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Marital Trusts

Stephen F. Matthews and Timothy W. Triplett
Department of Agricultural Economics
College of Agriculture

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Estate planning provides for orderly distribution of your assets during your life and at death. Estate planning also minimizes the impact that federal and state transfer taxes can have on your estate. This guide takes a look at the estate planning tool called the marital trust. The marital trust can reduce federal estate taxes and provide for professional management of assets passed on to heirs at death.

The right to pass property from one generation to another belongs to nearly everyone. But this right to pass property on to heirs may be subject to federal estate and gift taxes and state inheritance taxes. Estate planning minimizes the impact that these taxes may have on property passed during life and at death. Estate planning also provides for orderly distribution of property.

This guide has information on using one estate planning tool called the marital trust. The marital trust arrangement can reduce federal estate taxes and provide professional management for assets passed at death. This guide also emphasizes recent federal estate and gift tax changes which were brought about by the Tax Reform Act of 1976 and which may affect the use of the marital trust.

A more detailed description of estate planning, the objectives of estate planning, and the various legal tools available to the professional estate planner can be found in *Estate Planning for Missouri Families* (Manual 68) available from your local University of Missouri Extension Center. Neither the manual nor this guide is a substitute for the help and guidance of a professional estate planner such as your attorney, accountant, or bank trust officer.

What Is a Trust?

A trust is an arrangement authorizing one or more people (called trustees) to hold legal title to property. Once the original owner has placed title to property in the trustee, the original owner is called the trust *settlor*. The trustee manages the property and pays the earnings of the trust property to the beneficiaries of the trust according to the terms of the *trust document*. This trust document is simply an agreement between the settlor and the trustee specifying details of trust management and payments to beneficiaries.

Types of Trusts. Although various types of trusts are designed to accomplish different objectives, trusts generally fall into two categories: *inter vivos* and *testamentary*. *Inter vivos* trusts are those established by the settlor during his lifetime. These lifetime trusts may be either revocable or irrevocable and are designed to pay the trust's income to the settlor or to other designated beneficiaries.

The second type of trust is the *testamentary* trust. Testamentary trusts are established upon the settlor's death and are generally part of the settlor's will. The marital trust is basically a testamentary trust because it does not come into being until the settlor's death and because it is generally written into a will.

What Is a Marital Trust? A marital trust is really part of an arrangement for dividing the property belonging to the first spouse to die into two portions. These two portions are generally held in two separate trusts. One trust is called the *marital deduction trust*, and the other is called the *remainder trust*. Both generally provide income to the surviving spouse for life. However, power of control over the two trusts varies a great deal. These differences in control can have a significant effect on taxes.

Using the Marital Trust

As mentioned earlier, estate planning provides for orderly distribution of assets at death. However, estate planning provides not only for the distribution of assets upon the death of the first spouse to die, but also for the distribution of assets *upon the death of the spouse who survived the first to die*. In fact, because the survivor of the first spouse to die can often take advantage of the estate tax marital deduction, but the heirs of the unmarried survivor cannot, most estate tax problems may not arise until the death of the surviving

spouse. Estate planning, therefore, should truly be *family* estate planning.

How the Marital Trust Works. The marital trust scheme can be tailored to meet the needs of different people. A basic marital trust arrangement is described below to demonstrate the function of a marital trust.

Generally, when a marital trust arrangement is used, the property belonging to the first spouse to die is divided into *two portions* or two different trusts. One portion, called the marital deduction trust, takes advantage of the federal estate tax marital deduction. Under current law, to be eligible for the marital deduction, property must pass to the spouse outright; or, if the property is to pass to another trust, the spouse must be given what is called a general power of appointment over the property in the trust, in other words, the power to appoint or to give the money to anyone he or she may choose, including himself or herself.

Thus, the property qualifying for the marital deduction is either given to the surviving spouse *outright* or put into another *trust* for the spouse who will have general power of appointment over the property in the trust. *This portion of property in the marital deduction trust qualifies for the federal estate tax marital deduction at the death of the first spouse to die.* This portion of property will also be included in the gross estate of the surviving spouse upon his or her death.

The remaining portion of the estate of the first spouse to die is put into a trust called a remainder trust. The remainder trust property is used primarily to generate income for the surviving spouse during his or her lifetime. However, the surviving spouse *does not* have a general power of appointment over this trust property, but only the right to receive the trust income for life. Upon the death of the surviving spouse, the property in this trust passes to the children, *but is not included in the gross estate of the surviving spouse.* This remainder trust reduces estate taxes on the estate of the surviving spouse upon his or her death, while the marital deduction trust reduces estate taxes on the estate of the first spouse to die.

