

Abstract: This report examines how to successfully reduce estate taxes by transferring assets to a marital trust in the surviving spouse's name. Marital trusts vary widely in their complexity, so the article discusses various scenarios.

Estate Planning With Marital Trust Assets

The term "unlimited marital deduction" is often used to describe an amount ranging from all of the decedent's estate to the portion of the estate in excess of the lifetime gift and estate tax exemption equivalent (applicable exclusion amount is currently \$675,000). But for many families, merely delaying the payment of estate tax may not be enough. Without further planning, a large portion of your family's wealth will remain subject to estate tax, and the surviving spouse will need to do additional planning to reduce his or her taxable estate.

What Is the Unlimited Marital Deduction?

In general, a deceased spouse's estate can deduct the value of property transferred at death to the surviving spouse (or to a qualifying trust for the sole benefit of the surviving spouse) for federal estate tax purposes. This is called "the marital deduction." Estate plans often combine the use of the applicable exclusion amount with the marital deduction so no estate tax is payable on the first

spouse's death. As a result, estate taxes are deferred until the surviving spouse's death.

Most family assets in such a situation are available to or for the surviving spouse's use. Those assets generally include property the surviving spouse already owned and property he or she received from the deceased spouse either outright or in a marital trust. If the surviving spouse receives assets outright, then the full range of estate planning options is available. If the assets are left in a marital trust, the surviving spouse and trustee should undertake a careful analysis to determine what additional planning is needed.

Taking a Closer Look

The terms of marital trusts vary widely. Some marital trusts are more restrictive to insulate the surviving spouse from pressure a potential new spouse or overbearing children may exert. Others are set up to take advantage of tax planning opportunities, preserve assets for children from the decedent's prior marriage or provide protection for a spendthrift surviving spouse. Marital trusts

can also be much more flexible and used in lieu of an outright distribution to avoid probate and to provide the surviving spouse with structure or the guidance of a trusted advisor.

The ease with which the surviving spouse may obtain control over assets held in a marital trust will depend on the specific type of marital trust and the trust provisions that control distributions. For example, one of the least restrictive types of marital trusts gives the surviving spouse a lifetime general power of appointment which allows him or her to remove assets from the trust by appointing assets to him- or herself or others. The surviving spouse in effect has control over the trust assets.

Other powers the surviving spouse may possess include the power to withdraw assets from the marital trust. The power may allow unlimited withdrawals or be restricted to a five-and-five power, which allows the surviving spouse to withdraw the greater of \$5,000 or 5% of the trust value each year. Even the withdrawal of only 5% of the trust assets can allow the surviving spouse to control a significant amount of assets over time.

Consider the Possibilities

Once asset control is established, the surviving spouse and trustee can determine which estate planning options to implement. What if the surviving spouse uses his or her own assets to implement a substantial gifting program for the benefit of children, grandchildren and charities? The gifting program could involve simple outright gifts or more sophisticated planning. This type of process may be used if the trust agreement does not permit sufficient flexibility for the spouse to withdraw funds or the trustee to make distributions for making gifts.

Another option is for the surviving spouse to establish an irrevocable life insurance trust and have the trust acquire a life insurance policy on the spouse's life. Policies are available even for persons of advanced age, so don't dismiss the concept merely because a spouse is older. Life insurance proceeds would not be included in the surviving spouse's estate for estate tax purposes. In the interim, the spouse can use cash flow from the marital trust through either the income stream or principal withdrawals to give him or her sufficient cash to pay premiums. Further, if the surviving spouse's advisors are comfortable with the concept of a private split-dollar life insurance arrangement,

the marital trust may become the funding vehicle.

The fact that a substantial part of the surviving spouse's assets are held in a marital trust where the spouse has limited excess to the funds should not deter leveraged gift planning, such as the family limited partnership (FLP). Under one scenario, the marital trust would be one of the partners in the FLP. Distributions of limited partnership interests could be made to the surviving spouse as a distribution of principal. Those limited partnership interests could be the subject of future gifts by the spouse.

Facing the Future

Please let us know if you would like to learn more about estate planning options available to a surviving spouse. We can answer questions you may have about marital trusts or any other estate planning opportunities.