

The Unintended Consequence of Your Living Trust

By, Michael K. Elson, Attorney at Law

Many couples have executed an A-B "credit shelter" trust in order to preserve estate tax exemptions for both spouses. This can potentially benefit the heirs by saving nearly one million dollars in inheritance taxes. The consequence of the credit shelter trust, however, is that estate assets are necessarily sheltered from the surviving spouse. Because language in many trusts calls for the credit shelter trust to be funded with an amount equal to the federal exclusion amount in effect at the time of death, the sheltered amount can be quite large and leave the surviving spouse with too little in the way of assets. Fortunately, proper estate planning, including the use of a "disclaimer A-B trust," can relieve this problem.

This can potentially benefit the heirs by saving nearly one million dollars in inheritance taxes.

Use of a qualified disclaimer provision (I.R.C. § 2046; I.R.C. § 2518) is a method that has gained a great deal of favor due to its flexibility in many situations. The disclaimer allows provisions for federal estate tax planning to be included in trust drafting, while providing the surviving spouse the right to make a decision as to whether or not the transfer of the decedent spouse's share (via disclaimer to the credit shelter trust or outright, as provided in the estate plan) will actually take place. With federal estate tax exemption amounts drastically changing, there is more potential that, as of the date of a spouse's death, it may not be necessary for the surviving spouse to relinquish control of assets in order to eliminate federal estate tax. Taking into account his or her own needs and the prevailing tax environment, the surviving spouse will be able to fund the credit-shelter trust with an amount that makes sense. In many ways, this is preferable to locking in a fixed amount far in advance. Decisions can be made as of the date of death (and must be made within nine months of date of death), when applicable tax law and asset values can be ascertained and the best choices can be made based on current facts and your goals.

On the other hand, many estates are currently large enough or have the potential to be large enough that federal estate tax certainly could be an issue. If the tax has been phased out, or if the exclusion amounts have increased enough so the value of the surviving spouse's estate (after inheriting from the decedent spouse) will not exceed the applicable exclusion amount, then there is no need to relinquish control. Of course, the spouses may have other reasons for restricting the surviving spouse's control of assets upon the death of the first spouse.

For these reasons, use of the disclaimer provides the best of both worlds. Use of the disclaimer trust provides the greatest flexibility in overall planning, the greatest opportunity to apply current goals, tax law, and financial situation to make sound choices at the time decisions must be made, and retains the greatest degree of control for you. When reviewing your estate plan, changes in the law and your estate should be taken into account to avoid unintended consequences which may have been unforeseeable at the time the plan was initially executed.

Michael K. Elson is the principal of The Law Offices of Michael K. Elson, which provides estate and asset protection planning, including LLCs, corporations, family limited partnerships, and various trusts. He may be reached at (818) 763-8831 or (800) 781-7038 or by visiting www.LimitLiability.com.