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What Estate Plan Is Right for You?

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The choice facing many people considering estate planning requires them to compare the benefits of "living trusts" and "simple wills". Couples who ask for simple wills are saying they want everything to go outright to the survivor on the first spouse's death and presumably outright to their children after both parents' deaths. But the vast majority of couples whose combined estates (including their home, insurance, IRAs, employee benefits, and so on) are above the applicable federal estate tax exclusion amount ($1 million in 2003, $1.5 million in 2004 and increasing gradually to $3.5 million for calendar year 2009) choose a plan utilizing a living trust – referred to as a "shelter trust plan" – rather than simple wills, once they understand the following pros and cons of each of these two fundamentally different kinds of plans.

A. Federal estate tax consequences of a simple will plan.

1. First Spouse's Death. There are no federal death taxes on the first spouse's death because the entire estate goes outright to the surviving spouse and qualifies for the unlimited federal estate tax "marital deduction", thereby leaving no "taxable estate" for the IRS to apply the steeply graduated estate tax rates against.

2. Surviving Spouse's Death. When the survivor dies, however, federal estate taxes are assessed on the survivor's assets. Those assets will include whatever remains of the inheritance from the first spouse to die. If these assets (or "estate") exceed the federal estate tax exclusion amount, the taxes become very substantial. The federal estate tax applies to the excess of the value of the survivor's total assets over the federal exclusion – again, $1 million in 2003 and $1.5 million in 2004. The tax rates applicable in the year 2003 start at 41% at the $1 million level and increase to 49% (48% in 2004) for estates valued at more than $3 million.

Example - Federal and New Hampshire[1]
Estate Taxes with a Simple Will Plan

If both spouses' deaths occur in the year 2003 and total combined value of estates of husband and wife is:

	Up to $1 million	$1,500,000	$2,400,000	$3,500,000
First Spouse's Death	$0	$0	$0	$0
Survivor's Death	$0	$210,000	$631,000	$1,170,000
% of Estate to Taxes	$0	14%	26.29%	33.42%

B. *Federal estate tax consequences of a "shelter trust plan."*

1. *First Spouse's Death.* Unlike the simple will plan which leaves everything to the surviving spouse, on the first spouse's death the credit shelter plan diverts the federal exclusion amount (or the deceased spouse's entire estate, if less than the exemption amount in the year of the deceased spouse's death) to a shelter trust. This trust is also sometimes called a "credit shelter" or "family" trust. The property in this trust can be available to the surviving spouse during his or her lifetime to the extent that other assets are insufficient to provide for a suitable lifestyle for him or her. Any excess goes to the surviving spouse, either outright or in a marital deduction qualified trust (often a "QTIP" trust). There will be no federal estate tax because any excess of the first spouse's estate over the exclusion amount will qualify for the estate tax marital deduction.

2. *Surviving Spouse's Death.* Thus, like the simple will plan, no federal estate taxes are payable on the first spouse's death. But, unlike the result with a simple will, when the survivor dies, the assets remaining in the

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[1] The New Hampshire estate tax is called a "sponge" or "pick-up" tax. Until 2005, the estate tax paid to New Hampshire offsets a corresponding amount of federal estate taxes. The New Hampshire estate tax therefore does not increase an estate's overall estate tax obligation.

Beware – this may change in the near future. New Hampshire may follow the lead of her sister states who are enacting stand alone state estate tax systems to replace lost sponge tax revenues resulting from the 2001 changes made to the federal estate tax laws. If the New Hampshire estate tax law changes we will inform our clients and suggest any changes to their estate plans which might be appropriate to address the new state tax.

shelter trust created on the first death are exempt from the survivor's federal estate taxes. Hence, the name "shelter" trust. These taxes are assessed only against the survivor's own assets, including whatever remains of any marital trust or outright inheritance from the first spouse to die. The federal estate tax only applies to the excess of the survivor's own assets over his or her exclusion amount.

