



January 13, 2021

Subject: Important Updates for Clients Whose Living Trusts Create Family Trusts

This is important if your Living Trust creates a Family Trust at the death of the first spouse. These are irrevocable trusts that hold the deceased spouse's share of the estate. These trusts have many good uses – estate tax avoidance, Medicaid planning, second marriage planning, asset protection, and remarriage protection. However, unless your trust was obtained from our law firm since 2016, or we restated your trust in the last three years, your trust does not provide a step-up in basis when the surviving spouse passes. This creates capital gains when the assets are eventually sold by the children. Until recently, there was no accepted way to fix this problem. Now, there is.

While both spouses are alive, this can be easily fixed by amending your trust. I have attached an information sheet that outlines the problem and the solution. The change can save some families a huge amount of capital gains taxes by erasing unrealized capital gains at the death of the surviving spouse. This problem can be fixed after one spouse dies, but it is much more expensive. After both spouses die it cannot be fixed.

In addition, since 2016 our clients have been able to add remarriage provisions to the Family Trust. These provisions require the surviving spouse to obtain a premarital agreement if they remarry. Late season remarriages are poison for estate planning. Your trust and a premarital agreement are important protections for your planning.

If you have questions about this or if you feel like it is time for a trust review, please call our office. The cost of amending the Family Trust article to add one or both of these provisions is \$495.

Sincerely,

A handwritten signature in blue ink, appearing to be "RDB", written in a cursive style.

Robert D. Bond
Attorney/CPA

A handwritten signature in blue ink, appearing to be "Chris", written in a cursive style.

Christopher Brown
Attorney

Updating Your Living Trust to Avoid Unnecessary Capital Gains Taxes

Background: Irrevocable Trusts are often created when one spouse passes away. This irrevocable trust is designed to hold the deceased spouse's one-half of the community property and any separate property. The purposes of these trusts vary but may include estate tax savings, asset protection, Medicaid planning, remarriage protection, or protection of assets in second marriage situations. These trusts often have a bad side effect: There is no step-up in basis on the death of the surviving spouse. In some cases, this creates a huge, unnecessary capital gains tax when the assets are sold. How does this problem arise?

Understanding the Step-Up in Basis: When a person dies, all the property that they own with a few notable exceptions (Retirement Accounts, Annuities) receives a new value for calculating capital gains. For example, if someone owns Exxon stock valued at one million dollars for which they had paid \$100,000, and the person sells it, then there is a capital gains tax on the \$900,000 gain. The tax varies from 15% to 23.8%. On the other hand, if the person dies owning the Exxon stock, the basis is revalued to the value at date of death. If that value is a million dollars and the surviving spouse sells it for one million, there is no capital gains tax!

Texas Advantage: In community property states like Texas, all of the community property owned by husband and wife steps-up on the first death and all of the property owned by the surviving spouse steps-up upon the second death. Two big step-ups. For some families this is a huge potential advantage to dying with the property! Death can erase capital gains tax in long-held assets like farms, vacation homes, depreciated investment real estate, as well as stock and other investments. So what is the problem?

The Problem: If the couple created an irrevocable trust on the death of the first spouse to pass, those trusts do not allow for a step-up on the trust property when the surviving spouse dies. This will almost certainly create unnecessary capital gains taxes for the children of the couple if those assets are sold. Until the last two or three years, there was no good solution for this problem; now there is.

Solution: *If both spouses are still alive, they can amend their trust to add provisions to solve the problem.*