

# Two-Trust Estate Plan for Married Couples

If you have a large estate, a two-trust estate plan can help you and your spouse take full advantage of the federal unified tax<sup>®</sup> credit and transfer more of your assets to your children or other heirs free of estate and gift tax.

## The Unified Credit

Every individual is allowed a credit that permits a certain amount of property to be transferred to others free of federal estate and gift taxes. If your total taxable estate and lifetime gifts are less than or equal to the applicable exclusion amount (below), no federal estate tax will be due at your death.

ESTATE-TAX EXCLUSION AMOUNTS	
Year	Exclusion Amount
2011	\$5 million
2012	\$5,120,000
2013	\$1 million

As you can see, the estate-tax exclusion amounts for 2011 and 2012 are relatively large. However, unless new legislation is enacted, lower estate-tax exclusion amounts will return in 2013.

Married couples also can take advantage of another federal estate-tax provision, the unlimited marital deduction. The marital deduction generally allows a spouse to transfer an unlimited amount of property to the other spouse free of both estate and gift taxes. So, if you leave your entire estate to your spouse, no tax generally will be due on your estate.

## Potential Problems

While the idea of passing all of your property to your surviving spouse tax free may sound attractive, this planning approach isn't always tax-wise — especially if the value of your combined estates is greater than the exclusion amount. Because all of your property passes to your spouse under the marital deduction, your estate generally would not be able to make use of your unified credit.\* When your spouse dies, the property that remains will be included in your spouse's estate for estate-tax purposes.

\* Under the 2010 Tax Relief Act, the estate of a surviving spouse may be able to utilize any unused portion of the exclusion amount of a deceased spouse who dies in 2011 or 2012. The executor of the deceased spouse's estate must make the appropriate election.

For example, when Barry died several years ago, he had a \$6 million estate, which he left to his wife, Judy. On Judy's death in 2012, her taxable estate is also worth \$6 million. Because Judy didn't marry again, her estate can't use the marital deduction. Judy's estate claims the unified credit, but this credit effectively exempts only \$5.12 million of her estate from tax. Judy's estate is subject to an estate tax of \$308,000. If Barry's estate plan had been set up to use his unified credit, the tax on Judy's estate could have been avoided.

## A Better Plan

One way to make the most of your and your spouse's unified credits is to arrange for your estate to be divided into two parts at your death. One part is placed into a trust created in your will to take advantage of your unified credit — the "bypass" or "credit shelter" trust. The rest of the estate is placed in a trust that qualifies for the estate-tax marital deduction — the marital trust.

**Bypass/credit shelter trust.** This trust can pay your surviving spouse a lifetime income and then benefit your children or other named beneficiaries after your spouse's death. You can even give your spouse a limited power to withdraw trust assets. Some people limit the amount in the bypass/credit shelter trust to the credit exclusion amount so that any tax on the trust property will be offset by the credit.

At your death, your unified credit will be applied against the property in the credit shelter trust. If the value of those assets is less than or equal to the credit exclusion amount, no estate tax

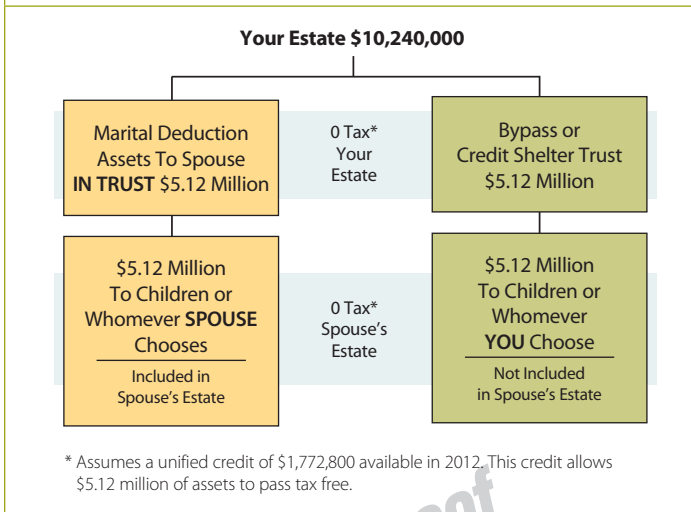
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## TWO-TRUST ESTATE PLAN



will be due. At your spouse's death, the value of the property in the bypass/credit shelter trust — including any appreciation — won't be included in his or her taxable estate.

**Marital trust.** No estate tax is due on the property passing to the marital trust, either. However, because these assets pass tax free under the marital deduction, they will be included in your spouse's estate. But your spouse's unified credit will be available to offset tax on some or all of those assets.

To qualify for the marital deduction, all of the income from the trust generally must be payable to your surviving spouse annually or more frequently. You may give your spouse a general power to distribute the trust property. Thus, your spouse could choose to withdraw all or part of the trust principal. Alternatively, you could give your surviving spouse the power to distribute the property only by will.

**QTIP trust option.** If you wish, you can set up your marital trust as a QTIP (qualified terminable interest property) trust so that you have control over who will receive the trust assets when your spouse dies. Very generally, a QTIP trust gives your spouse a right to the trust's income for life. At your spouse's death, the trust property passes to your children, grandchildren, or other beneficiaries you've chosen.

Your executor or personal representative can elect to claim the marital deduction for the trust property. While the trust property will be included in your spouse's estate for estate-tax purposes, the property must be distributed as you have directed in your QTIP trust agreement.

### Other Benefits

A two-trust estate plan can save or eliminate estate taxes. But tax savings are by no means the only benefits. When you name an experienced investment manager as your trustee, a two-trust estate plan can also:

- Protect your assets against mismanagement
- Relieve your spouse of the responsibility and burdens of managing assets
- Provide professional investment management for your children until they reach the age you and your spouse feel is appropriate for them to receive their inheritances

**Whether a two-trust estate plan is right for you and your family depends on your individual needs and objectives. Your legal and financial advisors can tell you more.**

To order this SmartSheet for your clients and prospects, please contact:



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