PORTABILITY

Estate Tax Exclusion Portability: Policy to Planning Ideas

Portability between spouses of the $5 million estate tax exclusion amount extends the policy framework of a married couple as a single unit and raises planning considerations.

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[pg. 8]

Marriage is a single topic that can generate heated debate in multiple arenas: history, tradition, law, politics, religion, morality, and economics, just to name a few. Since the founding of the U.S., the concept of marriage has held a revered place, both religiously and politically, and this respect for the concept of marriage has translated into the treatment of a husband and wife as one individual in many aspects of the law and society.

Following this perspective, the modern Internal Revenue Code has increasingly moved, with a few exceptions, toward the recognition of the husband and wife as one, single marital unit. The enactment of the concept of “portability” in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 is a further extension of this policy. By allowing a surviving spouse to use the unused estate tax applicable exclusion amount of a predeceased spouse, the husband and wife, as a single entity, can use the full estate tax exclusion amount of each individual without regard to the actual ownership of the assets at death. Therefore, Congress has again extended the concept of a husband and wife as one marital unit by truly taxing the marital unit at the death of the second spouse. This new concept of portability provides certain advantages for married couples, as well as planning opportunities for attorneys and practitioners, but it is not without significant risks.

Policy of marriage as a unit

Since the development of the modern tax code, Congress has increasingly moved toward the recognition of the husband and wife as a single marital unit rather than two individual taxpayers for purposes of tax liability. For example, within the income tax context, a husband and wife may file joint income tax returns and aggregate income between spouses on the joint return. [1] When the modern income tax was created in the Tariff Act of 1913, each person was required to file a separate income tax return, and husbands and wives were not able to aggregate income and losses between them. [2] In addition, the federal gift tax also generally reflects the policy of husbands and wives as a single marital unit, and the Code now includes an unlimited marital deduction so that transfers between spouses are not considered a gift for gift tax purposes, acknowledging that a person (assuming a husband and wife are one taxpayer) cannot make a completed gift to oneself. [3]

Similar to the federal income and gift tax laws, within the estate tax law, the concept of taxation only on the death of the second spouse

[pg. 9]

has evolved over time as well. This movement toward the taxability of the married couple as a single unit on the death of the second spouse began with the enactment of the marital deduction and then evolved as Congress increased the deduction limits over time. Prior to 2010, the Code allowed an unlimited marital deduction, but because each individual still had a separate estate tax applicable exclusion amount, the husband and wife were not fully merged into one taxpayer. Because the estate tax exemption was an individual attribute, any unused exemption was lost at death.

Although some practitioners, the public, and even the Congressional Budget Office, frequently referred to a married couple as having an exemption of $7 million when the individual exemption was $3.5 million, [4] this idea was true only if a married couple had divided their assets equally such that both spouses could take maximum advantage of using the full estate tax exemption and if the couple had properly structured wills containing bypass credit shelter trusts to shelter an amount of property equal to the estate tax exemption on the first spouse's death. If either spouse did not have a will or had a will that left his or her entire estate to his or her spouse, the unlimited marital deduction would apply, and the first spouse's estate would pass free of estate tax to the surviving spouse, but the first spouse's estate would not get the benefit of the first spouse's estate tax exclusion amount. Therefore, when the second spouse ultimately died, the second spouse's estate could claim his or her estate tax applicable exclusion amount, but the couple would not be able to use the full $7 million of both exclusions.

Likewise, if two spouses had not equalized their estates, such that one spouse had an estate less than the current exemption, and the other spouse had significantly more than the exemption amount, but the less wealthy spouse died first, then some portion of the deceased spouse's exemption would be lost. Therefore, under EGTRRA, the husband and wife were not treated as a single economic unit automatically. Rather, only those who engaged in proper planning and implemented sophisticated estate planning advice could take advantage of the combined estate tax exemption for a married couple.

