

Know Your Estate Planning ABCs

We all learned our ABCs as kids, and the nice thing about the alphabet is that it never changes. This is not the case for the ABCs of estate planning - where things can and do change often. What was once the correct estate planning technique for a client can suddenly become the wrong technique for that same client if estate tax laws change.

Just such an estate tax law change occurred in 2011 when federal law was changed so that the amount each person could pass estate tax free to their heirs jumped to \$5,000,000 and was indexed to inflation. This one change in the law immediately made certain AB trust planning the wrong estate planning strategy for some people where it had previously been the correct strategy for many years.

Do you know if you have a mandatory AB trust provision in your estate planning documents? If you do, you should review the reasons for having it, and make sure the reasoning still applies today in light of the recent estate tax law changes. See the AB trust diagram to the right for a refresher on how AB trusts work.

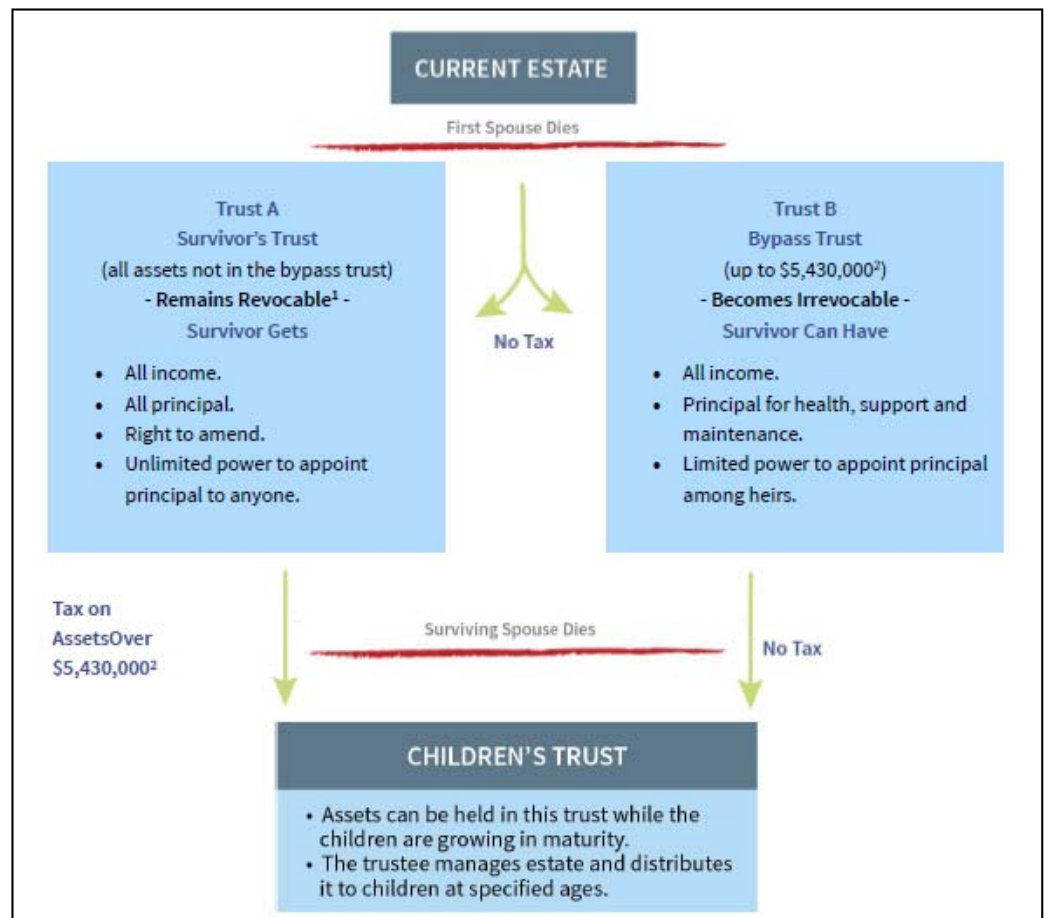
A lot of AB trust planning was done simply and solely as a technique to maximize the amount of money you could pass on to your heirs free of estate tax. When the estate tax exemption amount was only \$2,000,000 per person from 2006 through 2008, an AB trust arrangement was necessary just for spouses to pass \$4,000,000 to heirs free of estate tax.

