

**Southern Arizona Estate
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The Importance of Portability

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What is Portability

- The American Tax Relief Act of 2012 (ATRA) made “portability” permanent between spouses.
- It is effective for deaths occurring in 2011 or later where there is a surviving spouse.
- Portability allows the estate of a decedent who is survived by a spouse to make an election to transfer the decedent’s unused federal transfer tax exclusion (referred to as “the deceased spousal unused exclusion amount” or “DSUE”) to the surviving spouse so that the surviving spouse may then use the DSUE obtained from the deceased spouse to address the survivor’s own transfers during life and at death. IRC 2010(c)(4).
 - The 2022 basic exclusion amount is \$12,060,000

What Is Portability Intended to Accomplish?

- The legislative purpose of portability is to create “fairness” between those people who “plan” their estates and those who fail to do so.
 - It preserves the unused portion of the deceased spouse’s exclusion which might otherwise have been lost through inadvertence or failure to plan or not being able to fully fund the available exclusion at the first death of the spouses.
- It is designed to eliminate the need for many married couples to retitle their assets and maintain assets in the separate names of each spouse.
 - It is designed to not force the creation of potentially complex “bypass” trusts at the death of the first spouse for the sole purpose of using the federal exclusion.

Availability of Portability

- The portability rules are effective for the unused exclusion amount of the deceased spouse who dies after Dec. 31, 2010. i.e. the deceased spouse has to have died in 2011 or later. A surviving spouse of a decedent who died prior to 2011 may not claim a DSUE amount from the deceased spouse.
- The DSUE of the deceased spouse is available to the surviving spouse in addition to the surviving spouse's own applicable exclusion amount.

Availability of Portability

- While the basic exclusion amount for those persons living has been indexed annually for inflation, the DSUE is **not** indexed for inflation.
- The unused generation-skipping transfer tax exemption of a predeceased spouse is **not** portable.
- To date, state death tax exemptions have **not** been made portable, with the exception of state death tax laws in Hawaii and Maryland.
- If the basic exclusion amount is reduced by legislation, or the current law sunsets after 2025, the DSUE ported to a surviving spouse would NOT be reduced (“clawed back”). TD 9884 11/26/20. Reg. 20-2010-1

How Much DSUE IS Portable?

- The amount of the DSUE that is portable and available to be used by the surviving spouse is limited to:
 - The lesser of the applicable exclusion amount available in the year of the deceased spouse's death , *or*
 - The unused exclusion amount (after subtracting the exclusion amount used by the decedent during lifetime and at death) of the **last** deceased spouse.
 - Reduce the decedent's basic exclusion amount by any prior taxable gifts made by the decedent and transfers made at death that absorb the basic exclusion amount.

Portability Applies Only to the Unused Exclusion of the Last Deceased Spouse

- If the last deceased spouse has no unused exclusion available, the surviving spouse gets no benefit from portability from that spouse, and loses any remaining DSUE from a previously deceased spouse.
 - If none of the last deceased spouse's basic exclusion was used in lifetime or at death, the surviving spouse gets the entire DSUE from the deceased spouse, and may use his or her own basic exclusion amount as well.
 - Example: Spouse A died in 2021 without having used any exclusion, survived by Spouse B. In 2021, the exclusion received by Spouse B is the \$11.70 million from Spouse A. In 2022 Spouse B has B's own \$12.06 million (assuming no prior use), plus the \$11.70 from Spouse A, or a total applicable exclusion of \$23.76 million.

How DSUE and the Applicable Exclusion Are Applied

- A surviving spouse may use the predeceased spouse's DSUE either during lifetime (to offset potential gift tax liability) or at death.
- The law prescribes the order of use: the DSUE of the predeceased spouse is used before any DSUE of the surviving spouse is used.
- If a surviving spouse who has a DSUE makes a taxable gift, the DSUE is applied first, before using the surviving spouse's own basic exclusion amount.

An Election Is Required for Portability to Apply

- Portability is elective, rather than automatic.
 - An election must be made on a timely filed federal estate tax return (Form 706) (including extensions) filed for the estate of the predeceased spouse, regardless of the size of the gross estate.
- There are no special boxes to check or statements to make on Form 706 in order to make the portability election. Filing the return constitutes making the election.

