Wealth Enhancement Group®

MAXIMIZE YOUR **WEALTH**

The Benefits of Spousal Trusts in Estate Planning

Introduction

If you were able to retire early, just imagine what your life would look like. How about exploring new cultures across continents or relaxing in the vacation home of your dreams? These don't have to be figments of your imagination. They are achievable milestones you can reach with the right strategic plan.

Now imagine a future where you're no longer here. What becomes of your hard-earned assets? Who will ensure your spouse is comfortable and well taken care of? What will the future of your grandchildren look like? These questions are critical when properly planning your estate. But the unease one feels when asking the hard questions is nothing compared to the anxiety and stress accompanying a poorly structured retirement or estate plan.

Luckily, one way to help ensure that your spouse and family are taken care of is by including comprehensive estate planning into your financial plan. Depending on your situation, that may include one or more of the many kinds of spousal trusts. In this playbook, we'll focus on a few of the more popular spousal trusts, detail their many potential benefits, and help you start to think about whether adding one is right for you.

But first, let's go over some estate planning basics and recap how trusts can fit into your plan.

HOW TO INCORPORATE TRUSTS

JIM SANDAGER
Senior Vice President
Financial Advisor
West Des Moines, Iowa

No financial plan is truly complete without an estate plan. Everything you own—your house, your car, your possessions, and your money—is part of your estate, and you need to plan for what happens to your estate when you pass away. Without a carefully constructed estate plan, transferring your assets could come with some unintended negative consequences.

That's why it's so important. And as you begin to put together your estate plan, there are four key documents you need to consider adding:

Will

By far the most important, your will is the document that lays out who you want to give your assets to when you die and helps ensure that your assets are distributed properly when the time comes.

Power of Attorney

Often abbreviated as just POA, power of attorney allows you to designate someone to step in and manage your finances if you become unable to.

Health Care Directive

A health care directive functions similarly to a POA, but while a power of attorney traditionally handles your financial decisions, a health care directive handles your medical decisions.

Beneficiary Designations

These dictate who will receive the benefits in your retirement, pension, life insurance, etc. accounts when you pass away, and they actually supersede what's listed in your will.

There is, however, one more piece to this estate planning puzzle that isn't listed above, and it's called a trust. While not exactly a document, per se, trusts are still firmly rooted in the estate planning process. Whether you're looking to avoid probate, limit possible estate taxes, or assume greater control over how your estate is distributed after you pass, there a number of benefits that adding a trust to your estate plan can provide to you and your loved ones when it comes time to divvy up your assets.

Although trust law is complex, and establishing a trust requires the services of an experienced attorney, mastering the basics isn't hard.

What Is a Trust?

A trust is a legal entity created to hold assets on behalf of a beneficiary or beneficiaries—you quite literally "trust" them with your money and assets. There are three primary types of trusts, and the person setting up a trust (or, trustor) can dictate exactly how and when beneficiaries receive the assets in the trust.

There are dozens of types of trusts available to you, but they all fall within one of three primary classes:

Navigating the multitude of trust options in financial planning can be daunting. Each trust type serves different purposes, catering to distinct financial goals. The challenge often lies in understanding these differences and discerning whether a trust is a necessary component of your estate plan.

With so many options, making the right decision for your unique circumstances can be overwhelming. However, clarity and a secure plan are within your reach.

Below is a brief overview of the three primary classes of trusts. The goal is to equip you with an understanding of these key instruments in financial planning, enabling you to make informed decisions regarding their relevance and potential inclusion in your estate plan.

REVOCABLE TRUSTS · **IRREVOCABLE TRUSTS** · **TESTAMENTARY TRUSTS**

Revocable Trusts

A revocable trust can be altered—or even terminated—at any time during the trustor's lifetime. Because this class of trusts can be so flexible, revocable trusts are also known as "living trusts."

Being able to make alterations to the trust can be beneficial if you experience unexpected changes later in life—whether they be health care changes, a late-in-life marriage/divorce, or something else. Revocable trusts can also be used to try to avoid having your estate subject to probate (the legal process of distributing your estate). Probate can be a lengthy, expensive and public process, so it's not exactly an ideal route for your heirs when it comes time to administer your estate.

