

## Tax Exemption

**The federal estate tax, federal gift tax and federal generation skipping transfer tax** impose taxes upon the transfer of wealth to individuals other than a spouse who is a U.S. citizen. In 2017, the exemption from these taxes for each transferor was \$5,490,000. Under the new law, the exemption for 2018 is \$11,180,000 which will be adjusted annually for inflation. Unless Congress and the President pass additional legislation, in 2026 the exemption will revert to \$5,000,000 adjusted for inflation.



A married couple is allowed to share their respective exemptions pursuant to a provision called "portability". Therefore, with careful planning, a couple can transfer \$22,360,000 without imposition of any transfer tax regardless of which spouse is wealthier.

Although few people will be affected by these transfer taxes, many people created their estate plans when the exemption was much lower. The creative use of trusts sought to minimize these transfer taxes.

Even though the laws have changed over the years, those trusts are still effective, which may now create unintended results.

## Marital and Residuary Trusts

Couples often provided for their assets to be allocated to two trusts upon death. Typically, a Marital Trust was designed to provide for the surviving spouse and make sure the decedent's estate was eligible for the marital deduction. A Residuary Trust also provided for the surviving spouse, but was structured so the assets in that trust would not be included in the taxable estate of the spouse who died second.



If the allocation was based upon the then exemption, the assets were often split between the two trusts. Now that the exemption is so much higher, more assets than originally intended will be allocated to the Residuary Trust if the formula is not changed. This is particularly problematic if the Residuary Trust is to be held for the benefit of someone other than the surviving spouse.

Excess Residuary Trust funding can result in other problems, including:

- To accomplish its purpose of avoiding tax on the second death, the Residuary Trust is often more restrictive than the Marital Trust. Therefore, the surviving spouse's access to the assets may be limited by standards such as health, education, maintenance and support. In most estates, such restrictions are no longer needed to avoid the transfer taxes.
- As a general rule, the potential capital gains tax on assets owned by a decedent at the time of his/her death is forgiven. Assets owned by a Residuary Trust are not deemed to be owned by the surviving spouse at the time of his/her death. Therefore, the appreciation on those assets prior to the second death may be unnecessarily taxed when they are sold.

For many reasons, estate plans should be reviewed and updated to avoid unintended results and unnecessary rigidity and taxes. We invite you to contact one of our Couzens Lansky [estate planning attorneys](#) to schedule a review of your situation.