An Election Is Required for Portability to Apply

- Not timely filing Form 706 will effectively prevent the portability election.
- Can late elections be forgiven and corrected later?
- The IRS issued Rev. Proc. 2017-34 to allow a portability election to be made within two years of the decedent's date of death. No "late filing" penalty is imposed on this return, provided it was not a return required to be filed within 9 months of the decedent's date of death. When filing pursuant to this Rev. Proc., write "Filed pursuant to Rev. Proc. 2017-34" on the top of Page 1 of Form 706.
 - The IRS will allow a late filing (beyond two years after death) of an otherwise not required return to elect portability granting "Section 9100 relief", but if the filing is made later than two years after the decedent's death, a private letter ruling must be requested and obtained, and as of February 3, 2021, the cost of the user fee to apply for the ruling is increasing from \$10,900 to \$12,600. [Code Sec. 2010: Estates Granted Extensions to Make Portability Elections \(LTR 202204004, 202204005\) \(Jan. 31, 2022\)](#)

Who Makes the Portability Election?

- The election is made by the duly appointed executor or administrator of the estate. (Form 706, Part 6).
- If there is no duly appointed executor, a non-duly appointed executor in actual or constructive possession of the property of the decedent.
- A portability election made by a non-appointed executor cannot be superseded by a contrary election by another non-appointed executor of the same estate.

Should 'Small' Estates Bother to File Form 706 to Elect Portability?

- **There is a cost (fees) involved in preparing the Form 706, a cost that the decedent's family may resist.**
- **If filing Form 706 only to take advantage of portability, it is NOT necessary to address the consistent basis rules. Form 8971 need NOT be filed. IRC 1014 (f).**
- **It is submitted that failure to make a portability election is NOT the correct decision.**
 - What if the surviving spouse receives a "windfall" after the first spouse dies? [Luck through winning a jackpot or a lottery; inheritance from a wealthy relative; marriage to a wealthy (and generous) new spouse; recovery from being a personal injury victim].

Should 'Small' Estates Bother to File Form 706 to Elect Portability?

- Had the representative of the first decedent spouse simply elected portability, the additional exclusion would be available to the surviving spouse.
- What if the future exclusion declines via law changes – or sunset of the 2017 Act in 2026?
 - If the windfall does occur, and if no portability election was made, how much exclusion does the survivor have in his or her own right?
 - What if the IRS decides to stop allowing late elections?
 - Might the representative of the estate of the first decedent and other professionals be sued for negligence by the heirs of the second spouse to die?

How Is the DSUE Determined?

- Remarriage
 - If the surviving spouse remarries, the DSUE from the deceased spouse will still be available to the surviving spouse as long as his or her new spouse is living.
 - Therefore, use DSUE quickly.
 - If the “new spouse” of the surviving spouse dies, the “new spouse” is now the “last deceased spouse” and his or her DSUE (if any) is now eligible for portability to the surviving spouse. The DSUE of the prior deceased spouse (to the extent not already used) is lost. Caution: In a “blended family” no assurance the surviving spouse will be the primary beneficiary.
 - If the surviving spouse remarries and divorces, the later death of the “new” (and now divorced) spouse will not destroy the DSUE from the first deceased spouse.

The Unlimited Statute of Limitations to Resolve a DSUE Claim

- The IRS has an unlimited statute of limitations to resolve a DSUE claim to examine the return of the predeceased spouse in order to determine the correct DSUE amount available for use through portability by the surviving spouse. IRC 2010(c)(5), superseding IRC 6501. *Sower v. Commissioner*, 147 T.C. No. 11 (2017). [unreported gifts by the first decedent subtracted from DSUE claimed by spouse even though first decedent's estate received a closing letter and the DSUE adjustment was made more than three years after the first decedent's death].
 - This suggests the requirement of record preservation (and some potential **uncertainty**) by the executor for a potentially very long period of time.
 - The "adequate disclosure rules" do not apply to this situation.
 - Additional tax on the earlier Forms 706 can be assessed only within the normal statute of limitations period applicable to each deceased spouse's Form 706. Any increase in tax may be added to the surviving spouse's estate tax return.

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Caution

The 'Angry' or Vindictive Executor

- If the executor of the first spouse to die is resentful of the surviving spouse, he or she may choose to ignore the portability opportunity to deny the additional tax saving in the future estate of the surviving spouse.
- Perhaps the decedent's Will or Trust Agreement should contain a provision requiring a portability election to be made to avoid any conflicts
 - **The Regulations require the executor to make an affirmative statement on the Form 706 to opt out of portability.**
 - **A box is provided on Form 706 to opt out of portability. Part 6 Section A.**
 - **Not timely filing a Form 706 will also be considered such an affirmative statement opting out of portability.**

Complete and Properly Prepared Form 706

- **Special Rules for Estates Filing Only to Make the Portability Election**
 - There is a special rule for smaller estates not otherwise required to file Form 706.
 - Executors do not have to report the values of certain assets that qualify for the marital or charitable deduction.
 - For purposes of the Form 706, the executor must estimate the total value of the gross estate based on a “determination made in good faith and with due diligence”.
 - Property subject to the marital or charitable deduction only need report: Description, Ownership, and Beneficiary information to establish the estate’s right to the deduction.
 - This “simplified” method does not apply if the value of property is needed to determine what should pass to another recipient, or make elections under IRC 2032, 2032A or 6166; or if less than the entire interest in the property is marital or charitable deduction property; or if a partial disclaimer or a partial QTIP election is being made.

