

*Estate Tax Planning in 2013*By Richard S. Franklin

The federal estate tax exclusion amount is \$5.25 million for 2013, and this amount is indexed for inflation in future years. For married couples, any estate tax exclusion that is unused upon the first spouse's death may be transferred to the surviving spouse, who can thereafter use the deceased spouse's unused exclusion (DSUE) amount against the surviving spouse's gifts during lifetime and transfers upon death. This new system permitting the transfer of exclusion is called "portability". Both the large estate tax exclusion amount and portability are now permanent features of the federal estate tax law.

In response to these fundamental changes, we have considered alternatives to the traditional estate planning approaches. This Client Alert explains three new planning suggestions for married couples in the wake of these changes. Please call us to discuss whether these suggestions would be useful in your situation.

1. Authorize the Portability Election in Wills/Revocable Trusts and Address Responsibility for Costs of Filing Return Solely for Election. To enable the surviving spouse to use any DSUE, a federal estate tax return for the deceased spouse must be filed and the portability election must be made. We suggest that language be added to the wills and revocable trusts of married persons instructing the fiduciary for the deceased spouse to file the estate tax return and make the portability election.

Historically, the IRS has not required the filing of a federal estate tax return if the value of the deceased spouse's estate is less than the federal estate tax return filing threshold (i.e., less than \$5.25 million, including prior taxable gifts). However, to transfer the DSUE to the surviving spouse, the tax rules now require that a federal estate tax return be filed to make the portability election even if the estate is below the filing threshold. In some second marriages, the separate family of the deceased spouse may not wish to incur the expense of filing a return solely to provide a tax benefit to the surviving spouse's separate family. The costs of filing an estate tax return depend on many factors, including the extent and nature of the decedent's property. These costs could be just a few thousand dollars or much more.¹ The Will and/or Revocable Trust of the deceased spouse could ask that the surviving spouse pay the costs of preparing and filing the federal estate tax return to make the portability

¹ DC and MD each have an estate tax separate from the federal estate tax (Virginia and Florida, and about 28 other states, do not). The DC and MD estate taxes piggyback on the rules of the federal estate tax system, except that the DC and MD taxes apply if the value of the decedent's estate is over \$1 million. Therefore, the estate of a DC or MD decedent having more than \$1 million must file a DC or MD estate tax return even though the estate is not required to file a federal estate tax return if its value is less than the federal threshold (\$5.25 million). Because of the piggybacking on the federal estate tax, the DC and MD estate tax returns each require as part of their forms a completed federal estate tax return whether or not it would be required for federal purposes. Therefore, for a DC and MD estate over \$1 million, but less than \$5.25 million, the additional costs to actually file the federal return with the Internal Revenue Service would be a small incremental amount.

election or the documents could require the estate of the deceased spouse to bear these costs.

2. Consider Restructuring Existing Plans to Allow for Possible Use of Portability. For many married couples, the large federal estate tax exclusion amount of \$10.5 million (\$5.25 million per spouse) eliminates the possibility of paying federal estate taxes, assuming the portability election is made. The chart on the last page of this Alert projects the aggregate federal estate tax exclusion amount for a married couple, estimating inflation adjustments. Subject to certain exceptions, the income tax basis of a decedent's assets is automatically adjusted to equal the fair market value of the assets at death; thereby eliminating income tax on the decedent's pre-death accumulated capital gain. An estate plan using portability allows for this basis adjustment upon the surviving spouse's death for the entire aggregate estate. This would likely produce a better income tax result than relying upon a traditional by-pass trust, which is not entitled to a basis adjustment upon the surviving spouse's death.² A portability plan may attain better income and estate tax results, while at the same time providing the other benefits associated with a by-pass trust. These include asset management, spendthrift trust protection, disposition control upon the surviving spouse's death and GST exemption planning. In some cases, by employing more sophisticated strategies, portability planning may also provide better estate and income tax results for a married couple whose aggregate estate will exceed their aggregate federal estate tax exclusion amount.
3. Update Existing By-Pass Trusts. Some married couples may wish to continue using a traditional by-pass trust.³ In these situations, existing by-pass trusts may need updating for two reasons: First, in jurisdictions such as the District of Columbia and Maryland that have an estate tax separate from the federal estate tax, the formula language establishing the by-pass trust may be unclear or less than optimal as a result of changes that have occurred in state and federal laws. In some cases, because of changes in the law, the formula used to determine the amount passing to a by-pass trust could require that a tax be paid when the first spouse dies. Second, a mechanism can be added to the by-pass trust to achieve an income tax basis adjustment for appreciated trust assets without increasing federal estate taxes. Such a provision will be useful if the surviving spouse will have any unused applicable exclusion amount.⁴ This would mitigate the income tax detriment of the by-pass trust as compared to portability planning. There are a few possible mechanisms to accomplish this latter result and therefore the couple could select among these mechanisms based on which best fits their circumstances.

