can only do this by selling the residence. If the house is held in Mary's name, Bill's name or jointly it is exempt, and Bill is eligible for Medicaid.

While in many circumstances the county Departments of Job and Family Services have allowed real estate which is held in a Revocable Trust by either spouse to be transferred to the community spouse, it appears this policy position has changed and those who have utilized a Revocable Trust will be penalized.

The Ohio State Bar Association through the Estate Planning, Trust and Probate Law Section is recommending that attorneys notify their clients of this recent position and for middle class clients, who do not have long term care insurance, move forward with transferring the property out of the Trust either into one of the spouse's names with a "transfer on death" designation or a "joint and survivorship" deed between spouses or a "transfer on death" designation to the Revocable Trust.

The Ohio State Bar Association Estate Planning, Trust and Probate Law Section is working on a legislative remedy.

PORTABILITY: NOW IT'S FOR REAL

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Based on a presentation by Patrick Saccogna to the EPPTL Section of the Cleveland Metropolitan Bar Association on February 19, 2013.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act"), which was signed into law by President Obama on December 17, 2010,[1] contained numerous transfer tax provisions that have widely impacted the estate planning community. This article focuses on portability, one of the most important of those provisions, by (i) detailing the concept of portability, (ii) demonstrating how to calculate a surviving spouse's estate tax applicable exclusion amount applying portability, (iii) discussing the application of portability for federal gift and generation-skipping transfer tax purposes, (iv) outlining the requirements for making a valid portability election, and (v) identifying the estate planning implications of portability.

I. WHAT IS PORTABILITY AND WHERE DID IT COME FROM?

The 2010 Act introduced to the federal transfer tax laws the brand new concept of portability.[2] Portability is generally defined as the statutory transfer of a deceased spouse's unused estate tax exemption to his or her surviving spouse. Portability applies with respect to a married individual who dies after December 31, 2010 with unused estate tax exclusion amount.[3]

The concept of portability was introduced to the law by the 2010 Act's amendment of Section 2010(c) of the Internal Revenue Code of 1986, as amended ("I.R.C."), to provide that the estate tax applicable exclusion amount is (i) the basic exclusion amount of $5,000,000 per person (indexed for inflation) ***plus*** (ii) *for a surviving spouse,* the "deceased spousal unused exclusion amount," or "DSUE amount."[4] (emphasis added)

With many of the provisions of the 2010 Act set to expire on December 31, 2012, President Obama signed into law the American Taxpayer Relief Act of 2012 (the "2012 Act") on January 2, 2013.[5] The 2012 Act extended and modified some of the estate and gift tax provisions of the 2010 Act. Most importantly for purposes of this article, the 2012 Act made permanent the portability provisions of the 2010 Act (with one minor technical modification).[6]

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EXAMPLE 1—<u>Basic Portability Calculation</u>: Assume a married couple has a combined net worth of $10,000,000. Assume that Husband died in 2011 with $2,000,000 in assets, which passed to Husband's children. Under the 2010 Act, the estate tax exclusion amount for 2011 was $5,000,000 so Husband had $3,000,000 of unused estate tax exclusion amount ($5,000,000 less $2,000,000). Under pre-portability law, Husband's $3,000,000 of estate tax exclusion amount would be lost and, assuming Wife died later in 2011 owning the rest of the property (*i.e.,* with a net worth of $8,000,000), then after applying Wife's estate tax exclusion amount, Wife's estate would owe estate tax on $3,000,000. *<u>Compare</u>*: Assuming the same facts but applying the concept of portability, at Husband's death, Husband's $3,000,000 of unused exclusion amount could port to Wife, making her applicable exclusion amount $8,000,000 (*i.e.,* her own $5,000,000 exclusion amount plus Husband's $3,000,000 unused exclusion amount). As a result, Wife's entire estate would be sheltered from the federal estate tax at her death.

II. HOW MUCH IS PORTABLE?

As noted above, with portability, the estate tax applicable exclusion amount is now defined as (i) the basic exclusion amount **<u>plus</u>** (ii) *for a surviving spouse*, the DSUE amount.[7]Under current law, the basic exclusion amount is $5,000,000 per person, as indexed for inflation (in $10,000 increments) for decedents dying after December 31, 2011.[8] For 2013, the basic exclusion amount is $5,250,000 per individual (and thus $10,500,000 for married couples).

