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# WHY YOU NEED TO REVIEW YOUR ESTATE PLAN NOW

### *In this issue.....*

- ***How your present wills and trusts may be structured now***
- ***Why you might modify them for Increased Flexibility***
- ***Why mandatory funding of trusts might still make sense for some clients***
- ***Why you need to review beneficiary designations and ownership of joint assets***

Effective January 1, 2006, the Federal Estate Tax Exemption increased from \$1,500,000 to \$2,000,000. This was a significant increase in the exemption and a part of the phase-in process scheduled through 2009 under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Please see the graph later in this article for the complete breakdown of the expected exemption amounts for future years. The positive aspect of this exemption increase is that you will be able to protect a larger portion of your estate from the Federal Estate Tax payable at the time that you pass away. However, it also necessitates the review of your present estate planning documents and in particular your Last Will and Testament and/or Revocable Living Trust.

### **HOW YOUR PRESENT WILLS AND TRUSTS MAY BE STRUCTURED NOW**

Many Wills and Revocable Trust Agreements of married individuals prepared prior to the enactment of EGTRRA contain a "credit shelter" or "by-pass" trust for the benefit of the surviving spouse. This trust was typically drafted to benefit the surviving spouse and to receive the greatest portion of the estate of the first decedent spouse which could pass free of Federal Estate Tax using his or her available tax credit. The trusts were used to make sure that both a husband and wife were able to make use of their Federal Estate Tax credit and therefore maximize their tax savings. Absent the use of this trust planning, a couple might have only been able to use the surviving spouse's credit and effectively reduced their tax savings by one-half.

frequently remains in place for the remainder of the surviving spouse's lifetime and often allows for the Trustee or Trustees to pay both income and principal to the surviving spouse or the decedent's children at the Trustees' discretion. Frequently, the surviving spouse would act together with a Co-Trustee to manage the funds and make investment decisions for the assets in the trust. The surviving spouse would not make decisions relating to the trust without the Co-Trustee. Ultimately, upon the death of the surviving spouse, assets contained in the trust would transfer without Federal Estate Tax to the children of the husband and wife.

Prior to the law change, when the Federal Estate Tax Exemption was not expected to increase, documents were written to require mandatory funding of the credit shelter trusts upon the death of the first spouse. Today, clauses set forth in Wills or Revocable Trusts which call for a mandatory funding of the credit shelter or by-pass trusts may cause a much larger portion of the decedent's estate to pass into the trust than had originally been intended. This can result in a much smaller portion of the estate assets passing to the surviving spouse outright. It may be that when your Wills or Revocable Trusts were originally drafted, the maximum value of the assets that could be placed in the credit shelter or trust was \$600,000.00, 1 million or 1.5 million dollars. Now however, the maximum amount by law is 2 million dollars and will be increasing

The trust for the surviving spouse



to 3.5 millions dollars in 2009. It is quite possible that your original planning did not contemplate these much higher credit amounts. You could ultimately and unintentionally place your surviving spouse in an awkward and difficult financial circumstance if your estate planning documents are not updated to allow for a more discretionary funding of the credit shelter or by-pass trust.

### **OPTION FOR INCREASED FLEXIBILITY**

Many clients are now opting to prepare Wills and Revocable Living Trusts which contain “disclaimer trust” provisions rather than the mandatory funding provisions of the credit shelter or by-pass trust. A Will or Revocable Trust containing the disclaimer trust planning is usually written to name the surviving spouse as the primary beneficiary of all assets owned by the first decedent spouse.

The surviving spouse, however, is given the power to disclaim his or her right to receive the inherited assets. A disclaimer is an unqualified refusal to accept the assets which were given to someone through a Will, Trust or beneficiary designation. It is also possible to disclaim the right to receive a portion of jointly owned assets. Someone filing a disclaimer does not have to refuse all inherited assets. It is possible to file a partial or specific disclaimer. A partial disclaimer serves as a refusal of a percentage of an entire asset (i.e. 50% of a bank account or stock account). A specific disclaimer would serve as a refusal of one specific item such as piece of real estate or certain individual stock. The intention of the disclaimer trust is to create the flexibility for the surviving spouse to make decisions based on his or her financial circumstances as they relate to the federal estate tax law upon the death of the first spouse.

