

## Estate Tax Exclusions:

### WHAT IS PORTABILITY AND WHY IS IT IMPORTANT?

Portability is now a permanent feature of the federal transfer tax (estate and gift) law that allows a surviving spouse to use his/her deceased spouse's unused estate tax exclusion (up to \$5.43 million in 2015). The concept of portability could be important to you if you are a married person with an estate valued in excess of \$10,860. As you review this explanation of portability, ***remember that the estate and gift tax exclusions available to each person are "unified,"*** meaning that if a person uses some of his/her \$5.43 million exclusion to "pay" tax on lifetime gifts, the exclusion available to "pay" estate tax at his death is reduced by the amount used to "pay" the gift tax.

#### Why is portability a "big deal" for married couples?

A typical estate plan for a married couple (in this case "Bob" and "Sally") using a revocable trust takes advantage of each spouse's estate tax exclusion. At the death of Bob, a family trust (also known as a credit shelter or bypass trust) is established and funded with Bob's assets worth no more than his remaining exclusion amount, with the balance of his assets allocated to Sally, either in a marital trust or to the survivor's trust.

- If the value of Bob's share of the trust assets is less than his estate tax exclusion, with portability, the remaining exclusion can be transferred or "ported" to the Sally. ***In the past, the remaining exclusion was wasted.***
- Sally or her estate may use her own exclusion plus Bob's unused exclusion ("DSUE").

#### How does the surviving spouse claim the DSUE?

The executor of Bob's estate (or if there is no probate proceeding, the trustee of Bob's and Sally's trust) must make a portability election on a timely filed estate tax return. ("Timely filed" means a filing no later than 9 months after Bob's date of death or a later date if an extension of time to file was granted by the IRS.)

- Filing the return to make the election is necessary even though a return might not otherwise be required because the value of Bob's estate is less than the then effective exclusion amount.
- The estate tax return filed to claim DSUE is simpler than a return for which estate tax is payable. For assets of the estate other than those assets that qualify for the marital or charitable deduction, the executor is required to follow regular reporting requirements, identifying each asset and providing substantiation of its fair market value.
- For assets that qualify for the marital or charitable deduction, the executor need not disclose the value but must provide a description of the asset and disclose who will receive it in order to establish that the deduction is appropriate.
- Finally, the executor must include the computation of the DSUE amount for which the portability election is to be made.

#### When is making the portability election a good idea?

- When one spouse's assets are worth less than the other spouse's and are worth less than the owner/spouse's lifetime exclusion amount, it would be in the best interests of the spouse with the larger estate to elect portability if he or she were the surviving spouse.
- Or, if the spouses had modified their revocable trust to eliminate the family trust-survivor's trust division at the first spouse's death, with all of the assets passing to the surviving spouse at the first death, the survivor would elect portability, especially if the value of the combined trust was more than \$5.43 million.

### **How can the surviving spouse use the DSUE?**

The DSUE can be used by Sally to pay gift tax on gifts made by her during her lifetime and/or by her estate to pay estate tax. Some experts advise that a surviving spouse should **“use DSUE or lose it”** for several reasons:

- There is always a possibility that portability could disappear if the tax law were changed again. So, it might be wise for the surviving spouse to make gifts after his/her spouse's death and use some or all of the DSUE to “pay” tax on those gifts while portability is still in effect.
- Also, if the surviving spouse were to remarry, the portability rules prevent her from using the remaining DSUE of deceased spouse #1; she is limited to her own estate tax exclusion and any DSUE she receives at the death of her new spouse.

### **Should a married couple revise their revocable trust, given the availability of portability?**

If **you are married** and your estate plan requires that an irrevocable trust (often called the Family Trust, sometimes the Bypass Trust) and a revocable trust (usually called the Survivor's Trust) be established at the death of the first spouse to die, **you may want to revise your plan to eliminate the Bypass Trust.**

Why? Because of portability. Prior to portability, in order to use each spouse's exemption from estate tax, it was necessary to create and fund an irrevocable Family Trust with the deceased spouse's assets worth no more than his/her estate tax exemption. That Family Trust, no matter what its value, would not be subject to estate tax at the surviving spouse's death.

With portability, it is no longer necessary to establish a Bypass Trust to utilize the deceased spouse's unused exemption. The entire trust could continue for the surviving spouse's benefit as a revocable trust, and the surviving spouse could make the portability election. Both spouses' unused exemptions would be available at the survivor's death to reduce or eliminate estate tax liability.

Administration of the revocable trust would be simplified. With only the Survivor's Trust in place, no separate accounts would have to be maintained for the Family Trust during the surviving spouse's lifetime, and separate income tax returns would not be required for the Family Trust. The beneficiaries of the Survivor's Trust (usually the children) would receive a stepped-up basis in the inherited assets when the surviving spouse died. (That would not be the case if a Family Trust had been established at the death of the first spouse to die. The beneficiaries would receive a stepped-up basis on only the surviving spouse's estate assets.)

### **Are there reasons not to eliminate the Bypass Trust?**

Yes, definitely: With a Bypass Trust required, each spouse knows that if he or she were to die first, at least the assets in the Bypass Trust would be distributed as he or she wanted at the surviving spouse's death. If all the trust assets were held in the Survivor's Trust, the surviving spouse could amend that trust and direct the assets to anyone ... to his/her new spouse, for example. The assets of a Bypass Trust are protected against creditors of the surviving spouse; the assets of a fully revocable trust are not. The appreciation in the value of the Bypass Trust assets during the surviving spouse's lifetime is not subject to estate tax at his/her death. That can be a significant benefit if the value of the Bypass Trust appreciates at a rate greater than the rate of inflation.

Finally, if the surviving spouse had elected to use the deceased spouse's unused estate tax exemption and subsequently remarried, his/her estate would lose the deceased spouse's exemption, whereas with a Bypass Trust, the deceased spouse's exemption is protected whether or not the surviving spouse remarries.

Some advisors have suggested that **a married couple with an estate worth more than \$10 million** should keep the Bypass Trust as part of their revocable trust because the ability to shield the appreciation in the Bypass Trust from estate tax at the death of the surviving spouse makes up for the loss of the step-up in basis for Bypass Trust assets. Those advisors also suggest that **a married couple whose combined estate is not likely to ever reach \$10 million** could benefit from portability, primarily to take advantage of the benefits of the step-up in basis at the surviving spouse's death.

***We like another option...***

Amending the trust to provide that after the death of the first spouse to die, all of the trust assets will be held in the Survivor's Trust unless the surviving spouse chooses to allocate some or all of the deceased spouse's share of the trust assets to a Bypass Trust. This option provides flexibility to deal with changed circumstances, including a reduction of the estate tax exemption or elimination of the portability election.

Portability is important – and complicated. We recommend that you call Hoge Fenton attorneys Tim Maximoff or Jan Fox in our San Jose office, or Steve Siner in our Tri-Valley office.



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