Portability introduced. When the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“2010 Tax Relief Act”) was signed into law on 12/17/2010, Congress enacted a two-year extension to the estate tax law that included the additional concept of “portability” of the “deceased spousal unused exclusion amount.” [5] Restated in general terms, portability means that any unused estate tax applicable exclusion from the estate of the first spouse to die may be used by the estate of the surviving spouse, with some exceptions.

Although practitioners, academics, and politicians have discussed the concept for decades (see Exhibit 1), the 2010 Tax Relief Act was the first time that the concept of the portability of the unused applicable exclusion from a deceased spouse was included in legislation. Under section 303(a) of the 2010 Tax Relief Act, each individual has a $5 million basic exclusion amount. The applicable exclusion amount of a decedent, however, is the basic exclusion amount ($5 million, indexed for inflation [6]) increased by the “deceased spousal unused exclusion amount.”

Defined in section 303(a) of the 2010 Tax Relief Act, the deceased spousal unused exclusion amount of a surviving spouse is the lesser of the basic exclusion amount ($5 million) or the excess of the “basic exclusion amount of the last such deceased spouse of the surviving spouse over the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse.” [7] The “amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse” is the sum of the taxable estate of the deceased spouse plus the adjusted taxable gifts by the deceased spouse.

Unlike all estate tax exclusions in prior laws, because the 2010 Tax Relief Act includes the ability to use such unused exclusion of the predeceased spouse, the applicable exclusions of two spouses can truly be viewed as a single applicable exclusion. Even though the prior exclusion was often considered a joint exclusion for married couples, portability is truly a further extension of the concept of a married couple as a single unit because now the two individual exemptions are potentially combined into one

[pg. 10]

exemption for the husband and wife together.

Exhibit 1. Brief History of Portability

1988 American Bar Association (ABA) Tax Section, Task Force on Transfer Tax Restructuring. Holdsworth, “Report on Transfer Tax

Restructuring," 41 Tax Law. 395 (1988).

- Drafted as a "proposed response to the request of the Treasury Department for suggestions for reform of the Federal transfer taxes" and contained numerous, comprehensive suggestions for reform of various aspects of the transfer taxes, including a proposal for the "portability of exemption between spouses" that would allow "[a]ny exemption unused by a married individual or his estate" to be "made available for use after his death by his surviving spouse during her life or by her estate at her death."
- Offered several explanations for portability, including that couples would no longer be required to engage in complex estate planning. It was "consistent with the existing gift-splitting and marital deduction provisions in treating husband and wife as, in effect, a single taxable unit." In short, "Portability would simplify."
- Addressed two potential issues in cases where "nonpropertied spouse dies first" and in the case of "successive marriages."

Private letter rulings.

- The IRS administratively authorized the concept of portability through several private letter rulings. See Gans and Blattmachr, "Making Spousal Estate Tax Exemptions Transferable," ALI-ABA (9/7/2006 - 9/8/2006), at page 2. In general, the rulings authorize a plan in which a wealthier spouse creates a revocable living trust granting the less wealthy spouse a testamentary general power of appointment, and the less wealthy spouse "exercises the power of appointment in favor of his or her estate and then directs in the Will that it be placed in a credit shelter trust for the benefit of the wealthier spouse," so the exemption is not wasted in the event that the less wealthy spouse dies first. The wealthier spouse is able to retain control over the assets because they are in a revocable living trust. Therefore, the "rulings solve the problems of non-portability."

Various tax reform bills have included portability in the proposed legislation, but were never passed by both houses of Congress and signed into law. For example:

- The Permanent Estate Tax Relief Act of 2006, H.R. 5638, section 3, 109th Cong. (2006).
- The Taxpayer Certainty and Relief Act of 2009, S. 722, section 302, 111th Cong. (2009).

