

Trust Connection

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TRUST NEWS AND INFORMATION FROM YOUR TRUST REPRESENTATIVE OFFICE

Welcome to *Trust Connection*,
a regular communication from
Valley National Trust Services.



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Portability: Weird and Wonderful

The simplicity and complexity of Portability often creates unintended consequences. Let's discuss how to steer clear of traps for the unwary and anticipate the credit to come as we seek to understand the nuances of one of the newest features of the estate tax law. Optimizing the use of the Deceased Spousal Unused Exemption (DSUE) and avoiding common errors is crucial to make the most of this new law.

Wonderful. What is wonderful about what we call "portability" is in its simplicity. Portability has the potential to dramatically simplify the estate planning process and the use of trusts to try to preserve the exemption of the first spouse to die for the average American. The vast majority of Americans will never have a net worth in excess of the current estate tax exemption (reduced by certain lifetime gifts) of over \$12 million per individual or over \$24 million for a married couple, indexed for inflation. Yet, like most things created to simplify, there are unintended consequences for a few, and they can be significant and lead to significant planning opportunities for many of those few who fall into the no man's land of pushing the \$24 million as a couple. Even above the exemption amount factors need to be considered such as investments, lifestyle, spend-down, and potential for future changes in the law. So, in a simple, Ward and June Cleaver kind of world, portability should be the default planning strategy. But life is not always that simple.

Weird. When portability goes awry, it can produce weird results. Some of these also produce wonderful planning opportunities, but be forewarned, we will be poking fun at the potential scenarios to make the point. The law of unintended consequences is certainly at work in the application of this new law. For some that provides considerations that were not previously issues for us. For others, it may mean avoiding default decisions, that before, had no adverse consequences, but under this new law, might.

Let's begin with Wonderful. Since the dramatic increase in estate exemption in recent years and the new law which allows the surviving spouse to use the unused exemption of the first spouse to die, it means the formerly standard planning creating a separate trust to utilize the exemption of the first spouse to pass away is no longer necessary, IF you trust in certain things. One is that the law will remain in its current form. Congress has the power to write new legislation, and in the past 5 years serious proposals have ranged from a \$1 million exemption to repealing the tax

altogether. So, two points of caution for the average couple, not concerned about estate tax at current levels. First, "a bird in the hand is worth two in the bush" is a cliché for a reason. If one has any concerns that government will need more money in the future and perhaps "raise the estate tax" by lowering the exemption or raising the rates, or both, then one should consider setting up the separate trust to use the exemption. Since the funds can still be available to the surviving spouse it is the functional equivalent but locks in the exemption in case of future changes in the law. In the same way, this technique prevents many of the "weird" scenarios I will discuss next. Second point of caution for the couple using "portability" is that even though not required due to a net worth under the \$12 million exemption at death, an estate tax return needs to be filed for the first spouse's estate. Filing the return is how one elects portability. Finally, the best way to decide is to draft a single QTIP trust and make the final decision after the death of the first spouse as to whether to create a separate trust to use the exemption or rely on portability.

And now for the Weird. Let's start with the fact that most of us are not Ward and June Cleaver and have more "Modern Family" type lives. This complicates the use of portability because downstream it is unclear what future marriages may occur and what children (first marriage vs. later marriages) will eventually benefit. Very often I see the surviving spouse, when children of multiple marriages exist, redirecting the estate after the first spouse dies creating great friction within the family. It is nice to imagine that everyone is married only once, that all their children are of the same marriage, and that both spouses agree completely on what should happen to the estate assets and never waiver from that commitment, but that is just not the reality in over 50% of cases. Another weird result is that portability may disincentivize remarriage because the death of a second spouse may reduce the overall exemption of the surviving spouse. This could cost millions in additional taxes out of the estate for the children. A related weird result could be that in such a case as the death of my spouse will reduce my exemption may incentive some to divorce their spouse on their deathbed in order to preserve their first spouse's exemption, again potentially saving millions in estate tax. Regardless, an individual can never build up more than two exemptions, their own plus the unused exemption of their most recently predeceased spouse. Or can they? Yes, that's right, another weird thing about portability is that it appears skewed to the very wealthy. While the average American cannot

afford to give away much and maintain their accustomed manner of living, a wealthy widow/er could gift the unused DSUE of her most recently deceased spouse, marry again and do it all over. This gives those with substantial money a greater ability to legally game the system by utilizing many different spouses' DSUE. Weird. Again, the QTIP Trust can help us with many of these issues, from controlling the ultimate beneficiaries, to providing asset protection and creditor protection. The proper design of this kind of trust enabling us to make the decision after the death of the first spouse, is just as complex as drafting a Credit Shelter and Marital Trust, and thus does not simplify planning from the traditional method.

Any way you slice it Portability has a lot of unintended consequences that enable us to perhaps simplify, and at the very least empower one's executor to file the estate tax return and thus claim one's rightful carry-over of the exemption to the surviving spouse. Remember to seek out competent, professional representation for your tax, legal, and investment matters, because the Government's "simplification" has once again made things more complicated.

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