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After more than a decade of confusion Congress finally acted to bring greater certainty to the estate tax law. Under the American Taxpayer Relief Act of 2012 (ATRA) reunification of the estate and gift tax regimes, the $5 million exemptions for estate taxes, gift taxes, and generation-skipping transfer taxes became permanent and are no longer subject to periodic sunsets. Beginning in 2013 the top estate tax rate is increased from 35 percent to 40 percent. The ATRA permanently extended both indexing of the exemption and the portability provisions of the 2010 Tax Relief Act that allow any unused exemption to be passed to a surviving spouse without the need to re-title assets and establish complex wills and trusts (see the discussion of Portability on page 503).

Post ATRA, individuals will pay either no federal estate tax or an estate tax at the rate of 40 percent (see table on page 586). Subject to the federal estate tax, the Forty-Percenters are multi-millionaires with estates over $5.43 million (in 2015) that will continue to grow at or above the rate of inflation (over $10.86 million in 2015 in the case of a married couple). These Forty-Percenters also include~~s~~ those individuals whose current estates, although lower in value than these threshold amounts, will become subject to the federal estate tax as a result of appreciation greater than the rate of inflation (i.e., their estates will "overtake" the inflation-indexed exemption). Zero-Percenters include the vast majority of the rest of the population with estates below $5.43 million (under $10.86 million in the case of a married couple). Assuming appreciation less than the rate of inflation Zero-Percenters *will never be subject to the federal estate tax*.

Estate Planning for the Zero-Percenters.

With the inflation-adjusted exemption AFTRA permanently shielded these estates from the federal estate tax. For the Zero-Percenters federal estate taxes are no longer a consideration in estate planning. If the uncertainty and confusion of our federal estate tax laws in recent years caused these individuals to delay revising their estate plans, then now is the time to review their estates and update those outdated plans and documents.

Reconsider Gifts. Zero-Percenters should consider retaining assets in their estates in order to obtain a stepped-up basis for their heirs (i.e., there is no federal estate tax at death and the stepped-up basis will reduce the heir's income tax burden when assets are subsequently sold). See the Gifts & Split-Gifts chart on page 47 and the discussion of Stepped-Up Basis on page 561. The potential value of a stepped-up basis is enhanced by the recent increase in the maximum capital gains tax to 20 percent and the 3.8 percent Medicare tax on investment income (see pages 314 and 340).

Review Trusts. Changed circumstances may indicate a need to consider either foregoing gifts to the trust, canceling the trust and distributing the funds, or revising the trust terms (see Decanting on page 370).

Pointers

Asset Protection. In the past many estate tax avoidance techniques involved irrevocable trusts, limited liability companies, and family limited partnerships (see pages 170 and 465). These vehicles should not be discontinued merely because the federal estate tax no longer threatens the estate. There is still a need for asset protection, income shifting, and wealth management. In fact, as income tax planning becomes increasingly important, the combination of income tax efficiency and creditor protection makes life insurance an increasingly popular planning tool (see the new discussion regarding Life Insurance and Creditor Protection on pages 446).

State Death Taxes. With the passage of ATRA it is clear that revenue-sharing by the federal government via the state death tax credit will not return. Estates will continue to be subject to *state* death taxes in those states that have decoupled from the federal estate tax (see the discussion of Decoupling on page 371). Because of differences in state death tax exemptions and rates, planning for state of domicile has become an important aspect of estate planning for both Zero-Percenters and Forty-Percenters.

Estate Planning for the Forty-Percenters.

After ATRA the Forty-Percenters must recognize there is no longer any realistic expectation that the federal estate tax will be repealed. For the foreseeable future the taxable estates of Forty-Percenters will likely be subject to a federal estate tax of 40 percent on amounts above the inflation-adjusted exemption (in 2015, $5.43 million for single individuals and $10.86 million for a married couple). They will also be subject to *state* death taxes in states that have decoupled from the federal estate tax.

Reconsider the Bypass Trust. When assets are placed in a bypass trust future appreciation of those assets is taxed to the beneficiaries of the trust upon sale of the assets (see Trust Will chart on page 25 and QTIP Trust chart on page 35). However, if these assets are left outright to a surviving spouse, then upon the surviving spouse's death this appreciation will receive a stepped-up basis and upon subsequent sale the gain would be tax-free to the beneficiaries. Since with portability the estate tax exemption will not be lost, the first-to-die spouse should consider foregoing use of the bypass trust in order to obtain a stepped-up basis for subsequent appreciation (i.e., pass property to the surviving spouse, not to the trust). However, there may be exposure to state estate taxes and the benefits of an additional step up in basis should outweigh this exposure. Also, even with portability, there remain many non-tax reasons to use trust wills in estate plans (see the further discussion of portability on page 503).

Spousal Access Trust (SLAT). This is a type of irrevocable trust that is often funded with property which can include life insurance on the life of the grantor (non-beneficiary) spouse. The grantor's spouse can be a beneficiary of the trust while still removing property (including life insurance proceeds) from the taxable estate of both spouses. As beneficiary of the trust the spouse can also maintain access to the policy's cash surrender value. This new term is found on page 559. If both spouses create these trusts it is important to avoid application of the reciprocal trust doctrine (see discussion on page 524).

Wealth Transferring & Estate Freezes. There are few restrictions on the Grantor Retained Annuity Trust (GRAT) as a wealth-transferring device (see chart on page 59). Relatively low values and low interest rates make this a very attractive planning technique for the Forty-Percenters. With substantial estates a trust will can freeze the value of property during the surviving spouse's lifetime so that future appreciation will not be subject to federal estate taxes upon the surviving spouse's death. Other estate freeze techniques should also be considered.

Irrevocable Life Insurance Trust (ILIT). The ILIT remains a very effective estate planning tool to provide funds for paying estate taxes (among other purposes) for the Forty-Percenters (see chart on page 51).

Estate Planning for All.

Estate planning is primarily about people and their desire to provide for their loved ones. Given proper motivation, most clients will devote the time and energy that is necessary to develop and adopt an effective estate plan.

The Nontax Reasons for Estate Planning. The primary objectives of most estate plans involve estate creation, support and care of a surviving family, and the orderly transfer of property during lifetime or at death. This often involves providing for the care of minor children, support for disabled children and elderly parents, and protection of loved ones from creditors. For some individuals the motivation to plan their estates is found in a strong desire to assure the survival of a business, or to provide for their church or a charity.

Life Insurance. Are there enough life insurance proceeds, liquid assets, and other sources of income to maintain the current living standards of your client's surviving family? Unfortunately, all too many individuals remain underinsured. In this regard, see Facts About Human Life Value in the Courtroom, on page 100. For those clients needing insurance to pay taxes, delaying the purchase of currently needed life insurance could be disastrous. With increases in income tax rates, the tax-efficiency of life insurance has made it an increasingly popular tool for supplemental retirement planning (see new discussion of Life Insurance in Retirement Planning at page 444). Life insurance has also gained popularity in creditor protection planning (see new discussion of Life Insurance Creditor Protection Planning at page 446).

Coordination Is Important. It is often difficult, if not impossible; to design an effective estate plan without considering your client's employee benefit programs and business disposition plans. Effective planning cannot be achieved unless there is an awareness of the interplay between the various strategies and techniques of estate planning, business planning, and employee benefits. For example, the liquidity needs of a business owner's estate plan are directly influenced by whether the business is to be sold, continued, or liquidated (see chart on page 122). If the business is to be sold, then a funded purchase agreement may well provide all of the dollars needed for estate liquidity and family income. If the business is to be continued, then an employee benefit, such as split-dollar, could provide the necessary funds.

ESTATE PLANNING MATRIX

In the traditional sense, estate planning means preparing for the orderly and efficient transfer of assets at death. Within this definition, the basic objectives of estate planning are set forth in the discussion of the Estate Funnel on page 10.

However, estate planning has also come to involve planning for the accumulation and distribution of an estate during lifetime as well as at death. It must also be recognized that comprehensive estate planning will often involve the concepts and techniques contained in the business planning and employee benefits chapters of this guide. For example, although additional estate liquidity would be provided from the sale of a business interest, estate taxes will be increased through inclusion of the proceeds of the sale in the taxable estate. Likewise, an effective estate plan should maximize employee benefits, while at the same time taking into consideration their impact upon the estate.

The following matrix should provide a better understanding of how the concepts and techniques, represented in the charts, can be used to solve estate planning problems.

PROBLEM	SOLUTION(S)	PAGE
Loss of Estate Value Through Estate Tax	TRUST WILL provides the opportunity to reduce estate taxes.	24
	QTIP TRUST provides opportunity to reduce taxes while controlling disposition of estate.	34
	GIFTS & SPLIT-GIFTS remove property from the estate.	46
	LIFE INSURANCE AS PROPERTY shows how life insurance can be excluded from the gross estate for federal tax purposes.	74
	LIFE INSURANCE TRUST can remove life insurance death proceeds from the estate.	50
	CHARITABLE REMAINDER TRUST can remove from estate taxable property that can be replaced by life insurance in a Wealth Replacement Trust.	54
	GRANTOR RETAINED ANNUITY TRUST allows a grantor to retain an annuity interest while at the same time reducing estate taxes.	58

Loss of Estate Value Through Estate Tax (continued)	GENERATION-SKIPPING TRANSFERS shows use of exemption in 2015 to transfer $5,430,000 to grandchildren.	38
Estimating the Estate Tax	FEDERAL ESTATE TAX explains the calculations.	18
Payment of Estate Costs	LIFE INSURANCE PRODUCTS can be used to provide funds to pay these costs. Chart compares alternative plans and explains their basic characteristics and essential differences.	78
Distribution of Estate	SIMPLE WILL can provide for the distribution of estate assets, including specific bequests.	22
	TRUST WILL offers added tax savings and the post death management of assets.	24
	REVOCABLE LIVING TRUST (RLT) is a will substitute offering many advantages during lifetime and at death.	28
	POUR-OVER WILL functions as a "fail safe" device to transfer property at death into the RLT.	32
Replacement of Income:		
Upon Death	LIFE INSURANCE PRODUCTS can provide funds to replace lost income in case of death (one approach to determining the necessary funds is contained in the discussion of HUMAN LIFE VALUE on page 14).	78
Upon Disability	DIABILITY – THE LIVING DEATH demonstrates the need for proper planning before disability occurs.	244
Upon Retirement	DEFERRED ANNUITY can be used to accumulate funds on a tax-favored basis.	288
Insufficient Income or Assets for Custodial Care In Retirement	LONG-TERM CARE planning provides an understanding of the risk and cost of long-term care and how the risk can be managed.	260
Management of Assets and Orderly Payment of Income to Spouse and Children	LIFE INSURANCE TRUST provides for both asset management and ongoing payments.	50
	TRUST WILL with provisions for both asset management and payment of continuing income to beneficiaries.	24
	REVOCABLE LIVING TRUST can provide for management of assets both before and after death.	28
Guardianship of Children	SIMPLE WILL with provisions for appointment of guardian (TRUST WILL can also contain these same provisions).	22

THE ESTATE FUNNEL

The estate funnel helps to explain the types of property found in most estates, the problems often encountered in settling an estate, and the objectives of estate planning.

The property found in most estates generally falls into one of five categories:

Personal property, such as furniture, cars, jewelry, cash, bonds, savings, and other personal effects.

Real estate, such as a home, a vacation house, land, and rental property such as apartments or office buildings.[1]

Business interests, in the form of closely held corporations, partnerships, or sole proprietorships.

Life insurance, either group insurance or individual policies.

Government benefits, such as social security, disability, retirement, and survivor income benefits.

Unfortunately, at death there is often a great deal of CONFLICT. This occurs due to the differing and conflicting ways in which many of these assets pass to the family or other heirs. For example, personal property can pass by will, by state law if there is no will, by title, or by trust.[2] Real estate and business interests may also pass by all of these means, as well as by agreement. Generally life insurance passes by beneficiary designation, and government benefits by federal statute.

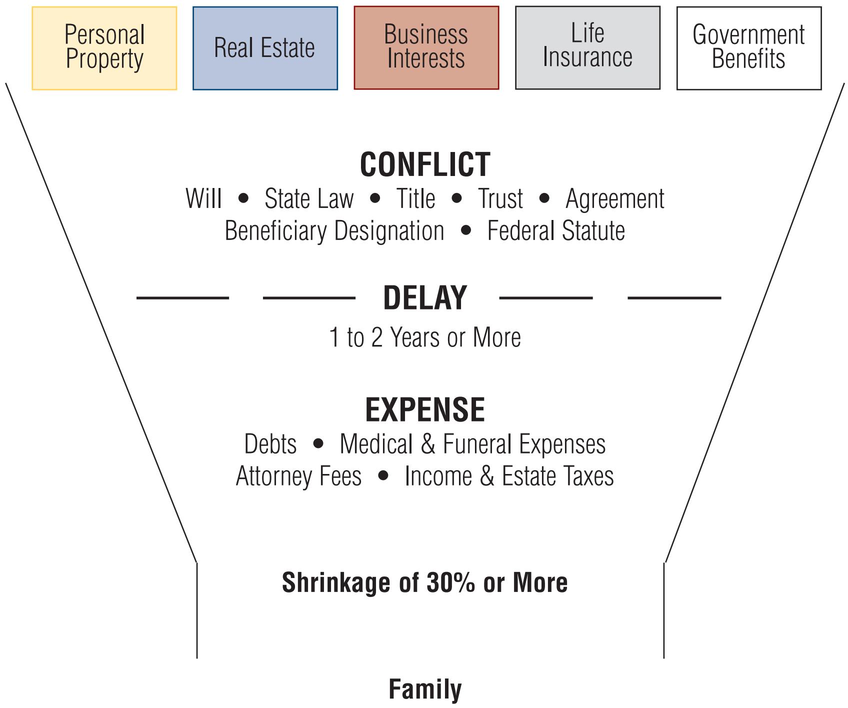
These conflicts, together with the generally slow probate process, can easily result in a DELAY of 1 to 2 years or more.[3]

Considerable EXPENSE may also be incurred during the estate settlement process. For example, existing debts must be paid. There are also medical expenses, funeral expenses, attorney fees, income taxes, and estate taxes. The final result is often a shrinkage of 30% or more by the time an estate is passed to the surviving family.[4]

The basic objectives of estate planning are to provide for the orderly and efficient accumulation, conservation, and distribution of an estate, while avoiding conflict, shortening delays, and reducing expenses.[5]

Footnotes on page 13

PEOPLE AT WORK - CAPITAL AT WORK



OBJECTIVES OF ESTATE PLANNING

Avoid Conflict • Shorten Delays • Reduce Expenses

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Names of client, spouse, and children.
2. Dates of birth.
3. For client and spouse – smoker/nonsmoker.
4. Type of wills (simple, exemption trust, marital share, etc.).
5. Trusts established.

Assets (determine how titled – individual, joint, etc.)

6. Personal and intangible property:

   liquid – cash, checking accounts, certificates of deposit, money market funds, mutual funds, municipal bonds, corporate bonds, annuities, options, etc.

   illiquid – contents of home, personal effects, jewelry, collections, cars, notes, leases, royalties, and tax sheltered investments.

   employee benefits – individual retirement accounts, HR-10 plans, tax deferred annuities, 401(k) plans, and vested deferred compensation and pension plan benefits (including beneficiary designations).
7. Real estate: home, vacation home, land, lots, commercial property, and investment property.
8. Business interests: corporations, partnerships, sole proprietorships, and farming operations.
9. Insurance: group and individual life insurance, disability and health coverage (including ownership and beneficiary designations).
10. Government benefits: social security disability payments, survivor benefits, and retirement payments.

Liabilities

11. Short-term debt: bills payable, loans, notes, consumer debt.
12. Long-term debt: home mortgage and home equity loans.

Obligations and Objectives

13. Debt to be paid at death (including final expenses).
14. Charitable bequests.
15. Monthly income required by surviving family.
16. Monthly income required by spouse after children are grown.
17. Cost for children's education (per year).
18. Monthly income in case of long-term disability or retirement.

Special Circumstances

19. Support for ex-spouse or children from prior marriage.
20. Support for other dependents.
21. Citizenship of client and spouse, if not U.S.

Footnotes

[1] Where more than one person owns real estate or certain types of personal property, the form of ownership determines how the property is passed upon death. The form of ownership also determines the extent to which the property is includable in the gross estate for federal estate tax purposes:

a. Where the property is owned in a **tenancy in common**, each tenant – or co-owner – has a fractional, divisible interest in the property. Upon the death of a co-owner, his fractional interest is probate property and passes by will or by state intestacy laws. Each surviving co-tenant retains his proportionate interest in the property. The fair market value of the decedent's fractional interest is includable in the federal gross estate.

b. Where the property is owned in **joint tenancy with right of survivorship**, each joint tenant has an undivided interest in the entire property. The survivorship right is the key characteristic: upon the death of a joint tenant, the decedent's interest passes by operation of law to the surviving tenant or tenants. The decedent's interest is not a probate asset and therefore cannot be disposed of by will or intestacy law. For federal estate tax purposes, joint tenancy with right of survivorship does not necessarily prevent all or any of the property from inclusion in the federal gross estate upon the death of a joint owner. However, a joint-and-survivorship property interest created *between spouses* after 1976 is considered to be a "qualified joint interest." As such, only *one-half* of the value is included in the gross estate for federal tax purposes. All other joint-and-survivorship property is *fully* includable in the gross estate of the first owner to die, except to the extent that the decedent's estate can demonstrate that the survivor contributed to the purchase price. However, jointly owned property obtained through gift or inheritance is included in proportion to the decedent's ownership interest.

c. Some states recognize a **tenancy by the entirety**. Generally, this form of ownership parallels joint-and-survivorship property except that it may be created by husband and wife only.

d. In **community property** states each spouse is considered to own an undivided one-half interest in such property during the marriage, and each spouse is free to dispose of his or her share of community property upon death. One-half of the fair market value of community property is includable in the decedent spouse's estate. See the expanded discussion of community property on pages 355-356.

[2] The unlimited marital deduction allows jointly owned property to pass to a surviving spouse free of the federal gift or estate tax. However, having virtually all property in joint title with right of survivorship can defeat the potential estate tax advantages of the Trust Will (chart, page 25). When property is jointly owned, it passes by law directly to the surviving spouse and therefore cannot pass into the non-marital, or "B" trust. Such over qualification of the unlimited marital deduction means that the property may be subject to taxation upon the subsequent death of the surviving spouse. Furthermore, there may be certain income tax disadvantages to having property jointly owned if and when the surviving spouse sells the property. See page 561 for an expanded discussion of stepped-up basis.

[3] For specific examples of the time delays that can occur when the valuation of closely held stock is left to chance, refer to the materials on pages 190-196. See also page 510 for a discussion of the probate process.

[4] Typical estate debts, costs, and taxes for various size estates are set forth on page 89. See also page 335 for a discussion of asset protection techniques.

[5] During the fact-finding phase of estate planning it is important to obtain for review numerous client documents (see page 86). See also, Survivor Checklist on page 94.

HUMAN LIFE VALUE

In determining how much life insurance should be carried for family income purposes, two basic methods are used. The **needs approach** involves a determination of the family's income requirements. The **human life value approach** involves a capitalization of that part of the breadearner's income devoted to the support of his family.[1]

Calculating an individual's human life value involves first determining the amount of his income allocated to family support. This is done by deducting income taxes, personal life and health insurance premiums, and the cost of self-maintenance from the breadearner's annual income from personal efforts. To illustrate, assume that the result is $10,000 per year.[2]

The next step involves determining the number of working years to retirement. Our example assumes the figure of 5 years.[3] A reasonable discount rate is then applied to arrive at the present value of these anticipated future earnings. For example, 5 percent might be used as representing a conservative after-tax rate of return for the surviving family.

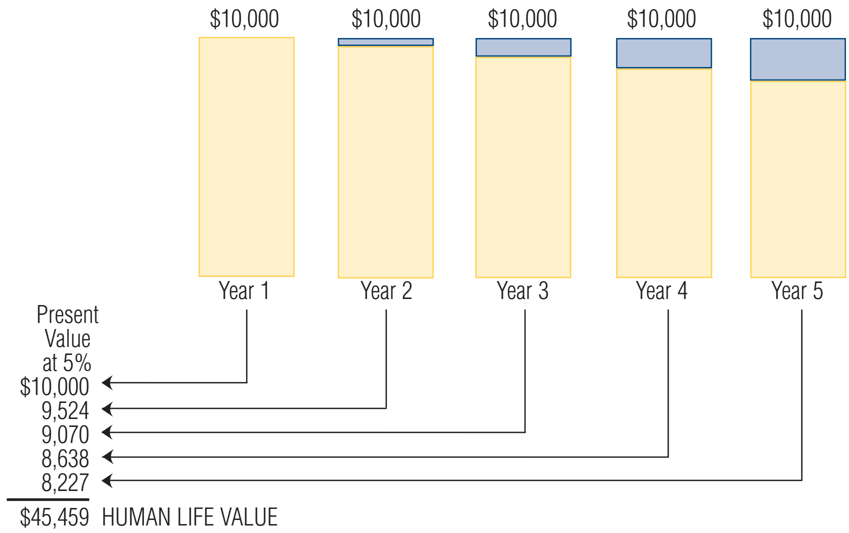
NO GROWTH. The present value of future earnings after the first year can then be calculated by multiplying them by the appropriate discount factors (e.g., multiplying the $10,000 expected to be earned for the family in the second year by a factor of .9524, we find that its present value is $9,524). When this amount is added to the present values of anticipated earnings in the other years, we determine a human life value of $45,459 (for the limited five-year period).[4]

8% GROWTH. However, it is important to anticipate that in future years the income devoted to the breadearner's family will likely *increase*. If we assume an annual increase of 8 percent, earnings are projected to be $10,800 in the second year. The present value of these earnings is $10,286 ($10,800 x .9524). Adding this amount to the present values of the anticipated earnings in the other years, we determine a human life value of $52,941, *16 percent more* than if "no growth" had been projected.

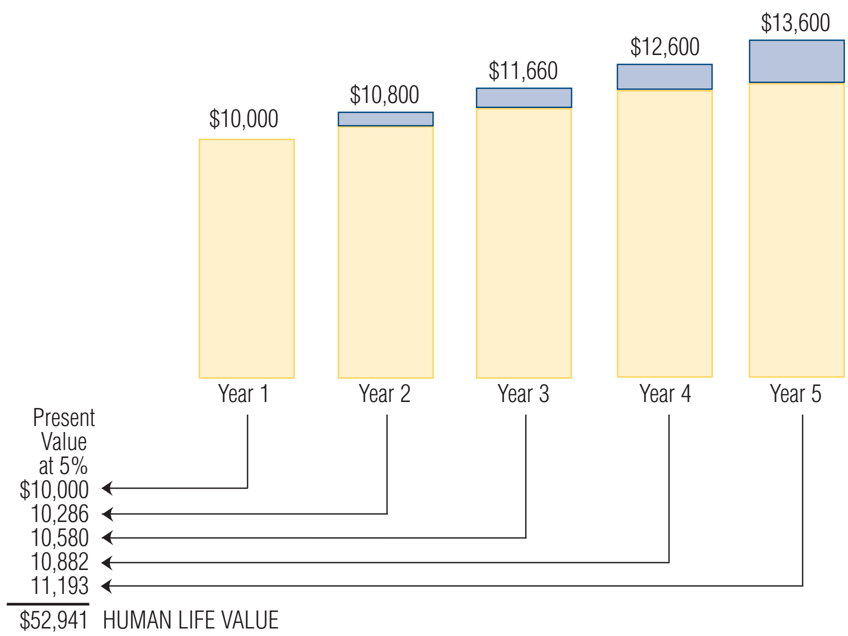
The more years to retirement, the greater is the contrast between "no growth" and "growth." An accurate estimate of human life values requires not only projections of anticipated growth but periodic reviews and updates of insurance needs.[5]

Footnotes on page 17

NO GROWTH



8% GROWTH



INSURANCE NEEDS AS A PERCENTAGE OF EARNINGS

A simplified **needs approach** to determining how much life insurance should be carried for family income purposes is contained in the following table. Developed by First National Bank of New York City (Citibank), it is based upon the assumption that a typical family can maintain its standard of living if they are provided with a continuing income equal to 75 percent of their after-tax income before the death of the breadearner. If income drops below 60 percent, the family's living standard would be substantially lowered.