Election required. The ability to use the unused exemption, however, is not automatic. The estate of the deceased spouse must file an estate tax return to report such remaining unused exemption and make an election that any unused exclusion amount may be used in the surviving spouse's subsequent estate tax return. [8]

Many commentators requested that a short estate tax return form be provided so that executors making the portability election did not have to file a full and complete estate tax return. By definition, if there is any deceased spousal unused exclusion amount, the deceased spouse's estate was a nontaxable estate and would otherwise not have to file an estate tax return. The newly issued regulations, [9] however, clarify that the executor must timely file the complete Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. [10] The Regulations do, however, provide special rules for reporting certain property in certain circumstances. In the case of property that will receive either a marital deduction or a charitable deduction, the executor must still report a description, the ownership, and the beneficiary of such property along with information necessary to establish the right to take a deduction, but the executor does not have to report the value of this property on the Form 706 when electing portability in some circumstances. [11]

This simplified rule does not apply, however, in the following circumstances:

(1) The value relates to, affects, or is needed to determine the value passing from the decedent to another recipient.

(2) The value is needed to determine the estate's eligibility for alternative valuation or special-use valuation elections or another Code provision.

(3) Less than the entire value of the property is deductible.

(4) A partial disclaimer or partial QTIP election is made with respect to property includable in the estate, part of which is marital deduction property or charitable deduction property. [12]

Even though the executor may not have to provide values for property subject to a marital or charitable deduction in certain cases, if the executor chooses not to provide such values, the executor must still exercise due diligence "to estimate the fair market value of the gross estate, including the property described in paragraph (a)(7)(ii)(A),” which is the marital deduction and charitable deduction property, outlined above. The executor must certify that the total gross estate lies within certain ranges of dollar values, which will be included on the Instructions for Form 706. Until the Form 706 is revised to include these estimate ranges, an executor should include, under penalties of perjury, his or her best estimate for the value of the gross estate, rounded to the nearest $250,000. [13]

If the executor chooses to make the portability election in the deceased spouse's estate, the IRS may examine the returns even after the period of limitations on assessment has expired. [14] Therefore, the IRS potentially could review the portable exclusion amount claimed on the return.

Guidance requested and provided for computing amount. The statute itself provides little explanation for the actual meaning of the “deceased spousal unused exclusion amount,” but authorizes the Secretary to prescribe necessary regulations in **Section 2010 (c)(6)**. The Joint Committee on Taxation's Technical Explanation of the 2010 Tax Relief Act (“JCT Technical Explanation”), published in March 2011, initially provided some explanations and several examples for computing the deceased spouse's unused exclusion amount prior to the issuance of the regulations. [15]

On 6/15/2012, the IRS finally issued temporary and proposed regulations on portability, which clarify many of the questions surrounding the application and administration of portability that were initially discussed after the enactment of the Tax Relief Act. As discussed in further detail below, however, the JCT Technical Explanation examples also illustrated some of the open issues and inconsistencies within the statutory language that the regulations attempted to clarify and correct.

In the simplest case outlined in the JCT Technical Explanation, if Husband predeceases Wife, Husband's estate makes taxable transfers of $3 million, leaving $2 million of unused exclusion amount, and the executor of Husband's estate makes the election to allow Wife to use Husband's unused exclusion amount. In this case, Wife has an applicable exclusion amount of $7 million, the sum of her personal $5 million basic exclusion amount and Husband's unused exclusion amount. Wife may then use this $7 million for her lifetime gifts or for transfers at death under the unified estate and gift tax applicable exclusion structure.

Successive marriages. These examples in the JCT Technical Explanation include additional explanation of how to deal with successive marriages, which was one of the concerns of the 1988 ABA Task Force. [16] Example 3 in the JCT Technical Explanation includes the possibility of the surviving spouse using the deceased spouse's unused exclusion amount first before using the decedent's basic exclusion amount. In this example, Wife survives Husband 1, but predeceases Husband 2. According to the Example 3, it appears that Wife's estate is

[pg. 12]

allowed to use the deceased spousal unused exclusion amount from Husband 1, and then apply her basic exclusion amount. The remaining unused exclusion amount is then available to increase Husband 2's applicable exclusion amount.

