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Portability, Marital Wealth Transfers, and the Taxable Unit

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Chapter 13
Portability, Marital Wealth Transfers, and the Taxable Unit

Bridget J. Crawford and Wendy C. Gerzog

Prior to 2011, the most efficient estate tax planning for married couples required a minimal level of asset equalization. In order to take maximum advantage of all existing wealth transfer tax exemptions and credits, each spouse needed to own, in an estate tax sense, enough assets to be able to fully utilize the estate tax credit or applicable exemption. This changed with the enactment of estate tax portability in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which became permanent under the American Taxpayer Relief Act of 2012. "Portability" refers to the ability of a surviving spouse to make full use of his or her predeceased spouse's unused exemption from estate tax. In an era of portability, if the less-wealthy member of a married couple dies first, he or she no longer "wastes" that exemption. It simply "ports"—or carries over—to the survivor.

At first glance, portability appears to implicate theoretical concerns, as it functions as a modern-day coverture that "merges" spouses into one unit. Furthermore, portability discourages some lifetime transfers of property to the less-wealthy spouse, who is more likely to be female. On the other hand, portability simplifies tax planning and benefits both spouses in a marriage. Portability was envisioned as a congressional "kiss" to a loving couple who sees itself as a unit. Yet the tax benefit is available regardless of whether the couple does in fact function as an economic unit, raising tax policy questions about the appropriateness of using the married couple as the primary tax unit. On balance, however, portability is a salutary addition to the law of wealth transfer taxation that minimizes complexity in estate planning and likely reduces the use of certain QTIP trusts, which minimize the autonomy of the surviving spouse, typically the woman, because a QTIP trust allows the marital deduction for one spouse's transfer of the underlying property to a third party and not to the other spouse.

Background to the Estate and Gift Tax Applicable Exemption

Legislative Flux 2001–2012

The period of 2001 through 2012 was one of great legal instability for estate planners and their clients. With the Economic Growth and Tax Relief Reconciliation Act of 2001[1] (EGTRRA) came a series of gradual increases in the estate and gift tax applicable exemption amount from $1 million to $3.5 million over a nine-year period. EGTRRA also lowered tax rates over the same period and provided for a temporary, one-year repeal of the estate tax in 2010. After 2010, pre-EGTRRA law was scheduled to spring back into effect, but ultimately that did not happen. At the end of 2010,

1 Pub. L. No. 107-16, 115 Stat. 38.

Congress enacted the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Act).[2] That law (retroactively) made elective EGTRRA's 2010 one-year repeal of the estate tax, increased the applicable exemption amount to $5 million (indexed for inflation), and further lowered tax rates—to 35 percent—but only through 2012. The 2010 Act also introduced into the wealth transfer tax system the concept of portability—the ability of a surviving spouse to make use of a predeceased spouse's unused exemption amount—which is referred to as the "deceased spouse's unused exemption amount."

All of these changes contained in the 2010 Act had been scheduled to (and did) sunset on January 1, 2013. Just a few days into January 2013, Congress enacted permanent wealth transfer tax legislation with the American Taxpayer Relief Act of 2012 (ATRA).[3] ATRA permanently codified the 2010 Act's applicable exemption of $5 million (indexed for inflation), raised the top wealth transfer tax rate to 40 percent, and made portability a fixed part of estate tax legislation. For the first time since 2001, then, estate planners and their clients now can enjoy a relatively stable legal landscape.

Pre-Portability

To understand the importance of portability and its extraordinary impact on much estate planning for married couples, one must first understand some wealth transfer tax basics and how the estate and gift tax applicable exemption worked prior to the 2010 Act.

Under Code § 2010, each taxpayer has a credit against gift and estate taxes. That credit is equal to the tax liability on a particular dollar amount of cumulative lifetime and death-time transfers, often colloquially called the "applicable exemption amount." From 2003 to 2009, the applicable exemption amount was: $1 million in 2003; $1.5 million in 2004 and 2005; $2 million in 2006, 2007, and 2008; and $3.5 million in 2009. In these years prior to the 2010 Act, in the case of a married couple seeking to minimize wealth transfer taxes on their combined assets, both members of the couple would need to own (in an estate tax sense) assets at least equal to the amount that could pass tax free (i.e., the applicable exemption amount). Otherwise, all or part of the credit would be wasted.

