

A COMPARISON OF VARIOUS LIVING TRUST TYPES UNDER THE CURRENT ESTATE TAX LAWS

(AN EXAMINATION OF THE CONTINGENT EXEMPTION TRUST
IN RELATION TO THE CONVENTIONAL TRUSTS
WIDELY USED IN THE PAST)

Due to the two drastic tax law changes in the last couple of years, it is necessary to review almost all trusts drafted in the past. A SUMMARY OF RECENT CHANGES IN ESTATE TAXES:
*Tax repealed in 2010. *Top 55% rate immediately cut to 50%, eventually to 45%. *Individual exemption raised to \$1 million in 2002, \$1.5 million in 2004, \$2 million in 2006, and \$3.5 million in 2009. These changes should impact most trusts established in the last few decades.

This discussion is to explain the differences between the following trust types widely used by married couples in the past: (1) The Probate Avoidance Trust (in the old days for those with less than \$600,000 total estate), (2) The A-B Marital Deduction Trust (for those couples with more than \$600,000), (3) The A-B-C Q-Tip Trust (for those with children from different marriages), and (4) the newly popular hybrid Contingent Exemption Trust (a hybrid between the Probate Avoidance Trust and the A-B Marital Deduction Trust).

If there are no separate children from either of the spouses to protect upon the first death, the A-B-C Q-Tip Trust (#3) may be less important than before. As for the other choices, you might consider the Contingent Exemption Trust because you will have the option after the first death to choose between #1 and #2 above according to need at that time.

The Contingent Exemption Trust (#4) is a hybrid of both the Probate Avoidance Trust and the A/B Marital Deduction Trust. If the tax benefits of the A-B Marital Deduction Trust are needed at the first death, they are available if certain 'DISCLAIMERS' are made in a timely manner. If death taxes are not an issue, then the disclaimers are not made and the trust is similar to a Probate Avoidance Trust. This gives you the best of two worlds if the Surviving Spouse acts in a timely manner. This will provide for either the current exemption amount or up to double the current exemption amount. Most older Probate Avoidance Trusts should be converted to this type of trust if there is any possibility that value of assets may increase greatly in the future.

PROBATE AVOIDANCE TRUST: (#1)

A single person always has and will always use a type of trust which is essentially a Probate Avoidance Trust for married couples. This is for the couple whose main goal is to avoid probate and little else. In this period of tax law uncertainty, it may be prudent to review all Probate Avoidance Trusts in light of your present assets. Remember that there is no "doubling" of the exemption amount for death taxes with this Probate Avoidance Trust.

A-B MARITAL DEDUCTION TRUST: (#2)

This trust was designed to double the "Exemption Amount" for any given year of death. It was the "**Trust of Choice**" for almost everyone whose assets exceeded the current "exemption amount" or what they used to call the "exclusion amount." For example, the exclusion amount was \$600,000 for many years. Without an A-B Trust, all a couple could pass to the next

generation was \$600,000 tax free. With an A-B Trust, it was double that amount. With the shifting exemption amount as shown above, it may be wise to count up the assets currently owned and see if the A-B Trust gives you any benefits. The problem is that if you do not need the A-B Marital Deduction Trust to save on death taxes, then it can become burdensome for the survivor to have to file extra tax returns each year for the B-Trust. This extra administrative burden was fine if hundreds of thousands of dollars could be saved from taxes. **If this A-B trust is of little or no tax benefits for your estate, you might consider converting it to a Contingent Exemption Trust which offers similar tax protection in case you later need it.**

Q-TIP MARITAL DEDUCTION A-B-C TRUST: (#3)

This was basically used for couples with children from different marriages to protect the children of the first spouse to die. It was also used for death tax purposes, but this utility for tax saving purposes diminishes if the lowering of estate taxes continues and the tax is abolished permanently.

CONTINGENT EXEMPTION TRUST: (#4)

If a Contingent Exemption Trust is used, the Surviving Spouse has an option upon the first spouse's death to decide if a Probate Avoidance Trust is all that is needed or if the benefits of an A-B Marital Deduction Trust type are better.

Upon the first death, the survivor simply adds up the assets at time of death and discusses with survivor's attorney about potential tax exposures in light of the survivor's health, wealth, and family situation. If at the first death, the Surviving Spouse sees that taxes might be significant on survivor's death, the Surviving Spouse informs the attorney and accountant that survivor wants to make a "**Disclaimer**" of the amount needed to minimize or eliminate death taxes completely. With this Contingent Exemption Trust, significant estate planning can be done by the survivor after the first spouse's death but no later than 9 months after the first death.

WHAT EVERY SETTLOR SHOULD DO AT REGULAR INTERVALS:

Make sure that your significant assets are placed in the trust name so that they will pass according to the terms of the trust. IRAs, deferred compensation plans, retirement plans, and similar plans generally have beneficiary designations built into the plan. Check periodically with the advisor on such plans to make sure that the correct beneficiaries are listed on the plan. Every two years, or when asset values or family situations significantly change, assemble all current bank, mutual fund, and stock brokerage statements and other evidence of title on investments. Consult with attorney to see if basic changes in type of trust is necessary. Doing this can help eliminate any trust types that no longer fit your asset situation.

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SPECIAL CONSIDERATION FOR SETTLORS WITH MINOR CHILDREN:

AVOIDING THE HORRENDOUS CHILD CUSTODY BATTLES:

If very young children of SETTLOR(S) are involved, it is very important to provide for Guardians of the Person(s) of the child or children if the parents should predecease the young child. Horrendous custody battles concerning Guardianship of the Person of the child can develop among various relatives if this is not settled in the estate planning documents. In addition to the custody issues, the matter of who will control the child's assets looms very large in almost every case.

AVOIDING THE DISTRIBUTION OF MONEY TOO QUICKLY TO A YOUNG CHILD:

Without a trust plan in place, the fiduciary who controls the assets left for the child is called a Guardian of the Estate of the child. The problem with a Guardianship of the Estate of the child is that a large amount of money is suddenly given to the child on reaching age 18. A child who is left without parents and suddenly in charge of a lot of money at 18 creates a very uncomfortable and dangerous scenario. The establishment of such a guardianship of the estate is costly, and the costs continue every two years until the child reaches 18. This cost can be many times more than the notorious "probate costs" that everyone fears. These problems can be effectively eliminated by proper planning using trusts and supporting documents. The choice of successor trustees becomes critical if the child is an infant or very young. There are important ways to protect very young children that can be incorporated into the estate plan which are often more important than the death tax issues. Bonding of fiduciaries for the estate of a young child should be considered.

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