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Clients and Friends:

As mentioned in our newsletter last January, 2013, there were two (2) major changes in the federal estate tax system:

1. The exemption from the Federal Estate Tax ("FET Exemption") became fixed at $5M per person, indexed for inflation. That number for 2013 was $5,250,000 per person, and is $5,340,000 per person for 2014.

2. The concept of "portability" has been added to the estate tax structure, allowing the surviving spouse to add any unused amount of the FET exemption of the first spouse to die (often referred to as the "Deceased Spouse's Unused Exemption" or "DSUE") to the survivor's FET exemption, thereby ensuring that the full $10,680,000 (2014) is then available to the "marital unit."

These two changes have revised the long-standing approach of the so-called "A-B" or by-pass trust planning for married couples that many clients still have in place. There is no longer the need to "split" the estate and use a B Trust, or by-pass trust, to save estate tax in the survivor's estate. Most of you have a variation of the A-B Trust arrangement, such as an A-B Disclaimer Trust, or an A-B-C Trust, or the standard A-B Trust.

It is now becoming apparent that the traditional A-B Trust arrangement may no longer achieve the best income and estate tax results. There is no step-up in income tax basis of the assets in the B Trust upon the death of the last to die, since the B Trust is not considered owned by the survivor and is not included in his or her taxable estate. Therefore, if the assets in the B Trust have appreciated since the death of the first spouse, there will be an income tax disadvantage when those assets are ultimately sold, either by the surviving spouse or the remainder beneficiaries later on. In total estates exceeding the $10,680,000 total (this year), this future capital gains tax would be somewhat offset by there being less estate tax due since the appreciation in the B Trust would not be included in the survivor's taxable estate. However, for most couples, with a combined estate of less than the $10,000,000 total, there is no estate tax to offset that capital gains tax. Those couples would be much better off if all was included in the survivor's taxable estate (no B Trust), since the entire estate would be "stepped-up" for capital gains purposes.

This has resulted in estate planning authorities suggesting the following approaches:

1. For couples who have considerably less than the $10M combined estate, the use of a QTIP Trust (which I often refer to as a "C Trust") will offer the benefits of the B Trust (such as control and creditor protection), but with the added benefit of having the assets in the C Trust stepped-up at the death of the last to die. This could be set up as a straight A-C Trust, or as a disclaimer A-C Trust, depending upon the control the first spouse desires over his or her share.

2. For couples who have larger estates – approaching the $10M number now or already exceeding it, authorities are suggesting a plan that allows the survivor to transfer the unused FET exemption of the first spouse to an irrevocable grantor trust created by the survivor for the descendants, which can provide even more tax advantages.

As indicated last year, we encourage each of you to have your Trust and estate plan reviewed, if you haven't done so already. The terms of the Trust that you have in place now may not provide the best way to plan your estates. If you have any questions, or want to discuss your planning further, please give us a call to set up a time to meet.

Very truly yours,

Dave