The DSUE amount is a new term that was added by the 2010 Act, refined by the 2012 temporary and proposed regulations, technically corrected by the 2012 Act, and is now defined in I.R.C. Section 2010(c)(4) as the ***<u>lesser</u>*** of (i) the basic exclusion amount, or (ii) the excess of [a] the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over [b] the amount with respect to which the tentative tax is determined under I.R.C. § 2001(b)(1) on the estate of such deceased spouse (*i.e.,* the amount of the deceased spouse's taxable estate plus his or her adjusted taxable gifts).[9]

On June 15, 2012, Treasury issued temporary and proposed regulations refining the definition and interpretation of the DSUE amount. Importantly, the regulations interpret the term "basic exclusion amount" to mean the basic exclusion amount in effect *at the death of the predeceasing spouse*.[10] This interpretation implies that there is no risk of a "clawback" in the event that the basic exclusion amount is reduced after the death of the decedent spouse.[11] Also, the regulations provide that any taxable gifts on which the decedent spouse *paid gift tax* are excluded from the computation of the DSUE amount.[12] Example 2 of Temporary Regulation Section 20.2010-2T(c)(5) clarifies that this exclusion applies to "the amount of gifts in excess of the applicable exclusion amount for that year."[13]

EXAMPLE 2—<u>Basic Calculation Assuming No Gifts:</u> Assume that Husband died in 2011, with a taxable estate of $2,000,000 and having made no taxable gifts. Assume further that Wife dies in 2013. Upon Wife's death, her total estate tax exclusion amount will be $8,250,000, calculated as follows: Wife's own basic exclusion amount of $5,250,000 (because she died in 2013) ***<u>plus</u>*** her DSUE amount which is calculated by taking the lesser of $5,000,000 (Husband's basic exclusion amount in effect in the year of his death), and $3,000,000 (the excess of Husband's applicable exclusion amount ($5,000,000) over the sum of his taxable estate ($2,000,000) and his adjusted

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taxable gifts ($0)). Wife's basic exclusion amount of $5,250,000 ***plus*** her DSUE amount of $3,000,000 gives her a total applicable exclusion amount of $8,250,000.

EXAMPLE 3—Taxable Gift Equal to the Gift Tax Applicable Exclusion Amount: Assume the same facts as in Example 2, except that in 2004, Husband made a taxable gift of $1,000,000 and reported the gift on a timely-filed gift tax return. Because the amount of the gift was equal to the applicable exclusion amount for that year ($1,000,000), $345,800 is allowed as a credit against the tax, reducing the gift tax liability to zero. When Wife dies in 2013, her total estate tax exclusion amount will be $7,250,000, calculated as follows: Wife's own basic exclusion amount of $5,250,000 ***plus*** her DSUE amount which is calculated by taking the lesser of $5,000,000 (Husband's basic exclusion amount in effect in the year of his death), and $2,000,000 (the excess of Husband's applicable exclusion amount ($5,000,000) over the sum of his taxable estate ($2,000,000) and his adjusted taxable gifts ($1,000,000)). Wife's basic exclusion amount of $5,250,000 ***plus*** her DSUE amount of $2,000,000 gives her a total applicable exclusion amount of $7,250,000.[14]

EXAMPLE 4—Taxable Gift Resulting in Gift Tax: Assume the same facts as in Example 3, *except that* in 2004 Husband made a taxable gift of $4,000,000 and reported the gift on a timely-filed gift tax return. After applying the applicable exclusion, Husband paid gift tax on $3,000,000 of the gift. When Wife dies in 2013, her total estate tax exclusion amount will *still be $7,250,000,* because Husband's total taxable gifts ($4,000,000) were reduced by the amount on which he paid gift taxes ($3,000,000) for purposes of this computation.[15]

A. MULTIPLE SPOUSES

The application of the portability rules becomes more complicated when there are multiple (deceased) spouses involved. I.R.C. § 2010(c)(4) refers to the basic exclusion amount of the "last such deceased spouse."[16] The temporary and proposed regulations confirm that the term "last deceased spouse" means "the most recently deceased individual who, at the individual's death after December 31, 2010, was married to the surviving spouse."[17]Generally, if the "*last* deceased spouse" of a surviving spouse has no DSUE amount available, the surviving spouse will have no DSUE amount for purposes of calculating his or her applicable exclusion amount under IRC Section 2010(c)(4), *even if* the surviving spouse had a DSUE amount from a *previous* deceased spouse.[18]Additionally, the surviving spouse's subsequent marriage has no impact on the calculation of the DSUE amount if the surviving spouse predeceases the subsequent spouse. Also, a subsequent marriage that ends in divorce or annulment does not change the identity of the surviving spouse's "last deceased spouse."[19]

EXAMPLE 5—Determining the Last Deceased Spouse: Assume that Wife was married to Husband 1 when he passed away in April 2011. She married Husband 2 in May 2011, but was divorced from him in December 2011. She married Husband 3 in February 2012. Husband 2 died in June 2013. Wife dies in September 2013. Wife's "last deceased spouse" is Husband 1. While she married Husband 2 after Husband 1 died and Husband 2 died before Wife did, Wife was not married to Husband 2 when he died. Husband 3 is not Wife's "last deceased spouse," because he survived her. Therefore, Wife's applicable exclusion amount would be calculated using Husband 1's DSUE amount, if any. *Compare:* If, instead, Husband 3 dies in August 2013 with

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no DSUE amount, then Husband 3 is now Wife's "last deceased spouse" for purposes of computing her DSUE amount. If Husband 3 has no DSUE amount, then Wife is limited to her individual basic exclusion amount of $5,250,000, even if Husband 1, who is also a "deceased spouse" as to Wife, had a DSUE amount remaining at his death. However, because Husband 1 is not the ***last*** deceased spouse as to Wife, Husband 1's DSUE amount does not figure in the calculation of her applicable exclusion amount at her death.