The differences in the power of control over the marital deduction trust and the remainder trust are important. If the spouse has a general power of appointment over *both* trusts, the property in the remainder trust will also be included in the gross estate of the last spouse to die. This would defeat one of the major advantages of the marital trust arrangement since *all* of the estate taxes due at the death of the first spouse to die would again be due at the death of the surviving spouse. The marital trust arrangement avoids this since only the property in the marital deduction trust is included in the gross estate of the surviving spouse.

How Much Property Should Be in the Marital Deduction Trust? The success of the marital trust arrangement in reducing estate tax impact depends on the amount of property that is placed in the marital deduction trust and the remainder trust.

Before the Tax Reform Act of 1976, when the estate tax marital deduction was equal to one-half of the adjusted gross estate and a $60,000 estate exemption was in effect, most marital trust arrangements provided for a quantity of the adjusted gross estate to be placed in the marital deduction trust so that "full use or advantage" would be taken of the estate tax marital deduction. This usually meant approximately one-half the estate was placed in the marital deduction trust.

However, in 1976 the estate tax marital deduction was changed to $250,000 or one-half of the adjusted gross estate, whichever is greater (assuming that that much property passes to the surviving spouse); and a unified transfer tax credit was established. Now, using "full use or advantage" language may result in the inclusion of too much property in the marital deduction trust. Too much property in the marital deduction trust may not make effective use of the unified credit available at the death of the first spouse to die. Also, too much property in the marital deduction trust would cause a greater than necessary estate tax on the death of the surviving spouse, since property placed in the marital deduction trust is included in the estate of the surviving spouse, assuming the surviving spouse does not use up the property. This greater than necessary tax is especially likely to occur if the surviving spouse owns property of his or her own, in addition to that which was inherited.

Why is this so? Under the marital trust arrangement *only* the portion of property put in the *marital deduction trust* will be taxable at the death of the surviving spouse. The remainder trust property will pass to the beneficiaries (named by the decedent—usually the children) estate tax free at the death of the surviving spouse. Therefore, if estate taxes can be avoided when the first spouse dies by making full use of the unified credit to cover the remainder trust property, and if the marital deduction trust is used only to the extent it saves taxes when the first spouse dies, *less* property will be subject to estate tax when the surviving spouse dies.

Income for Life. Remember also that the surviving spouse can receive income from all of the property, whether it is in the marital deduction trust or the remainder trust. Also, your attorney can explain special provisions which allow the surviving spouse to use part of the principal of the remainder trust under special situations. Thus, allocation of the property between the marital deduction trust and the remainder trust does not materially affect the *income* that the surviving spouse will receive during his or her lifetime. Shifting property between the two trust types will mainly affect the amount of property subject to federal estate tax on the death of the last spouse to die.

Check Current Wills. Since most marital trust arrangements drawn up before the Tax Reform Act of 1976 provided for a quanitity of property to be placed in the marital deduction trust so that "full use or advantage" of the estate tax marital deduction would be made, such arrangements should be reviewed with your attorney as soon as possible. A grace period provision in the Tax Reform Act of 1976 provides that such "old" language calling for full use or advantage of the marital deduction will be interpreted by the Internal Revenue Service as one-half the adjusted gross estate:

- if the decedent dies before January 1, 1979,
- only if the will or trust arrangement was drawn up before January 1, 1977, and
- if the full use or advantage clause has not been amended since that time.

However, reliance upon this grandfather provision is not the best approach. Your attorney can help you review your present estate plan in light of the 1976 tax changes and appropriate changes can be made in your estate plans.

Marital Trust Example

This example shows only how federal estate taxes can be saved by using the marital trust arrangement. Assume that no taxable lifetime gifts have been made. (See Guide 503 for an explanation of taxable lifetime gifts.) Also assume that the husband died in 1978; his widow died in 1981; and the husband owned all the property at his death.

Notice that the date of death makes a difference in the amount of unified transfer tax credit availalbe to offset estate taxes. This credit was enacted as part of the Tax Reform Act of 1976 to replace the $60,000 estate exemption. The credit is being phased in over a five-year period, with the highest available credit of $47,000 being available in 1981 and thereafter. See Table 1 for the new federal estate tax rates and Table 2 for the unified transfer tax credit amounts.

