

Keep estate tax exemption portable

Thanks to the Tax Cuts and Jobs Act (TCJA), only a very small fraction of the population has to worry about federal estate or gift taxes for 2018-2025. Plus, wealthy married couples have the extra tax advantage of exemption portability.

Strategy: Ensure a proper “deceased spousal unused exemption” (DSUE) election. The DSUE election (pronounced “D-Sue”) is made by the estate of the first spouse to die.

As a result, any unused portion of the deceased spouse’s estate tax exemption can be utilized by the surviving spouse’s estate (i.e., it’s portable). Under the TCJA, each exemption is \$11.18 million in 2018. Thus, a couple can shelter a whopping \$22.36 million from estate tax!

Here’s the whole story: It’s been a long and winding road to estate tax relief. For starters, most transfers between spouses are completely exempt from federal estate or gift tax under the unlimited marital deduction privilege. Other transfers are shielded from tax by the unified estate and gift tax exemption.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) really got the ball rolling by increasing the exemption from \$1 million to \$3.5 million over a decade ago, while gradually reducing the top estate tax rate from 55% to 35%. After a one-year hiatus when there was no estate tax—2010—subsequent legislation authorized and then preserved a \$5 million exemption, indexed for inflation, and a flat 40% tax rate. For 2017, the exemption was \$5.49 million.

Now the TCJA doubles the exemption to \$10 million, indexed for inflation, and retains the 40% tax rate. The exemption for 2018 is \$11.18 million. *Most important:* With the portability provision, a married couple can take full advantage of both spouse’s exemptions.

Example: Husband and Wife each own \$5 million individually and another \$10 million jointly (50/50) with rights of survivorship. They have three adult children. Their wills provide for their assets to pass first to the surviving spouse and then to the children.

Suppose Husband dies first in early 2018. His \$5 million goes to Wife under the unlimited marital deduction privilege, so his estate uses no part of his \$11.18 million exemption. Wife now owns all \$20 million of the couple’s assets.

If the DSUE election is made by Husband’s estate, the \$11.18 exemption can be used by Wife’s estate. For simplicity, say she dies late in 2018 when the total assets are still valued at \$20 million. Because of the portability provision, all of the assets are covered by the estate tax exemption.

In contrast, if the DSUE election isn’t made, \$8.82 million of the assets (\$20 million – \$11.18 million) is exposed to estate tax. At the 40% rate, the tax amounts to \$3.528 million!

This is not to say that portability solves all of a couple’s estate planning problems. For instance, trusts may still be used in certain circumstances, especially in cases involving divorces and children of prior marriages. But the new higher exemption should be incorporated into a couple’s estate plan. Note also that future indexing

provides even more flexibility if assets appreciate in value.

Finally, consider the potential impact of state death taxes, which may require other strategies.

Tip: This is not a do-it-yourself proposition. Obtain expert guidance from a pro.

Don't ignore the GST

The federal estate tax isn't the only tax hurdle in estate planning.

Strategy: Watch out for the "generation-skipping tax" (GST). The GST applies to most transfers that skip a generation, including transfers made to trusts set up to benefit your grandchildren.

The GST exemption amount of \$11.18 million is the same as the federal estate tax exemption. However, unlike the estate tax exemption, there's no portability with the GST exemption.

Tip: Make sure the exemption is properly allocated for the estate of the first spouse to die.