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Bye Bye Bypass Trusts: Restructuring and Rebirth of Marital Estate Planning for the Next Decade

PRESENTERS

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He was an adjunct professor in the Masters Program at Long Island University. He has spoken for the New York State BAR Association on complex trust and Estate Planning topics and regularly lectures before the Nassau and Suffolk BAR Association centers for continuing Legal Education, and their committees and sub committees. He is frequently asked to speak on trust topics for (NBI) the National Business Institute and other providers of legal education. He was technical editor for the publication "Fundamentals of Trust Accounting Income and Principal under the Revised NYS Laws" (ABA Publication 2013). Known in the community for his expertise on trusts and related matters, he acts as counsel to many large and small law firms, providing advice and guidance in his areas of concentration.

Bye Bye Bypass Trust?

This presentation will address the following questions:

a. **Is the Bypass Trust dead? What planning and structures should we use now to best avoid potential state and federal estate taxes?**

b. **Can we create a martial trust(s) to capture basis step up at the death of each spouse and draft for income tax planning?**

c. **Do we toss aside Portability totally or see it as a useful tool with practical applications?**

d. **What can we do to avoid the 3.8% Medicare surcharge on passive income and the higher trust income tax rates in marital planning trusts?**

I. Estate Planning Downturn

There has been a massive downturn for Estate Planners since 2012, especially for those with clients whose net worth is under $11mm. The life insurance industry has also reported major declines in sales due to the inability of agents to convince clients that potential estate taxes create the need for permanent life policies. These policies were easily sold in the past as a way to pay the tax on death because the estate tax affected most people in some fashion due to a $600,000 tax exemption amount that reigned for almost four decades. Even after the Federal exemptions elevated to a robust $5mm in 2012, New York's decoupling maintained the death tax angst by keeping its exemption at $1mm.

Then in 2014, New York increased its $1mm exemption by skipping it up annually on a fiscal year to match the Federal numbers by 2019.[1] This unexpected legislation really put the nail in the estate planning coffin. As of 2016, bypass trusts in wills and life insurance trusts, once staples of every marital estate plan, are rarely desirable by average wealth clients. With access to so much information on the Internet, clients proactively read whatever their search engine feeds them about estate planning. They tell us about

the simplicity of portability, and how basic wills would suit them just fine; and this is all based on the flawed concept that Congress has magically eliminated the need for planning since they are worth less $10.9 mm.

II. Background

In a typical marital estate plan, the will (or the operation of law) leaves all assets of the first to die to the survivor. This is an estate tax exempt transaction due to the unlimited marital deduction. The theory has always been that this simple "I love you" approach wastes the exemption of the first spouse to die. Drafting wills became more sophisticated with the idea that instead of all assets passing to the surviving spouse, a testamentary trust should be created in both wills. These trusts were designed to capture the unused estate tax exemption and hold that amount in trust for the surviving spouse's benefit until their death. The balance would pass to the surviving spouse either in a trust that qualifies as a Qualified Terminal Interest Property (QTIP)[2] or outright capturing the marital deduction, thus making the first death a non-taxable event. Assuming the trust was drafted without certain powers that would cause estate tax inclusion, the trust assets would be forever exempt from what at the time was a 55% estate tax rate (and if allocated, be exempt from any generation-skipping transfer -GSTT). The assets funding the trust would receive a stepped up basis for income tax purposes on the first death,[3] but not on the second. Until recent years, capital gains rates have traditionally always been lower than the estate tax rates and never appeared in the estate planners' crosshairs.

A bypass trust ("BPT") is a testamentary trust that shelters the estate tax exemptions of the first spouse to die and is not taxable in surviving spouse's estate. Creative lawyers devised the first formula based bypass trust (BPT), more affectionately known as the credit shelter trust ("CST"), to capture the tax benefits of the first spouse to die by allowing assets equal to the dollar value that equated to the unified credit at that time. The will with a CST typically included a specific bequest clause that required the largest amount possible that could pass free of estate tax based on the Federal credit available

in the year of the death of the first spouse to die to be set aside in trust for the benefit of the surviving spouse. The terms of the CST usually allowed discretion to pay income (not mandatory income since that would deplete the future growth of this estate tax exempt trust) and/or principal to the surviving spouse via an ascertainable standard and/or sprinkled to children by the trustee. It seemed a perfect solution to marital will drafting since the only restriction was to set aside about $600,000 of assets, and hold them in trust for the surviving spouse. Hence the BPT was born as a staple for married couples, even those with modest wealth.