Utilizing a revocable trust can be especially effective if you own property in multiple states. For instance, if you own a home in Iowa and have a cabin in northern Minnesota, you may be subject to probate in both states. However, if those two properties are owned inside of a revocable trust, you may be able to avoid probate entirely, thus making the process of administering your estate quicker and less costly.

Irrevocable Trusts

Contrary to revocable trusts, the terms of an irrevocable trust cannot be amended or terminated after the trust has been established. This includes any funds you place inside the trust, which means once they're in there, they cannot be accessed until the terms of the trust have been met.

While the more rigid nature of this class of trust might not make it attractive at first, irrevocable trusts offer other benefits. For instance, if you put money into one of these trusts, you've relinquished control of those funds. This means that money is effectively removed from your estate, meaning it won't be counted toward the rest of your assets and protect you from potential estate taxes.

This class encompasses everything from common spousal trusts (trusts specifically established for the benefit of a spouse) to something like an irrevocable life insurance trust (ILIT), which is a trust that holds one or more life insurance policies whose death benefits can be paid out to your heirs or help cover the costs of administering your estate without incurring any taxes.

Testamentary Trusts

Rather than creating and funding a trust immediately, it's possible to create a trust that goes into effect upon your death. Known as a testamentary trust, this type of trust is created through a will or revocable trust, and the terms of the trust are spelled out within the will.

Testamentary trusts are often used as a tool that can help you create a trust for minor children or a surviving spouse. Even though assets used to fund a testamentary trust may be subject to probate, the flexibility this type of trust offers when you desire to control the assets for a period of time after your death may outweigh its costs.

SHOULD I ADD A TRUST TO MY ESTATE PLAN?

Whether you're seeking to manage your own assets, control how your assets are distributed after your death, or plan for incapacity, trusts can be invaluable in helping you accomplish your estate planning goals. Their power is in their versatility—many types of trusts exist, each designed for a specific purpose. Review your financial situation with your advisor and ask if a trust is worth adding.

An experienced financial advisor can help you determine your estate planning goals. 1-888-829-1949

4 COMMON TYPES OF SPOUSAL TRUSTS

PAT WOLFE
Senior Vice President
Eden Prairie, Minnesota

You want to make sure your loved ones can keep as much of their inheritance as possible. Nobody wants to see their legacy get chipped away by a large tax bill, but that's exactly what could happen to your estate without careful planning.

1 A Trust (AKA Marital Trust)

A marital trust is a specific type of trust established for the benefit of a surviving spouse. It is a trust that takes advantage of the Unlimited Marital Deduction in order to avoid estate taxes at the time of the first spouse's death in the event that the first spouse's individual estate is more than the individual exemption amount.

Here's how it works: At the time of death, trust-owned assets are transferred to a trust for the benefit of the surviving spouse, essentially allowing estate taxes to be delayed until the second spouse's death. The surviving spouse must be the only beneficiary of the trust during his/her lifetime, however, at the time of the second spouse's death, the trust can pass to any other named beneficiaries like children, grandchildren, etc.

Additionally, an A Trust can give the surviving spouse broad access to the funds in the trust during the survivor's lifetime, even allowing the spouse to withdraw everything in the trust. Finally, A Trusts are irrevocable trusts, which means they cannot be changed or altered after the trust has been established.

2 Qualified Terminable Interest Property (QTIP) Trust

Most A Trusts are actually also QTIP trusts. However, for it to be a QTIP trust, only the surviving spouse can be the beneficiary of the trust during his or her lifetime, and the trust is required to pay all income generated by the trust (e.g. dividends and interest) to the surviving spouse at least annually. This is what keeps trust-owned assets in the surviving spouse's estate, even if he/she can't dictate where trust assets will go at death.

3 B Trust (AKA Bypass Trust)

B Trusts (also called family trusts or credit shelter trusts) work a little differently but are often used in concert with A Trusts—meaning oftentimes, when a spouse sets up an A Trust, they also set up a B Trust. B Trusts are once again created upon the death of the first spouse, but they're capped at whatever the current estate tax exemption allows. This means they can greatly reduce your estate tax liability, or, if the entirety of the estate is less than the combined exemptions of both spouses, then a B Trust can help avoid estate taxes altogether.

