



The Daily

Saturday Perspectives 

Do I Still Need Bypass Trust?

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Saturday, March 22, 2014

The American Taxpayer Relief Act of 2012 extended and made permanent a number of important tax code provisions that impact estate planning. The two biggest tax provisions made permanent were the federal estate tax exemption (with inflation indexing) and portability of a deceased spouse's unused exclusion amount. As a result of these changes, married couples can shelter up to \$10.6 million of net worth from the federal estate tax system. The exemptions not only reduce the number of individuals subject to the estate tax in the future, but portability will render most uses for the bypass trusts irrelevant.

Prior to ATRA, the federal estate tax exemption ("Federal Exemption") amount had risen from \$600,000 in 1997 to \$5 million in 2011, with many bumps in the road. Tax experts predicted that the Federal Exemption would be lowered, an easy way to raise federal tax revenue by taxing the wealthy. To combat the uncertainty with the Federal Exemption, wealthy couples utilized bypass trusts to set aside the deceased spouse's federal exemption amount to ensure it was fully utilized. This provided the surviving spouse with only an entitlement to an income stream and discretionary principal for their lifetimes from the trusts. But the Federal Exemption was preserved in case Congress decided to subsequently lower the amount.

After ATRA, the use of a Bypass Trust became an adverse tax strategy for many couples as a result of compressed trust income tax brackets and the loss of any step-up in basis at death. Today they are predominantly utilized to: (i) shelter future growth from taxation for very high net worth couples; (ii) preserve the Generation Skipping Tax Exemption, (iii) protect assets in the case of divorce or remarriage and (iv) spendthrift protection of the surviving spouse.

If your estate planning documents contain an involuntary Bypass Trust provision and your net worth is less than \$10 million, you may want to revisit your estate plan with your attorney. Many estate planning practitioners today use a modified disclaimer, at the surviving spouse's election, to achieve the same benefit.

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