SCHELL BRAY

SCHELL BRAY PLLC
Attorneys and Counselors at Law

WHAT DOES PORTABILITY OF THE ESTATE AND GIFT TAX EXEMPTION MEAN FOR YOU?

What is the estate and gift tax exemption?

The estate tax is a tax on the transfer of your property at death. The gift tax is a tax on the transfer of property during your lifetime. The estate and gift tax exemption is the amount you can transfer to individuals other than your spouse free of estate and gift taxes during your lifetime or at your death (Generally speaking, you can transfer as much as you want to your spouse without incurring estate and gift taxes). The estate and gift tax exemption was $1 million in 2002-2003, $1.5 million in 2004-2005, $2 million in 2006-2008, $3.5 million in 2009, $5 million or more in 2010 and 2011 (note: there were special rules for decedents dying in 2010); $5.12 million in 2012, $5.25 million in 2013 and $5.34 million in 2014.

What is portability?

Portability is the name for a concept that allows the surviving spouse of a decedent to inherit his or her estate and gift tax exemption. It means that a couple can pass, in 2014, up to $10.68 million in assets to their intended beneficiaries without having to set up a trust.

Is there a cost to elect portability?

Yes. A Federal estate tax return (Form 706) must be filed at the death of the first spouse to die, and the IRS has the ability to review that return until the inherited estate and gift tax exemption is used by the surviving spouse. It can be costly and time consuming to file Form 706.

Does portability apply to Generation Skipping Transfer (GST) taxes?

No. Portability does not apply to generation-skipping transfer (GST) taxes. If your estate plan has a "dynasty" type trust (a trust that is intended to provide for multiple generations of your family without incurring estate and gift taxes at each generation), portability does not change the need to use trusts to obtain that result.

What does portability mean for you?

1) While you may want to create a trust for your surviving spouse for other reasons, you may no longer need to do so to avoid estate and gift taxes. See below for the non-tax reasons you may want to create a trust for your surviving spouse.

2) If you have a plan that creates a trust for your surviving spouse, you should talk with an attorney who specializes in estate planning to determine if you still want/need to provide for such a trust.

3) If you still want/need a trust for your surviving spouse, it may be advisable to change the structure of that trust to provide greater income tax benefits to your heirs.

4) If your spouse has predeceased you and a trust was created for your benefit, you may want to consider modifying or terminating that trust for income tax reasons.

5) If you inherit your spouse's remaining estate and gift tax exemption (through portability) and then re-marry, there are restrictions on use of the inherited exemption, so you should consult with an attorney to see how portability applies to you.

What are some examples of non-tax reasons for creating a trust for your surviving spouse?

1) Creditor protection
2) Asset management
3) Control how the assets that you leave your spouse are disposed of at your spouse's death
4) Planning for incapacity of your spouse
5) Protection in the event of divorce/remarriage of your surviving spouse

Why might you want to change the trust to be established at your death for your spouse (or if you are the surviving spouse, the trust that was created for your benefit by your deceased spouse) for income tax reasons?

The short answer is to reduce capital gains taxes due if the property is sold after the surviving spouse's death.

Traditional estate planning often involved an "A-B estate plan" which means that the first spouse to die would use his or her estate and gift tax exemption to create a "credit shelter trust," typically for the benefit of the surviving spouse and/or children, with the remaining assets, if any, passing outright to the surviving spouse or in trust for the benefit of the surviving spouse (to qualify for the "marital deduction" from estate and gift taxes). Because the surviving spouse could not inherit the decedent's estate and gift tax exemption, the decedent used it to fund a credit shelter trust. The credit shelter trust was structured so that it would not be includible in the surviving spouse's taxable estate, and thus, was not taxable at the surviving spouse's death. Such a plan allowed a couple to pass the total of their two exemptions to other individuals free of estate and gift tax, assuming assets were titled in such a way (or disclaimers could be used) to fully fund the credit shelter trust at the first death. Since a credit shelter trust is not included in the surviving spouse's taxable estate, there is no step up in basis in the credit shelter trust assets at the surviving spouse's death. Given the rise in the estate and gift tax exemption amount ($5 million, indexed for inflation; currently, in 2014, $5.34 million), it may be advisable for the trust assets to be included in the surviving spouse's taxable estate and receive a step up in basis. That way, the family could sell the assets after the surviving spouse's death without paying capital gains tax.

Do individuals with assets less than $5 million make the portability election?

Yes, many people choose to do so. Congress could change the law to provide for a smaller estate and gift tax exemption amount ($3.5 million is the number that has been discussed the most and that the President used in his 2014 budget proposal, but it could be as low as $1 million). Many people view filing for portability as a type of insurance. Even if their own estate and gift tax exemption is reduced by Congress in the future, they hope that the inherited estate and gift tax exemption amount would stay the same. For example, if the surviving spouse had an estate of $1.5 million and he or she inherited $5 million in estate and gift tax exemption, there would be no estate

taxes at the surviving spouse's death even if the surviving spouse's personal estate and gift tax exemption was reduced to $1 million by Congress.