



# The Wealth Advisor

## "Portability" of the Federal Estate Tax Exemption - What does it Mean?

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With the political and economic climate as it is in the summer of 2008, we are not likely to see total repeal of the federal estate tax in the foreseeable future. However, both Republican and Democratic Presidential candidates support estate tax reform. Realistically, such

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reform is at least one year away, but the outlines are already clear. And while the top estate tax rate and the exemption amount are not yet established, both candidates support making the exemption "portable" for spouses.

On its face, exemption portability is a good thing. However, like many "good" things from Congress, this one may not be all that it is cracked up to be.

What is "Portability"?

Under current law, if a spouse dies without having planned for his or her exemption, that exemption will be lost. In other words, in 2008 a married couple can transfer a combined \$4 million of assets (\$2 million each) free of federal estate tax, but only if they set up what is commonly referred to as a credit shelter trust (aka "bypass" or family trust) for the \$2 million of the first spouse to die. This trust "shelters" or preserves the federal estate tax exemption of that spouse so that it is not lost at death. Without such a trust in place, the first spouse to die wastes his or her exemption and the surviving spouse can only transfer \$2 million free from federal estate tax. (Note that the state estate tax exemption may be less than \$2 million, as discussed below).

Under the portability proposals of both Presidential candidates, when the first spouse dies, the unused exemption would simply transfer to the survivor and be available for use when that spouse dies. In other words, the surviving spouse will have both spouses' federal exemptions. In some respects, such a change would simplify estate planning for surviving spouses by eliminating the need for credit shelter trusts (either in their wills or as part of a revocable living trust) set up solely to save estate taxes. Also, with portability, couples would not need to retitle assets to equalize their respective estates.

Thus, with portability, Barack Obama's proposal would effectively allow for a \$7 million federal estate tax exemption for couples. John McCain's proposal would allow for a \$10 million federal estate tax exemption for married couples. Does this mean that if a married couple has less than \$7 million they no longer need to plan or update their existing planning? Absolutely not.

## Shortcomings of Exemption Portability

The biggest shortcoming of federal estate tax exemption portability is the loss of asset protection by not utilizing a credit shelter trust in a revocable living trust or Will. While you may not believe that you are at risk for claims against these assets, consider this: a single car accident can result in a judgment that far exceeds your insurance limits, even where you believe that you are not at fault.

**Planning Tip:** Through the use of a properly drafted credit shelter trust, the assets in the credit shelter trust will never be subject to creditors of the surviving spouse or future beneficiaries, often children and grandchildren.

Additionally, these assets are not subject to federal estate tax no matter how much they grow during the surviving spouse's lifetime and beyond. Therefore, these assets can grow well past \$2 million and never be subject to federal estate tax.

**Planning Tip:** Your investment advisor can continue to invest these assets and grow them significantly over time without imposition of federal estate tax.

Furthermore, more and more states have **state** estate tax exemptions that are less than the federal estate tax exemption. Thus, while your surviving spouse might not be subject to **federal** estate tax upon your passing, your surviving spouse may have to pay significant **state** estate tax if you rely solely on the federal exemption portability. This is true even if you live in a state that does not currently have a state estate tax as it might institute one, or you might someday move to such a state or own property there.

Last, but not least, there is nothing to prevent Congress from changing the rules in the future. This is our country's fourth version of the estate tax, all instituted in time of war when the government needed money - which is arguably where we are today. Moreover, Congress continuously tinkers with the estate tax, and has done so nearly 20 times since 1976. What is to prevent Congress from doing so again, especially if we need to raise revenue? And if one spouse has already passed it will be too late.

**Planning Tip:** Congress has continuously tinkered with the federal estate exemption amounts and rates. There is no reason to believe that Congress will not continue to tinker with these in the future.

## Conclusion

Portability of the federal estate tax is an improvement of the "default" Congressional estate plan, but it is not a substitute for proper planning or continuous updating of existing planning. As your planning goals or assets change, so too should your estate planning change. By working together, your planning team can ensure that your planning stays current and will accomplish your unique goals and objectives.

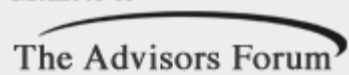
*the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax advisor based on the taxpayer's particular circumstances.*

You have received this newsletter because I believe you will find its content valuable. Please feel free to [contact me](#) if you have any questions about this or any matters relating to estate planning.

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