

ESTATE PLANNING FOR MARRIED COUPLES: IMPORTANCE OF BYPASS/CREDIT SHELTER TRUST 2024

The federal estate and gift tax system calculates the amount of taxes due by multiplying the value of the gross estate (plus adjusted taxable gifts) by the federal estate tax rate. A unified credit is then applied against this amount to arrive at the tax due.

For an unmarried individual, the unified credit amount (or rather its credit equivalent) is the benchmark against which taxpayers must measure the estate and plan accordingly. Amounts taxpayers possess in excess of the credit equivalent are subject to the federal estate tax.

Nothing in the operation of the federal estate and gift tax system changes for two individuals who happen to be married. Each spouse is entitled to his and her full unified credit and each spouse may pass to third persons, tax-free, the full value of their applicable credit equivalent amount. In addition, for spouses leaving their estates to a surviving spouse, there is an additional rule. The estate tax marital deduction for property passing from one spouse to another is unlimited, meaning, no federal estate tax due should be payable at the death of one spouse leaving their estate to the surviving spouse. However, a potential negative estate tax effect occurs by this common and typical scenario, and illustrates why proper estate tax planning is necessary. In most cases, spouses do leave the bulk of their estates to one another -- and this creates a potential estate tax problem at the death of the surviving spouse. If the surviving spouse is left with assets above the exemption amount/unified credit available to them to be used at their death, then at the death of the surviving spouse, federal estate tax will be due and payable by the couple's family and or other beneficiaries.

The use of a credit bypass trust, otherwise known as a credit shelter trust, an A/B trust, marital exemption trust, family trust, or non-marital trust, can reduce and or eliminate this result. Because the marital deduction under [the code](#) is unlimited, many persons assume that they can leave their estates (of whatever size) to their spouse with no estate tax consequence. In the short term, this is true; however, they will have thrown away the deceased spouse's unified credit. And, the deceased spouse will have stacked -- up to an amount equal to the annual estate exclusion amount that could have passed tax-free -- into the estate of the surviving spouse.

One of the single most important estate planning devices is to "shelter" the unified credit of the first spouse to die by placing this amount in the credit shelter trust using the marital deduction only with respect to the balance of the otherwise taxable estate. To avoid paying an estate tax in the estate of the first spouse to die, the amount transferred to the bypass trust cannot exceed the maximum federal estate tax exemption amount (e.g., \$13,610,000 for 2024). President Biden and Congress have proposed to significantly reduce the exemption amount so we will have to monitor this closely. Also, by 2026, the federal estate tax exemption is scheduled to be reduced to pre-2018 amounts which will

only be 5,500,000 per individual or 11,000,000 per married couple (with inflation adjustments).

The idea of the bypass/credit shelter trust is to ensure that this amount (i.e., the maximum amount that is excludable from the taxable estate of the first spouse) will pass to the next generation (or remainder beneficiaries) without being taxed in the estate of the decedent and without being included in the gross estate of the surviving spouse. This is done by structuring the trust so that the surviving spouse does not have the deceased spouse's property included in his gross estate upon death. In the majority of cases, the bypass trust will provide for income and principal distributions (subject to an ascertainable standard) to the surviving spouse. At the time of the surviving spouse's death (or at some later time) the trust can be terminated and the property can be distributed to the children or other beneficiaries, or, could continue as long as the couple desires.

For married couples whose combined estates are valued at the maximum estate exclusion amount, the planning objective is to use the unified credit amounts for both estates. In the estate plan of the first spouse to die, the marital deduction bequest may be the excess over the credit equivalent amount. The credit shelter amount is placed in the credit shelter (bypass) trust. The trust assets are not taxed on the first spouse's death because of the unified credit, nor are they taxed at the death of the surviving spouse because at death the survivor spouse has no taxable interest in the trust. The surviving spouse may be the beneficiary of the trust and continue to have the economic benefit of the trust assets. At the surviving spouse's subsequent death, the maximum credit equivalent amount will be available to protect the assets in the surviving spouse's gross estate.

If one spouse has a much smaller estate than the other (and that is less than the maximum estate exemption), the wealthier spouse may wish to consider making tax-free lifetime transfers to the less wealthy spouse. This accomplishes the objective of maximizing the use of each spouse's available unified credit.

When a married couples' combined estates exceed the maximum credit amounts, estate tax savings are still maximized by the use of a bypass trust in the estate of each spouse. However, if the maximum marital deduction has been used at the death of the first spouse for property owned in excess of the shelter amount -- and thus no taxes are paid on the death of the first spouse -- federal estate taxes will be due upon the survivor's death if he or she has not reduced his or her estate below the maximum credit equivalent amount.

Furthermore, as Maryland's estate tax exemption is limited to only \$5,000,000, an additional Maryland estate tax could be payable by an estate in excess of \$5,000,000 making the usage of the bypass/credit shelter trust even more significant. The bulk of this memo pertained to the federal estate tax system, but knowing that Maryland may collect an additional estate tax at a much lower exemption amount illustrates the importance of considering this estate planning tool being implemented as part of an estate plan.