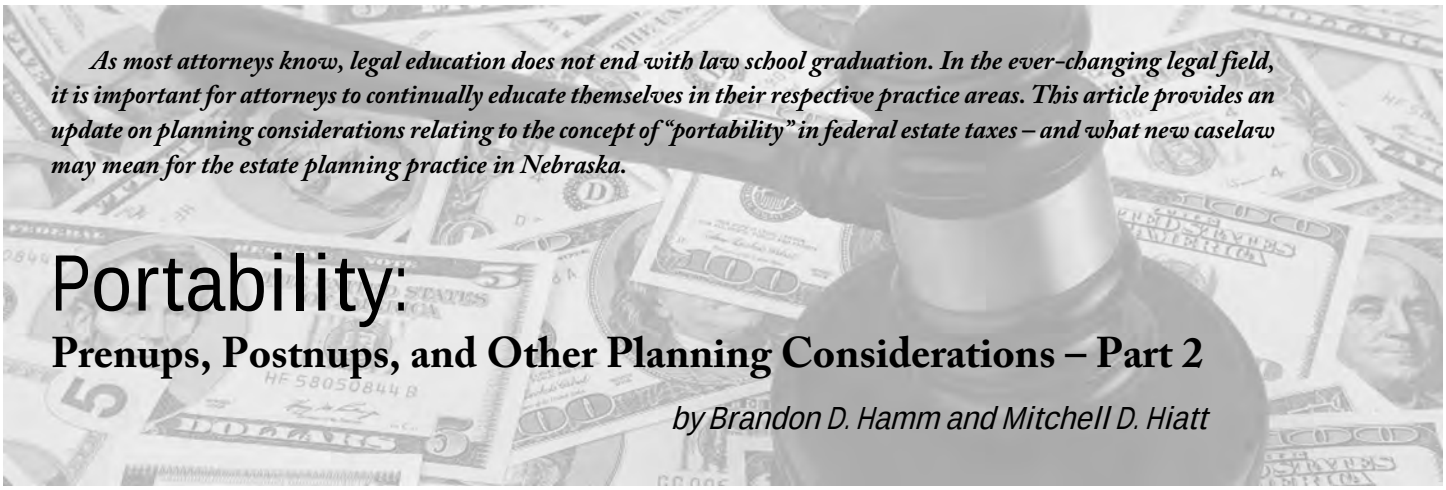

As most attorneys know, legal education does not end with law school graduation. In the ever-changing legal field, it is important for attorneys to continually educate themselves in their respective practice areas. This article provides an update on planning considerations relating to the concept of "portability" in federal estate taxes – and what new caselaw may mean for the estate planning practice in Nebraska.

Portability:

Prenups, Postnups, and Other Planning Considerations – Part 2

by Brandon D. Hamm and Mitchell D. Hiatt

Under federal estate tax law, each individual has the ability to transfer a certain amount of assets at death to non-spouse, non-charitable beneficiaries free of federal estate tax. This tax-free amount is known as the "applicable exclusion amount" ("Exclusion Amount"). The Exclusion Amount changes annually due to inflation adjustments and is currently $11,400,000.00. Prior to 2011, if an individual died without utilizing all of his or her Exclusion Amount to pass assets tax-free to non-spouse, non-charitable beneficiaries, the unused portion of the decedent's Exclusion Amount was forfeited.

In 2011, Congress did away with the "use it or lose it" nature of the Exclusion Amount for married couples by introducing a concept known as "portability," which allows the unused portion of a decedent's Exclusion Amount ("Unused Exclusion") to be transferred, or "ported," to the surviving spouse. To be clear, the surviving spouse is the *only* person to whom the Unused Exclusion can be ported. Under federal estate tax law, an executor of a decedent's estate is required to file an estate tax return if the estate exceeds the Exclusion Amount. But in order to port a decedent's Unused Exclusion to the surviving spouse, the executor of the decedent's estate *must* file a federal estate tax return, even if the decedent's estate is not large enough to otherwise require the filing of a return. The surviving spouse can then potentially use the ported Unused Exclusion, in addition to their own Exclusion Amount, to reduce or even eliminate federal estate taxes that might otherwise be incurred at the surviving spouse's death.