As noted by many commentators, including Steve R. Akers, however, this example was “not consistent with the statutory definition of the ‘deceased spousal unused exclusion amount.’” [17] Following the strict statutory definition of “deceased spousal unused exclusion amount,” there are no “references whatsoever to the amount of Wife's unused exclusion from Husband 1 in determining the amount of the unused exclusion that Husband 2 has from Wife.” [18]

Following the initial reaction by commentators, however, the Joint Committee on Taxation published an errata to its Technical Explanation noting that a “technical correction may be necessary to replace the reference to the *basic exclusion amount* of the last deceased spouse of the surviving spouse with a reference to the *applicable exclusion amount* of the last such deceased spouse, so that the statute reflects intent.” [19]

Rather than amend the statute, however, as described in the Preamble to the regulations, the IRS adopted the interpretation in the errata so that for **Section 2010(c)(4)(B)(i)**, through the regulatory interpretation, “basic exclusion amount” is interpreted to mean “applicable exclusion amount.” Therefore, Example 3 of the JCT Technical Explanation is now a correct interpretation of portability under the statute and temporary regulations. Furthermore, the regulations clarify that the surviving spouse's available deceased spousal unused exclusion amount from the “last deceased spouse” “means the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse.”

Furthermore, the regulations also state that the “last deceased spouse” for purposes of determining the surviving spouse's available deceased spousal unused exclusion amount means “the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse.” [20] The regulations further clarify this definition of last deceased spouse in **Temp. Reg. 20.2010-3T**.. Even if the surviving spouse remarries, as long as the second spouse does not predecease the surviving spouse, the “last deceased spouse” remains the same. In addition, if the second marriage ends in divorce, the death of the divorced spouse prior to the surviving spouse does not change the identity of the “last deceased spouse” for purposes of calculating the deceased spousal unused exclusion amount of the surviving spouse because the surviving spouse was not married at the time of the divorced spouse's death. [21]

Coordination with gift tax. The statute also did not make clear whether the concept of the deceased spousal unused exclusion amount would be available in the gift tax computation for the surviving spouse. The regulations clarify that in addition to the surviving spouse's estate being able to use the deceased spousal unused exclusion amount in the estate tax calculation, the surviving spouse may also use the deceased spousal unused exclusion amount for any calculation of any gift tax due by the surviving spouse as of the date of the decedent's death, if the deceased spouse's executor has made the portability election. [22] The surviving spouse is considered to use the deceased spousal unused exclusion amount first before applying his or her own basic exclusion amount to the gift. [23]

If the surviving spouse uses all or a portion of the last deceased spouse's exclusion amount in gifting during his or her lifetime, but then remarries and has a subsequent spouse predecease him or her, with the subsequent spouse becoming the new “last deceased spouse,” the regulations provide a special rule for the amount of deceased spousal exclusion available to the surviving spouse. [24] The regulations do not reduce the surviving spouse's deceased spousal unused exclusion amount from the second predeceased spouse by the deceased spousal unused exclusion amount from the first predeceased spouse that the surviving spouse already used for lifetime gifting. [25] Therefore, the regulations specifically authorize the use of multiple “last deceased

[pg. 13]

spouse” exclusion amounts in gifting by the surviving spouse. As noted in the Preamble to the regulations, this special rule does not allow the surviving spouse to use the sum of the deceased spousal unused exclusion amount from all prior deceased spouses at one time.

As demonstrated by these examples and the changes and interpretations in the regulations, the concept of portability is still a large step forward in the progression of the treatment of a husband and wife as a marital unit. A husband and wife are generally taxed on their aggregate income as a single unit, may make gifts as a single unit, and now, with portability of the deceased spouse's unused exclusion amount, a husband and wife, as a marital unit, are one step closer to being taxed only on the death of the surviving spouse while using the full exclusion amount of each spouse.

Finally, although Congress added the concept of portability and increased the applicable exclusion amount in the 2010 Tax Relief Act, the Act is effective for only two years, through 12/31/2012. [26]

Practical applications of portability

With the advantages and disadvantages of portability come corresponding planning opportunities and risks.