The following factors assume that the breadearner is covered by social security and that insurance proceeds will be invested to yield a net of 5 percent per year, after taxes and inflation. To use the table, multiply "your client's present gross earnings" by the factor under "present age of your client's spouse." For example, if your client has present gross earnings of $40,000, and the age of the spouse is 45 years, it would take $320,000 of life insurance to provide a 75 percent net-income replacement (8.0 × $40,000 = $320,000).

These results are only approximations of the amount of life insurance needed. It is generally a good practice to confirm the results with a more detailed needs analysis comparing specific family income objectives to available resources.

Your Client's Present Gross Earnings	Present Age of Your Client's Spouse							
	25 Years		35 Years		45 Years		55 Years	
	75%	60%	75%	60%	75%	60%	75%	60%
$ 7,500	4.0	3.0	5.5	4.0	7.5	5.5	6.5	4.5
9,000	4.0	3.0	5.5	4.0	7.5	5.5	6.5	4.5
15,000	4.5	3.0	6.5	4.5	8.0	6.0	7.0	5.5
23,500	6.5	4.5	8.0	5.5	8.5	6.5	7.5	5.5
30,000	7.5	5.0	8.0	6.0	8.5	6.5	7.0	5.5
40,000	7.5	5.0	8.0	6.0	8.0	6.0	7.0	5.5
65,000	7.5	5.5	7.5	6.0	7.5	6.0	6.5	5.0

Footnotes

[1] In the discussion of the Estate Funnel on page 10, it was recognized that there are essentially two ways to earn money. One is by "capital at work," that is, income from savings, stocks, bonds, and real estate holdings. The other is by "people at work," that is, income from individual work and effort. Human life value is a measure of "people at work." The concept is of particular importance to the client who has little capital, or relatively high earnings as compared to capital assets. Many highly compensated professionals, such as physicians, attorneys, and accountants, have estates that are relatively modest in comparison to their incomes. Because of this, their families become highly dependent upon "people at work," with little "capital at work" in reserve.

[2] The $10,000 figure was chosen for illustration because it is an easy number from which to make further determinations of human life value. If the actual amount were $20,000, the human life value figures would be twice those illustrated; and if the actual amount were $50,000, the human life value figures would be five times those illustrated.

[3] Although five years have been selected for purposes of demonstrating the concept of human life value, most individuals who are concerned about family income requirements have far more than five working years until retirement (e.g., a 35-year-old breadearner anticipating retirement at age 65 would have thirty years to retirement).

[4] A table of human life values at varying growth rates appears on page 102. Factors for calculating human life value can be obtained from the Future Value Table, on page 598, and the Present Value Table, on page 600. The following is an example of how to use this table to calculate the human life value assuming: (1) a 41-year-old breadearner; (2) age 65 retirement; (3) earnings of $55,000 per year, of which $45,000 is devoted to family maintenance; and (4) a projected 4 percent rate of earnings growth.

Working Years to Retirement:	24
Projected Growth in Earnings:	4%
Factor From Table (page 102)	215,465
Number of $10,000s	× 4.5
	$969,593

Note that in calculating human life value the first year earnings are not discounted in the chart on page 15 and in the table on page 102. This recognizes that the surviving family needs funds immediately upon the breadearner's death, not one year after his death.

[5] Life insurance offers a replacement for human life value by providing "capital at work" to replace "people at work." But what type of life insurance should be used? Obviously, insurance providing a *decreasing* death benefit appears inappropriate for the client whose human life value may increase in the future (e.g., upon periodic review the growth rate is found to be greater than initially projected). At the very least, insurance providing a *level* death benefit is necessary. It might even be advisable for the younger client to "take an option on tomorrow," by purchasing coverage which will provide *additional* insurance in later years through increasing term riders, paid-up additions, guaranteed purchase options, or an increasing death benefit equal to the annual increase of universal life cash values (sometimes referred to as either Option 2 or Option B). With two wage-earner families the use of a first-to-die life insurance product may be appropriate (page 411). When applying for insurance to cover an increasing human life value it is important to be familiar with any financial underwriting requirements (see expanded discussion on page 410).

FEDERAL ESTATE TAX

One of the potential expenses of settling larger estates is the federal estate tax.[1] It is a continuous lien on your client's property, but its foreclosure date is yet to be determined. Proper planning involves anticipating and reducing the estate tax liability wherever possible as well as providing for payment of the tax. Unlike other expenses of settling an estate, it can be particularly burdensome in that it is generally due and payable *in cash* 9 months after death.[2]

The estate tax computation is not difficult, and in many ways resembles the calculations involved in determining income tax. When we file our income tax return each year, the calculations involve terms such as gross income, taxable income, deductions, and credits.

When an *estate* tax return is filed, we are likewise dealing with terms such as gross estate, adjusted gross estate, taxable estate, deductions, and credits.

Generally, the **gross estate** includes *all* property of any description and wherever located, to the extent the decedent had any interest in the property at the time of death.[3] It may even include property previously given away or over which the decedent had no control at the time of his death.

To illustrate, assume that in 2015 we have an unmarried individual with an estate totaling $8,000,000. In determining the adjusted gross estate, we can subtract the decedent's debts, such as loans, notes, and mortgages, plus the debts of the estate, such as funeral and administrative expenses. If these debts totaled $500,000, then the **adjusted gross estate** would be $7,500,000. For this discussion, assume that the taxable estate is also $7,500,000[4] With a taxable estate of $7,500,000 the **tentative tax** would be $2,945,800.

However, in 2015 there is an **estate tax unified credit** available which can offset up to $2,117,800 of the tentative tax. Generally, the unified credit allows an individual to pass $5,430,000 of property free of federal estate taxes upon death.[5]

After taking advantage of the credit, the estate will still owe a tax of $828,000, which means that the amount of the original estate remaining for the children or other heirs has been reduced to $6,672,000. This represents shrinkage of ~~11.1~~ percent.[6]

Footnotes on page 21

GROSS ESTATE

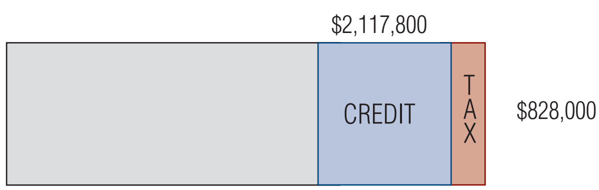
$8,000,000

ADJUSTED GROSS ESTATE

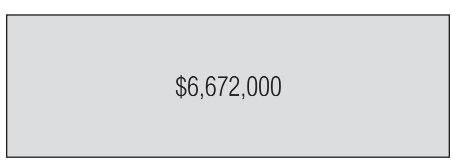
(Taxable Estate)

$7,500,000

BENEFIT OF UNIFIED CREDIT



REMAINING



Federal Estate Tax

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

Current listing and values of all property to include:

1. Cash.
2. Liquid assets (stocks, bonds).
3. Real estate (home, land, rental property).
4. Personal property (household goods, collections, and jewelry).
5. Business interests (closely held stock, partnership interests, and sole proprietorships).
6. Life insurance owned or insurance payable to estate (group insurance and individual policies).
7. Employee benefits (IRA, HR-10, 403(b) plan, pension/profit sharing, and 401(k) plan).
8. Current debts (short-term and long-term).
9. Prior taxable gifts made after December 31, 1976.

Note: A copy of the client's latest personal financial statement should disclose most of this information. Be sure to determine how the assets are titled (separate, joint ownership with spouse, community property, etc.). A copy of wills and trusts should also be obtained. See also pages 12 and 86.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 636. Taxation of income in respect of a decedent.
Q 675. Overview of estate tax.
Q 678. Explanation of "portability."
Q 679. Items included in gross estate.
Q 682. Gifts made within three years of death includable in estate under IRC Section 2035.
Q 686. Annuities or annuity payments includable in estate under IRC Section 2039.
Q 687. Joint interests includable in estate under IRC Section 2040.
Q 688. Powers of appointment includable in estate under IRC Section 2041.
Q 689. Life insurance proceeds includable in estate under IRC Section 2042.
Q 701. Deductions which are allowed.
Q 711. Credits that may be taken against the estate tax.
Q 717. Who must file a return and when tax is payable.
Q 760. How property is valued for estate tax purposes.

Footnotes

[1] This chart illustrates the federal estate tax as made permanent by the American Taxpayer Relief Act of 2012. In 2010 and thereafter estates over $5,000,000 (as indexed for inflation) are subject to federal estate taxes and the top estate rate beginning in 2013 is 40%. See Estate Tax Pointers on page 5.

[2] If certain strict conditions are met, payment of the *federal* estate tax can be deferred (see page 373). However, this does not mean that payment of applicable state inheritance and estate taxes can be similarly postponed (see page 91). A federal estate tax return (Form 706), if required, must be filed, and the tax paid, by the executor within nine months after death. The *penalty* for failure to file a timely return is 5 percent of the tax for each month the return is past due, up to a maximum of 25 percent. A detailed listing of these penalties is on page 496.

[3] The gross estate also includes "income in respect of a decedent" (IRD), which refers to those amounts to which a decedent was entitled as gross income, but which were not includable in his taxable income for the year of death. IRD is subject to income taxation in the hands of the person who receives it. For an expanded discussion see page 423.

[4] For purposes of illustration, this chart assumes there is no surviving spouse and that the adjusted gross estate is equal to the taxable estate. In the usual calculation sequence, debts (including funeral expenses), administrative expenses, and losses during administration are subtracted from the gross estate (as reduced by exclusions) to arrive at the adjusted gross estate. Charitable and marital deductions are then subtracted from the adjusted gross estate to determine the taxable estate. The principal deduction in this latter step has always been the marital deduction. Since it has been assumed that there is no surviving spouse, there can be no marital deduction, and therefore the adjusted gross estate is equal to the taxable estate. In community property states, the assumption of "no surviving spouse" means that all property is assumed to be separately owned.

[5] This $5,430,000 ($5,000,000 as indexed for inflation) is known either as the "applicable exclusion amount" or the "basic exclusion amount." When there is a surviving spouse, the "applicable exclusion amount" includes the $5,430,000 basic exclusion amount, plus the deceased spousal unused exclusion amount (i.e., the unused exclusion of the last deceased spouse). In 2015 the basic exclusion amount of $5,430,000 reflects indexing for post-2010 inflation. In the past this exemption has been variously referred to as the "exemption equivalent," "estate tax exemption equivalent," "unified credit equivalent," and "unified credit exemption equivalent."

[6] Because of the "unified" gift and estate tax rates, prior taxable gifts made during his lifetime would, in effect, reduce the amount of credit available at death. Upon death all adjusted taxable gifts made since 1976 are added to the estate when calculating the estate tax. However, this is not as bad as it might first appear, since the estate is, in effect, given a credit for prior gift taxes actually paid, or payable. The impact of this system generally is to push later transfers made during lifetime or at death into higher and higher tax brackets (due to the progressive estate and gift tax rates).

SIMPLE WILL

Everyone should have a will. By having a will, we can be sure that property goes to *whom* we want, and in the *amounts* we want, rather than as provided under a state's intestacy laws.

Although there are various types of wills, the most common is the *simple* will.[1] A typical simple will provides for: (1) payment of just debts and expenses; (2) appointment of an executor or executrix; (3) specific bequests; (4) transfer of the entire estate to the surviving spouse; (5) if there is no surviving spouse, then transfer of the estate to children or other heirs; and (6) appointment of a guardian or guardians for minor children and their property.

UPON THE FIRST DEATH, the simple will generally passes *all* property to the surviving spouse. No matter how large the estate, **no taxes** will be paid on this transfer. This is possible because of the unlimited marital deduction.

UPON THE SECOND DEATH, provided the estate does not exceed $10,860,000 ($10,000,000 as indexed for inflation in 2015), the estate will not be subject to federal estate taxes.[2]

For the individual who has a relatively small estate, the simple will is usually adequate. However, this most basic of wills does not take advantage of the opportunity to place assets in trust, provide for the continued management of estate assets for a surviving spouse, and assure that the estate will eventually pass to children upon the death of the surviving spouse.

1 Some commentators have suggested that, because it passes all property to the surviving spouse, the simple will should be called the "I love you" will. Without a will, property passes according to state law (see Degrees of Kindred, page 104, Intestate's Will, page 105, and State Laws on Intestate Succession, pages 106-114).

2 Each spouse has an estate tax exemption of $5,430,000 ($5,000,000 as indexed for inflation). This is called the "basic exclusion amount." When there is a surviving spouse, the deceased spouse's unused basic exclusion may be added to the surviving spouse's basic exclusion (called the "applicable exclusion amount"). Without prior planning this enables a married couple to pass to their children up to $10,860,000 ($10,000,000 as indexed for inflation) free of federal estate taxes (2 × $5,430,000 = $10,860,000). However, the surviving spouse can only claim this unused exclusion if the executor of the deceased spouse's estate files an estate tax return making a deceased spousal unused exclusion amount (DSUEA) election. With portability of the exclusion between spouses, it is not necessary to establish an exemption trust or by-pass will in order to realize federal estate tax savings (see discussion on page 503). See also, footnotes 1 and 6 on page 21.

ESTATE

UPON THE FIRST DEATH

All Property To Spouse

No Taxes

UPON THE SECOND DEATH

To Children

TRUST WILL

A will creating a trust can provide for the continued management of estate assets for a surviving spouse and assure that the estate will eventually pass to children upon the death of the surviving spouse. With large estates a trust can freeze the value of property during the surviving spouse's lifetime so that future appreciation will not be subject to federal estate taxes upon the surviving spouse's death.[1]

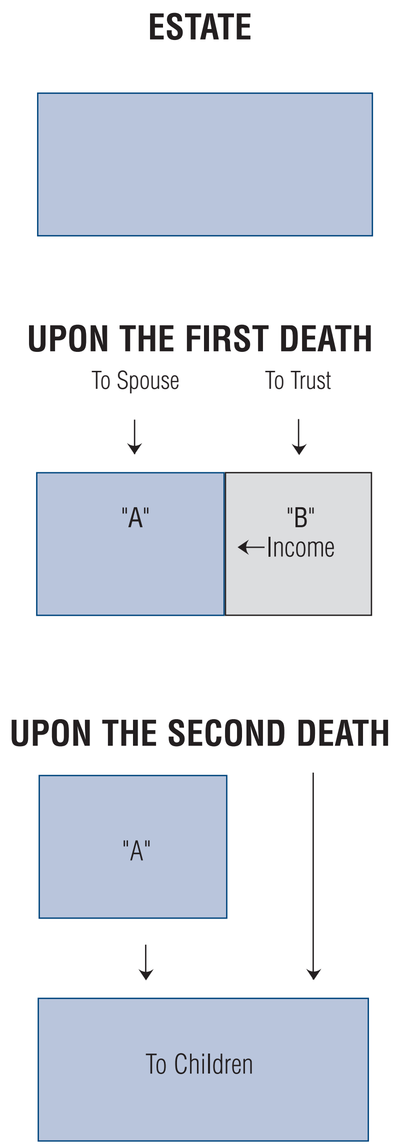
UPON THE FIRST DEATH, with the typical trust will, the estate is divided into *two* parts, with one part placed in a family or nonmarital trust ("B" trust in the chart).[2] No taxes are paid on this since the amount is equal to or less than the applicable exclusion amount (i.e., the amount in 2015 that each individual can pass tax-free to the next generation).[3]

Unless there is a disclaimer, the remaining estate is passed to the surviving spouse.[4] This qualifies for the unlimited marital deduction and can be passed free of federal estate taxes.[5] Although it is sometimes given outright, this portion of the estate is often placed in trust, which is referred to as either the "A" trust or the "marital deduction" trust.[6] If the property is placed in trust, the spouse should be given a life estate with a power of appointment or a QTIP interest.[7]

The surviving spouse can also be given a right to *all income* from the "B" trust, as well as the right to demand, each year, either $5,000 or 5 percent of the trust corpus, whichever amount is larger. Property subject to a $5,000 or 5 percent demand right held at death is subject to taxation in the surviving spouse's estate only to the extent of the demand right.

UPON THE SECOND DEATH in 2015, unless the surviving spouse's estate exceeds $5,430,000 ($5,000,000 as indexed for inflation), the estate will not be subject to federal estate taxation.[8] The amount previously placed in the "B" trust passes tax-free to the children under the terms previously established in that trust. Since the surviving spouse has no power to control the disposition of property placed in this trust, it is not included in her estate.

Footnotes on page 27


ESTATE
UPON THE FIRST DEATH
To Spouse
To Trust
"A"
"B"
Income
UPON THE SECOND DEATH
"A"
To Children

Trust Will

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

Attorney Drafting Will Must Know

1. Spouse's name.
2. Spouse's citizenship.
3. Children's names.
4. Name of executor/executrix.
5. Ages of minor children.
6. Names and ages of other beneficiaries.
7. Trustee after testator's death.
8. To whom, in what amounts, and when trust *income* is to be paid.
9. To whom, in what amounts, and when trust *corpus* is to be paid.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 700. Description of the estate tax marital deduction.
Q 711. Credits which may be taken against the estate tax.

Footnotes

[1] See footnote 6 on page 21 for an explanation of terms "applicable exclusion amount" and "basic exclusion amount" and page 503 for a discussion of the portability of the unused exclusion between spouses. Portability of the unused exclusion amount serves a similar function as a "family" trust in many estates, but proper planning will depend on the particulars of the individual estates, such as whether the estate ultimately faces some estate taxation.

[2] This is often referred to as a *limited* trust will, in that the amount placed in the "B" trust is limited to the applicable exclusion amount, $5,430,000 ($5,000,000 as indexed for inflation in 2015) if no lifetime taxable gifts were made (see footnote 6, page 21). This trust is also referred to as an exemption, bypass, unified credit, credit shelter, credit amount, or credit equivalent bypass trust. If most property is held by a husband and wife in joint title with right of survivorship, the "A" trust could be *overqualified* and there may not be $5,430,000 of other property available to place in the "B" trust. In contrast, when a tax-driven formula is used to determine the amount going to the "B" trust, it may become overfunded (e.g., when a will directs that the amount to the "B" trust shall be the maximum amount that can be passed without paying an estate tax). In contrast to the Trust Will, see the Marital Plan Will, page 544.

[3] In large estates in 2015 the $5,430,000 ($5,000,000 as indexed for inflation) generation skipping transfer tax (GSTT) exemption can be used when there is a desire to pass property to grandchildren while avoiding estate or gift taxation at the children's generation (see chart, page 39).

[4] There may be occasions when it is desired to give the surviving spouse the opportunity to take more, or less, property than would be received under the typical trust will. This can be accomplished with the use of disclaimers, which are more fully explained on page 380.

[5] There may be circumstances in which the testator will *not* wish to take advantage of the unlimited marital deduction. For example, by taking full advantage of the marital deduction, the business asset will continue to appreciate in the estate of the surviving spouse. This potential appreciation would be eliminated by passing the business to the children or other heirs upon the first death. However, the cost to do this is the early payment of estate taxes on business values in excess of $5,430,000 ($5,000,000 as indexed for inflation). Of course, considerations other than financial ones may influence the ultimate decision (e.g., adult children working in the family business have a strong desire to take over operation and full ownership of the business, rather than to receive the business upon the ultimate death of the surviving parent). Generally, the marital deduction is unavailable when the surviving spouse is not a United States citizen unless the transfer is to a qualified domestic trust (see expanded discussions, pages 487 and 516). For an expanded discussion of the marital deduction, see page 473.

[6] One type of marital deduction trust is also referred to as a "power of appointment" trust, in that the surviving spouse is given a general power of appointment over the trust during lifetime or at death. For a discussion of the power of appointment trust, see page 505.

[7] Refer to page 35 for a chart illustrating the use of a qualified terminable interest property trust. Also, see page 505 for a discussion of powers of appointment.

[8] In 2015 the combined estates of husband and wife would have to exceed $10,860,000 ($10,000,000 as indexed for inflation) before there would they would be subject to the federal estate tax. However, the estates could be subject to state death taxes (see page 91).

REVOCABLE LIVING TRUST

The revocable living trust (RLT) is a *will substitute* that can accomplish many estate planning objectives. It is an agreement established during the grantor's lifetime that may be amended or revoked at any time prior to the grantor's disability or death. The primary advantages of the RLT include: (1) providing for the management of grantor's assets upon his mental or physical disability thus avoiding conservatorship proceeding; (2) reducing costs and time delays by avoiding probate; (3) reducing the chances of a successful challenge or election against a will; (4) maintaining confidentiality by not having to file a public will; and (5) avoiding ancillary administration of out-of-state assets.[1]

Two additional documents are typically executed together with the RLT:[2]

- The **durable power of attorney** authorizes the power-holder to act for the grantor when the grantor is disabled.[3]
- The **pour-over will** functions as a "fail safe" device to transfer at death any remaining probate assets into the RLT, to undergo minimal probate as a means of clearing the estate of creditor claims, and to appoint guardians of any minor children.[4]

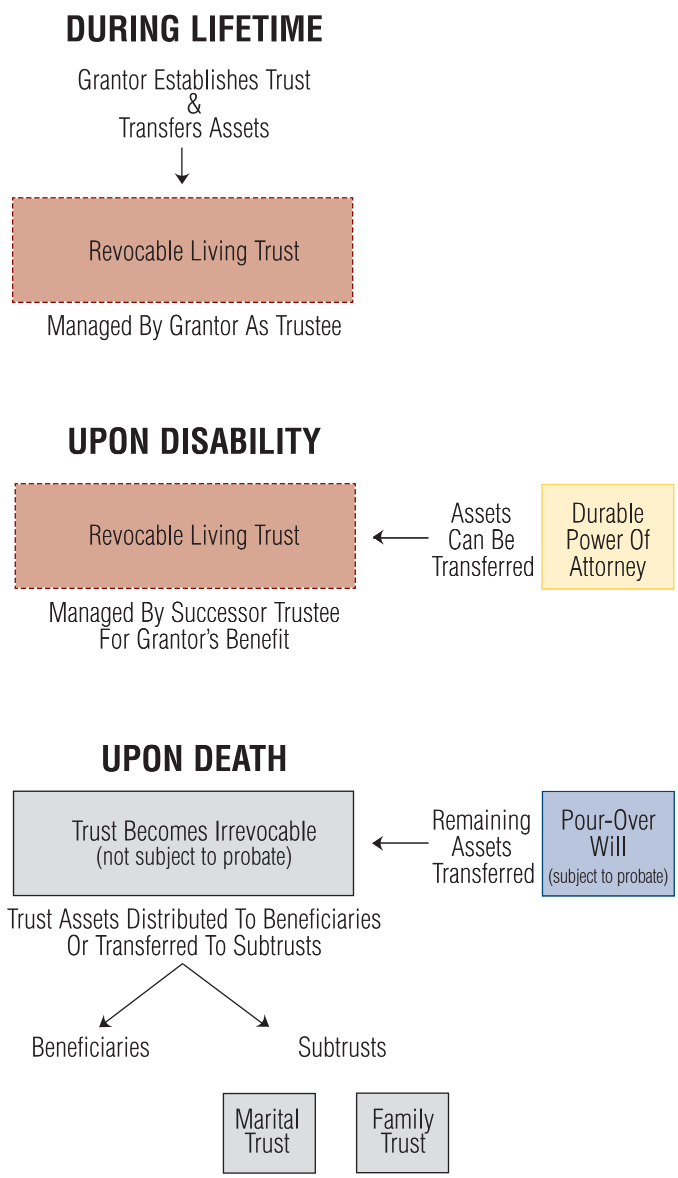
DURING LIFETIME. The grantor establishes the RLT and typically names himself as the sole trustee. Following creation of the trust the grantor retitles and transfers his property to the trust.[5] Because the grantor maintains full control over trust assets there are no income, gift, or estate tax consequences.[6]

UPON DISABILITY. If the grantor becomes disabled due to legal incompetency or physical incapacity, a designated successor trustee steps in to manage the grantor's financial affairs.[7] Disability is determined under trust provisions providing a standard of incapacity (e.g., certification by two physicians that the grantor is unable to manage his financial affairs). Also, during the grantor's disability, the holder of the durable power of attorney is authorized to transfer additional grantor-owned assets to the trust.

