



THE ASHMORE LAW FIRM, P.C.

Expertise. Experience. Excellence.

How Complex Does Your Estate Plan Really Need to Be?

A look into Estate Tax Planning, Portability & Trusts.

*by: Lori Ashmore Peters
Attorney at Law*



How Complex Does Your Estate Plan Really Need to Be?

Recent updates in estate and gift tax law have changed the way we approach estate planning for many families. In the past, if a couple's net worth was expected to be higher than the estate tax exemption amount, it was fairly standard to use bypass trust planning to maximize tax savings, which is discussed in further detail below.

Today, we can accomplish similar estate tax savings with much simpler planning thanks to the availability of "portability" of the estate tax exemption (also discussed in more detail below). However, due to increasingly higher income tax rates and the new tax on investment income, we now must balance both estate tax and income tax planning goals with a family's other non-tax planning goals. As a result, the choice between using traditional bypass trust planning and relying on portability is not always black and white. The following is a discussion of current estate and gift tax law and the other non-tax issues to consider when designing an estate plan in today's tax environment.

Estate & Gift Taxes in 2015 – Overview

| | 2013 | 2014 | 2015 |
|---|-------------|-------------|--------------------|
| Estate/Gift Tax Exemption | \$5,250,000 | \$5,340,000 | \$5,430,000 |
| GST Tax Exemption | \$5,250,000 | \$5,340,000 | \$5,430,000 |
| Annual Gift Tax Exclusion per Donee | \$14,000 | \$14,000 | \$14,000 |
| Estate & Gift Tax Maximum Rate | 40% | 40% | 40% |
| GST Rate | 40% | 40% | 40% |
| Portability of Unused Exemption Amount | Yes | Yes | Yes |

Under current Federal law, each individual can give away during lifetime and at death as much as \$5,430,000 in cash or other property without generating any gift or estate taxes. This amount is referred to as the "Exemption Amount," and it is indexed for inflation. Each individual also has a Generation Skipping Transfer (GST) Tax Exemption of \$5,430,000 (in 2015) which covers transfers of assets to grandchildren and other younger beneficiaries (whether outright or in trust).

In addition, each individual can give away \$14,000 each year to any person, without reducing the Exemption Amount. This \$14,000/year exclusion from the gift tax is known as the "Annual Exclusion," and it is also indexed for inflation. For example, an individual with three children may make gifts each year of \$42,000 to the children (\$14,000 per child) without paying any gift tax or filing a gift tax

return. If the same individual instead gifted \$60,000 to the children (\$20,000 per child) no gift tax would be payable but a gift tax return would need to be filed since a gift above the Annual Exclusion amount was made. This individual's Exemption Amount would also be used to the extent of \$18,000 (the amount of the gifts in excess of the Annual Exclusion amount). To the extent that the Exemption Amount is used on gifts made during life, the Exemption Amount which is available at death will be reduced. The tax rate for gifts or estate transfers in excess of the Exemption Amount is 40%.

Any person may also give an unlimited amount of property to a spouse without generating gift or estate taxes (the "Marital Deduction") as well as an unlimited amount of property to a qualified charity without generating gift or estate taxes (the "Charitable Deduction").

Portability or Bypass Trust: Which One is Right for You?

Recent changes in the estate and gift tax landscape have made permanent several important tax code provisions, including the portability of a deceased spouse's Exemption Amount to the surviving spouse. As a result of these changes, married couples may now shelter as much as \$10.86 million of their combined wealth from federal estate tax with very simple planning. However, traditional tax-wise planning may remain useful in certain situations.

Portability

Portability allows a surviving spouse to take advantage of any unused Exemption Amount of his/her deceased spouse.

Bypass Trust

Bypass trusts were traditionally used to preserve a deceased spouse exemption amount. Even in light of portability, a bypass trust may still be useful.

Pre-Portability

Before portability, a married individual's estate tax exemption died with him or her. If a deceased spouse left all of his/her assets to the surviving spouse, all of the couple's assets would be included in the survivor's taxable estate at death, yet only the survivor's estate tax exemption would be available to protect against estate tax.