B. PRIVITY

It is important to note that a surviving spouse may not use his or her deceased spouse's DSUE amount because of the requirement of *privity*. In other words, the portability rules effectively prohibit the transfer of DSUE amounts between individuals who were never married to each other.[20]

III. APPLICATION OF PORTABILITY FOR GIFT AND GST TAX PURPOSES

A. WHEN CAN THE DSUE AMOUNT BE USED?

The surviving spouse can use his or her DSUE amount *at any time* after the deceased spouse's death, provided the appropriate portability election is ultimately made.[21] Thus, the surviving spouse may use the DSUE amount during his or her lifetime or at his or her death for gift and estate tax purposes.

The surviving spouse is not required to wait until after an estate tax return is filed and a portability election is made to use the deceased spouse's DSUE amount.[22] However, if the executor of the deceased spouse's estate does not make the portability election, or makes but ultimately revokes the election, a transfer by the surviving spouse will not be covered by the expected DSUE amount.[23] In such a case, the surviving spouse's gift would use some of his or her applicable gift tax exclusion amount and possibly result in gift tax liability.[24] Even if a valid portability election is ultimately made, the resulting DSUE amount could be reduced to the extent of any valuation or IRS audit adjustments relating to the deceased spouse's estate tax return.[25]

B. GIFTING OPPORTUNITIES WITH MULTIPLE PREDECEASED SPOUSES

I.R.C. Section 2505(a) provides for a credit for gift tax purposes in each calendar year in the amount of "[t]he applicable credit amount in effect under Section 2010(c) which would apply if the donor died as of the end of the calendar year, reduced by the sum of the amounts allowable as a credit to the individual under [Section 2505] for all preceding calendar periods."[26] Because this section incorporates I.R.C. Section 2010(c), if the surviving spouse makes a gift after the last deceased spouse's death, the surviving spouse's unified credit will include the decedent spouse's DSUE amount.[27]

For purposes of calculating the surviving spouse's *gift* tax applicable exclusion amount, the "last deceased spouse" is determined *at the time of the gift*.[28] This is true even if a subsequent spouse dies before the end of the calendar year in which the gift was made.[29]

EXAMPLE 6—<u>Determining the "Last Deceased Spouse" for Gift Tax Purposes</u>— Assume that Wife was married to Husband 1, who died in June 2011 with a DSUE amount of $3,000,000. Assume further that Wife married Husband 2 in December 2012, but Husband 2 died in June 2013. If Wife made a gift of $3,000,000 in January 2013, Husband 1's DSUE amount would be applied to such gift, because Husband 1 was her "last deceased spouse" as of the date of the gift.

The regulations expressly address the order of application with respect to the DSUE amount and the surviving spouse's basic exclusion amount for gift tax purposes.[30] Specifically, the regulations state that "[i]f a donor who is a surviving spouse makes a taxable gift and a DSUE amount is included in determining the surviving spouse's applicable exclusion amount under section 2010(c)(2), such surviving spouse will be considered to apply such DSUE amount to the taxable gift *before* the surviving spouse's own basic exclusion amount."[31]

> **EXAMPLE 7—Order of Application**— Assume the same facts as in Example 6. When Wife makes her gift of $3,000,000, the DSUE amount from Husband 1 is applied to this gift first. As a result, after the gift is made, Wife still has her full basic exclusion amount for use on other gifts and at death.

The regulations also contain a special rule governing situations in which the surviving spouse has multiple deceased spouses and some or all of the DSUE amount from at least one of those deceased spouses has been applied to the surviving spouse's lifetime gifts.[32]Specifically, the regulations provide that, for both estate and gift tax purposes, "[i]f a surviving spouse has applied the DSUE amount of one or more last deceased spouses to the surviving spouse's transfers during life, and if any of those last deceased spouses is different from the surviving spouse's last deceased spouse as defined in Temporary Treasury Regulation Section 20.2010-1T(d)(5) at the time of the surviving spouse's death, then the DSUE amount to be included in determining the applicable exclusion amount of the surviving spouse at the time of the surviving spouse's death is the sum of (i) [t]he DSUE amount of the surviving spouse's last deceased spouse. . .and (ii) [t]he DSUE amount of each other deceased spouse of the surviving spouse, to the extent that such amount was applied to one or more taxable gifts of the surviving spouse."[33] The effect of this rule is essentially to permit a surviving spouse to take advantage of DSUE amounts from more than one deceased spouse by making gifts during the surviving spouse's lifetime and prior to the death of any subsequent spouse.