Despite the complexity and due to the obvious tax benefits, the BPT has been the method of choice to dispose of the estate of the first spouse to die for estate planners for almost 40 years. This became the drafter's basic "form" for all of their wills for married clients. In fact most lawyers used these BPT formula forms in one way or another, many of which may not have even fully understood the technical aspects and operations after death of the bypass structure.

In 1977 the tax law first set forth a credit against estate tax in the amount of $30,000[4] per person. That was the equivalent of $120,677 of assets available to fund a BPT without taxation. The sum of $120,677 in 1977 would have the approximate purchasing power in 2016 of about $500,000. Compare that with the actual 2016 exclusion amount of $5,450,000. The monetary value of what funded a BPT in 1977, is less than ten percent of the current amount one would have to lock up in trust to fund a BPT today. State decoupling and these large exemptions relative to the average person's wealth are leaving big questions for practitioners with regard to the best approach to do marital estate planning.

III. 2001 Economic Growth and Tax Relief Reconciliation Act (EGRTRRA)

The classic CST became more of a challenge in 2001 when the estate tax exemptions were uncertain. From 1986 until 2001 the formula based CST would be funded with a constant amount of $600,000 (only adjusted to for inflation by the year 2000 to

$675,000). Although some potential surviving spouses were never comfortable with any amount of their inheritance being forced in trust, these dollar amounts made most clients fairly unemotional about using such a modest amount of assets to be sheltered from estate tax.

The landscape rapidly changed in 2001 when the Bush Administration passed estate tax reduction over a ten year period that then reverted back due to sunset provisions in the law.[5] Beginning in 2004, the exemption would be $1,500,000 and every few years the exemption would increase until 2009 when it was $3,500,000 and then repealed by 2010. The BPT now carried great uncertainty as to the amounts that would have to be set aside in trust and even more so with the possible 2010 repeal. It was unknown if the law would sunset back to the pre EGTRRA exemption of $1,000,000 amount after 2010.

More tuned in practitioners began to use flexible martial trusts after 2001 and started to shy away from the rigid fixed formula based CST. This brought the birth of the disclaimer trust and the one lung QTIP which are both variations of the BPT without a fixed funding amount. There were other drafting suggestions such as using the state exemption as the formula trigger for less wealthy clients and there also was the CST with 2010 repeal language so the CST would not be overfunded. The CST was still used for very wealthy clients and many general practice attorneys continued to draft the CST in all wills and still do today.

IV. Portability

Clients are always well advised not to use "I love you" wills where their assets would pass to the surviving spouse with a full marital tax deduction, winding up with all the assets being all taxed in the spouse's estate and utilizing only one of the couple's estate tax exemptions.

As stated, most clients dislike the BPT, especially the spouse that was more likely to survive. In order to avoid the loss of the exemption of the first to die, the bypass trust would not allow unrestricted access to the assets without the discretion and consent of

another or independent trustee. However, the alternative of paying estate tax at a rate of 55% on any amount was a less desirable evil so most everyone with assets in excess of $1mm had this structure in some form as part of their estate planning. The message that was delivered to Congress expressed the populous gripe that lawyers were charging large fees to create and administer the BPT and that they were complicated and restrictive. There were many discussions in the House and Senate about a "fix" and finally in the 2010 sunset legislation[6] (that was enacted at the end of 2011) portability was on the books. No lawyer or adviser really took it too seriously since it was to expire in 2012, so estate planning strategies remained unchanged by the legislation. Portability then became permanent in 2012 under American Tax Relief Act (ATRA) along with a $5mm estate tax exemption amount, further complicating the BPT and traditional marital estate planning.

The concept of portability is simple; the unused estate tax exemption at the death of the first spouse to die can be moved or ported to the surviving spouse.[7] This inherited exemption by the survivor is affectionately called DSUEA.[8] However, it is the details, actions and restrictions that keep portability from being the marital estate planning panacea Congress and clients hoped for.

