Portability of a Deceased Spouse's Unused Estate Tax Exemption

One of the most important changes in federal estate taxation was the introduction of the "portability election."

Portability. Under Section 2010(c)(5)(A) of the Internal Revenue Code ("portability election"), the Executor may elect to allow the decedent's surviving spouse to use the deceased spouse's unused exclusion amount. The executor is required to file a Form 706 for the decedent's estate to establish the unused portion, even if the executor is not otherwise obligated to file a Form 706. The current exemption for 2014is $5.340 million (adjusted for inflation).

> **Example.** If a spouse dies with a $3.340 million estate, at the death of the survivor, the Executor may make an election on the Estate Tax Return for the unused exemption amount in the amount of $2 million (in the first deceased spouse's estate) to be used by the estate of the surviving spouse. Assuming that the surviving spouse had a $7.340 million estate, she would be able to use the predeceased spouse's unused exemption amount of $2 million, thus eliminating estate tax with respect to the surviving spouse's estate.

Advantage. The portability feature is advantageous where the surviving spouse's estate exceeds $5.340 million and not all of the available exemption was used by the predeceased spouse. This could happen where a substantial amount of the estate passes outright to the surviving spouse (insurance, retirement benefits and the residence) qualifying for the unlimited marital deduction and very few assets are available to soak up the exemption. Because this is so often the case, the portability feature is important to reduce those assets that are included in the surviving spouse's estate.

First spouse to die. The Executor in the estate of the first spouse to die needs to consider filing an estate tax return (Form 706), even though no return is due since the estate is under the $5.340 million exemption. The actual portability election is made by the Executor of the second spouse to die in order to claim the unused exemption.

Example. June and Bob have a $10 million community property estate. When Bob died. $2 million passed to the June and $3 million passed to the bypass trust for June. June's estate at the time of Bob's death was $5 million plus the $2 million received from Bob for a total of $7 million. In a community property estate, the surviving spouse has her $5 million plus the $2 million received from the estate of the first spouse to die. At her death, if the exemption is $5.34 million, the surviving spouse will be able to shield $7.34 million from the estate tax.

Loss of Portability. Portability may be lost two ways:

1. If no estate tax was filed at the death of the first spouse to die, then the unused exemption amount may not be claimed in the estate of the second spouse to die. This is so because there

would be no evidence of the amount of the exemption which would be claimed on the estate tax return.

2. If the surviving spouse, June, marries a second time to Jim who also predeceases June but has no unused exemption amount that may be elected by June's estate, then portability will be lost. Remarriage can cause the loss of the portability election. This is one of the few instances when marrying poor beats marrying rich.

3. If at the death of the surviving spouse and her estate is less than the exempt amount (*i.e.*, $3 million), then even if $2 million of unused exemption was available from Bob, June's estate is too small to benefit from the unused exemption.

The maximum amount available to the estate of the second spouse to die is limited to the value of the estate up to the exemption amount See Section 303(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111-312 (124 Stat. 3302) (TRUIRJCA) and section 2010(c)(5)(A) of the Internal Revenue Code (Code). The portability feature applies to the estates of decedents dying after December 31, 2010. The portability feature does not apply to the generation-skipping transfer tax.