The assets that are disclaimed would fall to the contingent beneficiary listed in the estate planning document which is the “Disclaimer Trust.” Thereafter, any disclaimed assets would be protected from Federal Estate Tax through the use of the first decedent spouse’s tax exemption. The assets would be managed in the same way as the “credit shelter” or “by-pass” trusts for the lifetime of the surviving spouse and would be distributed in the same way upon his or her death. The surviving spouse has simply gained the flexibility to create the trust or not based on all of the circumstances including his or her financial status and the tax law in place at the time.

### **WHY MANDATORY FUNDING MIGHT STILL**

### **MAKE SENSE FOR SOME CLIENTS**

Despite the fact that many clients prefer the flexible nature of the Disclaimer Trust planning, there continue to be those who retain mandatory funding provisions. Some, but not all, of the reasons for mandatory funding are discussed below.

Some clients choose to have a mandatory funding of the credit shelter or by-pass trust for the benefit of the surviving spouse for non-tax reasons. For example, some clients want to protect a portion of the inheritance for their children. They desire to provide assets in the trust for the benefit of the surviving spouse but want to insure that should there be a re-marriage the assets are protected against divorce or the naming of the new spouse as beneficiary by the surviving spouse. There would also be a great tendency to title assets jointly with the new spouse or even to name the new spouse as a beneficiary under a new will. The spousal trust would help to reduce the availability both under a new will and also if there was a subsequent divorce.

Some clients like to fund the trust to create creditor protection for the surviving spouse. The portion of the estate passing into trust will not be in the name of the surviving spouse and will therefore be much more difficult for creditors to attack. The surviving spouse may enjoy having financial protection even if it will require that they work with a Co-Trustee.

### **BENEFICIARY DESIGNATIONS AND JOINT ASSETS**

Regardless of the planning structure underneath of your Wills or Revocable Living Trusts, titling of assets and beneficiary designations are of paramount importance. You must make sure that your assets are titled in a way that will allow for the use of trusts under your estate planning documents. For example, if you name a spouse as a primary beneficiary and your children as contingent beneficiaries, the assets cannot pass into trust for the benefit of your surviving spouse or ultimately into trust for your children. The assets transfer directly to the beneficiaries named on an account or insurance policy. Assets owned jointly with another person will transfer automatically to the surviving joint owner and will not pass according to a Will or Revocable Trust. All of the best estate planning can be foiled by NOT integrating beneficiary designations and asset ownership.

If you ultimately select disclaimer trust planning, the preferred beneficiary designation structure would be to name your spouse as the primary beneficiary and the contingent beneficiary would be the disclaimer trust for the benefit of the surviving spouse. Therefore, the surviving spouse could choose to accept the benefit of the asset or could disclaim the asset allowing for it to pass into the trust for his or her benefit. Furthermore, (if so desired) these assets would go into trust for your children if both a husband and wife were to pass away.

### CONCLUSION

As you can see, the positive tax implications relating to the Federal Estate Tax Law changes can also cause the need for modified and updated estate planning documents. Reviewing these documents now and making necessary changes may ultimately serve to save thousands of dollars and protect the financial security of your surviving spouse and family. Your next step will be to pull out the old documents, review them and make sure that they still serve to carry out your intentions the best way possible. If the documents need to be updated, see to the revisions quickly to insure that a proper plan is in place.



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### Exclusion Amount and Estate Gift Tax Rate By Year

Calendar Year	Estate Tax Applicable Exclusion Amount	Top Estate and Gift Tax Rate
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	N/A (Taxes Repealed)	Top individual income tax rate (gift tax only)
2011	Tax returns unless extended by a future Congress	



*The information provided in this article relates only to Federal and Pennsylvania laws presently in effect as of the writing of the materials. Please keep in mind the possibility of future law changes and also differing laws in other states. The article is only intended to be informational and each case should be reviewed with a practicing professional.*



## NEED A SPEAKER FOR A CLIENT OR ORGANIZATION EVENT?

David M. Frees, III and Douglas L. Kaune are experienced presenters on many estate planning and estate administration topics, including:

Basic Estate Planning: What is it? Who Needs It? Why Do It?  
Planning To Prevent Your Heirs From Paying Federal Estate Taxes  
Protecting Your Assets from Nursing Care Spending  
The Executor and Trustee Workshop: Learning Your Responsibilities and Avoiding Personal Risk  
Keeping Your Children's Inheritance Safe From Their Creditors

To have David and Doug present a program for a group of your employees or clients on these or any related practice topics, call 610-933-8069 or contact them by e-mail at [dfrees@utbf.com](mailto:dfrees@utbf.com) or [dkaune@utbf.com](mailto:dkaune@utbf.com)

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