> **EXAMPLE 8—Calculation of Applicable Exclusion Amount When Multiple DSUE Amounts are Involved**: Assume that Wife is married to Husband 1 who dies in February 2011 with a DSUE amount of $4,000,000. Assume further that Wife makes a gift of $3,000,000 in March 2011. Under the ordering rules, Wife is deemed to have applied Husband 1's DSUE amount to this $3,000,000 gift. Therefore, immediately after the gift is made, Wife has an applicable exclusion amount of $6,000,000 ($5,000,000 of her own basic exclusion amount plus $1,000,000 of Husband 1's remaining DSUE amount ($4,000,000 DSUE amount less $3,000,000 applied to Wife's taxable gift)). Now assume that Wife marries Husband 2 in May 2012, but Husband 2 dies in November 2012 with a $2,000,000 DSUE amount. If Wife dies in December 2013, Wife's applicable exclusion amount would now be $10,250,000 ($5,250,000 of her own basic exclusion amount plus $2,000,000 of Husband 2's DSUE amount and $3,000,000 of Husband 1's DSUE amount that was applied to her earlier gifts). Under these circumstances, the temporary regulations operate to preserve the protections afforded by Wife's use of Husband 1's DSUE amount during Wife's lifetime. Wife can utilize Husband 2's entire DSUE amount upon her death, in addition to the DSUE amount from Husband 1 that she used during her life.[34] Wife could also use Husband 2's DSUE amount during her life to make additional gifts.

C. PORTABILITY DOES NOT APPLY FOR GST TAX PURPOSES

Portability applies for federal gift and estate tax purposes, but *not* for federal generation-

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skipping transfer ("GST") tax purposes. Thus, transfers made to younger generations may still result in GST tax, even if portability applies for gift and estate tax purposes.[35]

IV. MAKING A PORTABILITY ELECTION

I.R.C. Section 2010(c)(5)(A) provides that the DSUE amount of a deceased spouse may only be taken into account in determining the surviving spouse's applicable exclusion amount if "the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account."[36] After the due date for the Form 706 has passed, the election, if made, is irrevocable.[37]

A portability election is made by filing a "complete and properly-prepared" estate tax return on Form 706.[38] No affirmative statement or attachment to the Form 706 is necessary to elect portability. However, an executor will need to make an affirmative election if the estate is ***not*** electing portability.[39] Specifically, the instructions to Form 706 state that if the executor is electing *not* to have portability apply and, therefore, not to make the decedent spouse's DSUE amount available for use by the decedent's surviving spouse, the Executor must check the appropriate box in Section A of Part 6 of the Form 706 and not complete Sections B and C of Part 6.[40] Alternatively, if an estate tax return is not otherwise required to be filed, the executor may elect not to have portability apply by simply not filing a Form 706.[41]

A. "TIMELY FILED" REQUIREMENT

The executor of the deceased spouse's estate must file a Form 706 by the applicable due date, including extensions, in order to make a valid portability election.[42] An executor is generally required to file a Form 706 within nine months after the date of the decedent's death.[43] However, the Secretary may grant a reasonable extension of time for filing any return.[44] Under the applicable regulations, executors are granted an automatic six month extension to file the Form 706 upon request.[45] Generally, these rules permit the executor of the decedent spouse to wait 15 months after the decedent's death before making a portability election.

B. REVOCABILITY

Section 2010(c)(5)(A) states that a portability election, "once made, shall be irrevocable."[46] However, the temporary regulations clarify this rule by providing that "[a]n executor of the estate of a decedent. . .who timely files an estate tax return may make and may supersede a portability election previously made, provided that the estate tax return reporting the decision not to make a portability election is filed on or before the due date of the return, including extensions actually granted."[47] This means that a portability election becomes irrevocable once the due date for filing the estate tax return (including extensions) has passed. Until that time, however, a portability election can be revoked.

C. THE "EXECUTOR" MAKES THE ELECTION

The court appointed executor of the estate of the decedent spouse is responsible for making the portability election.[48] If there is no court appointed executor, any person in actual or constructive possession of the decedent spouse's property may elect portability (or elect not to have portability apply).[49] No portability election made by a non-appointed executor can be revoked by a subsequent election by another non-appointed executor, *unless* such subsequent non-appointed executor is the successor to the previous non-appointed executor.[50] Under these rules, if there is a court appointed executor for the estate of the decedent spouse, and if such executor chooses *not* to elect portability, the surviving spouse is unable to make such an election. On the other hand, if there is no court

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appointed executor and the surviving spouse is in actual or constructive possession of the decedent's property, the surviving spouse would be able to make a portability election without fear of revocation.