The article "Portability: Prenups, Postnups and Other Planning Considerations" that was published in the July/August 2013 edition of *The Nebraska Lawyer* ("2013 Article") highlighted several concerns related to portability and suggested that an individual's potential future Unused Exclusion be viewed by attorneys as an "asset," which should be addressed when negotiating marital agreements and preparing estate plans for clients in second (or subsequent) marriage situations, particularly where one spouse may face estate tax issues. One concern raised in the 2013 Article is that the executor of a decedent's estate may opt to avoid the cost and complication of

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filing an estate tax return to port the Unused Exclusion to the surviving spouse when federal law would not otherwise require the filing of the return. This risk is elevated in a second marriage situation where the beneficiaries of the decedent's estate are unlikely to be beneficiaries of the surviving spouse's estate and lack economic incentive to allow the executor to make the portability election and/or are hostile to the surviving spouse and unwilling to cooperate in preserving the Unused Exclusion for the surviving spouse's benefit.

In order to avoid this issue, the 2013 Article suggested that attorneys drafting prenuptial agreements consider including portability-related provisions designed to avoid complications between the beneficiaries of a decedent's estate and the surviving spouse and to ensure the availability of a decedent's Unused Exclusion for the benefit of the surviving spouse. Because clients often remarry without entering into prenuptial agreements, or have prenuptial agreements that do not address portability, the 2013 Article also suggested that attorneys drafting estate plans for married couples consider including portability-related provisions in the estate planning documents. These provisions would specifically direct the executor of the decedent's estate to preserve the Unused Exclusion for the surviving spouse by filing an estate tax return, even where the return would not otherwise be required and in the absence of a prenuptial agreement requiring the executor to do so.

In 2017, six years after the introduction of portability into the federal estate tax regime, in *In re Matter of the Estate of Anne S. Vose v. Lee*, the Oklahoma Supreme Court decided a case that involved the exact concerns raised in the 2013 Article. 390 P.3d 238 (Okla. 2017). Although the *Vose* case is not binding precedent in Nebraska, it may provide some insight into how courts in Nebraska and other states might view portability-related issues. The *Vose* case may also raise some uncomfortable questions for attorneys about whether the failure to address portability in prenuptial agreements and estate planning documents for married couples could constitute malpractice, if the executor of the estate refuses the surviving spouse's request to port the decedent's Unused Exclusion to the surviving spouse.

The *Vose* Case

In *Vose*, the decedent, Anne, and her then-fiancé, C.A., entered into a prenuptial agreement in May of 2006 (the "Prenuptial Agreement"). Under the terms of the Prenuptial Agreement, each party waived their right to be the executor of the other's estate and C.A. waived "all claims and rights" in Anne's estate. The couple married in June of 2006, and Anne died intestate 10 years later in January of 2016.

Following a dispute over the right to appointment as the executor of Anne's estate, the district court appointed Anne's son from a prior marriage, Robert, as executor. C.A. asked Robert to prepare and file an estate tax return to port Anne's Unused Exclusion to C.A. Robert, who apparently had a poor relationship with C.A., refused the request even though C.A. had offered to pay for the expense associated with filing the estate tax return. C.A. then asked the district court to compel Robert to port Anne's Unused Exclusion to C.A. After considering the matter, the district court ordered Robert to file the estate tax return to port Anne's Unused Exclusion to C.A. Robert then appealed the decision to the Oklahoma Supreme Court.

