

“PORTABILITY” UNDER TRA 2010

The “Tax Relief, Unemployment Insurance Reauthorization & Job Creation Act of 2010” (“TRA 2010”) was enacted on December 17, 2010 and generally extends the provisions of the 2001 Economic Growth and Taxpayer Relief and Reconciliation Act (“EGTRRA”) through 2012.

Of particular significance is the increase in the estate, gift & generation skipping transfer tax exemptions to \$5 million and a decrease in the maximum tax rate to 35% from 45%. Also, TRA 2010 introduces a new concept known as “portability,” which permits the personal representative of a deceased spouse’s estate to elect to transfer to the surviving spouse any unused estate tax exemption [the “Deceased Spousal Unused Exclusion Amount”] of the deceased spouse. This amount is defined as the lesser of: (1) the basic exclusion amount (\$5 million for 2011 & 2012) or (2) the basic exclusion amount of the surviving spouse’s *last deceased spouse* over the combined amount of that spouse’s taxable estate plus adjusted taxable gifts. The election must be made on a timely filed Form 706.

In practical terms, portability means that if the exclusion amount as of the predeceased spouse’s death is less than \$5 million, the lower amount will apply. It also means that only the most recently deceased spouse’s unused exclusion amount may be used by the surviving spouse, thereby prohibiting the surviving spouse from using his or her predeceased spouse’s deceased spousal unused exclusion amount. This is referred to as the “privity” requirement. Thus, if a spouse remarries and predeceases his or her second spouse, the second spouse may use only his or her predeceased spouse’s unused exclusion amount, exclusive of that spouse’s unused exclusion amount from a previous marriage.

Example: H1 dies with \$2 million of unused exclusion amount. Following H1’s death, W’s applicable exclusion amount is \$7 million [her \$5 million basic exclusion amount plus H1’s unused deceased spousal exclusion amount]. W remarries and predeceases H2 and dies with a taxable estate of \$3 million. If a timely election is made, H2 will have \$7 million of unified credit, consisting of W’s \$2 million of unused exclusion amount plus his \$5 million.

Even small estates must consider filing a Form 706 in order to take advantage of portability. The portability concept applies equally with respect to the gift tax exemption (but not the GSTT exemption).

Practice Pointer: A surviving spouse inclined to make gifts should utilize the deceased spouse’s unused exclusion amount sooner rather than later (particularly if he or she remarries), since it will be lost in whole or in part if the new spouse predeceases or if the basic exclusion amount is decreased. Nothing prevents a surviving spouse from using the first predeceased spouse’s unused exclusion amount to shelter lifetime gifts and then, if he or she survives the second spouse, utilizing his or her unused exclusion amount for estate tax purposes.

Does portability obviate the need for “Bypass Trust” planning? Probably not, for the following reasons:

- Portability is assured for only two years
- The unused exclusion from a predeceased spouse is lost if the surviving spouse remarries and survives his or her next spouse
- Appreciation in the assets will not be excluded from the surviving spouse's estate, as is the case with a Bypass Trust
- The traditional objectives of trusts, such as creditor protection and restrictions on beneficiary access to trust assets are still in play