



Portability of Applicable Exclusion Amount Between Spouses

Transfers of property during life or at death are generally subject to federal gift or estate taxes. However, each taxpayer has an amount of property that can be sheltered from federal gift and estate taxes by the unified credit, called the “applicable exclusion amount.”

Prior to 2011, each spouse was entitled to his or her own applicable exclusion amount, and any amount that a spouse did not use would be lost; so special planning was often used to insure neither spouse’s exclusion was wasted.

In 2011 and later, the estate of the first spouse to die can elect to transfer any applicable exclusion amount that is not used to the surviving spouse. This is known as “portability.” The applicable exclusion amount is redefined as equal to the sum of the basic exclusion amount of the surviving spouse and the unused applicable exclusion amount of the predeceased spouse, and the basic exclusion amount is equal to \$5 million as indexed for inflation each year (\$5,250,000 in 2013).

Now that portability and the increased exclusion, which had been scheduled to expire in 2013, have been made permanent, it is probably a good time to review your estate plan and documents. Portability of the exclusion between spouses and an increase in the basic exclusion amount should make estate planning easier for many estates.

Simple planning with portability

If you’re planning today, you could transfer everything to your spouse at your death, and your estate can elect to transfer your unused applicable exclusion amount to your surviving spouse. Your spouse will then have an applicable exclusion amount equal to the sum of his or her own basic

exclusion amount and your unused applicable exclusion amount, which your spouse can use for gift or estate tax purposes. For example, if you transfer your \$5,250,000 unused applicable exclusion to your surviving spouse, who also has a \$5,250,000 basic exclusion amount, your spouse then has a \$10,500,000 applicable exclusion amount in 2013 to shelter property from gift and estate tax. Such simple planning might be very practical for some married couples, especially where the spouses’ combined estates are expected to be less than their combined applicable exclusion amounts.

Potential need for more complex planning

There are a number of reasons why such simple planning with portability may not always produce the desired or best results. These might include (among others):

- You have family members or individuals other than your spouse who you would like to benefit prior to the death of your spouse.
- You have grandchildren or later generations who you would like to benefit. The \$5,250,000 (in 2013) generation-skipping transfer (GST) tax exemption is not portable between spouses.
- State exclusion amounts may be different than the federal applicable exclusion amount and may not be portable between spouses.
- The unused exclusion is not adjusted for inflation after the first spouse’s death, and may not fully protect appreciating property from estate tax in the surviving spouse’s estate.

Use of A/B trust arrangement

Prior to 2011, many married couples with estates that were greater than the applicable exclusion amount would set up an A/B (or A/B/C) trust arrangement. In general, the first spouse to die would transfer an amount equal to the applicable exclusion amount to the “B” or credit shelter bypass trust. The B trust could benefit the surviving spouse and their children, but the B trust would be designed to bypass the surviving spouse’s estate. The balance of the estate would be transferred to the surviving spouse, either outright or using an “A” marital trust, and qualify for the marital deduction. In some cases, a “C”, “Q”, or QTIP marital trust was also used if the first spouse to die wanted to control who received the marital trust property at the second spouse’s death. The A/B trust arrangement typically assured that there would be no estate tax at the first spouse’s death and that neither spouse’s applicable exclusion amount was wasted.

An A/B trust arrangement may still be useful, even with the availability of portability. For example, the B trust can be used to provide for family members or individuals other than your spouse (and even your spouse) prior to the death of your spouse. You could also allocate your GST tax exemption or state exclusion to the B trust. Also, appreciation of property after the transfer to the B trust should not be subject to estate tax at your spouse’s death. The A trust could use your spouse’s applicable exclusion amount, GST tax exemption, and state exclusion.

The use of trusts can also provide other benefits, such as control over who receives your property and when, investment management of trust property for trust beneficiaries, avoidance of probate, and asset protection.