

Credit shelter trusts

An estate-planning strategy for married couples

Although there currently is no estate tax in 2010, it appears possible that Congress will reinstate the tax for this year in a form somewhat similar to what was in effect in 2009. If Congress does nothing, the estate tax will return in 2011 with a \$1 million applicable exclusion – the value an estate must exceed before it's subject to the tax – and a 55% top tax rate. As a result, you should consider taking measures to help protect your heirs from estate taxes.

Married couples can effectively double the amount that will pass to their beneficiaries free from federal estate tax by including provisions in their estate plans to create a credit shelter trust. But it's important to understand that married couples do not get this benefit automatically – you must work with your attorney to add special provisions to your estate-planning documents.

The credit shelter trust is referred to by many different names. It is sometimes called a “bypass” trust, or it might be referred to as the “B” trust in an “A-B” trust plan, or the “family” trust in a “family/marital trust plan.”

How it works

The credit shelter trust does not actually come into being until one spouse dies. At that time, his or her will or living trust directs the executor or trustee to set aside an amount equal to the applicable exclusion (\$3.5 million in 2009) in the credit shelter trust.

The surviving spouse can receive income from the credit shelter trust. He or she can also have access to the principal according to standards included in the trust document.

Maintaining the surviving spouse's financial security is usually the trust's principal purpose. When the surviving spouse dies, any remaining principal can be distributed to children or remain in trust for their benefit, as you direct. The assets in the credit shelter trust are not considered to be part of the surviving spouse's taxable estate because he or she has only limited control over how they are distributed.

The resulting tax savings can be substantial. The estate tax had a 45% flat rate in 2009, so removing \$3.5 million from the surviving spouse's taxable estate, could have saved a family from incurring \$1.575 million in estate taxes.

This strategy may fit if ...

- You are married.
- You and your spouse have a combined estate in excess of the applicable exclusion.

This strategy may not fit if ...

- You are single.
- You are married, and you and your spouse have a combined estate that is less than the applicable exclusion.

Is this strategy right for you?

As you evaluate this or any other advanced planning strategy, ask yourself:

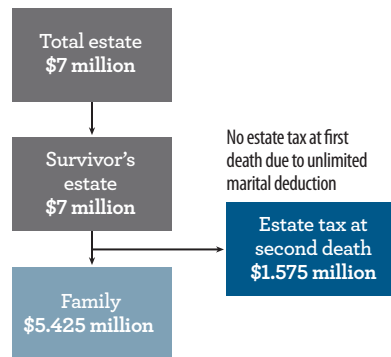
- Does it reflect my values?
- How does it affect my income and financial security?
- Is it consistent with my time horizon, risk tolerance and financial situation?
- Will it help to accomplish my goals and dreams?
- Does it build the type of legacy I want to create?
- How does it affect the people I care about most?

How it's implemented

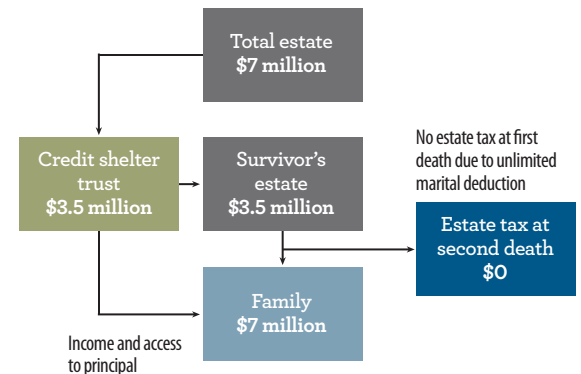
Your attorney can prepare your will or living trust to include the necessary provisions and can design your trust in a way that is most appropriate for your family situation and personal objectives.

Once you have the necessary provisions in your will or living trust, it's important to be sure that sufficient assets pass to the credit shelter trust. Talk with your attorney about the best way to structure asset titling and beneficiary designations. Your Financial Advisor can help you implement your attorney's recommendations.

Without a credit shelter trust*



With a credit shelter trust*



Frequently asked questions

I thought there was an unlimited marital deduction. Why shouldn't I just leave everything directly to my spouse?

It's true that you can leave an unlimited amount to your spouse with no estate tax. However, you cannot give your spouse your applicable exclusion. If the first spouse to die does not use his or her exclusion, it will be lost. The surviving spouse cannot combine the deceased spouse's exclusion and his or her own. If you don't create a credit shelter trust, the surviving spouse will have only one applicable exclusion available, and everything above that amount will be subject to estate tax.

