More good reasons to review estate documents

Personal Finance

PORTABILITY first emerged as an estate-planning strategy in 2011 and 2012 from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. It was made permanent by the American Taxpayer Relief Act of 2012.

Just what is portability? Generally, each taxpayer is allowed what is called an applicable exclusion amount. This is the amount of assets that, at your death, you can leave to others tax free for estate-tax purposes. Before the law change, spouses couldn't share their exclusions. The Tax Cuts and Jobs Act actually increased the exclusion significantly — for 2019 it is $11.4 million per person.

The portion not used by the deceased spouse can be transferred to the survivor. The good news here is that the exclusion is indexed for inflation as well. The bad news is that this exemption level is only in effect through 2025. At that time it will once again be lower — probably to around half of the current level.

Prior to this tax-law change, the most common way to maximize the exclusion amount was to set up a trust for each spouse. This is sometimes referred to as an A/B trust. Upon the first death, an amount equal to the exclusion would go to the B trust, which is also referred to as a credit shelter bypass trust. The assets in this trust would be outside the estate of the survivor and, as the exclusion was applied, not be subject to estate taxes.

Any amounts left in the estate of the first to die would be given to the survivor or could go into another trust, depending on the estate-planning needs. This trust was often referred to as an A or marital trust. Transfers to spouses aren't usually subject to estate tax, so assets passing to the A marital trust would be free from estate tax as well.

At the survivor's death, his or her exclusion would be applied to the assets in the A trust. In this manner, both spouses received the benefit of their exclusion.

This changed with the new tax law. In the current environment, the first to die uses the exclusion against assets in his or her estate. Any unused exclusion amounts can then be used by the survivor, along with their own, at his or her death.

While this would seem to simplify estate planning, for some the use of two separate trusts will no longer be needed. Here are a few factors to keep in mind though: The unused applicable exclusion amount from an earlier marriage usually isn't available. You may use the amounts only from your last deceased spouse in your estate planning. In planning for remarriage, this might be something to consider.

These unused exclusion amounts are not indexed for inflation. The property your spouse receives at your death might increase in value in the coming years. Its value could ultimately be greater than the unused exclusion. This contrasts with using a B trust. If assets were in the B trust, the appreciation would be excluded from the survivor's estate tax calculation.

In order to use portability, an estate tax return needs to be filed. The executor of the estate needs to make an election to do so by filing a return. This is true even if the estate would not normally be required to do so.

In light of the law changes, estate documents drafted before 2010 might no longer reflect your desires. Both portability and the increase in the exclusion amount can have an impact. It might make sense to review these with your estate-planning attorney to prepare for both the present and for any potential future changes.

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