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THE PERILS OF PORTABILITY

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Act) Pub. L No. 111-12, 124 Stat. 32 96 provides for "portability" of the applicable exclusion amounts between spouses. Marc S. Bekerman in an article entitled "Credit Shelter Trusts and Portability" in the May/June 2011 issue of Probate and Property (Vol. 25 No. 3) raises some interesting points and serious considerations in the use of portability. Here are some of the concerns which Marc Bekerman raises – what we call the "Perils of Portability:"

- Some practitioners have informally commented that portability will obviate the need for credit shelter trusts. Marc Bekerman strongly disagrees.
- To qualify for the DSUEA in the estate of the surviving spouse, both spouses must die after December 31, 2010.
- The surviving spouse is limited to the unused exclusion amount of his/her deceased spouse - the "ordering" of the use of the applicable exemption amounts in the estate of the deceased spouse, however, is in important issue, when the surviving spouse is remarried. Assume H1 survives W1, and then subsequently remarries to W2, and then predeceased W2. Depending the approach taken H1's DSUEA may or may not be available to W2. Marc Bekerman sets forth examples to show that the "ordering" is a justifiable concern. The joint committee on taxation explanation of the 2010 Tax Act adopts the approach most favorable to the taxpayer – i.e. in calculating the estate tax in H1's estate, first use the DSUEA of W1 and the balance of H1 applicable exclusion amount; then W2 gets the balance of H1's DSUEA.
- The estate of the surviving spouse is limited to the DSUEA of his/her most recent deceased spouse. This concern and the DSUEA of each party to a second marriage, may be the subject of numerous paragraphs in the premarital or postnuptial agreement -- how much DSUEA is available; when the same can be used and who will benefit.
- An Estate Tax Return must be filed in the first spouse to pass away. This may create administration requirements and costs, which would not otherwise be required. The estate tax return must show the amount of the unused exclusion amount and make an irrevocable election on the return designating the unused exclusion amount as such.
- The 2010 Tax Act eliminates a statute of limitations problem for the IRS, in that it provides that notwithstanding any applicable statute of limitations, the IRS will be permitted to examine the estate tax return of the estate of a deceased spouse to make determinations about the available DSUEA.
- Leaving the credit shelter amount of both estates to the survivor's estate may lead to increased federal or state estate taxation. The reason is that a properly drafted credit shelter trust will shelter from estate taxation the appreciation in asset value from the date of the first spouse's death to the date of the second spouse's death.
- Credit Shelter Trust may in fact be a better planning tool for descendants of the first spouse to pass away (i.e. children of the first marriage) - especially if there is a second marriage. Leaving an entire estate outright to a surviving spouse can place at risk the future inheritance of the deceased spouse's issue.
- Sunset Provision. The 2010 Tax Act sunsets for descendants dying after December 31, 2012. As such, planning for portability must be undertaken with the understanding that the future of portability for descendants dying after 2013 is uncertain – although many practitioners feel that once given it is difficult to take away; consequently, many practitioners believe that portability will be included in the next Gift, Estate and GST Tax Reform Act. (whatever else may be included). For an insightful review of portability please read Marc S. Bekerman's article – its worth the read.