PORTABILITY: AN EVOLUTION, NOT A REVOLUTION

By Derek Ball

Many commentators have opined that the estate tax portability rules have drastically changed the face of estate planning. While portability may change how a practitioner plans for certain clients, it should not be viewed as an easy way out from under difficult planning situations. It should instead be viewed as simply another tool in a practitioner’s arsenal. As always, a practitioner’s primary goal should be to achieve the optimal result for his or her clients. While tax issues may be at the forefront, tax reduction may not be the ultimate goal or optimal result the client is looking for. Clients may have controlling desires as to whom their assets should pass after death, and how that transition should occur. These clients expect their attorneys and tax professionals to construct tax efficient estate plans, but not at the expense of their other goals and asset protection desires. This article explains not only the basics of portability and the various elements every practitioner should know, but how portability fits into an estate planning toolbox. While portability is great for many clients, one should not completely revamp his or her practice in response to it.

Portability Guideline

A. The Election.

Portability first originated as part of the 2010 Tax Relief Act and, to the pleasure of tax professionals everywhere, became a permanent piece of the Code in the American Taxpayer Relief Act of 2012. First and foremost, the deceased spouse whose exclusion amount is being ported must have died on or after January 1, 2011. The portability election must be made by an executor on a properly prepared and timely filed IRS Form 706. Thus, portability requires filing an estate tax return even though no tax is due. Once elected, portability may only be revoked up to the deadline for filing the IRS Form 706 (usually 9 months after death).

B. DSUE.

Portability allows a surviving spouse to add the Deceased Spousal Unused Exclusion (“DSUE”) amount to his or her own lifetime exclusion amount. The DSUE is the amount of lifetime exclusion the deceased spouse had left at his or her date of death. Once determined, this amount remains stagnant. For example, if a spouse died in 2012 when the exclusion amount was $5.12 million and made $4 million of taxable lifetime gifts and non-spousal transfers, the DSUE amount will be $1.12 million and will never change. The surviving spouse now has his or her remaining exclusion amount, plus this $1.12 million DSUE.

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2 IRC §2010(c)(4).
4 IRC §2010(c)(4).
Portability only applies to the DSUE amount of the last deceased spouse.\textsuperscript{5} If the surviving spouse remarries and that new spouse passes away before the surviving spouse used the DSUE amount from the first deceased spouse, the first deceased spouse’s DSUE amount will be lost. Thus, if portability is being relied upon and the DSUE amount of the first deceased spouse is the entire $5.43 million 2015 exclusion amount, the full $5.43 million exclusion will be lost. This has the potential to increase a decedent’s estate tax liability by as much as $2.172 million.

Portability may be taken a step further and benefit the second spouse of the original surviving spouse. In this situation, the maximum amount that the original surviving spouse can port to the second spouse is the current lifetime exclusion amount. This occurs because any amount that was ported to the original surviving spouse by the deceased spouse is used first, allowing for the original surviving spouse’s lifetime exclusion amount to port to the second spouse.\textsuperscript{6}

C. Extended SOL.

The IRS typically has a three year statute of limitations from the filing of IRS Form 706 in which to audit the appraised value of estate assets. If portability is elected, this statute of limitations extends to three years after the filing of the surviving spouse’s IRS Form 706, potentially extending the statute of limitations by decades.\textsuperscript{7}

Planning Points

The ultimate goal of estate planning practitioners is to construct an appropriate post-mortem asset management and protection strategy. The tax savings facilitated by practitioners may be a significant consideration, but are frequently secondary to asset management and protection and other considerations. As illustrated below, portability should not be relied upon when doing so frustrates other asset management and protection desires. Nor is it a turnkey solution to most estate planning issues. Take for example the classic credit shelter or family trust. These trusts have long been used to protect a client’s assets from creditors and prodigal beneficiaries. Before portability they were also a means of utilizing the full lifetime exclusion amounts of each spouse. With portability, they become less important for preserving the lifetime exclusion amount, but still very important for protecting a client’s assets. Should a practitioner disregard the opportunity to establish a credit shelter trust simply because portability achieves tax goals? Portability is better treated as a tax planning scalpel that is deployed strategically to reduce estate tax exposure without jeopardizing other estate planning goals.