UPON DEATH. The RLT becomes irrevocable when the grantor dies. Under the grantor's pour-over will, any probate assets not previously transferred to the RLT during lifetime are transferred to the RLT as part of the grantor's residuary estate. Assets held in trust are then disposed of according to the terms of the trust. This can include an outright distribution to the trust beneficiaries, or the trust may contain provisions establishing separate tax-savings subtrusts similar to the marital and family trusts under the exemption trust will.[8]

Although the RLT is not for everyone, it clearly offers substantial benefits for many individuals. The utility of a funded revocable trust increases with the grantor's age, when there is an increased likelihood of incompetency or incapacity and the need for asset management.[9]

Footnotes on page 31


DURING LIFETIME
Grantor Establishes Trust
&
Transfers Assets
Revocable Living Trust
Managed By Grantor As Trustee
UPON DISABILITY
Revocable Living Trust
Assets Can Be Transferred
Durable Power Of Attorney
Managed By Successor Trustee For Grantor's Benefit
UPON DEATH
Trust Becomes Irrevocable
(not subject to probate)
Remaining Assets Transferred
Pour-Over Will
(subject to probate)
Trust Assets Distributed To Beneficiaries Or Transferred To Subtrusts
Beneficiaries
Subtrusts
Marital Trust
Family Trust

Revocable Living Trust

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

Attorney Drafting Trust Instrument Must Know

1. Name of trust grantor.
2. Name of trust grantor's spouse.
3. Name of individual who will be successor trustee.
4. Name of institution that will be alternate successor trustee.
5. Name of beneficiaries other than grantor.
6. Ages of minor beneficiaries.
7. Approximate size of grantor's gross estate (i.e., will estate be subject to federal estate taxes or state death taxes).
8. To who, in what amounts, and when trust *income* is to be paid.
9. To who, in what amounts, and when trust *corpus* is to be paid.

Attorney Drafting Pour-Over Will Must Know

1. Name of testator.
2. Name of testator's spouse.
3. Name of individual who will be personal representative or executor.
4. Name of individual or institution who will be successor personal representative or alternate executor.

Attorney Drafting Durable Power Of Attorney Must Know

1. Name of grantor.
2. Name of individual to be given the power.
3. Type of power to be given (e.g., *general* durable power of attorney or *special* durable power of attorney).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 144. When income of funded life insurance trust is taxed to grantor.
Q 145. When income is taxable to trust or to trust beneficiaries.
Q 663. Computation of federal income tax for trusts and estates.
Q 664. Description of the grantor trust and how it is taxed.
Q 679. Items that are included in a decedent's gross estate.
Q 741. Types of transfers that are subject to taxation.

Footnotes

[1] There is disagreement among commentators regarding the contestability of the RLT. Clearly, wills are subject to being challenged. Likewise, a trust can be attacked under contract law based on fraud, forgery, lack of mental capacity, and duress. However, it seems reasonable that once a RLT has been in existence and administered by the grantor for a number of years, it would be less vulnerable to a *successful* attack than a will that comes into being upon the testator's death. It has also been suggested that the perceived privacy or confidentiality advantage is of limited value, since most individuals are not all that concerned that their probate records will be available for public scrutiny. It has also been observed that it is wise to evaluate the actual costs being avoided, since establishing and maintaining a RLT involves both time and expense; and in most jurisdictions attorneys' fees and probate costs are quite reasonable (most estates never actually pay executor fees, since the typical will provides for a waiver of fees and commissions if a family member is appointed to act as executor, as is common). It is true that with both RLTs and wills, assets must be collected and distributed, bills must be paid, and tax returns must be filed. In the final analysis, the undoubted benefit of having professionals who enthusiastically advocate the use of RLTs is that it motivates their clients to do sorely needed planning. The merits of the RLT should be carefully evaluated in light of individual circumstances and needs.

[2] Other documents that should be considered as part of a comprehensive estate plan include: (1) **revocable assignments** transferring property to the RLT that is not subject to precise titling (e.g., jewelry); (2) the **appointment of a health care representative** to act for the grantor in health care matters (e.g., to sign insurance forms); and (3) a **living will** stating that in case of a terminal illness or condition the grantor does not wish to be subject to procedures that serve only to prolong the dying process (see page 468).

[3] The durable power of attorney is discussed on page 386.

[4] The RLT cannot be used to designate the guardian of a minor child. This must be done under a will that is subject to court approval. See Pour-Over Will chart on page 33.

[5] Although there is a fair amount of paperwork involved in transferring title to existing property, or putting new acquisitions in the name of a trust, it is likely that the grantor is better prepared to accomplish this task while alive and competent, than a conservator in case of disability or an executor in case of death. When done by the grantor, it facilitates management or transfer of assets upon the grantor's incompetency or death (and likely saves time and money). Even a partial transfer of assets to a RLT can reduce the size of an estate to the point where it qualifies for a summary probate and unsupervised administration. Before *real property* is transferred, it should be ascertained that the transfer would not cause acceleration of a note or mortgage, reassessment of the property for tax purposes, or loss of a real estate homestead exemption.

[6] Because the trust is revocable the assets are not removed from the grantor's estate, and since the grantor is considered the owner of the trust corpus, there are no income tax advantages (i.e., as a "grantor trust" all trust income is taxed to the grantor, see page 414). A transfer of property from the trust to someone other than the grantor would be subject to gift taxes (see chart, page 47). As long as the grantor is the trustee there is no requirement that a separate income tax return be filed. However, once a successor trustee takes over during disability a separate informational return must be filed. After title is transferred, the grantor would receive account statements reading: "John Q. Jones, as Trustee of the John Q. Jones Revocable Trust dated January 7, 2010."

[7] In those states (such as Florida) requiring executors or personal representatives to be state residents, the RLT can be used to facilitate the use of an out-of-state trustee.

[8] In and of itself, the RLT is not a tax-saving device. But the trust can offer estate tax benefits if it contains provisions similar to the Trust Will (see chart, page 25).

[9] With a young entrepreneur who is actively investing, buying and selling property, as a matter of convenience, property is often not transferred to the RLT. In these situations, the necessary transfers are made using the power of attorney and pour-over will.

POUR-OVER WILL

The "pour-over will" should be executed at the same time as the revocable living trust (RLT).[1] As a last will and testament, the essential functions of this document include:

- Providing for payment of obligations, expenses, and taxes not paid by the RLT (i.e., to clear the estate of creditor claims).
- Transferring tangible personal property.[2]
- Naming guardians of minor children.
- Functioning as a "fail-safe" device.

Generally the most important function of the pour-over will is in providing a fail-safe device. Assets not transferred (either intentionally or unintentionally) to the RLT prior to death will not be governed by the provisions of the RLT.[3] After death this clean-up feature sweeps these assets into the trust, thereby carrying out the grantor's intentions. Should the trust itself become invalid, or otherwise unavailable, the pour-over will can also direct distribution of all assets as would have been made under the trust.[4]

DURING LIFETIME. The grantor establishes a RLT and thereafter transfers property to the trust.[5] At the same time the grantor executes a pour-over will, the primary beneficiary of which is the RLT.

UPON DEATH. Any probate assets not transferred prior to death will become part of the grantor's probate estate and must *pass thru probate* before they can be transferred ("poured over") to the trust.[6] The assets are then distributed as provided for in the trust. However, provided the RLT has been diligently funded during the grantor's lifetime, it is possible that few, if any, assets will actually have to be transferred under the pour-over will (i.e., there will be a minimal probate for purpose of clearing the estate of the claims of creditors and the naming of guardians of minor children when both parents have died).

[1] The term "pour-over will" is not used in the legal document, but rather is merely used as an apt means of describing the process of transferring assets from the probate estate to the trust.

[2] The will may pass tangible personal property to a surviving spouse, make specific bequests to children and others, or make reference to distribution according to separate written and signed lists making gifts to named individuals.

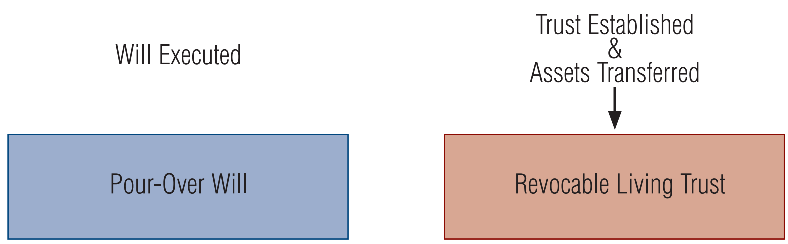
[3] Unless passed by joint tenancy with rights of survivorship or beneficiary designation, these assets will likely be distributed through the probate process under the state intestacy statutes. See State Laws On Intestate Succession on pages 106-114.

[4] In the absence of both a trust and a pour-over will, the *entire* estate will be distributed through the probate process under the state intestacy statutes (e.g., in North Carolina with only one child, real property goes ½ to spouse and balance to child, with respect to personal property, spouse gets first $30,000 plus ½ of balance, with remainder to child, see page 111).

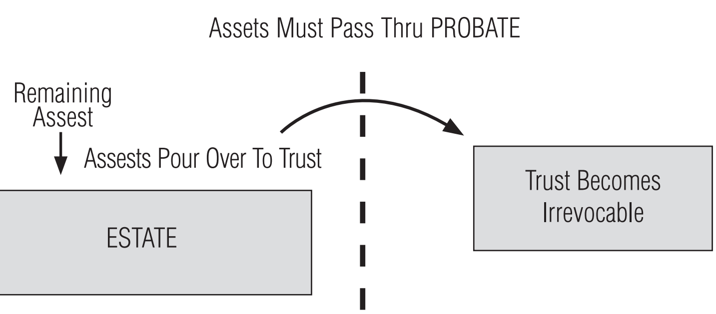
[5] See the Revocable Living Trust chart on page 29.

[6] Passing assets through probate can be both time-consuming and costly. See the discussion on page 510.

DURING LIFETIME



UPON DEATH



QTIP TRUST

With large estates the QTIP trust provides a way to defer estate taxes by taking advantage of the marital deduction, yet "control from the grave" by directing who will eventually receive the property upon the death of the surviving spouse.[1]

Under such a trust all income must be paid at least annually to the surviving spouse.[2] The trust can be invaded only for the benefit of the surviving spouse, and no conditions can be placed upon the surviving spouse's right to the income (e.g., it is not permitted to terminate payments of income should the spouse remarry). However, in order to qualify the executor must make an irrevocable election to have the marital deduction apply to property placed in the trust.[3] This requirement not only gives the executor the power to determine how much, if any, of the estate will be taxed at the first death, it also provides great flexibility for post-death planning based upon changing circumstances.[4]

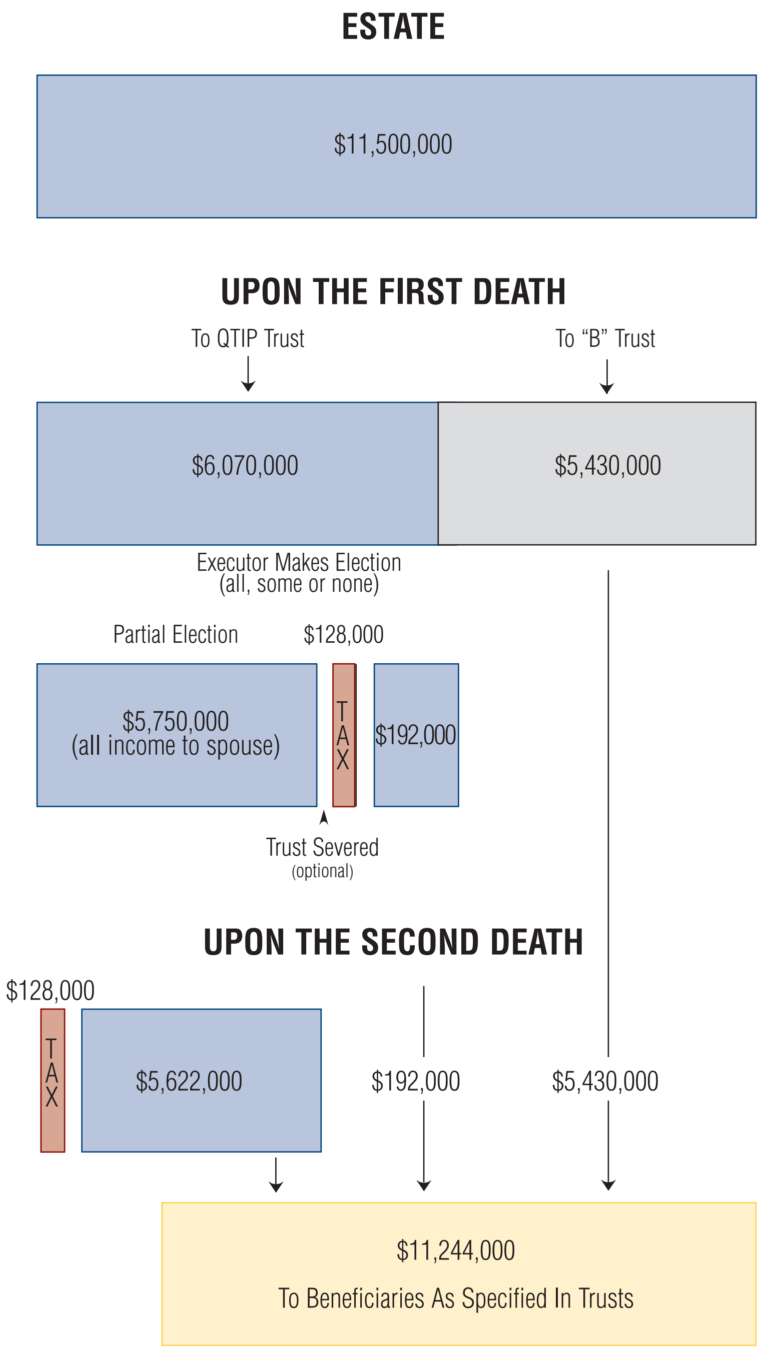
Our example assumes that in 2015 we have an estate of $11,500,000.[5]

UPON THE FIRST DEATH, the estate is divided into *two* parts, with one part equal to $5,430,000 placed in a family or nonmarital trust ("B" trust in the chart).[6] No taxes are paid on this amount since the trust takes full advantage of the $2,117,800 unified credit (i.e., the amount of credit in 2015 that allows each individual to pass $5,430,000 tax-free to the next generation). The remaining $6,070,000 is placed in the QTIP trust.[7]

The executor may elect to have all, some, or none of this property treated as marital deduction property. Assume that in order to avoid appreciation of assets in the surviving spouse's estate and obtain a stepped-up basis for additional assets taxed upon the first death the executor decides to make a partial election of $5,750,000 (i.e., of the $6,070,000 placed in the QTIP trust only $5,750,000 will be sheltered from estate taxes at the first death).[8] This means that $320,000, the "nonelected" property, will be taxed at the first death. Although $128,000 of estate taxes must be paid, the remaining $192,000 will now be excluded from the taxable estate of the surviving spouse (any appreciation of this property after the first death will also be excluded).[9] If authorized under the trust document or by state law, the executor can sever the QTIP trust into separate trusts.[10]

UPON THE SECOND DEATH, the estate subject to taxation is limited to $5,750,000 (the amount remaining in the trust for which estate taxes were deferred). After paying taxes of $128,000, there remains $5,622,000.[11] This amount, together with the $300,000 from the severed trust and the $5,430,000 from the "B" trust, are passed to the beneficiaries under the terms previously established in these trusts.[12]

Footnotes on page 37


ESTATE
$11,500,000
UPON THE FIRST DEATH
To QTIP Trust
To "B" Trust
$6,070,000
$5,430,000
Executor Makes Election
(all, some or none)
Partial Election
$128,000
$5,750,000
(all income to spouse)
TAX
$192,000
Trust Severed
(optional)
UPON THE SECOND DEATH
$128,000
TAX
$5,622,000
$192,000
$5,430,000
$11,244,000
To Beneficiaries As Specified In Trusts

QTIP Trust

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

Attorney Drafting Will And Trust Must Know

1. Spouse's name.
2. Spouse's citizenship
3. Children's names.
4. Name of executor/executrix.
5. Ages of minor children.
6. Information regarding children of prior marriages.
7. Names and ages of other beneficiaries.
8. Trustee after testator's death.
9. To whom, in what amounts, and when trust *income* is to be paid.
10. To whom, in what amounts, and when trust *corpus* is to be paid.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 700. Description of the estate tax marital deduction (to include qualified terminable interest property).

Q 711. Credits which may be taken against the estate tax.

Q 756. Description of the gift tax marital deduction (to include qualified terminable interest property).

Footnotes

[1] QTIP stands for "qualified terminable interest property." Assets placed in a QTIP trust are referred to as qualified terminable interest property. Under the Trust Will, to take advantage of the unlimited marital deduction the traditional "A" trust (marital trust) must give the surviving spouse the power to appoint, during lifetime or at death, all property placed in this trust in favor of the surviving spouse or the surviving spouse's estate (see chart, page 25). However, this arrangement is objectionable to some individuals, since control is lost over the eventual disposition of the property (e.g., a surviving widow could pass the property to her new husband or to her children by a prior marriage).

[2] Property placed in a QTIP trust must be income producing and the surviving spouse is typically given the power to force the trustee to make trust property productive. The spouse's *income* interest may be contingent upon the executor's election. Also, limited powers given to the spouse to invade the *corpus* of the QTIP trust may be contingent (e.g., upon the executor's election or upon the spouse not remarrying).

[3] This election by the executor *cannot* be mandated by the deceased prior to his death. It must be done on the estate tax return and cannot be revoked after the date for filing the return.

[4] For a discussion of the nontax reasons why a testator may *not* wish to take advantage of the marital deduction, see footnote 5, page 27.

[5] To simplify the example, the taxes are calculated assuming no debts, expenses, deductions, or prior taxable gifts, and no prior use of the unified credit.

[6] Funding of the "B" trust is limited to the applicable exclusion amount, $5,430,000 in 2015 (see footnote 6, page 21, and footnote 2, page 27). For example, rather than using a tax-driven formula to allocate property to the "B" trust, a single QTIP type trust is established. This allows the surviving spouse to disclaim assets that then pass into either the marital trust or the "B" trust.

[7] This example shows the QTIP trust being used only with the "B" trust (family trust). When the "A" trust (marital trust) is also used, it provides the executor even greater flexibility in allocating assets between the QTIP trust and "A" trust (see chart, page 25).

[8] The taxpayer has made a decision that it is worth paying $128,000 of estate taxes in order to shift subsequent appreciation on the remaining $192,000 out of the surviving spouse's estate and obtain a stepped-up basis at the prior spouse's death.

[9] Liquidity for paying estate taxes at the first death might come from the tax-free death proceeds paid to an irrevocable Life Insurance Trust (see chart, page 51).

[10] The division of the QTIP trust must be done on a fractional or percentage basis to reflect the partial election. It is not necessary that each asset be divided pro rata between the severed trusts; so long as it is based upon the fair market value of all trust assets at the time of the division.

[11] The estate has a right of recovery for any taxes paid, unless waived by the deceased spouse (if there is no waiver, then the failure to recover is subject to gift taxes).

[12] Lifetime QTIP trusts can be used as an alternative to outright gifts.

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GENERATION-SKIPPING TRANSFERS

The basic intent of the federal estate tax system is to tax property as it is passed from one generation to the next. The generation-skipping transfer (GST) tax is intended to prevent wealthy families from reducing estate taxes by skipping one or more generations (e.g., grandparents pass their estate to grandchildren in order to reduce or avoid estate taxes in their children's estates).

The GST tax is in *addition* to the normal estate or gift tax and is applied to the transfer of property to a person two or more generations younger than the transferor (e.g., from grandparent to grandchild).[1] The *maximum* estate tax rate, 40 percent in 2015, is used in calculating the GST tax.[2] However, there is an exemption which allows aggregate transfers of $5,430,000, during lifetime or at death, to be exempt from the GST tax ($10,860,000 total for both husband and wife).[3]

To illustrate, assume that Grandparents have an estate totaling $16,000,000. Assume also that their Children have substantial estates in their own right and the Grandparents desire to fully use their GST tax exemptions.

