

CONSIDER THE IMPORTANCE

Potent Portability

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Recently, the IRS issued Revenue Procedure 2022-32, which expanded a simplified method for taxpayers to make a “Portability” election. Since Portability can be one of the most impactful estate planning tools, let’s take a look at what it is, how it came to be, and what it means for clients.

PRE-PORTABILITY

Prior to the introduction of Portability, spouses only enjoyed their respective individual estate exemption. This seemed somewhat at odds with the unlimited marital deduction (enshrined in 1982), which effectively treated a married couple as a single economic unit and no longer imposed any kind of estate or gift tax on transfers between spouses. So, when one spouse died, all of that spouse’s solely-owned property (as well as jointly-held property) could pass to the surviving spouse with no estate or gift implications.

But what would that mean for the surviving spouse’s estate? Hypothetically, let’s imagine a married couple in 2022 with jointly-held assets of \$20 million. When the first spouse dies, their estate won’t need to use any of the \$12.06 million exemption because all of the assets are jointly-held. The surviving spouse, however, then dies with a \$20 million estate and only \$12.06 million of exemption. So, the surviving spouse has a taxable estate of \$7,940,000 and (at an estate tax rate of 40%) owes \$3,176,000 in estate taxes.

This situation gave rise to credit shelter trust (CST) planning, also known as A-B Trusts or Bypass Trusts. Upon the first spouse’s death, assets totaling the individual estate exemption would be placed into a Trust from which the surviving spouse could benefit but only to a degree that would keep the Trust from being included in their estate. This would preserve the first spouse’s exemption and allow the assets to pass free of estate tax (up to the exemption amount, that is).

PERMANENT PORTABILITY

In 2013, Portability was permanently enshrined into federal tax law, which makes a big difference to married couples for estate tax purposes. Taking Portability into account in the above example, when the first spouse passes the surviving spouse can elect to absorb any unused portion (in this case, all) of the

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deceased spouse's exemption (referred to as the "DSUE," meaning "Deceased Spouse Unused Exemption.") The surviving spouse now has \$24.12 million of exemption for the \$20 million estate, and no federal estate tax is owed!

We can see how permanent Portability followed along with the notion of treating a married couple as a single economic unit and brought federal estate taxation in line with the unlimited marital deduction. But, as always, there are a few estate planning items to address as a result.

PORTABILITY IN PRACTICE

One important thing to remember is that Portability is only enshrined at the federal level. Of the states that levy their own estate tax, only two – Hawaii and Maryland – allow for similar portability between spouses. So, in the remaining states, clients require additional care to optimize their estate planning from a tax perspective, often in the form of the credit shelter planning that was so prevalent prior to federal permanence or via Qualified Terminable Interest Property (QTIP) planning.

Also, because credit shelter planning was the "go-to" prior to Portability, many clients' estate plans still feature vestiges of it that may be no longer necessary or desired. Granted, there may be situations in which some form of credit shelter planning could still be beneficial. As such, it is best to review and potentially update clients' estate plans to introduce flexibility that accounts for Portability but leaves open the possibility for credit shelter planning if necessary.

WHERE DO WE GO FROM HERE?

A key component of Portability is that it is not automatic. The DSUE must be elected by the surviving spouse, and this is precisely what the recent IRS Revenue Ruling addressed. For deceased spouses' estates that were large enough to require a Form 706 (Estate Tax Return), the election would be made thereon. But for deceased spouses' estates that did not meet the threshold for filing, the surviving spouse had **two** years from the date of death to file a Portability election. The Revenue Ruling has increased this window to **five** years from the date of death. With the impending 2025-2026 sunset of the current exemption levels, it is vitally important to ensure that a client with potential estate tax liabilities properly and timely elects Portability.

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