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Portability in Estate Planning: Alternative Strategy for Maximizing Tax Benefits

Evaluating Advantages of Portability vs. Traditional Bypass Trusts

TUESDAY, OCTOBER 14, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Portability:

The Game Changer Revisited

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Strafford Webinars

October 14, 2014

Portability is here to stay

- *Portability is Permanent*
  - Temporary and proposed regulations have been issued
  - The gift and estate tax forms and instructions have been revised to address portability
  - Treasury's Priority Guidance Plan for 2014-15 under "Gifts and Estates and Trusts," calls for final regulations to be issued under §§2010 and 2505, as well as resolution of Rev. Proc. 2001-38

Implement These Changes NOW

- *Change your Intake Questionnaires to Ask if Client has DSUE Amount*
  - For example: "Did you have a spouse who died on or after January 1, 2011? Yes ☐ No ☐ If yes, please provide us with a copy of your deceased spouse's federal estate tax return."
  - It will be important to identify clients with DSUE amounts and collect the information needed for reporting DSUE usage on the surviving spouse's gift or estate tax returns.
  - Identifying clients whose spouse died after December 31, 2010 will also allow you to identify situations in which the portability election was not made. Often, the deceased spouse's estate would not have been required to file an estate tax return. Under the proposed portability regulations, not having filed an estate tax return means the portability election was not made. When appropriate, consider asking the IRS for an extension of time to file the portability election or see if the estate qualifies for relief under Rev. Proc. 2014-18.

Implement These Changes NOW

Use DSUE Amounts by Gift – the current rules allow any surviving spouse having DSUE from a deceased spouse since January 1, 2011, to use the DSUE by gift – the benefits of using DSUE by gift:

- Achieve Better Estate Tax Results
- Remove Concern with Remarriage
- Remove Concern over Lack of Indexing
- Consider 2519 Technical Transfers

Implement These Changes NOW

Authorize the Portability Election in Wills/Revocable Trusts

- Discretionary v. mandatory
- Address who is responsible for costs of filing a return solely to elect portability
- Maintenance of records
- Release of liability

Implement These Changes NOW

Portability Election

- *To take advantage of Portability, the executor must make the portability election on a "complete and properly-prepared" estate tax return which is timely-filed.*

Implement These Changes NOW

Late Portability Elections

- Treas. Reg. § 301.9100-3 Relief
- Regulatory Elections –
  - Rev. Proc. 2014-18 – 12/31/14 Deadline!!!!
  - PLRs 201407002, 201410013, 201418009, 201418014, 201418023, 201421002

Implement These Changes NOW

Consider Restructuring Existing Plans to Enable the Possibility of Using Portability

- *Perhaps still achieving the non-federal estate tax benefits of a by-pass trust.*

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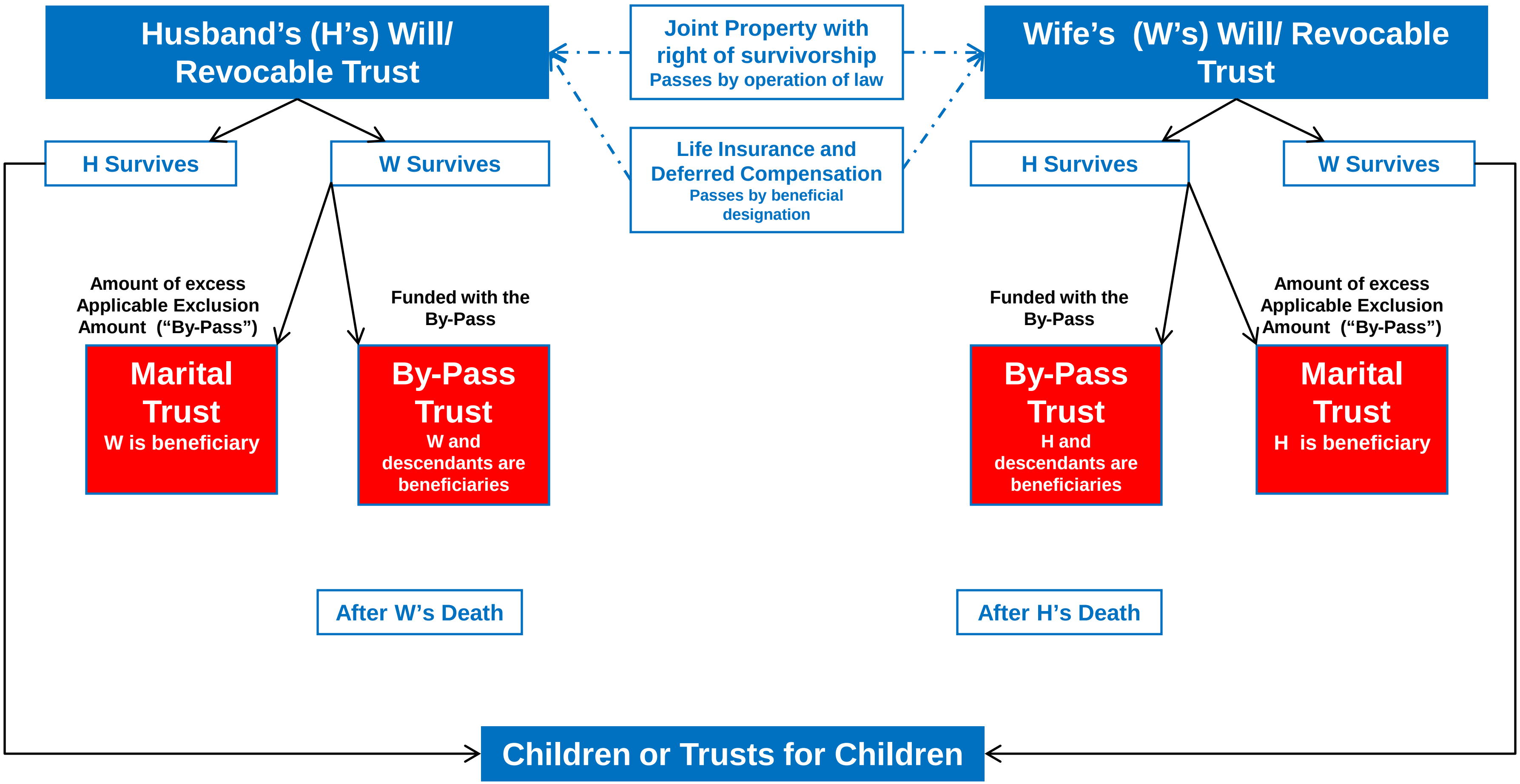
Portability vs. Traditional By-Pass Trust Planning