UPON THE FIRST GRANDPARENT'S DEATH. To take maximum advantage of the GST tax exemption in 2015, $5,430,000 could be passed to a GST tax-exempt irrevocable trust (the "B" trust). Discretionary distributions can be made to all family members from this trust.[4]

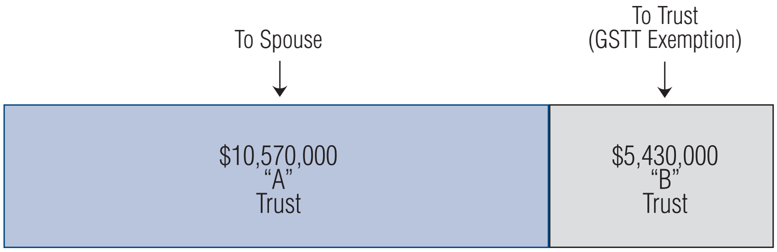
UPON THE SECOND GRANDPARENT'S DEATH. Again, in order to take maximum advantage of the GST tax exemption, an additional $5,430,000 could be passed to a GST tax-exempt irrevocable trust. After payment of $2,056,000 in federal estate taxes on a taxable estate of $5,140,000, $5,430,000 is passed to the GST tax-exempt irrevocable trust. In order to avoid any GST taxes, the remaining $3,084,000 is passed to the Children. Of the original $16,000,000 estate, estate taxes totaling $2,056,000 have been paid at the second death. Full use of the Grandparent's GSTT exemptions has the potential of producing estate tax savings of $4,344,000 at the Children's generation.[5]

Application of the GST tax can be quite complicated and its impact is substantial in larger estates. Careful analysis by qualified counsel is essential if unexpected tax consequences are to be avoided.[6]

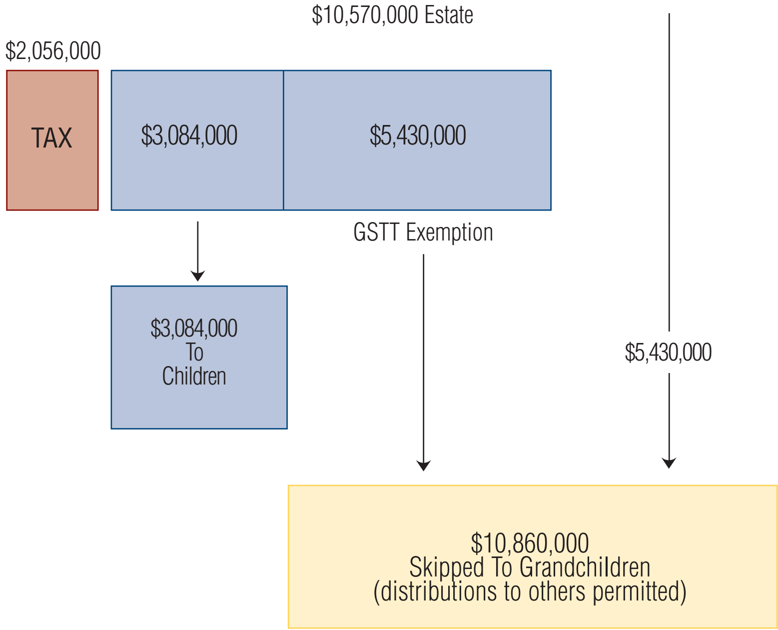
Footnotes on page 41

GRANDPARENT'S ESTATE

UPON THE FIRST GRANDPARENT'S DEATH



UPON THE SECOND GRANDPARENT'S DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Size of grandparent's estate.
2. Nature of prior gifts, if any, made by grandparents.
3. Numbers and ages of children and grandchildren.
4. Size of children's estates and ability of children to support themselves without inherited assets.
5. Existence of any predeceased family members.

See also information required for exemption trust wills on page 26.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 98. Life insurance proceeds and annuities are subject to GST tax.
Q 99. Gifts to life insurance trust and the GST tax.
Q 100. Leveraging the exemption with a life insurance trust.
Q 722. Overview of the generation-skipping transfer tax.
Q 723. What is a generation-skipping transfer (GST).
Q 724. Determination of the GST tax and exemption.
Q 725. Application of the GST exemption in determining the GST tax.
Q 727. Use of the Inclusion Ratio for purposes of the GST tax.
Q 728. How property is valued for purposes of the GST tax.
Q 731. When portions of a severed trust are treated as separate trusts for GST tax purposes.
Q 733. Explanation of the Reverse QTIP Election and how it is made for GST tax purposes.
Q 735. How individuals are assigned to generations.
Q 736. Split gifts can be made for purposes of the GST tax.
Q 737. Credits allowed against the GST tax.
Q 738. Return requirements for the GST tax.
Q 739. Who is liable for paying the GST tax.
Q 753. Discussion of "qualified transfers."

Footnotes

[1] Because grandchildren are two or more generations below the grandparent (transferor), they are known as *skip persons*, whereas children are known as *nonskip persons* (the transferor's spouse is also a nonskip person, since she is treated as being of the same generation as the transferor, whether she is or not). When the transfer is directly from one generation to a person two or more generations younger than the transferor it is referred to as a "direct skip" (e.g., in his will grandfather leaves property to grandchild). In the case of a direct skip, the GST tax is payable at the time of the transfer, not upon the death of the person in the skipped generation (e.g., the GST tax is payable upon the grandfather's death, not when the child dies). Any transfer is generally not subject to the GST tax if the person in the intervening generation (the child) is not alive at the time of the transfer to the skip person (the grandchild). The grandchild effectively moves up a generation upon the death of the child.

[2] The amount of tax is calculated by multiplying the "taxable amount" by the "applicable rate." The applicable rate is a product of the then effective maximum federal estate tax rate multiplied by the "inclusion ratio." The inclusion ratio, in turn, depends on the amount of GST exemption allocated to a specific transfer. For example, assume G transfers $5,430,000 to an irrevocable trust in 2015 and allocates $5,430,000 of GST exemption to the transfer. The applicable fraction is 5,430,000 ÷ 5,430,000, or 1. The inclusion ratio is 1 minus 1, or 0. The maximum estate tax rate, 40 percent, is multiplied by the inclusion ratio of 0, resulting in a 0 percent rate of GST tax for this irrevocable trust. Such a trust is commonly referred to as a GST tax-exempt trust. Under the Taxpayer Relief Act of 2010 the applicable rate in determining GST taxes for 2010 transfers was zero, meaning that in 2010 there was no GST tax.

[3] In 2015, the generation-skipping exemption is $5,430,000 (the same dollar amount as the estate tax applicable exclusion allowance). This exemption can be allocated on the gift tax return of the transferor, or on the estate tax return if claimed on a bequest. There is no GST tax imposed on direct skip gifts that qualify for the gift tax annual exclusion (see chart on page 47) or that are "qualified transfers." In general, qualified transfers are payments for the education or medical care of a skip person. In addition, a gift to a trust, which qualifies for the annual $14,000 gift tax exclusion, is generally GST tax-free (i.e., no allocation of GST exemption is required) if the trust is for the exclusive benefit of a skip person, and any remaining assets will be included in the skip person's gross estate.

[4] Depending on the type of transfer, the GSTT will be imposed at different times. Under the GSTT if the original transfer creates an interest in more than one party, at least one of whom is a skip person (the child) and one is a non-skip person (the grandchild), a tax will not be imposed until the non-skip person (the child) no longer has any interest in the trust. For example, in the chart on page 39 if income were paid to the child for life, with the remainder to the grandchild, the GSTT would not be imposed until the death of the child (i.e., upon the date of termination of the last remaining interest held by a non-skip person). This is an example of what is called a "taxable termination." Two other types of generation-skipping transfers are the "direct skip," where there is a transfer subject to gift or estate taxes, and the "taxable distribution," where there is any distribution from a trust to a skip person that is neither a direct skip nor a taxable termination. In the chart, allocation of the full $5,430,000 GST tax exemption eliminates the GST tax because the inclusion ratio is zero (1 – (5,430,000 ÷ 5,430,000) = 0). For further discussion, see footnote 2 above.

[5] This assumes that the Child's estate, often referred to as the "intervening generation's estate," would be subject to a maximum federal estate tax rate of 40 percent in 2015 (.40 × $10,860,000 = $4,344,000).

[6] Although a life insurance trust can be very effective in leveraging the GST tax exemption, application of the GST tax can be complicated. The GST tax generally applies to an irrevocable life insurance trust whenever grandchildren are trust beneficiaries. It is essential to maintain a zero inclusion ratio (see footnotes 2 and 4 above). To shelter such a trust from the GST tax, the exemption must be allocated by filing a timely gift tax return *after each gift* to the trust.

INSTALLMENT SALE & PRIVATE ANNUITY

Both the installment sale and the private annuity are used to transfer future appreciation through sale of property (e.g., a business interest) from one individual to another, in our example, from parent to child. There are, however, substantial differences in both the tax implications and resulting rights and obligations.[1]

INSTALLMENT SALE. The primary distinguishing characteristic of the installment sale, as compared to the private annuity, is the *fixed schedule* of payments made by the buyer. The parent (as seller) can spread a large gain and the resulting income tax liability over a number of years, while at the same time transferring future appreciation to the child (as purchaser).

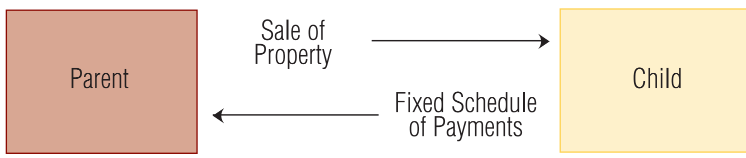
The child's obligation to the parent may be *secured*, which also distinguishes the installment sale from the private annuity. With respect to the parent, each payment is divided into gain, interest income, and a nontaxable recovery of basis. If the parent dies, payments continue to the parent's estate.[2] Although the child's obligation could be cancelled by the parent's executor, or passed by will to the child, previously unreported gain would still be taxable to the estate.[3]

PRIVATE ANNUITY. The private annuity obligates the child to make payments for the *lifetime* of the parent, and the obligation may not be secured in any way. Unlike the installment sale, the parent must recognize the entire amount of the gain or loss at the time of the transaction, and the child cannot deduct any part of the payments.[4] Each payment is divided into interest income and a nontaxable recovery of basis. Because payments terminate at the parent's death, the annuity is considered to have no value and should escape taxation in the parent's estate.

In considering a private annuity, both parties must recognize that if the parent lives for many years, the child could end up paying more for the asset then would have been paid with an installment sale. The parent must also recognize that the expected income could be in jeopardy if the child were to die. However, providing for insurance on the child's life sufficient to meet the annuity obligation can usually eliminate this risk.

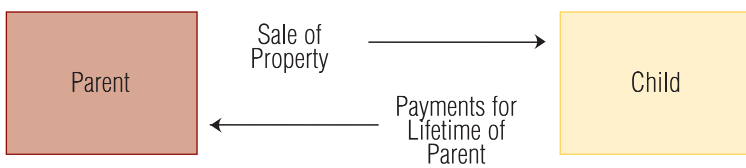
Footnotes on page 45

INSTALLMENT SALE



- May be secured
- Each payment is divided into gain, interest income, and a nontaxable recovery of basis
- Child deducts interest portion
- If parent dies, payments continue until obligation satisfied

PRIVATE ANNUITY



- May not be secured
- Each payment is divided into interest income and a nontaxable recovery of basis
- Child cannot deduct any part of payments
- When parent dies, payments terminate

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

Installment Sale

1. Value of property to be sold.
2. Seller's cost basis in property.
3. Number of years payments are to be made.
4. Interest rate to be used.
5. Purchaser:
    a. Sex.
    b. Date of birth.
    c. Smoker/nonsmoker.

Private Annuity

1. Value of property.
2. Seller's cost basis in property.
3. Seller's date of birth.
4. Purchaser:
    a. Sex.
    b. Date of birth.
    c. Smoker/nonsmoker.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 526. Taxation of payments received under private annuity.
Q 529. Tax consequences to obligor under private annuity.
Q 551. Usual private annuity results in nothing to be included in estate of annuitant (unless benefits payable to survivor).
Q 586. Nature and taxation of installment sale.

Footnotes

[1] The selection of either the installment sale or the private annuity depends upon a consideration of many factors, which include: the relative income and anticipated marginal tax brackets of the parties; the age of the seller; the need for flexibility in determining payments and tax consequences; the degree of trust between the parties; and the relationship between the parties (i.e., family members or disinterested third persons).

The tax implications can be compared by summarizing the breakdown of payments and tax allocations. The following calculations assume that real estate valued at $250,000 is transferred, with a cost basis to the seller of $100,000. The installment sale calculation assumes payments are made over a period of years approximating the seller's life expectancy under the Section 7520 mortality table (21.5 years) and uses 2.91 percent interest (the November 2014 long-term applicable federal rate). The private annuity calculation uses 2.2 percent interest (the November 2014 Section 7520 applicable federal rate).

	21-Year Installment Sale	*Private Annuity to Male, Age 60*
Annual Payment	$16,078	$15,294
Taxation to Seller:		
Gain	7,143	n/a
Interest Income	4,173	4,963
Nontaxable Recovery of Basis	4,762	10,331
Taxation to Purchaser:		
Interest Expense	4,173	-0-
Nondeductible Capital Expenditure	11,905	15,294

Note that such comparisons are heavily influenced by the assumed interest rate and the duration of the installment sale, as well as the age of the seller, who is also the annuitant in the private annuity arrangement. See also, footnote 4 below regarding proposed regulations.

[2] Use of an installment sale to purchase part or all of a business, or other property interest, after the owner's death offers little or no tax advantage to the estate. Because of the stepped-up basis, the estate will usually have no taxable gain, and thus no tax reason to spread gain over a period of years. In fact, reliance on the installment sale could be to the detriment of the estate and the heirs if the purchaser fails to make the agreed payments. Provided the business owner is insurable, funding a buyout agreement with life insurance is generally far better than an installment sale. If an installment sale is used, life insurance on the purchaser's life will assure that, if the purchaser dies, funds are available to make the required payments.

[3] The cancellation of an obligation between "related" parties (i.e., parent and child) will result in the seller, or his estate, having to recognize gain in an amount equal to the difference between the fair market value of the obligation on the date of cancellation and the seller's basis in the obligation. Passing a note by will to the purchaser is treated as a cancellation. There is no stepped-up basis, since this is "income in respect of a decedent," or IRD (see footnote 4 on page 21, and page 422). See also the expanded discussion of Self-Cancelling Installment Notes (SCINs) on page 550.

[4] In October of 2006 the IRS issued proposed regulations that would require the entire amount of the gain, or loss, to be recognized at the time of the sale (i.e., the parents would be in the same position as if they had sold the property for cash and then purchased the annuity). The regulations are effective for exchanges made after October 18, 2006 (except the effective date is delayed until April 18, 2007, for exchanges involving an unsecured annuity contract issued by an individual, provided the property that is exchanged is not sold or disposed of for a two year period). Any gain to the parent will be a capital gain if the asset qualifies for capital gain treatment. In this regard, see the discussion of the Capital Gains on page 340. Recovery of basis is spread equally over a period of years measured by the parent's life expectancy. After this period, each annuity payment will be entirely interest income.

GIFTS & SPLIT-GIFTS

For families that are potentially subject to estate taxes, lifetime giving is a very important part of estate planning, and can reduce the ultimate estate tax burden very substantially.[1]

INDIVIDUAL GIFTS. To illustrate, assume that a donor has money that is not needed for his own support. Under the federal gift tax provisions, an individual may give – under most circumstances – up to $14,000 per person, as indexed in 2015 for inflation, annually free of gift tax.[2] Thus, with three children the donor could give each of them $14,000 per year.[3] This per-donee exclusion is allowed each and every year, but it is *not cumulative* (i.e., exclusion unused in any year may not be "carried over" to the following year).

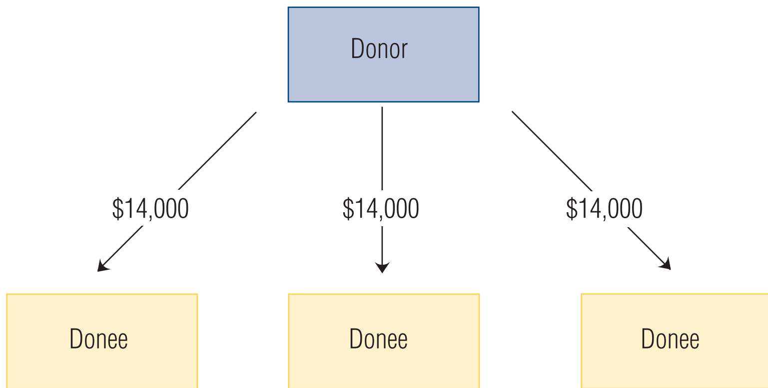
In order for the gift to be one that qualifies for the annual exclusion, it must be a *present interest gift*: the donee must be entitled to its immediate use and enjoyment.[4] If within the year the donor makes only present interest gifts, and gifts do not exceed a total of $14,000 per donee, the donor will *not* be required to file a gift tax return for that year and – under most circumstances – have no further income, gift, or estate tax consequences from the gift.[5] Likewise, the gift is not included in the donee's taxable income.

SPLIT-GIFTS. With split-gifts the spouse joins in making the gift, and this allows a married couple to increase their gifts to $28,000 per year to each donee. This can be done without tax consequences, provided it is a present interest gift. The funds could still be entirely either the husband's or the wife's, but by having a spouse join in making each gift, they are able to double the amount of their tax-free gifts. However, in order to claim the benefits of these provisions of the law, they must file a gift tax return.[6] Gift taxes, if any, are normally paid by the donor.[7] Split-gifts made to a trust of which one of the donors is a beneficiary face complicated limitations.

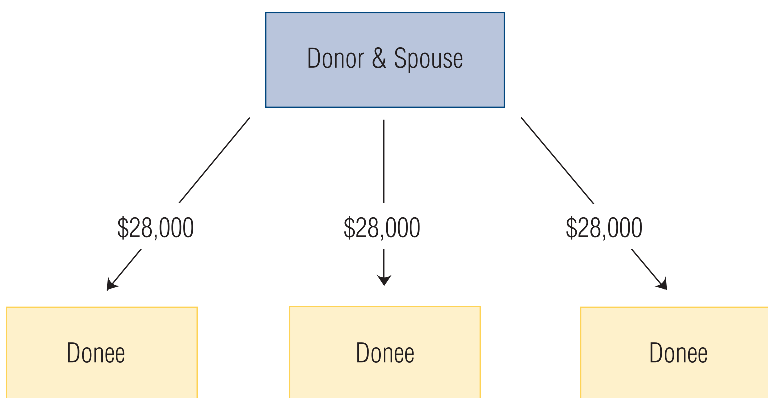
Present interest gifts that qualify for the annual exclusion are particularly attractive in reducing the donor's estate, since they will: (1) avoid the gift tax; and (2) likely be excluded from his estate for federal estate tax purposes no matter how soon death occurs after making the gift (e.g., the day after or even the moment after the gift is made).[8]

Footnotes on page 49

INDIVIDUAL GIFTS



SPLIT-GIFTS



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

To Determine Attitude Toward Making Gifts

1. Have prior gifts been made? If so, to whom and in what amounts?
2. Has client ever filed a gift tax return? If so, obtain copies.
3. Has client established trusts? If so, obtain copies.
4. Client's attitude regarding making cash gifts to children or others.
5. Would client consider making gifts in trust?

To Determine Ability To Make Gifts

6. Amount of cash available for gifts.
7. Other property available for gifts.
8. Inventory of life insurance policies owned by client or spouse.
9. Is client married (split-gifts)?

To Determine Benefits From Making Gifts

10. Numbers and ages of children and grandchildren.
11. Size of estate (i.e., to determine if currently subject to estate taxes).
12. Anticipated rate of estate growth.
13. Are client and spouse insurable?

See also information required for life insurance trusts on page 52.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 114. Valuation of life insurance for gift tax purposes.
Q 213. Use of annual exclusion to make gifts of policies and premiums.
Q 217. Gift of life insurance policy to minor qualifies for annual gift tax exclusion.
Q 219. Gift of policy within 3 years of death.
Q 655. Circumstances under which value of property given within 3 years of death is included in estate.
Q 740. General discussion of federal gift tax.
Q 741. Types of transfers subject to gift tax.
Q 748. Valuation of net gifts (donee pays tax).
Q 749. Gift to minor generally qualifies for annual exclusion.
Q 752. "Split-gift" provisions.
Q 753. Gift tax exclusions.
Q 755. Gift tax marital deduction.
Q 758. Unified credit and how it is applied against gift tax.
Q 759. Filing of return and payment of tax.

Footnotes

[1] Present interest gifts can be a highly effective estate planning tool without having to file a 4-page gift tax return (Form 709).

[2] The $10,000 annual exclusion for gifts is indexed for inflation and was increased from $13,000 in 2012 to $14,000 in 2013, 2014 and 2015. This cost-of-living adjustment is the percentage, if any, by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for the base calendar year (for these purposes a CPI calendar year ends August 31). However, any increases are rounded down to the next lowest multiple of $1,000.

[3] While gifts are generally discussed in a family setting, anyone can make gifts under these rules, whether the donor is a father, mother, child, distant relative, or even a benevolent stranger. In most states a gift to a minor under either the Uniform Transfers to Minors Act or the Uniform Gift to Minors Act will qualify as a present interest gift, even though the minor does not have legal capacity to make demands upon the custodian (see Minors and Life Insurance on page 483). The irrevocable life insurance trust offers an excellent means of taking advantage of the yearly opportunity to make present interest gifts through annual gifts to the trust for premium payments (see chart, page 51).

[4] When a gift is made late in the year in the form of a check it should be deposited in time to clear the donor's bank by the end of the year, otherwise the gift might not be considered complete until the following year. Payments made directly for medical or educational bills are not considered gifts for gift tax purposes, and therefore are not subject to gift taxes (the funds should be paid to the provider of medical services or the educational institution, not to the donee). Gifts to a charity can qualify for the gift tax charitable deduction (see discussion regarding charitable gifts of life insurance, page 346, and charitable remainder trust chart, page 55).

[5] Although the donee is not liable for income taxes upon receiving the gift, if the property is subsequently sold the donee would be liable for reporting and paying taxes on any gain realized from the sale. For the purpose of calculating gain, the donee's income tax basis is generally the same as the donor's basis in the property, often referred to as a "substituted" basis.

[6] The gift tax return, Form 709, must be filed by the donor on or before April 15 following the close of the calendar year in which the donor makes the gift, except that an extension of time granted for filing the income tax return serves also as an extension of time for filing the gift tax return. In order to avoid having to file a gift tax return, one spouse could transfer funds to the other spouse, and thereafter each spouse could then make separate gifts to the trust. Only a husband and wife can take advantage of split-gifts; unmarried individuals may not. The election on the IRS Form 709 to split gifts applies to all gifts made by the married couple during the year reported by the return.

[7] Although the donor is the party having primary liability for payment of the gift tax, a gift can be made subject to a condition that the gift tax is paid by the donee (or by the trustee if the gift is in trust). The value of the gift is reduced by the amount of the tax. In effect, the amount of the gift tax paid by the donee reduces the value of the gift and the gift tax liability. This net gift technique can be useful when the donor desires to transfer large amounts of property, but does not have cash to pay the gift tax. However, the donor ends up in the same position whether she transfers $1,350,000 to a donee and the donee pays $350,000 in gift tax, or she transfers $1,000,000 to a donee and pays the $350,000 gift tax herself. If the donor gives property, the donor will have to recognize income to the extent any gift tax paid by the donee exceeds the donor's basis in the property.

[8] One important exception is that proceeds of a life insurance policy *transferred* by gift from the insured within three years of the insured's death are brought back into the insured's estate.

LIFE INSURANCE TRUST

The trust is one of the most basic tools of estate planning. When made irrevocable and funded with life insurance, it accomplishes multiple objectives. For example, it can:

- Provide Creditor Protection
- Provide Income for a Family
- Provide Liquidity for Estate Settlement Costs
- Reduce Estate Taxes
- Avoid Probate Costs
- Provide for Management of Assets
- Maintain Confidentiality
- Take Advantage of Gift Tax Laws

DURING LIFETIME, it is possible for a grantor to establish a trust that will accomplish all of these objectives. The beneficiaries of such a trust are normally members of the grantor's family and likely to be estate beneficiaries.[1]

Once the trust is created, policies on the life of the grantor can be given to the trust. If no such policies are available, then the trustee would obtain the needed life insurance.[2] In either case, funds are given to the trust, which, in turn, pays the premiums to the insurance company.