***Example* - Federal and New Hampshire**
Estate Taxes with a Shelter Trust Plan

If both spouses' deaths occur in the year 2003 and
total combined value of estates of husband and wife is:

	Up to **$2,000,000**	**$2,400,000**	**$3,500,000**
Taxes on First Spouse's Death (with Shelter Trust)	$0	$0	$0
Taxes on Survivor's Death (with Shelter Trust)	$0	$167,000	$680,000
% of Estate to Taxes (with Shelter Trust)	0%	6.96%	19.43%
Taxes on Survivor's Death with Simple Wills	$0	$631,000	$1,170,000
% of Estate to Taxes (with Simple Wills)	Up to 21.75%	26.30%	33.43%
Tax Savings (with Shelter Trust)	*Up to* $435,000	$464,000	$490,000

C. Other advantages of a shelter trust plan.

1. Avoid Probate. Using a trust allows you to avoid probate administration on death. It also enables you to avoid probate guardianship if you become incompetent during your lifetime. You can only secure these benefits, however, to the extent that you transfer ownership of properties to the trust beforehand.

2. Summary of Shelter Benefits for Surviving Spouse. A trust can be the surviving spouse's shelter:

a. From Creditors and a Dissident Second Spouse, including, in the event of remarriage, a dissident second spouse seeking alimony or a property settlement or an undue share on the surviving spouse's death;

b. From Income Taxes, including possibly some income tax on trust capital gains, and ordinary income, depending on how the trust is designed;

c. From Federal Estate Taxes on Second Death, not only as to the original principal of the shelter trust (as illustrated in the above tables) but also as to (i) any growth in the value of the trust principal and (ii) any income left to accumulate in the trust;

d. From Probate Administration on Surviving Spouse's Death - typically a 2% to 4% family saving - or upon the surviving spouse's incapacity, and

e. From Harassing Salesmen and Investment Advisors. With a trust it is easier for a surviving spouse or other beneficiary to put off the well meaning investment advice and buying opportunities suggested by friends and relatives (as well as requests for "loans" and gifts) by referring them all to a third party trustee.

3. Inheritance Protection and Management for Children and Future Generations.

a. Federal estate and generation skipping transfer tax avoidance. Similar shelter benefits can be provided for each child who inherits in a further trust rather than outright. However, the death tax savings may be reduced by the amount of the confiscatory (49% flat rate in the year 2003, and 48% as of 2004) federal "generation skipping tax" (GST) on transfers from the trust to persons in a generation below the child's generation. The current GST law provides some relief by permitting each parent to leave a $1.12 million generation skipping shelter trust – the exemption amount in the year 2003 being $1.12 million – that will thereafter be totally exempt from the GST. These are benefits a child cannot create for himself once he or she inherits outright. (This generation skipping strategy is described in more detail in the separate memorandum included with this package). Moreover, these further shelter trusts may provide:

b. Management and preservation until child attains financial responsibility. A trust can provide professional management for a child's inheritance until he or she reaches an age more suitable than 18, and avoid the expense and red tape of a probate court supervised guardianship.

c. Equitable sharing of family education costs. If two or more children share the same trust until the youngest attains a certain age – such as 25, the expenses of the education and upbringing of the younger child or children need not unfairly come out of the equal shares of the younger children as would be the case without a trust.

d. Capital preservation for future generations. Giving a child the advantages of a lifetime shelter trust also tends to preserve capital. Inherited capital is more likely to be preserved and passed on to succeeding generations if retained in trust and not commingled with the child's other assets – even though the trust's invasion of principal and beneficiary control provisions may be quite liberal for maximum flexibility. These further trusts established for the children and their descendants after the surviving spouse's death can establish and foster financial responsibility and a spirit of stewardship, as opposed to entitlement, among the generations.

e. Protection from child's creditors and spendthrift tendencies. A trust can also protect a beneficiary against him or herself if he or she has spendthrift tendencies or takes a religious vow of poverty and transfers all his or her properties to the religious group. The trust assets may be placed beyond the reach of the beneficiary's creditors, a dissident spouse, etc.

f. Special protection for disabled or handicapped child. For handicapped or disabled beneficiaries, a shelter trust can provide a standby fund to supplement - and not replace - sources of private assistance available to him or her.

g. Productivity incentives. For those concerned about the potential disincentives created by inheritance (or even the expectancy of inheritance), a shelter trust can provide incentives for children and future generations to become and remain economically productive. One way to do this is to limit trust distributions to amounts which will match a defined percentage a beneficiary's annual earned income with additional distributions to heirs who have chosen less remunerative careers but have demonstrated a commitment to them.

