Estate Planning – Portability Provisions of TRA 2010

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The “Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010” was enacted December 17, 2010 and is referred to as “TRA 2010.” For calendar years 2011 and 2012, TRA 2010 reunified the estate, gift and generation-skipping taxes with a $5 million exemption and a 35% tax rate. The $5 million exemption will be indexed for inflation in calendar year 2012 only. If Congress fails to enact additional legislation by December 31, 2012, the taxes will remain unified but will be reduced to an inflation-adjusted $1 million exemption and increased to a 55% maximum tax rate.

Until TRA 2010 was enacted, married couples typically implemented a two-trust estate plan to take advantage of each spouse’s estate tax exemption. When the first spouse passed away, a credit-shelter trust would be funded first with an amount up to the deceased spouse’s estate tax exemption. A marital trust qualifying for the marital deduction would be funded if the value of the deceased spouse’s assets exceeded the estate tax exemption thereby deferring the payment of any estate tax. When the surviving spouse subsequently died, the combined value of the assets in the deceased spouse’s marital trust and the surviving spouse’s assets would be subject to the estate tax only to the extent it exceeded the surviving spouse’s estate tax exemption. The assets in the credit-shelter trust would not be subject to estate tax when the surviving spouse died, no matter how much the assets grew in value. Most importantly, in the event the estate tax exemption of the spouse who died first was not fully utilized when he died, i.e. the credit-shelter trust was not fully funded with assets having a value equal to the estate tax exemption, the unused amount of the deceased spouse’s estate tax exemption was lost. The worst outcome for clients who failed to implement an estate plan designed to reduce their exposure to the estate tax was that the estate tax exemption of the spouse who died first was totally lost, and the surviving spouse only had her remaining estate tax exemption to use when she died.

TRA 2010 made a significant change to the estate tax by adding the concept of “portability.” The executor of the deceased spouse’s estate may transfer any unused amount of the deceased spouse’s estate tax exemption to the surviving spouse. The executor of the deceased spouse’s estate must file an estate tax return (Form 706) on a timely basis, that is on or before nine months following the date of death, and make an election to permit the surviving spouse to utilize the unused estate tax exemption. When the surviving spouse subsequently dies, her estate tax exemption is increased by the “deceased spousal unused exclusion amount,” referred to as “DESUEA.” Therefore, if the first spouse of a married couple dies during calendar years 2011 and 2012,

especially for married couples who do not have the two-trust estate plan discussed above, consideration must be given to preparing and filing a Form 706 to make this election. Failure to do so on a timely basis will prevent the surviving spouse from having the DESUEA available at her death.

What if the first spouse of a married couple dies during calendar years 2011 and 2012 and a two-trust estate plan is in place? Many of these types of estate plans have been structured in recent years to allow the surviving spouse the flexibility to determine whether to fund the credit-shelter trust by the use of one or more disclaimers within the nine-month period following the deceased spouse's date of death. The following benefits may be realized by the surviving spouse by choosing to fund the credit-shelter trust:

- Post death appreciation of the assets in the credit-shelter trust will be sheltered from the estate tax.
- Trust assets will be protected from creditors.
- Trust assets may be protected when the surviving spouse remarries, assuming the surviving spouse is not the sole trustee of the credit-shelter trust.
- Portability ends after December 31, 2012, unless extended by future legislation.

Portability applies for the gift tax exemption as well as the estate tax exemption. Therefore, use of the deceased spouse's DESUEA would have significant benefits to the making of lifetime gifts by the surviving spouse. However, portability does not apply to the generation skipping tax exemption. Therefore, for clients who want an estate plan that takes advantage of the planning opportunities of generation skipping, the funding of the credit-shelter trust of the spouse who dies first would be important.

In the "General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals" (February 14, 2011), the Treasury Department explained how the President's 2012 budget proposals presume several important changes in the estate, gift and generation-skipping taxes. These changes included making "portability" of the deceased spouse's DESUEA permanent. However, we have no ability to predict whether Congress will enact such legislation. Therefore, it is important for clients to continue to be proactive in addressing their estate plans. Clients should not rely on the portability provision for solving their estate tax exposure in coming years.

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