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Massachusetts Estate Tax Explanation*

Each Massachusetts resident dying after January 1, 2023, can pass up to \$2 million at death without a Massachusetts estate tax. This \$2 million is referred to as the estate tax exclusion. So, it seems to reason that a married couple can pass a total of \$4 million to their children free of estate tax. However, without an estate plan, this would not be the case.

Consider a couple with \$5 million in assets, all of which they hold jointly with rights of survivorship. When the first spouse dies, all of the assets automatically pass to the surviving spouse as the surviving joint owner. There is no Massachusetts estate tax because there is a full marital deduction for all assets passing to a surviving spouse at death – regardless of amount.

The surviving spouse now has all \$5 million in assets, but can only pass \$2 million to the children free of estate tax. The first spouse's \$2 million exclusion was not used and is no longer available to the family.

The goal of estate tax planning is to use both spouses' estate tax exclusions and pass the full \$4 million to the children free of Massachusetts estate tax. This is done by preventing all of the assets from passing to the surviving spouse outright on the first death. This means not holding the assets as joint tenants with rights of survivorship. Instead, most or all of the couple's assets can be held in a trust that segregates husband's share and wife's share. On the first death, the deceased spouse's share of the assets for which there is an exclusion (up to \$2 million) pass to a trust for the benefit of the surviving spouse. Although the trust is for the benefit of the surviving spouse, the terms of the trust prevent those assets from being part of the spouse's taxable estate on death. This type of trust is often referred to as a "credit shelter trust".

How does the credit shelter trust impact the financial security and comfort of the surviving spouse? Unlimited access to assets will cause the credit shelter trust assets to be included in the survivor's taxable estate. While it is true that the surviving spouse's access to the assets in the credit shelter trust has to be restricted, the necessary restrictions are interpreted with the surviving spouse's standard of living in mind. The usual restrictions used (because they are sanctioned by the tax regulations) are health, education, maintenance and support. If these are the only purposes for which the surviving spouse can withdraw assets from the credit shelter trust, then the assets in the credit shelter trust on the survivor's death will not be included in his or her taxable estate. Again, these restrictions are interpreted with the surviving spouse's standard of living in mind, so the survivor should not want for anything reasonable while assets remain in the credit shelter trust.

With that in mind, the survivor should not be using the credit shelter trust assets unless absolutely necessary because these assets are specifically placed to pass to the children free of estate tax. Instead, the surviving spouse should spend his or her share of the couple's assets (the other \$2.5 million), as well as the excess from the decedent's estate (the \$500,000 that was not covered by any estate tax exclusion) because those assets are part of the survivor's taxable estate.

So, the surviving spouse is then left with \$3 million in assets – the \$2.5 million allocated to him or her, plus the \$500,000 (excess over the \$2 million exclusion) that passed as a result of the first death. Now the surviving spouse has \$3 million in assets with an estate tax exclusion of only \$2 million. Going forward, he or she would spend from that \$3 million because these are assets that are going to be taxed on death to the extent not spent. Preserving the assets in the credit shelter trust allows them to appreciate and grow so that even more than \$2 million will pass to the children on the survivor's death free of estate tax. Should the surviving spouse spend the \$3 million allocated to him or her, then the \$2 million in the credit shelter trust is there as a backup.

The credit shelter trust assets are available to the surviving spouse if needed, but the goal is to preserve them, let them grow and eventually pass them (with all of the growth) to the children free of Massachusetts estate tax.

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