Case 5 -- William and Sheila Goldman – Taxwise Planning

William and Sheila are happily married, with four children all of this marriage. They own a home, which is paid for, several insurance policies on their lives, a securities portfolio, and a large I.R.A. which Sheila has built over her career. Their estate is valued at approximately two million dollars, according to their accountant. Their entire estate is either jointly owned or controlled by beneficiary designations to the surviving spouse. They have planned with simple "I-love-you" wills, leaving everything to the surviving spouse and then to the children. They believe that they have avoided probate and estate tax.

At a visit with their attorney to review their estate plan, the Goldmans learn that they have only planned for the death of the first spouse to die. At that point they will indeed avoid probate and estate tax, but not so on the second death. Probate costs on the death of the second spouse to die could amount to over fifty thousand dollars. Their attorney points out that the probate process is public record, so at the death of the second spouse to die, all of the family assets and their values, and the name and address of all beneficiaries of the estate, will be available for public inspection. Furthermore, the estate of the survivor will be subject to estate taxes, in the amount of nearly one hundred thousand dollars. The total estate diminution could be close to one hundred fifty thousand dollars.

The Goldmans' attorney advises planning with Revocable Living Trusts to avoid the costs and publicity of probate. He counsels them to include a "Credit Shelter Trust" (also called a "Bypass Trust") provision in their living trusts to protect the estate tax exclusion of the first spouse to die.

A trust, explains the attorney, is a separate legal entity (like a corporation) that is owned and controlled by the person setting up the trust, called the "settlor," "trustor" or "grantor." The "settlor" can change ("amend") the terms of the trust, can make it go away ("revoke" it), and can put assets in and take assets out of the trust. The person setting up the Living Trust is usually also the "trustee," in control of the management of the trust's assets.

Living Trusts avoid probate because the assets transferred to the trust pass outside the estate administration process. Only assets owned directly in the name of the deceased and without a beneficiary are subject to probate. That means that as long as the Goldmans transfer their assets to their trusts, they avoid the costs and publicity of probate.

As the attorney explained, every individual can exempt one million dollars from Maryland estate tax under current law. Under their current "I-love-you" wills, however, the Goldmans have effectively given away the tax credit of the first spouse to die. The attorney advised the Goldmans on how to protect their estate from tax.

At the death of the first spouse to die, his or her trust will hold the first one million dollars in that spouse's "Credit Shelter Trust." Any excess in the deceased spouse's name or trust is distributed to the surviving spouse. The amount held in the Credit Shelter Trust of the first spouse to die will never be subject to estate tax, as long as it stays in the Trust.

The surviving spouse has complete control over all amounts owned by him or her, and should be sure to transfer all assets to his or her trust. That way the estate of the second spouse to die also avoids probate and, if under the exempt amount of one million dollars, will be free of estate tax. The surviving spouse can monitor his or her estate and give children or grandchildren any amount over the exemption.

This will effectively eliminate much of the costs associated with the mechanics of passing on the estate to the Goldman children. It will also keep the Goldmans' family matters private, unlike the probate process, which is public record.

Mrs. Goldman, anticipating being the surviving spouse under the law of averages, is not so sure that she appreciates being deprived of one million dollars at her husband's death by having that amount placed in a trust. Mr. Goldman obligingly agrees to die first, for purposes of illustration.

The attorney explains that in addition to unrestricted access to the full amount of her own Trust, Mrs. Goldman will receive all income (interest, dividends, etc.) from Mr. Goldman's Credit Shelter Trust each year. She can also tap the Credit Shelter Trust for her needs, such as health care and support and maintenance. Further, she can demand and receive up to five percent of the principal just for making a written request to the trustee, with no need for a demonstration of need.

Mrs. Goldman is still reluctant until the attorney points out that she will probably be the trustee of the Credit Shelter Trust. That leaves her in control of the investment and distribution of that trust. The attorney

hastens to point out, though, that this is a two-edged sword. The surviving spouse's control over the Credit Shelter Trust must follow the limitations of the trust – all income and principal at need, plus 5% of principal upon demand – or risk including the Credit Shelter Trust in the surviving spouse's estate for estate tax purposes.

The net effect of these provisions is that the Goldmans can save approximately $150,000 in costs, fees, and taxes, making that money available to their children for a fraction of that amount in planning fees. The Goldmans decide to take advantage of the planning opportunities presented by their attorney. As a result, not only is their will updated, but their estate plan takes advantage of modern techniques and avoids tax traps for the unwary.