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Marital/Family (AB) Trusts & Why You Probably Don't Need Them Anymore

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Prior to the major Estate and Gift changes which are now in effect, married couples were regularly advised that the best way to protect their assets from being taxed at their death was to create Marital and Family Trusts (often known as AB Trusts) in their estate plans – whether will-based plans or trust-based plans.

Typically, these plans were set up so that at the death of the first spouse, the assets would be distributed into two separate trusts: The Marital Trust (A Trust) and the Family Trust (B Trust). The Marital Trust would be for the benefit of the surviving spouse and the Family Trust would provide income (and possibly principal distributions for the surviving spouse) but the remainder would be for the benefit of the remaining beneficiaries named by the deceased spouse (normally children). The language would generally require that the Marital Trust only consist of the minimum amount necessary to avoid estate taxes upon the death of the first spouse. The rest of the assets would go to the Family Trust. Herein lies the dilemma. If the first spouse dies and does not have enough assets to trigger any estate tax, everything will go to the Family Trust and there is literally nothing to put into the Marital Trust. This can create hardships on the surviving spouse: however, in the past, this technique saved significant estate taxes from being paid – thus preserving the assets for the benefit of the family.

Here are the main issues with all assets being in the Family Trust:

- It is irrevocable upon the death of the first spouse, meaning it cannot be amended or changed.
- Surviving spouse can generally only utilize the income from the property in the trust. Principal can be used but only to an ascertainable HEMS standard (health, education, maintenance, and support). This is quite different than simply giving the surviving spouse the property outright.
- Surviving spouse must obtain a separate tax id number for the trust and file annual Federal and State Fiduciary tax returns for the trust for the remainder of the surviving spouse's life.
- Surviving spouse is burdened with keeping records and accounting for the property within the trust for the remainder of the surviving spouse's life. He/she must also provide these records and accountings to any beneficiaries upon request.

For some couples, this may be a feasible option. However, it has been our experience that most clients that have been put in the situation are dismayed to learn of this when no estate taxes are being saved. It was generally the couple's understanding that these restrictions and requirements on the surviving spouse would save significant estate taxes for the family. All of this has changed, however, for most people. Currently, the federal estate tax exemption is $11.8 million per person and the Illinois estate tax exemption is currently $4 million (with an unlimited marital deduction). That means that if a couple's assets do not exceed $4 million, there will be no death taxes – Federal or State. In this scenario, it is worth asking if saddling the surviving spouse with the restrictions of a Family Trust are worth it and for most people, it is not. In addition to estate tax irrelevance in these situations, by giving all the assets to the surviving spouse, when the survivor does pass

away, the family will receive a step-up in basis to the valuation on the date of death of the second spouse which can save significant capital gains tax.

Aside from the increased estate tax exemption, couples can also use what is called portability, at the federal level. A provision in a trust allowing for portability could achieve the same tax savings as was originally intended under the Marital/Family (AB) Trusts scenario. Portability allows the surviving spouse to "use" the unused balance of the deceased spouse's tax exemption upon his/her passing.

Let's look at an example:

Example: Spouse A dies with $2.2 million in estate assets passing to beneficiaries. This leaves $9.6 million available at the federal level that can be added to Spouse B's original exemption amount. Thus, at Spouse B's death, he/she can pass assets from his/her estate without facing federal estate tax consequences if they are less than $21.4 million. Unfortunately for most of us, we don't need to worry about having millions of dollars at the end of our life, so the portability provision can be very useful.

If you and your spouse are still both living, we highly recommend speaking with an attorney about revising your estate plan to determine if the Marital/Family (AB) Trusts are still in your best interests.