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## Why the bypass trust in your will may be unnecessary

Attorneys caution clients to review their estate planning documents, especially Wills, periodically especially for changes such as births, deaths, re-locations, etc. You may have executed a Will and other documents, such as a financial Power of Attorney and Advanced Directives a number of years ago; however, you might think that since the family dynamics remained the same that nothing needs to be updated. Most people would not be aware of changes in the law that might affect their documents. The most significant concern is the change in the amount of the federal estate tax exemption. The exemption amount changed dramatically in 2013; this now affects those with a bypass trust in their Wills. (See [www.elderlawanswers.com](http://www.elderlawanswers.com) in the newsletter section for more information).

A bypass trust, or credit shelter trust, or A/B trust are all names for a popular estate planning tool for spouses with significant assets. The purpose was to provide a way to avoid or reduce *federal* estate tax for the heirs after the second spouse passed away. This type of trust was important to consider in 2001 when the federal estate tax exemption was \$675,000 or in 2003 when the exemption amount was \$1,000,000.00. Now, in 2016, the exemption is \$5.45 million for an individual and \$10.9 million for a couple, indexed for inflation. Fewer people need the ability to avoid federal estate tax for their heirs.

The way a bypass trust works is when the first spouse dies, the surviving spouse may have an estate that exceeds the federal estate exemption (not unheard of in 2001). The standard practice was to split the estate that was in excess of the prevailing state or federal exemption amount and each spouse would create a trust to “shelter” the exemption amount of the first spouse to die. Usually the trust income would be paid to the surviving spouse, as well as any principal that the trustee deemed to distribute to the surviving spouse at his or her discretion. Since the surviving spouse had no control over distributions from the trust, the trust funds were not included in the surviving spouse’s estate at his or her death, and therefore theoretically subject to tax.

When the federal estate tax exemption changed, many people no longer had an estate large enough to merit a bypass trust. Moreover, we now have available a mechanism called “portability” which may allow the same result as in a bypass trust without some of the downsides. In other words, if the first spouse dies and did not “use up” all of his or her exemption (\$5.45 million in 2016), the surviving spouse can “tack it” on to his or her exemption provided the surviving spouse makes an election on the deceased spouse’s federal income tax return.

Some disadvantages of unnecessary bypass trusts are that the surviving spouse is limited in his or her rights to use the money segregated in the trust. The trust requires filing of accountings and separate tax forms. If not all of the income is distributed to the beneficiary, today’s income tax rules may result in a higher tax rate than if the money were not in a trust.

Another issue is that assets in a trust do not receive a “step up in basis” that would occur if the assets were not in a trust. Therefore, there is a possibility that capital gains tax would be assessed which might not have been necessary if the heirs had inherited the assets outright.

A bypass trust still can be useful in certain situations. However, in other situations it is unnecessary and can cause problems. Contact your attorney to see if you still need a trust and if all of your documents are up to date.