

## **HAUSWIESNER KING LLP**

### **The Bypass Trust – Why Estate Taxes Are Voluntary.**

A bypass trust is an integral estate planning tool that can save one literally hundreds of thousands of dollars. The way it works is as follows: The Internal Revenue Service gives each person a personal exemption from estate taxes. This exemption varies from year to year, for example, in 2007 the exemption is 2 million dollars with the exemption increasing to 3.5 million in 2009 followed by the elimination of the estate tax in 2010. This sounds great, however, Congress did not make the elimination of the estate tax permanent, therefore in 2011 the personal exemption level reverts to 1 million.

Any amount above the personal exemption is taxed at a percentage that also varies from year to year. The maximum tax rate is 46% for 2007, 45% in 2008-2009 and then the tax rate is phased out in 2010. However, starting in 2011 the maximum estate tax rate will revert to 55%! Congress will likely address this issue in the next few years however, it is prudent to plan ahead because the stakes are very high. At a 55% rate \$550,000 of every \$1,000,000 above the 1 million dollar exemption could go to the government!

The advantage of the bypass trust is that it uses each spouse's personal exemption. Let's use the 2011 personal exemption of 1 million dollars per person as an illustration. Mr. and Mrs. Jones have a 2 million dollar estate. Mr. Jones has a 1 million dollar personal exemption and Mrs. Jones has a 1 million dollar personal exemption as well. There is also an unlimited spousal exemption so when Mr. Jones dies and leaves all his assets to Mrs. Jones there will be no estate tax. Mr. Jones dies. Mrs. Jones now has a 2 million dollar estate; however, she is left with only her 1 million dollar exemption. Therefore, she could pay \$550,000 in estate tax when she dies. The solution for the Jones family is to set up a bypass trust to set aside the personal exemption amount when either Mr. or Mrs. Jones dies. After setting up this trust, when Mr. Jones dies 1 million is diverted to the bypass trust. The income from the trust is given to Mrs. Jones and she is

entitled to take out more money if she needs it (with certain limitations) and then the trust will go to the beneficiaries after Mrs. Jones death. This results in no estate tax. This simple tool saves the Jones family \$550,000.