

Portability

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Mark Merric, JD, MT, CPA In addition to being an attorney, Mark Merric holds a Masters of Taxation and he is a Certified Public Accountant, as well as an Adjunct Professor at the University of Denver's, Law School Graduate Tax Program. He has been quoted in Forbes, Investor's News, On the Street, the Denver Business Journal, Oil and Gas Investor, and the Sioux Falls Business Journal. Mr. Merric is the manager of the Law Firm of Mark Merric, LLC and a manager for the Alliance of International Legal Counselor, LLC. Prior to practicing as an attorney, Mark Merric developed a strong business background working for a Final Four Accounting Firm.

Mr. Merric presents nationwide more than a dozen annually. He is honored to have spoken at:

- Regis Campfield's Notre Dame Tax and Estate Planning Institute (2007) & (2009);
- Lonnie McGee's Southern California Tax and Estate Planning Forum, (2006), (2007), and (2009-2011); and
- Chicago Bar Association (2004), (2007-2010).

Mark Merric has had three, four, and five part series published in Estate Planning Magazine, Journal of Practical Estate Planning, and Leimberg LISI. He is also a co-author of the following three treatises:

- The Asset Protection Planning Guide: A State-of-the-Art Approach to Integrated Estate Planning, Commerce Clearing House (CCH) treatise, first edition;
- Asset Protection Strategies, American Bar Association (two chapters); and
- Asset Protection Strategies Volume II, American Bar Association published Apr. 2005 (MM responsible for 1/5 of the text).

Portability

■ Computation on Estate Tax Return

- Transfers the deceased spouse's unused exclusion amount "DSUEA"
- To the surviving spouse
- Can only inherit one DSUEA
- Currently 2011 & 2012

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A. General Rules

Many taxpayers lost the first spouse's use of the applicable exclusion do to their failure to use or properly implement B trust planning (i.e., synonymous with bypass, credit shelter, or exemption trust planning). Therefore, Congress created portability.

Portability allows the surviving spouse to utilize his or her deceased spouse's unused exclusion amount ("DSUEA"). A spouse can only inherit one DSUEA, which is the last spouse to have passed away. For example, if a spouse inherited a \$5 million DSUEA from her first spouse to pass away, and subsequently remarries, she may only receive her second spouse's DSUEA. Further, assume that the second spouse has utilized all of his \$5 million applicable exclusion by making gifts prior to the marriage. In this case, she loses her first husband's DSUEA, and has only her own DSUEA.

Advantages of Portability

- No trust planning for estate tax
- No need to balance assets
- Cavaets:
 - May still trust plan to protect a child's inheritance
 - May worry about the surviving spouse's judgment

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B. Advantages of Portability

1. No Estate Tax Planning

For a married couple with estates that are not anticipated to grow greater than \$10million, some planners make the general statement that there may be no estate tax reason for planning with A and B trusts (i.e. QTIP and bypass trusts). In this respect, when the first spouse passes away, there is also no trust administration or income tax returns attributable to these trusts.

2. No Need to Balance Assets

Remember with John's example, assets needed to be retitled so that each spouse would fund the B trust. With portability, there is no need to retitle assets.

3. Cavaets:

The simplicity of portability is balanced against the desire that many clients wish to protect their child's inheritance from creditors or an estranged spouse. This is done through the use of trusts. Second, some spouses are worried that when he or she dies, his wife with find Don Juan or her husband will find a snow bunny that will unduly influence them.

Step Up in Basis

§ 1014

Basis was
\$100,000



Fair Market Value at
Time of Death =
\$5,000,000

Assume appreciates to \$7 M before
surviving spouse passes away.

