

# Estate Planning in the Era of Portability and High Exclusion Amounts

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Douglas A. Mielock  
Foster, Swift, Collins & Smith, P.C.  
313 South Washington Square  
Lansing, Michigan 48933  
(517) 371-8203

## I. The Change in the Federal Estate Tax Landscape

### A. Increasing Federal Estate Tax Exclusion Amount

1. Historic change in federal estate tax exclusion amount – from \$60,000 in 1942-1976 to \$5.43 million in 2015

Decedent dying in:	Estate tax basic exclusion amount
1987-1997	\$600,000
1998	\$625,000
1999	\$650,000
2000	\$675,000
2001	\$675,000
2002	\$1,000,000
2003	\$1,000,000
2004	\$1,500,000
2005	\$1,500,000
2006	\$2,000,000
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000
2010	\$5,000,000 or N/A (estate tax repealed)
2011	\$5,000,000
2012	\$5,120,000
2013	\$5,250,000
2014	\$5,340,000
2015	\$5,430,000

- 2. Decrease in percentage of decedent's estates paying federal estate tax – less than 0.2 percent of decedent's estates now pay federal estate tax

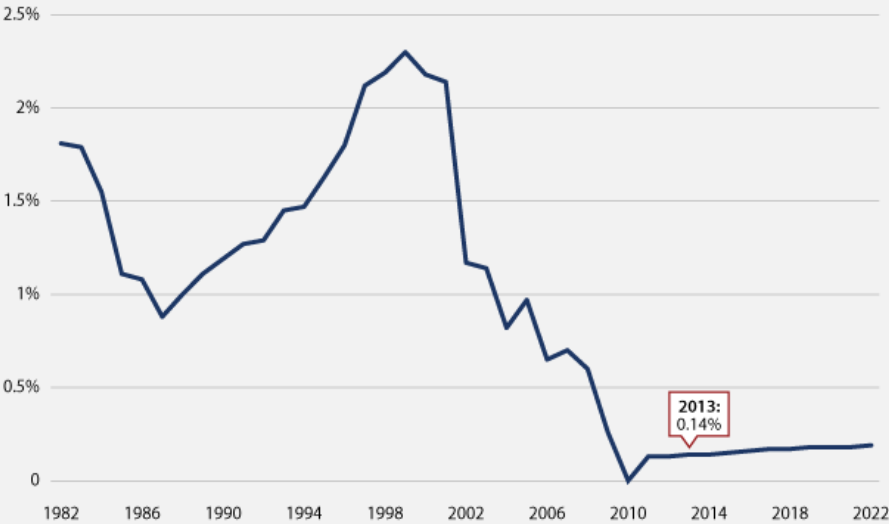
Percentage of Estates Paying Estate Tax  
Selected Years, 1934-2011



Source: 1934-2004: IRS, Statistics of Income Table 17; 2005-2011: Tax Policy Center.  
<http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=52>

**The share of estates paying tax has dropped to infinitesimal levels**

Taxable estate tax returns as a percentage of adult deaths, 1982-2022



Source: Internal Revenue Service, Centers for Disease Control and Prevention, Tax Policy Center, authors' calculations.

- B. Decrease in the Federal Estate Tax Rate – from 55% top marginal rate in 2001 to 40% flat rate in 2013 to present
- C. Introduction of “Portability” of the Deceased Spouse’s Unused Exclusion Amount

- 1. Estate Tax Terminology.

Each taxpayer is allowed an “**applicable credit amount**” equal to the amount of tentative (estate and gift) tax that would be due if the taxable estate was equal to the “**applicable exclusion amount.**”

The “**applicable exclusion amount**” is the sum of the “**basic exclusion amount**” and, in the case of a surviving spouse, the “**deceased spousal unused exclusion amount.**” IRC Section 2010(c)(2).

- 2. Beginning in 2011, the unused exclusion amount of the first spouse to die (DSUEA) may be transferred to the surviving spouse and added to the surviving spouse’s own basic exclusion amount in determining the surviving spouse’s applicable exclusion amount. Thus, under this new concept of the “portability” of the deceased spouse’s unused exclusion amount, the surviving spouse may, if necessary, file a federal estate tax return for the deceased spouse to obtain a significant increase his or her applicable exclusion amount. If the first spouse to die has not made any taxable gifts during his or her lifetime (and, therefore, has not used any of his or her basic exclusion amount), then, through “portability,” the surviving spouse could have an applicable exclusion amount of \$10.86 million (\$5.43 million x 2) at his or her death (using 2015 basic exclusion amount values). *See* Internal Revenue Code Section 2010.

