



Estate Tax Trusts – Don't Disinherit a Surviving Spouse!

Ryan E. Lamb

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The federal government imposes estate taxes on property held by an individual at death. Fortunately, an exclusion from estate taxes for the first \$5 million (plus adjustments for inflation since 2011) of an estate's assets is also provided. The amount of this exclusion has varied widely over the years. It was raised significantly and permanently with the enactment of the American Taxpayer Relief Act of 2012 ("ATRA") on January 2, 2013.

Historically, properly drafted and funded estate tax planning trusts for married persons could also double the effective tax exclusion. These trusts are commonly referred to as "marital deduction trusts," "credit shelter trusts," or "A-B trusts." These A-B trusts may still be useful in certain circumstances, but may no longer be necessary in others. This is due to the increased exclusion amounts and the new permanent "portability" features permitting a surviving spouse to claim the unused portion of a deceased spouse's exclusion amount if certain tax filings are properly and timely made.

However, many A-B trusts are drafted so that upon the death of the first spouse, the credit shelter trust is funded first, up to the maximum estate tax exclusion (currently adjusted to \$5.25 million), with only the remainder, if any, passing outright to the surviving spouse. This is especially common for tax planning trusts drafted prior to the estate tax act of 2001, which significantly increased the estate tax exclusion.

The problem with this formulation is it potentially disinherits the surviving spouse, which is probably not the grantor's intent. This is because the surviving spouse's access to the principal funds contained in a credit shelter trust is strictly limited. The principal funds of a credit shelter trust are held primarily for the benefit of the deceased's heirs or other identified beneficiaries (not including the surviving spouse), with certain limited benefits available to the surviving spouse during the surviving spouse's lifetime.

Consider a married couple with an estate of \$1.5 million, divided equally between two A-B trusts. Their existing trust documents will place assets equal to the maximum amount that could pass free from

AUTHORS/ CONTRIBUTORS

Ryan E. Lamb

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federal estate tax in a credit shelter trust for their children's benefit, with the balance of the trust assets passing to the surviving spouse tax free. Under the current exclusion, 100% of the deceased spouse's estate and trust assets would descend to the credit shelter trust, and the surviving spouse would receive nothing outright. This may produce a consequence unintended by the grantor, and may pose a significant financial problem for the surviving spouse.

Persons with existing A-B trusts should review their trust funding formulations, and may need to consider modifying their funding formula or replacing their existing trusts with a joint trust or a marital deduction disclaimer trust.

Please contact any Foster Swift estate planning attorneys to review the funding of A-B trusts if this issue may affect you.
