



Marital Deduction

JOSEPH O'BRIEN (Brighton, Michigan)



Understanding the marital deduction is very important to successfully prepare your estate plan. The marital deduction can help you save or even eliminate estate taxes if implemented properly. It is very important that you understand how the marital deduction operates so you can plan accordingly and avoid any negative consequences by utilizing the deduction improperly.

WHAT IS THE MARITAL DEDUCTION?

In the latest revision of the Internal Revenue Code, you have been provided with one of the most powerful federal tax deductions for estate planning purposes, known as the marital deduction. The marital deduction allows an unlimited amount of lifetime and testamentary tax-free transfers from one spouse to another. Simplified, the marital deduction is a type of tax deduction which allows you to give your assets to your spouse while effectively reducing or eliminating taxes.

WHO QUALIFIES FOR THE MARITAL DEDUCTION AND WHAT ARE THE REQUIREMENTS?

The marital deduction encompasses the entire value of the property given to your spouse to the extent that property is includable in your gross estate. It does not matter whether the property passes by will, intestacy, beneficiary designation, titling, or any other manner. What is required, however, is the following:

1. The decedent must be survived by a spouse;
2. The property must pass from the decedent to the surviving spouse;
3. The property is included in the decedent's gross estate;
4. The property is transferred outright and not as a life estate or other terminable interest (unless specific requirements are met and the property is passed by way of utilizing a qualified terminable interest property (QTIP) election).

Of the four requirements, the first requires that the parties be married. Also it is imperative that some form of a "simultaneous death" clause be placed in your will

and other estate planning documents to protect the marital deduction if both you and your spouse die and the survivor cannot be determined. If there is no presumption of survivorship in the will or your other estate planning documents, many states follow the Uniform Simultaneous Death Act which presumes that each spouse survived the other, reducing the benefit of the marital deduction for you or your spouse.

The QTIP election provides an exception to the requirement that the property transferred does not include property of a life estate or terminable interest. The election allows property to qualify for the marital deduction that would otherwise not qualify, as long as additional requirements are met including the following:

1. The property would qualify for the marital deduction for all other reasons other than it being considered a terminable interest; and
2. The election is made on the federal estate tax return to qualify the property for the marital deduction.

THE MARITAL DEDUCTION AND GIFT TAXES

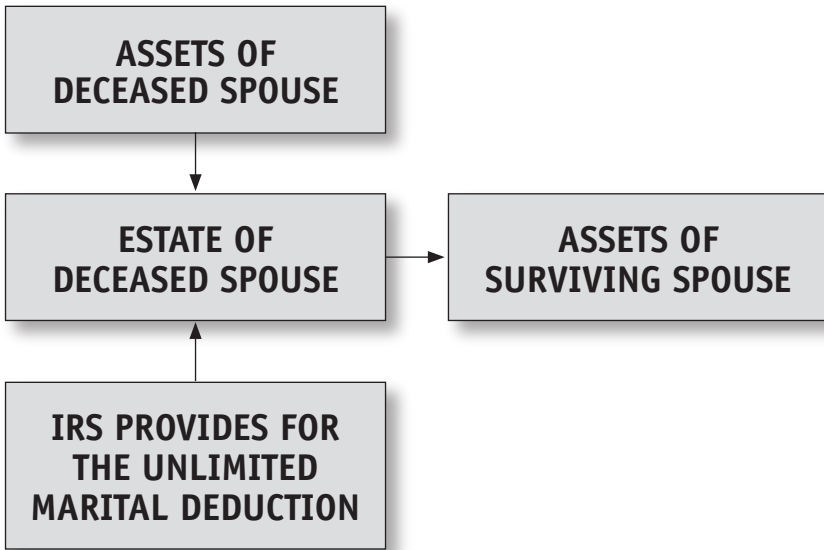
The marital deduction can apply to either estate taxes or gift taxes. Most of what we discussed above is applicable to estate taxes. However, the marital deduction is also available for the full value of any property transferred to your spouse as a gift. Typically, the gift is given outright to your spouse; conversely, it may be held in trust subject to two further requirements:

1. If the gift is held in trust, your spouse must have the absolute right to income for life; and
2. Your spouse must have a general power of appointment over such property.