- 3. What is the Deceased Spousal Unused Exclusion Amount (“DSUEA”)

IRC Section 2010(c)(4) defines the deceased spousal unused exclusion amount (“DSUEA”) as the lesser of: (a) the deceased spouse’s basic exclusion amount; or (b) the excess of the decedent’s applicable exclusion amount over the sum of the amount of the decedent’s taxable estate and the amount of adjusted taxable gifts of the decedent, which are the amount on which the tentative tax on decedent’s estate is determined under IRC Section 2001(b)(1).

- 4. Can the DSUEA be applied by the surviving spouse against lifetime gifts?

Yes. The DSUEA can be used by a surviving spouse to shelter gifts during lifetime. Treas. Regs. §25.2505-2T(a)(1). In fact, the DSUEA is applied to a surviving spouse's lifetime taxable gifts before the surviving spouse's basic exclusion amount.

*“(b) Manner in which DSUE amount is applied. If a donor who is a surviving spouse makes a taxable gift and a DSUE amount is included in determining the surviving spouse's applicable exclusion amount under section 2010(c)(2), such surviving spouse will be considered to apply such DSUE amount to the taxable gift before the surviving spouse's own basic exclusion amount.”* Treas. Regs. §25.2505-2T(b).

5. Can the surviving spouse lose the DSUEA once it is acquired?

No, if the surviving spouse does not remarry.

Maybe, if the surviving spouse remarries. The use of the predeceased spouse's DSUEA is limited to the “last deceased spouse,” which is defined as “the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse.”

*“(5) Last deceased spouse. The term last deceased spouse means the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse. See §§ 20.2010-3T(a) and 25.2505-2T(a) of this chapter for additional rules pertaining to the identity of the last deceased spouse for purposes of determining the applicable exclusion amount of the surviving spouse.”* Treas. Regs. §20.2010-1T(d)(5).

Thus, if Husband#1 and Wife are married, and Husband#1 dies, then Wife may receive Husband#1's DSUEA. However:

- (a) If Wife subsequently remarries Husband#2, then Wife will lose Husband#1's DSUEA if Husband#2 predeceases Wife (because Husband#2 would be “the most recently deceased individual” who, “at that individual's death”, was married to Wife).
- (b) If Wife dies before Husband#2, she can still use Husband#1's DSUEA to reduce or avoid federal estate tax on her taxable estate.
- (c) If Wife divorces Husband#2 (obviously, before Husband#2 dies), she can still use Husband#1's DSUEA regardless of whether Wife dies before or after Husband#2.

6. How does the surviving spouse receive the DSUEA of the deceased spouse?

The “executor” of the estate of the deceased spouse must file a federal estate tax return on which the DSUEA is computed and an election is made to take into account the DSUEA for the surviving spouse. IRC Section 2010(c)(5).

The IRS has rejected a suggestion that it produce a “short form” version of the federal estate tax return for taxpayers who file a federal estate tax return only to elect portability and are not otherwise required to file a federal estate tax return.

If the total value of the gross estate and adjusted taxable gifts is less than the basic exclusion amount and Form 706 is being filed only to elect portability of the DSUEA, the estate is not required to report the value of certain property eligible for the marital or charitable deduction. For this property being reported on Schedules A, B, C, D, E, F, G, H, and I, the executor must calculate his or her *best estimate* of the value. The federal estate tax instructions tell the executor to use a “Table of Estimated Values” provided in the instructions in reporting the total estimated value of the assets subject to this special rule. Treas. Regs. §20.2010-1T(d)(5).

7. Should you provide in the terms of the deceased spouse’s will or revocable trust that the personal representative or successor trustee is required to file a federal estate tax return to elect portability?
8. Can a surviving spouse receive her deceased spouse’s unused GST exemption?

No.

## **II. Estate Planning - The Rise of the Joint Trust (and the Fall of the “Two-Trust” Plan) for Married Couples**

- A. The Increased Attractiveness and Advantages of the Joint Trust in the New Federal Estate Tax Environment
  1. Simplicity in Implementation
    - a. No more dividing assets between the spouses.

- b. Assets can remain jointly owned as most married couples want.
  - 2. Simplicity in Administration Following Death of Spouse.
    - a. No funding of credit-shelter trust or marital trust (and corresponding legal fees).
    - b. No separate income tax return (Form 1041) for credit shelter trust or marital trust (and corresponding tax return preparation fees).
    - c. No need for trust accountings.
    - d. No fiduciary fees.
  - 3. More flexibility for surviving spouse in managing assets during surviving spouse's lifetime and disposing of assets at surviving spouse's death.
  - 4. Full step-up in basis on all assets upon death of surviving spouse
- B. The Obsolescence and Disadvantages of the "Two-Trust" Plan in the New Federal Estate Tax Environment

See above.

