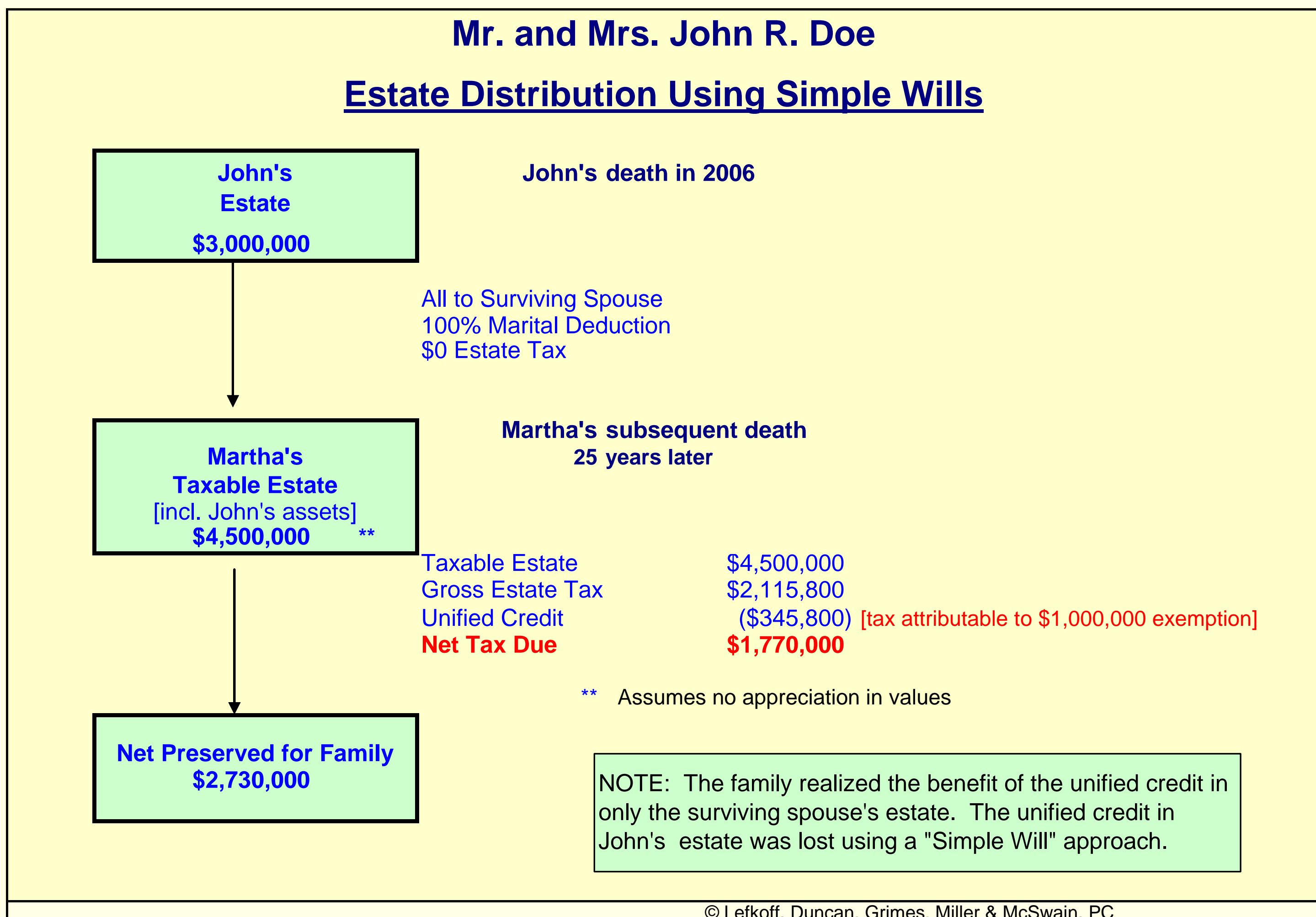
Optimum Marital Deduction Tax Planning

Where the value of the estate exceeds the amount of the estate tax exclusion available, appropriate provisions in each spouse's Will (and related trusts) can significantly reduce the impact of estate taxes on family wealth. For instance, in 2006 if the combined value of a couple's estate exceeds the $2,000,000 which is "protected" by the Unified Credit exclusion, it is important to plan to preserve the exclusions available in <u>both</u> estates, for a total (in 2006) of up to $4,000,000 in exclusions.

The structure of the estate tax system leads a taxpayer wishing to use a "simple" Will to waste one of the available exclusions. If, for instance, John were to die first and everything were left outright to his wife, Martha, there would be no federal estate tax because everything would qualify for the marital deduction. However, all of this property would be taxable in Martha's estate at her later death, along with her other assets, with only her $2,000,000 exclusion available. The $2,000,000 exclusion amount which was otherwise available in John's estate would have been wasted. The purpose behind using an optimized marital deduction provision in the estate plan is to take advantage of the exclusion amount allowed to the estate of the first spouse to die <u>and</u> the exclusion amount allowed to his or her spouse's estate.

<u>Example</u>. Assume that John and Martha Doe have combined total estates of $4,500,000, including $3,000,000 of asset value owned in John's name and $1,500,000 owned in Martha's name.

Using "Simple" Wills - Assume John dies first and leaves his entire estate of $3,000,000 outright to his wife, Martha, under a "simple" Will. There would be no estate tax due because of the marital deduction. Assume Martha dies some years subsequently, having preserved the principal of the property that John left her (ignoring any appreciation in value for the sake of simplicity.) For federal estate tax purposes, on Martha's death, the $3,000,000 of property left to her by John would be subject to the estate tax, along with her separate assets of $1,500,000 for a total of $4,500,000, and Martha's estate would use her unified credit exclusion to effectively cover the tax due on the first $1,000,000. (Remember, the exclusion reverts to $1,000,000 after 2010 under the current law.) The estate tax due would be $1,770,000. Note that, under this "simple" arrangement, the family ultimately only received the benefit of Martha's exclusion, and John's unified credit exclusion ($2,000,000 for 2006) was lost.



Using "Optimum Marital" Wills - If, however, John had used an "optimum" marital deduction plan, then on John's death, at least $2,000,000 (based on death in 2006) would have passed to a special "bypass" trust and would have been exempt from tax because of John's unified credit exclusion. The balance of John's property ($1,000,000) would have been left to Martha and would have been tax-free at John's death because it would have qualified for the federal estate tax marital deduction. Then, on Martha's death some years later, the $1,000,000 which Martha received from John as a marital deduction bequest would be included in her estate, along with her other property of $1,500,000 for a total of $2,500,000, and we would utilize <u>her</u> $1,000,000 Unified Credit exclusion. The tax due on the balance would be reduced to $680,000. There would be no tax due on the property in the "bypass" trust created under John's Will because it was protected by John's Unified Credit and Martha would not be deemed to be the owner of the property for estate tax purposes (even though she may have been the primary beneficiary and trustee of the bypass trust.)