A. GST Planning.

If a client or potential surviving spouse wishes to leave a significant amount to skipped generations, it is important to remember that portability does not apply to the GST

\textsuperscript{5} Treas. Reg. §20.2010-3(a)(1).
\textsuperscript{6} Treas. Reg. §20.2010-3(b)(1), (2).
\textsuperscript{7} IRC §2010(c)(5)(B).
exclusion amount.\(^8\) In other words, at the death of the second spouse to die, while he or she may have some or all of the first spouse’s DSUE available, he or she will not have the first spouse’s unused GST exclusion amount. Therefore, if assets will be gifted directly to skipped generations, those assets should be dealt with before either spouse passes away. Using the deceased spouse’s GST exclusion on these amounts could potentially save millions in tax if the surviving spouse intends to gift more than his or her available exclusion amount to skipped generations.

B. Unbalanced Asset Ownership.

Prior to portability, it was extremely important for couples with unbalanced asset ownership to ensure the exemption of each spouse could be fully used. This sometimes forced the splitting and equalization of assets between spouses in contravention of other desired results (e.g., asset protection for business owners). With portability it is somewhat less important to balance asset ownership to ensure the safety of the exclusion amount.

C. Remarriage.

The possibility of future marriage must be contemplated in this day and age. This may be viewed through a couple of different lenses. You could be counsel for the spouse who may die first or counsel for the surviving spouse. As counsel for the spouse contemplating death, you should discuss the client’s desire to protect his or her assets from future spouses. Upon remarriage and divorce, a significant portion of your client’s assets could be lost without a sound strategy to protect them. Portability is not one of these strategies. Credit shelter and other trusts, while unnecessary for estate tax purposes on account of portability, are still important tools for shielding your client’s assets from future spouses. As counsel for a surviving spouse who is considering remarriage, you may want to advise your client to use up the DSUE amount from his or her deceased spouse, which will be lost upon the death of the second spouse. As explained above, upon the death of the second spouse, another DSUE amount will arise and replace the unused DSUE amount from the first deceased spouse.

D. Creditors.

Future creditors are a significant concern when drafting estate plans. These could be future creditors of the client, of his or her spouse, of estate beneficiaries, or even future spouses. Portability does not protect assets from the potential insolvency of these individuals. For situations demanding creditor protection it may be advisable to create a credit shelter trust so that your client’s spouse or beneficiaries will not be able to squander the client’s assets, or lose them to creditors.

E. Time Value of Money.

One disadvantage of portability is that the DSUE amount, once calculated, remains stagnant. If you port $3 million to your surviving spouse, who never remarries and does not die for another 20 years, that $3 million does not increase with inflation. Considering the time value of money, $3 million in twenty years is worth significantly less than it is today. So

\(^8\) IRC §2631.
while the goal is to get full use of the exemption amount for each spouse, practitioners should keep in mind when drafting an estate plan whether or not the surviving spouse plans to gift assets in the near future or hoard them until his or her future death. If the desire is to maximize tax-free transfers to beneficiaries, it is generally better to allow those assets to grow in an estate tax free environment for as long as possible. In such case, it is better practice to use the first spouse’s exclusion amount as fully as practicable at his or her death.

**Conclusion**

Portability should only be used to yield positive results for practitioners and their clients. Certain practices such as asset equalization are less important than they were before 2011. But portability should not override the traditional estate planning instincts of practitioners. It cannot serve as justification for crafting simple “I Love You” wills when the situation otherwise demands carefully drafted trusts. Practitioners should not allow portability to revolutionize the way they structure their clients’ estate. Instead, think of portability as an additional tool that may be strategically deployed to help certain clients with certain specific estate planning issues.