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## Disclaimer Trusts: A Wait-and-See Estate Plan

The federal estate tax is uncertain and many changes to this area of law are scheduled in the future. A nontraditional way to plan during this period of uncertainty and change is including a "disclaimer trust" in your will. A disclaimer trust allows a married couple the ability to wait and see what the federal tax laws are so that when the first spouse dies, the survivor has the power to determine the best way to proceed in reducing the tax consequences.

### How it Works

Generally under today's law, a person is allowed upon death to pass an unlimited amount to his/her spouse and up to \$2 million to others free of federal estate tax. The \$2 million nonspousal amount is known as the "exemption equivalent amount" (EEA) and is scheduled to remain at this level until 2009 when it increases to \$3.5 million. In 2010 the federal estate tax is repealed. Unfortunately, it returns in 2011 when the EEA is only \$1 million. All of this is subject to future legislative change.

Most married individuals desire to leave everything to his/her spouse. However, leaving everything to a spouse results in the loss of the first spouse to die's EEA. This means the loss of potentially passing an extra \$2 million to \$3.5 million free of federal estate tax. Considering the current maximum federal estate tax rate of 45 percent, leaving everything to a spouse means potentially incurring an extra \$900,000 to \$1,575,000 in federal tax — a tax that might have been avoided by utilizing the first spouse to die's EEA.

The traditional way to utilize both spouses' EEA is to include a "credit shelter trust" in their wills. Typically, the terms of a credit shelter trust provide that assets are held for the benefit of the surviving spouse for his/her lifetime and on the survivor's death the assets pass to the couple's children. During the survivor's lifetime, he/she receives all of the trust's income and has access to its principal for his/her health, maintenance, and support needs. The traditional will automatically funds the credit shelter trust with the maximum EEA available at the time of the first spouse to die's death to the extent of his/her assets. Any excess is left to the surviving spouse. The amount in this credit shelter trust is never subject to federal estate tax. It is not subject to federal tax on the first death because of the use of the first spouse to die's EEA and is not subject to federal tax on the survivor's death because the survivor has only a limited/restricted interest in the trust.

One possible problem with the traditional plan is overfunding the credit shelter trust. This is caused in part by the increasing EEA and by the automatic funding of the trust under the terms of the traditional will. For example, assume a husband dies with \$2 million in 2009 when the EEA amount is \$3.5 million. Under the traditional will, the husband's entire \$2 million would go into the credit shelter trust and nothing would go to the surviving wife. This result may leave the surviving wife without the security of having sufficient assets in her name.

A nontraditional way to solve the issue of overfunding the credit shelter trust while preserving the ability to utilize all or a portion of the first spouse to die's EEA is to include a disclaimer trust in their wills. Unlike the traditional plan, a will with a disclaimer trust does not automatically force the creation and funding of the credit shelter trust. Instead, it leaves everything to the surviving spouse but gives the survivor the right to disclaim assets. Assets that the survivor disclaims would pass into a credit shelter trust for his/her benefit.

Under this type of plan, the survivor has the ability to see what the family's assets are worth and what federal tax laws exist at the time of the first spouse's death. At that time, the survivor would decide the amount of assets, if any, that would go into the trust. Using our prior example where the husband dies in 2009 with \$2 million when the EEA is \$3.5 million, under a disclaimer will, the surviving wife might determine that a credit shelter trust is not desired. As such, she would not disclaim any assets. If, however, the husband dies in 2011 when the EEA is at \$1 million, the surviving wife most likely would want to utilize all of her husband's EEA and would do so by disclaiming \$1 million which would pass into the credit shelter trust for her benefit free of any federal estate tax.

### Conclusion

A disclaimer trust is one way to plan today when the future of our federal estate tax system is uncertain. Whether a disclaimer trust is right for you depends on your individual facts and circumstances. \*

For more information on disclaimer trusts and other will/trust planning matters, contact John Lauer at MacDonald, Illig, Jones & Britton LLP at 814/870-7712 or [jlauer@mijb.com](mailto:jlauer@mijb.com).