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# Can I Benefit from A-B Trusts?





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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 exclusion (\$12.06 million in 2022).

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

However, with enactment of the American Taxpayer Relief Act of 2012, some couples may no longer need an A-B trusts arrangement to maximize the estate tax exclusion for both spouses. But before you make a decision about the use of a marital and bypass trust arrangement, 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 exclusion 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 exclusion to the surviving spouse, which allows surviving spouses to use their spouse's unused exclusion plus their own. The Tax Cuts and Jobs Act, signed into law in December 2017, doubled the gift and estate tax basic exclusion amount to \$11.18 million in 2018. It is \$12.06 million in 2022. After 2025, the exclusion is scheduled to revert to its pre-2018 level and cut by about one-half. Portability can enable a couple to exclude up to \$24.12 million from federal estate taxes in 2022.

However, many states have their own estate or inheritance taxes, or both, and don't have a portability provision. 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 exclusion or exemption. A trust may preserve a married couple's state estate tax exclusion or 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 A-B Trusts Work

Using a living trust with an A-B provision (a combination of a marital trust and a bypass trust), you ensure that both you and your spouse can take advantage of the exclusion — 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. An amount of estate assets up to the applicable exclusion amount is placed in the B trust (or bypass trust). The balance is placed in the surviving spouse's A trust (or marital trust) which qualifies for the estate tax marital deduction. This then creates two taxable trusts, each of which is entitled to use the exclusion.

The B trust is included in the taxable estate when the first spouse dies. But because it doesn't exceed the estate tax exclusion amount, no estate taxes will actually be paid. 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 bypasses the second spouse's estate. If the assets in the A trust don't exceed the applicable exclusion amount, no estate taxes are owed. 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, A-B trusts can be an effective way to help reduce estate taxes and preserve family assets.



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