

Article on the impact of marriage and estate taxes

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The ultimate estate planning strategy according Mark Skousen, editor of *Forecasts and Strategies* is to “**never die single.**” His “tongue-in-cheek” comment stems from the sweeping Economic Recovery Tax Act of 1981, (ERTA) which significantly changed the tenants of estate planning.

Before ERTA the federal estate tax charged on any decedent’s estate valued over a measly \$60,000 began at 32% and rapidly escalated to 75%. Upon the death of the first spouse, the estate of a married couple was divided in half and the survivor had to come up with cash to pay the tax within 9 months. The financial impact was especially devastating to the nation’s family owned businesses and farms. Then, Governor Ronald Regan witnessed first hand the devastation estate sales caused when widows were required to sell a major portion of the family farm to satisfy the IRS. During his 1980 presidential campaign he went so far as to claim that estate taxes had actually destroyed more farms in California than any pestilence or drought. He was outraged and made it known.

Shortly after Regan was elected president ERTA was signed into law establishing the long over due **marital exclusion**, allowing all jointly held assets to be passed to the surviving spouse 100% estate tax free. As long as there was a spouse to inherit what was left, no matter how much that was, no estate taxes would be due. The marital exclusion just recently celebrated its 26th birthday and has evolved into the main estate planning strategy for married couples. You could be worth as much as Bill Gates and pass your \$52 billion to Melinda without paying a dime to the feds. For the traditional Ozzie and Harriet family of the 20th century, the marital exclusion made sense.

But even as alluring as the marital exclusion may appear on the surface, because of significant marital paradigm shifts in recent decades, blind usage of this law has some serious hidden drawbacks:

- 1) Married couples often feel that since the survivor will receive it all tax free there is no need to properly plan and prepare their estate. Big mistake! What if death occurs simultaneous or within a few years? The marital exclusion doesn’t avoid estate taxes it simply postpones them until the death of the surviving spouse.
- 2) Currently anyone can pass the current \$2 million federal estate tax credit **tax free** to their heirs. Most couples falsely assume they can both take advantage of the credit. If the marital exclusion is used first, only one \$2 million credit can be applied. In the case of an estate valued at \$4 million this omission will result in a **voluntary \$935,000 tax mistake**. A 25% estate reduction that could have easily been avoided with the establishment of a simple A/B credit shelter trust, also known as a by-pass or Q-tip trust. This strategy requires prior planning however, and must be established before the death of the first spouse.
- 3) Today with the increasing number of “blended families” and multiple marriages, and because the surviving spouse automatically inherits **everything**, the “new spouse” can and often does, disinherit the children and grandchildren of the decedent. The best solution to avoid this travesty is the establishment of a prenuptial agreement, or better still and quite a bit more romantic, a Family Dynasty Trust (FDT). With a FDT, the surviving “new

spouse” can be designated to receive a portion of the estate, (the \$2 million exclusion), with the balance passing direct to the rightful heirs without probate, allowing both \$2 million credits to be used with full post mortem control for multiple generations.

- 4) Within the next two decades trillions in qualified accounts will pass to surviving generations. If not carefully planned the IRS can confiscate up 70% of the value, leaving a paltry portion to be divided between the beneficiaries. Furthermore, because the beneficiary designations in qualified accounts trump all other strategies, it is vital that these documents be reviewed with frequency. All too often “life events” occur and beneficiaries are not changed accordingly. In addition, in order to tax advantage of each estate tax credit, the marital exclusion and to “stretch” the income tax liability over many years and generations, the “restrictive beneficiary” language inside of an annuity or a Dynasty IRA Trust should be installed.

Planning estates in the 21st century seldom result in the traditional text book case. There are as many variations as one can possibly imagine. With the high national divorce rate and the fact that most money in America is in the ownership of women, the norm is the abnormal. Make certain your client understands all the choices, all the causes and effects. And most important make certain they take positive action, for “**never dying single**” is an option, but accurate estate planning is the only sure way to guarantee that the proper beneficiaries receive what is rightfully theirs.

Next month I will discuss the right way and the wrong way to establish a prenuptial agreement and how it relates to estate planning.

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