Advantages and planning opportunities

One of the main advantages to portability of the use of the deceased spouse's unused exclusion amount is that it puts couples who do not engage in complex estate planning on the same footing as couples who engage in estate planning with an advisor. Essentially, portability is post-mortem planning that is statutorily authorized by Congress.

Reduced need for trusts. For instance, under the prior law, couples with a joint taxable estate in excess of their combined applicable exclusions could use both of their full applicable exclusions only if they properly divided assets such that each spouse owned the applicable exclusion amount, at a minimum, and executed proper wills using bypass credit shelter trusts to hold the exclusion amount of the deceased spouse. Now, even under simple wills and without splitting assets equally between spouses or the use of trusts on death, where one spouse leaves all property to the other spouse, both spouses' exclusion amounts may be used on the death of the surviving spouse. Many clients may prefer the idea of avoiding trusts that they perceive as creating an additional administrative burden on the death of the first spouse.

For a married couple who has done no estate planning before the first spouse's death, portability provides the opportunity to do estate planning after death, as the practitioner may elect to use the exclusion amount of the deceased spouse for the surviving spouse. Therefore, the husband and wife as a marital unit may still use the full $10 million of applicable exclusion amount. Use of a disclaimer would have achieved the same result under the prior law, but use of the portable exclusion amount simplifies the process. Thus, administration of a deceased spouse's estate becomes simplified if proper planning was not done during life.

Avoids need for equalization of assets. In addition, spouses relying on portability of the exclusion amounts are not required to equalize property ownership prior to death. Under the prior structure, each spouse's unused applicable exclusion was lost on death because the exemption was an individual attribute. Therefore, it was crucial for spouses with potential estate tax liability based on their joint net worth to title assets in such a way that each spouse owned at least that spouse's exclusion amount that could then be placed in a credit shelter trust. The prior law without the portability feature penalized taxpayers who did not equalize their asset ownership.

With portability of the estate tax exclusion amount, the spouses no longer have to rely on a credit shelter trust structure, as described above, and therefore, no longer have to equalize the estates. As discussed below, however, the use of

[pg. 14]

the credit shelter trust should remain the primary basic estate planning tool for practitioners.

Use of exclusion amount during life. As described in Example 3 of the JCT Technical Explanation, and authorized by the regulations, the deceased spousal unused exclusion amount may be consumed by the surviving spouse before the basic exclusion amount of the surviving spouse.

Example. A married couple has a combined net worth of $10 million. Husband dies before making any gifts or doing any complex estate planning, but Husband's executor makes the portability election. Then, Wife desires to make gifts of $8 million to her children in excess of her $5 million basic exclusion amount. Wife may use Husband's $5 million exclusion amount as well as $3 million of her own exclusion amount, thus paying no gift tax on the transfer and retaining $2 million of her exclusion amount for use in future gifts or by her estate.

The availability to use the deceased spousal unused exclusion amount first in the gift tax context provides practitioners with multiple options in estate planning for surviving spouses, particularly with the uncertainty of estate and gift tax laws in 2013 and beyond.

Example. A spouse dies during 2011 or 2012, and the estate makes a timely election to permit use of the unused exclusion amount by the surviving spouse. If Congress appears to be unlikely to extend a $5 million exclusion amount as of 1/1/2013, but instead seems likely to allow the exclusion amount to revert to $1 million (or to eliminate the portability concept), the surviving spouse may take the opportunity to make lifetime gifts of his or her full applicable exclusion amount, including the deceased spousal unused exclusion amount and basic exclusion amount, in order to transfer a full $10 million prior to the end of 2012. In that manner, the surviving spouse would fully use both spouses' exclusion amounts.

Disadvantages and planning risks

Although the concept of portability has several advantages, practitioners need to be keenly aware of several disadvantages and risks. Ultimately, these substantial risks should prevent the practitioner from relying on portability as a proactive planning tool, but rather only as a retroactive planning tool when no planning has been done during the decedent's lifetime.