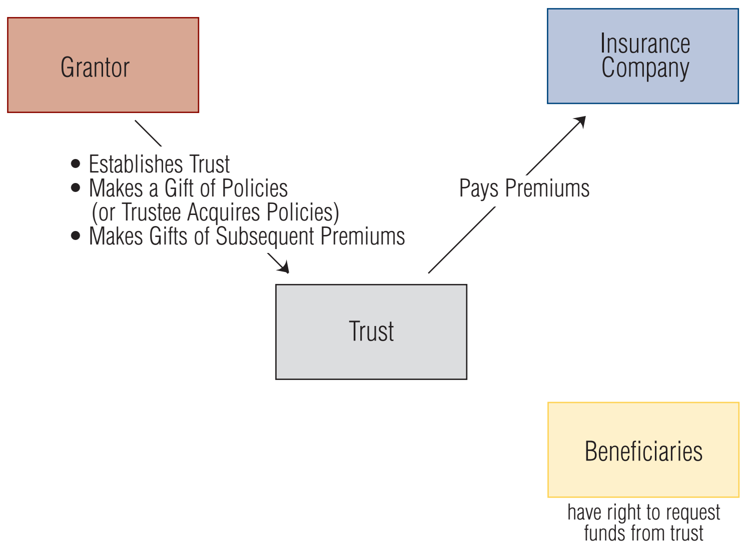
In order to take full advantage of the gift tax annual exclusion, the beneficiaries must have a limited right to demand the value of any gifts made to the trust each year.[3] However, in order not to defeat the purpose of the trust, the beneficiaries should not exercise this right to demand. In this way, each year up to $14,000 per beneficiary, as indexed for inflation in 2015, can be given gift tax-free to the trust.[4]

UPON DEATH, the grantor's property passes to his estate. At the same time, the insurance company also pays a death benefit to the trust. If the trustee was the original applicant for and owner of the policies, or if the grantor lived at least 3 years following any gift of existing policies to the trust, the death benefit will be received free of federal estate taxes.[5]

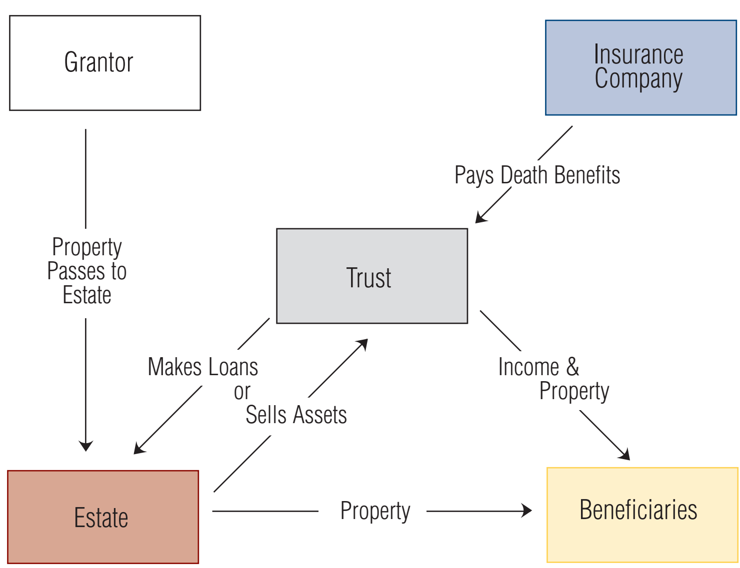
There are two ways the trustee can provide the liquidity to pay estate settlement costs. Either the trust **makes loans** to the estate, or the estate **sells assets** to the trust. In any event, guided by specific will and trust provisions the beneficiaries can receive distributions of **income** and **principal**.[6]

Footnotes on page 53

DURING LIFETIME



UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual to be insured (usually trust grantor).
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.

Attorney Drafting Trust Instrument Must Also Know

5. To whom, in what amounts, and when trust *income* is to be paid.
6. To whom, in what amounts, and when trust *corpus* is to be paid.
7. Trustee during insured's lifetime.
8. Trustee after insured's death.
9. Names of beneficiaries.
10. Ages of minor beneficiaries.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Income Tax

Q 142. When income of funded trust taxed to grantor.
Q 145. When income taxable to trust or to trust beneficiaries.
Q 148. Death proceeds received by trust free of income taxes.

Estate Tax

Q 74. When proceeds either included or excluded from insured's estate.
Q 176. When value of trust assets included in estate of income beneficiary.
Q 177. Insurance proceeds included in insured's estate when trustee *required* to pay estate debts and taxes.
Q 178. Transfer of income-producing property to trust.

Gift Tax

Q 149. Value of gift when policy transferred to trust.
Q 154. Qualification for gift tax annual exclusion.
Q 155. Annual exclusion and irrevocable trust for minor beneficiary (Sec. 2503(c)).
Q 156. Qualification for annual exclusion of gifts to trust to pay premiums (Crummey rules).
Q 157. When lapse of withdrawal right can result in gift from one beneficiary to another beneficiary.

Footnotes

[1] Just as the surviving spouse is often made a beneficiary of the family trust under the Trust Will ("B" trust on page 25), the surviving spouse can also be made a beneficiary and given "present interest" demand powers under the irrevocable life insurance trust (see footnote 4 below).

[2] During the insured's lifetime the trustee is typically an individual other than the grantor who: (1) takes possession of the life insurance policies; (2) applies for a taxpayer identification number using IRS form SS-4, Application for Employer Identification Number; (3) opens a checking account; (4) receives funds placed in the trust; (5) notifies beneficiaries of their right to make demands of these funds; and (6) pays premiums as they come due. It is usually advisable for a corporate trustee to be named at the insured's death. The new trustee then administers the life insurance proceeds according to the trust provisions.

[3] With respect to a demand power, the IRS has taken the position that the annual exclusion is available only when the powerholder is a *primary* trust beneficiary who has a substantial economic interest in the trust (e.g., child of the insured who stands to receive distributions from the trust). However, the Tax Court has held that a powerholder who is a beneficiary with only a *contingent remainder interest* would also qualify for the annual exclusion (e.g., grandchild would only take under the trust if his parent, who is the primary beneficiary, were deceased).

[4] The *right* to demand qualifies gifts for the annual exclusion as "present interest" gifts. Where there is more than one trust beneficiary this power is often limited to the greater of $5,000 or 5 percent of the trust corpus (often referred to as a "5-or-5" power). This right is considered a general power of appointment. When the beneficiary fails to exercise a general power of appointment, the "lapse" is deemed a non present interest gift from that beneficiary to the other trust beneficiaries to the extent that the property with respect to which the power lapsed exceeds the greater of $5,000 or 5 percent of the trust corpus. Such "gifts" *between beneficiaries* will result in an unnecessary utilization by the beneficiaries of their unified credit, or even payment of gift taxes. When premiums exceed $5,000 times the number of trust beneficiaries, one means of avoiding a lapse of the beneficiary's power of withdrawal is to use a "*hanging*" *Crummey power*. With this provision the beneficiary's entire power of withdrawal does not terminate within a specified period of time, but rather the beneficiary retains and accumulates his rights to demand gifts to the trust in excess of the "5-or-5" limit ($5,000, or 5 percent of the trust corpus, whichever is greater). Such accumulations of future rights of withdrawal (i.e., the hanging powers) give beneficiaries the right to demand distribution of prior gifts which exceeded the "5-or-5" limits. If in a future year the grantor makes no gifts to the trust, these accumulated powers lapse within the limits of the "5-or-5" power. The building up of substantial cash values would accelerate the lapse of these accumulated powers, since each beneficiary would have the right to demand the *greater of* $5,000, or 5 percent of the trust corpus (e.g., 5 percent of $150,000 in cash values is $7,500, and this is substantially more than $5,000). The *testamentary power of appointment* provides another means of avoiding the lapse of amounts in excess of $5,000 or 5 percent. Under such an arrangement, amounts exceeding $5,000 or 5 percent "partially lapse" to a limited testamentary power of appointment in favor of a designated class of beneficiaries (typically, the power holder's heirs). If the power is not exercised in the holder's will, then the amounts subject to the power vest in the trust. However, the amounts subject to this power are likely to be included in the holder's estate. The *cumulative power of appointment* is another technique used to avoid this problem (see page 358 for an additional discussion of present interest gifts).

[5] Provided the policy is purchased by another person, including a trustee, it now appears certain that, provided the proceeds are payable outside the estate, the death benefits of a life insurance contract will be excluded from the insured's estate no matter when death occurs (see the discussion on pages 405-406).

[6] There may also be provisions in both the trust and the grantor's will which provide for a merging of the trust and estate assets, with subsequent management of the combined assets for the beneficiaries. These are often referred to as "pour-over" provisions.

CHARITABLE REMAINDER TRUST

The charitable remainder trust enables an individual to make a substantial deferred gift to a favored charity while retaining a right to payments from the trust. Under the right circumstances use of such a trust offers multiple tax and nontax advantages, particularly to the individual who owns substantially appreciated property. These advantages include a charitable deduction resulting in reduced taxes, an increase in cash flow, avoidance of capital gains upon a sale of the appreciated property, the eventual reduction or elimination of estate taxes, and the satisfaction of knowing that property placed in the trust will eventually pass to charity. When combined with a wealth replacement trust, the full value of the estate can still be preserved for heirs.

DURING LIFETIME the grantor, after establishing a charitable remainder trust, gives property to the trust while retaining a right to payments from the trust.[1] A **unitrust** provides for the grantor to receive annually a fixed *percentage* of the trust value (valued annually), whereas an **annuity trust** provides for the grantor to receive annually a fixed *amount*.[2] Either type of trust could require that payments be made for the joint lives of the grantor and another person, such as the grantor's spouse.

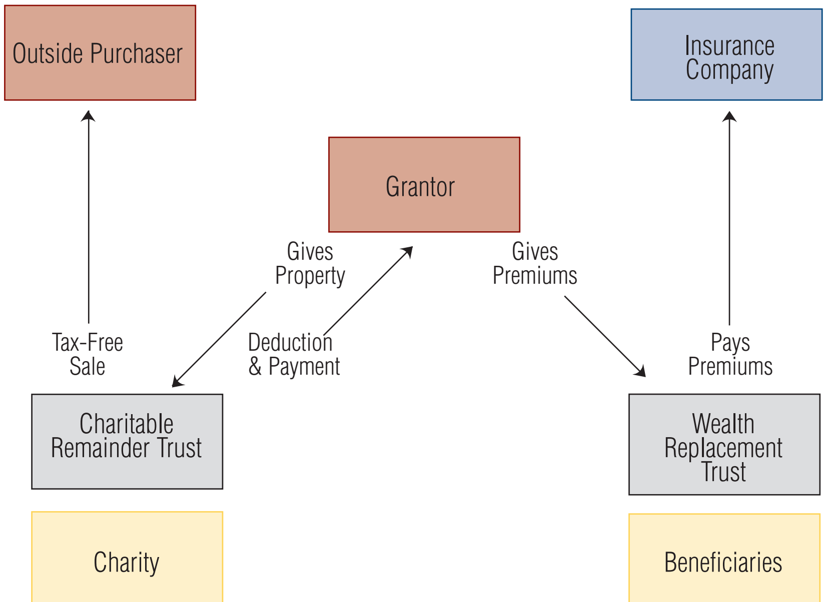
At the time the property is given to the trust, the grantor can claim a current income tax deduction equal to the present value of the charity's remainder interest.[3] Upon receipt of the gift, the trustee will often sell the appreciated property and reinvest the proceeds in order to better provide the cash flow required to make the payments to the grantor. This sale by the trust is usually free of any capital gains tax.[4]

The tax savings and increased cash flow offered by the use of a charitable remainder trust will often enable the grantor to use some or all of these savings to fund a **wealth replacement trust** for the benefit of his heirs, thereby providing for the tax effective replacement of the property transferred to the charitable remainder trust. If the wealth replacement trust is established as an irrevocable life insurance trust it is often possible to gain gift tax advantages during the grantor's lifetime, while at death entirely avoiding inclusion of the life insurance proceeds in the estates of the grantor and the grantor's spouse.[5]

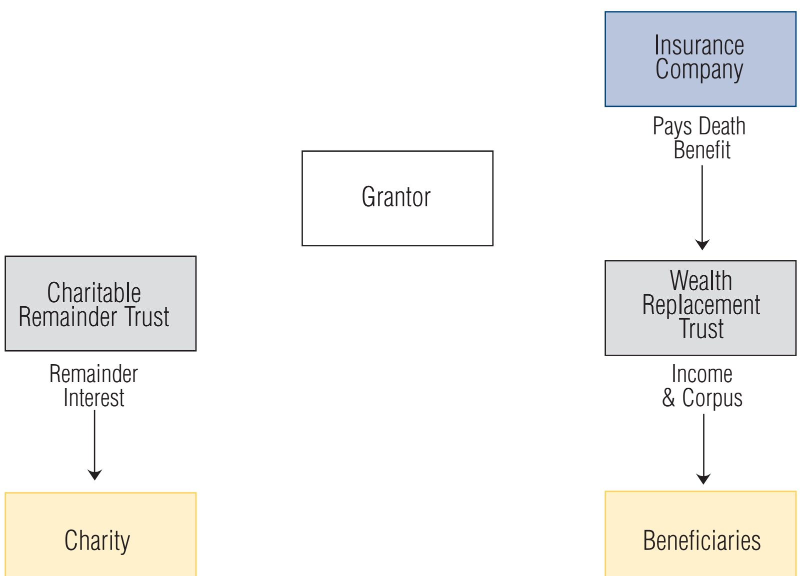
UPON DEATH the property placed in the charitable remainder trust passes to the designated charity. At the same time a tax-free death benefit is paid to the wealth replacement trust, which funds can then be held or distributed to the grantor's heirs pursuant to the terms of this trust.

Footnotes on page 57

DURING LIFETIME



UPON DEATH



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Fair market value of property transferred to trust.
2. Date of transfer to trust.
3. Payout rate (if unitrust) or amount (if annuity trust).
4. Payment frequency (annually, semiannually, quarterly, or monthly).
5. Age of person whose life determines length of payments.
6. Age of joint annuitant (if payout for two lives).
7. Discount rate (as published monthly by IRS).

See also information required for life insurance trusts on page 52.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 115. Charitable contribution deductions may be taken for the gift of a life insurance policy, life insurance premiums, maturing annuity, and endowment contract.
Q 633. Maximum annual limits on income tax deductions allowed for charitable contributions.
Q 700. Value of spouse's interest in a charitable remainder trust will generally qualify for the estate tax marital deduction.
Q 757. A gift tax deduction is generally allowed for gifts to charitable organizations.
Q 765. How remainder interests are valued.

CROSS REFERENCES TO TAX FACTS ON INVESTMENTS (2015)

Q 7978. When charitable deduction allowed for contributions to a charitable remainder trust.
Q 7979. Charitable remainder annuity trust defined.
Q 7980. Charitable remainder unitrust defined.
Q 7988. Pooled income fund defined.
Q 7990. Deduction for gift to charitable remainder annuity trust or unitrust.
Q 7991. Beneficiary subject to four-tier income tax treatment.

See also cross references to life insurance trusts on page 52.

Footnotes

[1] The term "grantor" is used to describe a person who establishes a trust, whereas the term "donor" is used to describe a person who makes a gift. For simplicity, only the term "grantor" has been used in describing the charitable remainder trust.

[2] Characteristics common to both unitrusts and annuity trusts are: (1) payments must be made at least annually and may not be less than 5 percent, nor more than 50 percent, of the net fair market value of the trust assets (determined when trust is created with an annuity; determined annually with a unitrust); (2) value of charity's remainder must be at least 10 percent of trust assets; (3) the trustee cannot be required to invest in specific assets (e.g., stock in a corporation or life insurance); and (4) payments may be for a term not greater than 20 years, or for the life or lives of the beneficiary(ies). Any individual beneficiary must be living when the trust is created.

[3] Selection of a payout rate can have a substantial impact upon the current income tax deduction (i.e., the present value of the charitable remainder interest). If the deduction is to be meaningful, the payout rate is usually limited to 7 percent or less. For example, assuming a $100,000 gift to a charitable remainder unitrust to be paid for the beneficiary's life, the following table illustrates the interrelationship of the beneficiary's age and the selected payment percentage:

Age of Beneficiary	Payout	Deduction
50	5%	25,943
	10%	9,413
60	5%	37,656
	10%	17,530
70	5%	51,905
	10%	30,197

[4] With gifts of long-term capital gain property, the full present value of the remainder interest is deductible if the property is intangibles or real estate. Tangible personal property is not appropriate.

Whether the deduction can be taken in a particular year depends upon the application of three percentage limitations that relate to the taxpayer's "contribution base" (i.e., adjusted gross income computed without regard to net operating loss carryback). These limits depend upon whether the gift is to a public charity or a private foundation (see page 508); and whether the gift is one of either cash or ordinary income property, or a gift of long-term capital gain property. The deduction cannot usually exceed the following percentages of the taxpayer's contribution base:

	Cash or Ordinary Income Property	Long-Term Capital Gain Property
Public Charities	50%	30%
Private Foundations	30%	20%

If the gift is made to a public charity there is a five-year carryover of any unused deduction.

A charitable remainder trust (CRT) that has unrelated business income (UBI) is subject to income taxation on all of its income. Generally, UBI is the net income from the conduct of a trade or business that is not substantially related to the exempt purpose of the CRT. Income from property that is debt-financed and not related to the exempt function of the CRT is generally considered UBI. However, debt-financed income is excluded from UBI for the first ten years following transfer to the CRT if the debt had been placed on the property more than five years prior to the transfer.

[5] The "wealth replacement trust" is another name for an irrevocable life insurance trust (see chart on page 51). For an expanded discussion of the gift and estate tax ramifications of an irrevocable life insurance trust, see the discussion on page 50. Funding with survivorship life insurance can be particularly attractive (see page 566).

GRANTOR RETAINED ANNUITY TRUST (GRAT)

The Grantor Retained Annuity Trust (GRAT) is an estate planning technique that can be used to transfer *future* appreciation to family members, or others, free of gift and estate taxes provided the grantor survives the trust term.[1]

TRUST ESTABLISHED. In order to implement a GRAT, the grantor creates an irrevocable trust for a specified number of years, names his children as trust beneficiaries, and transfers to the trust property that has a potential for substantial appreciation.[2] The grantor retains the right to receive, for the term of the GRAT, a "qualified annuity interest" based on either a specified sum or fixed percentage of the initial value of the property transferred to the trust. This annuity is mandatory and must be paid at least annually. The annual payment may be increased, provided the increase is not greater than 120 percent of the prior year's payment. Additional contributions to the GRAT are not permitted.

Only the value of the remainder interest payable to the trust beneficiaries is subject to the gift tax. This value is determined by subtracting from the fair market value of the property transferred to the trust the present value of the annuity retained by the grantor.[3] The value of this annuity is increased by a longer-term trust, larger annuity payments, and lower assumed interest rate used to make the present value calculation. To summarize, gift tax exposure is *reduced* if the present value of the retained annuity is increased and the value of the remainder interest is decreased:[4]

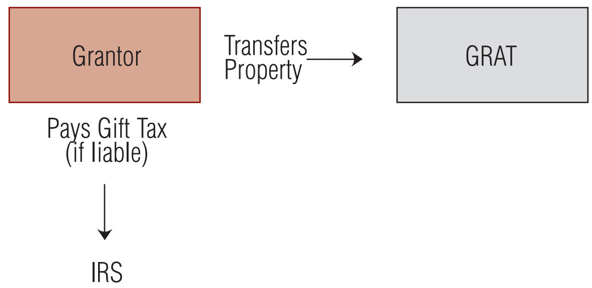
Exposure to Gift Tax ↓	↑ Value of Retained Annuity	Value of Remainder Interest ↓

DURING TRUST TERM. Tax-free annuity payments are made to the grantor. Trust assets may be used to make these payments. For federal tax purposes the GRAT is considered a grantor trust, meaning that the grantor pays taxes on all trust income.[5] Should the grantor die before the end of the trust term, the annuity payments continue to be made to the Grantor's Estate and the property is subject to estate taxes.[6]

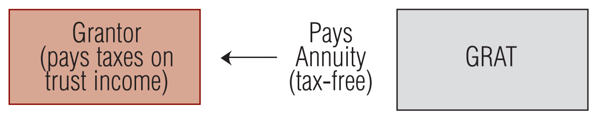
AT END OF TRUST TERM. Any property remaining in the trust, including appreciation and earnings, is paid to the trust beneficiaries (i.e., the remainder interest). Provided the grantor lives to the end of the trust term (and does not die within 3 years of the transfer), this property is not subject to estate taxes.[7]

Footnotes on page 61

TRUST ESTABLISHED

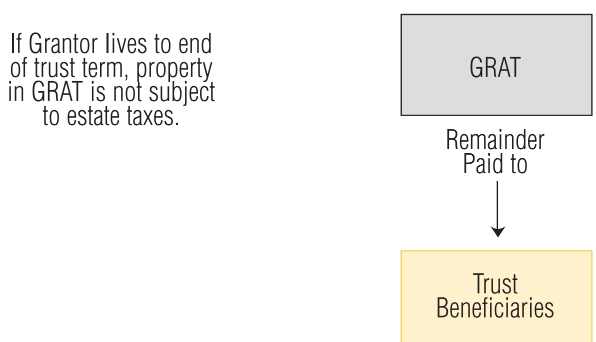


DURING TRUST TERM



IF GRANTOR DIES BEFORE END OF TRUST TERM

AT END OF TRUST TERM



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Fair market value of property transferred to trust (provide appropriate appraisals).
2. Term of trust (in years).
3. Annuity to be paid (as dollar amount or percent of initial trust value).
4. Payment frequency (annually, semiannually, quarterly, or monthly).
5. Increase in annuity as a percent, if any (not to exceed 120 percent of prior year).
6. Age of grantor (if grantor retains reversion).
7. Date of transfer to trust (needed to set payment dates and determine Section 7520 interest rate as published monthly by IRS).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 664. Grantor trust and how it is taxed.
Q 741. Types of gifts subject to gift tax.
Q 753. Gift tax exclusions.
Q 758. Unified credit and how it is applied against gift tax.
Q 760. Valuation of property for gift tax purposes.
Q 777. General discussion of the Chapter 14 valuation rules.
Q 781. Special valuation rules under Chapter 14 that apply to transfer of an interest in trust, to include grantor retained annuity trusts.

Footnotes

1 Section 2702 of the Internal Revenue Code provides the basic rule that if a transferor makes a gift in trust for the benefit of the *transferor's family*, for purposes of gift taxation any interest retained by the transferor (grantor) will be valued at zero (the so-called "zero-value rule"). If the retained interest has no value, then the gift tax value of the remainder interest is equal to the full fair market value of the property transferred to the trust (not a good gift-tax result for the transferor). But this zero-value rule does not apply when the retained interest is a "qualified annuity interest" meeting requirements set forth under Treasury Regulations (e.g., trust must be irrevocable, mandatory payments must be made at least annually, no payments may be made to anyone other than the grantor, and increases in annuity payments may not be greater than 120 percent of the prior year's payment). A "qualified annuity interest" is valued using the valuation tables provided by Code Section 7520 and a "Section 7520" interest rate in effect for the month in which the valuation date occurs (i.e., when the property is transferred to the GRAT). This chart describes a GRAT meeting the requirements for a qualified annuity interest (i.e., grantor's children are trust beneficiaries).

