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Estate Planning with Portability

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The American Taxpayer Relief Act of 2012 [ATRA] made "portability" a permanent part of the tax code. Portability, in its simplest terms, is the ability of a surviving spouse to "inherit" the unused estate tax exemption of the deceased spouse. ATRA also made permanent the $5 million federal estate tax exemption, indexed for inflation from 2010. Portability combines with recent increases in income tax rates to make income tax planning an important compliment to, and part of, the estate planning process.

Where portability has the greatest impact is on couples with a combined net worth less than their combined exemptions, and whose ages and circumstances are such that their net worth is unlikely to ever exceed the combined exemptions. *Couples who meet this description should review their estate planning documents and consult with their tax and estate advisors.*

The typical estate plan for a married couple provides that at the first death the assets of the deceased spouse are divided into Marital (Trust A) and Credit Shelter (Trust B or Family Trust) shares, with the Credit Shelter trust being funded up to the amount of the exemption and the balance going into the Marital trust. So for 2013, the first $5.25 million will go into the Credit Shelter Trust and the remainder of the estate (if any) to the Marital Trust. Most Credit Shelter trusts name children or other descendants as potential beneficiaries during the life of the surviving spouse. This means the Credit Shelter trust likely does not qualify for the marital deduction, is not included in the taxable estate of the surviving spouse and does not get a step-up in basis at the second death.

Going forward, couples with an estate of less than their combined exemption will **want** the Credit Shelter trust to be taxable at the second death in order to get a step-up in basis.

Things to know about Portability:

- The unused exemption is known as DSUE amount – Deceased Spouse Unused Exemption.
- The DSUE amount is from the "last deceased spouse"; it cannot accumulate from multiple spouses.
- Portability is not automatic. A timely filed federal estate tax return is required at the first death and the executor must elect to use portability.
- The DSUE amount is not indexed for inflation; the amount is determined at the time of first death and does not change.
- The DSUE amount applies for gift tax purposes, allowing the surviving spouse to make lifetime gifts of both the DSUE amount and his/her own estate tax exemption without incurring tax.
- The IRS can examine the return of the deceased spouse at any time for purposes of determining the DSUE amount. In effect, no statute of limitations for determining this amount.
- The IRS has issued regulations allowing a simplified return for determining the DSUE amount if an estate tax return is not otherwise required.

- The Generation Skipping Transfer Tax (GST) exemption is not portable.

- Leaving everything outright to the surviving spouse is not usually the solution; many other reasons for putting assets in trust still exist including:

  - Asset protection

  - Inability of surviving spouse to manage finances

  - Worry of remarriage or undue influence (that the assets may not end up where deceased spouse would have preferred)

  - State inheritance tax that might be due at the second death

  - Full use of GST exemption at the first death

- Portability decreases the need to name a trust as the beneficiary of retirement accounts at the first death.

- The estate tax exemption in 2013 is $5.25 million.

- A trust established for the sole benefit of a surviving spouse typically qualifies for the marital deduction at the first death and is included in the taxable estate of the surviving spouse, getting a step-up in basis. The typical vehicles for the spousal trust are:

  - Qualified Terminable Interest Property (QTIP) trust: All income must be paid to surviving spouse and the surviving spouse is the only potential beneficiary during his/her lifetime. This requires an election at the first death, made by the executor on a timely filed federal estate tax return.

  - General Power Of Attorney (GPOA) trust: The surviving spouse has a testamentary general power of appointment over the trust. This means the surviving spouse, in his or her will, has the right to appoint the assets to any, or a combination of, his/her self, estate, creditors or creditors of the estate. The power to appoint can include other persons or entities, but it is these entities that create a GPOA.

- ATRA did not affect the ability of spouses to make unlimited gifts to each other without incurring gift tax.

The new legislation provides changes broad and sweeping enough that all individuals should readdress their estate plans with their advisors and family members.

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