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Portability—great idea but full of planning problems

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The enactment of “portability” in the Tax Relief Act of 2010 has met with widespread approval, particularly among those who tend to procrastinate in their estate planning efforts. For individuals and couples who simply did not get around to restructuring asset ownership after marriage or who harbored a deep reluctance to leave the other spouse with enough property to achieve a rational tax result over both deaths, the enactment seemed to be a good move.

Basically, the provision allows a surviving spouse to use the remaining amount of the unused exclusion amount from the estate of the deceased spouse at the surviving spouse’s death.

The problems with portability relate, principally, to—

1) the requirements imposed on the estate of the first spouse to die,

2) the pressures created in selecting a new spouse after the death of the first spouse; and
3) an unexpected order of death.

Requirements imposed on the estate of the first to die

The statute makes it clear that a deceased spouse’s unused exclusion amount “. . . may not be taken into account by a surviving spouse . . . unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account.” Inasmuch as it is not known how large an estate the surviving spouse will ultimately have at death (and what the allowable exclusion amount is at that time) it means the only safe planning approach will be to file a Form 706, the federal estate tax return and make the election in

every instance where a spouse survives. Unexpected increases in asset values, an unanticipated

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Handbook updates
For those of you subscribing to the handbook, the following new update is included.

Supplemental Revenue Assistance -- A1-44 (3 pages)

Farm Cost and Returns – 2010 -- C1-10 (12 pages)

Farmland Value Survey - Realtors Land Institute -- C2-75 (2 pages)

Please add these files to your handbook and remove the out-of-date material.

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inheritance or gift or a successful experience with the lottery or the gaming tables could boost the surviving spouse’s estate to a level exceeding what could be covered by the available exclusion amount at the surviving spouse’s death. Moreover, the return must be filed in a timely fashion (with extensions) even though no federal estate tax may be due. If the return is filed late, the statute states that “no election may be made.”

Moreover, portability only applies with respect to a surviving spouse of a deceased spouse who dies after Dec. 31, 2010. It is also important to note that the portability concept, along with the rest of the 2010 enactments in Title I of the 2010 Act “sunset” after Dec. 31, 2012. That means the only assurance of the availability of portability is where the first spouse dies during the two-year period of 2011 and 2012. The uncertain future of efforts to extend the concept beyond 2012 has been made even more uncertain by the sudden interest in Congress in controlling budgetary outlays and limiting revenue losses.

Care needed in selecting a successor spouse

The portability concept has introduced an entirely new dimension into selection of a successor spouse after the death of a spouse after 2010. In particular, a surviving spouse whose deceased spouse died after 2010 with no estate should be very careful not to lose the \$5 million of the “deceased spousal unused exclusion amount” by marrying a new spouse who does not come with such a rich dowry inasmuch as the unused exclusion amount is only available from the “basic exclusion amount of the last such deceased spouse of such surviving spouse. . . .”

The message is clear – it could be financially disadvantageous to remarry and to have the new spouse die and wipe out the benefits assured from the estate of the first spouse. All else being

equal, remarriage ideally would be to someone who promises to give an equal or greater “unused exclusion amount” than the predeceased spouse provided.

Order of death problems

The order-of-death problems can cause unintended consequences in remarriage situations, as noted above, but note that the reference is to “. . . the last such deceased spouse. . . “ not the “last spouse.” So as long as the original surviving spouse dies before the new spouse dies, the financial dowry from the original predeceased spouse is preserved. That would suggest attention might be given, if there is interest in remarriage, all else being equal (and maybe even if it isn’t) to marry a much younger spouse the second (or third or whatever) time around.

What if the moneyed spouse dies first? There is no way to reverse the process of portability (which might be called reverse portability) and allow the predeceased spouse’s estate to anticipate the “. . . unused exclusion amount. . . “ expected at the death of the surviving spouse. However, use can be made of the federal estate tax marital deduction (including qualified terminable interest property or QTIP) effectively to move part of the estate of the first spouse to die to the surviving spouse’s estate.

Uncertainty over the “basic exclusion amount”

With a relatively short assured life for the \$5 million “basic exclusion amount” (of two years, 2011 and 2012), there is uncertainty over what the “basic exclusion amount” will be after 2012 – and whether there is a federal estate tax in 2013 and later years. The portability concept anticipates that in the formula for applying the “unused exclusion amount” in the estate of the eligible surviving spouse by specifying that the “deceased spousal exclusion amount” is the lesser of

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the basic exclusion amount of the last deceased spouse or the excess of that basic exclusion amount over the amount with respect to which the tax in the surviving spouse's estate is calculated.

Authority to promulgate regulations

The portability statute gives specific authority to the Department of the Treasury to prescribe regu-

lations “. . . as may be necessary to carry out this subsection.” Those regulations will be eagerly awaited.

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Impacts of a farm policy do-over for historical 1998 to 2010

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Over the last 13 years, 1998-2010, government payments for crops totaled \$152.2 billion for an average of \$11.7 billion per year. Keep in mind that these numbers do not include government subsidies to crop and revenue insurance products and other products that have been promoted as a substitute for ad hoc disaster payments.

In the present political climate with the focus on debt reduction, most observers are expecting that the House and Senate ag committees will have less money to work with even though there are a significant number of current farm programs whose funding will end with the end of the current farm legislation.

In this policy climate, are there a set of policies that would cost less, but maintain farm income under a wide range of price and production conditions?

To answer that question, we examined the 13 years from 1998 through 2010. During that period, local elevator corn prices were as low as \$1.50 a bushel for an extended period of time (well below the cost of production) and as high as \$7 a bushel—other crops saw similar numbers. For us this seemed like the perfect period over which to identify a set of policies that would reduce government payments, allow farmers to earn most of their income from

the market and maintain the value of production adjusted by government payments and variable costs.

While in the real world there are no do-overs, we decided to use our POLYSYS model to conduct a do-over of the 1998-2010 period to see if we could identify policies that would meet our objectives of reducing government payments while maintaining farm income.

The policies that we looked at are a modification of the ones that were thrown out with the 1996 Farm Bill—a bill that resulted in farm payments in the 1998-2001 period that were as large as \$20 billion in a year. It was during that time period that government payments to farmers exceeded net farm income in a number of grain producing states.

Under a contract with the National Farmers Union, we looked at the use of a farmer-owned reserve where the initial loan rate was set by the 3-year running average of the difference between the variable and full cost of production for corn. For subsequent years, the rate was modified by the change in a farmer purchased production-input price index. For corn the loan rate went from \$2.27 in 1998 to \$2.60 in 2010.

To provide a wide band in which the market could work to signal production needs and allocate crop