The AB Trust

With the ever-changing landscape of taxes, it is growing increasingly difficult to understand how legislation affects clients and could possibly impact their financial future. As a leader in the financial services industry for over 30 years, we get it. That's why HD Vest Financial Services® is constantly seeking ways to share the latest knowledge we acquire with you. We've created the Taxes & Investments: Timely and Timeless Strategies series to share timely information and provide our Advisors and their clients with practical information and ideas they can build on.

The AB Trust is a critical part of many high net-worth estate plans. This strategy is designed to allow a spouse access to the family assets while reducing the possible estate tax due upon the deaths of both spouses[1]. The AB Trust is broken down into two individual trusts:

- The A Trust, commonly referred to as a Marital Trust, QTIP Trust or Marital Deduction Trust
- The B Trust, commonly referred to as a Bypass Trust, Credit Shelter Trust or Family Trust

What is an AB Trust?

An AB Trust is designed to eliminate estate taxes at the death of the first spouse and reduce the estate tax due upon the death of the second spouse by maximizing the applicable exclusion amount and the unlimited marital deduction[1]. Taxpayers first include the appropriate AB Trust language in their Last Will and Testaments or Revocable Living Trusts. Once the AB Trust language is established, the spouses then take steps to ensure that their assets are divided in order to equalize the estates of each taxpayer.

When the first spouse dies, the B Trust is funded up to the applicable exclusion amount, which for 2015 is $5,430,000. There are no estate taxes due on the amount in the B Trust as long as the gift does not surpass the exclusion amount at the first spouse's death. In addition, no taxes will be due at the surviving spouse's death, because the B Trust is written so that the surviving spouse has no rights to the assets of the trust that would cause it to be included in their estate[1].

After the B Trust has been fully funded, the remaining assets of the deceased taxpayer are transferred to the A Trust for the benefit of the spouse using the unlimited marital deduction. Assets in the A trust will be subject to estate tax upon the death of the surviving spouse because of the broad powers given to the spouse in the trust document. When the surviving spouse later dies, the estate tax exemption will remain at $5,430,000 in 2015.

New Portability Laws[2]

In 2011, the federal estate tax exemption was made transferable between married couples. This means that the surviving spouse can use any part of the total exemption for both spouses—$10.68 million for deaths in 2015—that isn't used by the first deceased spouse. This effectively reduces the need for the AB Trust unless:

- There are children from a first marriage that the parent wishes to inherit assets. Many people in second marriages desire that children from a prior marriage inherit certain assets. The B Trust is a vehicle to ensure that those assets transfer to the children as intended while still providing the flexibility of the parent to allow a second spouse to use the assets for as long as they live.
- An individual is not currently married to their partner. Portability rules only apply to legally married individuals. If an individual and his or her partner are not married, he or she will not be able to use his or her partner's unused personal exemption.
- A taxpayer owes state estate tax. If a taxpayer lives in a state that imposes their own estate taxes then they may consider an AB Trust. State estate taxes are in addition to the federal estate tax, and exemptions in those states are typically lower than the federal exemption. There are also no portability options. It is possible to owe state estate tax even if you do not owe federal estate tax.
- An individual has assets that are likely to appreciate. Appreciation of property after the transfer to the B Trust should not be subject to estate tax at the surviving spouse's death.

An AB Trust can play an integral part in an individual's estate and legacy plan. Not only can it reduce or possibly eliminate estate tax due upon the death of each spouse, it can also create a way to provide for a surviving spouse while still leaving the assets to a different designated beneficiary. Due to the intricacy of AB Trust planning, it is important to work with a trusted HD Vest Advisor. An HD Vest Advisor can help navigate the complexities of this strategy and can make sure the right professionals are in place to accurately craft the AB Trust.

Sources:
[1]Leimberg, Stephan R. "Marital Deduction and Bypass Trusts." Tools & Techniques of Estate Planning. Erlanger, KY: National Underwriter, 2011. Print.
[2]IRS.gov- What's New - Estate and Gift Tax: http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Whats-New-Estate-and-Gift-Tax

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