

The Estate Planning Benefits of Marriage: What Unmarried Couples Need to Know

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It is becoming increasingly commonplace for people to enter long-term romantic relationships without legally marrying. While there are no exact statistics on how many Americans fall into this growing category, a 2019 Pew Research Center study estimated that 12% of Millennials were living with an unmarried partner, compared to 8% of Gen Xers—an increase of 50% from one generation to the next. While this trend is influenced by various social and political factors, many of these couples may not fully appreciate the extensive economic and legal benefits they forgo by remaining unmarried to their partner. In fact, over 1,000 federal laws provide legal benefits and privileges to married couples.

It is beyond this article's scope to discuss every way in which the law favors married couples. Rather, this article will highlight just a few of the many estate planning benefits and opportunities that are conferred on married couples that are not shared by unmarried couples. As I will illustrate, often with little planning, married couples can defer, reduce, or completely eliminate taxes.

Unlimited Marital Deduction - Lifetime Gifting

Any gift exceeding the annual gift tax exclusion amount, which in 2024 is \$18,000 per donor per recipient, is a taxable gift that must be reported by filing a gift tax return (IRS Form 709). However, there is a very significant exception to this rule. One spouse may convey to the other spouse an unlimited amount of assets at any time and as often as desired without incurring any gift tax liability.

This creates many estate planning opportunities. As just one example, married couples can strategically retitle assets between each other to maximize the “step-up” in the capital tax basis that these assets receive at death. The “step-up” means that any appreciation in an asset from when the decedent first acquired it gets wiped away at death, and the recipient receives the asset with an adjusted capital tax basis as of the decedent's date of death. Thus, married couples can convey assets to each other so that upon the death of the first spouse, the surviving spouse receives highly appreciated assets with a one-half or even full step-up, saving significant capital gains taxes when the asset is later sold.

Unlimited Marital Deduction – Inheritance

The unlimited marital deduction also applies to transfers between spouses at death, shielding the surviving spouse's inheritance from any estate taxes. This powerful tool allows the surviving spouse to defer the payment of any estate taxes resulting from the first spouse's death for their entire lifetime. This gives the surviving spouse time to spend down or gift these assets to minimize or eliminate estate tax liability for their future heirs at the time of their death.

The unlimited marital deduction is also key to “by-pass” trust planning, a technique that ensures that no estate taxes are owed at the death of the first spouse while maximizing the use of their estate tax exemption. By-pass trust planning works as follows:

upon the first spouse's death, two trusts are established for the surviving spouse's benefit. One trust is funded with assets up to the estate tax exemption amount, allowing these assets to continue to appreciate outside the surviving spouse's estate. When the surviving spouse passes away, this trust terminates, and the assets are distributed to the ultimate beneficiaries free of estate tax. The second trust is funded with the remaining estate assets and is structured to take advantage of the unlimited marital deduction.

Portability

A spouse may claim the deceased spouse's unused exemption (DSUE) for their later use via a concept known as portability. To claim the DSUE of the deceased spouse, the surviving spouse must timely file a federal estate tax return (IRS Form 706). Unlike a "bypass" trust plan, portability requires no advanced estate planning and incurs no administrative costs or inconvenience. Regardless of any subsequent changes in the law, the DSUE will be available for the surviving spouse to benefit from in their estate. With the current estate tax exemption amount at a historical high, it is a particularly advantageous time to file an estate tax return solely for portability purposes.

Those intending to rely on portability planning should be cautious, as the surviving spouse cannot claim any unused state estate tax exemption amount. Therefore, portability planning may be sufficient for residents of New Jersey, which abolished its estate tax in 2018, but it may not be adequate for residents of New York, which has an estate tax. Unused generation-skipping transfer tax exemption amounts are also not portable between spouses.

Inheritance Tax

For New Jersey residents, an inheritance tax is imposed on certain classes of recipients of a decedent's estate assets. The surviving spouse, a Class "A" beneficiary, is wholly exempt from inheritance tax liability. For those married clients who wish to provide an inheritance for beneficiaries in a class that would be subject to the inheritance tax, making lifetime gifts outright or in an irrevocable trust remains a valid strategy for avoiding the inheritance tax.

Inherited IRAs

Before the enactment of the SECURE Act, beneficiaries of inherited IRAs were permitted to take required minimum distributions (RMDs) based on their life expectancy. A beneficiary younger than the original account owner would have much smaller RMDs, allowing the IRA assets to appreciate over a long period of time income tax deferred.

The SECURE Act largely eliminated this strategy. Under current law, most beneficiaries must liquidate their inherited IRA within ten (10) years of the death of the original account holder. The SECURE Act carved out an exception to this rule; it allowed those deemed an "eligible designated beneficiary" ("EDB") to take RMDs based on their life expectancy. Among the limited categories of EDBs, you guessed it, the surviving spouse is deemed an EDB. A husband or wife who outlives their spouse for many years could see these assets significantly appreciate over their lifetime. Moreover, the surviving spouse has significantly more flexibility in taking withdrawals above the RMD in years when the assets will be taxed at lower marginal income tax rates.

Challenges for Unmarried Couples

The flip side to all the planning opportunities available to the married couple is that the unmarried couple cannot benefit from any of them. Any gifts between the unmarried couple above the annual exclusion amount would be taxable. Unmarried couples who receive the inheritance of their deceased partner's estate may be subject to estate taxes, significantly reducing the assets that the surviving partner would otherwise have available for their support. In New Jersey, in addition to any estate tax liability, a non-married surviving partner may be subject to inheritance tax liability. Lastly, the surviving partner may not be an EDB; thus, they will need to withdraw the entire amount of the IRA within ten years, potentially losing out on years of further appreciation.

Of course, the unmarried couple still needs estate planning. Indeed, if an unmarried person were to die without preparing a will or trust, the intestacy laws of most states would direct their assets automatically to children, parents, or siblings. There are

also tax planning techniques available for the unmarried couple to reduce estate taxes, such as the establishment of one or more lifetime irrevocable trusts. This kind of planning, however, is more expensive, and the administration is costly and burdensome.

State legislatures have taken some meaningful steps to protect the rights of unmarried couples in recent years. For example, both New York and New Jersey recognize domestic partnerships, a legal arrangement that confers some of the benefits afforded to married couples on unmarried couples. For example, a domestic partner in New Jersey is a Class “A” beneficiary, exempt from inheritance tax. However, most tax planning opportunities available to married couples remain unavailable to domestic partners.

I am hopeful that future legislatures will address some of these disparities, particularly as the unmarried share of the population continues to grow. However, until that legislative fix occurs, sometimes the best planning advice for an unmarried couple in a long-term relationship is to change their marital status.