TO FUND…..OR NOT TO FUND:
WHAT TO DO WITH THE BYPASS TRUST

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I. INTRODUCTION

Since 1996, the federal estate tax exemption amount has grown by over **2,000%.** It has expanded far faster than the rate of inflation (cumulative growth of 93.35%; *Bureau of Labor Statistics*) and, even including periods of substantial market growth, increased more than the Dow Jones Industrial Average (cumulative growth of 1,009%; *Officialdata.org)*.

For many clients, planning that they would have undertaken in 1996, with an exemption amount of $600,000, or in 2004 (with an exemption amount of $1,000,000) or even in 2012 (with an exemption amount of $5,120,000) might be significantly different than planning they may undertake in 2023 with an exemption amount of $12,920,000 (and which is scheduled to continue to slightly increase along with the rate of inflation for another two years, and then, absent Congressional action, would fall back to its previous $5,000,000 threshold, indexed for inflation).

A table with the estate and gift tax exemption amounts since 1996 is attached an Exhibit A.

While clients can proactively take advantage of this increased exemption amount (and planning flexibility) through updated wills or trusts, there are countless clients who make no updates—and then one of the spouses passes away. After the surviving spouse visits with the attorney to commence probate, and after the attorney reviews and explains the structure that is called for in the decedent's will or trust, many times the surviving spouse will undoubtedly ask whether or not they have to fund the Bypass Trust created under the deceased spouse's will. The surviving spouse may complain about the complexity involved, especially after reading an article in the NY Times, AARP Magazine or even the attorney's client newsletter, which highlights the goal of using only beneficiary designations to avoid probate; emphasizes the increased exemption amount; or introduces the concept of estate tax exemption portability and how portability can mitigate concern with respect to the federal estate tax.

As much as it may be administratively efficient for the surviving spouse to receive all assets outright and free of trust, before advising such a client on steps related to funding (or not funding) the Bypass Trust, there are several factors that both the attorney and the client will need to consider.

While this paper focuses on situations involving a surviving spouse and underlying estate planning which includes a Bypass Trust, many of the same considerations discussed herein would be relevant for decisions related to any testamentary trust. Additionally, the scenarios in this paper assume that Husband predeceased Wife.

II. COMMON SCENARIOS

A. Fact Patterns

While each client situation is unique, and the factors one may need to consider will differ, there are a few situations which may prove to be more common than most:

- Husband & Wife were married for 40 years. They undertook estate planning in 1996, which included the traditional A-B Will (which created a Bypass Trust). Wife dies in 2023. Husband brings you the Will, along with the original planning binder, which includes the attorney's diagram illustrating the tax savings from directing $600,000 to the Bypass Trust instead of outright to the surviving spouse. At the time of Wife's death, their total estate is $3,000,000 ($500,000 house; $950,000 IRA; $50,000 personal property; and $1,500,000 in investment and bank accounts).

- Husband & Wife were married for 17 years. They had a Revocable Living Trust prepared in 2004, which includes a traditional A-B trust split at the death of the first spouse. Husband dies in 2014. Total estate is $8,000,000 ($1,000,000 house; $1,000,000 second home in Colorado; $2,000,000 in private investments; $1,000,000 in bank and investment accounts; and $3,000,000 in an IRA which passes directly to Wife).

- Husband and Wife were married for 20 years. They prepared tax-planned Wills in 2007, which each include a Bypass Trust for estate tax planning purposes. Total estate is $15,500,000, of which $9,000,000 is in an investment account. When they switched investment advisors in 2012, and without checking with their estate planning attorney, the investment account ownership was re-styled as "Joint Tenants With Right of Survivorship." While a qualified disclaimer could be an option to help fix this situation for planning purposes, for sake of this example, we assume that the assets in this investment account bypass the will and probate altogether (i.e., surviving spouse already claimed these funds, opened an investment account in her own name and used and directed the funds in this account).

- Husband and Wife were married for 40 years. Realizing that failing health might require personal care and preferring to age in place, the couple included a testamentary trust in their estate plan to pay for the surviving spouse's disability and preferred living arrangements. W dies in 2023. Husband brings you the Will along with the original planning binder which includes the attorney's diagram illustrating how one might utilize the Medicaid in-home care program to pay for costly in-home care for the surviving spouse by funding the testamentary trust. Although H has some health concerns, he wants to know if he should avoid funding the trust because (1) there are no estate tax issues; (2) he knows that trusts are often taxed at a higher rate; and (3) he just wants to simplify his life. At the time of Wife's death, their total estate is $900,000 ($275,000 house that needs significant updating; $300,000 IRA; $25,000 personal property; and $300,000 in investments and bank accounts).

Occasionally, this paper will refer back to one of these common scenarios.

B. Probate vs. Non-Probate Assets

Similar to the third example, above, there are numerous occasions where the manner and method in which clients hold their assets has changed since the time they implemented their Wills or Revocable Trust. Where the estate planning attorney is part of the overall process, then adjustments can be made to their planning documents. However, some clients opt for simplicity and probate avoidance, and, as such, there are many occasions when there is a disconnect between the estate planning documents and the ownership style of the assets. A few of the common non-probate assets which may be encountered in client's portfolio, include:

- Retirement Accounts – frequently, retirement plans pass directly to named beneficiaries, thereby passing outside the reach of the client's Will or Revocable Trust. For a fair amount of clients, retirement accounts are their largest assets.

- Life Insurance – Similar to retirement accounts, it is common for life insurance to pass directly to named beneficiaries. Where a client is utilizing tax-planned Wills, or if the client has younger

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