

Abstract: Portability allows a taxpayer's estate to elect to permit his or her surviving spouse to use any available estate tax exclusion amount that's unused at the taxpayer's death. Fortunately, this functionality was preserved under the 2017 Tax Cuts and Jobs Act (TCJA). This article provides a brief history of the exclusion and explains how portability works in practice.

Estate planning portability lives on under the TCJA

When the TCJA was passed, the big estate planning news was that the federal gift and estate tax exclusion doubled from \$5 million to an inflation-indexed \$10 million. It was further indexed for inflation to \$11.18 million for 2018 and now \$11.4 million for 2019.

Somewhat lost in the clamor, however, was (and is) the fact that the new law preserves the "portability" provision for married couples. Portability allows your estate to elect to permit your surviving spouse to use any of your available estate tax exclusion that is unused at your death.

A brief history

At the turn of this century, the exclusion was a mere \$675,000 before being hiked to \$1 million in 2002. By 2009, the exclusion increased to \$3.5 million, while the top estate tax rate was reduced from 55% in 2000 to 35% in 2010, among other changes.

After a one-year estate tax moratorium in 2010, the Tax Relief Act (TRA) of 2010 reinstated the estate tax with a generous \$5 million exclusion, indexed for inflation, and a top 35% tax rate. The American Taxpayer Relief Act (ATRA) of 2012 made these changes permanent, aside from increasing the top rate to 40%.

Most important, the TRA authorized portability of the estate tax exclusion, which was then permanently preserved by the ATRA. Under the portability provision, the executor of the estate of the first spouse to die can elect to have the "deceased spousal unused exclusion" (DSUE) transferred to the estate of the surviving spouse.

How the DSUE works

Let's say Kevin and Debbie, who have two children, each own \$5 million individually and \$10 million jointly with rights of survivorship, for a total of \$20 million. Under their wills, all assets pass first to the surviving spouse and then to the children.

If Debbie had died in early 2019, the \$10 million (\$5 million owned individually and \$5 million held jointly) in assets would be exempt from estate tax because of the unlimited marital deduction. Thus, her entire \$11.4 million exclusion would remain unused. However, if the election is made upon her death, Kevin's estate can later use the \$11.4 million of the DSUE from Debbie, plus the exclusion for the year in which Kevin dies, to shelter the remaining \$8.6 million from tax, with plenty to spare for some appreciation in value.

What would have happened without the portability provision? For simplicity, let's say that Kevin dies later in 2019. Without being able to benefit from the unused portion of Debbie's exclusion, the \$11.4 million exclusion for Kevin in 2019 leaves the \$8.6 million subject to estate tax. At the 40% rate, the federal estate tax bill would amount to a whopping \$3.44 million.

Although techniques such as a traditional bypass trust may be used to avoid or reduce estate tax liability, this example demonstrates the potential impact of the portability election. It also emphasizes the need for planning.

Other points of interest

Be aware that this discussion factors in only federal estate taxes. State estate taxes may also have a significant impact, particularly in some states where the estate tax exemption isn't tied to the federal exclusion.

Also, keep in mind that, absent further legislation, the exclusion amount is slated to revert to pre-2018 levels after 2025. Portability continues, although, for those whose estates will no longer be fully sheltered, additional planning must be considered.

Furthermore, portability isn't always the best option. Consider all relevant factors, including nontax reasons that might affect the distribution of assets under a will or living trust. For instance, a person may want to divide assets in other ways if matters are complicated by a divorce, a second marriage, or unusual circumstances.

Details, details

Every estate plan includes details that need to be checked and rechecked. Our firm can help you do so, including deciding whether portability is right for you.

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