To illustrate, consider a hypothetical married couple, *X* and *Y*. For simplicity purposes, assume that *X* predeceases *Y* at a time when the applicable exemption amount is $5 million and estate tax is imposed at a flat rate of 50 percent.[4] *Y* dies four months later, with no changes to the law. Assume that neither *X* nor *Y* has made any lifetime taxable gifts, the value of assets does not change over time, and no assets are consumed. Estate planners typically encounter several common estate planning mistakes made by a couple such as *X* and *Y*.

First Common Mistake: Leaving All Property Outright to Survivor

To illustrate the first common estate planning mistake, assume that *X* has $5 million in assets in *X*'s own name and *Y* has $10 million in *Y*'s own name. Further assume that the couple has no joint assets. If *X* leaves her $5 million outright to *Y*, the transfer qualifies for the marital deduction, and thus *X* does not use any of her estate tax credit under Code § 2010 in order to achieve an estate tax

2 Pub. L. No. 111-312, 124 Stat. 3296.

3 Pub. L. No. 112-240, 126 Stat. 2313 (2013).

4 Compare these figures to the actual 2014 exemption amount of $5.34 million and a flat estate tax rate of 40 percent.

bill of zero. *X* thus is said in the pre-portability era to "waste" the advantage of her credit because the applicable exemption amount dies with *X* and cannot be used later by *Y*. When *Y* subsequently dies with $10 million in his own name and the $5 million he inherited from *X*, only $5 million of that aggregate $15 million can pass tax free. Instead of *X* passing $5 million tax free and *Y* passing an additional $5 million tax free, the couple shelters only $5 million from estate tax. At the assumed rate of 50 percent, the real tax "cost" of this mistake is $2.5 million.

Second Common Mistake: Not Having Enough Assets in One Spouse's Name

A second common estate planning mistake that a couple like *X* and *Y* might make in a pre-portability era is failing to make maximum use of the wealth transfer tax exemption. Assume that *X* has $1 million in assets in *X*'s own name and *Y* has $10 million in *Y*'s own name, and that the couple has no joint assets. Even if *X* leaves her estate in a nonqualifying form, making it possible for *X* to fully use $1 million of her $5 million exemption, she still "wastes" $4 million of exemption because she did not have enough assets to fully soak up the full $5 million exemption. A more effective tax strategy would be for *Y* to transfer $4 million to *X* during her lifetime. That transfer would qualify for the gift tax marital deduction and thus would not attract any gift tax. Now with $5 million in her name, *X* can fully utilize her $5 million exemption at death by making her own outright, nonspousal transfers. *Y* also can utilize his $5 million exemption at death. Together, the couple passes $10 million tax free to their beneficiaries. The couple has saved an additional $2 million in taxes by *Y*'s transfer of $4 million to *X*.

Third Common Mistake: Jointly Owning All Property

Consider a third common mistake that *X* and *Y* might make in a pre-portability era—owning all assets jointly. Assume, for example, that *X* and *Y* own $10 million in assets as tenants by the entireties. Upon *X*'s death, *Y* automatically becomes the sole, outright owner of the couple's $10 million in assets. This is true regardless of what *X*'s will says, as the jointly owned property passes outside the will. There will be no estate tax due upon the death of *X* because the transfer qualifies for the marital deduction. When *Y* subsequently dies, leaving $10 million to the couple's child, only *Y*'s $5 million exemption is available. Like the couple making the first common mistake, this couple has also "wasted" *X*'s $5 million exemption, at a tax cost of $2.5 million.

Pre-portability, "use it or lose it" was a phrase that aptly applied to the estate tax exemption. In that era, a married couple seeking to minimize the overall wealth transfer tax burden had a financial incentive to "equalize" the spouses' estates, or, at a minimum, to make sure that the less-wealthy spouse had enough assets in her (or his) own name to take maximum advantage of the exemption amount.

Portability

Estate planners will report that, in the pre-portability era, it was not uncommon for married couples to commit one or more of the errors ascribed to hypothetical couple *X* and *Y*: failure to use the exemption that one has, failure to have enough assets in the "poorer" spouse's name to make full use of that exemption, or owning all assets jointly. However, with the enactment of portability in the 2010 Act, later made permanent by ATRA, these potential mistakes were eliminated. Under existing law, it does not matter if the poorer spouse has any (let alone "enough") assets in her (or his) own name. When the first spouse to die simply does not have enough wealth to employ

some or all of his or her exemption, the unused portion, called the "deceased spouse's unused exemption" or "DSUE," becomes fully usable by the survivor.