2 The effectiveness of the GRAT can be further enhanced by selecting assets that offer discounts for lack of control and marketability (e.g., a family limited partnership, page 171).

3 A "zeroed out" GRAT occurs when the value of the grantor-retained annuity is essentially equal to the value of the asset transferred to the trust, resulting in a nominal gift or no gift because the remainder interest has virtually no value for gift tax purposes.

4 Conversely, exposure to the gift tax is increased when the value of the retained annuity is decreased and the value of the remainder interest is increased. It is important to keep the value of the gift low, as the transfer to the trust is considered a gift of a future interest and the $14,000 gift tax annual exclusion is not available (see chart on page 47). To the extent there is available unified credit, it is allocated to the gift; otherwise, the grantor pays a gift tax on the transfer.

5 The grantor trust rules are discussed on page 414.

6 The effectiveness of the GRAT as a wealth transferring device is dependent upon: (1) the grantor surviving the trust term (i.e., not dying until the remainder interest passes to the trust beneficiaries); and (2) the property held in the trust appreciating at a rate that is higher than the Section 7520 interest rate used to determine the present value of the annuity paid to the grantor (i.e., the more the appreciation, the more that will pass to the trust beneficiaries free of both gift and estate taxes). Should the grantor die before the end of the trust term, any unified credit utilized when making the gift would be restored to the estate (i.e., the tax effect is the same as if the GRAT had never existed).

7 Lower Section 7520 interest rates make GRATs particularly attractive, since the effect is to allow more assets to be placed in trust with less exposure to the gift tax (see footnote 1 above). For example, assume that a grantor transfers an asset with a fair market value of $100,000 into either: (1) a 5-year GRAT paying the grantor a fixed annuity of $20,000 per year; or (2) a 10-year GRAT paying the grantor a fixed annuity of $10,000 per year; with the remainder interest passing to the grantor's children. The following table compares the results of varying Section 7520 interest rates and GRAT durations.

		GRAT Funded with $100,000			
		$20,000/year for 5 years		$10,000/year for 10 years	
Date	Section 7520 Interest Rate	Retained Annuity	Gift of Remainder	Retained Annuity	Gift of Remainder
Dec - 2009	3.2%	$91,074	$8,926	$84,438	$15,562
Dec - 2006	5.8%	$84,708	$15,292	$74,303	$25,697
Dec - 2000	7.0%	$82,004	$17,996	$70,236	$29,764

PRIVATE SPLIT-DOLLAR

Whereas a traditional split-dollar plan involves an employer and an employee, a private split-dollar plan is an agreement between individuals, or between an individual and a trust.[1] A private split-dollar plan enables an insured to *both* have the policy cash values available for emergency and retirement purposes and exclude life insurance proceeds from his estate. For example, assume that a married couple wishes to establish a private split-dollar plan.[2]

DURING LIFETIME. The individual who will become the insured establishes an irrevocable life insurance trust with his spouse and children as trust beneficiaries.[3] The trustee then applies for a life insurance policy on his life and enters into a collateral assignment split-dollar agreement with the spouse. This agreement provides for the sharing of both premiums and death benefits between the spouse and the trust. However, under the agreement the spouse owns all cash values (although the policy is owned by the trust) and retains the sole right to borrow against or withdraw policy cash values.[4]

The trust's share of the premium is equal to the "economic benefit" of the death benefit payable to the trust.[5] To fund the trust's portion of the premium, the insured makes annual gifts to the trust. These will qualify as "present interest" gifts provided the trust beneficiaries have Crummey withdrawal powers.[6]

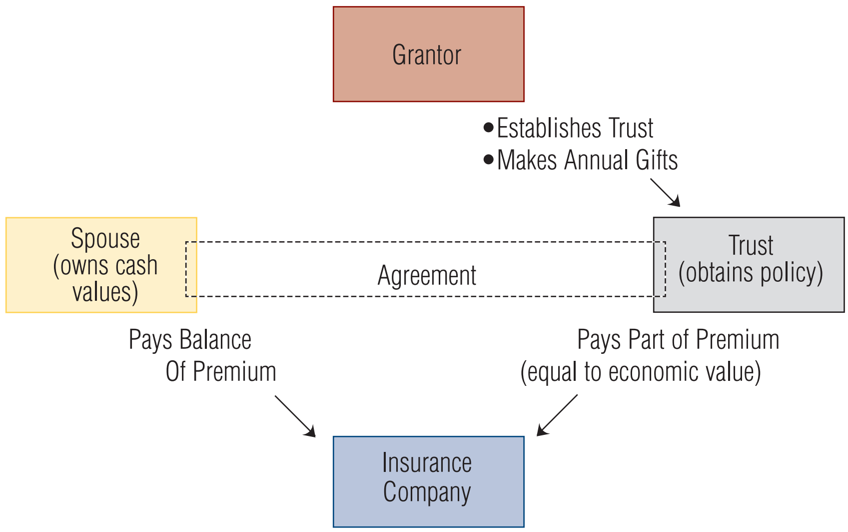
The spouse pays the balance of the premium. These funds either come from the spouse's separate property or are given by the grantor (insured) to his spouse free of any gift tax liability (i.e., the marital deduction enables married persons to pass unlimited amounts of property to each other during lifetime or upon death free of gift or estate taxes).[7]

Prior to or during retirement the spouse can access policy cash values free of income taxes through withdrawals or loans against the policy. By this means the insured has indirect access to the cash values.[8]

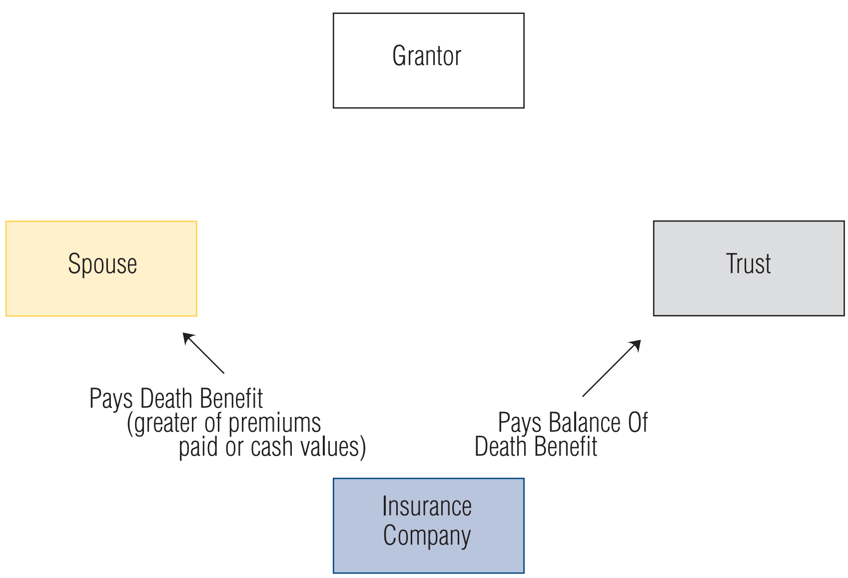
UPON DEATH. The death benefit payable to the spouse is the greater of the total premiums paid by the spouse or the policy cash values (less any outstanding loans). The trust receives the balance of the death benefit. Since the insured had no incidents of ownership in the policy, none of the death benefit is included in his estate.[9] Guided by the specific provisions of the trust, these estate tax-free proceeds are used to pay trust income and principal to the trust beneficiaries.

Footnotes on page 65

DURING LIFETIME



UPON DEATH



Private Split-Dollar

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual to be insured.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.
5. Amount of desired death benefit.

Attorney Drafting Trust Instrument And Split-Dollar Agreement Must Also Know

6. To whom, in what amounts, and when trust *income* is to be paid.
7. To whom, in what amounts, and when trust *corpus* is to be paid.
8. Trustee during insured's lifetime.
9. Trustee after insured's death.
10. Names of beneficiaries.
11. Ages of minor beneficiaries.
12. Name of spouse who will be a party to the split-dollar agreement.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Split-Dollar

Q 148. Death proceeds received by trust free of income taxes.
Q 175. Description of private split-dollar and how it is taxed.

Estate Tax

Q 174. When proceeds either included or excluded from insured's estate.
Q 308. Estate taxation of split-dollar.

Gift Tax

Q 111. Gift taxation of split-dollar.
Q 154. Qualification for annual gift tax exclusion.
Q 156. Qualification for annual exclusion of gifts to trust to pay premiums (Crummey rules).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 2 (2015)

Q 3899. Description of split-dollar.
Q 3904. Income tax consequences of transfer or "rollout" of split-dollar policy.

Footnotes

[1] Prior to 2002 there was little authority for private split-dollar plans. In Notice 2002-8 the IRS acknowledged the existence of private split-dollar plans without actually sanctioning them. The final split-dollar regulations issued in 2003 specifically state that they apply "for gift tax purposes, including private split-dollar life insurance arrangements." Such affirmative guidance on how to structure private split-dollar plans may encourage more of these plans to be established for wealth transfer purposes.

[2] When involving family members, such an arrangement is also referred to as "family split-dollar."

[3] This trust would be similar to that shown in the Life Insurance Trust chart on page 51. Private split-dollar involving both an irrevocable life insurance trust and a split-dollar plan requires a great deal of planning, implementation, and ongoing administration. If estate tax-free death benefits are important, but access to cash values is unimportant, then third party ownership or an irrevocable life insurance trust should be considered. On the other hand, if access to cash values is important, but estate tax-free death benefits are unimportant, then the insured might better own the policy (see the discussion of life insurance as property on page 74).

[4] This is a "nonequity collateral assignment plan" intended to be taxed under the economic benefit regime set forth in the split-dollar regulations (compare with other designs discussed on page 232). As the insured ages, a plan subject to gift taxation under the economic benefit regime can become difficult to maintain. This is due to the substantial gifts that must be made to the trust to cover the increasing value of the insurance coverage (see footnote 3, page 235). When there is a need for permanent life insurance, such as to pay estate taxes, it is important to establish an "exit strategy" for maintaining the policy (see Split-Dollar Rollout, page 558).

[5] Under the regulations, this "economic benefit" is measured by "life insurance premium factors" to be published by the IRS. Until these factors become available, the Table 2001 rates on page 588 should be permissible.

[6] For an expanded discussion of Crummey withdrawal powers, see page 368 and footnote 4 on page 53. As the insured gets older the trust's portion of the premium will increase substantially, particularly if the insured lives past age 80 (see footnote 3, page 235). If the spouse is also a trust beneficiary, failure of the trust to pay its portion of the premium could be considered a gift by the spouse to the trust with a retained life interest. This would cause a portion of death proceeds to be included in the *spouse's* estate (see discussion of retained life estate on page 406). To avoid imputed gifts from the spouse to the trust, the trust must continue paying for any death benefits it receives (even if premiums are not currently being paid). If the trust's portion of the premium exceeds the amount that can be qualified as a present interest gift to the trust, then a portion of the gift becomes taxable and the insured must either use some of his unified credit or pay gift taxes. Attempts to avoid these problems have involved: (1) establishing a trust-owned premium prepayment account; and (2) reducing in later years the death benefit paid to the trust.

[7] The marital deduction is more fully discussed on page 473.

[8] A stable marriage and confidence in the noninsured spouse is essential. To avoid income taxation, withdrawals are made up to the spouse's income tax basis in the policy. Thereafter, loans could be taken against the policy (see page 481). Other less attractive alternatives involve having the cash values owned by a QTIP trust, adult child, S corporation, or limited partnership.

[9] However, if the spouse dies *before* the insured, and the spouse's interests in the policy cash values pass in any way that cause the insured to have an incident of ownership in the policy, upon his subsequent death the death proceeds will be included in his estate. This means that the insured cannot be a trustee of a trust holding the policy, nor can he act as executor of the deceased spouse's estate if the policy is part of the estate. See discussion of incidents of ownership on page 405.

INTENTIONALLY DEFECTIVE TRUST

The intentionally defective trust is a wealth-transferring device used by larger estates. It is an irrevocable trust that has been carefully drafted to cause the grantor to be taxed on trust income, yet have trust assets excluded from the grantor's estate.[1] Once established, it can offer multiple planning opportunities and benefits, particularly when combined with both gifts and installment sales.[2]

TRUST ESTABLISHED. When establishing the trust, the grantor will typically retain a right to substitute assets of equivalent value. Retention of this right in a nonfiduciary capacity violates one of the grantor trust rules.[3] The grantor is then considered the "owner" of the trust for income tax purposes, but not for estate, gift, and generation-skipping tax purposes. As to income taxes, the grantor and the trust are considered one and the same; trust income, deductions, and credits are passed through to the grantor.

Once established, the grantor then makes a gift of cash or other liquid assets to the trust, equal in value to 10 percent or more of the value of the property that will be sold to the trust in the subsequent installment sale.[4]

INSTALLMENT SALE. Thereafter, the grantor and the trustee enter into a sales agreement providing for the purchase of additional assets from the grantor at fair market value. Under this agreement the trustee gives the grantor an installment note providing for payment of interest only for a number of years, followed by a balloon payment of principal at the end of the term.[5] The assets sold will typically consist of property subject to a valuation discount (e.g., a non-controlling interest in a limited partnership, a limited liability company, or an S corporation).[6] The amount of this valuation discount is immediately removed from the grantor's estate.[7]

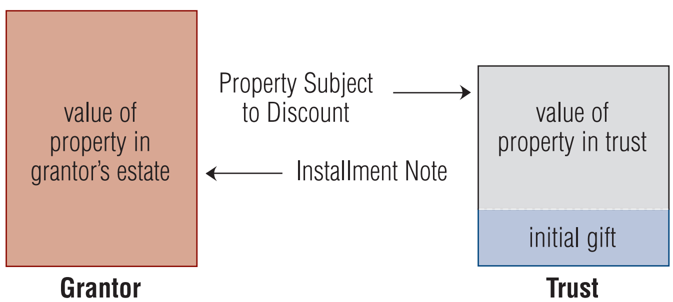
SUBSEQUENT ADVANTAGES. Payment of taxes by the grantor upon the trust income enables the trust to grow income tax-free, and is a tax-free gift from the grantor to the trust beneficiaries. The interest and principal payments by the trust are "tax neutral," meaning that they have no income tax consequences for either the grantor or the trust. Any growth of invested trust assets is excluded from the grantor's estate.[8]

If appropriate, the trustee could also use cash flow in excess of required interest payments to purchase life insurance on the grantor. Since the grantor/insured is not the "owner" of the trust for estate tax purposes, the death proceeds would be excluded from the grantor's estate.

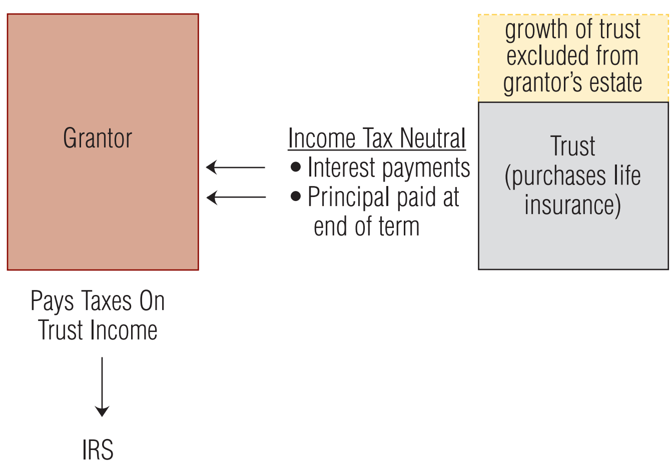
Footnotes on page 69

TRUST ESTABLISHED

INSTALLMENT SALE



SUBSEQUENT ADVANTAGES



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Names and ages of trust beneficiaries.
2. To whom, in what amounts, and when trust income is to be paid?
3. To whom, in what amounts, and when trust corpus is to be paid?
4. Trustee(s) of trust (both before and after grantor's death).
5. Client's: (a) Date of birth; (b) Sex; (c) Smoker/nonsmoker.
6. Client's annual taxable income (to determine marginal tax bracket).
7. Approximate size of estates of both client and spouse (generally, gross estates less outstanding debts and liabilities).
8. Extent to which client and spouse have used their annual gift exclusion ($14,000 each in 2015).
9. Extent to which client and spouse have each used their available gift tax unified credit ($2,117,800 each in 2015, allowing them to each give $5,430,000 of property).
10. Property available for the initial gift.
11. Nature of income-property available for installment sale (preferably, an asset subject to valuation discount).
12. Client's cost basis in income-property.
13. Anticipated annual income from income-property.
14. Length (term) of the installment note.
15. Minimum interest rate to be paid on installment note (applicable federal rate).

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 141. When life insurance trust will provide income tax savings for grantor.
Q 142. Income of trust used to pay premiums on life insurance policy insuring grantor is taxed to grantor.
Q 143. Income of trust used to pay premiums on life insurance policy insuring grantor's spouse is taxed to grantor.
Q 147. With a "defective trust," grantor is allowed to take income tax deduction for interest paid on loan against trust-owned policy.
Q 174. When proceeds of life insurance either included or excluded from insured's estate.
Q 178. Transfer of income-producing property to trust. When proceeds of life insurance either included or excluded from insured's estate.
Q 586. Installment sale and how it is taxed.
Q 664. Grantor trust and how it is taxed.
Q 758. Gift tax unified credit.

Footnotes

[1] This trust is also referred to as a "grantor trust," or an "intentionally defective irrevocable trust (IDIT)." Historically, the inadvertent inclusion of these powers in a trust resulted in the grantor being taxed on the trust income. Since the grantor was usually in a *higher* tax bracket than the trust, the results were undesirable, and the trust was considered defective. Today, the grantor will likely be in a *lower* tax bracket than the trust (compare the federal income tax tables on page 585).

[2] The intentionally defective trust is most often merely funded with a large gift of income-producing property. The additional installment sale funding is typically used when the grantor has no available gift tax exemption, or when the needs of the trust are very large (e.g., to pay premiums on a very large life insurance policy).

[3] See page 414 for a more complete explanation of the grantor trust rules, and other applications of the defective trust.

[4] In order to keep the trust free of any generation-skipping transfer taxes (GSTT), the grantor should file a gift tax return allocating GST exemption to the trust in the amount of the gift. However, provided it falls within the grantor's available annual exclusion and/or gift tax exemption, the gift can be made without paying gift taxes (see chart, Gifts & Split-Gifts on page 47). The primary reason for making this initial gift is to establish that the trust has a degree of independence from the grantor. The concern here is that the IRS might challenge the installment sale as a sham, by arguing that it is unlikely a valuable asset would be sold to someone who has no ability to pay. Funding of the trust prior to the installment sale will also help defend against a challenge by the IRS that the asset should be brought back into the grantor's estate under the Section 2036(a)(1) theory that the sale was actually a transfer with a retained interest. See also, the discussion on page 406.

[5] Unlike the assets sold, the note will not appreciate in the grantor's estate. However, upon the grantor's death the assets will not receive a stepped-up basis. Although the term of the note could be 20 years or more, to avoid any suggestion that the transaction creates an income interest for the grantor's lifetime, the term should be less than the grantor's life expectancy. The federal mid-term rate is used for installment notes of more than three years, and not more than nine years; whereas, the higher federal long-term rate is used for notes of more than nine years. Choice of a shorter deferral period takes advantage of lower interest rates, reduces the amount paid to the grantor, and improves the chances that the loan will be paid off prior to the grantor's death. See footnote 7, below.

[6] Such discounts can range from 35 percent to as much as 65 percent. Rather than selling assets directly to the trust, the grantor will often place the assets in a family limited partnership, which is then sold at a discount to the trust.

[7] If the grantor dies prior to final payment, the estate includes the promissory note. There is disagreement among commentators, as to whether gain on the outstanding note must be recognized upon the grantor's death (i.e., at death the defective trust becomes non-defective, and the estate becomes a separate tax-paying entity).

[8] The installment sale to a defective grantor trust resembles a grantor retained annuity trust (GRAT). See page 415. Both are intended to remove an asset from the grantor's estate and affect a tax-free transfer of assets to heirs. Although many features of the defective grantor trust are superior to a GRAT, unlike the GRAT there is no specific statutory authority for a defective trust (the IRS will not issue a ruling on them). The defective trust is a sophisticated estate planning technique that should only be undertaken with the advice of competent tax counsel.

EXCESS SOCIAL SECURITY AND LIFE INSURANCE ~~AS PROPERTY~~

Affluent individuals who are nearing retirement or already retired may realize that they do not need their social security income.[1] They have brokerage accounts, pension plans, and other assets that they feel are sufficient for their own retirement needs. But, because social security is not a needs based program, these clients will still receive their benefits in retirement. However, these same clients may be concerned about leaving a legacy for their children or grandchildren. Although they are fortunate enough to receive a social security benefit, they may not be confident that social security will remain viable to assist their children's retirement.

These individuals who do not need their social security can either save it or use the social security income to purchase a life insurance policy. If they choose to save their social security income into a side fund, they would have to consider taxes affecting the side fund, a premature death which could mean less money to their heirs, and additional long-term care or chronic illness needs. Life insurance can provide tax benefits, an attractive rate of return at life expectancy, and can be structured to offer long-term care and chronic illness benefits.[2]

The first step in this type of strategy is to identify the social security income that is not needed. The client should factor in future needs — have they considered inflation? Have they factored in potential long-term care needs?

The second step is to create a plan for the excess Social Security Income (SSI). The client can either save the SSI in a side fund (and invest it into CDs, mutual funds, bonds, etc.) or ~~they~~ can use the SSI to fund a life insurance policy. By saving the money into a side fund, the money would always be accessible to the client. If the client were to pass away in the earlier years though, the benefit received by their heirs would be small. In addition, the side fund would most likely have income tax consequences.

The client can potentially increase the amount to heirs if ~~they~~ purchase a life insurance policy with the SSI instead. In addition, the death benefit is usually received on a tax-free basis. The cash surrender value of the life policy would also grow tax deferred. If needed, tax free distributions could be taken through withdrawals and loans.[3] In addition, for clients who are concerned with long-term care costs, a long-term care or chronic illness rider might be a solution.

If estate taxes are a concern, the client could create an Irrevocable Life Insurance Trust (ILIT). At death, the policy death benefit will pass to the ILIT, free of estate and income tax.[4]

Life insurance, of course, comes with its unique benefits and considerations.[5] It is important to understand the specifics of any life insurance policy that is purchased and to fully evaluate the risks associated with that product type, illustrated funding arrangement, and the issuing company ratings and stability.[6]

Footnotes on page 73

EXCESS SOCIAL SECURITY BENFITS AND LIFE INSURANCE PLANNING CASE STUDY

CLIENTS: Robert and Ann Schultz

STATUS: Ages 67 and 63, Preferred Non Smokers. Robert and Ann have an estimated monthly Social Security Benefit of $2,500 before taxes ($19,000 annually after taxes), and they have plenty of retirement income coming in from a pension and other retirement accounts.

