

The best trust plan for your spouse

Providing for a surviving spouse, often the single most important objective in a family's estate planning, never has been as simple as creating a will that leaves "all my property to my beloved." Today's complex and changing tax laws only make the job more challenging. The answers to the following questions will shape the strategy for providing for your spouse:

- **Will federal estate taxes be an issue?** Whether an estate will owe a federal death tax is a function of both the size of the estate and the year of death. (See the table "Planned changes to the federal estate tax" below for a summary of what's already on the books for the next few years.) Keep in mind that planning must take into account two deaths, not just one. True, all estate taxes may be deferred when the first spouse dies, but the entire estate could be exposed to tax at the death of the survivor. If the survivor lives to 2011 or later, the tax threshold is scheduled to be a relatively low \$1 million.

- **Who will manage the investments?** For older couples, taking care of routine financial management can be a burden—hence, the growing popularity of living trusts. A widow or widower similarly will benefit from the oversight that an experienced professional trustee brings to asset management.

- **How much income will be needed?** Will the spouse require the income of the entire estate? Or will it be advantageous to begin the process of transferring wealth to younger generations?

- **What about beneficiaries at the spouse's death?** That's when the children typically come into their inheritance. But should that inheritance be fixed when the first spouse dies? Or should the surviving spouse have the power to alter that plan as family and financial circumstances change?

Trust approaches to consider

Take this fictitious example. John and Mary own assets worth \$5 million. John's health is poor. Mary's is quite good, and she's a few years younger than he is. So the plan should assume that she'll be a widow for ten years or longer. John simply could provide that all the family assets pass to a marital deduction trust. There would be no federal estate tax at John's death, preserving

the full estate for Mary’s benefit. If John names a corporate fiduciary to manage the trust, Mary will have the benefit of professional asset management for the rest of her life. The trust would name the surviving beneficiaries at Mary’s death, and Mary would be able to alter that plan through appropriate provisions in her will.

The one glaring defect in this plan is that the full \$5 million will be exposed to estate tax at Mary’s death, creating a potential tax cost of hundreds of thousands (even millions) of dollars. Such exposure is not necessary. If John creates a second trust, known as a “bypass trust,” he can reduce the potential for tax damage sharply. A bypass trust can provide all of its income to Mary for her life, but will be drafted so as to avoid taxation in her estate. (Typically, she will not be able to redirect the trust principal.) The size of the trust ordinarily is keyed to the amount exempt from federal estate tax at John’s death—if he dies in 2008, it would be \$2 million, for example. In that event, only the remaining \$3 million will be subject to estate tax when Mary dies, and her own exemption will provide some relief as well.

Now add this fact: John has children from his first marriage, as well as children with Mary. He needs his plan for the trust assets at Mary’s future death to be irrevocable. That’s possible with a Qualified Terminable Interest Property (QTIP) trust, an approach that is growing in popularity. Just as with a traditional marital deduction trust, Mary would receive all of the trust income for the rest of her life, but she wouldn’t have the power to alter the disposition of the trust principal.

Basic estate planning for married couples isn’t too difficult, but it’s not automatic. The documents need to be drafted and executed. An estate planning attorney’s supervision will be required. And, of course, we would be pleased to be of assistance.

Planned changes to the federal estate tax		
Year	Exemption amount	Maximum federal estate tax rate
2008	\$2 million	45%
2009	\$3 million	45%
2010	No federal estate tax	
2011 and later	\$1 million	55%

Marital trust choices				
Trust type	Estate tax exposure at spouse’s death?	All income to spouse?	Spouse can direct remainder?	Comment
Traditional marital deduction trust	Yes	Yes	Yes	Best for larger estates, paired with a bypass trust

Qualified Terminable Interest Property (QTIP) Trust	Elective	Yes	No	Best for multiple-marriage situations
Credit shelter trust	No	Elective	No	Appropriate by itself for estates smaller than \$2 million; but may be paired with traditional or QTIP trust
Qualified Domestic Trust (QDOT)	Yes	Yes	No	For a spouse who is not a U.S. citizen

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Any developments occurring after January 1, 2008, are not reflected in this article.