

Should You Transfer Unused Gift and Estate Tax Exemptions to a Surviving Spouse? (Part II)

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In our [previous post](#), we discussed the advantages of portability as an estate planning tool. However, there are some non-tax reasons why a couple might not opt for planning of this type. Almost all relate in one way or another to the reluctance of one spouse to give the other spouse unrestricted control over all assets following the first death. This may be because the spouses have different beneficiaries as a result of having children from prior marriages, because one or both spouses have spendthrift tendencies, because of a fear of the surviving spouse's remarriage, or because the likely surviving spouse is totally inexperienced in asset management.

In addition to the non-tax reasons, there are at least four possible tax reasons why a couple might decide that they are not candidates for joint trust planning and reliance on portability:

1. **Possible repeal:** Perhaps the least worrisome is that portability might be repealed. As described above, even before portability couples could achieve the same tax result with proper planning, so all that portability did was eliminate the need for sophisticated tax minimization planning. It doesn't seem likely that Congress would act to in effect impose a tax burden on the unwary (although I suppose that it might be argued that lots of taxes do exactly that).
2. **Advantages of using a by-passing Trust:** More importantly, with traditional planning all future appreciation in the value of assets held in a by-passing trust is sheltered from estate tax in the surviving spouse's estate. That is not true of assets that pass outright to the surviving spouse or are held in a joint trust. This makes traditional separate trust planning much more attractive for a couple whose combined wealth is likely to approach or exceed their combined BEAs prior to the death of the surviving spouse. For example, if our hypothetical couple, Bob and Mary, have assets worth \$10,000,000 and they are not elderly or in failing health, it might be a reasonable conclusion that holding \$5,340,000 in a trust for the surviving spouse would be a good idea to shelter future appreciation in the \$5,340,000 from estate tax in the surviving spouse's estate. This of course also means that when planning for couples in this situation, it still makes sense to assure that each spouse has significant assets that can be sheltered from estate tax by his or her BEA. I can hear myself telling clients that "it no longer matters for transfer tax purposes who owns what". In fact, it might matter quite a bit.

3. **Surviving spouse's remarriage:** If the surviving spouse remarries, and if the new spouse dies before the surviving spouse, the unused BEA carried over from the first spouse is lost. In other words, if Bob dies first and Mary remarries Peter, and then Peter precedes Mary in death, Mary will lose Bob's unused BEA. Apparently the only way around this is to have the surviving spouse make large taxable gifts while his/her new spouse is still living, since these gifts would first be sheltered from gift tax by the original decedent's unused BEA. Depending on a few factors (e.g. the surviving spouse's age and cash flow needs), such a large gift might be unpalatable.
4. **Generation-skipping:** Portability doesn't apply to a person's Generation-Skipping Transfer Tax ("GSTT") exemption, which is the amount (equal to but completely separate from the gift and estate tax BEA) that a person can transfer to a trust or trusts that are sheltered from transfer tax in that person's descendants' estates. For wealthy couples who are interested in sheltering assets from tax in their children's and grandchildren's estates, failure to fully fund a by-passing trust on the first spouse's death sacrifices some or all of that decedent's GSTT exemption.

For most couples, the availability of portability makes their planning (and the administrative burdens on the surviving spouse) much simpler. However, there are situations where the reflexive decision to use a joint trust is not the best option.

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National Law Review, Volume IV, Number 328

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