

What is a Leveraged Credit Shelter Trust?

A Leveraged Credit Shelter Trust (CST) is a basic wealth transfer planning technique that allows clients to take the existing credit shelter trust assets, and reposition these assets into life insurance to maximize the amount of wealth available to heirs at the second death. The CST provides a solid base for effective estate plans. For years, it has been a standard component of a married couple's estate plan. If the CST is properly drafted, the assets in the trust will not be subject to estate tax at either spouse's death.

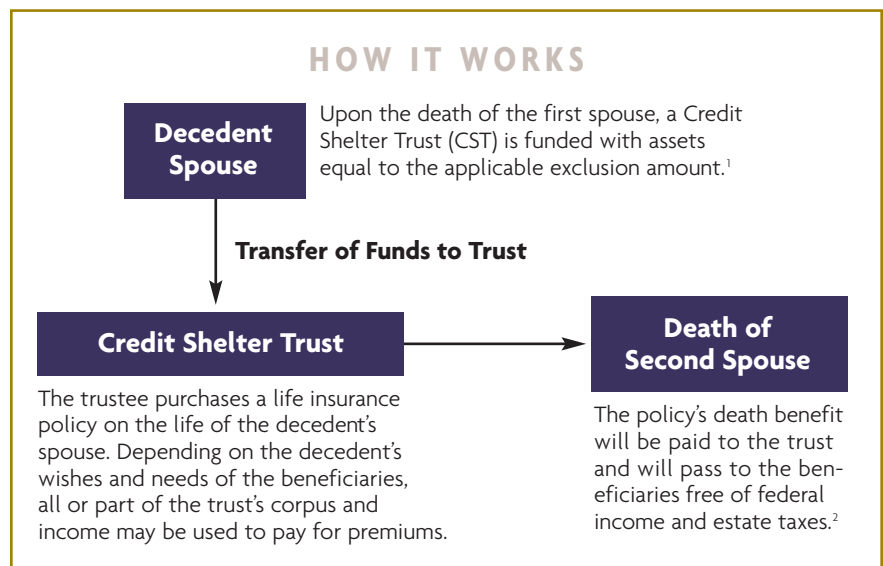
Funding a Credit Shelter Trust with life insurance provides an effective way for individuals, like you, to maximize tax-deferred investment growth, income and estate tax benefits. Properly drafted, the credit shelter trust funded with life insurance can leverage all or part of the trust assets to create a larger death benefit that will be income tax-free and estate tax-free to trust beneficiaries. Also, the growth of the policy cash value will be tax-deferred.

Here's How it Works

The CST (also known as "B" trust or "family trust") is funded upon the first death of the husband or wife, using that spouse's available unified credit amount. In 2006, the exclusion amount that is sheltered from estate taxes at death is \$2 million, assuming no lifetime taxable gifts were made. Upon the first death, the estate is divided into two parts, one part is funded up to \$2,000,000 (assuming no lifetime taxable gifts were made) and placed in a family or non-marital trust ("B" trust) and the balance is transferred to the surviving spouse either outright or in trust. No estate taxes are paid since the trust makes complete use of the exclusion amount and the unlimited marital deduction.

Upon the second death, the assets of the CST will pass estate tax-free to the beneficiaries and not be included in that spouse's estate.

By using all or a portion of the trust assets to purchase life insurance, individuals can use the tax advantages of life insurance, including a death benefit that passes to the heirs free of estate, income and capital gains taxes.



¹The applicable exclusion is \$2,000,000 in 2006, increasing to \$3,500,000 in 2009, and reverting back to \$1,000,000 in 2011 under current law.

²Any income earned by the trust as a result of any investment of the death proceeds prior to distribution will be taxable to the trust or the beneficiaries.

Not FDIC/NCUA insured. May lose value. No bank/credit union guarantee. Not a deposit. Not insured by any federal government entity.

Advantages of Funding a Credit Shelter Trust with Life Insurance³

Donor Advantages

- ▶ Designed to take advantage of the unified credit exemption
- ▶ Opportunity for tax-deferred growth inside a life insurance policy
- ▶ Ability to enhance the value of a credit shelter trust and reduce estate taxes
- ▶ Opportunity to select from a variety of life insurance product options with a variety of death benefit guarantees

Beneficiary Advantages

- ▶ Receives larger death benefit free of income, capital gains or estate taxes
- ▶ Potential for increased inheritance at second death

Common CST Provisions

Income to Spouse

Typically, all income earned by the Trust is paid to the spouse during his or her lifetime.

Special (or Limited) Powers of Appointment

Often a surviving spouse is given a special Power of Appointment over assets held in a CST. For example, the Trust may allow the surviving spouse to exclude, at his or her death, certain remaining beneficiaries or change the allocation to each beneficiary. The spouse typically cannot name new beneficiaries nor make his or her estate a trust beneficiary.

Five and Five Powers

The Trustee distributes to the surviving spouse the greater of \$5,000 or five percent of the trust balance without including the entire trust value in his or her taxable estate.

Spouse as Trustee

Often the surviving spouse is the trustee of the CST giving him or her power to oversee trust investments within the trust's provisions. Even though the spouse *is the trustee and a beneficiary*, it is necessary to properly draft the trust to avoid having any assets included in the surviving spouse's gross estate at his or her death.

³ Partial withdrawals and loans will affect the policy proceeds and account value and may be subject to income tax. If the policy is classified as a Modified Endowment Contract (MEC) under IRS rules, distributions are generally subject to income taxes and a federal tax penalty if made before the age of 59½.

What You Need to Know

Tax Implications

- ▶ Death proceeds payable to the trust will not be included in the surviving spouse's estate if the trust is properly drafted.
- ▶ Trust proceeds from the life insurance distributed to your beneficiaries will also be tax-free as life insurance proceeds, §101 (a). However, any income earned on that money following the death will be taxable income to the trust or beneficiary, if distributed.
- ▶ Any use of 5 and 5 powers, or limited powers of appointment in a trust must exclude the life policy or it could subject all or part of the death proceeds to estate tax at the death of the surviving spouse.

Life Insurance as a Permissible Trust Funding Vehicle

- ▶ The trustee must have the authority to purchase life insurance as a trust investment.
- ▶ Many, if not most trust agreements, have provisions giving the trustee a great deal of discretion with respect to the types of assets that may be purchased, and may even specifically list life insurance on the life of the surviving spouse and/or a trust beneficiary as a permissible trust investment.
- ▶ If the trust agreement does not provide clear authority for the purchase of life insurance, state law should be reviewed.

Summary

The Credit Shelter Trust is an effective wealth transfer technique that takes advantage of each spouse's unified credit amount to fund a life insurance policy. The appeal of funding a CST with a life insurance policy is the ability to leverage all or part of the trust assets to increase the beneficiaries inheritance. The death benefit proceeds will be income and estate tax-free to the trust beneficiaries, and the earnings grow tax deferred.

If you would like to learn more about how a Leveraged Credit Shelter Trust can help you control and preserve more of your assets, and prevent less from being lost to federal estate taxes, contact your Sun Life Financial representative today.

About Sun Life Financial

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