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3. Double Step Up in Basis

Under IRC § 1014, assets other than those that are classified as income in respect of a decedent (and a few other exceptions), receive a step up in basis to fair market value for income tax purposes. Income in respect of a decedent property is generally retirement assets, tax deferred annuities, and accrued interest on bonds.

a. Death of First Spouse

Assume that the client has \$5 million of non-income in respect of a decedent property. The basis of the property is \$100,000. For income tax purposes, if the client holds the property until time of death, the basis in the property will be increased to \$5 million for income tax purposes. If his spouse sells the property shortly after the client's death, little (if any) gain will be realized.

b. Death of Second Spouse

Assume the surviving spouse holds onto the property until she passes away. At this time, the fair market value is \$7 million. The basis in the property will step up a second time to \$7 million.

c. Net Worth Greater Than the Applicable Exclusion Amount

However, if her total net worth exceeds her applicable exclusion plus her deceased husband's DSUEA amount, the beginning estate tax rate is 35%. This must be compared to a future capital gain which may be taxed to a child at the capital gain rate (20% - 15% federal + 5% state).

Advantages B Trust Planning

1. Second or subsequent marriages
2. Concerns with remarriage
3. Appreciation out of estate
4. GST planning
 - No portability of GST amount
5. Creditor protection surviving spouse
6. Decouple states

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C. Advantages of B Trust Planning

There are primarily six reasons why a couple may wish to use B trust planning, rather than relying on portability. The first two reasons are sensitive issues to many clients, and these factors will generally be the determining factors of whether or not to use B trust planning instead of portability. The third reason applies in higher net worth estates. The fourth, GST planning applies when the children will not consume their inheritance, but rather it will pass to the client's grandchildren. Fifth, in some cases, a surviving spouse may have or potentially have some creditor issues. In this case, A and B planning may be more favorable than portability. Finally, in states that have retained an estate tax and the exemption amount is less than the federal exemption, A and B planning may be the preferable option. Since Colorado currently has no estate tax, this issue is not discussed in this outline.

Second or Third Marriages

Portability is based on no potential conflicts between families



No Conflicts



Potential Conflicts

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1. Second or Third Marriages

Portability is based on the concept that there are no current or potential conflicts between the surviving spouse and the children. In a second or subsequent marriage, seldom is this the case.

With portability, all of the assets are transferred individually to the name of the surviving spouse. Should the surviving spouse prefer his or her children over the deceased spouse's children, then the surviving spouse may choose to leave the deceased spouse's children nothing.

Concerns With Remarriage

Trust first spouse's judgment



Snow Bunny



Sven

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2. Concerns With Remarriage

Even with a first marriage, some spouses are concerned that his or her spouse may marry subsequently remarry someone who will take advantage of the surviving spouse. Should this be a concern, portability provides no protection. Conversely, the traditional A and B trust planning may be structure to mitigate this issue.

Appreciation Out of Estate

Dad has	\$5 M	Mom has	\$ 5 M
	↓		Grows 5 to 9
	→		-----
Mom's Estate			\$ 14
Applicable Exclusion			10

Taxable Estate			\$ 4

Estate Tax – Rate?

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3. Appreciation Out of the Estate

If the surviving spouse most likely will have a taxable estate, then A and B trust planning has the advantage of removing any appreciation from the surviving spouse's estate. For example, assume that husband has a net worth of \$5 million and wife has a net worth of \$7 million. Further assume that W passes away ten years later when H's assets are now worth \$9 million.

If H's assets were placed in the B trust, the appreciation of \$4 million (9-5) is excluded from W's estate.

Filing the Portability Election

File for

1. Estates greater than \$5 M

- Including adjusted taxable gifts

2. Portability election

- Regardless of size
- 9 months after decedent's death
- + 6 months ext. Form 4868

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D. Filing the Portability Election

The estate tax return must be filed in two situations. First, form 706 must be filed if the decedent has an estate greater than \$5 million, which includes any adjusted taxable gifts in the computation of the \$5 million amount. Second, regardless of the amount of the estate, any time the decedent wishes to transfer his or her DSUEA to the surviving spouse, form 706 must be filed.

The estate tax return is due nine months after the decedent's death. However, the personal representative may file for an automatic six month extension.

Form 706, Part 6, Election

Form 706 (Rev. 8-2012)

Estate of: _____ Decedent's social security number _____

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

Portability Election

A decedent with a surviving spouse elects portability of the deceased spousal unused exclusion (DSUE) amount, if any, by completing and timely-filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount.

Section B. QDOT

Are any assets of the estate being transferred to a qualified domestic trust (QDOT)?

