

## Can I Benefit from an A-B Trust?

Married couples have several ways to potentially avoid any estate tax liability when they leave assets to each other.

Because of the unlimited marital deduction, no estate taxes are due when one spouse dies and leaves his or her assets to the survivor (as long as the surviving spouse is a U.S. citizen). However, this may merely postpone taxes that would be due until the death of the second spouse. Federal estate taxes would be owed on the portion of the estate that exceeds the applicable estate tax exemption (\$5.43 million in 2015).

One basic method to maximize the exemption for both spouses has been an A-B trust (also known as a bypass trust), which preserves the estate exemption of the first spouse to die and also enables the last-surviving spouse to utilize the exemption — essentially doubling the amount exempted from the estate tax.

However, with enactment of the American Taxpayer Relief Act of 2012, some couples may no longer need an A-B trust to maximize the estate tax exemption for both spouses. But before you make a decision about the use of a bypass trust, there are a number of issues to consider.

First, a little background on the changes in the estate tax as a result of the American Taxpayer Relief Act of 2012. The law permanently extended the higher applicable exemption amount (\$5 million, indexed for inflation after 2011) and raised the federal estate tax rate to 40 percent from 35 percent. The increased threshold alone eliminates many people from being subject to the federal estate tax. The act also made permanent "portability" of the exemption to the surviving spouse, which allows surviving spouses to use their spouse's unused exemption plus their own, enabling a couple to exempt up to \$10.86 million from federal estate taxes in 2015.

However, many states have their own estate or inheritance taxes, or both, and only one state (Hawaii) currently has any portability provisions. This means that when married couples leave all their assets to their spouses, the surviving spouse will be able to use only his or her state estate tax exemption. A trust may preserve a married couple's state estate tax exemption. Additional considerations favoring a trust are the ability to shelter appreciation of assets placed in the trust, to protect assets from creditors, and to benefit children from a previous marriage.

## How an A-B Trust Works

Using a living trust with an A-B provision (aka A-B or bypass trust), you ensure that both you and your spouse can take advantage of the exemption — once upon the death of the first spouse to die and then again upon the death of the second spouse.

When the first spouse dies, two separate trusts are created. The assets of the surviving spouse are transferred to the A trust, and an amount up to the estate tax exemption of the deceased spouse's assets is transferred to the B trust. This then creates two taxable trusts, each of which is entitled to use the exemption.

The B trust is subject to estate taxes. However, because of the applicable exemption, no taxes will be owed. The surviving spouse maintains control of the assets in the A trust and receives income from the B trust. Then, upon the death of the second spouse, only the A trust is subject to federal estate taxes because the B trust was taxed at the first death. After the death of the surviving spouse, the B trust can continue for the benefit of the grantors' family, often the children. The trust assets can be divided into separate equal trusts for the benefit of the grantors' children, who will receive net income; and then, at some specified age, they will receive the principal.

There are many considerations involved with A-B trusts, including upfront costs and administrative fees. As the use of trusts involves a complex web of tax rules and regulations, you should consider the counsel of an experienced estate planning professional and your legal and tax advisers before implementing such strategies. However, the A-B trust can be an effective way to help reduce estate taxes and preserve family assets.

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