<u>The Problems with Portability and DSUEA are:</u>

1. Affirmative timely election is required without clear relief if deadlines are missed;
2. Statute of limitations could extend for decades on the first spouse's estate filing;
3. Filing of a full federal estate tax return is required and formal appraisals necessary;
4. No portability for the New York State exemption at all;
5. No portability for the GST exemption of the first to die; and
6. New marriages and DSUEA erosion due to the last spouse rule.

V. <u>Clayton Martial Planning Trusts</u>

The Case: The Clayton trust idea stems from a 1992 Federal Court of Appeal case involving a Texas estate.[9] Mary Clayton was the surviving spouse of Arthur M. Clayton Jr., the decedent. Mary was the second wife of Arthur who had 4 children from a prior

marriage. Arthur died in 1987 and his will presented an unconventional version of the "A-B marital testamentary trust structure[10] calling for all the assets that were specified under the QTIP election to go into a testamentary marital trust (the "B" Trust) and the balance in essence pouring back to a CST (the "A" Trust) for the benefit of his 4 children. Mary Clayton was the Co-executor[11] that made the timely filed QTIP election when she signed the estate's tax return (Form 706). The amount elected and passing to the "B" trust was just over $1mm. Of course the math worked out that the "A" trust was funded with an amount of securities which totaled Arthur's maximum unused unified credit of $600,000.

The IRS rejected the QTIP election and argued that the ability of the surviving spouse to make a post death decision on how Arthur's assets passed was tantamount to a general power of appointed in Mary. The government's position was in essence a gift argument since the "A" trust was for the benefit of the four children from Arthur's first marriage. By making the election post mortem, Mary made a defacto taxable gift to his children of about $1mm and the IRS disallowed the QTIP election.[12] The entire $1mm would be subject to estate tax plus penalties and interest. The Tax Court agreed with the Service and upheld the IRS deficiencies and Mary appealed.

The U.S. Court of Appeals for the 5th Circuit heard the case and reversed in favor of the taxpayer. They cited the long history of the marital deduction and the QTIP election determining that the unlimited marital deduction provisions should be applied very broadly. They crushed the IRS arguments that the post mortem actions by the spouse were not the direction of Arthur and that they were self-directed making the property passing not from Arthur, but passing from Mary instead. The Court made reference to the disclaimer[13] provisions where a surviving spouse affirmatively renounces assets bequeathed to him or her into a disclaimer trust.[14]

As a result the Clayton trust has since been used by many practitioners as a tool. However disclaimer trusts[15] and one lung QTIPS[16] have been the primary methods of

choice for creating flexibility around the law fluctuations and uncertain estate tax exemption amounts. I do not know many attorneys who use Claytons regularly and they are typically created only in the limited circumstances where the client desired exemption funding flexibility, disliked disclaimers but also was looking to benefit children as additional trust beneficiaries on the first death.

The Comprehensive Clayton:

I suggest that if the Estate is in excess of one spouse's state exemption (assets above say $4.2mm) we set aside planning dinosaurs like the formula CST; disclaimer trusts; and even the one lung QTIP trust. Portability can still be used as a tool in certain fact specific scenarios. However, in my opinion, the best way to approach marital estate planning is to use what I call the "Comprehensive Clayton". This structure, if done correctly, can be the most flexible trust for both tax and non-tax reasons; can minimize Federal and State death taxes using post mortem planning; can utilize and maximize both spouse's GST exemptions; and can be drafted to achieve stepped up basis for income tax in both spouses' estates.

Drafting a Clayton Trust Structure in a Will:

The terms of a Clayton will direct that the residuary estate pass to the trust under a later article in the document. Note that the following A-B structure is the opposite layout of the actual Clayton case but works just the same. The portion "A", or Marital Trust, should provide that the surviving spouse will receive all of the income from the trust, to be paid at least annually, and may receive principal payments in the absolute discretion of the Co-Trustee other than the spouse. These various features allow the spouse to receive all of the income and some or all of the principal needed during their lifetime, without disrupting the tax benefits. A testamentary special power of appointment can be added or any retirement plan QTIP language[17] should the trust be the designated beneficiary of a spousal IRA.