² See our Tax Planning Update entitled [Portability, By-Pass Trusts, and Special By-Pass Trusts](#) for a more detailed discussion of by-pass trusts and portability planning.

³ Many reasons may account for this, including second marriages where one or both spouses wish to ensure that property and tax benefits pass to a pre-existing family without any interference from the surviving spouse.

⁴ For example, suppose that upon the surviving spouse's death, the by-pass trust has \$4 million of assets, and that the surviving spouse has assets of \$3 million and remaining applicable exclusion of \$6.5 million. The surviving spouse will have \$3.5 million of excess applicable exclusion amount. If the by-pass trust has any appreciated property in it, the idea is to subject all or a portion of such appreciated assets to estate taxation in the surviving spouse's estate. If the amount subjected to estate taxation is not more than the excess exclusion of \$3.5 million there is no estate tax liability, but there would be an income tax basis adjustment for the applicable appreciated assets.

If you have any questions about these suggestions, please contact one of our lawyers.

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Applicable Exclusion Amounts in the Future

This chart projects the aggregate applicable exclusion amounts (AEA) that will be available to a married couple, considering annual inflation adjustments to the basic exclusion amount (BEA). The axis across the table is the year of the first spouse's death – to that point in time the BEA component of both spouses' AEAs are being indexed, and thereafter going down the axis on the left side of the table to the year of the surviving spouse's death, only the BEA of the surviving spouse's AEA is being indexed. This may assist in determining whether it is reasonable to assume the couple will have an estate tax liability.

Projected Aggregate Applicable Exclusion Amount based on the Year of the Deceased Spouse's Death and Surviving Spouse's Death