Generation-skipping transfer (GST) tax. One of the main disadvantages to the use of the deceased spouse's unused exclusion amount is that the GST tax exemption is not portable between spouses. Therefore, although a married couple with aggregate wealth of $10 million may owe no estate tax on the death of the survivor by use of the deceased spousal unused exclusion amount, if the surviving spouse leaves over $5 million to individuals more than one generation removed or to trusts that include potential distributions to skip persons, the surviving spouse's estate will owe GST tax on any amount in excess of the basic exclusion amount, currently $5 million.

In addition to the fact that the GST exemption is not portable, the differences between state law are also greater as many states have set exemptions that are lower than the federal applicable exclusion and do not include any portability feature. Therefore, if a married couple relies on portability to preserve both spouses' federal basic exclusion amounts, they could likely lose the deceased spouse's unused state estate tax exemption if proper estate planning is not done prior to death. A couple in a state with an estate tax and qualified terminable interest property election could make a state-level QTIP election but still elect portability for purposes of federal estate tax law in order to preserve the state exemption on the death of the first spouse.

Effect of asset appreciation. Another significant disadvantage to the use of portability is that the use of the traditional credit shelter trust structure provides the potential to transfer more assets to lower generations than reliance on portability of the deceased spousal unused exclusion amount. The following two examples illustrate the benefit of the credit shelter trust in this context.

Example. A husband and wife each have $5 million in assets, neither having made any taxable transfers during life. The husband then dies, leaving everything to his wife outright, with the husband's estate making an election for the wife's estate to use a deceased spousal unused exclusion amount of $5 million. When the wife dies several years later, her estate has appreciated to $12 million ($6 million attributable to the husband's assets and $6 million attributable to the wife's assets).

[pg. 15]

The wife's estate can use her basic exclusion amount of $5 million along with the $5 million deceased spousal unused exclusion amount, leaving $2 million as taxable.

Example. The facts are the same as in the immediately preceding example, except the husband's $5 million was transferred into a credit shelter trust when he died, fully using the husband's $5 million basic exclusion amount. Then when the wife died, her personal estate was $6 million. The wife's estate could use her $5 million basic exclusion amount, leaving a taxable estate of $1 million and the full $6 million in the credit shelter trust. Therefore, the appreciation from the husband's assets is sheltered by the credit shelter trust and transferred to future generations free of tax.

The lesson here is that reliance on portability means that the appreciation on the assets of the deceased spouse remains subject to taxation in the estate of the surviving spouse.

Expiration date. Although use of the portable exclusion amount is a simple estate planning tool for those couples who have not or will not engage in complex estate planning, practitioners and taxpayers face significant planning risks if they rely on the use of a deceased spousal exclusion due to the uncertain future of the law, administrative requirements that may be overlooked, and potential remarriage of the surviving spouse. Most importantly, as stated above, the 2010 Tax Relief Act is only effective through 12/31/2012. Although the Budget of the United States Government, Fiscal Year 2013 proposed by the Obama Administration assumes portability will continue into 2013, [27] Congress has not passed any extensions of the 2010 Tax Relief Act at this time.

Therefore, if the Act sunsets, or if Congress passes a new act that does not include a portability feature, those estates electing use of the deceased spousal unused exclusion amount in 2011 or 2012 risk the loss of the unused exemption if the surviving spouse is still living on 1/1/2013. Placing complete reliance on a tax law with an unknown future is an unnecessary risk for practitioners and taxpayers to take.

Election deadline. Next, the exclusion amount may be lost also by the failure of a deceased spouse's executor to make a timely election under the law. A couple who has done no estate planning, such that reliance on portability of the exclusion amount is required, is less likely to consult an attorney or receive advice on the death of the first spouse. If the election must be made on the estate tax return of the first spouse, within nine months of the date of death of the first spouse, the personal representative of the deceased spouse's estate, who is often the surviving spouse, could easily mistakenly miss the time deadline for filing and, therefore, forfeit use of the deceased spousal unused exclusion amount.