Yes	No
<input type="checkbox"/>	<input type="checkbox"/>

If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.)

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

1	Enter amount from line 9c, Part 2—Tax Computation		
2	Enter amount from line 7, Part 2—Tax Computation		
3	Divide amount on line 2 by 35% (0.35). (do not enter less than zero)		
4	Add lines 1 and 3		
5	Enter the amount from line 5, Part 2—Tax Computation		
6	Subtract line 5 from line 4 (do not enter less than zero)		
7	DSUE amount portable to the surviving spouse (Enter the lesser of line 6 or line 9a, Part 2—Tax Computation)		

Section D. DSUE Amount Received from Predeceased Spouse(s) (To be completed by the estate of a deceased surviving spouse with DSUE amount from predeceased spouse(s))

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1. Making the Election

The election is made by timely filing form 706. Part 6 has been added to Form 706. Should one wish to opt out of portability, the personal representative checks Section A. If a U.S. citizen decedent is transferring assets to a QDOT for the benefit of a non-citizen spouse, there are some special considerations that need to be made.

For those making the portability election, Section C is completed to determine the decedent's unused exclusion amount. Line 1 is the deceased's applicable credit amount (after being combined with any DSUEA from a previous spouse, if any).

Example – First Spouse’s Death

- 1. Pa owns $\frac{1}{2}$ of a farm – \$3 M**
 - **Joint tenancy w/ rt. of survivorship**
- 2. Ma owns the other $\frac{1}{2}$**
- 3. Pa also owns \$1 million in securities in his own name**
 - **Left to two children**
- 4. Pa passes away 3/17/2011**

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E. Example First Spouse Death

In this example, Ma and Pa own a farm joint tenancy with right of survivorship. The fair market value of the farm is \$6 million at the time of Pa’s death. Therefore, the value included in his estate is \$3 million. Pa also owns \$1 million of securities in his own name, which under his will he leaves equally to his two children.

Form 706 (Rev. August 2012) Department of the Treasury Internal Revenue Service		United States Estate (and Generation-Skipping Transfer) Tax Return		OMB No. 1545-0015	
		▶ Estate of a citizen or resident of the United States (see instructions). To be filed for decedents dying after December 31, 2011, and before January 1, 2013.			
		▶ Information about Form 706 and its separate instructions is at www.irs.gov/form706 .			
1	Total gross estate less exclusion (from Part 5—Recapitulation, item 13)	1		4,000,000	
2	Tentative total allowable deductions (from Part 5—Recapitulation, item 24)	2		3,000,000	
3a	Tentative taxable estate (subtract line 2 from line 1)	3a		1,000,000	
b	State death tax deduction	3b			
c	Taxable estate (subtract line 3b from line 3a)	3c		1,000,000	
4	Adjusted taxable gifts (see instructions)	4			
5	Add lines 3c and 4	5		1,000,000	
6	Tentative tax on the amount on line 5 from Table A in the instructions	6		330,800	
7	Total gift tax paid or payable (see instructions)	7			
8	Gross estate tax (subtract line 7 from line 6)	8		330,800	
9a	Basic exclusion amount	9a	5,000,000		
9b	Deceased spousal unused exclusion (DSUE) amount from predeceased spouse(s), if any (from Section D, Part 6—Portability of Deceased Spousal Unused Exclusion)	9b	0		
9c	Applicable exclusion amount (add lines 9a and 9b)	9c	5,000,000		
9d	Applicable credit amount (tentative tax on the amount in 9c from Table A in the instructions)	9d	1,722,800		
10	Adjustment to applicable credit amount (May not exceed \$6,000. See instructions.)	10			
11	Allowable applicable credit amount (subtract line 10 from line 9d)	11		1,722,800	
12	Subtract line 11 from line 8 (but do not enter less than zero)	12		0	
13	Credit for foreign death taxes (from Schedule P). (Attach Form(s) 706-CE.)	13			

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1. Complete Page 1 First

When the first spouse passes away, the first page of Form 706 must be completed to determine the DSUEA amount on page 4, part 6. Since Pa's ½ interest in the farm is held joint tenancy with right of survivorship, it automatically transfers to Ma under property law. Since this transfer is not a non-deductible terminable interest, the transfer of the ½ interest in the farm qualifies for the marital deduction.