Starting Basic Exclusion Amount		\$ 5,250,000		Inflation Adjustment		2.45%		Year of Deceased Spouse's Death																
		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030					
Year of Surviving Spouse's Death	2013	10,500,000																						
	2014	10,630,000	10,760,000																					
	2015	10,760,000	10,890,000	11,020,000																				
	2016	10,890,000	11,020,000	11,150,000	11,280,000																			
	2017	11,030,000	11,160,000	11,290,000	11,420,000	11,560,000																		
	2018	11,170,000	11,300,000	11,430,000	11,560,000	11,700,000	11,840,000																	
	2019	11,320,000	11,450,000	11,580,000	11,710,000	11,850,000	11,990,000	12,140,000																
	2020	11,470,000	11,600,000	11,730,000	11,860,000	12,000,000	12,140,000	12,290,000	12,440,000															
	2021	11,620,000	11,750,000	11,880,000	12,010,000	12,150,000	12,290,000	12,440,000	12,590,000	12,740,000														
	2022	11,780,000	11,910,000	12,040,000	12,170,000	12,310,000	12,450,000	12,600,000	12,750,000	12,900,000	13,060,000													
	2023	11,940,000	12,070,000	12,200,000	12,330,000	12,470,000	12,610,000	12,760,000	12,910,000	13,060,000	13,220,000	13,380,000												
	2024	12,100,000	12,230,000	12,360,000	12,490,000	12,630,000	12,770,000	12,920,000	13,070,000	13,220,000	13,380,000	13,540,000	13,700,000											
	2025	12,270,000	12,400,000	12,530,000	12,660,000	12,800,000	12,940,000	13,090,000	13,240,000	13,390,000	13,550,000	13,710,000	13,870,000	14,040,000										
	2026	12,440,000	12,570,000	12,700,000	12,830,000	12,970,000	13,110,000	13,260,000	13,410,000	13,560,000	13,720,000	13,880,000	14,040,000	14,210,000	14,380,000									
	2027	12,610,000	12,740,000	12,870,000	13,000,000	13,140,000	13,280,000	13,430,000	13,580,000	13,730,000	13,890,000	14,050,000	14,210,000	14,380,000	14,550,000	14,720,000								
	2028	12,800,000	12,930,000	13,060,000	13,190,000	13,330,000	13,470,000	13,620,000	13,770,000	13,920,000	14,080,000	14,240,000	14,400,000	14,570,000	14,740,000	14,910,000	15,100,000							
	2029	12,980,000	13,110,000	13,240,000	13,370,000	13,510,000	13,650,000	13,800,000	13,950,000	14,100,000	14,260,000	14,420,000	14,580,000	14,750,000	14,920,000	15,090,000	15,280,000	15,460,000						
	2030	13,170,000	13,300,000	13,430,000	13,560,000	13,700,000	13,840,000	13,990,000	14,140,000	14,290,000	14,450,000	14,610,000	14,770,000	14,940,000	15,110,000	15,280,000	15,470,000	15,650,000	15,840,000	15,840,000				
	2031	13,360,000	13,490,000	13,620,000	13,750,000	13,890,000	14,030,000	14,180,000	14,330,000	14,480,000	14,640,000	14,800,000	14,960,000	15,130,000	15,300,000	15,470,000	15,660,000	15,840,000	16,030,000	16,030,000				
	2032	13,560,000	13,690,000	13,820,000	13,950,000	14,090,000	14,230,000	14,380,000	14,530,000	14,680,000	14,840,000	15,000,000	15,160,000	15,330,000	15,500,000	15,670,000	15,860,000	16,040,000	16,230,000	16,230,000				
2033	13,770,000	13,900,000	14,030,000	14,160,000	14,300,000	14,440,000	14,590,000	14,740,000	14,890,000	15,050,000	15,210,000	15,370,000	15,540,000	15,710,000	15,880,000	16,070,000	16,250,000	16,440,000	16,440,000					
2034	13,970,000	14,100,000	14,230,000	14,360,000	14,500,000	14,640,000	14,790,000	14,940,000	15,090,000	15,250,000	15,410,000	15,570,000	15,740,000	15,910,000	16,080,000	16,270,000	16,450,000	16,640,000	16,640,000					
2035	14,190,000	14,320,000	14,450,000	14,580,000	14,720,000	14,860,000	15,010,000	15,160,000	15,310,000	15,470,000	15,630,000	15,790,000	15,960,000	16,130,000	16,300,000	16,490,000	16,670,000	16,860,000	16,860,000					
2036	14,410,000	14,540,000	14,670,000	14,800,000	14,940,000	15,080,000	15,230,000	15,380,000	15,530,000	15,690,000	15,850,000	16,010,000	16,180,000	16,350,000	16,520,000	16,710,000	16,890,000	17,080,000	17,080,000					
2037	14,630,000	14,760,000	14,890,000	15,020,000	15,160,000	15,300,000	15,450,000	15,600,000	15,750,000	15,910,000	16,070,000	16,230,000	16,400,000	16,570,000	16,740,000	16,930,000	17,110,000	17,300,000	17,300,000					
2038	14,860,000	14,990,000	15,120,000	15,250,000	15,390,000	15,530,000	15,680,000	15,830,000	15,980,000	16,140,000	16,300,000	16,460,000	16,630,000	16,800,000	16,970,000	17,160,000	17,340,000	17,530,000	17,530,000					
2039	15,100,000	15,230,000	15,360,000	15,490,000	15,630,000	15,770,000	15,920,000	16,070,000	16,220,000	16,380,000	16,540,000	16,700,000	16,870,000	17,040,000	17,210,000	17,400,000	17,580,000	17,770,000	17,770,000					
2040	15,340,000	15,470,000	15,600,000	15,730,000	15,870,000	16,010,000	16,160,000	16,310,000	16,460,000	16,620,000	16,780,000	16,940,000	17,110,000	17,280,000	17,450,000	17,640,000	17,820,000	18,010,000	18,010,000					