A Commonly Held View is that a By-Pass Trust has advantages over portability. The non-federal estate tax reasons for continuing to use a By-Pass Trust plan, include:

1. Asset management
2. Asset protection via spendthrift trust protection
3. Disposition control by the decedent spouse (i.e., preventing the surviving spouse from diverting the assets)
4. Use of the deceased spouse's GST exemption (i.e., no GST exemption portability)

Traditional By-Pass Trust Plan

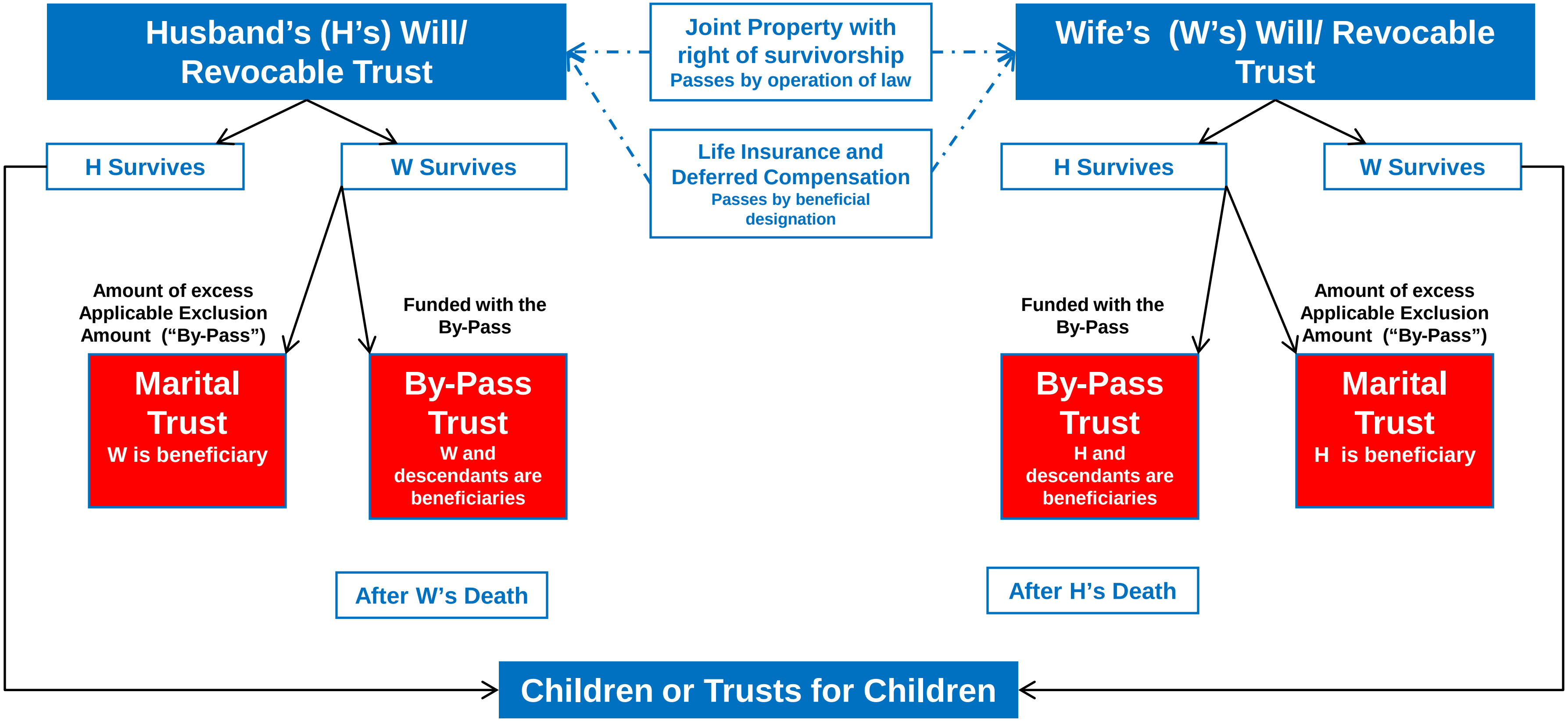


Strategic Reasons to Continue Using Traditional By-Pass Trust Planning

Consider these reasons when analyzing whether to use a Traditional By-Pass Trust rather than portability

1. Protecting accretions in value from estate tax upon the surviving spouse's death
2. Second marriages and blended families
3. Limiting disclosure of the deceased spouse's estate tax return to the surviving spouse (i.e., a desire for privacy)
4. Protection of the surviving spouse from losing the DSUE Amount by remarriage

Traditional By-Pass Trust Plan – Numerical Example



EXAMPLE #1: Suppose that a couple has $5 million in assets (no IRD items), has the traditional by-pass trust plan illustrated above, and have followed the traditional approach of splitting their assets between them, $2.5 million in each of their respective names or revocable trusts. Suppose further that the husband dies in 2013, that during the wife's subsequent lifetime all of the assets double in value, and that upon the wife's death the portability feature is still part of the law.

The Problem with Traditional By-Pass Trust Planning

Wife
$2.5 Million

Upon Husband's Death

➢Husband's estate uses $2.5 million of his exclusion amount funding the By-Pass Trust and ports the remaining $2.75 million to the surviving wife.

Husband's Will/Revocable Trust
The entire estate of $2.5 million passes to the By-Pass Trust for the surviving wife's benefit.

By-Pass Trust
$2.5 Million
Wife and descendants are beneficiaries of the By-Pass Trust during her lifetime.

➢During wife's subsequent life, the assets of the By-Pass Trust and the wife's assets double in value.

Upon Wife's Death

Wife's Property
Total Value $5 Million

Wife's Estate	
Gross Estate	$5,000,000
Exclusion	$8,000,000
Estate Tax	$ 0

➢By relying on the traditional By-Pass Trust planning, there is no federal estate tax in this example, but there is potential income tax liability on $2.5 million.