The \$1 million in securities that were transferred by will to the children does not qualify for the marital deduction. Therefore, the tentative estate tax on such amount is \$330,000.

Line 9a is the basic exemption amount. Since Pa was only married to Ma during his life, he does not have a DSUEA that was received from a prior spouse and line 9b is zero. Line 9c computes the applicable exclusion amount that is converted into a credit on line 9d.

As discussed on the next page, the credit is not carried forward. Rather, the exemption amount is carried forward to the surviving spouse.

Form 706, Part 6

Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

Portability Election

A decedent with a surviving spouse elects portability of the deceased spousal unused exclusion (DSUE) amount, if any, by completing and timely-filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount.

Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount.

Section B. QDOT

Are any assets of the estate being transferred to a qualified domestic trust (QDOT)? Yes No

If "Yes," the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.)

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

1	Enter amount from line 9c, Part 2—Tax Computation Exclusion Amount	1	5,000,000	
2	Enter amount from line 7, Part 2—Tax Computation	2		
3	Divide amount on line 2 by 35% (0.35). (do not enter less than zero)	3		
4	Add lines 1 and 3	4	5,000,000	
5	Enter the amount from line 5, Part 2—Tax Computation Taxable Estate	5	1,000,000	
6	Subtract line 5 from line 4 (do not enter less than zero)	6	4,000,000	
7	DSUE amount portable to the surviving spouse (Enter the lesser of line 6 or line 9a, Part 2—Tax Computation)	7	4,000,000	

2. Portability Election

The election is made by timely filing form 706. Part 6 has been added to Form 706. Should one wish to opt out of portability, the personal representative checks Section A. Conversely, for those making the election, Section C is completed to determine the decedent's unused exclusion amount.

Line 1 is the deceased's applicable credit amount (after being combined with any DSUEA from a previous spouse, if any). Line 2 and 3 give the deceased spouse credit for any gift tax that was paid during the deceased spouse's life. This would have occurred if the deceased spouse gifted property over the former \$1 million gift tax amount, resulting in a gift tax paid. Line 4 is the total of the basic exclusion amount plus the adjustment for gift tax paid, if any. Line 5 subtracts the taxable estate amount to generally arrive at the DSUEA.

No Form 706 EZ . . . But

- Marital deduction assets need not be individually valued
- \$250,000

SCHEDULE E—Jointly Owned Property

(If you elect section 2032A valuation, you must complete Schedule E and Schedule A-1.)

PART 1. Qualified Joint Interests—Interests Held by the Decedent and His or Her Spouse as the Only Joint Tenants (Section 2040(b)(2))

Note. If the value of the gross estate, together with the amount of adjusted taxable gifts, is less than the basic exclusion amount and the Form 706 is being filed solely to elect portability of the DSUE amount, consideration should be given as to whether you are required to report the value of assets eligible for the marital or charitable deduction on this schedule. See the instructions and Reg. section 20.2010-2T (a)(7)(ii) for more information. If you are not required to report the value of an asset, identify the property but make no entries in the last three columns.

Item number	Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.	Alternate valuation date	Alternate value	Value at date of death
1	Pa's ½ interest in farm			

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3. No Form 706 EZ . . . But

There is no such thing as a Form 706 EZ to accommodate a portability election for estates with less than \$5 million in assets. However, the valuation and reporting rules are generally greatly simplified if the property passes under either the marital deduction or charitable deduction. Exceptions to the general rule for not reporting the value are:

1. The value of such property affects the value passing from the decedent to another person;
2. The value is needed to determine the value under the (a) alternate valuation of IRC § 2032; (b) the special use valuation under IRC § 2032(A); (c) or the 10 year installment payment plan under IRC § 6166.
3. Less than the entire value of an interest in property includible in the decedent's gross estate is marital deduction property; or
4. A partial disclaimer or partial qualified terminable interest property election is made. Treas. Reg. § 20.2010-2T.

