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Do You Still Need Your Bypass Trust?

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Many estate planning instruments contain bypass trust provisions. Typically, when the first spouse dies, assets equal to his or her exemption from either the New Jersey or the Federal estate tax are placed into this trust. The surviving spouse has access to the interest and the principal, but at the death of the surviving spouse the trust assets bypass the surviving spouse's taxable estate and go directly to the children. The objective is to use both spouse's exemption from the New Jersey or the Federal estate tax.

This strategy has been a part of fundamental estate planning for many years. However, effective January 1, 2017, the New Jersey exemption increased from \$675,000 to \$2,000,000 and the New Jersey estate tax is scheduled to be eliminated completely effective January 1, 2018. The Federal exemption currently is \$5,490,000 and there is talk of possibly eliminating the Federal estate tax.

In light of these increased exemption amounts and the possible elimination of estate taxes altogether, many surviving spouses are questioning the merits of maintaining the bypass trust formed when the first spouse died. For a family with total assets, including the assets held in the bypass trust, below the current estate tax exemption, it may be advisable to eliminate the bypass trust. By terminating the bypass trust, the assets within the trust pass into the name of the surviving spouse. Upon the death of the surviving spouse, the transferred assets are not subject to estate tax and such assets get "stepped up" to their current market value, meaning the children can sell the appreciated assets without triggering any capital gains tax.

The potential income tax savings may make the reasons to terminate a bypass trust somewhat compelling. However, consideration should be given to the fact that the exemption laws could change and that bypass trusts afford protection from creditors. Also, if the assets from a terminated bypass trust are distributed to the surviving spouse, he or she could decide to give the assets to someone other than his or her descendants, for example, perhaps to a new spouse.

We recommend that you consult with your estate planning attorney to consider if terminating a bypass trust makes sense for your family.

Contact our Business Group if you should have any questions.

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