D. COMPLETE AND PROPERLY PREPARED RETURN

Generally, a "complete and properly-prepared" Form 706 is one that is prepared in accordance with the applicable instructions.[51] However, the temporary regulations provide for more relaxed requirements in reporting the values of certain assets.[52] Specifically, with respect to assets that qualify for the marital or charitable deductions, the value of each such asset is not required to be reported on the Form 706.[53] Instead, only a description of such assets, their ownership, and the beneficiaries of each, along with the necessary information to establish the right to the applicable deduction must be reported.[54] However, there are certain exceptions to this general rule set forth in the temporary regulations.[55]

E. DUE DILIGENCE REQUIREMENT

An executor is required to exercise "due diligence" in estimating the value of the decedent's gross estate.[56] This requirement also applies to assets passing to the decedent's surviving spouse or to charity.[57] Specifically, the executor must identify the range of values in which the "executor's best estimate" falls.[58] The preamble of the temporary regulations provides that in determining the "executor's best estimate," the inquiry required "is the same an executor of any estate must make under current law to determine whether the estate has a filing obligation. . ."[59] Although a formal appraisal does not seem to be required, the executor may need more accurate valuation information for other purposes, including to support the amount of any step-up in basis under I.R.C. § 1014.[60]

F. COMPUTATION OF THE DSUE AMOUNT ON FORM 706

Section C of Part 6 of Form 706 now contains a section for computing the DSUE amount.

G. EXTENDED STATUTE OF LIMITATIONS

I.R.C. § 6501 generally limits the time during which the IRS can examine a previously filed estate tax return and assess taxes.[61] However, if portability is elected, I.R.C. § 2010(c)(5)(B) permits the IRS to examine a return of a deceased spouse *at any time* for purposes of determining the DSUE amount available to the surviving spouse.[62]

V. ESTATE PLANNING IMPLICATIONS

A. WHO BENEFITS MOST FROM PORTABILITY?

Portability should be most useful for married couples with a combined estate of more than $5,250,000, but less than $10,500,000. When a married couple's combined estate falls within this range, they could employ simple wills (and/or use jointly held assets or other contractual benefits, like retirement accounts) leaving all of their assets to the survivor of them, use portability to avoid estate tax completely on their combined estate, avoid the complexities associated with credit shelter or similar trusts, and ensure a second basis step-up on the surviving spouse's death with respect to the assets received from the first spouse to die which are then included in the surviving spouse's estate.

> **EXAMPLE 9—<u>Combined Estate Between $5,250,000 and $10,500,000</u>:** Assume that Wife and Husband have a combined estate of $10,500,000. Assume further that Husband died in January 2013 with an individual estate of $3,000,000 and a DSUE amount of $2,250,000. If Wife dies in October 2013, her applicable exclusion amount will be $7,500,000 ($5,250,000 of her basic exclusion amount plus $2,250,000 of DSUE

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amount from Husband). Assuming that there was no change in the value of her estate of $7,500,000, her entire estate will be sheltered from estate tax. *Compare—No Portability*: Assume the same facts, *except that* portability does not apply. Under these circumstances, no estate tax would be due at Husband's death because his applicable exclusion amount covers his estate. However, $2,250,000 of his applicable exclusion amount will be unused. At Wife's death, because her applicable exclusion amount is only $5,250,000, $2,250,000 of her estate will be subject to estate tax ($7,500,000 less $5,250,000 leaves $2,250,000).

B. ARE REVOCABLE TRUSTS STILL ADVISABLE?

With portability in play, the strict "need" for a credit shelter trust to maximize the use of the estate tax exclusion amount has technically disappeared, because the unused estate tax exclusion amount of the first spouse to die can be passed to the surviving spouse with a valid portability election. Married couples may consider "I Love You Wills" whereby the first spouse to die leaves all of his or her assets to the surviving spouse. This may permit the surviving spouse's estate to benefit from a "second" step-up in basis at such survivor's death. However, portability is not a perfect solution. There are several tax and nontax reasons that may make credit shelter trusts preferable to portability from a planning perspective.[63]

(i) <u>Protection from Appreciation</u>

Because the DSUE amount of a decedent spouse is fixed as of the date of the decedent spouse's death,[64] increases in the value of the assets of the decedent spouse after his or her death are not protected from tax in the surviving spouse's estate. As a result, if a married couple decides to rely on portability to maximize the use of their combined estate tax exclusion amounts, any increase in the value of the decedent spouse's assets after his or her death will be included in the gross estate of the surviving spouse.

