

D.C. Tax Revision Commission Policy Options
Policy Option #27: Defer Estate Tax Until Surviving Spouse Dies

MEMORANDUM

Proposal: Defer estate taxes until the death of the surviving spouse

Tax Type: Estate Tax

Origin: Public

Commission Goals: Competition and simplicity

Current Law

D.C. imposes an estate tax up to a maximum rate of 16% on all estates worth more than \$1 million not passing at death to a surviving spouse or charity. The federal government imposes an estate tax up to a maximum rate of 40% on property in excess of \$5.25 million not passing at death to a surviving spouse or charity. At both the D.C. and federal level, the marital deduction permits the first spouse who dies to automatically transfer his/her entire estate tax-free to the surviving spouse.

As of January 2013, the \$5.25 million federal tax exclusion is portable. That is, a deceased spouse's unused estate tax exclusion can be used by the surviving spouse against gifts made by the surviving spouse during life or at death. As a result, married couples can pass \$10.5 million (or two times \$5.25 million) of assets to their beneficiaries free of the federal estate tax.

The D.C. exclusion is not portable. In order for beneficiaries receive both spouses' D.C. exemptions (currently two times \$1 million), the first spouse to die must use a Qualified Terminable Interest Property (QTIP) trust or otherwise transfer the property to a non-spousal party.

Proposed Changes

Give D.C. taxpayers a portability option, and defer the tax on amounts between the federal and D.C. exemption until the second spouse dies. Alternatively, give D.C. taxpayers a separate D.C. QTIP option, which will defer tax on amounts between the federal and D.C. exemption until the second spouse dies (as Maryland now provides).

Reason for Change

Creating a QTIP trusts is administratively and financially burdensome. Wealthier couples have more access to these trusts, which allow their beneficiaries to receive either spouses' exemptions (or two times \$1 million) after the second spouse dies. In addition, many couples would like to defer all estate tax payments until the death of the surviving spouse.

Pros

- Portability would eliminate the need for sophisticated QTIP trusts, and eases administrative and financial burdens for taxpayers.
- Portability would even the playing field and allow more couples to give their beneficiaries two D.C. estate tax exemptions when the second spouse dies.

- Deferring the tax on the difference between the federal and D.C. exemptions until the death of the second spouse could be good policy since beneficiaries do not have access to the assets till the second spouse dies.
- Alternatively, allowing spouses to supplement federal portability with the option to create separate District QTIP trusts would also defer tax on the difference between the federal and D.C. exemptions until the death of the second spouse.

Cons

- Deferring the tax on the difference between the federal and D.C. exemptions until the death of the second spouse would delay collection by D.C.
- D.C. may never collect tax if the second spouse were domiciled in another jurisdiction when he/she dies.

Revenue Impact

An official revenue impact estimate from ORA is TBD.