Portability was designed to benefit the typical married couple where one spouse, usually the husband, owns all or a majority of the couple's property during their joint lifetimes but wants to leave all of his property to his wife when he dies. Portability allows *X* and *Y* to be treated taxwise like a couple in a community property state. At the 2008 hearing before the Senate Finance Committee, Shirley L. Kovar, testifying on her own behalf and on behalf of the American College of Trust and Estate Counsel (ACTEC), called portability "the best estate tax planning idea for a surviving spouse since the unlimited marital deduction in 1981."[5] She said that although it is commonly believed that a married couple's estate tax exemption is twice that available to a single individual, that perception is wrong. If all assets are transferred to the surviving spouse, then the couple's combined exemption is only equal to one spouse's exemption because the deceased spouse's exemption is lost. Thus, portability was enacted to help couples in that situation, both to simplify their transactions and to retain each spouse's exemption amounts.

Therefore, those wealthy spouses who write "I love you" wills, wherein the wealthier spouse leaves "too much" under the pre-portability estate tax rules to the poorer spouse, are not disadvantaged taxwise. Likewise, portability allows these couples to avoid complex trusts and couple estate planning. They do not have to create a credit-shelter or bypass trust that limits the surviving spouse's interest in, and control over, property placed in that type of trust.[6] Portability allows the surviving spouse to own the couple's property outright after the first spouse dies. With a credit-shelter or bypass trust, the surviving spouse may be the income beneficiary, but a third party owns the remainder interest after her death. That split inevitably "raises issues of fiduciary duties owed to the remainder beneficiaries by the trustee" even if the trustee is the surviving spouse.[7] Portability obviates the need for any trust for the surviving spouse. This is especially helpful in the case of a married couple that considered assets to be "theirs," even if the assets were formally titled in the wealthier spouse's name. For example, the wealthier spouse might have purchased a car, titled it in his name, and then given it to his wife as a de facto gift but never transferred title to her. The couple might have consistently referred to the car as "her" car, and would have been surprised that, on his death, the car would have been included in his estate because he had forgotten to retitle it in her name. Portability takes the tax sting out of such a scenario.

5 *Outside the Box on Estate Tax Reform: Reviewing Ideas to Simplify Planning: Hearings Before the S. Fin. Comm.*, 110th Cong. 121 (2008) (prepared statement of Shirley L. Kovar, attorney at Branton & Wilson APC, fellow of ACTEC, and chair of ACTEC's Transfer Tax Study Committee). The legislative proposal was unanimously passed by ACTEC's Board of Regents on March 10, 2008.

6 Kovar also pointed out that without the necessity of drafting a credit-shelter or bypass trust, there would be no need for: (1) the complex marital-deduction-formula clause common in those trusts; (2) a separate trust with its own taxpayer identification number and separate income tax return; and (3) a preliminary trust created with its own taxpayer identification number and separate income tax return to hold the assets until after the estate tax return is filed and the credit-shelter or bypass trust is funded. *Id.* at 122.

7 *Id.* at 123.

Estate Tax Portability, Gender, and Structural Inequality

Identifying the Poorer Spouse

In 2010, the average life expectancy at birth for people of all races in the United States was 76.2 years for men and 81 years for women.[8] Among whites, life expectancies were slightly higher than for people of all races.[9] The average white man's life expectancy at birth was 76.5 years; the average white woman had a life expectancy of 81.3 years.[10] For blacks, average life expectancies at birth were 71.8 years for men and 78 years for women.[11] The differing life expectancies for men and women are built into the assumptions that private insurers make. In 2007, for example, the federal government calculated that a 62-year-old woman was 35 percent more likely than her male counterpart to survive to age 85.[12] Insurers price annuities and other mortality-based products accordingly. The federal government, too, gets into the mortality business. There are rules requiring mandatory withdrawals from IRAs and retirement plans, and the calculation of the required amount may depend on a spouse's life expectancy where the spouse is a sole beneficiary and more than 10 years younger than the account owner.[13] The same tables are used to calculate the wealth transfer tax value of retained life estates and remainder interests, except in certain circumstances.[14] Thus, for estate and gift tax purposes, age matters.