### **III. Estate Planning - Converting from a Two Trust Plan to a Joint Trust Plan**

- A. When to recommend that a married couple convert from a Two Trust Plan to a Joint Trust Plan
- B. Should you be *actively* contacting clients with Two Trust Plans to recommend conversion to a Joint Trust Plan?
  - 1. How to contact and communicate with clients regarding this issue.
    - a. Client database – targeted direct letter or other communications.
    - b. Client newsletter – general information on this issue.
  - 2. How to explain/justify legal fees involved in converting from a Two Trust Plan to a Joint Trust Plan.
  - 3. What to do with each spouse's "old" separate trust after creating the new joint trust.
    - a. Terminate (revoke) the "old" separate trusts?

- b. Assign assets of separate trusts to the new joint trust and allow the old separate trusts to lie “dormant” with no apparent assets?

This appears to be the better choice because it provides a better way to deal with an asset discovered after death to be still owned by the trustee of the decedent’s “old” separate trust.

#### **IV. Estate Planning - When Not to Use a Joint Trust (the Two Trust Plan is Not Dead!)**

##### **A. Federal Estate Tax reasons for use of a Two Trust Plan**

The DSUEA is a fixed amount. A properly funded credit-shelter trust can grow significantly in value between the death of the deceased spouse and the surviving spouse.

##### **B. Non-Federal Estate Tax reasons for use of a Two Trust Plan**

- 1. Deceased spouse providing for children from prior marriage.

The creation of a credit-shelter trust or marital trust by the deceased spouse allows the deceased spouse to control the disposition of the remaining credit-shelter trust and marital trust assets upon the death of the surviving spouse (e.g. distribution to the deceased spouse’s children from a prior marriage).

- 2. What might happen if the surviving spouse remarries?

- a. Might the original estate plan be altered?
- b. Might the assets be consumed by the spending of the new spouse?
- c. Might the surviving spouse lose the deceased spouse’s DSUEA through remarriage (and remaining married to the new spouse when the new spouse dies)?

But the surviving spouse could, perhaps, then obtain the DSUEA of his or her second deceased spouse.

- 3. Concern on what surviving spouse might do with the assets (mismanagement of investments, excessive spending, mental health issues, substance abuse, susceptibility to undue influence, etc.).
- 4. Asset protection (Creditor Protection)

A credit-shelter trust with an applicable spendthrift provision can provide significant protection from the creditors of the surviving spouse.

5. Need for asset management.

A separate fiduciary can administer a credit-shelter trust or marital trust for the benefit of the surviving spouse.

## **V. Estate Administration – The Unnecessary Credit-Shelter Trust**

- A. What to do when first spouse dies with a separate trust calling for the creation and funding of a credit-shelter trust that appears unnecessary to avoid federal estate tax at the surviving spouse's death?

- B. First, Assess the Non-Federal Estate Tax Advantages of the Credit-Shelter Trust  
See above.

- C. Options Available to Avoid Creation and Funding of Credit-Shelter Trust

1. Disclaimer by Surviving Spouse

No gift tax if it is a “qualified disclaimer” under IRC Section 2518.

But, assets disclaimed are no longer available to the surviving spouse.

2. Disclaimer by Remainder Beneficiaries

Gift tax liability for remainder beneficiaries for gift made to lifetime beneficiary.

How do you bind all of the remainder beneficiaries to the disclaimer?

3. Exercise of Power of Appointment

4. Exercise of Trustee's Power to Distribute Trust Assets

5. Trust Termination with Distribution of Actuarial Interests to Beneficiaries

Virtual representation issues

6. Trust Modification – MCL 700.7411; 700.7412; 700.7416

7. Trust Reformation – MCL 700.7415



8. Ignoring the terms of the trust
  - a. Trust law implications
  - b. Gift tax implications
  - c. Who is your client?

**VI. Estate Administration – When to File Federal Estate Tax Return for Sole Purpose of Obtaining Portability of the Deceased Spousal Unused Exclusion Amount**

- A. When to advise surviving spouse of option to file federal estate tax return to obtain DSUEA
  1. How large is the value of the combined estate?
  2. How old is the surviving spouse?
- B. How to advise surviving spouse
  1. Assess likelihood of needing DSUEA to avoid federal estate tax liability upon death of surviving spouse.
  2. Estimate fee for preparing and filing federal estate tax return
  3. You should give the advice in writing and receive (or document) the client's decision in writing.