

Bypass Trust

Under federal law, each individual has an “applicable exclusion amount,” a specified dollar amount of assets protected from federal estate tax. Between spouses, however, a person can pass any size estate to his or her US citizen spouse without concern for a federal estate tax because of the “unlimited marital deduction.”¹ For many married couples, an “I love you” will simply leaves everything to the surviving spouse.

Before 2011, however, when the surviving spouse later died, and the combined estate passed to the ultimate heirs, there was only the survivor’s single applicable exclusion amount to shield the estate from federal estate tax. Using the unlimited marital deduction at the first death, in effect, wasted the applicable exclusion amount of the first-to-die.

To preserve the applicable exclusion amount of the first-to-die, many married couples used a “bypass” trust (also called an “exemption” or “credit shelter” trust). At the first death, the bypass trust would be funded with assets up to the applicable exclusion amount in effect for that year. A bypass trust is not subject to federal estate tax at either the first or second death, even though the assets in the trust may appreciate greatly in value.

A bypass trust is also useful in that it can be written to give the surviving spouse access to the income from the trust for life, as well as access to the trust principal, in extreme situations, for his or her health, education, support, and maintenance.

2010 and 2012 Tax Legislation

The 2010 Tax Relief Act brought a number of significant changes to federal estate tax law. One provision increased the applicable exclusion amount to \$5,000,000 in 2011 and to \$5,120,000 in 2012. Another section provided that any applicable exclusion amount remaining unused at the death of the first-to-die of a married couple could be carried over and used by the survivor, in addition to the surviving spouse’s own applicable exclusion amount.

The American Taxpayer Relief Act of 2012 made permanent a number of the provisions in the 2010 Tax Relief Act, including the increased applicable exclusion amount and the carryover of any unused spousal applicable exclusion amount.

¹ If the surviving spouse is not a US citizen, special rules apply.

Tax Cuts and Jobs Act of 2017

The Tax Cuts and Jobs Act of 2017, for 2018-2025, increased the base applicable exclusion amount from the \$5,000,000 level set in the 2010 act, to \$10,000,000.² Adjusted for inflation, the applicable exclusion amount for 2020 is \$11,580,000. Thus, for married couples, for 2020, the combined effect of all these changes is to effectively protect from federal estate tax up to \$23,160,000 in assets, with or without a bypass trust.

Is the Bypass Trust Dead?

With such a large dollar amount protected from federal estate tax, many estate owners will find that a bypass trust is no longer necessary, at least from a *federal* estate tax perspective. When planning for the *state* death taxes, however, which often have much lower taxability thresholds, the bypass trust may continue to be a valuable estate planning tool. Note that there may also be *non-tax* reasons for including a bypass trust in an estate plan.

Those with estates large enough to be subject to federal estate tax will likely benefit from continuing to use bypass trusts as a part of their estate plan.

² Under current law, in 2026, the \$5,000,000 base applicable exclusion amount will again apply, adjusted for inflation.

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