a professional before deciding on using a marital trust to make use of the deceased spouse's GST exemption.

Next Steps?

Plan in advance—incorporate portability into estate planning documents and/or property agreements.

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