



PORTABILITY VS. CREDIT SHELTER TRUSTS FOR MARRIED COUPLES

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 increased the federal gift and estate tax exemption to \$5 million for the years 2011 and 2012 (indexed for inflation in 2012) and introduced the concept of exemption “portability” between spouses - if one spouse does not use all of his or her \$5 million exemption and dies in 2011 or 2012 (and if his or her executor elects portability on a timely filed estate tax return), then the unused exemption may be used by the surviving spouse during life or at death (subject to some conditions and limitations), effectively creating a \$10 million exemption for married couples without the need for any planning with credit shelter trusts or equalizing of assets between spouses. The federal estate tax rate for estates over the exemption amount is a flat 35%.

Portability does not apply to state estate taxes. The Connecticut estate tax exemption is \$3.5 million, and tax rates for estates over that amount start at 7.2% and increase to a maximum 12%.

PROS

1. No Need For Trusts for Moderate Estates.

A. If your combined estate will be less than \$3.5 million on the second spouse’s death and you wish to leave your entire estate outright to each other, portability allows you to avoid federal and CT estate tax on both deaths without the use of trusts (assuming portability is in effect when first spouse dies, executor makes timely election, and this was the surviving spouse’s last spouse to die before her death).

B. If your combined estate will be less than \$10 million on the second spouse’s death and you wish to leave your entire estate outright to each other, portability allows you to avoid federal estate tax on both deaths without the use of trusts (subject to same assumptions as above). However, there will be additional CT estate tax on the second spouse’s death since the first spouse’s CT estate tax exemption will have been wasted. (See paragraph #2 under “Cons.”)

2. **Can Be Used If You Have Specific Assets You Wish to Pass Outright to Spouse.** If you will not fully fund your credit shelter trust because you have specific assets which are owned jointly or will pass outright to the surviving spouse (e.g., retirement assets or a residence), portability can be used for the unused exemption.

3. **Avoids Need to Retitle Assets Between Spouses.** If you will not fully fund your credit shelter trust because most assets are titled in the other spouse’s name (e.g.,

corporate benefits that must be held by the employee), portability can be used for the unused exemption.

4. For NY Residents and Those Owning NY Property: Can Defer State Estate Taxes And Still Use Federal Exemption. If you live in, or own property in, New York or another state which has a low state estate tax exemption (\$1 million) and no state “qtip” election (Connecticut has a state qtip election available), any assets held in a credit shelter trust which exceed the state exemption will be subject to state estate tax at the first spouse’s death. Portability allows you to fund the credit shelter trust with the state exemption amount (or gift that amount during life) and then leave the balance outright to (or in a marital trust for the benefit of) the spouse. The state estate tax will then be deferred until the second spouse’s death; however, the marginal tax rate on the second spouse’s death will be higher than it would have been if the tax had been paid on the first spouse’s death.

5. Avoids Trust Administration Costs and Burdens. If you have most assets passing outright to your spouse and the credit trust would otherwise be fairly small, a trust may be too burdensome. For any size trust, trust administration fees can be avoided with portability since no trust is needed.

6. Step-Up in Basis. Assets which pass outright to the surviving spouse receive a step-up in basis to fair market value at the surviving spouse’s death. Assets in a credit trust, on the other hand, get a step-up in basis at the first spouse’s death, but not at the second spouse’s death. (If assets go down in value, then assets get a step-down in basis.)

CONS

1. Future growth is not sheltered. A credit shelter trust shelters from future estate tax on the second spouse’s death the appreciation in value between the first and second spouse’s death. Portability shelters only the first spouse’s unused exemption amount.

2. Portability does not apply to state estate taxes. No states recognize portability for state estate tax exemption purposes. If you leave all assets outright to your spouse, you are wasting your state estate tax exemption. For CT residents, this is an issue if your combined estate at second spouse’s death is over \$3.5 million. For example, if the combined estate is \$7 million on second spouse’s death, CT estate tax will be almost \$307,000 on second spouse’s death, but if a credit trust had been used, then this tax would have been avoided.

3. GST Exemption is Not Portable. Portability does not apply to the generation skipping tax (GST) exemption, so any amounts passing to grandchildren in excess of the \$5 million exemption will not be sheltered from the GST tax.

4. Portability is Scheduled to Expire At the End of 2012. If you rely on portability and the law expires, and if you die before changing your plan to include a credit shelter trust, then your exemption will have been wasted.
5. No Protection From Creditors. Trusts can be used to protect assets from a beneficiary's future creditors. If your child gets divorced, a trust can protect those assets without the need for a prenuptial agreement.
6. No Management. Trusts are useful to help a beneficiary manage money.
7. No Protection for the Children. Trusts can be used to protect assets for your children in case your spouse remarries. Similarly, if this is your second marriage, trusts can be used to protect assets for children from your first marriage.
8. May Be Forfeited If You Remarry. Since portability is between you and your last deceased spouse, you will lose the exemption of your first spouse if you remarry and your second spouse also predeceases you. (In that case, second spouse's exemption may or may not be available for you to use.)
9. Requires a Timely Filed Federal Estate Tax Return. If the executor of the first spouse to die does not timely file a federal estate tax return, portability will not be available and exemption may be wasted.

Planning Hedge For Those Who Don't Like Trusts. If the only reason you have a trust is to save estate tax, but (i) you don't want to waste your state estate tax exemption, or (ii) you don't want to risk wasting your federal estate tax exemption if portability is later not available, you can leave your estate to your spouse and set up a "disclaimer trust" under your Will or revocable trust agreement, i.e. you give your spouse the right to decide within nine months of your death that any assets he or she does not accept will pass into a trust. Alternatively, you can leave the amount exempt from state estate tax to a credit shelter trust, and leave the balance to your spouse, with the right to disclaim any portion to a trust. (These options have certain restrictions which we can explain in more detail.)

Bottom Line: Portability is most appropriate for first marriages where the combined estate will be under \$3.5 million on the second spouse's death and where trusts are not desired for non-tax reasons. It also can be used for estates up to \$10 million, but there will be additional CT estate tax which could have been avoided if a trust had been used. It also is useful where you have a credit shelter trust set up but you have particular assets that are not conducive to being held in a trust, or you do not have sufficient assets in your name to use the full amount of your exemption. However, even if portability is appropriate for you, you can't rely on it because it may not be available for you as discussed above.

Caveat: Since portability is based on federal law, it does not apply to couples in civil unions or to same sex couples who are married since those are not recognized as marriages under federal law.