B Trusts also do three things differently than A Trusts and QTIP trusts: They keep the trust-owned assets out of the surviving spouse's estate, trust-generated income does not need to be paid out, and anybody can be a beneficiary of trust assets during the lifetime of the surviving spouse. In fact, there's no requirement that the surviving spouse has to receive anything. In order to keep the assets out of the survivor's estate, the surviving spouse cannot have complete control over the assets. If the spouse is the trustee, there has to be limitations for access to trust principal to an "ascertainable standard" (usually health, education, maintenance and support). These trusts are also irrevocable, so once they're established, they're set in stone.

4 Spousal Lifetime Access Trust (SLAT)

A SLAT is an irrevocable trust set up by one spouse for the other during his or her lifetime; the donor spouse does not need to pass away for this trust to be created, which is a stark difference between SLATs and the other trusts mentioned above. While the donor spouse makes an irrevocable gift to the trust and gives up any right to the funds, the beneficiary spouse, and potentially other beneficiaries such as children and grandchildren, are provided access to the gifted funds right away.

Basically, you put money into a separate account that only your spouse (and maybe your kids and grandkids) can access. Because the terms of a SLAT are so flexible, the money in the account can be used for a wide variety of purposes.

OTHER KINDS OF TRUSTS

There are myriad types of trusts that serve many purposes. What kind of trust(s) you want to add to your estate plan (or even whether or not you want to add one) is entirely up to you and your legacy goals. An estate planning professional can help you determine what, if any, trust is right for you. Interested in getting a professional's opinion?

Get in touch with Wealth Enhancement Group for a free introductory call. **1-888-829-1949**

WHAT IS A QUALIFIED TERMINABLE INTEREST PROPERTY TRUST?

LANE MARMON
Senior Vice President,
Financial Advisor
Darien, Connecticut

As you progress through life, considering what happens after your passing becomes increasingly important. It's a challenging topic to face, yet crucial for ensuring the well-being of your loved ones. Estate planning, specifically creating a trust, is a strategic method for providing security to your family in your absence. It's not merely a legal step but an essential measure of your enduring commitment to their future.

Not only can establishing a trust (or even multiple trusts) help keep your assets with your family and beneficiaries, but it can also reduce your estate tax liability. Arguably the most common types of trusts fall under the general category of spousal trusts, and among this category lies what's known as a Qualified Terminable Interest Property (QTIP) Trust.

A Little Background: Marital Trusts

Before we dive into QTIP Trusts, let's quickly recap marital trusts—also called A trusts. In the broadest terms, a marital trust is an account set up to benefit your spouse. At the time of your passing, your assets are transferred into the trust account, and for the remainder of your spouse's life, only they have access to the funds in the trust. But at the time of your spouse's passing, they can decide to whom any remaining trust assets should transfer, like children, grandchildren, etc.

Marital trusts also take advantage of the unlimited marital deduction to help you put off paying estate taxes. Typically, at the time of your passing, if your individual estate is more than the individual estate tax exemption amount, your estate would be taxed. In 2023, the federal estate tax exemption is $12.92 million, although, some states also have their own estate taxes with lower exemptions, so depending on the size of your estate, you could still have to pay taxes on it. But by establishing a marital trust and transferring those funds to your spouse, you can potentially avoid that taxation at your death. However, the trust would then be subject to estate taxes after your spouse passes.

How QTIP Trusts Are Different

QTIP trusts function almost the same as marital trusts. They're both irrevocable trusts that can only name the surviving spouse as beneficiary during that spouse's lifetime.

However, the major distinction between the two is that with a QTIP trust, the grantor of the trust maintains control of it even after death. This means that you're giving your spouse all the income from the trust but can limit their right to the principal, meaning you can place restrictions on what the funds are used for and even how much can be taken out. Not only can you limit the extent to which your spouse can access the funds in the trust, but they also do not get to decide what happens to any remaining funds after they pass—that power still lies with you.

Although, while your spouse may not have control of the principal, the QTIP trust is required to pay all income generated by the trust (e.g. dividends and interest) to them at least annually. This is what keeps trust-owned assets in the surviving spouse's estate, even if they can't dictate where trust assets will go at death. However, these payments will cease upon your spouse's death, at which point remaining trust funds simply transfer to any other named beneficiaries.

