

# A-B Trust

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## What is an A-B Trust?

An A-B trust is a joint trust created by a married couple for the purpose of minimizing estate taxes. An A-B trust is a trust that divides into two upon the death of the first spouse. It is formed with each spouse placing assets in the trust and naming as the final beneficiary any suitable person except the other spouse.

The trust gets its name from the fact that it splits into two upon the first spouse's death – trust A or the survivor's trust, and trust B or the decedent's trust.

## How an A-B Trust Works

After the death of an individual, his estate is taxed heavily before his beneficiaries receive it. For example, a married couple has an estate worth \$3 million by the time one of the spouses die. The surviving spouse is left with \$3 million which is not taxed due to the [unlimited marital deduction](#) for assets flowing from a deceased spouse to a surviving spouse. However, if the other spouse dies and his or [estate tax](#) exemption is \$1 million, the taxable portion of the estate will be \$2 million. This means that \$2 million will be taxed at 40% and the remaining amount will be transferred to the beneficiaries.

To circumvent the estate from being subject to such steep taxes, many married couples set up a trust under their last will and testaments called an A-B trust. Following the example above, if the couple instead had an A-B trust, the death of the first spouse will not trigger any estate taxes as a result of the lifetime exclusion. After death, the sum of money equal to the estate [tax exemption](#) in the year that s/he dies is put in an [irrevocable trust](#) called the Bypass trust, or B trust. This trust is also known as the decedent's trust. The remaining amount, \$2 million, will be transferred to a Survivor's trust, or A trust, which the surviving spouse will have complete control over. The estate tax on the A trust is deferred until after the death of the surviving spouse.

## Key Takeaways

- An A-B trust minimizes estate taxes by splitting the estate into a survivor portion and a bypass portion.
- The surviving spouse has limited control over the decedent's trust but the terms of the decedent's trust can be set to allow the surviving spouse to access property and even draw income.
- A-B trusts are not widely used as the estate tax exemption is sufficient for most estates.

## Advantages to an A-B Trust

The A trust contains the surviving spouse's property interests, but s/he has limited control over the assets in the deceased spouse's trust. However, this limited control over the B trust will still enable the surviving spouse to live in the couple's house and draw income from the trust, provided these terms are stipulated in the trust. While the surviving spouse can access the bypass trust, if necessary, the assets in this trust will bypass his or her taxable estate after s/he dies. After the surviving spouse dies, only the assets in the A trust are subject to estate taxes. If the estate tax exemption for this spouse is also \$1 million and the value of assets in the survivor's trust is valued at \$2 million, only \$1 million will be subject to estate tax.

The federal tax exemption is transferrable between married couples through a designation referred to as the portability of the estate tax exemption. If one spouse dies, the unused portion of his or her estate tax exemption can be transferred and added to the estate tax exemption of the surviving spouse. Upon the death of the surviving spouse, the property in the decedent's trust passes tax-free to the beneficiaries named in this trust. This is because the B trust uses up the estate tax exemption of the spouse that died first, hence, any funds left in the decedent's trust will be passed tax-free. As the decedent's trust is not considered part of the surviving spouse's estate for purposes of estate tax, [double-taxation](#) is avoided.

## Net Worth and A-B Trusts

If the deceased spouse's estate falls under the amount of his or her tax exemption, then it may not be necessary to establish a survivor's trust. The unused portion of the late spouse's federal tax exemption can be transferred to the surviving spouse's tax exemption by filling out [IRS Form 706](#).

While AB trusts are a great way to minimize estate taxes, they are not used much today. This is because each individual has a combined lifetime [federal gift tax](#) and estate tax exemption of \$5.43 million. So only people with estates valued over \$5.43 million will opt for an A-B trust. With the portability provision, a surviving spouse can include the tax exemption of his or her late spouse, allowing up to \$10.86 million in assets that can be transferred tax-free to beneficiaries.