By-Pass Trust
$5 Million

By-Pass Trust	$5,000,000
Estate Tax	$ 0
Potential Cap. Gain	$2,500,000

At a 23.8% rate of taxation, the potential capital gain will cost $595,000. In this example, if the husband and wife had owned all of their assets in joint names with rights of survivorship or tenancy by the entirety, there would be no federal estate tax and no potential capital gain.

Results with Portability QTIP Trust Plan

Wife
$2.5 Million

Upon Husband's Death

- Husband's estate uses portability and ports the entire $5.25 million of DSUE to the surviving wife, makes the QTIP election and reverse QTIP election for QTIP Trust

Husband's Will/Revocable Trust
The entire estate of $2.5 million passes to the QTIP Trust for the surviving wife's benefit.

QTIP Trust
$2.5 Million
Wife is beneficiary during her lifetime.

- During wife's subsequent life, the assets of the QTIP Trust and the wife's assets double in value.

Upon Wife's Death

Wife's Property
Total Value $5 Million

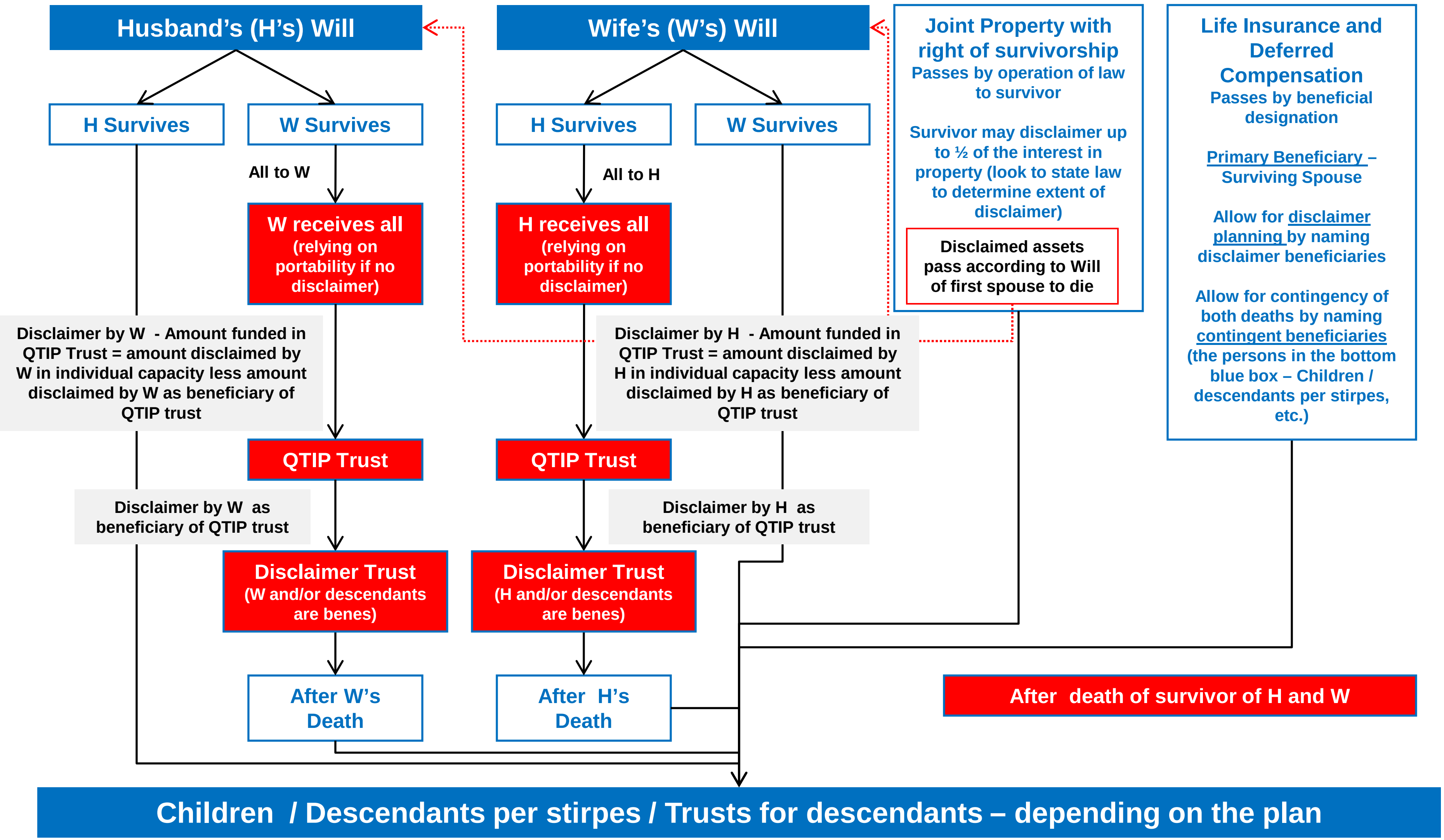
Wife's Property	$ 5,000,000
QTIP Trust	$ 5,000,000
Exclusion	$10,500,000
Estate Tax	$ 0

- By relying on the portability QTIP plan, there is no federal estate tax or income tax in this example.