The estate tax exemption is \$5,430,000 per person in 2015, and surviving spouses are allowed the unused portion of this amount (referred to as "portability"). So you now can pass as estate worth \$10,860,000 estate tax free without having an AB trust provision in your estate

Executive Summary

- Estate tax laws change often.
- Such estate tax law changes can turn a good estate planning strategy into a bad one for the same client.
- In 2011, federal law changed to allow each person to pass \$5,000,000 (indexed to inflation) to their heirs' estate tax free.
- This change in the estate tax law made AB trust planning unnecessary for many people.
- You need to review the pros and cons of AB trust planning to see if you still need or want to fund a B trust at the death of either you or your spouse.
- We can help you make this decision along with your estate planning attorney.

planning documents. Are there still reasons to use AB trusts even if the value of your estate is unlikely to ever exceed \$10,860,000? Yes, absolutely.



Reasons to Continue Using AB Trusts Even if Your Estate's Value is below \$10,860,000

- To avoid future estate tax: If you think your estate may some day be larger than \$10,860,000 plus the inflation rate, you should consider using a B trust. This is because growth in B trust assets is not subject to estate tax at the second death; however, it is subject to capital gain tax.
- Protection against creditors: B trust assets are protected from future creditors.
- Long-term care protection: B trust assets are not considered available resources for purposes of determining Medicaid eligibility. Although B trust assets could still be subject to a lawsuit to provide for the needs of the surviving spouse.
- To retain control over assets: B trusts protect the decedent's heirs in the event the surviving spouse gets remarried.
- To transfer assets to grandchildren: Couples who want to take advantage of passing on assets to their grandchildren still need AB trusts in order to use their generation-skipping exemptions.
- Planning for state estate tax: Currently there is no California estate tax, but there are many states that have some form of estate or inheritance tax. If you plan to move to a state that has estate or inheritance tax, a B trust could still be a relevant too.

As you can see, there are legitimate reasons for using B trusts besides reducing federal estate taxes. That stated, there are also many reasons why you may not want to be forced to split your estate into two trusts when the first spouse dies.

Reasons to Discontinue Using AB Trusts

- None of the benefits listed above appeal to you or pertain to you.
- More legal and accounting cost: AB trust estate planning is more expensive and there are ongoing tax preparation fees for B trusts.
- More administrative work: The Trustee is responsible for the annual accounting of the B trust and the issuance of K-1s to the beneficiaries.
- Higher Potential Capital Gains Taxes at the Second Death: B trust assets do not receive a second step-up in basis at the death of the surviving spouse.
- Higher taxes: Income from B trusts is taxed at the top tax rates (including the new 3.8% Medicare surtax) once the income exceeds \$11,950.

What Should You Do?

First, look to see if you have an AB trust provision in your estate planning documents (frequently the B trust is referred to as a "bypass" trust). Second, review how AB trusts work so that you thoroughly understand them. Third,

sit down and review the main reasons you decided to use the AB trust estate planning strategy in the first place.

Try to weigh the pros and cons of using AB trust planning to make the best choice for your personal circumstances. Along with your estate planning attorney, we can help you think through your situation and decide on the best course of action. Finally and most importantly, work with your estate planning attorney to make the necessary changes to your documents in light of this review.

B trusts are still a very valuable planning tool but they certainly are not for everybody — especially now that an estate of \$10,860,000 can be passed onto the next generation estate tax free.

Summary

Because of estate tax law changes, AB trust planning is often not necessary to avoid federal estate taxes. If your estate is over \$10,860,000 or you think it will be over this amount plus inflation in your lifetime, you will almost certainly want to make use of the more advanced estate planning strategies, such as AB (and C) trusts.

On the other hand, If you are certain that your estate will not exceed \$10,860,000 (plus inflation) in you and your spouse's lifetimes, you need to review the other reasons why B trusts still make sense to see if any of these reasons pertain to you. If they do, then add or continue to use the AB trust planning or similar strategy. If they don't, then consider eliminating the AB provisions in your documents, or at least have your estate planner give you the flexibility to fund or not fund a B trust at the death of the first spouse.

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