

To Married Couples and Surviving Spouses: Review your estate plan if it has been more than 3 years since your last update

If your estate plan was put in place more than 3 years ago, the plan is likely designed to save estate taxes at the sacrifice of income tax benefits. Estate tax is no longer a concern for married couples owning less than \$11 million of assets. We recommend reviewing your estate plan to confirm that it has the flexibility to adapt to tax law changes and to secure income tax benefits.

Traditional “Credit Shelter” Trust Planning

Traditional estate planning for a married couple calls for the creation of an irrevocable trust on the first spouse's death to hold assets equal to the first spouse's remaining "Estate Tax Exclusion Amount." The Estate Tax Exclusion Amount is the maximum amount of the deceased spouse's assets that an individual can pass to non-spouse beneficiaries without triggering an estate tax. This irrevocable trust may be referred to in your revocable living trust (or Will) as a “Credit Shelter Trust,” “Bypass Trust,” “Family Trust,” or sometimes a “B Trust.” This irrevocable trust avoids estate tax at the surviving spouse's death, regardless of how much the trust assets appreciated in value since the first spouse's death.

However, a downside of the “Credit Shelter Trust” is the assets in that trust will not receive a basis “step-up” to fair market value for income tax purposes on the surviving spouse's death. A sale of assets in the Credit Shelter Trust after the surviving spouse's death may trigger capital gain tax. Alternatively, if a Credit Shelter Trust had not been created and the assets were owned by the surviving spouse outright (or in a “QTIP” marital trust for the sole benefit of the surviving spouse), the assets *would* receive a basis step-up and a sale of the assets shortly after the surviving spouse's death would avoid capital gain tax.

Tax Law Changes

Avoiding estate tax was the focal point of the traditional estate plan; and therefore, most estate plans required the establishment of a “Credit Shelter Trust” upon the first spouse's death. **Due to the following tax law changes, income tax planning may now be more important than estate tax planning and funding a Credit Shelter Trust may not be optimal:**

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- *Most estates are no longer subject to estate tax.* An individual dying in 2017 may have up to \$5.49 million of assets at death without being subject to estate tax. The \$5.49 million “exemption amount” increases with inflation each year, and is set to increase to \$5.6 million in 2018. Married couples may have around \$11 million of assets without being subject to estate taxes.
- *Lower estate tax rate.* Historically, the estate tax rate substantially exceeded the capital gain rate (55% vs. 15%-20%). The estate tax rate is now 40%, and the combined federal and California capital gain tax rates total about 30% (20% + 10%).
- *Introduction of “Portability” in 2013.* Traditionally, a married couple had to utilize the first spouse's Estate Tax Exclusion Amount by creating a Shelter Trust, or the shelter provided by the Estate Tax Exclusion Amount would be lost. This “use it or lose it” rule no longer applies since “portability” became permanent in 2013. Under portability, if the deceased spouse does not utilize his or her entire Estate Tax Exclusion Amount, the unused portion may be transferred (“ported”) to the surviving spouse. If the first spouse to die leaves everything outright or in a QTIP marital trust to the surviving spouse, the surviving spouse may shelter up to \$11 million of assets from estate tax. In addition, the value of all of the couple's assets will be “stepped up” to fair market value such that the beneficiaries inheriting the assets can sell the assets without incurring capital gain tax.

Who Should Consider an Estate Plan Review?

If you answer “yes” to either of the following questions, you should consider reviewing your estate planning documents with an estate planning attorney:

- **It has been more than 3 years since your revocable living trust was established (or was last updated).**
- **You are the surviving spouse and a beneficiary of a Credit Shelter Trust established by your spouse.**

Please contact us to help you determine whether your estate plan requires the automatic funding of a “Credit Shelter” type trust at the death of the first spouse, and to evaluate whether the planning is still necessary or advisable for you. Or, if you are the current beneficiary of a Credit Shelter Trust, we can help you determine if there may be a way for those who will receive trust assets after your death to avoid capital gain tax.

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