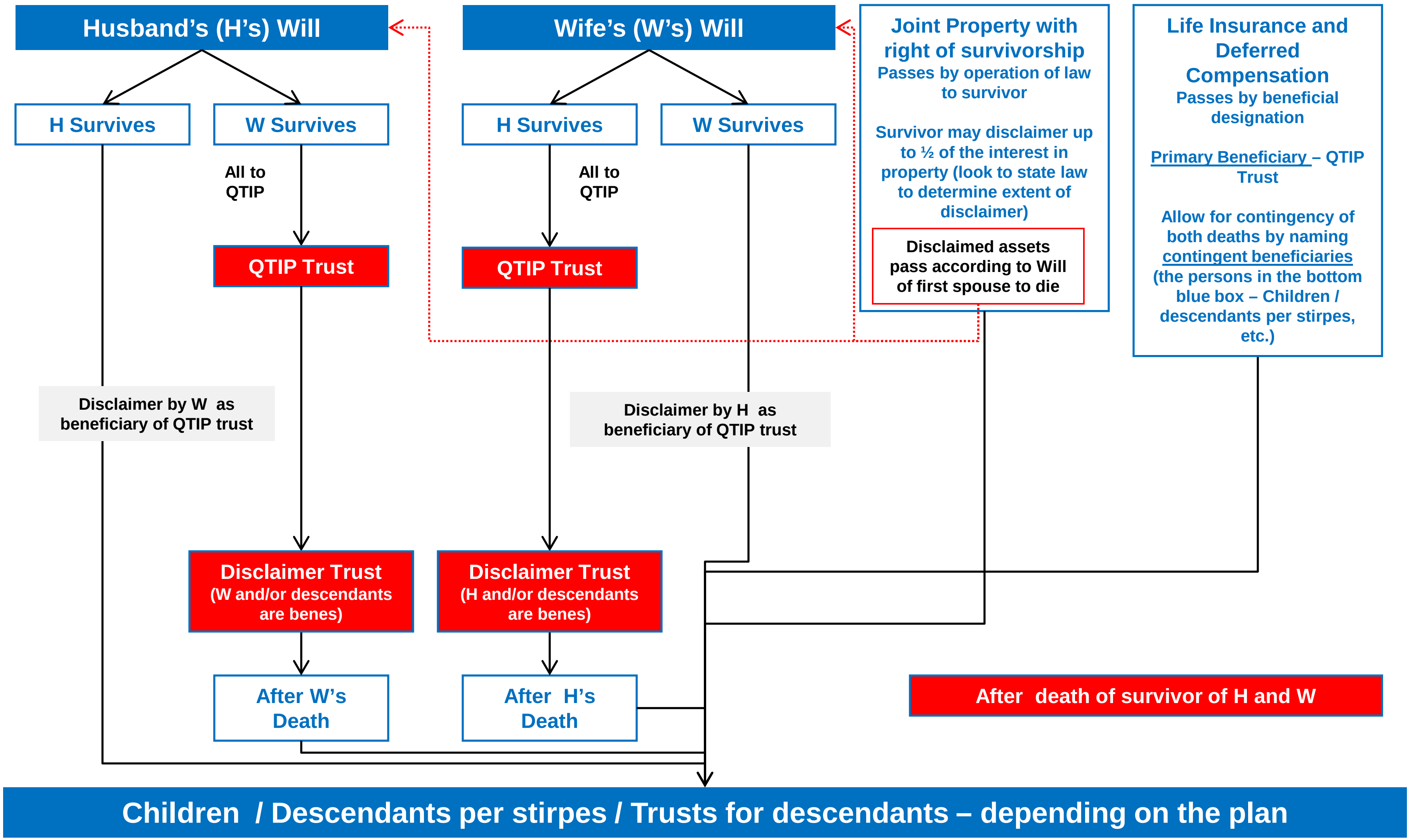
QTIP Trust
$5 Million

QTIP Trust	$5,000,000

Waterfall Disclaimer Portability Plan

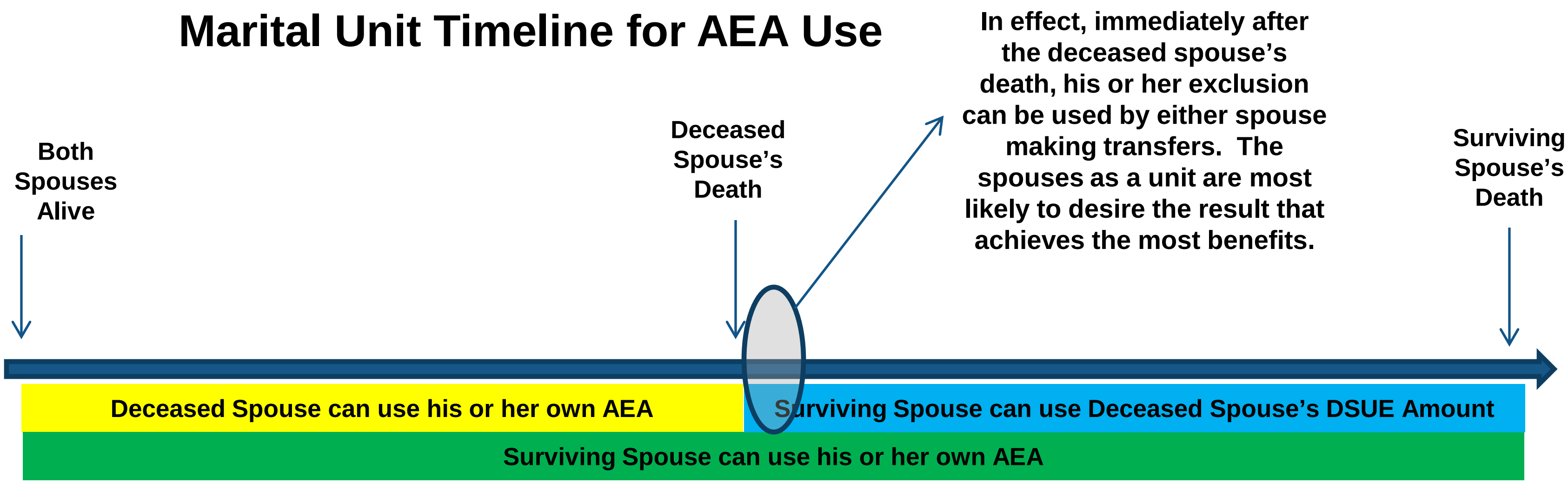


QTIP Trust Portability Plan



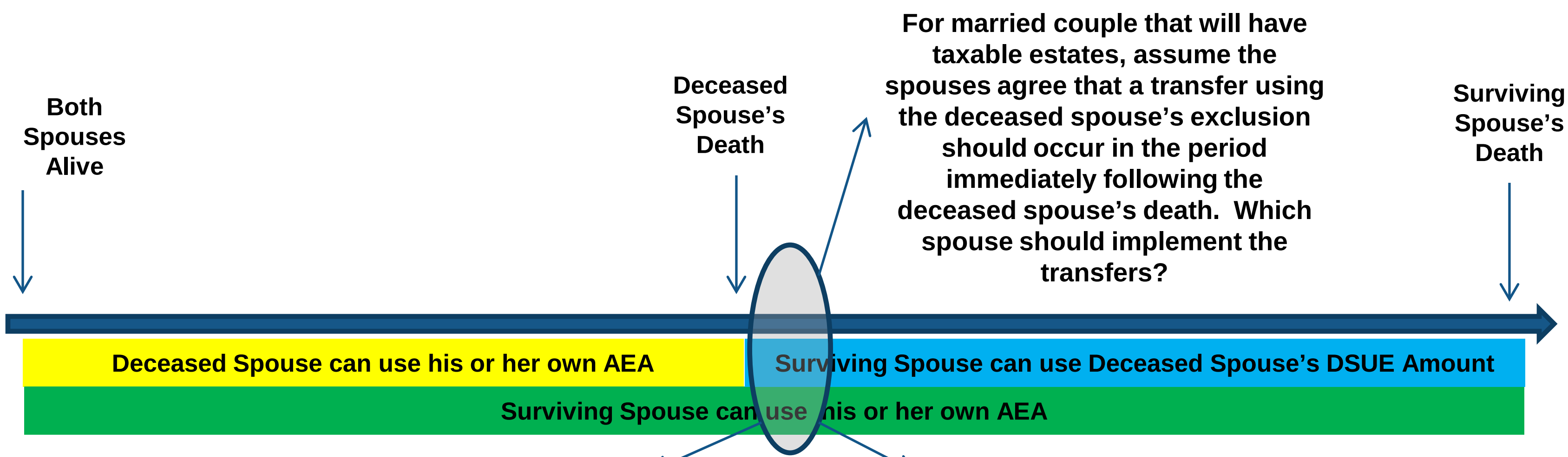
Portability Usage Timeline

Chart #1
Marital Unit Timeline for AEA Use



Portability Usage Timeline

Chart #2
Marital Unit Timeline for AEA Use



Deceased spouse controls the implementation of transfers using the deceased spouse's AEA through bypass trust if and to the extent that:

The clients are concerned that:

- The surviving spouse could divert deceased spouse's share of the marital unit's assets to someone other than the natural beneficiaries of the marital unit;
- The surviving spouse needs creditor protection or may be subject to undue influence; or
- The surviving spouse needs assistance with asset management; <u>and</u>

the couple is concerned that the surviving spouse might divert the tax benefits of the deceased spouse's exclusion amount to someone other than natural beneficiaries of the marital unit.

Surviving spouse controls the implementation of all other transfers using both spouses' AEAs.

The Basic Waterfall Disclaimer Portability Plan is changed to the QTIP Trust Portability Plan if the clients are concerned that:

- The surviving spouse could divert deceased spouse's share of the marital unit's assets to someone other than the natural beneficiaries of the marital unit;
- The surviving spouse needs creditor protection or may be subject to undue influence; or
- The surviving spouse needs assistance with asset management.

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“Portability Substitutes” – Chasing the Step-Up in Basis

- Since the introduction of portability, for marital estates less than 2x the basic exclusion amount, it is possible to have all assets included in the surviving spouse’s gross estate and receive a full step-up in basis for all assets
- Many authors and lecturers believe that the loss of the by-pass trust benefits outweigh the advantages provided by portability
- As a result, the same authors and lecturers have attempted to devise plans outside of portability utilizing the traditional by-pass trust while still achieving the full step-up in basis for all assets

Today's Buzz-Worthy Concept: Add a "Basis Adjustment Mechanism" to By-Pass Trusts

Wife
$2.5 Million

Husband's Will/Revocable Trust
The entire estate of $2.5 million passes to the By-Pass Trust for the surviving wife's benefit.

- Husband's estate uses $2.5 million of his exclusion amount funding the By-Pass Trust and ports the remaining $2.75 million to the surviving wife.

Upon Husband's Death

By-Pass Trust
$2.5 Million
Wife and descendants are beneficiaries of the By-Pass Trust during her lifetime.

- During wife's subsequent life, the assets of the By-Pass Trust and the wife's assets double in value.

