What is Portable, but You Can't Take it With You?

By Richard F. Roth

It may be time to review your estate plan to take advantage of “portability.”

For a couple of years now, when preparing revocable trusts or amendments to trusts, I have provided that all of the trust assets will be distributed to a Marital Trust for the benefit of the surviving spouse. This is a new and different approach in estate planning.

If, in the past, you created a revocable trust as part of your estate plan, the odds are great that your trust provided that the trust assets would, upon your death, be divided into a Marital Trust and a Family Trust, with the Family Trust being funded first with the lifetime exemption amount, which is the total amount an individual can have, at death, without being liable for federal estate taxes (“Lifetime Exclusion Amount”). The purpose of this approach was to ensure that the Lifetime Exclusion Amount was utilized in the Family Trust to minimize the estate tax liability upon the death of you and your spouse.

After distribution of the Lifetime Exclusion Amount to the Family Trust, the balance of the estate would pass to the Marital Trust, which was also not taxable based on the unlimited marital deduction for the surviving spouse. Therefore, no taxes would be due when the first spouse died. Since the Family Trust restricted the surviving spouse from having unlimited access to the trust funds, it was also not taxable upon the death of the surviving spouse, and the surviving spouse’s estate could use his or her Lifetime Exclusion Amount to offset any estate taxes then due.

We used to say “use it or lose it.” If you did not use your Lifetime Exclusion Amount or if the first-to-die had insufficient assets, your spouse could not use the deceased spouse’s Lifetime Exclusion Amount — it was lost forever. The Lifetime Exclusion Amount may have been less than $1,000,000 when your trust was prepared. In 2017, the Lifetime Exclusion Amount is $5,490,000 per individual. (Some people refer to this amount as the unified credit.) This has become a significant amount.

In the above scenario, both spouses could fully utilize their Lifetime Exclusion Amount. On the other hand, if the surviving spouse had received all of the deceased spouse's estate (which means the deceased spouse's Lifetime Exclusion Amount was not used), upon the death of the second spouse, any amount in excess of the surviving spouse's Lifetime Exclusion Amount would have been subject to estate taxes, with a top marginal rate of 55% (with exceptions). If the first spouse's assets were less than the Lifetime Exclusion Amount, then the surviving spouse would have been unable to use the "lost" exclusion amount.

Estate tax laws changed for years after 2012, with the enactment of a concept informally known as "portability." Portability allows a surviving spouse to use a deceased spouse's unused Lifetime Exclusion Amount. Simply stated, if a married individual passes away without using all of his/her Lifetime Exclusion Amount, the surviving spouse can use the deceased spouse's unused Lifetime Exclusion Amount, as long as the personal representative makes an election on an estate tax return which is timely filed for the deceased spouse. Thus, the surviving spouse's estate would have the benefit of his or her Lifetime Exclusion Amount as well as the unused Lifetime Exclusion Amount from the deceased spouse.

As a result of this tax law change, in addition to increases in the Lifetime Exclusion Amount (which is currently almost $5.5 Million per individual), many of our trust documents now leave everything to the surviving spouse in the Marital Trust without any restrictions on the surviving spouse as to the use of income and/or principal. Upon the death of the surviving spouse, the trust assets are distributed to the Family Trust for distribution to beneficiaries. Some advantages of this new approach are:

- it simplifies post-death matters and avoids later confusion regarding funding of the sub-trusts;
- with all of the trust assets distributed to the Martial Trust for the benefit of the surviving spouse, the surviving spouse has the benefit and/or use of the deceased spouse's unused Lifetime Exclusion Amount and his/her own Lifetime Exclusion Amount; and
- upon the death of the surviving spouse, all of the assets (with exceptions) get a step-up in basis, which would reduce the income tax liability, if any, when an asset is sold.

Some disadvantages to the new approach are:

- it may be easier for the surviving spouse to dissipate the estate's assets;
- assets in a Marital Trust may not be protected from claims of the surviving spouse's creditors;
- upon the death of the second spouse, the Marital Trust's appreciation will be subject to estate taxes, if the Lifetime Exclusion Amount is exceeded; and
- if the surviving spouse remarries, he or she cannot use the Lifetime Exclusion Amount of their former deceased spouse.

Since the exclusion amount for a married couple in 2017 is $10,980,000, it may be more advantageous to leave everything to your spouse. We recommend that you speak with your estate planning attorney to determine whether all of your estate should be distributed to the Marital Trust for the benefit of your surviving spouse.