For example, If John died with a \$4 million estate and passed all of his assets to Jane, who also had assets of her own worth \$5 million, Jane's taxable estate at death would be \$9 million, but only \$5.43 million of her estate (her Exemption Amount) could be shielded from federal estate tax.

In order to take advantage of both spouse's estate tax exemptions, a married couple had to fund a "Bypass Trust" at the first spouse's death. The Bypass Trust was funded with the deceased spouse's assets up to his Exemption Amount; any excess would pass to the surviving spouse or to a marital trust for her sole benefit, deferring any applicable estate tax until the second spouse's death as seen in the chart on the next page.

During the spouse's lifetime, Bypass Trust assets are held for the benefit of the surviving spouse (and the children, if desired). Upon the surviving spouse's death, assets in the trust (including any appreciation) "bypass" taxation in the survivor's estate and pass tax-free to the next generation. The end result is that the Bypass Trust provides support for the surviving spouse during his or her lifetime and allows a married couple to take advantage of both estate tax exemptions to minimize tax and maximize wealth passing to their heirs.

| BYPASS TRUST | MARITAL TRUST |
|---|--|
| Funded with deceased spouse's assets up to his/her available federal estate tax Exemption Amount. | Funded with deceased spouse's remaining assets. (In the alternative, assets may pass outright to the surviving spouse). |
| Surviving spouse (and children, if desired) may receive distributions of income and principal. | Surviving spouse is the only permissible trust beneficiary. Surviving spouse receives all trust income and may receive principal distributions. |
| Surviving spouse may serve as Trustee as long as distributions are limited to those needed for his/her health, education, maintenance and support. | Surviving spouse may serve as Trustee as long as distributions are limited to those needed for his/her health, education, maintenance and support. |
| Trust provides a measure of asset protection and guards against loss of assets due to remarriage. | Trust provides a measure of asset protection and guards against loss of assets due to remarriage. |
| Upon surviving spouse's death, assets (including growth) are not included in surviving spouse's taxable estate and therefore assets do not receive a step-up in basis* at the surviving spouse's death. | Upon surviving spouse's death, assets are included in the surviving spouse's taxable estate and therefore receive a step-up in basis*. |
| Deceased spouse dictates how assets are distributed at surviving spouse's death. Surviving spouse can be given a power to appoint assets among a limited group (e.g. the children and/or charities). | Deceased spouse dictates how assets are distributed at surviving spouse's death. Surviving spouse can be given a power to appoint assets among a limited group (e.g. the children and/or charities). |

*The basis in an asset is generally what was paid for it. A capital gain or loss is the difference between the asset's basis and the amount for which it is later sold. At an individual's death, assets which are included in his or her taxable estate receive a "step up" in basis, meaning the asset receives a new basis equal to its fair market value (as of the date of death). Therefore, upon the sale of an asset, heirs will only be responsible for paying income tax on gains which occur from the date they inherit the asset – a potentially significant tax savings.

For example, assume a decedent's basis in stock prior to death was \$5 per share. Upon death, the stock received a step-up in basis to its current fair market value, \$20 per share. If heirs subsequently sold the stock for \$22 a share, the capital gain recognized would be only \$2 per share. If the decedent had sold the stock during life for \$22 per share, his/her gain would have been \$17 per share.

Post-Portability

Because a deceased spouse's unused estate tax exemption amount is now "portable" to the surviving spouse, a married couple may now utilize both spouses' estate tax exemptions by simply (a) leaving all assets to the surviving spouse (outright or in trust) at the first spouse's death and (b) having the executor file a timely estate tax return to elect portability.

Does this mean the Bypass Trust is obsolete? Not necessarily. Relying on portability has its limitations and Bypass Trust planning has benefits aside from preserving estate tax exemptions.

One size does not fit all and the following considerations should be taken into account when determining the best course of action for your family's estate plan.