If Congress decides to extend the portability provisions in future extensions of the estate tax law past 2012, then it could consider an automatic allocation of portability, unless the deceased spouse's estate intentionally elects otherwise. Practically, due to valuation issues, this option would be available, however, only to estates in which the first spouse's estate filed an estate tax return declaring the value of the assets in the estate at the time of such spouse's death but forgot to make the portability election. Otherwise, proving the value of the assets on the death of the second spouse, potentially decades later, could be difficult or impossible.

Example. A married couple has an aggregate of $10 million of assets. They properly establish credit shelter bypass trust wills, but one spouse owns $3 million worth of assets and the other spouse owns $7 million worth of assets. The spouse with $3 million dies first and, under the current law, the deceased spouse's estate does not have to file an estate tax return. If the executor does not file or forgets to make an election to use the deceased spouse's $2 million of unused exclusion amount, the couple, in essence, loses the option to elect portability.

Therefore, when the second spouse dies, he or she will have only his or her $5 million basic exclusion amount. If portability is an automatic allocation, the deceased spouse's estate would still be required to file an estate tax return, even though the estate is under the exemption, but the $2 million remaining unused applicable exclusion could be automatically applied to the surviving spouse's estate without any particular election by the deceased spouse's estate.

Risk upon remarriage. Finally, the deceased spousal unused exclusion amount applies only to the last deceased spouse of the decedent. This rule means that the unused exclusion amount of the first spouse

[pg. 16]

is at risk of loss if the surviving spouse remarries and the second spouse then predeceases the surviving spouse. The surviving spouse has lost the use of his or her first spouse's unused exclusion amount if he or she does no gifting. Particularly in cases where children of the first marriage are involved, those children might face increased estate tax exposure on the death of the surviving spouse.

Example. Husband 1 dies without using any exclusion amount, and his executor elects to use his deceased spousal unused exclusion amount in Wife's applicable exclusion. Husband 1 and Wife had two children during their marriage. No estate taxes are due on the death of Husband 1 due to the unlimited marital deduction. Several years later, Wife marries Husband 2, who subsequently passes away. At the time of his death, Husband 2 has already used $4 million of his applicable exclusion. Because Wife can use the exclusion amount of only her last deceased spouse, Wife loses the use of Husband 1's $5 million applicable exclusion and can elect to use only Husband 2's remaining $1 million deceased spousal exclusion. Several years later, Wife dies with an estate of $10 million, leaving her entire estate to her two children from her first marriage. Wife's estate has an applicable exclusion of only $6 million, consisting of her $5 million basic exclusion amount and Husband 2's $1 million deceased spousal exclusion. Therefore, she has a taxable estate of $4 million.

If Wife had been able to use Husband 1's full applicable exclusion, she would have had no taxable estate. Her children from her first marriage have lost the use of their father's $5 million applicable exclusion, and now their inheritance is reduced based on the prior gifts of their stepfather, of which they likely did not benefit, and most certainly would not have benefitted if he made gifts prior to the marriage. Because of the reliance on the portable exclusion amount, and the rules regarding successive marriage treatment, the surviving spouse's estate became taxable.

As demonstrated above, although portability offers great opportunity for planning, particularly for those couples with no complex estate planning, the significant risks associated with reliance on portability should not change the most common estate planning techniques used by practitioners under prior law. Each of the risks highlighted in this section can be avoided by use of a credit shelter trust. Therefore, based on the disadvantages and risks outlined above, practitioners should continue to use equalization of ownership of assets and credit shelter trusts for married couples such that the exclusion amount is transferred to the credit shelter trust on the death of the first spouse, and they should not rely on portability of the exclusion amount using simple wills instead of the traditional credit shelter trusts. Practitioners and taxpayers should use portability only as a backstop for couples who do not engage in proper planning and not as an affirmative estate planning technique.