Upon Wife's Death

Wife's Property
Total Value $5 Million

Wife's Estate	
Gross Estate	$5,000,000
Exclusion	$8,000,000
Estate Tax	$ 0

- By relying on the traditional By-Pass Trust planning, there is no federal estate tax in this example, but there is potential income tax liability on $2.5 million.

By-Pass Trust
$5 Million

By-Pass Trust	$5,000,000
Estate Tax	$ 0
Potential Cap. Gain	$2,500,000

Commonly Discussed "BAM's"

- Independent Trustee with unlimited power to distribute
  - Benefits: Allows appreciated assets to be distributed, loss assets to remain in by-pass trust, and it is a relatively simple arrangement, not based on a formula or involving complicated power of appointment issues
  - Risks: Independent Trustee will be shy in exercising the authority, the spouse's unexpected death before distributions, distributed assets exposed to spouse's creditors
- Independent Trustee can grant a GPOA
  - Benefits: Independent Trustee can avoid any abuse of discretion with respect to distributions and, instead, can grant a GPOA to cause gross estate inclusion; this can apply even over only appreciated assets
  - Risks: What if the beneficiary is in a jurisdiction where property subject to a GPOA is reachable by creditors?

Commonly Discussed "BAM's"

- Formula GPOA
  - Benefits: mechanical formula can eliminate the fiduciary risk in granting a GPOA or exercising discretion
  - Risks: too many variables for a viable formula to work
- Delaware Tax Trap
  - Benefits: by violating the Delaware Tax Trap, inclusion can occur without any fiduciary discretion
  - Risks: How to get this to happen if the by-pass trust is already funded? What if you live in a state where the applicable rule against perpetuities provides that you cannot violate the Trap?
  - X-Factor: decanting
  - X-Factor #2: states with anti-Trap laws may change them for this purpose (see Florida)

BAM's are Not as Efficient as Portability

Example:

- Assume that when H dies in 2013 his by-pass trust is funded with two assets each with a value of $1.5 million ($3 million total). H's applicable exclusion amount (AEA) is $5.25 million. The DSUE amount passing from H to W is $2.25 million.

- W does not remarry, has not made any gifts, and the basic exclusion amount (BEA) has increased via indexing from today's amount of $5.25 million to $5.75 million. Suppose that when W dies her estate is $5.5 million. W's AEA is $8 million, which is comprised of her BEA of $5.75 million and $2.25 million of DSUE. If none of the by-pass trust is taxed as part of W's estate, there will be $2.5 million of W's AEA remaining unused (i.e., $8 million AEA - $5.5 million estate).

- Suppose that upon W's death, the two by-pass trust assets have appreciated each to $2.25 million, so that upon W's death there is total by-pass trust appreciation of $1.5 million, potentially subject to capital gains tax at some point in time.

