

Do You Still Need An “A-B” Trust?

By Rocky Mills, North Ranch Resident



LIKELY NOT.

First, what is an “A-B” Trust? Up until a few years ago, it was a very popular way to take advantage of both spouses’ estate tax exemption and pass along a larger share of assets to their beneficiaries.

Let’s take the case of John and Mary Smith. They’re married, have a net worth of \$20 million, and a decade or so ago they set up a living trust that, upon the first death, turns into a pair of sub-trusts (“A” & “B”). Let’s say that John dies first, at a time when both John and Mary were entitled to a \$1 million estate tax exemption. At that time, their \$20 million in assets will be divided between the two sub-trusts:

\$1 million will go into an irrevocable “Bypass” trust – or shortened to simply “B” – to fully take advantage of John’s \$1 million exemption. Accordingly, this “B” trust of John’s pays no estate taxes. Mary can access the income from this “B” trust. At Mary’s death, the assets remaining in this “B” trust will pass to John & Mary’s beneficiaries, estate tax free.

The other \$19 million goes into a “Marital” trust, otherwise known as an “A” trust. This “A” trust is revocable – Mary can do with it as she pleases. And, at Mary’s death, her \$1 million exemption will be applied to the assets to lower the estate tax. By utilizing the A-B structure, John & Mary’s beneficiaries get the benefit of both \$1 million exemptions. Without the A-B, they would have been able to utilize only one exemption.

But in 2011, the laws changed, including these two major improvements:

The exemption, for each spouse, rose to \$5 million and increases each year for inflation. For 2016, it is now \$5.45 million.

Portability: any unused exemption from the first spouse can be used by the surviving spouse.

The combination of these two improvements means, in our example, that without using an A-B structure, at Mary’s death the assets may get the full \$10.9 million exemption. That’s very different than the \$2 million under the old law and with the A-B structure. Portability has some limitations, such as its use with multiple spouses and generation skipping – your attorney can guide you on this.

What’s the downside to keeping the A-B structure? Upon the first spouse’s death, the instructions of an A-B trust cannot be ignored. Mary will have to establish two new trusts. That means extra accounting and legal expenses, both at the onset and ongoing.

It also means more accounts being established at banks and brokerage firms, more rules to follow, and less access to funds. It may also mean more in capital gains taxes, as the assets in the irrevocable “B” trust do not get another step-up in basis at Mary’s death.

Could there still be reasons to keep the A-B structure intact? Possibly. The irrevocability of the “B” trust limits how much the surviving spouse can spend. And it does not allow the spouse to change who gets the remaining assets.

Bottom line: If you have an A-B trust, make it a point to visit with your estate planning attorney. It may be time for some streamlining.

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