“ One size does not fit all when it comes to estate planning. ”

- Lori Ashmore Peters

Factors Favoring Bypass Trust Planning

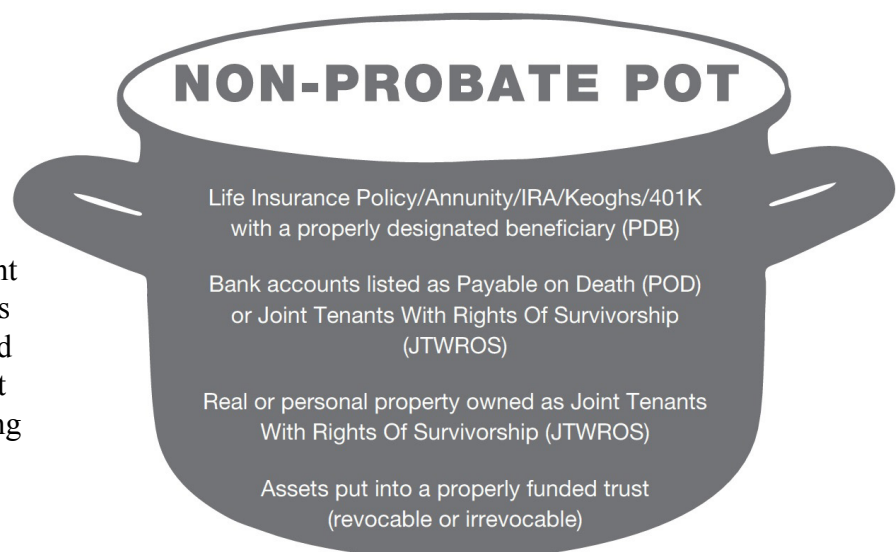
- **A deceased spouse's unused Exemption Amount is not indexed for inflation.** While the unused exemption does not increase, the assets which it is intended to protect from estate taxes will likely to continue to grow. However, appreciation of assets inside of a Bypass Trust remains sheltered from federal estate tax. This can result in significant tax savings where there is large gap of time between the two spouse's deaths.
- **A deceased spouse's unused exemption amount can be lost.** Through the use of Bypass Trust, a deceased spouse's exemption benefits his or her intended heirs and is not lost through remarriage. With portability, the surviving spouse controls who benefits from the unused exemption amount (as well as the assets if they are not placed into a marital trust). In addition, a surviving spouse may only use the unused exemption amount of her last surviving spouse. Therefore, when a surviving spouse remarries and does not survive the second spouse, the first spouse's unused exemption amount is forfeited.
- **Generation Skipping Transfer (GST) Tax Exemption is not portable.** A deceased spouse's exemption from the GST Tax (which applies to transfers to grandchildren and more remote descendants) is not portable. However, GST Exemption can be applied to a Bypass Trust, exempting all trust assets from the Estate and GST Tax for multiple generations.
- **A Bypass Trust offers asset protection, asset management and can dictate ultimate transfer of assets.** As with many types of trusts, the Bypass Trust offers its beneficiaries the benefit of creditor protection and asset management. Assets in the trust will also be protected from potential divorcing spouses of trust beneficiaries. The provisions of the trust can also dictate to whom the remaining assets pass to upon the surviving spouse's death. Unless a marital trust is used in conjunction with portability, the deceased spouse's assets are exposed to creditor claims and are subject to the full control of the surviving spouse. This may not be desirable, particularly where a surviving spouse remarries or where the deceased spouse had children from a prior marriage.

Factors Favoring Portability

- **Portability is simple.** Relying on portability is simple; all that is required is a timely filing of the estate tax return to elect portability upon the first spouse's death.
- **Portability is cost effective.** Reliance on portability eliminates the costs associated with setting up and administering a trust.
- **All assets are included in the surviving spouse's taxable estate and therefore are eligible for a full step-up in basis at the survivor's death.** Upon the death of the first spouse, all assets in his or her taxable estate receive a full step-up in basis. When portability is used, assets receive an additional step-up in basis at the surviving spouse's death. However, assets held in a Bypass Trust generally do not receive an additional step-up in basis at the survivor's death. This can be a significant factor to weigh considering the current high income tax rate environment.
- **Trusts are subject to compressed income tax brackets.** Trust-generated income is subject to the highest marginal income tax rate once the income of the trust reaches the low threshold of \$12,301. Where the assets are held individually by the heirs, related income could be taxed at a far lower tax bracket.
- **Portability may make sense when the bulk of an individual's estate is comprised of non-probate assets or assets that are difficult to administer in trust.** Non-probate assets are those assets which pass by beneficiary designation (life insurance proceeds or an IRA) or which are held jointly with rights of survivorship (i.e. a home). These assets pass by contractual terms or operation of law and are not governed by the terms of a Last Will and Testament. Therefore they will not be available to fund a Bypass Trust. IRAs and qualified plans can be made payable to the trust but special provisions must be included to ensure optimal income tax deferral.