By-Pass Trust Techniques to Attain Basis Adjustments are Not as Efficient as Portability

- If portability had been used, upon the W's death, the total estate would be $10 million (W's $5.5 million and H's 4.5 million) and W would have $11 million of AEA (H's $5.25 million of DSUE and W's BEA of $5.75 million). There would be no federal estate tax and the aggregate estate assets would receive an adjustment in basis to FMV (i.e., no capital gain potential).
- With using the by-pass trust, W cannot be granted a GPOA over the entire by-pass trust, as that would add $4.5 million to her taxable estate. With $3 million of H's AEA being used upon H's death when funding the by-pass trust, W only has $8 million of AEA when she dies. If the total by-pass trust is added to her taxable estate, $2 million would be subjected to estate tax at 40%. The best that could be hoped for in this case is to partially increase the basis of the by-pass trust assets by using one of the techniques to cause a portion of the by-pass trust to be taxed in W's estate.
- This example illustrates that, in many cases these techniques will only help to mitigate the income tax disadvantage of the by-pass trust, not eliminate it.
- Another point to consider is that these techniques are less efficient than portability in the respect that exclusion is being used two times to cover at least part of the same asset value from estate taxes -- i.e., once when the by-pass trust is funded and once by inclusion in the surviving spouse's estate.

Portability, QTIP Trusts and Rev. Proc. 2001-38

- Rev. Proc. 2001-38 was enacted to prevent inadvertent QTIP elections and forces use of the applicable exclusion amount
- Applies to QTIP elections under §2056(b)(7) where the election was not necessary to reduce the estate tax liability to zero.
- Rev. Proc. 2001-38 specifically **does not apply to:**
  - protective elections;
  - situations where a partial QTIP election was needed to reduce estate tax liability to zero and the executor made the election with respect to more property than was necessary;
  - elections that are stated in terms of a formula designed to reduce the estate tax to zero; or
  - Gift tax QTIP elections.
- After the advent of portability, a taxpayer may wish to establish a QTIP trust and have his or her executor make the QTIP election (*i.e.*, within the scope of Rev. Proc. 2001-38) to enable his or her estate tax exclusion to pass to his or her spouse via portability.
- ABA Comments and Priority Guidance

Portability Planning, Gifts and Grantor Trusts
Portability Plan – QTIP/Disclaimer Trust – assume W dies first

Wife's (W's) Will

H Survives

All to QTIP Trust. QTIP election, Portability election and Reverse QTIP election all made.

QTIP Trust

H could disclaim amount equal to state death tax exemption amount. Allocate GST exemption.

Disclaimer Trust
(H and descendants are benes)

Husband's (H's) Inter-vivos Planning

Inter-vivos Gifting Trust for Descendants

- Trust is a grantor trust for Federal income tax purposes;
- H initially funds trust same amount funded in QTIP Trust (i.e., Federal – State estate tax exemption);
- H allocates his GST Exemption to this Trust; and
- Dynastic trust for descendants, per stirpes.

Future Planning
- H could continue to fund the trust during his lifetime with any remaining lifetime exemption. H would allocate GST exemption to the extent possible.

(H's) Will

At Death

- Pay taxes, expenses and debts
- Balance to be divided and allocated to the GST Exempt and Non-Exempt Trusts created for the benefit of descendants

After H's Death

Children / Descendants per stirpes / Trusts for descendants – depending on the plan

All examples are for illustrative purposes only

Portability Plan – QTIP/Disclaimer Trust – assume W died first

Wife's (W's) Will

Results upon W's death:

- W's applicable exclusion amount passes to H
- QTIP trusts cover all the non-federal estate tax issues
- Husband fully utilizes W's unused GST Exemption
- There is no state death tax that is triggered (for states with state death taxes) on W's death
- All income taxes on this trust are paid with pre-estate tax dollars.

Husband's (H's) Inter-vivos Planning

Inter-vivos Gifting Trust for Descendants

Results with H's gift plan:

- Fully utilizes W's DSUE. Appreciation is thereafter removed from H's estate
- By making a gift, H avoids state death tax (on the amount passing into the trust (which is effectively a substitute for a by-pass trust for descendants)). Caution - CT with its gift tax
- Allocates H's GST exemption to this trust
- Since this is a grantor trust:
  - All income taxes are paid by H, with pre-estate tax dollars
  - H can do sales with this trust to leverage its value (i.e., the so-called sale to defective grantor trust technique)
  - H can virtually step-up the basis by swapping assets.

(H's) Will

At Death

Results upon H's death:

- Since H used W's DSUE by gift:
  - The lack of DSUE indexing concern is eliminated
  - A subsequent marriage could not jeopardized the DSUE; and
  - H always gets credit for the used DSUE, even if a subsequent marriage results in a new "last deceased spouse"
- The balance of H's unused GST exemption and estate tax exemptions are used.

Children / Descendants per stirpes / Trusts for descendants – depending on the plan

All examples are for illustrative purposes only

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Asset Protection Issues

Traditional By-Pass Trust

1. Division of assets to fund separate by-pass trusts often destroyed asset protection during both spouses' lifetimes – e.g., division of TBE property. Note new statutes providing for TBE protection for transfers to revocable trusts
2. Discretionary beneficial rights in spouse should be protected by spendthrift clause
3. Caution with by-pass trust techniques to attain basis adjustments
   - Independent Trustee with unlimited power to distribute
   - Independent Trustee can grant a GPOA
   - Formula GPOA
   - Delaware Tax Trap

Portability QTIP/Disclaimer Plan

1. Spendthrift creditor protection, at least as to principal
2. Mandatory income interest in QTIP Trust – creditors may be able to reach income once distributed --more exposed to creditors than a totally discretionary by-pass trust
3. Discretionary principal rights should be beyond creditors' reach
4. Disclaimers to fund disclaimer/by-pass trust
   - Surviving spouse may need to be solvent at the time of disclaimer
   - Some states treat a disclaimer by an insolvent person as a fraudulent transfers
   - May disqualify spouse for Medicaid benefits
5. Clayton QTIP
6. Using DSUE for gifts to Self Settled "Grantor" Irrevocable Gift Trust

Consider Diversifying Approaches for Applicable Exclusion Amount Usage and Planning to Create Flexibility in Estate Plans

- Exclusion up 500% since 2003 – Diversify Approach
  - Techniques
  - Assets
- Flexibility, flexibility, flexibility
  - Disclaimers
  - Partial QTIPs, reverse QTIPs
  - Independent Trustees with broad powers to distribute
  - Decanting and merger
  - Protectors and Powers of Amendment

Projected Remaining Aggregate Applicable Exclusion Amounts for Married Couple Who Each Gave $5 Million in 2011

This chart projects the remaining aggregate applicable exclusion amounts (AEA) that will be available to a married couple **<u>who each gave $5 million in 2011</u>**, considering annual inflation adjustments to the basic exclusion amount (BEA). The axis across the table is the year of the first spouse's death – to that point in time the BEA component of both spouses' AEAs are being indexed, and thereafter going down the axis on the left side of the table to the year of the surviving spouse's death, only the BEA of the surviving spouse's AEA is being indexed. This may assist in determining whether it is reasonable to assume the couple will have an estate tax liability.

