

Your Estate Planning - When Simpler May Not Be Better

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Married clients with relatively uncomplicated financial matters are often delighted to learn that the creation of a trust under the Will of the first of them to die is no longer necessary in order to optimize the use of both spouses' Federal estate tax exemptions (currently \$5,430,000) in their estates. The alternative to creating such a trust (often referred to as a "unified credit trust" or a "bypass trust") is to bequeath the entire estate outright to the surviving spouse, and rely on the "portability" of the exemption between spouses to increase the estate tax exemption of the surviving spouse to, for instance, \$10,860,000 in 2015.

An "I Love You" Will is simple, easy, and low cost, right? What's not to like about that? For some clients, however, relying on "portability" may not be the best choice in the long run. Clients often ask us to explain the pros and cons of establishing a bypass trust upon the death of the first spouse to die versus relying on the simpler estate plan of leaving everything outright to the other and relying on "portability" to offset the substantial estate tax that often comes due upon the death of the survivor.

The Pros

- By setting aside the exemption amount in a bypass trust on the death of the first spouse to die, any appreciation in value of that trust is sheltered, completely, from estate tax upon the death of the surviving spouse. With portability, any growth in the assets bequeathed outright to the surviving spouse during his or her life will be subject to estate tax at death.
- Using portability leaves much to chance or changes in circumstance. For example, if the surviving spouse remarries and is then widowed again, the first deceased spouse's unused exemption amount will be lost forever, because the surviving spouse is only entitled to the unused exemption of his or her most recent spouse. Where the second predeceased spouse has children from a prior marriage, as will often be the case, he or she will generally want to use the estate tax exemption for his or her children. In that case, the second predeceased spouse's executor can be expected not to opt for portability, that is, will not allow the second spouse's exemption to be used by the surviving spouse, and the surviving spouse's estate will pay tax on an additional \$5,430,000 or more.
- Putting assets in a bypass trust places control of the assets with a trustee as well as with the surviving spouse (who may act as a co-trustee); it also protects those assets from the claims of creditors during the life of the surviving spouse, and ensures that those assets ultimately end up with the couple's children or family and not with a creditor, or the survivor's new spouse, or the new spouse's family.
- Portability has only recently been added to the Federal estate tax law and may not survive further changes to the law.

- Portability does not apply to the generation-skipping transfer (GST) tax. If clients wish to shelter the maximum amount from GST tax, a bypass trust in the estate of the first to die is essential.

The Cons

- New York and most other states where Kelley Drye & Warren practices do not have portability of their estate tax exemptions. Fully funding a bypass trust (currently \$5.43 million) will incur New York estate tax of \$444,800, although New York's exemption is scheduled to increase to match the Federal exemption by 2019. Clients in New Jersey, Connecticut, Maryland and many other states will also face substantial state estate taxes by establishing a fully funded bypass trust upon the death of the first spouse. There are ways to minimize the state taxes, including by limiting the bypass trust to the state exemption amount (currently \$3,125,000 in NY, \$675,000 in NJ, \$2,000,000 in CT and \$1,500,000 in MD.)
- The surviving spouse will not have full control of the assets in trust, which may or may not be regarded a good thing depending on each client's circumstances and perspective.
- Trusts have some administrative costs, such as the preparation of annual fiduciary income tax returns and Trustee commissions.