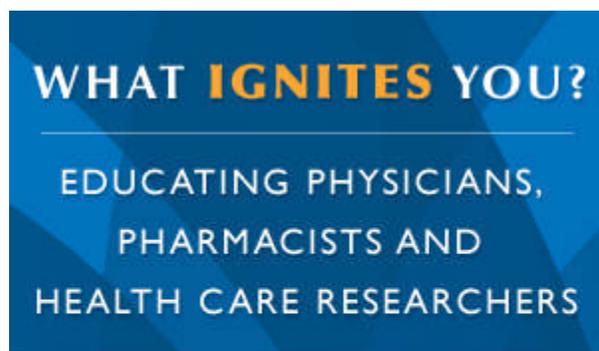


Portability comes with a catch

By Steven Cox

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On Dec. 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 became law. The new law raised the federal estate tax



exclusion amount to \$5 million (reduced by taxable gifts made during lifetime) for individuals who die in 2011 or 2012. In the past, without proper planning, a decedent

either used the exclusion or lost it.

Now, for the first time, the unused portion of a decedent's exclusion amount can be passed to his or her surviving spouse to increase the amount available at the survivor's death. This "portability" of the exclusion between spouses can provide a substantial tax break to widows and

widowers. However, portability may not be as good as it seems.

The rules governing portability contain significant limitations.

For example, portability applies only to the last deceased spouse of an individual. Therefore, if a widow remarries and her most recent spouse also dies first, she is limited to the new spouse's unused exemption amount, even if it is lower than the amount remaining from the first spouse.

Furthermore, the law expires on Dec. 31, 2012. Unless the benefits are extended, portability will no longer be available after 2012. Surviving spouses and heirs relying on the tax benefits of portability may be disappointed if those benefits are later disallowed. While many expect that portability will be renewed, there is no guarantee. Moreover, portability does not cover other

taxes like the generation-skipping transfer tax imposed on gifts to grandchildren and the estate tax imposed at the state level.

Portability is not automatic. In order for a surviving spouse to use a deceased spouse's exclusion amount, an election must be made by the executor of the deceased spouse's estate on a timely filed federal estate tax return. In many cases, a return would be otherwise unnecessary because the deceased spouse's gross estate is less than the exclusion amount.

Under the new rules, even small estates must file a return if they want to preserve any unused exemption. Because surviving spouses can acquire unanticipated wealth, every executor should consider filing an estate tax return when the exclusion amount was not fully used. Of course, the preparation of a federal estate tax return often requires the payment of professional fees and the cost of appraisals.

While many couples may be tempted to rely on portability as a substitute for more traditional planning methods, the associated limitations, risks and hidden costs may outweigh portability's apparent benefits.

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