

Estate Tax & Transfers to Spouses

Take a closer look at the unlimited marital deduction - how it works and who it can benefit.

When developing an estate plan, it's important to consider the impact of taxes on loved ones. The unlimited marital deduction is a powerful tool that allows one spouse to leave their entire estate to the surviving spouse without incurring federal estate tax.¹ Let's take a closer look at the unlimited marital deduction—how it works and who it can benefit.

What is the unlimited marital deduction?

The unlimited marital deduction is a provision in the United States Internal Revenue Code that allows an individual to transfer, free from estate and gift tax, an unrestricted amount of assets to their spouse during life or at death.

It's important to remember that simply leaving all wealth to the surviving spouse may result in a larger-than-necessary taxable estate when they die. Coordinating the use of the marital deduction with each spouse's lifetime federal gift and estate tax applicable exemption amount may help reduce taxes.

How it works

The lifetime gift and estate tax exemption is the amount each individual can gift or leave to heirs before triggering estate or gift taxes. If the first spouse to die leaves less than the full applicable exemption amount to heirs other than their spouse, the executor of the deceased's estate can elect to add the unused portion of the last deceased spouse's applicable exemption amount to their own lifetime exemption. This provision is called the portability rule.

An alternative to the portability rule would be to use the exemption trust and marital trust approach.

Here's how that might play out: A couple's estate plan indicates that upon the first spouse's death, the estate's assets will be split into 2 components - one share to be applied against the deceased spouse's applicable exemption amount, with the other share of the estate assets passing to the surviving spouse under the unlimited marital deduction. The first share would go to fund an exemption trust - often referred to as a bypass or credit shelter trust - with the deceased spouse's remaining federal lifetime gift and tax exemption amount. Any remaining assets would be placed in a marital trust or given outright to the surviving spouse. For example, state estate tax considerations aside, the first deceased spouse with \$14 million in assets might direct, by will or revocable trust, \$13.99 million (the amount of the lifetime gift and estate tax exemption in 2025) to the exemption trust and approximately \$10,000 to the marital trust.²

A 2-trust strategy

An exemption trust is designed to prevent estate taxation on the assets in that trust when the surviving spouse dies. While alive, they have limited control over the trust and limited access to its principal. The surviving spouse does not have to be the only income beneficiary of the trust; in fact, it's not even required for the spouse to be listed as one of the trust's beneficiaries. The beneficiaries of the exemption trust can be given the right to receive income annually, or income may be paid out to them at the discretion of the trustee. The surviving spouse's rights to the principal in the trust must be limited, or those assets risk being included in the surviving spouse's estate. In general, the surviving spouse can receive principal at the trustee's discretion provided the trustee is someone other than the spouse, or based on a specified standard—for example, to cover health care, education, and living expenses. The surviving spouse also may be able to designate the balance of the trust to a certain limited class of beneficiaries. The overriding objective for the exemption trust, however, is to limit the surviving spouse's control over the trust's assets, in order to allow any assets remaining at the surviving spouse's death to escape estate taxation.

Portability is generally³ not permitted for state estate tax exemptions (for states that levy state estate tax) and the federal generation-skipping transfer tax exemption. Therefore, without the use of a marital disclaimer trust (or traditional CST), any unused state estate tax exemption and federal generation-skipping transfer tax exemption of the first spouse to die will be lost.

A marital trust, on the other hand, requires in most cases that the income generated by its assets be distributed at least annually to the surviving spouse. A marital trust generally doesn't offer any additional tax benefits beyond the marital deduction, but it does come with 2 key nontax-related benefits. First, it allows the deceased spouse to provide for the surviving spouse, while directing who inherits the remaining marital trust assets after the surviving spouse's death. This can help ensure that the assets eventually will pass to the couple's children, even if the surviving spouse remarries. Second, a marital trust generally protects the trust's assets from creditors' claims during the surviving spouse's lifetime. Among the better-known types of marital trusts is the qualified terminable interest property (QTIP) trust.

The strategy of splitting assets between an exemption trust and a marital trust generally results in no federal estate tax due at the time of the first spouse's death. Assets in the exemption trust are offset by the federal estate tax exemption, while assets in the marital trust are shielded by the unlimited marital deduction. Upon the death of the surviving spouse, assets in the marital trust could potentially be subject to estate tax, but those in the exemption trust will avoid taxation—regardless of how much the trust's assets may have increased in value since the first spouse's death. Other considerations include the potential impact of state taxes. Speak with your attorney or tax advisor about your specific situation.

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1. Surviving spouse must be a US citizen.
2. This example does not take into account the impact of any state laws.
3. Only two states with state estate tax, Hawaii and Maryland, offer portability.