Complete and Properly Prepared Form 706

- The executor must identify the range for the executor's best estimate of the value of the gross estate.
 - The executor may end up estimating the estate's total value, rounded to the nearest \$250,000.
- If a complete and properly prepared return is filed in accordance with these "simplified" rules, the portability election is deemed made. Reg.20.2010-2(a)(7).
- Form 706 provides a ten-step calculation (Part 6, Section C) to show the DSUE amount being portable from the deceased spouse to the surviving spouse.
- **PROBLEM:** If the simplified method is used, how, then is a reverse QTIP election made to be sure the transferor of property uses the non-portable GST exclusion?
- **SOLUTION:** The IRS says to use the "standard" rules for filing Form 706 when a reverse QTIP is desired. (Complete Schedule R).

Estate Tax Form 706 Part 6 - Portability

- Section B of Part 6 asks whether any assets are being transferred to a Qualified Domestic Trust (QDOT) which would require the re-computation of the DSUE at the time of the final distribution of the QDOT or other taxable event.
- When there is a QDOT for a surviving spouse and DSUE available:
 - The Executor determines a preliminary DSUE amount in Section C of Part 6.
 - This amount decreases as Section 2056A distributions are made to the spouse.
 - The DSUE is not available to the surviving spouse against tax on lifetime gifts since final determination of DSUE is postponed until the death of the surviving spouse, or the termination of the QDOT.
 - **NOTE: A United States citizen surviving spouse will not receive any inherited exclusion amount from a non-resident noncitizen spouse.**

Gift Tax Return - Form 709 Schedule C – Reporting DSUE

- **Part 1 - Line 19 on the first page of Form 709 addresses portability by asking, “Have you applied a DSUE amount received from a predeceased spouse to a gift reported on this or a previous Form 709?” If “Yes” complete Schedule C of Form 709. Schedule C addresses the (DSUE) received from prior spouses.**
 - **The surviving spouse can use the DSUE received from the last deceased spouse as well as DSUE received from prior deceased spouses (so long as used when that spouse was the last deceased spouse) as an additional gift tax exclusion.**
 - **If a taxable gift is made, the DSUE amount received from the last deceased spouse is applied before the surviving spouse’s basic exclusion amount.**

Advantages and Disadvantages of Portability

- Simplification
 - **The most obvious advantage of portability is that it simplifies the estate planning process for many people.**
 - **Its use will provide a date of death basis in the assets left to the surviving spouse which remain unspent at the surviving spouse's death. (A second potential "step-up").**
 - **Caution: What if future tax laws eliminate fair market value basis at death?**
 - **Portability may eliminate for many families the use of a bypass (credit shelter trust).**
 - **Portability will also be helpful when the assets of the first deceased spouse pass outside of the will or revocable trust and are unavailable to fund the non-marital share of a "typical" marital–nonmarital planning division.**

Advantages and Disadvantages of Portability

- Retirement Plan Roll Over Advantage:
 - With the increased exclusion and the portability option, persons with large retirement plans will be more likely to leave them outright to their spouses and retain the spousal rollover as a viable planning option. The retirement plan will not have to be used to fund a credit shelter trust. This allows a more favorable use of the survivor's life expectancy for required minimum distributions after the Secure Act of 2019.

Advantages and Disadvantages of Portability

- **Planning for States with Independent Death Taxes**
 - **What planning is appropriate in circumstances where there may still be a state death tax regardless of the fact that there may not be a federal estate tax as a result of the estate falling short of the federal exclusion, but exceeding the state exclusion?**
 - **Be careful of formula planning that directs an entire estate to pass to a credit shelter trust.**
 - **Similarly, be careful of ignoring the presence of a state death tax exclusion at the first death of a married couple by passing the entire estate at the first death to the surviving spouse.**

Is the Simple Plan the Better Plan?

- The intentional rejection of a bypass trust can be viewed as either an advantage or a disadvantage.
 - It gives more control over property to the surviving spouse.
 - Pros and Cons: Issues of asset protection, management, protection from future spouses of the surviving spouse and spouses of children, protection of blended family heirs of one spouse but not the other, ultimate control of the disposition of the property by the first spouse to die, etc. must be considered as part of the portability discussion.

Is the Simple Plan the Better Plan?

