

DECODING ESTATE PLANNING JARGON: “PORTABILITY”

If you are married and have discussed estate planning with an advisor recently, chances are the term “portability” has come up. The concept itself is not complicated, but the application to individual circumstances can be very complicated.

The Basics.

Often the goal on the death of the first spouse is to make the entire estate available to the surviving spouse and to minimize taxes. On the death of the first spouse, there are two primary estate tax “shields” available.

- The estate tax exemption (aka the “applicable exclusion amount”). This is an amount that may pass to anyone free of estate tax. In 2016, that amount is \$5,450,000.
- The estate tax marital deduction. This allows an unlimited amount of assets to pass free of estate tax, but only to, or in a special trust for, the surviving spouse.

The Dilemma.

Often spouses would like to simply leave their entire estate to one another free of any restrictions. One problem with this approach prior to “portability” was that the estate tax exemption of the first to die would be wasted. That is, while all assets could pass to the surviving spouse free of estate tax (marital deduction), on the death of the survivor, when assets pass to children or others, only the surviving spouse’s estate tax exemption would be available. The first to die’s estate tax exemption was not used and therefore was wasted. The solution to this dilemma was to set aside in a separate trust the first to die’s estate tax exemption amount. The trust was structured so that the surviving spouse is a beneficiary with good access to the trust, but the trust itself escaped estate tax at the second death.

Portability.

In 2010, the law was changed to minimize this dilemma. In essence, the estate tax exemption of the first to die became “portable” to the surviving spouse – that is, if the first to die did not use his or her exemption, the survivor could use it at the second death.

For some clients, leaving all assets to the surviving spouse will work fine and in fact will achieve a result superior to using a separate trust for the exemption amount. For example, assets allocated to a separate trust generally do not get a new, fair market value income tax basis at the second death, while assets given to the survivor using the marital deduction will get a new basis. On the other hand, using a separate trust will shield not only the exemption amount but also asset appreciation after the first death, while a gift using the marital deduction will not. There are many other wrinkles to consider.

You need your attorney to help you understand whether or not you can or should use portability given your individual circumstances. The concept is simple, but the application can become quite complicated.