The Advantages of QTIP Trusts

Aside from the assurance that your spouse is taken care of after you pass away, QTIP trusts have some great benefits. Like marital trusts, QTIP trusts allow you to take advantage of the unlimited marital deduction. Once again, this means that if you happen to have a particularly large estate (over the $12,920,000 threshold), you can push off paying estate taxes until after your spouse passes away.

But unlike Marital Trusts, QTIP Trusts have a few nuances that make them particularly beneficial in specific situations. Since your spouse does not have control over the principal of the trust, you have the power to dictate any trustees (which could still be your spouse, but if this happens, principal distributions are typically limited to specific purposes) and even future beneficiaries. This means that while your spouse is receiving the income generated from the trust, they never actually have any ownership over the trust.

This can be particularly helpful if you've remarried. Say you have children from a previous marriage (and maybe they even have children) and want to ensure that they become the new beneficiaries of the trust after your new spouse passes. If you only establish a marital trust, there's no way to be 100% certain that your kids and/or grandkids take over the trust in the future. Your new spouse would be free to name anyone they wanted as beneficiary after their passing—even their new spouse if they decide to remarry.

Additionally, by placing limits on the amount to which your spouse can access the trust funds, you can provide some protections from scams or incapacity. For instance, as your spouse advances in age, they may become more susceptible to scams. Maybe someone calls claiming to be a grandchild in need and looking for money. Maybe your spouse replies to a phishing email. If you limit their ability to access the funds—like they can only be used for health care or they can only be accessed after being approved by a separate trustee—you can protect those funds from falling into the wrong hands.

IS A QTIP TRUST RIGHT FOR ME?

Estate planning is difficult on its own, and it can be even more difficult when you introduce things like trusts. The truth is, every situation is different, so something that might be right for your friends or other family members may not be right for your circumstances. But if it makes sense, adding a QTIP trust to your estate plan has some clear benefits. If you like the idea of creating financial stability for your spouse while maintaining control of the funds, then you may want to look into a QTIP trust.

An experienced financial advisor can help you determine if a trust is right for you. 1-888-829-1949

SHOULD YOU CONSIDER A SPOUSAL LIFETIME ACCESS TRUST?

KATE MAIER
Senior Financial Planner
Plymouth, Minnesota

Depending on the size of your estate and the state in which you live, many of your financial moves may be susceptible to estate taxes. That means that even when you want to leave something behind for your spouse or heirs, Uncle Sam gets a piece of the pie. That's where trusts can help.

> Establishing a trust (or trusts) is a common part of the estate planning process and is a great way to reduce your estate tax liability. Creating one can help keep more of your money with your family and beneficiaries, especially if you have a large estate.

However, the larger your estate, the larger your federal estate tax liability. So, if you have a federal estate worth more than $12 million and are looking to take advantage of higher estate tax exemptions, and you want to see the benefits of your marital trust while you're still around, then you may want to consider a spousal lifetime access trust (SLAT).

What is a Spousal Lifetime Access Trust (SLAT)?

A SLAT is an irrevocable trust set up by one spouse for the other during his or her lifetime, meaning the donor spouse does not need to pass away for this trust to be created, which is a stark difference between SLATs and other types of marital trusts that are only established upon death. While the donor spouse makes an irrevocable gift to the trust and gives up any right to the funds, the beneficiary spouse, and potentially other beneficiaries such as children and grandchildren, are provided access to the gifted funds right away.

The beauty of SLATs is that they can still be used in your lifetime, and they have a number of benefits that you can see in your lifetime.

What are the advantages of creating a SLAT?

SLATs allow you to take advantage of the large federal estate tax exemption during your lifetime, potentially helping to increase what you can pass on estate-tax-free in the event that the exemption amount is reduced. This is particularly important for estates worth north of $12 million that are subject to the federal estate tax, as the current federal exemption amount established by the Tax Cuts and Jobs Act is set to decrease by half in 2026. If you don't use the current high exemption rate before the end of 2025, or if a new law is passed before 2026, more of your estate will be subject to estate taxes—which is not ideal for you.

SLATs may also be useful for asset protection. Because you're putting the money into an irrevocable trust for somebody else's benefit and giving up all control or use of the assets, it is no longer considered yours for attachment in either bankruptcy or litigation. Additionally, if you use an independent trustee who has discretion over how and when distributions may be made to your spouse, the assets may also be safe from your spouse's creditors.

