



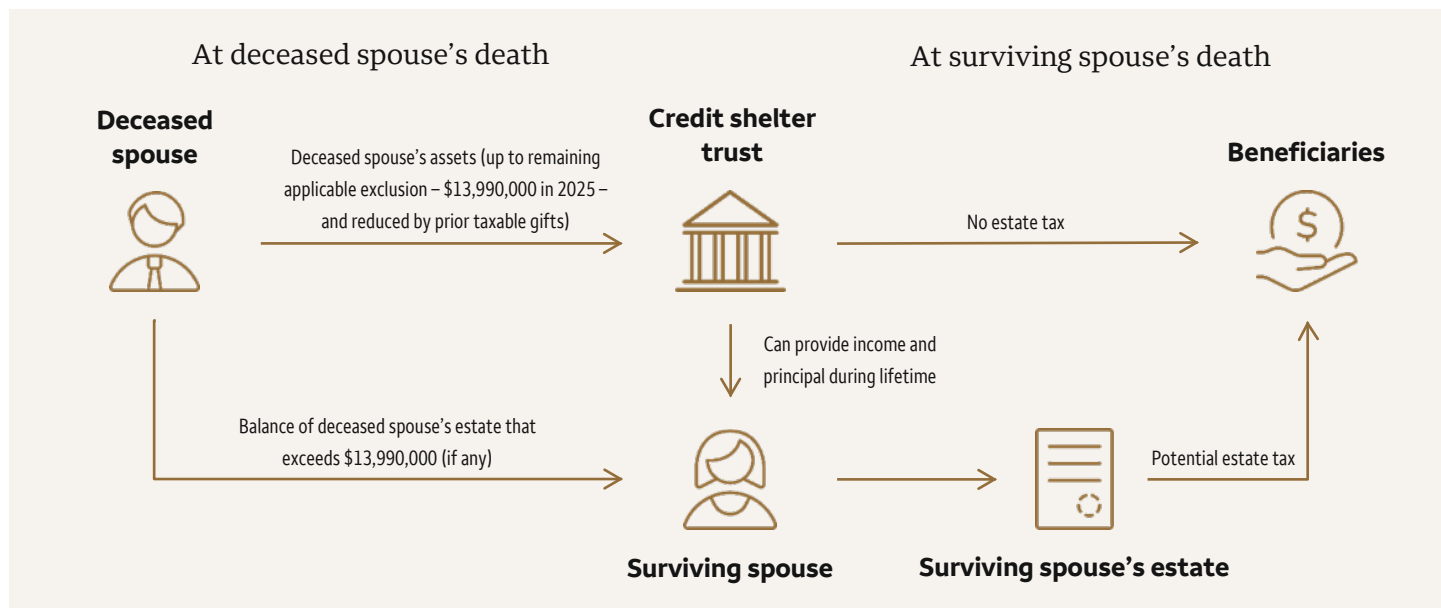
Credit shelter trusts

The following information and opinions are provided courtesy of Wells Fargo Bank, N.A.

As married couples do not automatically qualify for a double estate tax exclusion, credit shelter trust planning is one way for couples to use both of their exclusions to protect up to \$27,980,000 (in 2025) or more from estate taxes. An alternative strategy, the portability election, which allows transfer of any “unused” estate tax exclusion from a deceased spouse to a surviving spouse, is further explained below.

A credit shelter trust (CST) can be used as part of a married couple’s estate planning strategy. For 2025, the estate tax exclusion amount is \$13,990,000 per person (indexed for inflation), but is scheduled to “sunset” after 2025, essentially reducing it by one-half. This type of trust is often structured to provide benefits to a decedent’s surviving spouse and their descendants while avoiding inclusion in that spouse’s estate. Property held in this type of trust can pass to descendants with no estate taxes. A credit shelter trust is also referred to as a bypass, credit-equivalent, credit-exemption, exemption-equivalent, family, or residuary trust.

How does a CST work?



This information is hypothetical and is provided for illustrative purposes only. It is not intended to represent any specific strategy, nor is it indicative of future results.

The diagram above depicts the general concepts and flow of assets when using the credit shelter trust strategy.