In the above example, Pa's ½ interest in the farm is his full interest. Since the entire interest passes to Ma, its value does not affect the value of other property (i.e. the securities) that pass to the children. Therefore, Pa identifies the farm on Schedule E since it is property held joint tenancy with right of survivorship. However, the last three columns, including the value are left blank.

Other Attachments

1. “My best estimate of the fair market value of the gross estate rounded to the nearest \$250,000 is \$ 4 million.”

Signed: *Personal Representative*

This is not an itemized list, rather the total fair market value

2. Must also attach evidence of title to confirm beneficiary is the spouse

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4. Other Attachments

There are two other attachments that need to be included with the estate tax return. First, a statement to the personal representative's best estimate the fair market value of the gross assets of the estate. This estimate should be within \$250,000. Also, all other information necessary to establish the right of the estate to the (marital) deduction, such as deed stating the farm is held in joint tenancy right of survivorship. Other examples demonstrating the right to the marital deduction would be the beneficiary designation on an insurance policy or a retirement plan or the will leaving all the property to a spouse. Temp. Treas. Reg. § 20.2010-2T(7)(A).

Example – Second Spouse’s Death

1. Ma owns entire farm – \$8 M

- Pa’s ½ increased to \$4 M
- Ma’s ½ increased to \$4 M

2. Ma also owns \$1 million in securities

3. Ma leaves all property to two children

4. Ma passes away 5/21/2015

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E. Second Spouse’s Death

Five years later, Ma passes away. The value of the farm has appreciated to \$8 million. Ma received ½ of the farm four years ago at Pa’s death, and has a basis of \$3 million in this interest. Ma owned the other ½ of the farm for many years, and her basis is assumed to be \$100,000 in her ½. At her death, both ½ interests step up to the fair market value of \$8 million.

In addition to the \$8 million farm, Ma owns \$1 million of securities. She leaves her \$9 million estate to her two children equally.

Form 706 (Rev. August 2012) Department of the Treasury Internal Revenue Service		United States Estate (and Generation-Skipping Transfer) Tax Return ▶ Estate of a citizen or resident of the United States (see instructions). To be filed for decedents dying after December 31, 2011, and before January 1, 2013. ▶ Information about Form 706 and its separate instructions is at www.irs.gov/form706 .		OMB No. 1545-0015	
1	Total gross estate less exclusion (from Part 5—Recapitulation, item 13)	1		9,000,000	
2	Tentative total allowable deductions (from Part 5—Recapitulation, item 24)	2		0	
3a	Tentative taxable estate (subtract line 2 from line 1)	3a		9,000,000	
b	State death tax deduction	3b			
c	Taxable estate (subtract line 3b from line 3a)	3c		9,000,000	
4	Adjusted taxable gifts (see instructions)	4			
5	Add lines 3c and 4	5		9,000,000	
6	Tentative tax on the amount on line 5 from Table A in the instructions	6		3,130,800	
7	Total gift tax paid or payable (see instructions)	7			
8	Gross estate tax (subtract line 7 from line 6)	8		3,130,800	
9a	Basic exclusion amount	9a	5,000,000		
9b	Deceased spousal unused exclusion (DSUE) amount from predeceased spouse(s), if any (from Section D, Part 6—Portability of Deceased Spousal Unused Exclusion)	9b	4,000,000		
9c	Applicable exclusion amount (add lines 9a and 9b)	9c	9,000,000		
9d	Applicable credit amount (tentative tax on the amount in 9c from Table A in the instructions)	9d	3,130,800		
10	Adjustment to applicable credit amount (May not exceed \$6,000. See instructions.)	10			3,130,800
11	Allowable applicable credit amount (subtract line 10 from line 9d)	11			0
12	Subtract line 11 from line 8 (but do not enter less than zero)	12			
13	Credit for foreign death taxes (from Schedule P). (Attach Form(s) 706-CE.)	13			

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2. Page 1 Complete 2nd

Ma reports the total value of her estate of \$9 million. An estate tax of \$3,130,800 is computed against it. On line 9a, Ma reports her basic exemption amount. Line 9b is her DSUEA she received from Pa. Her total applicable exclusion amount is \$9 million, and she computes a unified credit of \$3,130,800. Her estate tax is zero.