The terms of the portion "B", or Family Trust, which is the pour back bypass portion should provide that income and/or principal may be paid to spouse but ideally should include the children from the existing marriage or from any prior marriage. Grandchildren and further issue can also be included as current beneficiaries provided the GST exemption is allocated after death to the "B" trust. By structuring the trust in this way, not only will the principal of the Portion "B", or Family Trust protected from possible creditor claims, but the income will as well. Ideally, this trust would be funded with an amount no greater than the "applicable exclusion amount" but can be manipulated by the Executor to be any lesser amount including the New York State exemption or some amount the client wishes to benefit the children. Precatory language can also be used here to help guide the Executor as to the testator's intentions on the "B" trust funding.

Basic Clayton Will Provisions:

> Any property directed to be divided and distributed by my Co-Executors in accordance with the provisions of this ARTICLE ____ shall be divided, administered and distributed as follows:
>
> My Co-Executor (other than my spouse), in said Co-Executor's absolute discretion, may elect (if an election is available) to take as a Federal or State marital deduction with respect to any part or all of the property belonging to my estate which is directed to be divided and distributed in accordance with the provisions of this ARTICLE _____ that could qualify for a marital deduction as qualified terminable interest property (the "QTIP Election"). If my Co-Executor (other than my spouse) shall elect to have any part or all of the trust hereunder qualify for such marital deduction, notwithstanding any other provisions of this Will, none of the powers or discretions granted or made to my Co-Executors and

Trustees by this Will shall be exercisable or enforceable in such manner as to disqualify such portion or all of the trust for which such QTIP Election has been made from the marital deduction allowable in determining the federal estate tax on my estate. Generally, I anticipate that my Co-Executor will elect to minimize the estate tax payable by my estate. However, I would expect that some consideration be given to the estate tax payable on my spouse's estate upon my spouse's death. It is my intention although not legally binding that the "non-qualified trust" or Portion B Family Trust, described below, be funded with a sum up to the largest amount that can pass free of federal estate tax under this Article by reason of the applicable exclusion credit as defined in section 2010(c) of the Code (hereinafter referred to as the "Applicable Exclusion Amount"), or any successor statute thereto.

If my Co-Executor (other than my spouse) elects to qualify only a portion of the trust fund for the marital deduction for federal estate tax purposes (hereinafter such portion shall be referred to in this Will as a "qualified trust" portion or Portion A), then such Portion A shall be distributed to my Trustees hereinafter named to be held and administered as a separate Portion A Marital Trust fund in accordance with provisions of subparagraph (A) below, and my Trustees shall have the power to first divide the trust into separate trusts to reflect such election. I further direct that any payment of principal to or for the benefit of my spouse under this Article shall be charged against the qualified Portion A of the trust until such portion is exhausted.

The remaining portion of the trust for which no QTIP Election to

qualify for the marital deduction is made (hereinafter such portion shall be referred to in this Will as the "non-qualified trust" portion or Portion B), shall be distributed to my Trustees hereinafter named to be held and administered as a separate Portion B Family Trust fund in accordance with the provisions of subparagraph (B) below.

A. At any time my Trustees are directed to hold trust property in a Portion A Marital Trust in accordance with the provisions of this subparagraph (A), my Trustees shall hold same IN TRUST as a separate trust (or in as many separate trusts, each upon the terms set forth in this Article, as the Trustees, in their absolute discretion, shall determine) for the benefit of my wife, _____, and my Trustees shall invest and reinvest the same and shall pay or apply during the life of my wife, all of the net income, at least quarter-annually, to or for the benefit of my wife.

In addition, my Trustee, other than my spouse, if my spouse is a Trustee, may pay or apply such part or all or none of the principal of the trust at any time or from time to time, to or for the benefit of my wife during her lifetime, as the Trustee, other than my spouse if she is a Trustee, in such Trustee's absolute discretion may deem advisable for the best interests, support, maintenance or general welfare and happiness of my wife. In exercising the discretionary powers herein, my Trustee may, but need not, consider any other resources of any beneficiary and shall give primary consideration to the needs and desires of my spouse during her life. In the event all of the principal of such trust is paid or applied as herein provided, such trust shall thereupon terminate. My spouse, if she is a Trustee, shall be excluded from exercising any

discretionary powers of distribution given to my Trustee under this Article and shall be excluded from exercising any powers or rights with respect to any policies of insurance on the life of my spouse.

