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Estate Planning for Marital Assets

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Rebecca Rosenberger Smolen, left, and Amy Neifeld Shkedy, right, of Bala Law Group.

As we are entering our 14th year of writing these columns it's not easy to come up with a helpful topic that we haven't directly covered before. We have nevertheless found a good one for our readers: optimal titling of marital assets for estate planning purposes. It may be good that we waited.

Even though the advice is generally the same now as it was back in 2012, the discussion these days is a bit different now that we have a "portable" $15 million federal estate tax exemption, compared to the $1 million exemption we were factoring in back in 2012 (and $600,000 before that in the '90s). It is also impacted by the elimination of the "stretch out" opportunity for IRAs and qualified retirement assets under the terms of the Secure Acts (which used to drive decisions to more often name the surviving spouse as sole primary beneficiary).

This topic comes up in nearly all of our meetings with married couples these days. It has always been an issue of importance, and remains so despite the significant increase in the federal estate tax exemption over the last 30 years, and the advent of the portability election. The thrust of the discussion on this topic resolves around both how to title a married couple's assets, and whether to provide assets outright, or in trust, to a surviving spouse.

If the default "tenants by the entirety" joint titling for a married couple is used, or if the surviving spouse is named as the direct beneficiary of any accounts that pass by beneficiary designation, all of those assets of the first spouse to die pass to the surviving spouse and will be under the full dominion and control of the surviving spouse. However, if assets are titled in individual name of the first spouse to die, and if joint accounts are held as tenants in common (instead of tenants by the entirety), the first spouse to die can fund a trust structure for the benefit of the surviving spouse instead. In this fashion, the trust assets can still support the surviving spouse, but, they can also be better preserved for the next tier beneficiaries upon the death of the surviving spouse.

In the 1990s, when the federal estate tax exemption was only $600,000, and it was a "use it or lose it" opportunity to shelter an individual's assets from a tax of 55%, it seemed that all clients place a priority on ensuring that a spouse did not waste his or her exemption and thereby cost the family the extra tax of at least $330,000 (55% x $600,000). The taxes saved could be even greater when the surviving spouse lived a long time and the assets would double or triple, along with the potential tax savings for the family, when the surviving spouse would later die (of course this compounding of tax benefit continues to be the case with the higher exemption for families where this may end up mattering).

Now, with the federal estate tax exemption at $15 million, at first glance, titling of assets for optimal usage of the exemption is less of a focus for most clients—both because the surviving spouse will have a generous $30 million of exemption available due to the portability regime, and because many families have less than $15 million so they are not concerned with capturing the exemption of the first spouse to die.

We believe that in many cases it will prove to be shortsighted to rely on the high exemptions and portability to sufficiently protect family wealth from the confiscatory federal estate and generation skipping transfer taxes. First of all, the exemption may be reduced in the future, so planning to maximize the use of the exemption of the first spouse to die remains the most advisable approach, just in case the amount will be lowered. Secondly, without getting into all the details, there are reasons why the ported exemption may become nullified (or may never be properly secured to begin with), so it's best not to rely on it as a first planning option. Of course there is also always the possibility of winning the lottery, or having wealth unexpectedly enhanced for other reasons, which would make the optimal usage of the exemption on the first death desirable.

Further, even if portability ends up working to provide sufficient coverage from the federal estate tax, it's important to be mindful that the exemption from the federal generation skipping transfer tax is NOT portable. So, if a surviving spouse dies with more than his or her exemption, the failure to secure the exemption of the first spouse to die may end up costing a family millions of dollars in federal estate or generation skipping tax when wealth passes down to the grandchildren's generation.

Even for families who will never need to be concerned about the federal estate tax, whether because of their level of wealth, or because they simply don't care about the tax reducing the inheritance for their heirs upon death, it is still advisable to focus on how marital assets are titled for the following two primary reasons:

- Creditor/Predator Protection for the Surviving Spouse. Most of our clients want to be sure that all, or nearly all, of their assets will be available to meet the financial needs of a surviving spouse before being available to the next tier of beneficiaries. However, they also typically would like to make sure that the assets are protected from a surviving spouse's potential (or actual) creditors, as well as potential new romantic partners or other parties who may be (or become) involved in the surviving spouse's life outside of the intended next tier of beneficiaries. Many clients are concerned about losing the creditor protection feature of tenancy by the entirety ownership, but, they often lose sight that all of the assets will be exposed to the creditors of the surviving spouse and you can never truly know in advance which spouse that will be.
- Protection of Inheritance for Next Tier Beneficiaries. A major nontax reason for creating a trust for the surviving spouse is to ensure that any assets of the first spouse to die that are not needed by the surviving spouse will be directed to the second tier objects of the bounty of the first spouse to die. Many times, a surviving spouse can be relied on to protect the inheritance goals of the first spouse to die, but far too many times that will not end up being a safe bet. It is truly impossible to know in advance what the future will hold, so, the best approach is to use a trust structure to ensure that these second tier estate planning goals will be implemented as intended. This is a concern for ALL marriages—whether the spouses have different children (or other intended beneficiaries) or not.

With all of those objectives in mind, our general advice for long-term married couples with the same second-tier beneficiaries is to strive to balance out their joint assets as equally as possible (whether in individual or tenant in common accounts), so that a trust could be funded with as close to 50% of their assets as possible on the first death. For most newly married couples, or couples with different second-tier beneficiaries (i.e., typically those who had been in prior marriages, or who did not end up raising children together), our typical advice is to avoid moving

independent assets to joint accounts except for cash accounts that are routinely used for regularly recurring joint expenses. By taking the care and effort to title assets this way, the parties will retain the option to fund a trust on the first death if they choose to do that.

For married couples who choose to keep it “simple” and just use tenancy by entirety accounts (which automatically pass the account assets to the surviving spouse by operation of law), the trust protection option will generally be lost to the family after the first spouse’s death. The price of that simplicity may be undesirable estate litigation and/or major family disappointment and discord—as well as, in many cases, millions of dollars of extra estate taxes for a family. That financially and emotionally costly result can be avoided with a little foresight and extra care taken in planning for assets held by a married couple.

Rebecca Rosenberger Smolen *and* **Amy Neifeld Shkedy** *are members and co-founders of Bala Law Group. They focus their practices on tax and estate planning.*

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