

EXPLANATION OF THE USE OF THE MARITAL DEDUCTION AND CREDIT SHELTER TRUST TO MINIMIZE FEDERAL ESTATE TAXES

HOW THE FEDERAL ESTATE TAX WORKS

The estate tax is an easy tax to forget about. It is unique in that it is payable only once, and then only after you are gone. The impact of the estate tax is not on you, but on your survivors. It does not burden your business or lifestyle while you are alive, but is inflicted upon your family after your death.

There are death taxes imposed by the county of residence (inheritance tax) and by the State of Nebraska, but by far the major item of concern is the federal estate tax. Prior to 1976, there were separate federal estate and gift tax rates. The 1976 Tax Reform Act merged these taxes into a single unified tax based upon the total of all gifts made during the life (with some exceptions) and all property owned at death. Gifts of less \$12,000.00 to any individual in any year are not included nor are gifts made from one spouse to the other. Gifts made above the \$12,000.00 amount in any year result in the excess being included in the estate of the person making the gift at the fair market value of that gift as of the date it was given.

The federal estate tax marital deduction is the common name given to the Internal Revenue Code provision which allows a person to transfer, at death, property to his or her surviving spouse free of federal estate tax. Prior to January 1, 1982, the deduction was limited to the greater of one-half of the property owned at death or \$250,000.00. Thus, if an estate was less than \$500,000.00 in size, the deduction could be greater than one-half of the property owned. Since January 1, 1982, the marital deduction allowable to an estate is unlimited and will apply to all qualifying property that is transferred from the decedent to the surviving spouse.

There is a credit against any gift tax or estate tax which is commonly referred to as the unified credit. This is a direct credit against tax rather than an exemption of property from tax. Beginning in 2002, the unified credit will increase to \$1,000,000.00 and will continue to increase through 2009. There is no estate tax in 2010, but the estate tax returns to its level in 2001, under the sunset provision. Although it may be unlikely that congress will allow the estate tax to revert completely back to its 2001 level after 2010, in the absence of additional legislation, the 2001 estate tax law will return effective January 1, 2011. The following table shows the phasing in of the credit and the value equivalent of the unified credit for 2001 through 2009.

<u>Year</u>	<u>Unified Credit Against Tax</u>	<u>Value Equivalent of Unified Credit</u>
2001	\$220,550.00	\$675,000.00
2002-2003	\$345,800.00	\$1,000,000.00
2004-2005	\$555,800.00	\$1,500,000.00
2006-2008	\$780,800.00	\$2,000,000.00
2009	\$1,565,800.00	\$3,500,000.00

The \$2,000,000.00 value equivalent has been in effect since January 1, 2006. It takes this much property to generate an estate tax of \$780,800.00, which is offset by the unified credit. This is why the unified credit is many times referred to as the \$2,000,000.00 exemption.