What assets are counted in determining my taxable estate?

Basically, everything you own or control is counted as part of your taxable estate. This includes investment assets, real estate, IRAs and retirement plans, and the death benefits from life insurance that you own.

Do I have to do this now? Or can my family wait and create this trust after my death?

Even though a credit shelter trust does not come into being until after your death, the directions to create it must be included in your will or living trust during your lifetime.

*Assuming the 2009 estate tax rate and applicable exclusion.

If I already have credit shelter trust provisions in my current will or living trust, will they automatically apply to all of my assets?

No. Some assets are not governed by your will or trust. For example, assets held in joint tenancy automatically pass directly to the surviving joint tenant. And assets with a beneficiary designation — retirement plans, IRAs, annuities and life insurance — will pass directly to the named beneficiary. To ensure that your trust operates as expected, it's important to talk with your attorney about the best way to structure asset titling and beneficiary designations.

What if the estate tax applicable exclusion changes? Will I need to change my will or trust?

In most cases, your attorney will draft your will or trust to take advantage of the exclusion in effect in the year of your death, whatever that may be. So usually it's not necessary to amend your estate-planning documents as the exclusion changes.

Does the credit shelter trust have to pay out all income to the surviving spouse?

No. This is the most common provision, but if you wish, you can permit the trustee to “sprinkle” income among your spouse, children and grandchildren, or any other beneficiaries.

Can the surviving spouse access the credit shelter trust's principal if needed?

Yes. Most credit shelter trusts give the surviving spouse access to the principal. You can set the standards under which the trustee may distribute the principal.

Can the surviving spouse be the trustee of the credit shelter trust?

Yes, with one important condition. If the surviving spouse is also the trustee, the spouse's ability to pay principal to himself or herself must be limited by an “ascertainable standard.” For example, a provision that lets the surviving spouse distribute principal for “health, education, maintenance or support” would be acceptable.

Can the surviving spouse have any control over the ultimate disposition of the trust?

Yes, but it must be limited. The surviving spouse cannot have a “general power of appointment” (complete control over the disposition of the trust's principal, with the ability to leave it to anyone). But if you wish, you may give your spouse a “limited power of appointment” (for example, the power to direct how the trust's principal will be distributed among children and grandchildren, but no power to make distributions outside of that limited group).

When the surviving spouse dies, what happens to assets remaining in the trust? Do they have to be distributed outright to children at that point?

When you create your trust, you will include provisions directing how to distribute any remaining principal after the surviving spouse's death. You can direct an outright distribution to children, or you can have the assets remain in trust.

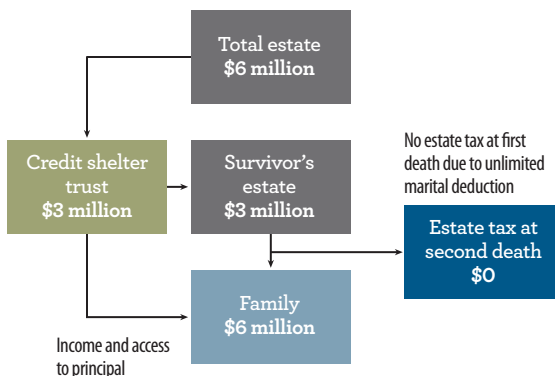
You can count on us

Your Financial Advisor can work with you and your attorney to create an estate plan, possibly including a credit shelter trust, to help reduce your potential exposure to estate taxes.

How does the credit shelter trust work in a community property state?

In a community property state, each spouse is regarded as owning half of all assets acquired during the marriage. If one spouse dies, his or her estate includes the deceased spouse's separate property and half of the community property. The credit shelter trust would be funded out of the deceased spouse's estate.

Credit shelter trust in a community property state



I live in a state with an exemption from state estate tax that's smaller than the federal exemption. How does this affect my decisions about credit shelter trust planning?

If you live in a state that imposes an estate tax and the state exemption is lower than the federal exemption, then full funding of the credit shelter trust could result in some state-level estate tax being due at the first spouse's death. It's important to talk with an attorney in your state about how to deal with this situation because what's "best" can vary widely depending on state tax law and the specifics of your situation.

What if estate tax laws change? Should I wait to do this until we know what tax laws will be in the future?

Tax laws change frequently. If you put off planning, you may never begin. It makes sense to put a plan in place now, but build in flexibility to respond to future tax law changes.

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