Because women tend to live longer than men, gender also matters when it comes to life beyond actuarial tables. Available economic data suggests that women earn less than men,[15] own less than men,[16] and have fewer assets than men at retirement.[17] According to IRS estimates, there are approximately 2,290,000 people in the United States having gross assets of $2 million or more.[18] Of these, 1,320,000 (or 57.6 percent) are male and 970,000 (or 42.4 percent) are female.[19] Of the estimated 470,000 individuals having gross assets of $5 million or more (roughly, the population that would be subject to estate tax for years 2013 and after), 281,000 (or 59.8 percent) are male and 189,000 (or 40.2 percent) are female. Of the estimated 184,000 individuals having gross assets of $10 million or more, 112,000 (or 60.9 percent) are male and 72,000 (or 39.1 percent) are female. Across the entire sample pool, wealthy women were more likely to be widowed than their

8 Donna L. Hoyert & Jiaquan Xu, *Deaths: Preliminary Data for 2011*, NAT'L VITAL STAT. REP., Oct. 10, 2012, at 3 tbl.A.

9 *Id.*

10 *Id.*

11 *Id.*

12 Elizabeth Arias, *United States Life Tables, 2007*, NAT'L VITAL STAT. REP., Sept. 28, 2011, at 3.

13 *See Retirement Topics—Required Minimum Distributions (RMDs)*, INTERNAL REVENUE SERV. (Apr. 29, 2014), http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Required-Minimum-Distributions-%28RMDs%29.

14 *See, e.g.*, I.R.S. Pub. No. 1457, Actuarial Valuations: Version 3A (2009). Where Code § 2702 applies, however, retained interests are valued at zero.

15 Neelakantan Yunhee Chang, *Gender Differences in Wealth at Retirement*, 100 AM. ECON. REV. 362 (2010). The older a couple is, the larger the gap there is in earned wealth. *See* Lucie Schmidt & Purvi Sevak, *Gender, Marriage, and Asset Accumulation in the United States*, 12 FEM. ECON. 139, 156 (2006).

16 MARIKO LIN CHANG, SHORTCHANGED: WHY WOMEN HAVE LESS WEALTH AND WHAT CAN BE DONE ABOUT IT 2 (2010) (indicating that women own 36 cents for every dollar of wealth held by men).

17 Chang, *supra* note 15.

18 Brian Raub & Joseph Newcomb, *Personal Wealth, 2007*, STAT. INCOME BULL., Winter 2012, at 169 tbl.1.

19 *Id.* at 171 tbl.2, 173 tbl.3.

male counterparts.[20] Even among wealthy individuals, men have a greater average net worth than women do, although the median net worth was similar across the genders, suggesting the existence of a small number of ultrawealthy men.[21] What the IRS data do not reveal is how many wealthy individuals are married to other wealthy individuals. Whether some of the men subject to the estate tax (roughly those with more than $5 million in gross assets) are also married to women subject to the estate tax is unknown. Absent additional information, then, it appears that the "poorer" spouse is more likely to be the wife.[22] Portability removes any pure tax incentive the wealthier spouse would have had to make equalizing (outright) transfers to the "poorer" spouse. To be sure, though, even in a portability scenario, there will be many wealthy spouses who view their marriage as a partnership, putting all assets into a joint account, or others who choose to make substantial lifetime gifts of property. For these couples, the presence or absence of portability will not impact their sharing behavior.

It is worthwhile to note that portability's "merger" of the two spouses into a single tax unit for purposes of the wealth transfer tax exemption resembles coverture, the common-law doctrine that caused a woman's legal personhood to merge with her husband's upon marriage:

> By marriage, the husband and wife are one person in the law: that is, the very being or legal existence of the woman is suspended during the marriage, or at least incorporated and consolidated into that of the husband; under whose wing, protection, and cover, she performs everything; and is therefore called ... a feme-covert.[23]