PRODUCT: They purchase a Current Assumption Survivorship Universal Life policy, which buys approximately $1.7M of death benefit using a premium of approximately $19,000.

EFFECTS OF USING SOCIAL SECURITY BENEFITS TO FUND LIFE INSURANCE		
	CURRENT STRATEGY	**PROPOSED STRATEGY**
Social Security Benefit	$2,500	$2,500
Consumer Price Index (i.e. Benefit Inflation Rate)	1.00%	1.00%
Approximate Total Premiums Paid by Year 29	–	$551,000
Side Fund in Year 29 (A/T Growth rate of 2%)	$877,831	$126,037
Approximate Death Benefit in Year 29		$1,700,000
Net to Heirs in Year 29	**$877,831**	**$1,826,037**
Potential Gain Due from Planning	**–**	**$948,206**

The figures used in this case study are hypothetical, for discussion purposes only, are not guaranteed and may not be used to project or predict results. Actual results may be more or less favorable. Specific product and policy elements would be found in a policy illustration provided by an insurer. With any decision regarding the purchase of life insurance, a client would need to determine which type of life insurance product is most suitable for their specific needs.

Excess Social Security and Life Insurance ~~as Property~~

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual to be insured.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.

To Determine Type of Contract

5. Attitude toward risk – determine need for guarantees and suitability for variable life.
6. Possible need for lifetime distributions – determine need for long-term care or chronic illness rider.
7. Income – determine eligibility for insurance and suitability of product type.
8. Ne~~w~~ worth – determine eligibility for insurance and suitability of product type.

CROSS REFERENCES TO SOCIAL SECURITY & MEDICARE FACTS (2015)

Q 1 - Q 2 Understanding and Planning for Social Security
Q 132 - Q 145. Social Security Coverage
Q 146 - Q 159. Filing for Benefits
Q 160 - Q 189. Benefit Computation
Q 223 - Q 233. Loss of Benefits Because of "Excess" Earnings
Q 234 - Q 242. Taxation of Social Security Benefits

Footnotes

[1] See a discussion of considerations for determining when to begin taking Social Security benefits on page 316.

[2] See a discussion of Long-Term Care Combination Products at pages 469-470. Long term care riders and chronic illness riders are similar in many ways, but they are not identical. Moreover, there are significant differences even among long-term care or chronic illness riders. It is important to understand the differences between the various types of living benefit riders that have become very common in the market-place because of the continually increasing cost of stand-alone long-term care products and the high cost of long term care.

[3] Loans and withdrawals will reduce the death benefit, cash surrender value, and may cause the policy to lapse. Lapse or surrender of a policy with a loan may cause the recognition of taxable income.

[4] See a discussion of life insurance trust planning on pages 50-53.

[5] The potential benefits of using excess social security benefits to purchase life insurance for your heirs includes life insurance can increase the amount left to heirs, life insurance cash surrender values grow tax deferred and cash values can be accessed tax-free through loans and withdrawals, and the death benefit can be received tax free. Also, depending upon state law (see discussion of life insurance creditor protection by state on pages 446-461), life insurance policies may enjoy creditor protection.

[6] See a discussion of life insurance products at pages 78-81. See also a discussion of life insurance company ratings at pages 442.

LIFE INSURANCE AS PROPERTY

Life insurance differs from most other kinds of contracts because life insurance can potentially place specific rights in three types of persons: the *insured*, the *owner*, and the *beneficiary*. These characteristics make life insurance unique when compared to other types of property. In fact, their arrangement will determine whether or not the death benefit will be subject to estate or gift taxes.[1]

A Death proceeds *Will* **be included in the gross estate** if the insured possesses any incidents of ownership in the contract at the time of his death, or within three years of his death, no matter who might be the beneficiary.[2]

B Likewise, when the insured's estate is named beneficiary, the death proceeds will be included in the gross estate, even though the insured may have possessed no incidents of ownership.

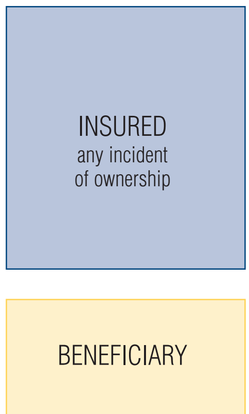
C Death proceeds *Will Not* **be included in the gross estate** of the insured if he possesses no incidents of ownership in the policy at death or within three years before death and proceeds are not payable to, or for the benefit of, his estate. However, there may be gift tax problems where the insured, the owner, and the beneficiary are all different persons. This arises, for example, where one spouse is the insured, the other spouse the owner (with a right to change beneficiaries), and a child the beneficiary. When the insured dies, the surviving spouse will be considered as having made a gift of the death proceeds to the child. For purposes of the gift tax, property owned by one person (the surviving spouse) is transferred upon the insured's death to another (the child). This deemed transfer from owner to beneficiary is a gift and could result in the surviving spouse having to pay a *gift tax*, or in having to use up some or all of the available unified credit.[3]

D Where estate and gift tax issues are a concern, all incidents of ownership should be held by the beneficiary from the issuance of the policy.[4] For example, one individual would be the insured and the policy would be owned by and payable to either his spouse, a child, or an irrevocable life insurance trust.[5] This arrangement will assure that the proceeds from the life insurance contract are received untouched, untaxed, and on time: **untouched** in that they would be payable directly to the heirs; **untaxed** in that they would be free of income and estate taxes; and **on time** in that they would be paid when needed at death, whether death occurs immediately or at some indefinite time in the future.[6]

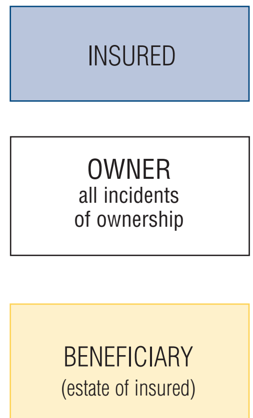
Footnotes on page 77

Death Proceeds WILL Be Included In Estate

A

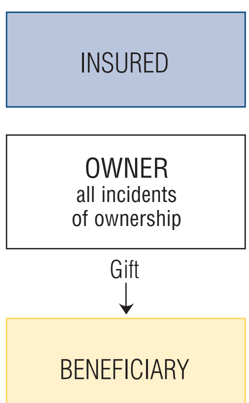


B



Death Proceeds WILL NOT Be Included In Estate

C



D

INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Obtain copies of all insurance policies.
2. Determine original applicant, owner, and beneficiary from photostat copy of application contained in policy.
3. Review endorsements that may reveal a subsequent change of owner or beneficiary.
4. Ascertain premium payor.

TRANSFER FOR VALUE

The following transfers of ownership will not violate the transfer for value rules:

1. A bona fide gift (as to another family member)is not considered to be a transfer for value.
2. Transfers for value to:
   a. the insured.
   b. a partner of the insured.
   c. a partnership in which the insured is a partner.
   d. a corporation in which the insured is a stockholder or an officer.
   e. a corporation from another corporation in a tax-free reorganization.
   f. a spouse.

Note: An expanded discussion of these rules is contained on pages 573-574.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 1. Basic discussion of the life insurance contract.
Q 10. Rules for taxing living proceeds of life insurance contracts.
Q 64. For death proceeds to be excludable from income, a life insurance policy must meet certain requirements.
Q 76. Circumstances under which death proceeds are included in insured's gross estate.
Q 77. Proceeds payable to estate are included in gross estate.
Q 80. Proceeds payable to beneficiary other than estate yet included in gross estate.
Q 81. "Incidents of ownership" which cause death proceeds to be included in estate.
Q 83. Incident of ownership as fiduciary will generally not cause death proceeds to be included in gross estate (but see Fifth Circuit position in text).
Q 91. Estate taxation of life insurance policy given away within 3 years of death.
Q 209. Policy owned by someone other than insured can result in gift if beneficiary is not also owner.
Q 264. Sale or other transfer for value will cause loss of income tax exemption for death proceeds.
Q 265. Transactions that constitute a "transfer for value."

Footnotes

[1] As property, the cash values of a life insurance policy are potentially subject to income taxes when there is a *withdrawal* from or *surrender* of the policy. However, when received, the cash values are taxed under the "cost recovery rules," meaning that such amounts are included in gross income only to the extent they exceed the investment in the policy (e.g., cash surrender values of $21,000 and total premiums of $15,000 would result in a $6,000 taxable gain, assuming no dividends and no prior distributions from the policy). A *loan* is not includable in income provided the policy is not a modified endowment contract. Distributions and loans from a modified endowment contract are taxed under different rules (see expanded discussion on pages 438-439).

[2] An incident of ownership includes the right to: (a) change the beneficiary; (b) surrender or cancel the policy; (c) assign the policy; (d) revoke an assignment; (e) pledge the policy for a loan; and (f) obtain a policy loan. Under Section 2035 if the insured owns a contract of insurance on his own life and then makes a *gift* of the policy to another, he would have to live *more than* 3 years before the proceeds would be excluded from his estate (see discussion on pages 405-406). However, if the policy were *sold* at fair market value to an irrevocable grantor trust, Section 2035 does not apply to a sale and the death proceeds payable to the trust would be excluded from his estate no matter when death occurred (this is often referred to as the "Swanson" Technique after a case holding that transfer to a grantor trust is a transfer to the insured). See also, the discussion of the grantor trust rules on page 414.

[3] As shown in Diagram "C" of the chart, *gift* tax consequences may result when owner and beneficiary are not the same (i.e., "non-parallel" owner and beneficiary and often referred to as the "Goodman Triangle"). However, when the deemed transfer of death proceeds occurs in a corporate setting, it can cause serious *income* tax problems when a contract owned by a corporation pays a death benefit to the widow of a stockholder. Payment of the death benefit will likely be non-deductible to the corporation and taxable as a *dividend* to the widow – despite the fact that under a different arrangement the payment could have qualified as a tax-free receipt of death proceeds. At best, the corporation could deduct the payment as a salary continuation expense, but the payment would be includable in the gross income of the estate or beneficiary as "income in respect of a decedent." See discussion on page 422.

[4] After numerous losses, including the *Leder*, *Headrick*, and *Perry* cases, the Internal Revenue Service issued an action on decision announcing it would no longer litigate the issue of whether life insurance proceeds are includable in the insured's estate, where the life insurance policy is procured by a third party at the instance of the insured, the insured pays the insurance premiums, and the insured dies within three years of procurement of the policy by the third person (i.e., the "beamed transfer" theory). For an expanded discussion, see Estate Taxation of Life Insurance, pages 405-406. Also see ownership and beneficiary arrangements on page 93.

[5] With the unlimited marital deduction the decedent spouse's estate may well be free of federal estate taxes, but substantial taxes may be levied at the surviving spouse's death. For this reason, if it is desired to reduce exposure to estate taxes, the spouse of the insured should *not* be owner and beneficiary of the policy. Where the spouse is both owner and beneficiary, the arrangement is often referred to as a "cross-owned policy" and the death benefit received upon the insured's death will *increase* the surviving spouse's estate. In order to shift these death benefits from one generation to another free of estate taxes, it may be advisable to have the policy owned by an adult child, or placed in a Life Insurance Trust, as described in the chart on page 51. See also the discussion of minors and life insurance on page 483.

[6] The underlying principles discussed in this chart are as applicable to the analysis of existing policies as they are to proposed new insurance coverage. With many new clients, some of the easiest, yet most effective, estate planning recommendations will come from a policy audit involving an analysis and restructuring of the ownership and beneficiary provisions of existing insurance. As to new insurance, it is important to be familiar with the requirement that an applicant have an insurable interest in the life to be insured (see expanded discussion, page 427). Life insurance proceeds payable to a C corporation are not necessarily free of income taxes (see Corporate Alternative Minimum Tax, pages 363-365. Also, for the death benefits to be income tax-free, employer-owned life insurance must meet strict notice and consent requirements (see Company Owned Life Insurance (COLI), pages 357-359).

LIFE INSURANCE PRODUCTS

TERM INSURANCE. If an estate plan is to be built on a solid foundation, life insurance protection is essential. Term insurance provides protection for a *limited* period of time for a younger person whose insurance needs must be met on a modest budget. However, the premium for this protection will usually increase, until it becomes prohibitively expensive for most people to maintain. While term insurance can provide a lot of protection for a lesser cost, it builds no cash values and has no permanent values. In this sense it has been described as "rented" but not "owned."[1]

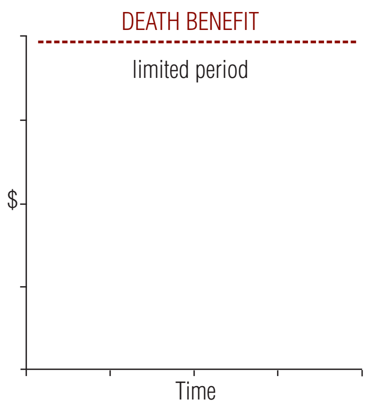
PERMANENT INSURANCE, in contrast to term insurance, provides for a tax-deferred build-up of cash values over the life of the contract.[2] This cash value element, combined with level or limited premium increases, means that the death benefit will be available for an *unlimited* period. While the outlay for permanent insurance is greater than term insurance in the early years, most plans provide for payment of a level premium. Even if the plan requires an increasing premium, these increases are usually limited in both amount and duration. Typically, both the cash values and the death benefits are guaranteed, unless they are dependent upon payment of projected dividends.[3]

UNIVERSAL LIFE INSURANCE offers flexible premium payments, an adjustable death benefit, and cash values that are sensitive to current interest rates.[4] Most contracts pay a *current interest rate* which is highly competitive with that available in the money market. However, these rates are subject to change and are not guaranteed over the life of the contract. The *guaranteed interest rate* is usually very modest and will likely result in a lapse of the policy if additional premiums are not paid. Likewise, most universal life policies offer lower *current (nonguaranteed) mortality* charges, but provided for higher *guaranteed mortality* charges. Taken together, the lower guaranteed interest rate and higher guaranteed mortality charges represent the "down-side risk" of a universal life contract. The policyholder is asked to accept this risk in return for the opportunity to receive the benefits of higher current interest rates and lower charges for the amount-at-risk element in the contract.[5]

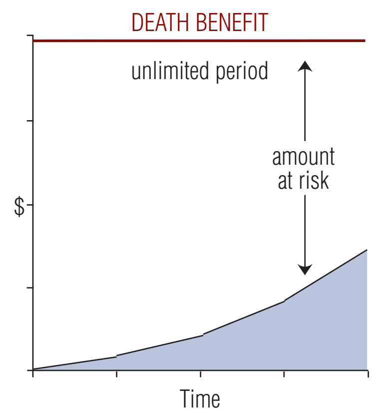
VARIABLE LIFE INSURANCE is similar to universal life insurance, except that the underlying cash values can be invested in an equity portfolio, typically a mutual fund or bonds.[6] The policy owner is usually given the opportunity to redirect his investment to another portfolio although some limitations and restrictions may be imposed.[7]

Footnotes on page 81

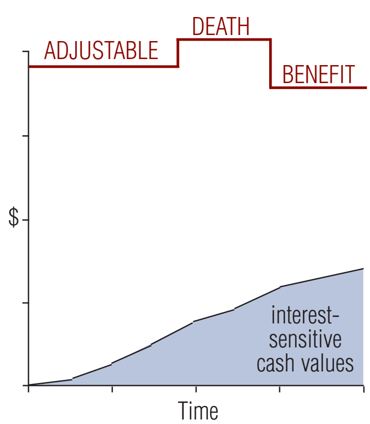
TERM LIFE INSURANCE
(increasing premium)



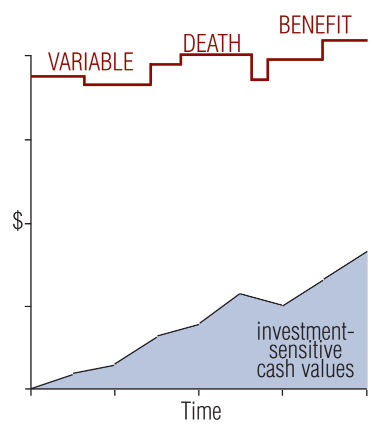
PERMANENT INSURANCE
(fixed premium)



UNIVERSAL LIFE INSURANCE
(flexible premium)



VARIABLE LIFE INSURANCE
(flexible premium)



INFORMATION REQUIRED FOR ANALYSIS & PROPOSAL

1. Name of individual to be insured.
2. Sex.
3. Date of birth.
4. Smoker/nonsmoker.

To Determine Type of Contract

5. Reasons for purchase – temporary vs. permanent need.
6. Funds available for purchase – term vs. permanent (cash value).
7. Attitude toward risk – suitability for variable life.
8. Income – suitability for variable life.
9. Net worth – suitability for variable life.

CROSS REFERENCES TO TAX FACTS ON INSURANCE & EMPLOYEE BENEFITS, VOL. 1 (2015)

Q 1. Basic discussion of the life insurance contract.
Q 2. Premiums for personal life insurance not deductible.
Q 8. Annual cash value increases generally not taxable income to policyholder.
Q 13. Taxation of distributions from policies classified as modified endowment contracts.
Q 36. Income tax consequences to seller of life insurance or endowment contract.
Q 43. Income tax consequences to purchaser of life insurance or endowment contract.
Q 44. When exchange of one contract for another is considered nontaxable.
Q 51. Income tax results when contract surrendered for cash values.
Q 54. Income taxation of an "accelerated death benefit."
Q 62. Death proceeds generally received free of income taxes.
Q 64. For death proceeds to be excludable from income, a life insurance policy must meet certain requirements.
Q 72. Income taxation of death proceeds of policy previously transferred for value.
Q 73. Income taxation of death proceeds of policy previously transferred as a gift.
Q 194. Estate taxation of life insurance policy that insures more than one life.
Q 206. Gift taxation of life insurance policy that insures more than one life.

Footnotes

[1] Term insurance is available in many forms, the most common being annual renewable, five-year renewable (and/or convertible), 10-year renewable and convertible (R&C), 15-year R&C, 20-year R&C, and term to a specific age, such as age 65. A specialized form of term insurance, decreasing term, is also available, and usually purchased to cover a decreasing loan or mortgage obligation. Term insurance can be tailored to fit almost any temporary insurance need – level, decreasing, or even increasing.

[2] Permanent life insurance is often called "whole life." This is because, so long as the policy remains in force, it provides protection for the "whole of life." The whole of life is assumed to be to age 100 under many mortality tables, although in recent years lesser ages have been used (i.e., age 90 or 95). If the insured lives to age 100, the policy endows with the cash values equaling the face amount of the policy.

[3] Both term and permanent insurance are available as *participating* policies, which offer the opportunity for dividends that may be used to: reduce the premium outlay; purchase paid-up additions (which accrue their own cash values); enhance the amount of available death benefit through a combination of one-year term insurance and paid-up additions (the fifth dividend option); or augment the cash values by being left to accumulate at interest.

[4] Universal life insurance has many unique features not found in traditional whole life policies. Most importantly, your client *controls* many aspects of the contract because of the built-in flexibility of the universal life policy. Specific features of universal life include:

a. An adjustable death benefit that may be increased or decreased to suit the obligations and needs of the insured (often subject to insurability if the death benefit is increased).

b. Tax-deferred current interest earnings on cash values.

c. Flexible premiums that allow changes in payments to suit individual needs (but see the discussion regarding life insurance premium limitations, pages 438-439).

[5] Interest-sensitive whole life is a hybrid between permanent (whole life) insurance and universal life insurance. It is also known as excess-interest whole life, current assumption whole life, irreplaceable life, pseudo universal life, fixed premium universal life, and adjustable cash value whole life. The product typically requires a fixed premium, and in return provides a *guaranteed* death benefit and minimum interest rates, and current higher nonguaranteed interest rates. Premiums are usually fixed, although additional funds can be "dumped" into the policy in order to vanish, or short pay, premiums. As with universal life, a surrender charge is often assessed when the contract is surrendered in the early years, although some contracts allow withdrawals of "excess" earnings. A "bailout feature" may be offered, which enables the policyholder to withdraw funds without penalty if the credited interest rate drops below a certain level.

[6] Variable life insurance is considered a fourth type of insurance, in that the death benefit and cash values reflect the performance of an underlying portfolio of equity investments, such as stocks and bonds. While these investments can provide a hedge against inflation, and the possibility for growth in both cash reserves and death benefits, there is also the risk that investment performance will be poor and that the cash reserves will decrease or be lost. Since variable life insurance is a security, the agent must hold a valid federal securities license (and state license where required) in order to sell the product. In addition, *a prospectus must be delivered* with or preceding a specific proposal to a prospect or client.

[7] In recent years, joint life insurance policies insuring multiple-lives have become popular for funding a variety of insurance needs (see First-To-Die Insurance, page 411, and Survivorship Life Insurance, page 566). Company owned life insurance (COLI) is used to fund a number of nonqualified benefits (pages 357-359). A table of comparative Insurance Company Ratings is set forth on page 442. See also, Life Insurance Default Risk, page 435.

DISCOUNTED DOLLARS

The death benefits of a life insurance contract are often referred to as "discounted," in the sense that payment of a relatively small yearly premium, from 1 to 5 percent of the death benefit, depending upon age and rating category, will guarantee that the full face amount will be available when needed.

In this sense, the purchase of life insurance is analogous to the *leverage* obtained by the individual who invests in property with a small down payment and a large mortgage. The investor expects to benefit from the future appreciation of an asset worth many times his cash investment, whereas payment of modest insurance premiums enables the insured to provide a substantial death benefit as security for his family.

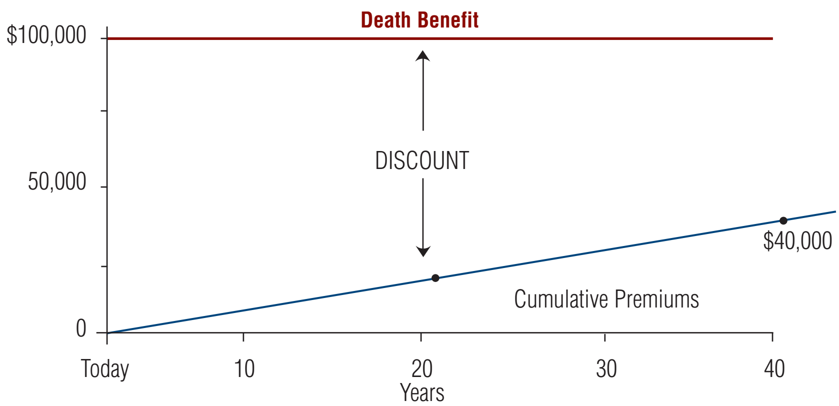
WITH INSURANCE, assume that a 35-year-old insured purchases $100,000 of level death protection for his family requiring an annual premium of $1,000 per year.[1] This purchase guarantees $100,000 of discounted dollars payable upon death at any time. The *discount* is represented by the difference between the death benefit and *cumulative premiums* paid.[2] After 20 years the discount would amount to $80,000 ($100,000 - $20,000). If our insured lives for 40 years and pays premiums totaling $40,000 there is still a discount of $60,000.[3]

WITHOUT INSURANCE, a surviving family might be forced to borrow in order to pay estate settlement costs. Repaying a 6 percent loan of $100,000 in 10 equal annual installments requires total payments of $135,870.[4] If the family were able to obtain a 40-year loan under the same terms, its total payments would be $265,880. However, it is unlikely that a surviving family would be able to borrow money at only 6 percent interest. A more realistic rate would probably be 12 percent, in which case the family's total repayments are more likely to be $176,990 over 10 years, or $485,240 over 40 years.