Given the flexibility in trust terms, a SLAT can also be combined with other types of trusts such as an irrevocable life insurance trust (if the SLAT owns an insurance policy), a dynasty trust (if the trust remains in being for children and grandchildren), and a credit shelter trust (to use up your lifetime exemption amount).

Because the terms of a SLAT are highly customizable, there are many considerations to take into account when establishing the trust:

1. **Forecast Assets**

   Make sure an advisor runs forecasts to ensure that you will be able to afford transferring assets to a SLAT. While your spouse will still retain access to the funds, you will likely still want to use assets that remain in your own names for ordinary lifestyle expenses. Additionally, you will need to determine what will happen in the event of death or divorce and you lose access to the funds.

2. **Determining the Trustee**

   Because the donor spouse must give up all control over the assets, he or she may not act as the trustee. If the beneficiary spouse acts as the trustee, distributions must be restricted to what's called an "ascertainable standard," namely health, education, maintenance or support. Depending on your goals, using an independent trustee may make sense, as they have wide discretion to make distributions for any reason.

3. **Naming Beneficiaries**

   Typically, the beneficiary spouse is the primary beneficiary of the SLAT. However, children, grandchildren, or other family members may also be named as current or remainder beneficiaries, helping to keep the funds within the family.

4. **Handling Multiple SLATs**

   If you and your spouse both set up a SLAT for each other, you will want to make sure the two trusts differ enough in order to avoid the "reciprocal trust doctrine." If your two trusts are too similar, the IRS will treat each trust as being created for the donor and will disregard the trusts for tax purposes. In order to avoid this outcome, you will want to make sure enough of the following terms differ between the trusts:

   a. Fund with different types of assets

   b. Fund with different amounts

   c. Create and fund at different times

d. Use different trustees

e. Establish the trusts in different states

f. Set up different terms for distributions (e.g. one spouse may have wide latitude to access income and/or principal, while the other is limited to specific purposes)

g. Provide for different powers of appointment of trust assets, as these powers provide the ability for the beneficiary spouse to direct trust assets to be paid to various other beneficiaries like children and/or grandchildren

5

Tax Considerations

Most SLATs are set up as "grantor trusts," which means that all income generated by the trust is taxed on the tax return of the donor spouse instead of to the trust. This allows you to make additional non-taxable "gifts" to the trust in the amount of the income tax owed. However, a SLAT can also be a non-grantor trust so that all income is taxed to the trust itself. Depending on the state in which the trust is located, this may enable you to avoid state income taxes.

6

Liquidity of Assets

You may want to consider allowing the trustee to make loans of trust assets to the donor spouse. This will allow you to access the funds to cover cash flow needs in the event that the assets you own outright become illiquid. The loan would then be paid back by your estate at death.

7

Death of Spouse or Divorce

Because you have given up control of the assets for the benefit of your spouse, if that spouse dies prematurely, or if you get a divorce, you will lose the indirect access to the funds you had through your spouse. You will want to speak with your attorney about ways to potentially replace the funds, such as only making the funds available for any current spouse (and not any former or estranged spouse), giving your spouse a power of appointment to be able to direct the funds back to you, or purchasing life insurance to be paid to you upon your spouse's death.

8

Protecting Your Credit

If there is any possibility that you may be sued or have to file for bankruptcy, care must be taken when transferring assets to the trust so that you can avoid any potential fraudulent transfers. Consider having your attorney run an inquiry to determine if there are any claims against you before making any transfers. You may also want to consider making multiple contributions to the trust over a period of time so that even if one transfer may be considered fraudulent to avoid judgment, early transfers will not.

Visit wealthenhancementgroup.com to learn more about retirement planning.

Retirement planning doesn't have to be complex.

CALL US TODAY
1-888-829-1949

It can be very simple. Take advantage of our free, no-obligation meeting and discover how our revolutionary 3-step UniFi™ process can transform your financial landscape.

Don't miss the opportunity to start your journey towards a life that's more streamlined and free of financial stress.

(For best service, please call between 8:00 a.m. and 5:00 p.m. Central Time)

1-05372935 6/2023

Wealth Enhancement Group®