Supercharging Your Credit Shelter Trust

A common estate planning strategy for married couples with significant wealth, and potential federal estate tax liability, is the creation of a credit shelter trust upon the first spouse's death. The credit shelter trust can shield assets from estate taxes equal to the estate tax exemption ($5M, indexed annually for inflation). The trust assets can then be used for the benefit of the surviving spouse, children, and perhaps even future generations. While this is a powerful estate planning strategy, it can be "supercharged" and made even more powerful, particularly for those who wish to perpetuate wealth. How do you do that?

Solution: Life Insurance in the Credit Shelter Trust:

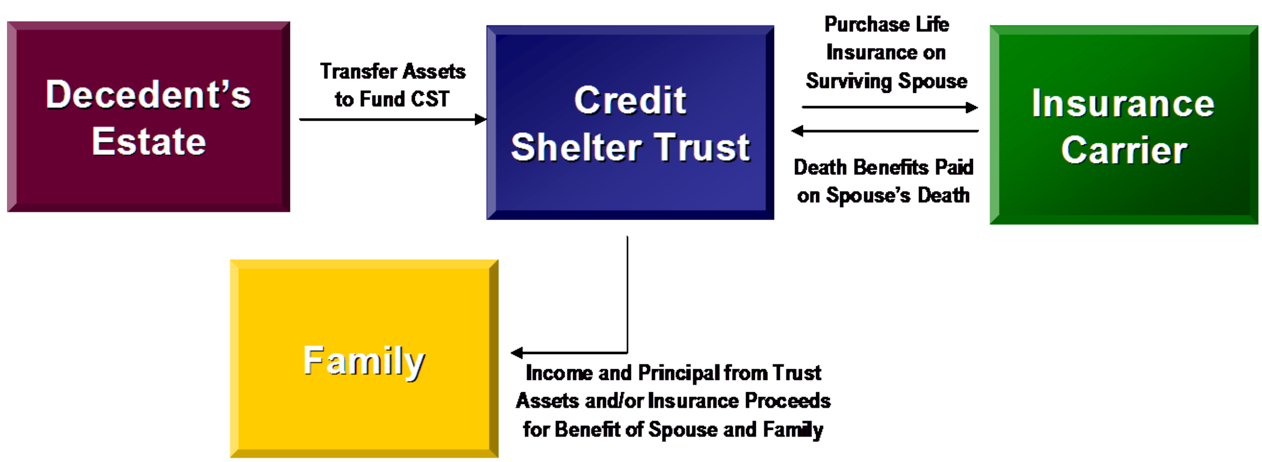
The credit shelter trust ("CST") is also known as a B trust, unified credit trust or bypass trust. The purpose of a CST is to take advantage of the federal applicable exclusion amount (a/k/a basic exclusion amount.) The applicable exclusion amount is that amount that any U.S. citizen may pass to non-spouse beneficiaries (e.g., children) free of federal estate taxes. That amount is $5 million (indexed annually for inflation). Accordingly, a married couple can protect up to $10 million from estate taxes. Properly drafted, the CST may provide a lifetime benefit to the surviving spouse, children and even to future generations.

Depending upon the state you live in, the assets in the CST may also potentially be shielded forever from estate taxes and from creditors of the trust beneficiaries. In this way, the CST acts like a perpetual "family bank."

In order to maximize the power of a CST, the CST may use income or trust assets to purchase life insurance on the surviving spouse. When the spouse passes away, the life insurance further increases the amount of money in the trust for the benefit of the children and future generations.

Considerations:

- The value of the CST at the surviving spouse's death would be substantially increased by the life insurance death benefit, thus "supercharging" the CST.
- An independent trustee (i.e., a trustee who is not a trust beneficiary) can access the cash value of the insurance policy for the benefit of the surviving spouse and/or children, if necessary, although for maximum utility the trust assets should be left undisturbed. This requirement is to avoid any possibility that the insurance policy will be included in the surviving spouse's estate for estate tax purposes.



- The CST is a separate legal entity, subject to income taxes on income generated by the trust assets. The cash value of a permanent life insurance policy, however, grows tax-deferred and, therefore, reduces trust income generated by this asset.
- The trust may be designed to also leverage the generation skipping transfer ("GST") tax exemption which would allow the trust assets to escape estate, gift, and GST taxes for the life of the trust. Depending upon the state, trusts may potentially last in perpetuity.
- The assets in the trust may also be protected from the creditors and ex-spouses of the trust beneficiaries (i.e., the spouse, children, grandchildren, etc.), particularly if an independent trustee is used and a beneficiary is not also a trustee making distribution decisions.
- The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 created a new feature in estate planning: portability. The American Taxpayer Relief Act of 2012 made portability permanent. "Portability" allows a surviving spouse to "port in" the unused estate tax exemption amount of the "last deceased spouse". Portability has been touted as the death knell of Credit Shelter Trusts (a/k/a Bypass Trusts) and as ending the need for A-B trust planning, simplifying the use of both exemptions for married couples. There are several reasons, however, why married couples may still wish to include a CST in their estate plan. First, even though portability was made permanent, Congress can change the law and remove it. Next, portability does not provide the asset protection and estate freezing features of a CST. Also, portability does not apply to generation skipping transfers and state death taxes. For a detailed discussion of these and more reasons why portability may not be an appropriate substitute for a properly funded CST, please refer to the Business Resource Center publication: *The Problems With Portability – Nine Pitfalls*.

Life insurance in a credit shelter trust is an effective way to leverage the basic exclusion amount to create a substantial and well-funded "family bank." It also allows leveraging the estate, gift, and generation skipping transfer tax exemptions. Done correctly, the trust may be free of these taxes for the life of the trust and also protect the assets against the creditors of the trust beneficiaries. Yet, flexible provisions in the trust will still ensure that funds will be available to care for the needs of the surviving spouse, children and generations to come.

Please consult with your Guardian Financial Representative if you have any questions concerning this document.

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