

# How to Maximize Estate-tax Exemptions

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The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 provides a special federal estate-tax break for married couples. Under the recently enacted legislation, the estate-tax exemption may effectively be transferred between spouses. A new IRS notice provides some guidance on making this election. The future remains uncertain. That is good news. But here is some bad news: Unless Congress acts again soon, the “portability” provision will expire after 2012.

**Background:** Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the estate-tax exemption for an individual was gradually increased from \$1 million to \$3.5 million for decedents dying in 2009. At the same time, the top estate-tax rate was decreased from 55% to 45%. EGTRRA also “decoupled” the estate- and gift-tax systems and retained a lifetime gift-tax exemption of \$1 million.

Then EGTRRA repealed the federal estate tax, but only for decedents dying in 2010. The estate tax was scheduled to be reinstated in 2011, with only a \$1 million estate-tax exemption and a top 55% estate-tax rate. Subsequently, the 2010 law created an estate-tax exemption of \$5 million with a top estate-tax rate of 35%. The government recently announced that the inflation-adjusted exemption for 2012 is \$5.12 million.

Among other changes, the new law reunifies the estate- and gift-tax systems and allows portability of estate-tax exemptions for married couples.

**How it works:** If a deceased spouse’s estate does not exhaust the entire exemption, the balance becomes available to the estate of the surviving spouse. Thus, heirs may more easily benefit from the maximum \$10.24 million in exemptions (\$5.12 million for the estate of each spouse in 2012), but only if both spouses die before 2013.

**Example:** John White owns assets valued at \$3.5 million, and his wife Mary owns assets worth \$6 million. They each have designated their children as their primary beneficiaries. John dies in 2012, so the \$5.12 million estate-tax exemption shelters the entire amount. Then Mary dies later in 2012. Because John’s

unused exemption of \$1.62 million is transferred to Mary's estate, the combined exemption shelters the entire \$6 million in assets she owns.

The new IRS Notice explains how to use the portability provision. Briefly, the estate can transfer any unused portion of the exemption for a deceased spouse to the surviving spouse by filing the requisite form for federal estate-tax returns. No affirmative election is required. The estate will be treated as having made the portability election as long as a return is filed in a timely fashion. Other issues will be addressed in future pronouncements from the IRS.

**Note:** The rules pertaining to annual gift-tax exclusion remain in effect without any change. Therefore, you can reduce the size of your taxable estate in 2012 and the foreseeable future by giving lifetime gifts up to the annual limit (\$13,000 per recipient in 2012). You should coordinate lifetime gift-giving with other aspects of your estate plan. Rely on your estate-planning advisers for guidance.

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