Starting Basic Exclusion Amount $ 5,250,000 Inflation Adjustment 2.45%

If the first spouse dies in 2020, his or her remaining AEA would be $1,220,000.

Year of Surviving Spouse's Death	Year of Deceased Spouse's Death																	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
2013	500,000																	
2014	630,000	760,000																
2015	760,000	890,000	1,020,000															
2016	890,000	1,020,000	1,150,000	1,280,000														
2017	1,030,000	1,160,000	1,290,000	1,420,000	1,560,000													
2018	1,170,000	1,300,000	1,430,000	1,560,000	1,700,000	1,840,000												
2019	1,320,000	1,450,000	1,580,000	1,710,000	1,850,000	1,990,000	2,140,000											
2020	1,470,000	1,600,000	1,730,000	1,860,000	2,000,000	2,140,000	2,290,000	2,440,000										
2021	1,620,000	1,750,000	1,880,000	2,010,000	2,150,000	2,290,000	2,440,000	2,590,000	2,740,000									
2022	1,780,000	1,910,000	2,040,000	2,170,000	2,310,000	2,450,000	2,600,000	2,750,000	2,900,000	3,060,000								
2023	1,940,000	2,070,000	2,200,000	2,330,000	2,470,000	2,610,000	2,760,000	2,910,000	3,060,000	3,220,000	3,380,000							
2024	2,100,000	2,230,000	2,360,000	2,490,000	2,630,000	2,770,000	2,920,000	3,070,000	3,220,000	3,380,000	3,540,000	3,700,000						
2025	2,270,000	2,400,000	2,530,000	2,660,000	2,800,000	2,940,000	3,090,000	3,240,000	3,390,000	3,550,000	3,710,000	3,870,000	4,040,000					
2026	2,440,000	2,570,000	2,700,000	2,830,000	2,970,000	3,110,000	3,260,000	3,410,000	3,560,000	3,720,000	3,880,000	4,040,000	4,210,000	4,380,000				
2027	2,610,000	2,740,000	2,870,000	3,000,000	3,140,000	3,280,000	3,430,000	3,580,000	3,730,000	3,890,000	4,050,000	4,210,000	4,380,000	4,550,000	4,720,000			
2028	2,800,000	2,930,000	3,060,000	3,190,000	3,330,000	3,470,000	3,620,000	3,770,000	3,920,000	4,080,000	4,240,000	4,400,000	4,570,000	4,740,000	4,910,000	5,100,000		
2029	2,980,000	3,110,000	3,240,000	3,370,000	3,510,000	3,650,000	3,800,000	3,950,000	4,100,000	4,260,000	4,420,000	4,580,000	4,750,000	4,920,000	5,090,000	5,280,000	5,460,000	
2030	3,170,000	3,300,000	3,430,000	3,560,000	3,700,000	3,840,000	3,990,000	4,140,000	4,290,000	4,450,000	4,610,000	4,770,000	4,940,000	5,110,000	5,280,000	5,470,000	5,650,000	5,840,000
2031	3,360,000	3,490,000	3,620,000	3,750,000	3,890,000	4,030,000	4,180,000	4,330,000	4,480,000	4,640,000	4,800,000	4,960,000	5,130,000	5,300,000	5,470,000	5,660,000	5,840,000	6,030,000
2032	3,560,000	3,690,000	3,820,000	3,950,000	4,090,000	4,230,000	4,380,000	4,530,000	4,680,000	4,840,000	5,000,000	5,160,000	5,330,000	5,500,000	5,670,000	5,860,000	6,040,000	6,230,000
2033	3,770,000	3,900,000	4,030,000	4,160,000	4,300,000	4,440,000	4,590,000	4,740,000	4,890,000	5,050,000	5,210,000	5,370,000	5,540,000	5,710,000	5,880,000	6,070,000	6,250,000	6,440,000
2034	3,970,000	4,100,000	4,230,000	4,360,000	4,500,000	4,640,000	4,790,000	4,940,000	5,090,000	5,250,000	5,410,000	5,570,000	5,740,000	5,910,000	6,080,000	6,270,000	6,450,000	6,640,000
2035	4,190,000	4,320,000	4,450,000	4,580,000	4,720,000	4,860,000	5,010,000	5,160,000	5,310,000	5,470,000	5,630,000	5,790,000	5,960,000	6,130,000	6,300,000	6,490,000	6,670,000	6,860,000
2036	4,410,000	4,540,000	4,670,000	4,800,000	4,940,000	5,080,000	5,230,000	5,380,000	5,530,000	5,690,000	5,850,000	6,010,000	6,180,000	6,350,000	6,520,000	6,710,000	6,890,000	7,080,000
2037	4,630,000	4,760,000	4,890,000	5,020,000	5,160,000	5,300,000	5,450,000	5,600,000	5,750,000	5,910,000	6,070,000	6,230,000	6,400,000	6,570,000	6,740,000	6,930,000	7,110,000	7,300,000
2038	4,860,000	4,990,000	5,120,000	5,250,000	5,390,000	5,530,000	5,680,000	5,830,000	5,980,000	6,140,000	6,300,000	6,460,000	6,630,000	6,800,000	6,970,000	7,160,000	7,340,000	7,530,000
2039	5,100,000	5,230,000	5,360,000	5,490,000	5,630,000	5,770,000	5,920,000	6,070,000	6,220,000	6,380,000	6,540,000	6,700,000	6,870,000	7,040,000	7,210,000	7,400,000	7,580,000	7,770,000
2040	5,340,000	5,470,000	5,600,000	5,730,000	5,870,000	6,010,000	6,160,000	6,310,000	6,460,000	6,620,000	6,780,000	6,940,000	7,110,000	7,280,000	7,450,000	7,640,000	7,820,000	8,010,000