EXAMPLE 10—<u>Tax Implications of Post-Death Appreciation:</u> Assume that Wife and Husband are married, but Husband dies in February 2011 with an estate of $3,000,000, all of which passes to Wife. Husband's DSUE amount would be $5,000,000 (since all of his assets passed to wife and were covered by the marital deduction). Assume further that Wife has $5,250,000 of her own assets. If, after Husband's death, his assets appreciate to $10,000,000, when Wife dies in December 2013, her estate will be valued at $15,250,000 ($5,250,000 of her own assets and $10,000,000 of her Husband's appreciated assets). Wife's applicable exclusion amount is $10,250,000 ($5,250,000 of her basic exclusion amount and $5,000,000 of DSUE amount from Husband). Under these facts, $5,000,000 of Wife's estate will be subject to estate tax. *Compare*—If Husband had instead established a credit shelter trust to hold and administer his assets ($3,000,000) after his death, the appreciation in the value of Husband's assets ($7,000,000) would be entirely excluded from Wife's gross estate and, because her basic exclusion amount ($5,250,000) would cover her individual assets ($5,250,000), no portion of her estate would be subject to estate tax.

(ii) <u>DSUE Amount Is Not Indexed For Inflation</u>

Although the 2012 Act provides that the basic exclusion amount is indexed for inflation, the DSUE amount is fixed as of the date of the decedent spouse's death. As a result, that inflation adjustment will *not* cover any portion of the increase in value of the decedent spouse's assets after his or her death.

(iii) <u>Transferred DSUE Amount May be lost</u>

If A Surviving Spouse Remarries and His or Her New Spouse Predeceases

As discussed above, the DSUE amount is determined by reference to the "last deceased spouse."[65] If a surviving spouse has DSUE amount available from his or her deceased spouse but decides to remarry, and if the new spouse predeceases, the first deceased spouse's DSUE amount will be lost for estate tax purposes. This result may increase the tax liability. However, the risk of losing the DSUE amount of the first predeceased spouse may be avoided if the surviving spouse makes lifetime gifts of assets equal to the transferred DSUE amount prior to the death of a subsequent spouse.[66]

(iv) Portability Does Not Apply to the GST Exemption

Because portability does not apply to the GST exemption, reliance on portability at the death of the first spouse may waste the first spouse's unused GST exemption.

> **EXAMPLE 11—Portability and the GST Exemption:** Assume that Husband and Wife are married, but Husband dies in June 2011 with a DSUE amount of $4,000,000 and an unused GST exemption amount of $5,000,000. Assume further that Wife dies in November 2013 with a taxable estate of $9,250,000, all of which skips her children and passes to her grandchildren. Because Wife's applicable exclusion amount is $9,250,000 ($5,250,000 of her basic exclusion amount and $4,000,000 DSUE amount from Husband), her entire estate is protected from estate tax. However, because the assets in her estate will pass to her grandchildren, the GST tax comes into play. Wife can use her $5,250,000 GST exemption amount to cover a portion of this amount, but the $4,000,000 excess will cause a GST tax. *Compare*—Had Husband left his assets in a credit shelter or other trust and allocated his GST exemption to such trust, all GST tax liability could have been avoided

(v) Creditor Protection

Planning for portability generally involves the outright transfer of assets to the surviving spouse at the death of the first spouse via an "I Love You Will," jointly owned assets, and contract assets. This type of planning, however, offers no protection from the surviving spouse's creditors. On the other hand, credit shelter trusts do offer such protection.

(vi) Asset Management

Many individuals simply do not possess the knowledge or skill to successfully manage a large outright transfer of assets. A credit shelter trust administered by a corporate Trustee or other skilled fiduciary provides an asset management mechanism designed to ensure that the assets are invested and managed property.

(vii) Control Over Ultimate Asset Disposition

The outright transfer of assets to the surviving spouse inherent in portability gives the surviving spouse complete discretion and control with respect to the ultimate disposition of such assets. Often, clients are uncomfortable with this idea, particularly in blended family situations. For example, if the spouse who dies first had been married previously and had children from a prior marriage, portability offers no assurances that his or her children will benefit from his or her assets. A credit shelter trust, on the other hand, could provide protection for such children by allowing the decedent spouse to provide for the surviving spouse during his or her life, but permitting the decedent spouse to control the ultimate disposition of such assets at the death of the surviving spouse.

C. THE "COMBINED APPROACH"

Instead of "choosing" to use either a credit shelter trust or portability to fully utilize a married couple's combined applicable exclusion

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amount, portability can be used to supplement a credit shelter trust in situations where the decedent spouse simply lacks wealth or the couple otherwise fails to split ownership of their assets during life.

EXAMPLE 12—Using Portability to Supplement the Use of a Credit Shelter Trust When the Decedent Spouse Lacks Wealth: Assume that Husband and Wife are married, but Wife dies in March 2011 with $2,000,000 in assets, all of which pass to a credit shelter trust. Under this scenario, Wife would utilize $2,000,000 of her individual applicable exclusion amount and protect these assets from GST tax. With respect to Wife's remaining $3,000,000 applicable exclusion amount ($5,000,000 applicable exclusion amount less $2,000,000 utilized by wife), Wife's executor could elect portability, resulting in a DSUE amount of $3,000,000 for Husband. If Husband died in December 2013, Husband's applicable exclusion amount would be $8,250,000 ($5,250,000 of his own basic exclusion amount plus $3,000,000 of Wife's DSUE amount).