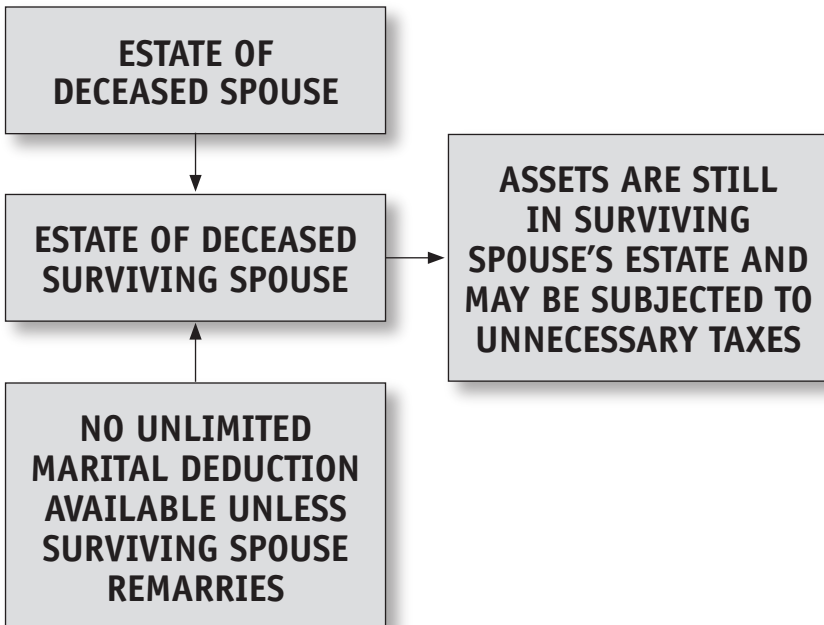
Once again, the QTIP election allows you to remove the general power of appointment requirement and still qualify for the marital deduction by requiring an irrevocable election claimed when filing a gift tax return.

HOW THE MARITAL DEDUCTION WORKS

Marital Deduction on First to Die Spouse



Marital Deduction on Surviving Spouse's Death



WHAT OTHER CREDITS AND DEDUCTIONS SHOULD I KNOW ABOUT TO PLAN PROPERLY?

For many, the unlimited marital deduction may be the simplest solution to estate tax problems. However, the marital deduction may not solve all of your estate tax problems. To properly plan and utilize the marital deduction, it is imperative that you also understand the unified credit.

The unified credit allows an individual to dispose of assets without tax liability up to a specified amount — currently \$2 million. By utilizing the unified credit and the marital deduction, assets will be preserved from estate taxation upon the death of the first spouse, and with proper planning will preserve some or all of the assets from taxation in the second estate.

The unified credit allows you to pass a certain amount of assets estate tax-free to your heirs. Congress has provided the following unified credit exemption amounts per individual per year.

YEAR	EXCLUSION AMOUNT	MAX AND TOP TAX RATE	YEAR	EXCLUSION AMOUNT	MAX AND TOP TAX RATE
2002	1,000,000	50%	2007	2,000,000	45%
2003	1,000,000	49%	2008	2,000,000	45%
2004	1,500,000	48%	2009	3,500,000	45%
2005	1,500,000	47%	2010	Unlimited	0%
2006	2,000,000	46%	2011	1,000,000	55%

COMMON PLANNING EXAMPLES:

TOTAL ESTATE VALUE FOR HUSBAND AND WIFE IS BELOW THE UNIFIED CREDIT AMOUNT: If your and your spouse's combined estimated estate value is below the unified credit exemption amount, currently \$2 million, the marital deduction is enough to prevent any estate taxes at the federal level. For example, if your estate is worth \$1 million and your spouse's estate is worth \$500,000, the total estate value after the assets are transferred after the first death is \$1.5 million. This amount is under the unified credit amount and is thus exempt from federal estate taxes.

TOTAL ESTATE VALUE FOR HUSBAND AND WIFE IS ABOVE THE UNIFIED CREDIT AMOUNT: If your and your spouse's combined estimated estate value is above the unified credit exemption amount, currently \$2 million, the marital deduction is not enough to prevent all estate taxes and more planning is needed to ensure tax savings are maximized. For example, in 2008, federal estate tax is not owed on a combined \$3 million estate when the estate passes from one spouse to another because the marital deduction allows for the transfer. However, upon the death of the surviving spouse, an estate tax of \$450,000 (not

including any possible state tax) is owed. With proper planning, this \$450,000 tax can be saved.

Joseph O'Brien (www.josephdobrien.com) provides estate planning, business, and tax services. His knowledge of estate planning and tax law allows him to solve even the most complex estate planning problems.

Marital Deduction Planning

PROPERTY INTEREST	AMOUNT THAT QUALIFIES FOR MARITAL DEDUCTION
Outright bequest to spouse	Full amount
Joint tenancy WROS with spouse	One-half
Tenancy in common	To the extent of decedent's interest
Community property	Full amount (one-half)
Life insurance death benefit	Full amount if payable as a lump sum (installment option and life income) None if interest only
Life estate	None
QTIP	Full amount
Terminable interest	None
Power-of-appointment trust	Full amount
General power of appointment	Full amount
Special power of appointment	None
Qualified domestic trust (QDOT)	Full amount