The legal disabilities of married women were not changed until the nineteenth century with the enactment of married women's property acts, which allowed women to own property in their own names.[24] The effect of portability is to treat the two members of a married couple as "one person" for purposes of wealth transfer taxation. Portability in effect suspends the "tax existence" of the poorer spouse, in the event that the poorer spouse dies first. (If the richer spouse dies first, the exemption will be fully utilized.) In that sense, when the poorer spouse is the first to die, the first decedent's exemption is "incorporated and consolidated" into the survivor. Because the law of estate tax portability—unlike coverture—is gender-neutral on its face, it is not immediately implicated in gender concerns. Coverture works to merge wife into husband, whereas portability merges the (exemption of the) first spouse to die with that of the second. Nevertheless, portability should be understood as part of the U.S. tax system's embrace of the marital unit as the appropriate taxable unit. This makes the United States a relative outlier, as very few other developed countries

20 *See id.* at 165 ("Most wealthy individuals of both sexes were married, although a significantly higher proportion of wealthy females were widowed compared to widowed wealthy males.").

21 *Id.*

22 It is not clear how interests in qualified terminable interest property (QTIP) trusts or discretionary trusts figure into the IRS estimates. Estimates appear to be based on data derived from the "complete listing of a decedent's assets and debts" contained in the estate tax return. *Id.* at 156. To the extent that the value of a QTIP trust for the benefit of a surviving spouse needs to be reported on the survivor's estate tax return upon his or her subsequent death, the IRS methodology would appear to capture QTIP trusts. With respect to wholly discretionary interests created by a third party, the results are different. Because the decedent's executor is not required to include the value of the wholly discretionary interest in the trust in the decedent's gross estate, that value will not be included in estimates of the decedent's wealth.

23 1 William Blackstone, Commentaries *430.

24 Richard Chused, *Married Women's Property Law: 1800–1850*, 71 Geo. L.J. 1359, 1425 (1983).

treat married couples as a single taxable unit, even among countries that permit joint returns (i.e., those that calculate tax liability on a per individual basis).[25]

Portability and the QTIP Trust

One way in which portability benefits the "poorer" spouse, typically the wife, is that lifetime qualified terminable interest property (QTIP) trusts will be less common. In the pre-portability context, rich men who did not want to make outright equalizing transfers to their wives instead funded lifetime QTIP trusts. This allowed them to make a transfer that would "count" as the wife's property for estate tax purposes but would give the wife very little economic interest (and likely zero control) over the trust property. QTIP trusts secured the benefit of the wife's exemption in the unlikely event of her earlier death, and the rich husband was also able to ensure that those assets would then pass to persons of his own choosing. Portability eliminates the need for these trusts, which are inherently sexist.[26]

Since its enactment in 1981, the QTIP marital deduction trust has become the most popular form for taking advantage of the marital deduction. The QTIP provisions are an exception to the marital deduction terminable interest rule, which generally requires an outright (or equivalent) transfer to obtain the benefit of the deduction. Unlike the other transfers that qualify for the marital deduction, the QTIP exception allows the wealthy spouse to receive the benefit of a marital deduction without ceding control or ownership of the transferred property to his spouse. The fiction of the QTIP as a marital transfer is thus intrinsically deceptive.

The QTIP provisions allow a gift tax (or estate tax, if the QTIP is created at death by the wealthy spouse) marital deduction for the full value of the underlying property, even though the transferee spouse only receives a qualifying income interest for her life from the trust property. The QTIP provisions require the donor spouse to make a timely election to benefit from the marital deduction; unfortunately, however, QTIP decisions do not require the transferee spouse's participation. In a QTIP trust, the donor, or decedent, spouse alone determines the ultimate beneficiary of the property. Yet, although the recipient spouse will possess only a lifetime income interest in the property, which has a relatively small value, the QTIP provisions provide that for marital deduction purposes the entire QTIP property will be treated as if it has passed to the donee spouse and that no part of such property will be deemed to be owned by the ultimate beneficiaries of the trust selected solely by the donor.