[Consider here if using a testamentary Special Power of Appointment in Spouse]

During the term of any trust held pursuant to the provisions of this subparagraph (A), in addition to any other rights my spouse may possess hereunder, my spouse shall have the right, exercisable in my spouse's absolute discretion, to demand at any time or from time to time, that my Trustees, notwithstanding the broad powers conferred upon them by this Will, make income producing any unproductive property or property interests then held in such trust. Upon receipt of such demand from my spouse, my Trustees shall, within a reasonable time thereafter, either make such property productive or convert such unproductive property into income-producing property.

Upon my spouse's death, my Trustees shall distribute remaining trust A assets in accordance with the provisions of subparagraph _____ below.

B. At any time my Trustees are directed to hold trust property in a Portion B Family Trust in accordance with the provisions of this subparagraph (B) my Trustees shall hold same IN TRUST as a separate trust (or in as many separate trusts, each upon the terms set forth in this Article, as my Trustee, other than my spouse, in his absolute discretion, shall determine) and my Trustees shall invest

and reinvest the same and shall during the lifetime of my spouse pay or apply such part or all or none of the net income and principal of the trust to or for the benefit of [**my spouse and/or any one or more of my issue]**, of whatever degree as shall from time to time be living as my Trustee, other than my spouse if she is a Trustee, in such Trustee's absolute discretion may deem necessary or advisable. Such expenditures of net income and principal need not be made equally among the members of the class of beneficiaries, but shall be made according to the respective needs of each such beneficiary as my Trustee, other than my spouse if she is a Trustee, may in such Trustee's absolute discretion determine them to be, and such expenditures need not thereafter be equalized. In exercising this discretionary power, my Trustee may, but need not, consider any other resources of any beneficiary. No later adjustment shall be made to compensate for unequal discretionary income or principal distributions among beneficiaries. Any undistributed net income shall be accumulated and added to principal at intervals determined by my Trustee. In the event all of the principal of such trust is paid or applied as herein provided, such trust shall thereupon terminate. This trust shall be administered by my Trustee in such Trustee's absolute discretion.

My spouse, if she is a Trustee, shall be excluded from exercising any discretionary powers of distribution given to my Trustee under this Article and shall be excluded from exercising any powers or rights with respect to any policies of insurance on the life of my spouse.

[Consider the income tax step up provisions here that are

discussed below]

Upon my spouse's death, my Trustee shall distribute remaining trust B assets in accordance with the provisions of subparagraph ____ below.

VI. Summary of the Comprehensive Clayton:

1. Residuary estate is paid to a single trust in the will of the first to die to be split in 2 or more trusts after death.
2. Structured as an "A/B" disposition "A" trust being the QTIP and the balance of the estate to spill back to the "B" or bypass trust.
3. Allows post mortem planning for using some or all of the State or Federal exclusion amounts.
4. Allows control of the ultimate disposition of assets for nontax reasons if there are children from prior marriages.
5. Allows growth on the bypass trust to be excluded from estate tax but can include provisions to obtain basis step up on second death if desired.
6. Allows QTIP election and allows use of both spouses GST exemption if a reverse QTIP election is made.
7. Clayton properly structured between husband and wife can create discounts – i.e. if there is a family business and it is allocated at the death of first spouse to each of the A trust and the B trust owning less than a controlling interest (say 49% in each of the A and B trusts), then discounts can be achieved in the estate of the second to die.[18] This is useful when the client's assets are just above the couple's combined current $10.9mm estate tax exemptions.
8. Trust should and can include the other income tax planning options discussed below.

VII. Obtaining an Income tax step up in Marital Estate Planning

1. There is no step up in basis on the exempt bypass trust on the second death; compared to portability that allows a full step up on the death of the survivor.
2. The only way to get step up once the BPT is set up is to somehow cause the trust asset to be included in the estate of second to die.
3. Discounts - Good for transfer tax savings - bad for income tax step up – limit the use of valuation discounts when trying to achieve a step up when the high estate tax exemptions protect the estate from estate taxes. Loosen restrictions on FLP and LLC operating agreements and argue to limit discounts in the same manner that the IRS has been doing for 30 years.
4. The combined Federal and NYS rate for Income Tax is about 50% (39.6 + 3.8 +6.85%) so with the NYS estate at 4%-16%, it is much cheaper to pay the NYS estate tax rather than losing a step up for Federal and state income tax purposes.
5. If you want a low basis asset back in the estate that may have been gifted to a spousal lifetime access trust (SLAT) or some other trust, find mistakes made by the client and argue that IRC §2036 applies and have it included in the estate.
6. If there was a sale to a trust for a promissory note that is still unpaid, default and have the grantor foreclose on the note and reclaim the low basis asset; assuming there is a security agreement.
7. Use powers of substitution to get back low basis assets into the estate just before death.[19]
8. Transfer assets from the well spouse to an infirm spouse to obtain a step up and have them go into a martial trust instead of back to the donor spouse to potentially avoid the one year rule under IRC §1014(e).

