

How Portability Has Changed GST Planning

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I. Background.

- A. Portability of Deceased Spousal Unused Exclusion (“DSUE”) Amount.** In an “intact” and/or harmonious family, under Portability, it will be important to consider whether it will be more advantageous to place appreciation between the death of the first spouse to die and the surviving spouse outside the surviving spouse’s estate to avoid federal estate tax or to include appreciated assets in the second spouse’s estate in order to obtain a step-up in basis.
- B. No Portability of GST Exemption.** Unlike the DSUE, the GST exemption is not portable.

II. Planning for a Non-Portable GST Exemption.

- A. Portability creates a different GST planning paradigm.** We are used to allocating GST exemption to a bypass trust. Now, we may have no bypass trust, and so we can expect to see more reverse QTIP trusts.
- B. Reverse QTIP in Large Estates.** One option to consider in a very large estate is to fund a reverse QTIP trust with an amount equal to the decedent’s GST tax exemption, and have an amount equal to the decedent’s remaining estate tax exemption and possibly the surviving spouse’s remaining exemption pass outright to the surviving spouse, who would immediately use her gift tax exemption plus her deceased spouse’s DSUE to fund a grantor trust for descendants.

1. Benefits of this Approach.

- a. The risk of loss of DSUE as a result of remarriage is eliminated because the transfer has already occurred.
- b. Because the trust is a grantor trust, additional wealth can be transferred by the surviving spouse paying the income tax on income accruing to the trust.

2. Disadvantages of this Approach (compared to a GST exempt bypass trust).

- a. The surviving spouse can be a beneficiary of a bypass trust without risking inclusion under section 2038.
- b. The bypass trust will not be subject to state estate tax when the surviving spouse dies.
- c. The bypass trust is not a grantor trust.

- 3. Disadvantage of Both Approaches (compared to not using the GST exemption of the first spouse to die).** The assets in the GST exempt trust will not receive the basis adjustment that would be received if the assets are held until the surviving spouse's death.
- C. Reverse QTIP in Smaller Estates.** Having the flexibility of funding a QTIPable trust at the death of the first spouse to die – whether created pursuant to the terms of the will or revocable trust or through a spousal disclaimer – allows for the use of the decedent's GST tax exemption (as well as post mortem tax planning, which may now be relevant for estates not subject to a federal estate tax).
- D. Possible Drafting Approach.** It may be that the best approach to drafting is to build in flexibility through the use of Clayton QTIPs and disclaimers to enable post-mortem customization on the death of the first spouse to die.