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Navigating Estate Tax Exemption: Know Your Options

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Key Takeaways:

- Proper estate planning can lower your estate tax burden and create a smooth transfer for your spouse or heirs.
- Estate planners recommend one of three exemption strategies: Portability, Credit Shelters/Bypass Trusts or Disclaimer Provisions.
- Each strategy has its advantages and disadvantages; choose the one that best aligns with your estate planning goals.

Estate planning is a crucial, and often overlooked, aspect of financial planning. Set up your estate properly, and you'll leave your spouse or heirs with a thought out, tax-efficient transfer. Fail to do so, and your estate may be more hassle, and pay more in taxes than necessary.

One of the challenges estate planning presents is the uncertainty around estate tax laws, which can change frequently and drastically. When deciding how to best utilize your remaining estate tax exemption amount (currently $12,920,000 per individual in 2023[1]) estate planners utilize one of three strategies:

- Portability
- Credit Shelters/Bypass Trusts
- Disclaimer Provisions

And this issue is set to become even more important. Effective January 1, 2026, current estate tax exemptions will be cut in half, leaving many families with an important decision to make.[2]

Here we will explore three helpful exemption strategies and how they could play a part in your estate plan.

Portability

Portability, also known as the Deceased Spouse Unused Exemption, or DSUE, allows your surviving spouse to use any unused portion of your estate tax exemption. When your spouse elects portability upon your passing, any unused estate tax exemption will "port" to the surviving spouse. Your surviving spouse can, in turn, apply the unused portion, in addition to their own exemption, to reduce or eliminate estate taxes upon their passing.

The key benefit to portability is ease. Portability can be a simple and effective strategy for married couples with relatively modest estates, as it eliminates the need for a credit shelter trust or bypass trust.

However, portability is not without its limitations. For starters, portability is only available for federal estate tax purposes, and not for state estate tax purposes. Additionally, portability does not provide any asset protection, which may be a concern. Portability also does not provide as much flexibility as using disclaimer provisions in your estate plan.

To make the most of tax exemptions, estate planners recommend one of three strategies: Portability, Credit Shelter Trusts/Bypass Trusts or Disclaimer Provisions

Credit Shelter/Bypass Trust

A credit shelter trust, also called a bypass trust, is a technique that is often incorporated in estate planning documents for high-net-worth individuals. This trust structure allows a married couple to take full advantage of their combined federal estate tax exemptions.

The credit shelter trust is designed to hold assets of the deceased spouse equal to their remaining estate tax exemption. The assets in this trust are not included in the surviving spouse's estate for estate tax purposes, and the appreciation of these assets is also exempt from future estate taxes at the passing of the second spouse. The trust is designed to provide for the benefit of the surviving spouse and, potentially, descendants.

A credit shelter trust has key advantages over both portability and disclaimer provisions. First, it provides more flexibility than portability because it allows the individual making the estate plan to direct assets to specific beneficiaries. It also provides more protection than portability or using disclaimer provisions because the assets in a credit shelter trust may be protected from creditors and divorce proceedings.

Disclaimer Provisions

Disclaimer provisions in a will or trust enable a beneficiary to disclaim an inheritance in favor of another individual or trust, such as a credit shelter trust. By disclaiming the inheritance, the beneficiary can effectively transfer the assets to the other beneficiary without incurring an estate tax liability.

One of the main advantages of using disclaimer provisions is flexibility. The provisions can be tailored by your attorney to meet your specific needs. Provisions also allow a surviving spouse or heirs to make estate tax decisions based on their circumstances at the time of your passing.

Let’s consider a married couple with a net worth currently below the estate tax exemption amount. However, the couple anticipates a taxable estate in 2026 after the sunset of the current tax law. They want to leave all their assets to the surviving spouse, so they set up a joint estate plan and include a disclaimer provision.

At the time of passing, the surviving spouse can exercise the disclaimer provision. At this point, they can decide whether to elect portability of the deceased spouse's unused exemption, or to disclaim some or all of the assets to a credit shelter trust to take advantage of the increased exemption amount.

The use of disclaimer provisions can be particularly effective when estate tax laws are uncertain, as it allows your spouse or other heirs to wait until after your passing to make a decision about whether to accept the inheritance or disclaim.

However, disclaimer provisions do have disadvantages. They require your spouse or heirs to decide within a relatively short period after your passing. If your spouse or heirs are not aware of the disclaimer provisions or do not understand how they work, they may inadvertently lose the opportunity to use them effectively.

Which Exemption Strategy is Right for You?

The right exemption is the one that aligns with your estate planning goals. As you've seen, there are advantages and disadvantages to each exemption strategy.

- Portability. Offers simplicity but limited in its protection.
- Credit Shelter/Bypass Trust. Offers flexibility and protection, but it requires establishing a trust.
- Disclaimer Provisions. Offers options at the time of passing, but it requires your heirs to make a quick, informed decision.

A good estate planner can help you navigate these decisions and build an estate plan that will protect your money. At Comerica, we have 174 years of experience working together with clients to realize their financial goals and plan for the future.

Want to know more?

For more information about this topic or any other, Comerica welcomes the opportunity to help. Contact your Comerica Relationship Manager or Contact Comerica to request to speak with a Comerica Professional.

[1]Internal Revenue Service. *Estate Tax*. https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax

[2]The Federal Register. *Federal Register.*, www.federalregister.gov/documents/2018/11/23/2018-25538/estate-and-gift-taxes-difference-in-the- basic-exclusion-amount