Future of portability

If the 2010 Tax Relief Act is allowed to sunset, the law reverts to the law as it would have existed in 2001 prior to the enactment of EGTRRA, without the concept of portability. This reversion would be movement away from the concept of the marital unit. In addition, as described above, Congress would have to address the issue of still-living surviving spouses whose predeceased spouses' estates made the portability election in connection with a death in 2011 or 2012. Congress will have significant difficulty removing the concept of portability now that it has been enacted. If portability is removed from the future law, then Congress will likely need to institute a grandfathering provision to allow the surviving spouses of decedents who died during 2011 or 2012 to use the deceased spousal unused applicable exclusion on the surviving spouses' deaths.

Conclusion

With the development of the modern Code, Congress has increasingly expanded the idea that a husband and wife are a single, economic unit rather than two separate individual taxpayers. This preference has been exhibited throughout the income, gift, and estate tax sections. Although the progression has been slow, with each new amendment to the Code, Congress has expanded the protection and concept of the marital unit since the modern tax Code was enacted in 1913. With the enactment of portability of the applicable exclusion amount in the 2010 Tax Relief Act, Congress again pushed the concept one step farther in recognition of a complete and cohesive marital unit for purposes of the tax Code.

As discussed above, portability provides significant advantages, particularly for couples who have not engaged in complex estate planning during their lifetimes. Yet, it also creates certain risks that the practitioner must weigh carefully when drafting documents based on this new law. Ultimately, practitioners should use portability of the exclusion amount only when necessary to correct prior lack of planning, but should not rely on portability as a feature of a properly planned estate.

1

Section 6013.

2

Tariff Act of 1913, Pub. L. No. 63-16, ch. 16, § II(A)(2), 38 Stat. 114, 116 (1913).

3

Section 2523.

4

See, e.g., Congressional Budget Office, *The Estate Tax and Charitable Giving*, page 4 (July 2004), available at http://www.cbo.gov/doc.cfm?index=5650&type=0&sequence=1; Fried, "The Obama Tax Cuts: What They Mean for You," (12/7/2010), available at http://moneywatch.bnet.com/economic-news/blog/daily-money/the-obama-tax-cuts-what-they-mean-for-you/1773/.

5

Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. Law No. 111–312, section 303 (2010).

6

The basic exclusion amount has increased to $5.12 million in 2012. For simplicity, however, examples contained in this article assume the basic exclusion amount is still $5 million.

7

Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 §303(a) (codified as **Section 2010(c)(4)**).

8

Id. (codified as **Section 2010(c)(5)(A)**).

9

TD 9593 and REG-141832-11, 6/15/2012.

10

Temp. Reg. 20.2010-2T(a)..

11

Temp. Reg. 20.2010-2T(a)(7)(ii)..

12

Temp. Regs. 20.2010-2T(a)(7)(ii)(A)(1) through (4).

13

Temp. Reg. 20.2010-2T(a)(7)(ii)(B).

14

Section 2010(c)(5)(B).

15

Joint Committee on Taxation, Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" Schedule for Consideration by the U.S. Senate (12/10/2010) [hereinafter JCT Technical Explanation].

16

See Exhibit 1 for explanation of 1988 ABA Task Force proposal.

[17] Akers, “Estate Planning Effects and Strategies Under the 'Tax Relief... Act of 2010,'” Bessemer Trust (1/10/2011).

[18] *Id.*

[19] Joint Committee on Taxation, Errata “General Explanation of Tax Legislation Enacted in the 111th Congress,” para. 1 (3/23/2011) (emphasis added).

[20] **Temp. Reg. 20.2010-1T(d)(5)**.

[21] **Temp. Reg. 20.2010-3T(a)(3)**.

[22] **Temp. Reg. 25.2505-2T(a)**..

[23] **Temp. Reg. 25.2505-2T(b)**..

[24] **Temp. Reg. 20.2010-3T(b)**..

[25] **Temp. Regs. 20.2010-3T(b)** and **25.2505-2T(c)**.

[26] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. Law 111-312, section 101 (2010).

[27] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals*, page 76 (February 2012) (stating proposal that “portability of unused estate and gift tax exclusion between spouses would be made permanent”).