Table 1. Unified Estate and Gift Tax Rate*

If the amount with respect to which the tentative tax to be computed is:	*The tentative tax is:*
Not over $10,000	18% of such amount.
Over $10,000 but not over $20,000	$1,800, plus 20% of the amount over $10,000.
Over $20,000 but not over $40,000	$3,800, plus 22% of the amount over $20,000.
Over $40,000 but not over $60,000	$8,200, plus 24% of the amount over $40,000.
Over $60,000 but not over $80,000	$13,000, plus 26% of the amount over $60,000.
Over $80,000 but not over $100,000	$18,200, plus 28% of the amount over $80,000.
Over $100,000 but not over $150,000	$23,800, plus 30% of the amount over $100,000.
Over $150,000 but not over $250,000	$38,800, plus 32% of the amount over $150,000.
Over $250,000 but not over $500,000	$70,800, plus 34% of the amount over $250,000.
Over $500,000 but not over $750,000	$155,800, plus 37% of the amount over $500,000.
Over $750,000 but not over $1,000,000	$248,300, plus 39% of the amount over $750,000.
Over $1,000,000 but not over $1,250,000	$345,800, plus 41% of the amount over $1,000,000.
Over $1,250,000 but not over $1,500,000	$448,300, plus 43% of the amount over $1,250,000
Over $1,500,000 but not over $2,000,000	$555,800, plus 45% of the amount over $1,500,000.
Over $2,000,000 but not over $2,500,000	$780,800, plus 49% of the amount over $2,000,000.
Over $2,500,000 but not over $3,000,000	$1,025,800, plus 53% of the amount over $2,500,000.
Over $3,000,000 but not over $3,500,000	$1,290,800, plus 57% of the amount over $3,000,000.
Over $3,500,000 but not over $4,000,000	$1,575,800, plus 61% of the amount over $3,500,000.
Over $4,000,000 but not over $4,500,000	$1,880,800, plus 65% of the amount over $4,000,000.
Over $4,500,000 but not over $5,000,000	$2,205,800, plus 69% of the amount over $4,500,000.
Over $5,000,000	$2,550,800, plus 70% of the amount over $5,000,000.

*Source: Internal Revenue Code of 1954, as amended, Section 2001.

Example: Use of a Two-Portion Marital Trust

	Husband (1978)	*Widow (1981)*
Gross Estate	$322,580	$166,000
Less Deductions*	(22,580)	(11,620)
Adjusted Gross Estate	$300,000	$154,380
Less Marital Deduction (Trust)	(166,000)	(0)
Remainder Trust	$134,000	$ 0
Taxable Estate	$134,000	$154,380
Tax	$ 34,000	$ 40,202
Less Unified Credit	(34,000)	(47,000)
Tax Due	$ 0	$ 0

*Assume deductible administration expenses of 7% of gross estate.

Table 2
Unified Transfer Tax Credit:

1977	$30,000
1978	$34,000
1979	$38,000
1980	$42,000
1981	$47,000

Notice that under the marital trust arrangement at the death of the husband in 1978, full use was made of the unified credit. However, the marital deduction trust (and therefore the marital deduction) is used only to the extent needed to insure that no federal estate tax would be due on the death of the husband ($166,000 instead of the full $250,000).

Two additional considerations. First, the creation and management of marital trust arrangements cost money. These additional costs should be discussed with your attorney and compared to the federal estate tax savings that would result from using a marital trust arrangement.

Second, the marital trust arrangement is most effective when the spouse owning a significant portion of the property dies first. For this reason, a husband and wife should discuss with their attorney the portioning of assets between husband and wife while both are alive. Assets can generally be divided between the spouse without incurring significant gift taxes by using lifetime spousal gifts. After assets have been divided between spouses, reciprocal marital trust arrangements can be drawn up to minimize federal estate taxes regardless of the order of death between spouses.

More Information

Estate planning is a concern of most families and should result in a "family" estate plan that foresees the federal estate tax impact on estate assets not only at the death of the first spouse to die, but also at the death of the surviving spouse.

We have explained the marital trust as a legal tool that can be particularly important in saving estate tax dollars.

For more estate planning information, refer to *Estate Planning for Missouri Families* (Manual 68), University of Missouri Guide 503, *Lifetime Gifts: An Estate Planning Tool,* and Guide 505, *Farmland Valuation for Federal Estate Tax Purposes,* which are available at your local UM Extension Center. Professional guidance should, of course, be sought in making your estate plan. Estate planning is a complicated endeavor and should not be attempted without the advice of your attorney and other professional advisors.

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