

"Portability" of the Federal Estate Tax Exemption **What does it Mean?**

Included is a story from an estate planning colleague, Guy Jackson, which had a profound impact on his client - and him.

Ten Dollars Worth of Flowers

Sometimes, the little that we have is more than we think. Sometimes, what it is we have can bring joy, healing, and understanding to others. Sometimes, we touch people in the smallest of ways that turn out to be profound! And, we may only learn of it much later - if at all.

Such is true of a new estate planning client who called me recently at the suggestion of a friend. She told me she needed to come in and talk. We set up a meeting for the next day.

What follows is a story she told me (with her permission to re-tell it). But first, some background. This lady owns a flower shop and loves what she does. It's her dream. She's been struggling, though. Bookkeepers busted the payroll tax deposits. Employees stole from her. Associates cheated her. A supplier overcharged her. A felon assaulted her. Her lawyer abandoned her, and someone she loved recently died. She needed help.

There was plenty of discouragement to work through and, for almost an hour, it was pretty gloomy. But hoping to end on a positive note, I asked her what she enjoyed about the flower shop.

Her eyes quickly lit up, and then came the story.

Last year, a young man, about 20, came into her shop and started looking around. She asked if she could help him. He said he wanted to buy something for his wife. She asked about his price range. Ten dollars. She knew ten dollars imposed limits, but she began working with the man anyway, showing him flowers she had in that price range.

A few minutes and a little small talk later, the man caught her eye. "Would you . . . would you mind praying with me? You see this flower is for my wife. She's so sad. She's pregnant and we found out last week that the baby is dead. We're on our way to the Claremore Indian Hospital right now to have it taken. Ever since she found out, she just cries all the time and I don't know what to do. I thought maybe some flowers would help."

The florist was touched. How could she not be? Young couple, spirits crushed, the weight

of the world on their shoulders.

After praying with him like he asked, she then did something only small businessmen and women seem to do best. She walked over to an arrangement she had been working on, a beautiful \$80 piece, and said here, take this one.

The man saw the price tag. He knew he only had \$10, and reminded her. But the florist said she knew. To him, though, she said the price was \$10.

At this she said the man lost it. Broke down. The stress had been working on him, too. He didn't know what to do or say. All he could do was cry. Finally, he gathered himself and asked the florist to come out to the car to meet his wife.

She did. Beat-up, old little car. His wife, the young mother, looked awful - like you would expect her to look knowing the baby she had been carrying for the past nine months was dead. The florist offered some words of encouragement and a few moments later, the couple drove off.

Days went by. The sun came up, the flower shop opened for business, and several customers were in the shop. The florist was busy. She happened to look up and see a man wearing a suit and dark glasses enter the shop. After finishing with the other customers, she walked over to him.

It was the young man. He was back. Said he was on his way to his baby's funeral and wanted her to come. She apologized, saying she couldn't because no one was there to watch the shop. She was sorry.

The man said he understood, but before he left, he told her he wanted to show her something. He took out a photo from his coat and handed it to her. The photo showed a baby, his baby, next to her flowers. He had taken a picture of his stillborn baby, prepared for burial, next to her beautiful flowers. He now can never see one without being reminded of the other.

Neither can she.

"Portability" of the Federal Estate Tax Exemption - What does it Mean?

With the political and economic climate as it is in the summer of 2008, we are not likely to see total repeal of the federal estate tax in the foreseeable future. However, both Republican and Democratic Presidential candidates support estate tax reform. Realistically, such reform is at least one year away, but the outlines are already clear. And while the top estate tax rate and the exemption amount are not yet established, both candidates support making the exemption "portable" for spouses.

On its face, exemption portability is a good thing. However, like many "good" things from Congress, this one may not be all that it is cracked up to be.

What is "Portability"?

Under current law, if a spouse dies without having planned for his or her exemption, that exemption will be lost. In other words, in 2008 a married couple can transfer a combined \$4 million of assets (\$2 million each) free of federal estate tax, but only if they set up what is commonly referred to as a credit shelter trust (aka "bypass" or family trust) for the \$2 million of the first spouse to die. This trust "shelters" or preserves the federal estate tax exemption of that spouse so that it is not lost at death. Without such a trust in place, the first spouse to die wastes his or her exemption and the surviving spouse can only transfer \$2 million free from federal estate tax. (Note that the state estate tax exemption may be less than \$2 million, as discussed below).

Under the portability proposals of both Presidential candidates, when the first spouse dies, the unused exemption would simply transfer to the survivor and be available for use when that spouse dies. In other words, the surviving spouse will have both spouses' federal exemptions. In some respects, such a change would simplify estate planning for surviving spouses by eliminating the need for credit shelter trusts (either in their wills or as part of a revocable living trust) set up solely to save estate taxes. Also, with portability, couples would not need to retitle assets to equalize their respective estates.

Thus, with portability, Barack Obama's proposal would effectively allow for a \$7 million federal estate tax exemption for couples. John McCain's proposal would allow for a \$10 million federal estate tax exemption for married couples. Does this mean that if a married couple has less than \$7 million they no longer need to plan or update their existing planning? Absolutely not.

Shortcomings of Exemption Portability

The biggest shortcoming of federal estate tax exemption portability is the loss of asset protection by not utilizing a credit shelter trust in a revocable living trust or Will. While you may not believe that you are at risk for claims against these assets, consider this: a single car accident can result in a judgment that far exceeds your insurance limits, even where you believe that you are not at fault.

Planning Tip: Through the use of a properly drafted credit shelter trust, the assets in the credit shelter trust will never be subject to creditors of the surviving spouse or future beneficiaries, often children and grandchildren.

Additionally, these assets are not subject to federal estate tax no matter how much they grow during the surviving spouse's lifetime and beyond. Therefore, these assets can grow well past \$2 million and never be subject to federal estate tax.

Planning Tip: Your investment advisor can continue to invest these assets and grow them significantly over time without imposition of federal estate tax.

Furthermore, more and more states have *state* estate tax exemptions that are less than the federal estate tax exemption. Thus, while your surviving spouse might not be subject to *federal* estate tax upon your passing, your surviving spouse may have to pay

significant *state* estate tax if you rely solely on the federal exemption portability. This is true even if you live in a state that does not currently have a state estate tax as it might institute one, or you might someday move to such a state or own property there.

Last, but not least, there is nothing to prevent Congress from changing the rules in the future. This is our country's fourth version of the estate tax, all instituted in time of war when the government needed money - which is arguably where we are today. Moreover, Congress continuously tinkers with the estate tax, and has done so nearly 20 times since 1976. What is to prevent Congress from doing so again, especially if we need to raise revenue? And if one spouse has already passed it will be too late.

Planning Tip: Congress has continuously tinkered with the federal estate exemption amounts and rates. There is no reason to believe that Congress will not continue to tinker with these in the future.

Conclusion

Portability of the federal estate tax is an improvement of the "default" Congressional estate plan, but it is not a substitute for proper planning or continuous updating of existing planning. As your planning goals or assets change, so too should your estate planning change. By working together, your planning team can ensure that your planning stays current and will accomplish your unique goals and objectives.

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