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Portability – What Was Fixed and What Was Forgotten

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The American Taxpayer Relief Act ("ATRA") signed into law by President Obama on January 2, 2013 made the concept of "portability" permanent. Portability allows the $10.5 million estate tax exemption (for married couples) to be available to the surviving spouse to the extent that it is not used by the deceased spouse. This means that ownership of all property accumulated by a couple can pass to the surviving spouse on a tax-free basis, and the surviving spouse will be able to use the entire $10.5 million exemption at their death, regardless of the actual assets each spouse owned individually in their name.*

The concept of portability was unfortunately not extended to the generation-skipping transfer (GST) tax. The generation-skipping transfer tax is an additional tax on gifts and bequests to grandchildren when their parents are still alive. Many individuals who might otherwise leave their entire estates outright to their children allocate their generation-skipping exemption to transfers to generation-skipping trusts for the benefit of their children and grandchildren. Such trusts will be funded with cash or property worth up to the available generation-skipping transfer tax exemption, thereby avoiding the imposition of the GST tax on these assets.

Assume, for example, that a Husband and Wife have a combined estate worth $15 million. Husband owns assets worth $5,250,000 in his name individually and Wife owns the balance of their estate, worth $9,750,000, in her name individually. Because Husband owns assets with a value equal to the GST exemption amount, when Husband dies he can allocate the entire amount of the exemption to the trusts for his children or grandchildren. Wife can then allocate the entire amount of her exemption to the trusts for her children or grandchildren when she later dies. Therefore, the maximum amount flowing to GST Exempt trusts will be $10,500,000, with the balance of $4,500,000 flowing to GSTNon-Exempt trusts.

Assume instead, that Husband and Wife have an estate worth $15 million, but all of the assets are in Wife's name individually. In this circumstance, assuming that the Husband dies with no assets in his name, he is unable to allocate any GST exemption to trusts for his children or grandchildren. The result will be that the maximum amount flowing to GST Exempt trusts will be $5,250,000, with the balance of $9,750,000 flowing to GST Non-Exempt trusts. Given that the rate of GST tax is 40%, maximizing this exemption in larger estates is critical.

While many practitioners expected Congress to fix this "GST loophole" and make it permanently portable (as they did with the estate tax exemption), Congress failed to remedy this issue. Therefore, from a planning perspective, it will still be necessary to continue to split assets between spouses in large estates where one spouse owns the majority of the assets in order to preserve the GST exemption.

*Portability is available to a surviving spouse only if an election is made by the Executor of the estate of the first spouse to die on a timely filed estate tax return (Form 706).



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