

Using a Bypass Trust to Provide for Children from Remarried, Step and Blended Families

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Estate planning is an important issue for Montana families and remarried, step and blended families bring varying challenges to the estate planning process.

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ESTATE PLANNING IS AN IMPORTANT ISSUE FOR

Montana families. Families come in many different forms. Some are traditional with married parents and children only from one marriage. Other families involve remarriage and may have children who are “his,” “hers,” and/or “ours.”

Remarried, step and blended families bring varying challenges to the estate planning process. Complex relationships often exist among family members. Another challenge is rooted in the Montana laws that determine who will inherit property when the deceased did not create an estate plan. While these laws often align closely with the estate planning needs of a traditional family, they are less likely to address the complex issues of remarried, step and blended families.

A will with a bypass trust is a combination of tools that can help remarried, step and blended families create an estate plan that meets their goals for passing property to specific heirs. The property in the bypass trust can provide income for the surviving spouse during his or her lifetime. After the death of the surviving spouse, the property can pass to the desired heirs mentioned in the bypass trust.

Step family situation

Bill and Karen operate a farm that Karen inherited from her father. The value of the farm is approximately \$950,000 and is titled in Karen’s name as sole owner. They also have other non-farm assets (mutual funds, certificates of deposits, and U. S. savings bonds), valued at \$300,000, that are titled with Karen and Bill as joint tenants with rights of survivorship.

Karen and Bill each have an adult child from a previous marriage. They have agreed they want Karen’s daughter to inherit the farm because she has been

involved in its operation for several years. They want Bill’s son and Karen’s daughter to share equally the non-farm assets in their estate.

Bill and Karen do not have a premarital agreement, written will or any other type of transfer plan in place. They recently attended an Extension sponsored estate planning seminar and learned that without a written will, their property would be transferred based on Montana law.

What if Karen dies first and has no written will?

If Karen dies before Bill, all \$300,000 of the non-farm assets transfer directly to Bill. Why? The assets are held in joint tenancy with rights of survivorship between Karen and Bill. Under Montana law at the death of one of the joint tenants, the survivor receives all.

Even if Karen had written a will with a provision passing the non-farm assets to her daughter and Bill’s son, the joint tenancy with rights of survivorship, takes priority over the will. At Karen’s death, Bill becomes the owner of the \$300,000 of non-farm assets.

Because Karen did not have a written will, she is deemed to have died “intestate,” and her farm assets, valued at \$950,000 and titled in her name only, are divided via the probate process according to Montana’s intestacy statutes. Bill (as the surviving spouse) receives the first \$150,000 in value of the farm assets, plus half of the remaining property in the probate estate, or \$400,000. The other half of the farm assets pass to Karen’s daughter.

The result is Bill receives a total of \$550,000 (\$400,000 + \$150,000 = \$550,000) in value of the farm property that was solely owned by Karen. Karen’s daughter receives the remaining \$400,000 of the

farm property. Thus, Karen's daughter and Bill will be operating the farm together. Bill's majority ownership (58 percent) gives him control over the farm operation. He could possibly sell the farm land (even if Karen's daughter doesn't agree) or gift his interest to his son. Bill's total inheritance upon Karen's death is \$850,000 (\$550,000 farm assets + \$300,000 non-farm assets = \$850,000). Bill's son receives nothing upon Karen's death.

Assume Bill dies several years after Karen, also without a written will. Bill's son would receive all of Bill's interests in the farm (58 percent interest) and all of the non-farm assets (that Bill had inherited at Karen's death with a \$300,000 value). Karen's daughter and Bill's son would then become co-owners of the farm. This isn't the outcome Bill and Karen were envisioning.

What if Bill dies first and leaves no written will?

If Bill dies before Karen and doesn't have a written will, all of the \$300,000 of non-farm assets transfer directly to Karen. Why? The assets are held in joint tenancy with rights of survivorship between Karen and Bill. At the death of one of the joint tenants, the survivor receives all. Even if Bill had written a will indicating the non-farm assets were to pass to his son and Karen's daughter, the joint tenancy with Karen takes priority over Bill's will. At Bill's death Karen becomes the owner of all \$300,000 of the non-farm assets.

The farm property is not affected by Bill's death because it is titled in sole ownership in Karen's name. At Bill's death Karen now owns all of the assets. Bill's son does not receive anything following his father's death.

Assume Karen dies a few years later, also without a written will. Karen's daughter inherits the entire estate based on Montana's intestacy statutes. Bill's son does not receive anything following his step-mother's death. This potential outcome is also not what Bill and Karen envisioned.

Developing an Estate Plan

Bill and Karen decided to share their concerns with an attorney, who explained that they have several options. The first option uses a will for both Bill and Karen. While this option is simple and easy to implement, it may not meet all of Bill and Karen's goals of providing an equitable division for their respective children.