- What happens if the assets left by the first decedent appreciate dramatically during the lifetime of the surviving spouse—who may survive the first decedent by many years?
 - **If portability is used, all of the appreciated property will be taxable at the death of the surviving spouse.**
 - **Portability is not indexed for inflation, so the DSUE of the first decedent is “frozen” and offers no help to address significant appreciation and inflation.**
 - **What if the allowable exclusion is reduced by political change?**
 - **Had the credit shelter bypass trust been used instead of portability at the first death, the appreciation would stay with the credit shelter trust, which would not be subjected to transfer tax at the second death, but would not be awarded a basis equal to fair market value at the second death.**

What to Tell the Clients About Planning?

- Consider the Clayton QTIP (i.e. a regular QTIP with an additional clause in the trust document). Clayton v. CIR, 976 F.2d 1486 (1992).
- The trustee may elect, at the grantor's death, to fund the QTIP with some or all of the grantor's property, and distribute the balance (if any) outright or in a credit shelter trust or in the QTIP trust.
- Flexible plan. Can address blended families.
- Allows for funding the by-pass trust to address the available GST exemption of the first spouse to die.
- Better than a disclaimer: Have 15 months to make funding decisions (9 month due date for 706, plus 6 month extension) vs. strict 9 month from date of death disclaimer requirement.

Sophisticated Planning Moves to Address the Appreciation Concern—
Without Losing the Basis Step-Up

- Consider using portability, and then having the surviving spouse take the assets with the greatest appreciation potential and use them in conjunction with a “defective grantor trust” to be created by the surviving spouse.
- The inherited assets are then sold to the trust in exchange for an installment note.
 - This freezes the value of the ported assets in the hands of the survivor at the amount of the note, and allows all future appreciation to inure to the benefit of the trust beneficiaries.

Sophisticated Planning Moves to Address the Appreciation Concern— Without Losing the Basis Step-Up

- The grantor is responsible for the income tax on the trust income, allowing the income tax payments by the grantor to reduce the grantor's estate without being considered gifts by the grantor to the trust beneficiaries. Rev. Rul. 2004-64
- This should solve the appreciation concern.
 - **The power used by the surviving spouse to make the trust defective should be the power of substitution. IRC 675**
 - **The exercise of this power will enable the surviving spouse to substitute cash or higher basis property from time to time for the property in the trust, thus “managing” the basis issue while the trust property appreciates outside of the survivor's estate.**

Sophisticated Planning Moves to Address the Appreciation Concern—Without Losing the Basis Step-Up

- If there is concern that the use of the credit shelter trust will not allow for a basis adjustment at the surviving spouse's death, consider giving a trustee or a trust protector the right to grant the trust beneficiary a general power of appointment exercisable at death.
- If the surviving spouse's estate will avoid federal estate tax, granting this power will cause an estate inclusion and corresponding FMV basis at death. If the surviving spouse's estate exceeds the federal estate tax threshold, don't grant the power.

Sophisticated Planning Moves to Address the Appreciation Concern— Without Losing the Basis Step-Up

- To make this possible general power of appointment planning “work,” the first decedent spouse must be comfortable that the survivor will follow through and accomplish everything envisioned by this plan, and is “trusted” to name “acceptable” beneficiaries if exercising the power of appointment. If the “full” general power is too broad (self, estate, creditors, creditors of estate) consider limiting the exercise of the general power by the surviving spouse to creditors only.

Sophisticated Planning Moves to Address the Appreciation Concern— Without Losing the Basis Step-Up

- Another method to use to address the concerns about appreciation and the desire for the double basis step up issue is to use a credit shelter trust and plan it so that the “Delaware tax trap” can be triggered by the surviving spouse to cause the trust assets to be includable in the surviving spouse’s gross estate.
- The credit shelter trust would be created at the death of the first spouse thereby “controlling” the future appreciation issue.
 - The trust would be drafted to give the surviving spouse a limited power of appointment that includes the power to grant to other beneficiaries new presently exercisable powers of appointment to appoint the trust property in further trust.

Two Sophisticated Planning Moves to Address the Appreciation
Concern—Without Losing the Basis Step-Up

- If the surviving spouse wants to trigger estate inclusion, the spouse would exercise the original limited power to create a presently exercisable power of appointment in someone else.
 - That would cause estate inclusion in the surviving spouse's gross estate
 - **i.e., it would "spring" the Delaware tax trap. IRC 2041(a)(3).**

Conclusions

- Portability is without question a huge “game-changer” in estate planning for many clients
- The concern is that people will overlook some of the traditional “safe harbors” that trusts at the first death provide
- Portability comes with another risk—that despite its benefits, it will be ignored or rejected by many it is most designed to help.
- For the large estates, the credit shelter bypass trust remains a viable recommendation

- The bottom-line conclusion here is that portability is a case-by-case determination
 - It is a more complex issue than first appears

Thank you for attending today's program