4. Necessity of "Independent" Trusteeship. Much of the tax and creditor protection benefits described above can only be achieved by providing for a third party "independent" trustee, referred to in your documents as a "disinterested Trustee", of the shelter trust to exercise discretionary powers to distribute trust property to a beneficiary. This may be an individual (a friend, advisor, business associate, or even a remote relative) or an institution. The provisions of a shelter trust relating to the disinterested Trustee's discretion can be as flexible as you wish them to be. For example, the disinterested Trustee can be given the discretion at all times to distribute trusts' assets to the "primary" beneficiary or the beneficiary's issue or even to new trusts for the beneficiary and issue – and to add undistributed income to the shelter trust principal at each year end. The primary beneficiary is usually defined as the surviving spouse during his or her lifetime, and later, when the separate further shelter trusts are created along lines of your family headed by your children, each child and ultimately the oldest living descendent who is one of the many beneficiaries of his or her separate trust

5. Giving Extensive Controls and Powers to Primary Trust Beneficiary. While the appointment of an independent trustee is often necessary, this does not mean that the primary beneficiary must be made powerless against the arbitrary decisions of a third party in the management and distribution of the property in the beneficiary's trust. Insofar as you so decide, each trust's primary beneficiary can have powers over the property which will give him or her virtually the same control over his or her shelter trust inheritance as though it were received outright. The nature and extent of these powers can be carefully drawn to approach, but not cross, the line drawn by the federal estate tax law to distinguish arrangements which will provide the tax and credit shelter benefits described above, and those which will not.

For example, with respect to a shelter trust for a surviving spouse or child, the trust agreement could provide that:

a. Primary beneficiary as co-trustee. For example, a daughter, perhaps after a stated age, such as 25, can be the family trustee of her own trust. And again after a later age, such as 35, her decisions can control all trust investments or control the operation of any family business held in the trust;

b. Removal power over independent trustee. The independent trustee can be a person or a bank with a trust department of your spouse or child's own choosing, subject to the spouse or child's power as family trustee to remove the independent trustee with or without cause without court involvement as long as replaced with another independent person or bank, and

c. Power to direct distribution of trust assets to certain persons. Your spouse or child can have a "special power of appointment" at all times to make gifts of any part or even all of the trust's assets during his or her lifetime or effective on death to anyone other than the spouse or child, him or herself, her or his creditors, or estate.

D. The disadvantages of a shelter trust plan vs. a simple will plan.

1. Initial Cost. The preparation of a trust and a will for one or both spouses plus ancillary documents (such as trust integrated insurance, qualified plan, and IRA beneficiary designation forms, declarations of trust ownership, and so on) necessarily involves an "up front" fee. Typically, the cost of a shelter plan (including probate avoidance funding) is at least $2,500 to $4,000 higher than a simple will plan. It can even be more expensive depending upon the size of the estate, the nature of the assets, and other complicating factors such as the number of other trusts and ancillary documents prepared. This fee will usually include any charge for any other estate planning documents including a "pour over will", "durable" property management powers of attorney, living wills, and health care powers of attorney.

2. Annual Administration Costs. Once a shelter trust comes into operation (after the first spouse's death), the trustee must keep the marital and shelter trust properties separate and maintain careful records for as long as the surviving spouse is alive so that the shelter benefits are not lost. The annual administration cost involved including the necessary separate trust income tax returns can range from 0.5% to 2.0% of the market value of the trust's assets. The greatest variable in determining these costs involves whether there is professional investment guidance and who provides such guidance. New Hampshire bank trustees' average fee for trusts with full investment management are relatively reasonable and range from approximately .60% to 1% for large trusts over $3 million, to over 1% if the trust has a value under $500,000.