Legal Assistance Practice Points: The Credit Shelter Option to Avoid Estate Taxes: Part 1

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Most married people don't give it much thought, but many service-members are millionaires. That's right. If you consider a home worth close to $500,000 (often the case in the Washington, D.C.-Baltimore metropolitan region), $400,000 for SGLI life insurance and another $100,000 or so in savings, investments (such as the Thrift Savings Plan), cars, china, jewelry and other household goods, that adds up to a million or more. If this is the case with your estate and you are married, there are a few simple estate-planning strategies you should strongly consider implementing in order to ensure the maximum amount of your property will pass to your children and grandchildren down the road. The easiest of these strategies is the credit shelter trust option.

The credit shelter trust option is an easy to implement technique that is fully approved by the Internal Revenue Service and state taxation offices. There is no downside to implementing it into each parent's will, but failure to do so can have serious estate tax repercussions.

Spouses can bequeath an unlimited amount of property and assets between each other, either during their lifetime or upon death of the first of the spouses, without estate tax implications. This is commonly referred to as the unlimited marital deduction. Estate taxes are implicated upon the death of the second spouse. To help preserve a portion of a couple's estate from estate taxes, both spouses have a unified credit that exempts a set amount from estate taxes if that spouse were to bequeath property to surviving children or other people. In 2008, each spouse is entitled to a $2 million unified credit exemption, meaning, the first $2 million is exempt from estate taxes (the top estate tax rate currently stands at 45%) but anything that is passed to surviving children above the first $2 million is subject to estate taxes. In 2009, the amount rises to $3.5 million. In 2010, there is no limit whatsoever but in 2011, the unified credit drops to $1 million. The key concern is that if the unified credit of each spouse is not preserved prior to death, that spouse's unified credit vanishes when the spouse dies. Thus, a surviving spouse will inherit all property passed from the deceased spouse, but once the surviving spouse subsequently dies, that surviving spouse can only exempt their unified credit amount because the first spouse died without any preservation strategies. Any additional remaining property or assets that passed from the first deceased spouse to the second deceased spouse and now is intended for the children will be subject to the estate tax if the second deceased spouse's unified credit amount is already consumed.

We do not know what Congress and the new President will do to address the unified credit in future years. Thus, it is wise to prepare for a lower unified credit exemption because death is unpredictable.

Stay Tuned for How to Prepare the Credit Shelter Option in the next issue.

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