VIII. Making the Clayton "B" Trust (non QTIP) Income Tax Flexible:

1. Make sure the trust has language to split into multiple identical trusts to segregate appreciating assets from less performing or other boring assets.
2. Add a clause allowing a protector or other non-fiduciary to grant a general power of appointment[20] (GPOA) to the spouse. The GPOA causes the assets to be included in the second estate. The assets would still be disposed of pursuant to the trust terms but to the extent the power of appointment applied, the assets would be fully stepped up for income tax purposes. If there is second or later marriage and concern over allowing a GPOA an idea might be to limit the general power to the creditors of the spouse's estate.
3. Give pure discretion in independent Trustee to distribute all of the trust assets to the spouse for step up in the second estate. This is good in first marriages since there will not as much concern about the children being disinherited.
4. Add an administrative power to allow the surviving spouse to substitute assets of equivalent value and swap cash for low basis assets prior to death. This will not create grantor trust status but it will allow the spouse to exchange a low basis stock or family business that may be in the bypass portion of the trust for newly purchased assets, bonds or cash.
5. Make the trust a true grantor trust. Instead of a will create an intervivos QTIP trust during the lifetime of the client. Each spouse creates the trust for the benefit of the other[21] and funds it with the appropriate or desired assets. The trust of the first die directs that a bypass trust be created which retains grantor trust status to the surviving spouse. This allows the bypass trust to avoid any income tax, Medicare tax or capital gains tax from the corpus. All taxes are paid at typically substantially lower rates by the surviving spouse and the trust grows income and estate tax free exponentially without diminution from taxes.

IX. Using Portability as an Effective Planning Tool:

The portability election can be useful in martial estate planning. Generally, I use it as a default plan and not as the plan itself. If marital trusts are not part of an estate plan, at least on the first death making a timely election can preserve the Federal exemption.

GST planning using Portability: The portability election can still be made regardless if all or some the assets passed to a QTIP trust as opposed to the surviving spouse outright.[22] As such, it can considered as a means to protect the exemption where a plan for a second marriage requires a marital trust for non-tax reasons. The will or revocable trust could dispose of all the estate residuary to a testamentary QTIP trust. The election for both QTIP and portability would may be made on the same tax return even if there are not enough assets to create a taxable estate.[23] A reverse QTIP election[24] can be made on the marital trust. The effect would be that GST would be allocated to the QTIP using and not wasting the first spouse to die remaining GST exemption amount that would otherwise occur using portability alone.

IRA and Retirement accounts: If the client's assets are comprised of a significant retirement accounts, leaving those assets to a trust causes complications. An IRA can designate a CST or a QTIP trust as the primary or disclaimed beneficiary, but there are many caveats. First when it comes to a CST, the retirement account typically can only be stretched over the life expectancy of the oldest trust beneficiary. This is usually the surviving spouse. Once the surviving spouse dies, the account must be paid out to the children (assuming they are the trust beneficiaries here) and cannot be treated like their own inherited IRA.[25] When a QTIP is the designated beneficiary, the same issue arises, however, the will must include the language from Revenue Ruling 2006-26, to ensure the QTIP election will not be invalid. In this instance it may be best to use portability to the extent of the value of the retirement account(s). Then the client

can name the spouse as primary beneficiary, roll over the IRA account at death of first spouse and obtain the full stretch to the children on the second death.