- Provisions to create a CST are included in a will or revocable living trust. The CST does not come into existence until the first spouse's death.
- At the first spouse's death, an amount up to the remaining applicable exclusion is allocated to the CST. This could include the exclusion amount (less prior taxable gifts), plus any additional amounts received from a previously deceased spouse.¹
- A CST is typically designed to pay income (and principal, if needed) to the surviving spouse for life.
- CSTs can also be designed to benefit other family members.
- When the surviving spouse dies, trust assets are distributed to named beneficiaries, either outright or in trust.
- Due to limited control of the assets by the surviving spouse, a CST can be a tool for the first spouse to control how assets are protected (e.g., from surviving spouse's creditors, depletion by children, or remarriage).

Benefits of a CST

- Because a CST is not included in the surviving spouse's taxable estate, assets placed in the CST, along with any future growth, are "sheltered" from estate tax when the surviving spouse dies.
- Step-up in cost basis is available. This is an adjustment in basis for an asset that has appreciated in value. This occurs upon the death of the owner of the asset to the date of death value, which erases any embedded capital gains upon sale of the asset. However, there is no potential step-up in cost basis at the death of the surviving spouse.
- Surviving spouses still have their own remaining exclusion available at their death, plus any unused exclusion "ported over" from the deceased spouse.

Other considerations

- For CST planning to be effective, it's important to consider how assets are titled. Jointly held assets pass directly to the surviving joint tenant and sidestep the CST. In some cases, CST planning can be more effective if jointly held assets are retitled.

1. The amount of a decedent's estate that can pass tax-free upon death is indexed for inflation based on the Tax Cuts and Jobs Act, which is effective January 1, 2018. This amount is applicable in the year of a person's death.

- It may not be advantageous to maximize funding of the CST if the surviving spouse is likely to have a taxable estate smaller than the applicable exclusion.
- There may be expenses related to setting up and maintaining a CST, including trust accounting, tax filings, and administration services.

How does portability work?

A special tax election, commonly referred to as a “portability” election, allows the transfer of a deceased spouse’s unused estate tax exclusion to a surviving spouse if done in a timely manner. This potentially enables the surviving spouse to exclude a much greater amount from estate tax at the second death.

- Assets are left to the surviving spouse in a manner that does not leverage the estate exclusion of the deceased spouse. This could be in the form of a transfer under a will, revocable trust, beneficiary designation, transfer-on-death designation, or via joint tenancy with right of survivorship. Alternatively, the transfer could be to a trust that qualifies for the marital deduction.
- The deceased spouse’s executor files a timely estate tax return (even if a return would not otherwise be required due to the estate size).
- If a portability election is made, the assets owned by the surviving spouse will receive a step-up in cost basis at the death of the first spouse, as well as second step-up on the death of the surviving spouse. This is because assets are included in the surviving spouse’s estate and may also be sheltered from estate tax due to combination of both spouses’ estate exclusions.
- Portability only protects the deceased spouse’s unused exclusion from estate tax at the surviving spouse’s subsequent death and is not indexed for inflation.

- A deceased spouse’s unused exclusion amount can be ported over to the surviving spouse up to five years after the decedent’s death.²
- A potential benefit of electing portability can be minimizing the expense associated with trust accounting and tax filing requirements that are part of administering a CST.

Other portability considerations

- If a timely estate tax return is not filed for the deceased spouse, this planning opportunity will be lost, potentially resulting in a larger estate tax at the second death.
- The surviving spouse can only use the additional exclusion from his or her “most recently deceased” spouse. If the survivor remarries and outlives another spouse, the transferred exclusion may be lost.
- The value of the transferred exclusion is fixed. Any growth in value of the transferred assets will be part of the surviving spouse’s taxable estate.
- While the estate tax exclusion is portable, the generation-skipping transfer (GST) tax exemption is not.
- With limited exceptions, state exemptions are not portable, so specific trust planning to fully utilize them may still be required. State laws change frequently, so it’s important to work closely with an attorney in your state as you review estate strategies.

Consult with your advisors

A well-thought-out estate plan deals not only with the disposition of your assets at death and may incorporate some of the strategies outlined above. For more information on which strategies may be most appropriate to meet your estate planning goals and how they should be structured for your specific situation, talk to your estate planning attorney.

² [irs.gov; Instructions for Form 706 \(10/2024\); https://www.irs.gov/pub/irs-pdf/i706.pdf](https://www.irs.gov/pub/irs-pdf/i706.pdf)

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