

Estate Tax Complexities

Years ago, the way to most efficiently save on estate taxes was to set up credit shelter trusts that would pour assets from one spouse to another when death occurred, so that both spouses would get the maximum estate tax exemption. In those simpler days, people who didn't have to pay estate taxes didn't have to file an estate tax return.

Today, we live in a very different world. No longer is a credit shelter trust necessary; the surviving spouse gets to keep the unused portion of the deceased spouse's estate tax exemption regardless of who owns which assets at the time of death. And with the exemption up to \$5.43 million per spouse, you would think that fewer people would have to file estate tax returns.

This last assumption would be wrong. In order to claim the portable exemption of the deceased spouse, the estate has to file Estate Tax Form 706 on behalf of the survivor. This form can be complicated; it requires the executor to report the value of the assets that don't need to be reported for tax purposes, and to subtract that amount from the exemption—in order to calculate the exemption amount that the survivor can keep and use when he or she dies and passes on assets to heirs. So you still have to do an estate valuation.

If you know for sure that your future estate won't exceed \$5.43 million indexed for inflation, then there is no need to file an estate tax return. But when people factor in the (hopefully) appreciating value of their house, in addition to their retirement assets over the years they expect to live, a surprising number of people should opt to file the tax form.

There's one other complication: although the surviving spouse's exemption will keep rising with inflation, the portable amount stays fixed until it's eventually used.

And one more: people who die with assets in their name get a step-up in cost basis on their investments—which basically means that the capital gains taxes that would otherwise be owed when those investments are sold will go away. So although it no longer matters, from an estate tax perspective, who owns which assets, it is beneficial for the deceased spouse to own assets that have a low cost basis—things like a home purchased many years ago, or stocks acquired before a large runup in value, or shares of a small business that started with zero value. But

beware transfers on a spouse's deathbed; if the deceased dies less than a year after the transfer, the tax code treats it as if the transfer were never made.

What? You expected the government to simplify your estate taxes?

Sources:

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