[1] State of New York Executive Budget 2014-15
[2] I.R.C. § 2056(b)
[3] I.R.C. § 1014
[4] Before 2010, a tax computation was required in order to determine and express the value of the estate tax credit as a dollar figure. The Economic Growth and Tax Relief Reconciliation Act of 2001, introduced the term "applicable exclusion amount" as $1,000,000. The current law continues to provide for an applicable exclusion amount ($5,450,000 indexed for inflation annually) which is the statutory dollar value of the assets that can be passed free of gift and estate tax. The "credit" approach has been eliminated.
[5] Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub.L. 107–16, 115 Stat. 38, June 7, 2001)
[6] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub.L. 111–312, H.R. 4853, 124 Stat. 3296
[7] This does not occur automatically since a formal election must be made by the executor of the first spouse by timely filing an estate tax return (Form 706). I.R.C. § 2010(c)(5)(A)
[8] Deceased Spouses Unused Exemption Amount, Internal Revenue Bulletin: 2012-28, July 9, 2012 ,T.D. 9593
[9] Estate of Clayton v. Commissioner, 976 F.2d 1486 (5th Cir. 1992), rev'g 97 T.C. 327 (1991)
[10] The typical "A" trust is a CST funded by specific bequest formula as the largest amount that can pass without estate tax (or sometimes expressed as the lowest amount that due to the maximum use of the marital deduction creates the least estate tax). The "B" trust bequests the residuary over to Marital Deduction trust that qualifies for QTIP treatment and then a QTIP election is made on the B Trust.
[11] There was a Bank named as the corporate Co-Executor with the spouse however, there was some arrangement or possibly some provision under Texas law that did not allow the Bank to act as a co-fiduciary until the estate tax returns were filed. It seems to me that this was arranged to keep the bank from having any liability for estate taxes after their attorneys read the then untested A-B trust provisions in the Clayton will.
[12] IRC §2056(b)(5), Treas. Reg. §20.2056(b)(5)(g)
[13] I.R.C. § 2518
[14] The Court stated on comparing the Clayton will disposition and a disclaimer that "both are volitional acts; both can only be made after the death of the testator; both relate back ab initio, to the date of death of the testator; and both have the effect of causing estate property which would otherwise pass to the Surviving Spouse to pass instead directly to or for the benefit of other parties"
[15] A will with provisions that allow a surviving spouse to not accept specific assets as inheritance and divert them into a bypass trust by disclaiming ownership of a portion of the estate. The surviving spouse can receive all income from the trust as well as principal distributions but cannot have a Special Power of Appointment. Disclaimed property interests are transferred to the trust, without gift taxes by the spouse.
[16] A residuary bequest to a single marital trust with full QTIP provisions and the surviving spouse as the sole beneficiary. After death the surviving spouse could split the trust in two or more trusts and control the amounts post mortem that were treated as the bypass trust.
[17] Rev. Rul. 2006-26, 2006-1 C.B. 939
[18] Estate of Mellinger v. Commissioner, 112 TC 26 - Tax Court 1999
[19] Note this cannot be done with a house in a QPRT; Treasury Reg. §25.2702-5(c)(9)
[20] I.R.C. §2041(2)
[21] The reciprocal trust doctrine does not apply to QTIP trusts created by husband and wife for each other based on Treasury Reg. § 25.2523(f)-1
[22] Treasury Reg. §20.2010-2T(a)(7)(ii)(C) Example 2.
[23] Rev. Proc. 2001-38 was originally designed to prevent taxpayers from inadvertently making an irrevocable QTIP election on the bypass trust. The 2013-2014 Treasury-IRS Priority Guidance Plan, released on August 9, 2013 was to address the application of Rev. Proc. 2001-38 "regarding the validity of a QTIP election on an estate tax return filed only to elect portability." The members of the Estate and Gift Tax Committee of the Income and Transfer Tax Planning

Group of the RPTE requested that the Treasury reexamine Rev. Proc. 2001-38 and consider portability, "where one may not want to intentionally make a QTIP election in estates having less value than the deceased spouse's available applicable exclusion amount." Ron Aucutt stated in *ACTECT Capital Letter No. 34, Priority Guidance Plan Published, Commissioner Nominated* (August 12, 2013) related to the Treasury giving relief and guidance to the above mentioned paradigm with Rev. Proc. 2001-38 "It is not always the case that the appearance of a project on the Priority Guidance Plan makes it clear what the outcome of the project will be, but it is clear in this case."

[24] I.R.C. §2652(a)(3)

[25] What I have done in this situation is keep the trust open and continue to pay out over the deceased spouses life expectancy and make annual distribution to the children as opposed to having to pay tax on the accelerated distribution.