EXAMPLE 13—Using Portability to Avoid Having to Split Assets: Assume the same facts as in Example 12 above, *except that* Husband has $20,000,000 in assets. Without portability, in order to fully utilize both Husband and Wife's individual applicable exclusion amounts, Husband would need to transfer assets to Wife so that Wife could fully utilize her individual applicable exclusion amount. Otherwise, if Wife died first, $3,000,000 of Wife's individual applicable exclusion amount would be unused and Husband's estate would incur additional (unnecessary) tax at his death. However, using portability, Wife could establish a credit shelter trust for her $2,000,000 worth of individual assets and Wife's executor could make a portability election as to the remaining $3,000,000 that would otherwise be unused. Thus, Husband need not transfer additional assets to Wife during his life in order to use the full exemption amount.

VI. CONCLUSION.

Portability is here to stay and should be of great interest to married couples with sufficiently large estates to concern themselves with federal transfer taxes. Portability, in theory, is an appealing concept. Practitioners, however, need to understand and inform their clients of the tax and non-tax advantages and disadvantages of portability versus other credit shelter planning options. Ultimately, some clients may choose to employ more than one alternative to attempt to fully utilize their applicable exclusion amounts.

CIRCULAR 230 DISCLOSURE: Nothing contained herein or in any attachment hereto is intended to be used, or can be used (i) to avoid penalties imposed under the Internal Revenue Code, or (ii) for promoting, marketing or recommending to any party any transaction or matter addressed herein.

ENDNOTES:

[1]Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312, H.R. 4853, 124 Stat. 3296.

[2]Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312, § 301 et seq., H.R. 4853, 124 Stat. 3296.

[3]Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312, § 303(a), H.R. 4853, 124 Stat. 3296.

[4]Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312, § 303(a), H.R. 4853, 124 Stat. 3296.

[5]American Taxpayer Relief Act of 2012, Pub.

L. 112-240, H.R. 8, 126 Stat. 2313.

[6]American Taxpayer Relief Act of 2012, Pub. L. 112-240, §§ 101(a)(2), 101(c)(2), H.R. 8, 126 Stat. 2313.

[7]I.R.C. § 2010(c)(2).

[8]I.R.C. § 2010(c)(3).

[9]See I.R.C. § 2010(c)(4); Temp. Treas. Reg. § 20.2010-2T(c)(1). The 2012 Act simply conforms the statutory language to that of the temporary regulations, and thus confirms Congress's agreement with Treasury's view of the legislative intent of the portability rules.

[10]Temp. Treas. Reg. § 20.2010-2T(c)(1)(i).

[11]See Steve R. Akers, *Portability Temporary and Proposed Regulations (Issued June 15, 2012)*, June 2012, at 12-13.

[12]Temp. Treas. Reg. § 20.2010-2T(c)(2).

[13]Temp. Treas. Reg. § 20.2010-2T(c)(5), Ex. 2.

[14]See Temp. Treas. Reg. § 20.2010-2T(c)(5), Ex. 1.

[15]See Temp. Treas. Reg. § 20.2010-2T(c)(5), Ex. 2.

[16]I.R.C. § 2010(c)(4)(B)(i).

[17]Temp. Treas. Reg. § 20.2010-1T(d)(5).

[18]Temp. Treas. Reg. § § 20.2010-3T(a)(2), 25.2505-2T(a)(2).

[19]Temp. Treas. Reg. § § 20.2010-3T(a)(3), 25.2505-2T(a)(3).

[20]Subsequent to the enactment of the 2010 Act, there was some confusion with respect to whether privity was required for the use of the DSUE amount. See Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted by 111th Congress*, March 23, 2011. The 2012 Act made the technical correction suggested by the Joint Committee on Taxation's report to clarify that privity does, in fact, apply. See American Taxpayer Relief Act of 2012, Pub. L. 112-240, § 101(c)(2), H.R. 8, 126 Stat. 2313.

[21]Temp. Treas. Reg. § 20.2010-3T(c)(1).

[22]Temp. Treas. Reg. § 20.2010-3T(c)(1).

[23]See Temp. Treas. Reg. § 20.2010-3T(c)(1)(i).

[24]See Temp. Treas. Reg. § 20.2010-3T(c)(1) - (c)(1)(i).

[25]See Temp. Treas. Reg. § 20.2010-3T(c)(1)(ii)-(iii).

[26]I.R.C. § 2505(a).

[27]See Temp. Treas. Reg. § 25.2505-2T(a)(1).

[28]Temp. Treas. Reg. § 25.2505-2T(a)(1)(i).

