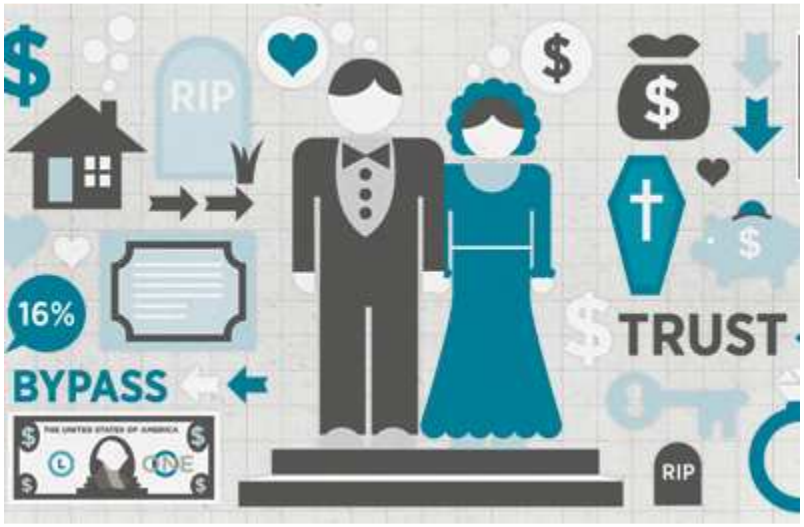
The new estate law allows couples to do without trusts--if they trust each other.



Miami lawyer Nelson C. Keshen and Talma, his wife of 45 years, have always had simple "I love you" wills leaving all their assets to each other directly. That's remarkable, considering he has spent decades drafting more complicated estate plans for other affluent couples--plans designed to minimize estate taxes by putting some assets of the first spouse to die into a "bypass" trust for the kids. But regardless of tax costs, Keshen says, he didn't want his own widow (should he die first) to have "to account to my children or grandchildren."

The estate tax overhaul President Obama signed in December liberates many other well-off couples to follow the Keshens' lead and dispense with costly, cumbersome trusts--assuming they are in stable first marriages and trust each other to manage their joint wealth. Here's what married folks need to know and do now.

The New Breaks

Under the new law, just as under the old one, you can leave a citizen spouse or a charity an unlimited amount, without worrying about tax. But the new law makes two key changes. First, it raises each individual's lifetime exemption from federal estate and gift tax for transfers to nonspouse heirs to a hefty $5 million, from $3.5 million in 2009 and only $2 million in 2008. Second, it makes the exemption "portable" between spouses--meaning a surviving spouse can add any unused exemption of her just-deceased spouse to her own $5 million exemption. So a widow or widower can pass on as much as $10 million, untaxed, through either lifetime gifts or bequests.

The Gotchas

Portability isn't automatic. To get it, the executor of the estate of the first spouse to die must file an estate tax return, even if no tax is due. Surviving spouses should get this return filed even if they have nowhere near $5 million of their own, because someday, who knows? Portability also isn't retroactive, so it's no help to those who lost spouses before 2011. Finally, it doesn't apply to the $5 million per person exemption from "generation-skipping" tax--the extra tax imposed on gifts to grandkids whose parents are still alive. That means the truly rich will want to use up their own $5 million exemptions, likely through gifts in the next two years. Now You See It

The new estate law expires at the end of 2012. If Congress doesn't act before then, not only will portability lapse but the exemption amount will revert to $1 million and the estate tax rate will increase to 55% from the current 35%. Rapidan, Va. estate expert Howard M. Zaritsky insists this makes it risky to rely on portability when redoing estate plans. Others strongly disagree. "Portability is here to stay," Columbia Law professor Michael J. Graetz told estate-planning pros in January. Graetz, who wrote a book on the history of the estate tax, also predicts the $5 million tax-free amount won't be reduced.

Your Old Bypass Trust

If you're affluent, but not truly rich, your current estate plan likely includes a bypass or family trust--a legal concoction designed to preserve the estate tax exemption of the first spouse to die, without leaving the survivor short of funds. At the death of the first spouse, an amount up to his exemption goes into a trust for the kids. The surviving spouse has access to the earnings (and in some cases principal) of the trust, but the money isn't hers outright and bypasses her estate when she dies.

Look at your will; if it funds a bypass trust up to the full federal exemption (as opposed to a set amount), your spouse could be left with nothing outside the trust. That's inconvenient and can have bad income tax consequences. Change the wording, or consider eliminating the trust. Sure, trust-loving lawyers are now touting the nontax virtues of trusts--protecting assets from creditors, from those who prey on the elderly and from a new spouse if a widow remarries. But James A. Houle, a lawyer with Bernstein Shur in Portland, Me., says candidly: "The majority of my clients would choose not to have a bypass trust if it were not necessary to save estate taxes."

Remarriage Rules

Those who want to provide for both a current spouse and children from an earlier marriage might still use bypass trusts to make sure their kids don't get disinherited if a stepparent turns evil.

Meanwhile, portability creates some intriguing opportunities--for example, using a new spouse's unneeded $5 million exemption. (Call it a tax break dowry.) Ellen K. Harrison, a lawyer with Pillsbury Winthrop Shaw Pittman in Washington, D.C., has one wealthy client married to a woman who has less than $1 million of her own. Both have children from prior marriages. They are considering an

arrangement in which she'll share $4 million of her own lifetime gift tax exemption with him (this process is called gift-splitting) so he can give more to his kids now, tax-free.

What about someone who loses a spouse now and remarries later? A widow or widower gets only the unused exemption of the most recent spouse to die. So if a widow with a $10 million exemption (half from her late husband) marries a rich man who has used up his $5 million break making gifts and he dies from a heart attack on their wedding night, she's left with only her own $5 million exemption.

I Disclaim, You Disclaim

Lawyers are now touting an idea they used to belittle: disclaimer trusts. You leave everything to your spouse outright, but give her the right to disclaim (turn down) all or part of the inheritance and have it go into a bypass trust, allowing her to make an informed decision based on her finances and the latest federal and state estate tax laws.

Currently 16 states and the District of Columbia impose estate taxes, and most have exemptions of $1 million or less. In January Illinois adopted a tax with a $2 million exemption, joining Connecticut, Delaware, Hawaii, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Ohio, Oregon, Rhode Island, Vermont and Washington State on the tax list. No state now has portable exemptions.

Since state tax rates can exceed 16%, a survivor might want to fund a bypass trust up to the state exemption amount--or might not, says Susan T. Bart, a lawyer with Sidley Austin in Chicago. She notes that assets left outright to the surviving spouse and included in her estate get an adjustment or "step-up" in basis to their value at the date of her death, which (if they've continued to appreciate) minimizes the capital gains tax heirs will owe. Assets in a trust are stuck with their basis at the time they went into the trust.

So what have attorneys had against disclaimer trusts? Disclaimers can be tricky; you can't, for example, disclaim assets you've already touched. But mostly, some lawyers haven't trusted surviving spouses to disclaim assets when they should. Now the new game in estate planning is an old-fashioned form of trust--between spouses.

Deborah L. Jacobs is the author of Estate Planning Smarts: A Practical, User- Friendly, Action-Oriented Guide