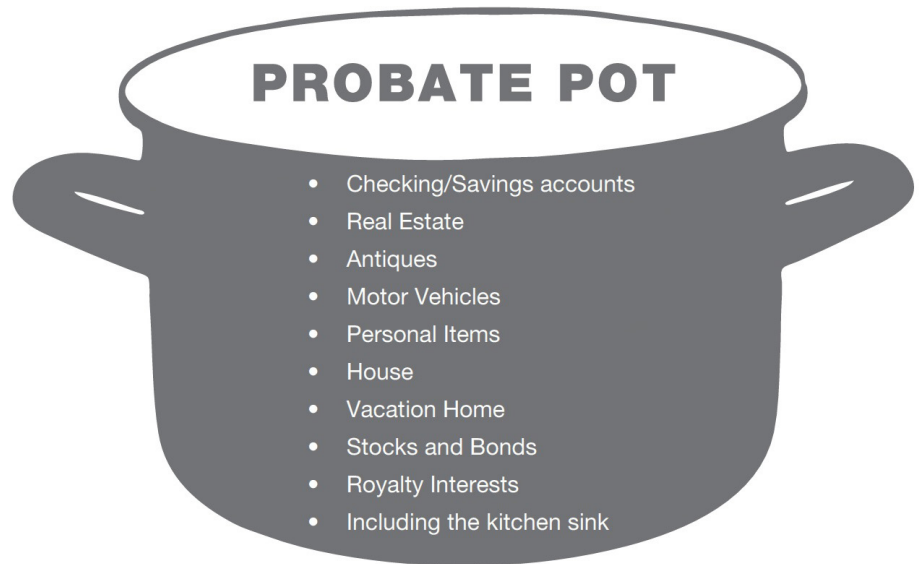
Non Probate Assets versus Probate Assets

“**Non-Probate assets**” pass upon death to the named survivor or beneficiary “outside of probate.” These assets are those that do not pass under the terms of a Will. They are assets that pass to a beneficiary named on the document that was signed when the asset was created. Think of your probate and non-probate assets as two different pots. This list only gives a sampling of these types of assets; it is by no means all inclusive.



Non Probate Assets versus Probate Assets

“Probate assets” would include all interest and assets, real or personal, tangible or intangible, that are owned outright by a person at the time of his or her death. “Probate assets” are those assets that have no beneficiary designation and will pass under the terms of the Will. This list only gives a sampling of these types of assets; it is by no means all inclusive.



Income Tax

The highest marginal tax rate in 2015 is 39.6%, up from 35% in 2012. For 2015, the highest tax rate applies to income in excess of \$464,850 for married couples filing jointly (\$413,200 for single filers). In contrast, for trusts and estates, the highest marginal tax rate applies to income in excess of \$12,301. Capital gains and qualified dividends are also now taxed at a maximum rate of 20%. In addition, beginning in 2013, a tax of 3.8% applies to net investment income, resulting in a potential combined income tax rate of 43.4% for taxpayers in the highest marginal tax bracket.

In conjunction with the information presented above, the decision as to whether to rely on portability or a Bypass Trust will depend on many factors including the value of the taxable estate, the nature of assets owned, anticipated asset growth, family structure, age of each spouse and whether GST planning is desired. An experienced estate planning attorney can help you decide the best fit for your family.

For more information, please contact Ashmore Law Firm at 214-559-7202 or visit www.ashmorelaw.com.



THE ASHMORE LAW FIRM, P.C.

Expertise. Experience. Excellence.

Probate | Guardianship | Family Law | Estate Planning | Personal Injury | Civil Litigation

Lori Ashmore Peters

Attorney at Law

T 214.559.7202

F 214.520.1550

www.AshmoreLaw.com