[29]See Temp. Treas. Reg. § 25.2505-2T(a)(1)(i).

[30]See Temp. Treas. Reg. § 25.2505-2T(b).

[31]Temp. Treas. Reg. § 25.2505-2T(b).

[32]See Temp. Treas. Reg. § § 25.2505-3T(b), 25.2505-2T(c).

[33]Temp. Treas. Reg. § § 20.2010-3T(b)(1), 25.2505-2T(c).

[34]See Temp. Treas. Reg. § 20.2010-3T(b)(2).

[35]For further discussion and an example relating to this issue, see Section IV(B)(iv), *infra*.

[36]I.R.C. § 2010(c)(5)(A). For further discussion on the requirement of filing an estate tax return, see James J. Lanham, *Does Portability Mandate Estate Tax Returns for Married Decedents?*, 23 No. 4 Ohio Prob. L.J. NL 3 (Mar/Apr 2013).

[37]I.R.C. § 2010(c)(5)(A).

[38]Temp. Treas. Reg. § 20.2010-2T(a)(2).

[39]Temp. Treas. Reg. § 20.2010-2T(a)(3)(i).

[40]See Part 6 of the Instructions for Form 706, Unites States Estate (and Generation-Skipping Transfer) Tax Return (Revised August 2012).

[41]Temp. Treas. Reg. § 20.2010-2T(a)(2)-(3).

[42]Temp. Treas. Reg. § 20.2010-2T(a)(1).

[43]I.R.C. § 6075(a).

[44]I.R.C. § 6081(a).

[45]Treas. Reg. § 20.6081-1(b).

[46]I.R.C. § 2010(c)(5)(A).

[47]Temp. Treas. Reg. § 20.2010-2T(a)(4).

[48]Temp. Treas. Reg. § 20.2010-2T(a)(6)(i).

[49]Temp. Treas. Reg. § 20.2010-2T(a)(6)(ii).

[50]Temp. Treas. Reg. § 20.2010-2T(a)(6)(ii).

[51]Temp. Treas. Reg. § 20.2010-2T(a)(7)(i).

[52]Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii).

[53]Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii)(A).

[54]Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii)(A).

[55]Such exceptions include the following: (i) situations in which the value relates to, affects, or is needed to determine the amount passing to other beneficiaries, (ii) if the value is necessary to determine the estate's eligibility for

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alternate valuation, special use valuation, or I.R.C. § 6166 deferral, (iii) if only a portion of a specific asset passes to the surviving spouse or to charity, or (iv) if there is a partial disclaimer or a partial QTIP election. Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii)(A).

[56]Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii)(B).

[57]Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii)(B).

[58]Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii).

[59] See T.D. 9593, 77 Fed. Reg. 36150 (June 18, 2012).

[60]See examples provided in Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii)(C).

[61]See I.R.C. § 6501.

[62]I.R.C. § 2010(c)(5)(B), Temp. Treas. Reg. § 20.2010-3T(d).

[63]For an overview of some of the tax and nontax reasons for using credit shelter trusts, see Steve R. Akers, *Estate, Gift and Generation-Skipping Transfer Tax Provisions of "Tax Relief. . .Act of 2012," Enacted December 17, 2010,* December 21, 2010, at 13.

[64]See Temp. Treas. Reg. § 20.2010-2T(c)(1)(i).

[65]See I.R.C. § 2010(c)(4)(B)(i).

[66]For further discussion and examples relating to this issue, see Section III(B), *supra*.

CHARITABLE VEHICLES: DETERMINING THE RIGHT FIT FOR A CLIENT

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Clients are motivated to make charitable contributions for various reasons. For some clients, such contributions are driven by charitable motives alone. For other clients, public acknowledgment or public relations may serve as motivation. Others may be motivated by the role of tax benefits because the tax laws reflect a national policy of encouraging charitable contributions by sharing the cost of such contributions between the donor and the government.

Determining the "right fit" for a client involves more than understanding the motivation to make a charitable contribution. The advisor must consider and analyze various facts and issues before advising a client regarding which of several charitable vehicles is the "right fit." This article briefly considers and analyzes various charitable vehicles and how they might be suitable for various client situations.

PRIVATE FOUNDATIONS

Private foundations have been a mainstay of philanthropy for generations. A private foundation is an entity that is tax exempt by virtue of being described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended ("I.R.C."), and typically receives support from one source such as an individual, family or corporation. A private foundation usually generates income from investments rather than from a consistent flow of charitable contributions and makes grants for charitable purposes rather than conducting its own programs.

The income tax charitable contribution deduction for a gift to a private foundation is subject to percentage limitations. For gifts of cash and ordinary income property, a deduction is limited to 30% of a donor's "contribution base," which is basically his or her adjusted gross income. I.R.C. §§ 170(b)(1)(B) and (G). The deduction for contributions of capital gain

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