Unlike the paltry interest and power in a QTIP given to the donee spouse, portability may be viewed as bestowing at least some power to the "poorer" donee spouse should she also be the first spouse to die. With portability, the executor of the first spouse to die must make the "portability election," even if the estate of the deceased spouse would otherwise not have to file an estate tax return. While it is unlikely that the financially strapped spouse will actually hire her own attorney, at least in theory she could. She could amend her will and insert a statement that would not automatically allow the "porting" of her exemption. She could alternatively provide that her executor be prohibited from filing an estate tax return for portability purposes unless her estate has a value above a specified threshold. In each instance, it would seem that her executor would be bound to carry out her wishes, even if the executor is the surviving spouse. But query whether

25 *See, e.g.*, Anthony C. Infanti, *Decentralizing Family: An Inclusive Proposal for Individual Tax Filing in the United States*, 2010 Utah L. Rev. 605, 623.

26 *See* Wendy C. Gerzog, *The Marital Deduction QTIP Provisions: Illogical and Degrading to Women*, 5 UCLA Women's L.J. 301 (1995); *see also* Joseph M. Dodge, *A Feminist Perspective on the QTIP Trust and the Unlimited Marital Deduction*, 76 N.C. L. Rev. 1729 (1998).

this would be a mostly symbolic exercise of power—and one with negative tax consequences. Denying a surviving spouse the deceased spouse's unused exemption amount burdens the ultimate beneficiaries of the second spouse to die. To the extent that those beneficiaries are shared, then the first spouse to die has simply created a larger tax bill for her own beneficiaries, too.

In the portability era, wealthy individuals have no wealth transfer tax incentive to make outright transfers or to fund lifetime QTIP trusts for the less-wealthy spouse. Portability also discourages the use of credit-shelter or bypass trusts because no longer will the first spouse to die need to "use or lose" his or her exemption. Previously, a wealthy spouse would have funded a bypass trust with, say, $5 million to make sure to fully utilize the exemption. A typical bypass trust would be structured as a pot trust for the benefit of the surviving spouse and descendants, with the surviving spouse having no mandatory interest of any kind in the trust. To the extent that portability discourages the use of lifetime QTIP trusts and credit-shelter or bypass trusts, then, portability produces welcome results because those strategies inherently limit the interests and powers of the poorer spouse. Increasing women's economic independence during marriage also increases their power, offering some increased insulation from the worst of abuse and dysfunction that can occur in relationships.[27]

A good way to encourage inter vivos transfers to the poorer spouse—who, statistically speaking, is more likely to be female—is to reinstate graduated transfer-tax rates above the threshold for tax-free transfers. After applying our large current exemptions, we now have a flat tax rate. However, if we returned to progressive rates either by lowering the transfer-tax exemptions or by adding progressive tax rates applicable above the current exemption amounts, we would thereby encourage spousal sharing. That is, in order to "run up the lower brackets" of *both* spouses in a world with graduated tax rates, the wealthy spouse would be encouraged to make lifetime transfers to his spouse. That would affect the very wealthy as this benefit would adhere primarily to taxable estates (i.e., those couples whose assets exceeded the couple's combined exemption amounts). This strategy known as "estate equalization" was one of the two main options that used to be urged by practitioners to lower the couples' combined estate taxes.[28] And the steeper the progression, the greater the tax savings when the couple shares their assets during their lifetime. Progressive rates and estate equalization encourage the wealthier spouse to engage in lifetime asset sharing.

Unintentional Benefits of Portability: Help for Some Marginally Rich

The congressional Joint Committee on Taxation in 2008 identified certain unwarranted advantages that portability could also produce.[29] Specifically, a couple with a total amount of assets at the death of the first spouse that is lower than the maximum individual exemption amount might be able to transfer more property free of estate and gift taxes than they could have transferred using pre-portability estate planning techniques, if their assets greatly appreciate between the death of the first spouse and the death of the surviving spouse.[30] For example, assume a married couple owned a total of $3 million in assets at the first spouse's death (all titled in the name of the first spouse). Assume that the first spouse left everything to his surviving spouse, and the exemption amount at that time was $5 million. Further assume that the first spouse's executor elected portability. When the surviving spouse dies, perhaps many years later, her estate would add a total of $5 million of

27 *See* Chang, *supra* note 16, at 8.

28 Dodge, *supra* note 26, at 1737.

29 Staff of J. Comm. on Taxation, Pub. No. JCX-23-08, Taxation of Wealth Transfers Within a Family: A Discussion of Selected Areas for Possible Reform (2008).

30 *Id.* at 10.

unused spousal exemption amount to the surviving spouse's own exemption at the time of her death (as long as the exemption was at least $5 million at that time).[31] This essentially allows them as a couple to have a portable credit for assets not held by either of them at the time of the first spouse's death.