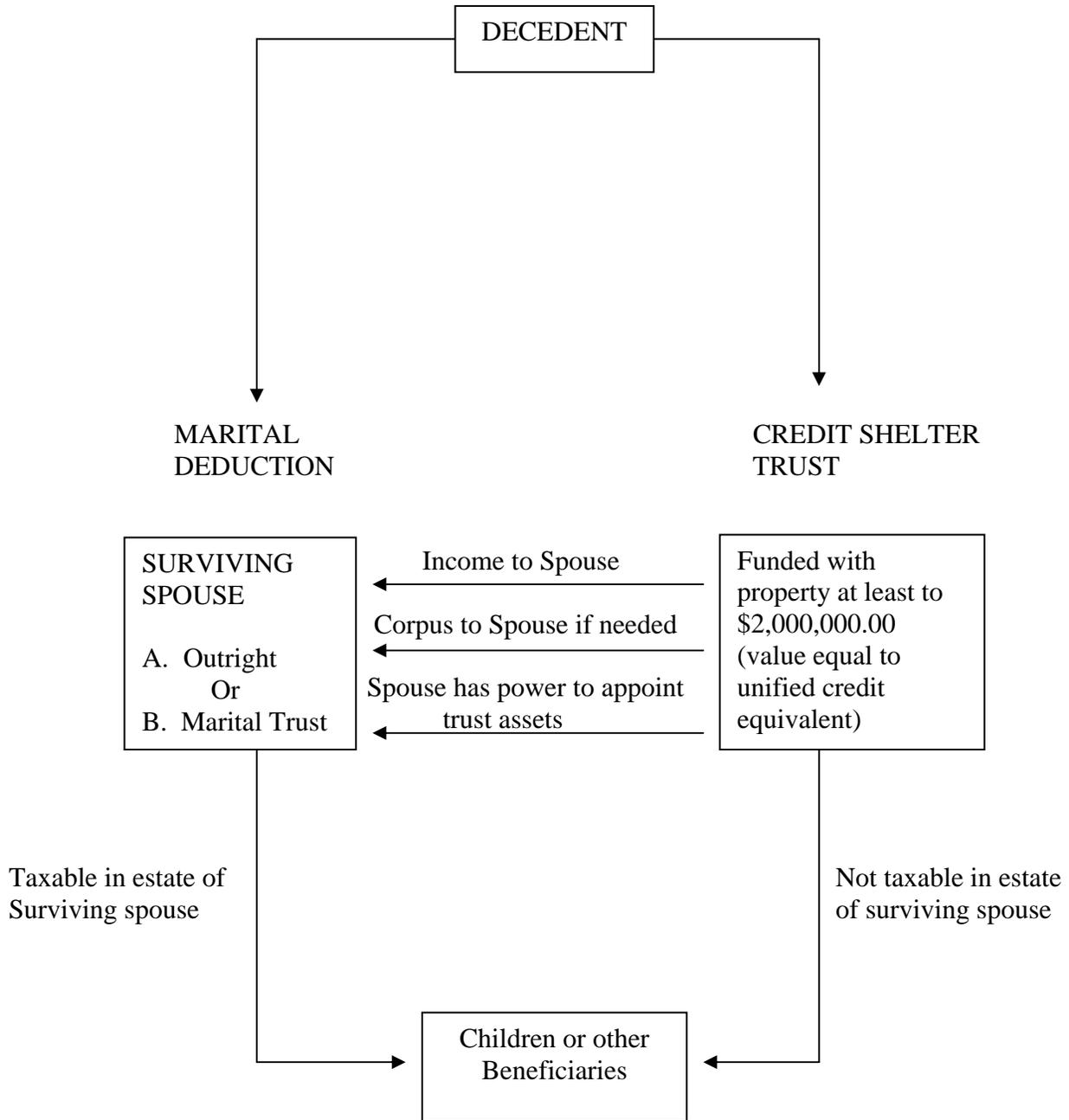
The estate tax is first computed according to the estate tax rates and then the credit is deducted from the tax so determined. Thus, the beginning estate tax bracket is now 41%. The current estate tax rates are displayed at the end of this explanation.

MARITAL DEDUCTION

For those estates in which the combined value is \$2,000,000.00 or less, it is possible to use only the marital deduction to avoid tax in either estate.

The marital deduction is obtained by passing property to the surviving spouse either as an outright gift in the Will or by leaving the property in a marital trust for the benefit of the surviving spouse. If this latter approach is used, care must be taken so that the surviving spouse has rights which will cause the property to be taxable to his or her estate when the surviving spouse dies. In such a trust, in addition to giving the surviving spouse the income from the property, the surviving spouse is also given the right to invade or sue the principal for any purpose or reason and the right to appoint it to anyone by his or her Will. In this type of trust, the concern is not for the protection of the people who will receive the property after the trust has ended (at the death of the surviving spouse), but rather to provide management assistance to the surviving spouse if it is deemed necessary. The key, whether the gift is outright or by trust, is that the property must go to the surviving spouse in such a manner that it will be taxable to the estate of the surviving spouse should the surviving spouse die still owing the interest in the property. If the property does not pass in this manner to the surviving spouse, the marital deduction will be disallowed and additional federal estate taxes will be paid on the value of that property, if that value exceeds the \$2,000,000.00 unified credit value equivalent.

