



January 2007

## Supercharged Credit Shelter Trust<sup>SM</sup> – How to Get the Most Out of Your Estate Tax Shelter

Through creative planning, it is possible to permit the assets of the Credit Shelter Trust to build income tax-free by having the surviving spouse pay all the income tax on the assets of the Trust.

The estate plan of most married clients includes making maximum use of the Federal estate tax shelter available at death (currently \$2,000,000) and leaving assets in excess of the shelter in a form that qualifies for a marital deduction. The consequence is zero Federal estate tax at the death of the first spouse, with the estate tax burden being deferred until the death of the surviving spouse. An amount equal to the shelter is normally held upon the death of the first spouse in a trust, often referred to as the Family Trust, the Bypass Trust or the Credit Shelter Trust. The purpose of the Credit Shelter Trust is to eliminate any Federal estate tax on the assets transferred to the Credit Shelter Trust in the estates of both the first spouse to die and the surviving spouse, while permitting the surviving spouse access to the funds if needed.

The Credit Shelter Trust can be viewed as a holding vehicle for assets not subject to transfer tax. Normally, generation-skipping transfer (GST) tax exemption is also allocated to the Credit Shelter Trust so that the assets, as long as they remain in trust - even upon distribution to a beneficiary, will not be subject to Federal estate, gift or GST tax (GST tax generally applies when property transfers to generations below the donor's children).

Viewed as a tax-free fund, the goal, of course, is to maximize the value of the Credit Shelter Trust to the greatest extent possible. This permits the greatest transfer of wealth to descendants. Several methods come to mind. One is to make payments to the surviving spouse for his or her use first out of other (estate taxable) assets, thus permitting the assets of the Credit Shelter Trust to accumulate. Another is to invest in assets that are expected to have a high total yield, and to provide for the income needs of the family from other sources. However, as an important enhancement, we suggest that through some creative planning, it is possible to permit the assets of the Credit Shelter Trust to build income tax-free by having the surviving spouse pay all the income tax on the assets of the Trust.

It might seem that permitting the surviving spouse to pay income tax on the Credit Shelter Trust assets would constitute a contribution to the trust, thus raising gift tax concerns. However, if the Credit Shelter Trust could be structured as a "grantor trust" with respect to the surviving spouse, no such gift tax consequence would result. A grantor trust is a trust created by a taxpayer that is disregarded for income tax purposes, but not for other tax purposes. Thus, the grantor or creator of the trust is treated as if he or she owns the trust assets for income tax purposes only. And, as the "owner" of the trust assets, the income



tax liability follows. The IRS has recently confirmed in published guidance that because the Internal Revenue Code makes the grantor of a grantor trust the taxpayer for income tax purposes, the payment of the trust's income tax cannot result in a gift to the trust.

Normally, a Credit Shelter Trust is created by the first spouse to die through his or her estate plan. Thus, it is difficult to see how the surviving spouse would be treated as the grantor or creator of the trust. But what if, instead, the Credit Shelter Trust of the first spouse to die were, in fact, created by the surviving spouse? Sound impossible?

Actually, the regulations promulgated under the Internal Revenue Code offer us an opportunity. The method involves having the spouse who is expected to be the survivor create a lifetime Marital Trust for the spouse expected to die first. The Marital Trust would be in the form of a so-called QTIP trust, which generally requires all the income to be paid to the spouse who is the beneficiary. When the first spouse dies, the lifetime QTIP trust is included in the estate of that spouse for estate tax purposes, and would then, by formula, create a Credit Shelter Trust using the first spouse's estate tax shelter.

Because the lifetime QTIP is so included, the Credit Shelter Trust for estate tax purposes is deemed created by the spouse first to die. But for income tax purposes, the creator of the QTIP trust, in this example the surviving spouse, is treated as the grantor of all trusts created under the instrument, including the succeeding Credit Shelter Trust. And, since the surviving spouse is a potential beneficiary of the Credit Shelter Trust, the trust will be a grantor trust as to the surviving spouse.

There are, of course, a number of legal issues that must be addressed for the strategy to work, but we believe nearly all of them are explicitly resolved by the regulations under the Internal Revenue Code; the few remaining issues can be solved with appropriate drafting.

What are the benefits? Income tax-free compounding in the Credit Shelter Trust, thus "supercharging" the economic performance of the trust. In some ways it is superior to a retirement plan because a withdrawal of funds will not trigger income tax to the recipient. And to hedge against the possibility of not knowing which spouse will live longest, there is no reason each spouse cannot create a trust for the other. Any potential tax consequences resulting from the creation of "reciprocal" trusts can again be managed with proper drafting and timing of contributions.

So how good is it? The chart below may give you an impression. This is an opportunity for everyone with a taxable estate who wishes to maximize the tax-free transfer of wealth to his or her family.



**Amount in Credit Shelter Trust (in millions) at Death of Surviving Spouse**

Years Between Deaths of Spouses	Payment to Spouse Each Year @4%	No Payment to Spouse (Spouse not Taxed)	No Payments to Spouse (Spouse Pays Income Tax)
5	\$2.32	\$2.68	\$2.94
10	\$2.69	\$3.58	\$4.32
15	\$3.12	\$4.79	\$6.34
20	\$3.61	\$6.41	\$9.32
25	\$4.19	\$8.58	\$13.70

**Assumptions: \$2 million initial funding; 8% annual return, 25% effective income tax on undistributed income.**

*Pursuant to U.S. Treasury Department Circular 230, unless we expressly state otherwise, any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties or (ii) promoting, marketing or recommending to another party any matter(s) addressed herein.*

*Supercharged Credit Shelter Trust<sup>SM</sup> is a service mark of Mitchell M. Gans, Jonathan G. Blattmachr and Diana S. C. Zeydel.*



This GT Alert was written by Diana Zeydel in the Miami office. Please contact Ms. Zeydel at 305-579-0500 or your Greenberg Traurig liaison if you have questions regarding the subject matter of this GT Alert.

<b>Albany</b> 518.689.1400	<b>Houston</b> 713.374.3500	<b>Sacramento</b> 916.442.1111
<b>Amsterdam</b> + 31 20 301 7300	<b>Las Vegas</b> 702.792.3773	<b>Silicon Valley</b> 650.328.8500
<b>Atlanta</b> 678.553.2100	<b>Los Angeles</b> 310.586.7700	<b>Tallahassee</b> 850.222.6891
<b>Boca Raton</b> 561.955.7600	<b>Miami</b> 305.579.0500	<b>Tampa</b> 813.318.5700
<b>Boston</b> 617.310.6000	<b>New Jersey</b> 973.360.7900	<b>Tokyo</b> + 81 3 3264 0671
<b>Chicago</b> 312.456.8400	<b>New York</b> 212.801.9200	<b>Tysons Corner</b> 703.749.1300
<b>Dallas</b> 972.419.1250	<b>Orange County</b> 714.708.6500	<b>Washington, D.C.</b> 202.331.3100
<b>Delaware</b> 302.661.7000	<b>Orlando</b> 407.420.1000	<b>West Palm Beach</b> 561.650.7900
<b>Denver</b> 303.572.6500	<b>Philadelphia</b> 215.988.7800	<b>Zurich</b> + 41 1 364 26 00
<b>Fort Lauderdale</b> 954.765.0500	<b>Phoenix</b> 602.445.8000	

*This Greenberg Traurig ALERT is issued for informational purposes only and is not intended to be construed or used as general legal advice. The hiring of a lawyer is an important decision. Before you decide, ask for written information about the lawyer's legal qualifications and experience. Greenberg Traurig is a trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. ©2006 Greenberg Traurig, LLP. All rights reserved.*