Portability & State Death Taxes

- Use Portability to Defer or Eliminate State Death Taxes on DSUE
  - *In the District of Columbia and Maryland, we have separate estate taxes, with a $1 million exemption. To fully fund $5.25 million to a by-pass trust would require the payment to DC or Maryland estate tax of $420,800 to $478,182 depending on how the taxes are charged.*

Maryland Estate Example -- Funding By-Pass Trust	Apportion MD Estate Tax to By-Pass Trust	Apportion MD Estate Tax to Residue
Taxable Estate (2014):	5,250,000	5,728,182
Deduction for State Death Tax (MD):	420,800	478,182
Tentative Tax Base:	4,829,200	5,250,000
Tentative Tax:	1,877,480	2,045,800
Gross Federal Estate Tax:	1,877,480	2,045,800
Applicable Exclusion Amount:	5,250,000	5,250,000
Unified Credit:	2,045,800	2,045,800
Net Federal Estate Tax:	-	-
Assumed State Death Tax:	420,800	478,182
Total Federal and State Tax Payable:	420,800	478,182
Net Estate Remaining:	4,829,200	5,250,000
Taxes as Percentage of Taxable Estate:	8.02%	8.35%
DSUE	**420,800**	-

Portability and Pending Marriages

Marital Agreements

Two new types of clients

- Client #1 - Those who are contemplating to marry where one spouse (or both spouses) may be able to leave DSUE amount to the surviving spouse. Generally where there is a “moneyed” spouse and a “non-moneyed” spouse
- Client #2 - Those clients who are coming to a marriage with the DSUE amount, where such DSUE amount may be lost when a spouse dies. In some cases, both spouses could be coming to the marriage with DSUE amounts

Portability and Pending Marriages

Planning for Client #1

- Should the surviving spouse be named as the Personal Representative of the Will or the Trustee of the Revocable Trust?
- Will the election be mandatory or discretionary (consider conflict of interest)?
- Who pays the cost of making the election?
- Who retains copies of documents?

Planning for Client #2

- Should the surviving spouse be named as the Personal Representative of the Will or Trustee of the Revocable Trust
- Will the election be mandatory or discretionary
- Who pays the cost of making the election
- How do you make up for the loss of the DSUE amount on the death of the spouse? Consider life insurance trusts.
- Consider gifting to reduce the risk of loss of the DSUE amounts.

Portability and Second Marriages

- Portability has a place, even with second marriages
- "QTIP Portability Plan" – assuming guidance is provided to disregard the applicability of Rev. Proc. 2001-38, all assets upon deceased spouse's ("DS") death pass to QTIP Trust for surviving spouse ("SS"), with all of DS's DSUE ported to SS
  - RISK #1: SS could divert benefits away from DS's children
  - RISK #2: SS remarries and new spouse predeceases, leaving SS no DSUE, resulting in the loss of DS's DSUE

Portability and Second Marriages

Example:

- Upon DS's death, the QTIP Portability Plan is implemented, with the Resulting Trust qualified as a QTIP Trust and SS receives DS's DSUE of $5 million.
- Two years after DS's death, SS marries new spouse (NS) who has a net worth of $100 million.
- Over the next three years, NS partakes in a gifting program in which SS agrees to split the gifts, so that ultimately, SS's deemed gifts consume all of his/her DSUE as part of NS's gifting program.
- Upon SS's death, SS's individual assets are valued at $5 million and the QTIP Trust is valued at $5 million. SS provides in his/her will that federal estate taxes are apportioned under §2207A.
- Result: $2 million of estate taxes charged at SS's death are assessed against the QTIP Trust courtesy of §2207A apportionment; as a result, SS's family receives $5 million free and clear, whereas DS's family bears the burden of all estate taxes and only receives $3 million

Portability and Second Marriages

Solution #1 - Post-Nuptial Agreement mandating a "DSUE Recovery Provision"

- Each spouse agrees that if he or she is the surviving spouse, his/her individual assets will pay the estate taxes assessed against the QTIP Trust to the extent of the lesser of
  - DSUE transferred to him/her, or
  - The value of the QTIP Trust for federal estate tax purposes on his/her death
- Change in Example:
  - As a result of DSUE Recovery Provision, the $2 million in federal estate taxes would instead be assessed against SS's individual assets.
  - Thus, SS's descendants would bear the burden of SS's use of the DSUE for the benefit of NS, which is the fair result since SS chose to gift-split with NS, which effectively deprived his/her descendants — and not DS's descendants — of property through the use of his/her applicable exclusion amount

Portability and Second Marriages

Solution #2 - §2519 Technical Termination Approach

- SS releases 1% interest in QTIP Trust; taxable gift of 1% pursuant to §2511, but a RELEASE of the ENTIRE QTIP TRUST VALUE under §2519
- The gift causes the use of DS's DSUE given to SS
- In actuality, DS still has a 99% interest in the QTIP Trust so his/her actual economic position has barely changed
- Upon SS's death, QTIP Trust is included in SS's estate NOT under §2044, but rather under §2036, so 99% of the QTIP Trust receives its step-up in basis
- For GST purposes, the transferor HAS NOT CHANGED, which means that if a reverse QTIP election was made upon DS's death, DS IS STILL THE TRANSFEROR so GST Exemption IS NOT LOST!!!
- Approach works even if trust contains spendthrift protection

Portability Resources:

Franklin and Karibjanian, *Port ability and Second Marriages – Worth a Second Look*, 39 BNA/Tax Management's Estates, Gifts and Trusts Journal 179 (Sept. – Oct. 2014).

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Karibjanian & Law, *Portability and Prenuptials: A Plethora of Preventative, Progressive and Precautionary Provisions*, 38 BNA/Tax Management's Estates, Gifts and Trusts Journal 175 (March – April 2013).

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ABA-RPTE Section's Comments to Treasury on the New Temporary and Proposed Regulations (October 4, 2012).
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US 706 for 2012 (Form and Instructions), Vincent F. Lackner, Jr., LISI Estate Planning Newsletter #2016 (October 23, 2012).
http://leimbergservices.com/files/LISILackner2.doc

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