If a husband and wife have a combined estate in excess of \$2,000,000.00, then additional tax planning should be done to avoid any unnecessary federal estate tax in the surviving spouse's estate. Ownership of assets becomes important as each spouse's Will must control a sufficient amount of property to properly shelter it from tax in the surviving spouse's estate. This additional planning uses the marital deduction concept in conjunction with a "credit shelter trust" to achieve the maximum exemption of property from federal estate tax. A "credit shelter trust" is a trust created by the Will of the first spouse to die and is funded with property at least equal to the value equivalent of the unified credit, i.e. \$2,000,000.00. The remainder of property owned by the estate of the first spouse is then transferred to the surviving spouse (either outright or through a marital trust) and qualifies for the unlimited marital deduction. By use of these two concepts, and with proper ownership and transference of assets through each spouse's estate, a maximum of \$4,000,000.00 of property can be sheltered from federal estate tax. This division of property at the death of the first spouse is illustrated by the following example:



The provisions of your Will passing property to the surviving spouse in order to qualify for the unlimited marital deduction while reserving enough assets to fully utilize the value equivalent of the unified credit may be found in the paragraph of your Will entitled "marital trust".

CREDIT SHELTER TRUST

With the introduction of the unlimited marital deduction in 1982, it became possible to leave all property outright to a surviving spouse and pay no tax in the estate of the first spouse. However, this has the potential of wasting a \$2,000,000.00 exemption (the amount equal to the value equivalent of the unified credit in the first estate), as the property equal to that value equivalent would be included in the estate of the surviving spouse and unnecessarily taxed in that estate.

This unnecessary tax can be solved by leaving an amount of property equal to the value equivalent of the unified credit directly to the children or other family members. It may be a desire, however, that the income from all property in the estate of the first spouse be made available to the surviving spouse for life.

Through the use of a trust for the value of equivalent of the unified credit (the \$2,000,000.00 exemption) the property can be held so that the surviving spouse can receive all of the income. In addition, the surviving spouse may invade this type of trust for the medical expense, support and maintenance of the surviving spouse without the property being subject to estate tax in his or her estate. Generally, these properties are held in trust for the lifetime of the surviving spouse. At the death of the surviving spouse, the trust property may be passed to children or other family members as designated by either the person creating the trust or as designated by the surviving spouse. The right to designate give to a surviving spouse is called a "power of appointment". It does not make the trust property subject to estate tax in the estate of the surviving spouse. However, this power to appoint is limited to a class composed of the issue of the husband and wife.

This type of trust is generally referred to as a "credit shelter trust" because it shelters the value equivalent of the unified credit from tax in the surviving spouse's estate. Its provisions are set forth at in the paragraph of your Will entitled "credit shelter trust".

DISTRIBUTION AT DEATH OF SURVIVING SPOUSE

At the death of the surviving spouse, the assets held in the credit shelter trust are usually distributed pursuant to the Will of the surviving spouse. The passage of property in the estate of the surviving spouse is accomplished in another paragraph of the Will and is not complicated by the federal estate tax considerations which make the wording of the marital trust and the credit shelter trust more difficult. The distributions should be controlled by family considerations rather than estate tax considerations.

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TAX TABLE

Amount subject to tax:	Tax rate:
Over \$250,000, but not over \$500,000	\$70,800, plus 34% of the excess of such amount over \$250,000
Over \$500,000, but not over \$750,000	\$155,800, plus 37% of the excess of such amount over \$500,000
Over \$750,000, but not over \$1,000,000	\$248,300, plus 39% of the excess of such amount over \$750,000
Over \$1,000,000, but no over \$1,250,000	\$345,800, plus 41% of the excess of such amount over \$1,000,000
Over \$1,250,000, but not over \$1,500,000	\$448,300, plus 43% of the excess of such amount over \$1,250,000
Over \$1,500,000, but not over \$2,000,000	\$555,800, plus 45% of the excess of such amount over \$1,500,000
Over \$2,000,000, but not over \$2,500,000	\$780,800, plus 49% of the excess of such amount over \$2,000,000
Over \$2,500,000, but not over \$3,000,000	\$1,025,800, plus 53% of the excess of such amount over \$2,500,000
Over \$3,000,000	\$1,290,800, plus 55% of the excess of such amount over \$3,000,000

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