

Dust Off Your Existing Trusts

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July 9, 2014



Rising federal estate tax exemptions are providing you an opportunity to reconsider your existing trusts to determine whether a trust termination may provide an income tax benefit to your trusts' ultimate beneficiaries. For example, the federal estate tax exemption has steadily increased from \$600,000 in 1997 to \$5,490,000 in 2017. The exemption is indexed for inflation and could continue to increase depending on inflation rates.

Background

Through the years, many trusts have been established in a manner specifically designed to provide benefits to an individual yet prevent the trust assets from taxation in the individual's estate. For example, many married couples create a trust for the surviving spouse precisely for this purpose. These trusts often are called "Credit Shelter Trusts," "Bypass Trusts," "Family Trusts," or "A-B Trusts."

Similarly, parents often establish trusts for a child during the parent's lifetime or at the parent's death. These trusts are often designed as generation-skipping trusts in order to provide benefits to the child during the child's lifetime yet escape taxation in the child's estate.

New Tax Considerations

With today's significantly higher estate tax exemptions, avoiding estate taxation in a surviving spouse's estate or a child's estate may not be necessary. In other words, if you have one of these trusts and the trust assets were to be distributed to your surviving spouse or your child, your surviving spouse's or child's estate still may be less than the expected estate tax exemption at death.

If there is little or no anticipated estate tax savings for continuing your trust, you need to consider whether a distribution of the trust assets or termination of the trust could create an income tax opportunity for your surviving beneficiaries.

When assets are included in an individual's taxable estate, the beneficiaries receive a new basis for capital gains tax purposes, often referred to as a "stepped-up basis." Specifically, the beneficiary's new or stepped-up basis is the fair market value of the asset on the date of the owner's death. However, assets that remain in a trust until the beneficiary ("Original Beneficiary") dies and then pass from most trusts to the trust's ultimate beneficiaries at the Original Beneficiary's death generally do not receive a new or stepped-up basis at the date of death of the Original Beneficiary. Therefore, it may be beneficial to completely distribute or terminate a trust in order to obtain a new or stepped-up basis for the ultimate trust beneficiaries if the ultimate beneficiaries of the trust and beneficiaries of the individual's estate are identical.

What To Do

If you or anyone who is a current beneficiary of a trust does not anticipate that the beneficiaries' assets at death will exceed the estate tax exemption amount, you should seek advice to determine whether there is a potential benefit to completely distributing or terminating the trust.

However, it is important that you weigh any potential benefit of terminating your trust against the potential downsides to the termination. For example, it is possible to actually lower a basis if your trust assets have depreciated during the Original Beneficiary's lifetime. Also, your trust may have been created to provide asset protection, governmental assistance planning, or control of assets for the Original Beneficiary, and the termination of the trust may jeopardize accomplishing these goals. Lastly, while the current estate tax law is "permanent," it always is possible that Congress could lower the federal exemption.

Conclusion

This is not a "call" to terminate all existing trusts. There likely is a prevailing purpose for continuing most, if not all, of them. With that said, your existing trusts should be reviewed to determine whether changes in tax law and changes in facts and circumstances warrant further consideration regarding termination, continuation, or other modification.

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