A second option utilizes an additional estate planning tool, a bypass trust. This option is more complex, but it helps ensure that both Karen's daughter and Bill's son will receive the specific assets their parents want them to receive.

Estate plan utilizing two wills: Option #1

The attorney informed Bill and Karen that a written will can address many of their concerns. For example, Karen's will could state that if Bill is living when she dies, the farm land assets that Karen has titled in sole ownership are to be inherited by her daughter. The remaining non-farm assets held in joint tenancy with the right of survivorship with Bill would pass outside the will directly to Bill. If Bill is not living when Karen dies, then her will could contain a provision that divides the non-farm assets equally between Bill's son and her daughter.

Bill could also write a will. Bill's only properties are the non-farm assets held in joint tenancy with right of survivorship with Karen. If Bill were to die first, his will would have no assets to direct because the joint tenancy with right of survivorship title on the non-farm assets transfers all of his jointly owned assets to Karen. However, if Karen dies first, Bill's will controls all the non-farm assets. Bill's will could contain a provision for his son and Karen's daughter to share in the non-farm assets equally.

Both Karen's and Bill's wills could contain a provision stating that if they die in a common accident their non-farm assets are to be divided equally between Bill's son and Karen's daughter.

Although this plan does accomplish Bill and Karen's estate planning goals, it does have several disadvantages. First, if Karen dies before Bill, the farm land assets are inherited by her daughter. Because Karen's daughter now owns the farm, Bill may find himself in the uncomfortable position of having to ask Karen's daughter to let him remain in the house on the farm. Will the daughter agree? Would she charge Bill rent? What if Karen's daughter decides she wants to live in the house? Bill could be forced to relocate.

Second, if Karen's daughter decides to sell the farm, Bill could not prevent her from doing so because he isn't the owner. Where would Bill live? Bill and Karen are concerned about these potential outcomes even though they may seem remote with the positive family relationships that exist between them and their adult children at the present time.

Estate plan with a will including a bypass trust: Option #2

Another option is an estate plan that adds a bypass trust to their wills. This plan is more complex than the previous estate plan, but it provides additional options for Bill and Karen. This more advanced estate plan would allow specific assets to be placed in a bypass trust when the first spouse dies.

A bypass trust is so named because the assets are included in the estate of the first to die, thus bypassing the estate of the second to die. In prior years, a bypass trust was often utilized to minimize federal estate taxes. However, changes in the federal estate tax exemptions have largely removed this motivation for bypass trusts. For couples who anticipate having (at the death of the first spouse to die) estates valued collectively at more than \$11.4 million (the individual estate tax exemption in 2019), planning for minimizing the federal estate tax can still be an important factor. More information on the Federal estate tax can be found in the MSU Extension Montguide, *Federal Estate Tax (MT199104HR)*.

The bypass trust could include a provision allowing the surviving spouse to continue to have use of assets placed in the trust. The surviving spouse could also utilize the income generated by the assets of the trust during his or her lifetime. After the second spouse dies the assets are then distributed by the trustee of the bypass trust to the beneficiary or beneficiaries indicated in the trust of the first spouse to die.

As an example, Karen's will could state that if she dies before Bill, then the land assets will be transferred to the trustee of a bypass trust for the lifetime benefit of Bill and for the ultimate benefit of her daughter. The provisions of the bypass trust, as administered by the trustee, could allow Bill to live in the house and receive the income from the farm land, but restrict him from selling or giving that farm land away.

After Bill dies, under the terms of the bypass trust, the trustee distributes the farm land to Karen's daughter. Thus, with the bypass trust Karen can ensure Bill's use and benefit from the farm land until his death. After he dies the trustee is directed to transfer the land to Karen's daughter.

Conclusion

A will with a bypass trust is combination of tools that can help any family, and particularly remarried, step and blended families, create an estate that meets their goals for passing property to specific heirs. The property in the bypass trust can provide income for the surviving spouse during his or her lifetime. After the death of the surviving spouse, the trustee can be directed to pass the property to the desired heirs. A bypass trust may not be appropriate for all estate plans, but some families will find it a valuable tool to ensure their wishes are carried out.

Other resources

For additional information about estate planning visit the MSU Extension estate planning website at: www.montana.edu/estateplanning

Acknowledgement

This MontGuide has been reviewed by representatives of the Business, Estates, Trusts, Tax and Real Property Section of the State Bar of Montana, who recommends its reading by Montanans who are interested in an introduction to how bypass trusts could accomplish their estate planning goals. The Section encourages all persons considering a bypass trust to obtain competent legal advice.

Disclaimer

This publication is not intended to be a substitute for legal or tax advice. Rather, it is designed to help families become better acquainted with some of the devices used in estate planning and to create an awareness of the need for such planning. Future changes in laws cannot be predicted, and statements within this fact sheet are based solely upon those laws in force on the date of the publication.



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