After the Oklahoma Supreme Court dismissed arguments by Robert related to subject matter jurisdiction and federal preemption, it turned its attention to whether C.A., by waiving "all claims and rights" in Anne's estate per the terms of the Prenuptial Agreement, had waived his right to demand that the estate port Anne's Unused Exclusion to C.A. In considering this question, the Court found that C.A. had no interest as an heir of the estate or any right to an intestate share. The Court noted, however, that portability only arose under federal tax law in 2010, well after the Prenuptial Agreement had been signed by the parties in 2006. Although the Court found that the parties intended the Prenuptial Agreement to serve as a comprehensive waiver of their marital rights, it concluded that C.A. had not waived his right to demand that the estate port Anne's Unused Exclusion to him because it was not part of the tax law at that time the Prenuptial Agreement was signed.

Based on this finding, the Court determined that C.A. "may have a pecuniary interest as the surviving spouse in the portability of the [Unused Exclusion], independent of his ability to take as an heir." In doing so, the Court indicated that it viewed Anne's Unused Exclusion as an asset of the estate and that Robert's failure to preserve the Unused Exclusion for C.A.'s subsequent use would waste this asset in contravention of his fiduciary duties to preserve estate assets. The Oklahoma Supreme Court affirmed the district court's decision to force Robert to make the portability election and that C.A. pay for all costs related to the preparation and filing of the estate tax return necessary to do so.

The Uncomfortable Questions Raised By *Vose*

The *Vose* case is notable because it appears to be a case of national first impression, where a court forced the executor of an estate to file an estate tax return porting a decedent's Unused Exclusion to the surviving spouse. The *Vose* case may be instructive as to how courts in Nebraska and other states will view portability issues, and they may follow the lead of the Oklahoma Supreme Court when deciding cases with facts similar to those of the *Vose* case.

However, attorneys should view the *Vose* case more broadly and perhaps with greater trepidation. In that regard, consider

this question: Would the Court in *Vose* have compelled Robert to port Anne's Unused Exclusion to C.A. if the prenuptial agreement had been entered into after portability became available in 2011? The *Vose* opinion seems to make it fairly clear that it would not.

Assuming this interpretation is accurate, attorneys who prepare marital agreements and estate plans for clients should focus on these questions raised by the *Vose* case:

- If (i) you prepare (or prepared) a prenuptial agreement after the introduction of portability into the federal tax code in 2011, (ii) your client is the eventual surviving spouse, and (iii) the decedent's executor refuses to port the decedent's Unused Exclusion to your client, could your failure to include portability-related provisions in the prenuptial agreement preserving the Unused Exclusion for your client constitute malpractice?
- If (i) you prepare an estate plan for clients who previously signed a prenuptial agreement waiving "all rights" in each other's estate (and the prenuptial agreement does not include portability-related provisions), (ii) the estate plan does not include provisions directing the decedent's executor to port the Unused Exclusion to the surviving spouse, and (iii) the decedent's executor then refuses to port the decedent's Unused Exclusion to the survivor, could your failure to include portability-related provisions in the estate plan constitute malpractice?

When considering these questions, recall that the Court in *Vose* treated the decedent's Unused Exclusion as an "asset" of Anne's estate. With the current federal estate tax exclusion amount being $11,400,000.00 and the federal estate tax rate being 40%, the federal estate tax savings associated with porting a decedent's Unused Exclusion to a surviving spouse could potentially be as high as $4,560,000.00. Under the view of the court in *Vose*, that would seem to be a fairly significant "asset" to fail to address in a prenuptial agreement or estate plan.

Analyzing whether the failure to address portability in a prenuptial agreement or estate plan could lead to a successful malpractice claim is beyond the scope of this article. However, including portability provisions in marital agreements and estate plans for married clients should help prevent a malpractice claim from ever arising. For sample portability-related provisions for both marital agreements and estate plans, see the 2013 Article (found here https://cdn.ymaws.com/www.nebar.com/resource/resmgr/nebraskalawyer_2010plus/2013/julyaugust/tnl-0713c.pdf, *The Nebraska Lawyer*, Vol. 16 No. 4, July/August 2013, pg. 11-14).