By comparison, absent portability, if the first spouse held all of the assets and those assets were valued at $3 million, that spouse would have made a taxable transfer to third parties (e.g., the couple's children, or to a trust for the benefit of the surviving spouse and the couple's children, which would not qualify for the marital deduction) that would have taken maximum advantage of the couple's then-available $5 million exemption, and that would have been the extent of the couple's available exemption. If the surviving spouse then won the lottery, she would have been limited to her own $5 million exemption. Portability thus raises a fairness question of whether couples should be able to benefit from an apparent "fluke" of good fortune, as two couples with similar assets at the time of the first spouse's death would be taxed differently for no apparent reason other than the "luck" of having died during portability. This result, which appears to be completely unintentional and unwarranted, could be resolved by requiring the couple to hold at least $5 million (or even $10 million) as a couple at the time of the first spouse's death.

Moreover, this serendipitous result also makes us wonder about what constitute "a couple's" assets: do they include assets acquired after one of the spouses becomes a widow or widower? At that time, the surviving spouse is treated as single for most purposes.[32] Does portability extend the marital unit potentially well beyond the end of the marriage? It would appear that is the case.

A Final Word on Portability

Practical Consequences

It has been asserted that portability is most beneficial for those couples with assets greater than one exemption amount but not greater than their two exemptions in total. In other words, the estate plan of a married couple with, say, $7 million of assets is much simpler in the era of portability than it was pre-portability. That couple need not draft wills containing a bypass trust in order to preserve the exemption of the first spouse to die. As long as the first decedent's executor files an estate tax return electing portability, the exemption will be available in the estate of the second spouse to die. The survivor will either consume the assets or die owning less than the couple's combined exemptions, and, in either event, will owe no estate tax. With portability, the administration of the

31 I.R.C. § 2010. The entire amount of the exemption is available to the surviving spouse because the transfer from the first spouse would have been shielded from estate tax by the marital deduction and not the credit against the estate tax. *Id.* § 2056. By contrast, if the first spouse left all of his assets of $3 million to third parties, there would only be an extra $2 million that could be added to his surviving spouse's applicable exemption amount at the time of her death.

32 After one spouse dies, the couple may file a joint income tax return but only for the year of the decedent's death. *Id.* § 6013(a)(2). In the two years following the decedent's death, the surviving spouse may continue to use the tax rates applicable to married couples filing jointly if he or she maintains a household that is the principal place of abode of his or her dependent child (i.e., if the surviving spouse is a "qualifying widow(er)"). *Id.* §§ 1(a), (c); 2(a). Many of the benefits provided to widows or widowers are limited to those with that "qualifying widow(er)" filing status; however, there are some Code provisions that assist surviving spouses regardless of whether or not they have dependent children. *See, e.g.*, *id.* §§ 72(s)(3) (surviving spouse annuity beneficiary), 121 (special rule for sales of principal residence by certain surviving spouses).

first decedent's estate is simple: there are no bypass trusts, just a transfer to the surviving spouse. The surviving spouse has total control over the couple's assets. Portability thus has a significant impact on these couples.

In contrast, for those with greater wealth—couples having assets that exceed the value of their combined exemptions—portability may not change their estate plans. Where each spouse has significant wealth in his or her own name and there are descendants of the marriage, the estate plan likely will include a bypass trust to which the first decedent allocates his or her exemption. The assets in the bypass trust are available to the surviving spouse as one of the trust's discretionary beneficiaries, but in the ordinary course of events, the assets will continue to appreciate free of tax for the benefit of the descendants.[33] The bypass trust "freezes" the transfer-tax value of the assets in the trust, freeing those assets from estate taxation on the appreciation in their value that occurs between the two spouses' deaths. The benefit of "freezing" the asset value in a bypass trust motivates most wealthy couples to obtain traditional estate planning incorporating a bypass trust for the exemption amount and some kind of transfer qualifying for the marital deduction for the amount of assets above the estate tax exemption.

Theoretical Consequences

In a theoretical sense, portability raises questions about the tax system's use of the married couple as the appropriate taxable unit. It is not obvious that the state should be channeling financial benefits into relationships that are presumably sexual.[34] Perhaps the strongest argument for allowing married couples to constitute a taxable unit is the difficulty of tracing assets to a particular spouse because they may commingle their assets without keeping track of deposits and withdrawals.[35] Curiously, though, the married couple is enshrined as the unit regardless of whether, in fact, the spouses do commingle assets. Those who cannot or choose not to marry but who do commingle assets court tax trouble if they do not track deposits and withdrawals. The marriage license exempts married couples from the burden of such record-keeping requirements.

On the one hand, portability allows married couples to achieve what previously required estate planning for them to do (and more). Discussing the advantages of portability, the Joint Committee on Taxation described the difficulties involved not only in engaging a lawyer to create a credit-shelter or bypass trust, but also in the constant retitling of assets to ensure that each spouse has sufficient property to fund that trust fully:

> Even where couples do have such [credit-shelter or bypass] trusts in place, if the first spouse to die does not have sufficient assets titled in his or her own name at the time of death to fund the trust up to the amount of the then-applicable exemption amount, a portion of such spouse's exemption amount may be lost.[36]

On the other hand, portability further entangles marriage, the tax system, and economic benefits.

33 *See Outside the Box on Estate Tax Reform*, *supra* note 5, at 122–23.

34 For a powerful critique of the state's role in policing sex and intimacy, see Laura A. Rosenbury & Jennifer E. Rothman, *Sex in and out of Intimacy*, 59 EMORY L.J. 809, 817 (2010) ("states continue to play a role in channeling sex into particular forms of intimacy").

35 *See* Gerzog, *supra* note 26.

36 STAFF OF J. COMM. ON TAXATION, *supra* note 29, at 10.

Portability and First Principles

From this consideration of estate tax portability, there emerge two significant underlying tax norms. The first is the importance of identifying the correct taxable unit. Estate tax portability reflects a further reification of the married couple as the taxable unit, although this chapter raises questions about the correctness of that choice. With the *Windsor* decision,[37] the blatant discrimination in the tax laws against same-sex married couples has been eliminated. This is a salutary change to the law. Yet the ongoing reliance on a (presumably) sexual relationship as the correct determinant of the taxable unit deserves further study and scrutiny. Most developed nations have moved toward a single-taxpayer unit for taxation, and it is far from obvious that the married couple is the correct or even best taxable unit.

Like Joseph Dodge in Chapter 12 of this volume, we are concerned about the distortive effects of current wealth transfer tax laws. Portability has minimized the need for lifetime QTIP trusts and bypass trusts for married couples with less wealth than their combined exemptions. But the incentives to use these trusts remain for some taxpayers. In that sense, portability shores up what Dodge calls the redistributive effects of the gift and estate tax system in the form of transfers "from the very wealthy to the moderately wealthy," presumably in the form of fees for estate planning and similar professionals.

The search for a nondistortive system with respect to marital transfers might be enhanced by a shift to an accessions tax or a personal income tax system that treats gratuitous transfers as income combined with a cash-flow consumption tax. Under each system, the receipt by one spouse of outright transfers from the other could be tax free. But of all the systems Dodge mentions, the reformed federal estate and gift tax may be the most practical. The fiction of the decedent's bearing the brunt of the tax—it is obvious that the heirs bear the brunt of any estate tax—is a tolerable one for two reasons. It centralizes the administration and reduces some practical problems when there are many taxpayers. We might do well to consider supplementing the estate tax system with a "realization on death" rule for income tax purposes. The choices need not be either estate tax or income tax; the tax system could accommodate both.

This chapter highlights how estate tax portability likely functions in the lives of married couples who are subject to the estate tax. Admittedly this is a small and financially privileged group. But whether a particular law applies to many or few taxpayers, it is important to investigate the law's likely impact: who benefits and why. To the extent that a law privileges marital relationships over nonmarital relationships, or one member of a married couple over the other, it is worthwhile to expose and interrogate the law's structure and function. Too often, the so-called "detached" or "academic" perspective turns a blind eye to power and privilege. In putting people—mindful of gender, race, sexual orientation or other identities—at the center of the analysis, one can become more attuned to inequalities exacerbated, reified, or perpetuated by the tax law. Nondiscrimination is a norm to which the tax code should aspire.

37 United States v. Windsor, 133 S. Ct. 2675 (2013).