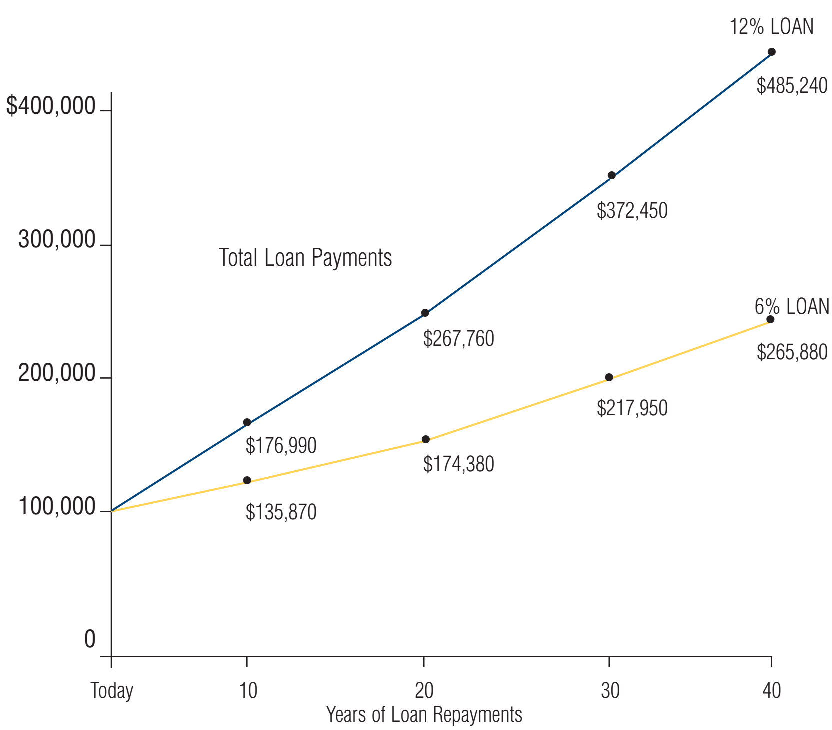
Paying estate settlement costs with the discounted dollars of life insurance is far better than putting a surviving family in the position of having to borrow large sums of money at high rates of interest. Most families would find it far easier to pay premiums totaling $40,000 over a 40-year period than to make loan repayments of $485,240 over a similar period of time.[5] Properly arranged, the discounted dollars provided from a life insurance contract will be received untouched, untaxed, and on time: **untouched** in that they are paid directly to the beneficiary; **untaxed** in that they are free of income and estate taxes; and **on time** in that they are paid when needed, whenever death occurs.[6]

Footnotes on page 85

WITH LIFE INSURANCE



WITHOUT LIFE INSURANCE



WHY LIFE INSURANCE?

Estate and business continuation plans are only as good as the financial arrangements that support them. The cash for estate settlement costs must come from somewhere. The family must have the cash sooner or later, since everyone is going to die. The only question is when.

There are three ways to pay these estate settlement costs:

(1) *From Estate Resources – the 100% method*. But in most cases the estate will not have sufficient liquid assets. Even when the costs can be paid by selling estate assets, the family pays 100-cent dollars from the decedent's hard-earned and hard-taxed estate. Under the Insurance Plan, the family pays the costs with discounted dollars – discounted to the extent that the cumulative premiums paid will likely be far less than the insurance proceeds received by the family.

(2) *By Borrowing the Money – the 100%+ method*. But the credit standing of the family could be affected by the decedent's death. Changing economic trends also influence a lender's decisions about making loans. By borrowing, the family is obligated to pay interest as well as to pay back the principal. Under the Insurance Plan, the borrower pays the equivalent of 1 to 5 percent interest during his life and his family never has to worry about paying back the principal.

(3) *The Insurance Plan – the discounted dollars method*. This is the only funding device that will guarantee a definite sum of money to be available at an indefinite time in the future. The cost of that money will be only a few cents on the dollar when death occurs in the early years of the contract, and may involve a substantial discount even when death does not come for many years. Furthermore, this money will be income tax-free to the family, since the death proceeds of life insurance are received free of federal income tax.

Footnotes

[1] This example assumes the purchase of a non-participating permanent contract. If participating insurance were illustrated, the premium might be higher, but dividends would likely be available. If the dividends were used to *reduce* premiums, the "cumulative premiums" would increase at a decreasing, or slower, rate. If the dividends were used to buy *paid-up additions* (the fifth dividend option), the "death benefit" would not be level, but would increase from year to year. If the dividends were used to purchase *term insurance*, then the "death benefit" would also increase, but at a much faster rate, until the age at which the term coverage was no longer available. At this point, the coverage in excess of the basic amount initially issued would terminate.

[2] The *cash values* of the contract have intentionally not been mentioned. The concept of discounted dollars involves only the *cumulative* premium payments relative to the death benefit payable. However, under many circumstances, cumulative cash values will exceed total payments in the later years of the contract, depending upon the product, the age of the insured at the time of issue, and the rating. The term "discounted dollars" should *not* be used in discussing the cost of a life insurance policy. In this regard, see the discussion of the interest adjusted net cost method on page 427.

[3] The actual life expectancy for a 35-year-old male is 43.05 years. For other average future life spans, see the Commissioners 2001 Standard Ordinary Mortality Table (page 591).

[4] From the Amortization Table on page 602, it can be seen that a loan of $1,000 for 10 years at 6 percent interest requires annual payments of $135.87. Therefore, annual payments for a $100,000 loan would be $13,587 (100 × $135.87).

[5] This chart also demonstrates the benefits of *insuring existing liquidity* in an estate. For example, if $100,000 of estate liquidity were preserved for the surviving family, and amortized over 10 years at only 6 percent, they would receive $35,870 of interest income over that period. If they were able to amortize this same $100,000 over 10 years at 12 percent, they would receive $76,990 of interest income. Amortizing the $100,000 at 12 percent for longer periods of 20 and 30 years would yield total interest income of $167,760 and $272,450. Actually, these figures would be higher if the family reinvests the original $100,000 as it is repaid to them. The purchase of discounted dollars will assure that this existing liquidity is preserved. Over 20 years, your client would pay cumulative premiums of $20,000. On the other hand, if your client died, the preserved liquidity would provide at least $167,760 of interest income for the family, if amortized at 12 percent over the same 20-year period.

[6] Life insurance proceeds payable to a C corporation are not necessarily free of income taxes. For an expanded discussion, see Corporate Alternative Minimum Tax, pages 363-365. With a living benefits rider it has become possible for the death benefit to be paid prior to death if the insured has a terminal illness that is expected to result in death within twelve months (see page 329).

CHECKLIST OF DOCUMENTS

	Check As Obtained
1. Wills – client	❏
– spouse	❏
2. Trust Agreements	❏
3. Life Insurance Policies – client	❏
– spouse	❏
4. Medical Insurance Policies	❏
5. Disability Income Policies	❏
6. Personal Balance Sheet (or similar listing of cash, securities, real estate, personal effects, mortgages and other liabilities)	❏
7. Business Balance Sheets	❏
8. Business Profit and Loss Statements	❏
9. Business Disposition Agreements (buy/sell agreements, partnership agreements, etc.)	❏
10. Employee Benefits (retirement plans, stock options, deferred compensation, etc.)	❏
11. Income Tax Return (most recent)	❏
12. Gift Tax returns	❏
13. Dates of Birth (of family members)	❏
14. Other: ________________________________	
________________________________	
________________________________	
________________________________	
________________________________	

Date of Meeting: ______________________________

Time: ______________________________

Place: ______________________________

GIFT TAX CALCULATION STEPS

Gross Value of Current Gift(s)	$______
Less: 50% of Gift if Split-Gift(s)	(______)
Annual Exclusion[1]	(______)
Marital Deduction[2]	(______)
Charitable Deduction[2]	(______)
Current Taxable Gift(s)	$______
Plus: Sum of All Prior Taxable Gifts	______
Total Cumulative Taxable Gifts	$______
Tax on Total Cumulative Taxable Gifts[3]	$______
Less: Taxes Paid on Prior Taxable Gifts	(______)
Tentative Tax	$______
Less: Unified Credit	(______)
Gift Tax Payable[4]	$______

ESTATE TAX CALCULATION STEPS

Gross Estate	$______
Less: Debts of Decedent	(______)
Administration Expenses	(______)
Losses during Administration	(______)
Adjusted Gross Estate	$______
Less: Marital Deduction[2]	(______)
Charitable Deduction[2]	(______)
State Death Tax Deduction	(______)
Taxable Estate	$______
Plus: Adjusted Taxable Gifts	______
Computation Base	$______
Tentative Tax[3]	$______
Less: Post-1976 Gift Taxes Payable	(______)
Unified Credit	(______)
Pre-1977 Gift Tax Credit	(______)
Foreign Death Tax Credit	(______)
Credit for Tax on Prior Transfers	(______)
Estate Tax Payable[5]	$______

1 See page 46 for details regarding the gift tax annual exclusion.

2 Full value of property passed to spouse or charity may be taken as a deduction.

3 See page 586 for estate and gift tax rates.

4 Transfer taxes payable during life may also include the generation-skipping transfer tax.

5 Transfer taxes payable at death may also include the generation-skipping transfer tax (see chart, page 39).

HISTORY OF THE FEDERAL ESTATE TAX[1]

The long and tortured history of the federal estate tax.

1797 – The first federal "estate" tax was passed to help fund a naval buildup. This was actually a stamp duty on legacies and intestate shares of personalty, and was not effective until 1798. The tax was 25¢ on a share over $50 and under $100, 75¢ on a share between $100 and $500, plus $1 per additional $500 share, or portion thereof.

1802 – The stamp tax was repealed.

1862 – To help fund the Civil War, Congress imposed a legacy tax on personalty if personal estate exceeded $1,000 (share of spouse was exempt) and a stamp tax on probates of wills and letters of administration (from 50¢ to $20 for estates up to $150,000, with $10 more for each additional $50,000, or fraction thereof).

1864 – The legacy tax was increased and a succession tax on realty was added, ranging from 1% to 6% on the basis of relationship to the deceased.

1870 – The legacy succession tax was repealed.

1872 – The stamp tax was repealed.

1894 – At the beginning of the Spanish-American War, a 2% "income" tax was imposed upon "money and value of all personal property acquired by gift or inheritance."

1898 – The rates were changed, and ranged from .75% to 2.25%, but estates under $10,000 were exempt (as well as legacies to surviving spouses).

1902 – The "income" tax was repealed.

1916-21 – The modern estate tax was enacted, followed by a succession of changes. Initially, there was an exemption of $50,000, and the rates ranged from 1% on the first $50,000, to 10% on estates over $5 million. Thereafter, the 1% rate increased to 1.5%, then to 2%; and the 10% rate increased to 15%, then to 25% (on estates over $10 million).

1924 – The gift tax was imposed, a state credit was allowed, and the estate tax was increased on all taxable estates over $100,000 (estates over $10 million were taxed at 40%).

1926 – The gift tax was repealed, the exemption was raised from $50,000 to $100,000, and the 1924 rates were retroactively removed. As a result, $250 million was refunded to just seven estates, while other estates received lesser refunds.

1931 – The exemption was reduced from $100,000 to $50,000, and rates were more than doubled.

1932 – For estates over $1 million, the maximum rate was increased from 19% to 45%.

1934 – For estates over $10 million, the maximum rate was increased to 60%.

1935 – The exemption was further reduced to $40,000, and the rates were increased to 2% on the first $10,000 bracket, and increased to 70% on amounts over $50 million.

1940 – To help finance World War II, a "temporary" defense tax increased estate taxes 10%.

1941 – The progressive rates were increased, and the "temporary" defense tax became permanent. The rates were increased to 3% on the first $5,000 bracket, and increased to 77% on amounts over $10 million.

1981-99 – During this 19-year period, no less than 126 new estate tax laws were enacted (an average of seven per year).[2]

2001 – EGTRRA 2001 repeals the estate tax for the year 2010.

2010 – The 2010 Tax Relief Act reinstates the estate tax with an increased exemption of $5 million and a maximum rate reduced to 35% (for the years 2011 and 2012). Estates of 2010 decedents may opt for repeal of estate tax in favor of modified carryover basis.

2012 – The American Taxpayer Relief Act of 2012 makes permanent the $5 million exemption (indexed for inflation after 2011) and portability of any unused exemption to a surviving spouse. The top estate tax rate is increased from 35% to 40%.

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[1] Portions of this history have been compiled from an exhaustive work by Louis Eisenstein, contained in "The Rise and Decline of the Estate Tax," Tax Law Review, 1956, pages 223-259.

[2] See, Hal Graff, "Estate Tax Law Changes: More Sales Opportunities for Financial Advisors," Journal of Financial Service Professionals, July 2001, page 87.

TYPICAL ESTATE DEBTS, COSTS, AND TAXES

GROSS ESTATE	DEBTS AND LIABILITIES	+	PROBATE COSTS	+	STATE TAX	=	TOTAL EXPENSES
100,000	5,600		5,000		1,700		12,300
200,000	10,600		9,900		4,400		24,900
300,000	15,600		14,700		6,000		36,300
400,000	20,400		19,600		11,000		51,000
500,000	25,000		22,500		16,600		64,100
600,000	29,400		26,880		21,400		77,680
700,000	33,600		31,220		26,700		91,520
800,000	37,600		35,520		32,600		105,720
900,000	41,400		39,780		38,900		120,080
1,000,000	45,000		44,000		45,800		134,800
1,500,000	62,250		65,250		71,800		199,300
2,000,000	84,000		86,000		100,000		270,000
3,000,000	120,000		126,000		180,000		426,000
4,000,000	154,000		164,000		260,000		578,000
5,000,000	185,000		200,000		350,000		735,000

Explanation of Table. Debts and Liabilities are calculated on a descending scale from 5.6 to 3.7 percent and Probate Costs on a descending scale from 5.0 to 4.0 percent. Both reflect actual government studies involving estates of various sizes. Specific debts, costs, and taxes will differ from those illustrated.

STATE EXEMPTIONS FOR LIFE INSURANCE

The following states, unless otherwise noted, completely exempt from taxation insurance proceeds payable to a named beneficiary, provided the named beneficiary is not the insured's estate. Because of the many variations among state laws, it is recommended that the specific statute be reviewed when developing an individual's estate plan.

Indiana	Nebraska
Iowa	New Jersey
Kentucky	Ohio
Maryland	Pennsylvania[1]

[1] All proceeds are exempt, including those paid to estate.

STATE INHERITANCE AND ESTATE TAXES[1]

The following states have a separate estate tax.

Connecticut	Massachusetts	Rhode Island
Delaware	Minnesota	Tennessee
Illinois	New Jersey	Vermont
Maine	New York	Washington
Maryland	Oregon	

The following states have an inheritance tax.

~~Indiana~~	Maryland	New Jersey
Iowa	Nebraska	Pennsylvania
Kentucky		

COMMUNITY PROPERTY STATES[2]

In the following states, community property laws govern the ownership of property between husband and wife.

Alaska[3]	Louisiana	Texas
Arizona	Nevada	Washington
California	New Mexico	Wisconsin
Idaho		

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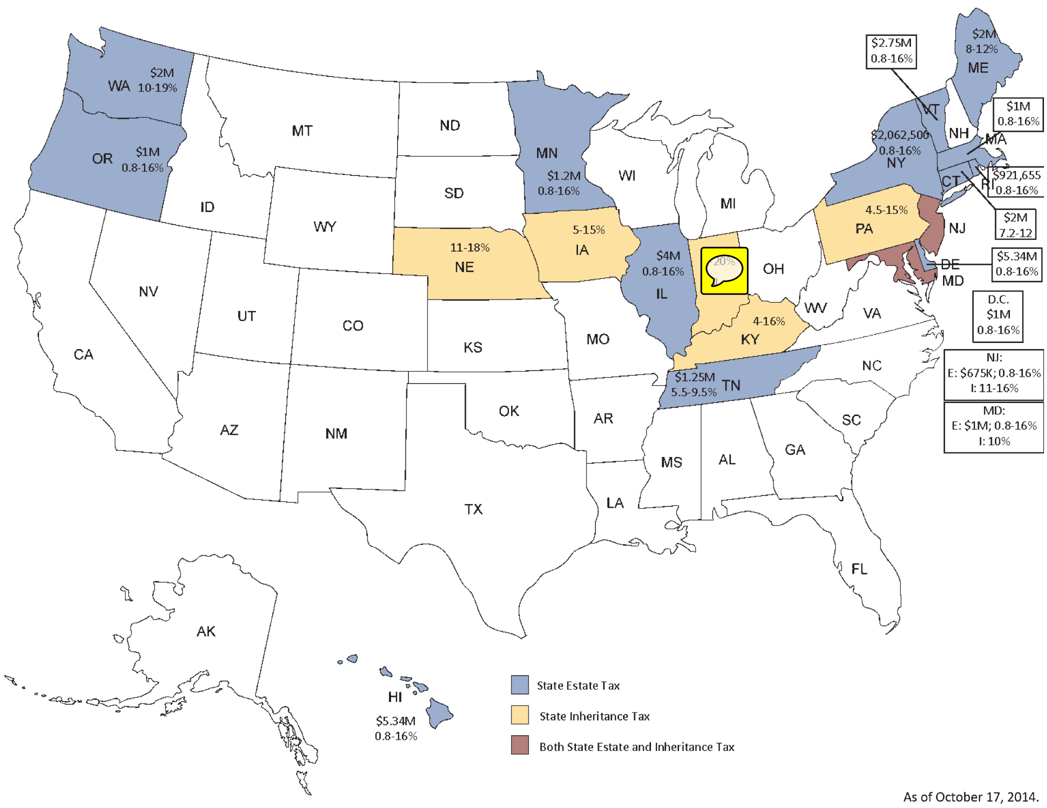
[1] Last researched: October, 2014.

[2] Community property is discussed on pages 355-356.

[3] In Alaska, a married couple must opt into the community property system.

STATE INHERITANCE TAX MAP



As of October 17, 2014.

INFLATION ADJUSTER

Additional Life Insurance Required in ~~2014~~
to Keep Up with Inflation

Year Policy	Death Benefit of Original Life Insurance Policy				
Purchased	50,000	100,000	250,000	500,000	1,000,000
2013	750	1,500	3,750	7,500	15,000
2012	1,200	2,400	6,000	12,000	24,000
2011	2,838	5,677	14,192	28,384	56,768
2010	3,684	7,368	18,419	36,838	73,676
2009	3,469	6,938	17,345	34,691	69,382
2008	5,501	11,002	27,505	55,009	110,018
2007	7,055	14,110	35,275	70,549	141,099
2006	8,881	17,761	44,403	88,807	177,614
2005	10,883	21,765	54,413	108,826	217,653
2004	12,526	25,053	62,632	125,265	250,529
2003	13,965	27,929	69,823	139,646	279,291
2002	14,988	29,976	74,940	149,880	299,760
2001	16,808	33,615	84,038	168,077	336,153
2000	19,079	38,158	95,396	190,791	381,583
1999	20,599	41,198	102,994	205,989	411,977
1998	21,728	43,457	108,642	217,285	434,569
1997	23,378	46,756	116,891	233,782	467,564
1996	25,580	51,159	127,898	255,796	511,591
1995	27,696	55,392	138,479	276,958	553,916
1994	29,716	59,432	148,579	297,159	594,317
1993	32,107	64,215	160,537	321,073	642,147

Explanation: This table shows the amount of additional insurance required to maintain a given purchasing power. For example, if $100,000 of insurance had been purchased in 2002, then an additional $31,539 of insurance would have to be available to provide the same purchasing power in 2013 (i.e., what $100,000 would have purchased in 2002 will require $131,539 in 2013). All calculations are based upon the CPI figures set forth on page 317.

OWNERSHIP AND BENEFICIARY ARRANGEMENTS

	Advantages	Disadvantages
POLICY OWNER		
Insured	Insured retains control of policy and owns cash values. See page 74.	Proceeds subject to estate tax. Policy transferred within 3 years also included in estate.
Spouse of Insured	Simple to arrange. Insured retains indirect control of policy (provided marriage stable). See footnote 5, page 77.	If spouse predeceases insured, policy ownership could return to insured (by will, intestacy laws, or policy provisions). Proceeds not given away or consumed included in spouse's estate.
Children of Insured	Simple to arrange. Not taxed in estate. No costs to establish. See page 483.	Insured loses control of policy (or never had control if children were applicants). If children minors, must have legal guardian appointed before proceeds paid (time consuming and costly).
Irrevocable Trust	Proceeds not subject to estate tax. Continued maintenance of policy if insured becomes incompetent. See page 50.	Insured does not control policy and cannot change or revoke trust. Costs to establish and trustee fees after death.
POLICY BENEFICIARY		
Individual – paid as lump sum	Simple to arrange. No costs to establish or collect proceeds. No delay in payment of death benefit. In the case of a minor beneficiary if the beneficiary designation includes a custodial nomination, the proceeds can be transferred to a custodian without appointing a guardian.	Control of proceeds by beneficiary may lead to loss of funds or refusal to make proceeds available to pay settlement costs and taxes.
Individual – paid under settlement option	Simple to arrange. No costs to establish or collect proceeds. Funds remaining with carrier are secure.	Not flexible, insurance company must pay under original option despite beneficiaries changing circumstances. Proceeds not available to pay estate settlement costs and taxes.
Estate of Insured	Simple to arrange. No costs to establish or collect proceeds. Provides liquidity to estate.	Proceeds subject to estate tax and claims of creditors, as well as increasing probate costs.
Irrevocable Trust	Flexible, trust can give trustee broad authority to pay or withhold benefits, provide for successor beneficiaries, and make proceeds available for settlement costs. Provides professional management and investment advice. Not subject to claims of creditors.	Time consuming to establish. Initial costs for drafting of trust and trustee fees after funded by death benefit. Must coordinate with remainder of estate plan.

SURVIVOR CHECKLIST

Check As
Accomplished

1. Request 10 copies of death certificate (funeral director will assist). ❑
   Deceased's date of birth: ____ .
2. Contact employer regarding group insurance and other benefits. ❑
3. Contact insurance companies (auto, life, and health). Have policy numbers available. ❑
4. If deceased was a government retiree or employee, contact Civil Service Personal Management Office (1-888-767-6738: www.opm.gov). ❑
5. If deceased was retired from the military, contact Defense Finance and Accounting Service (1-800-321-1080: www.dfas.mil). ❑
6. If deceased was a veteran, contact Veterans Administration (1-800-827-1000: www.va.gov/survivors). ❑
7. Notify Social Security Administration (1-800-772-1213: www.ssa.gov). ❑
   Deceased's Social Security number: ____________________________ .
   Spouse's Social Security number: ____________________________ .
8. Check items in safe deposit box. ❑
9. Locate Last Will and Testament and Trust documents. ❑
10. Notify banks and stock brokerage companies. ❑
11. Contact credit card companies and other charge accounts. ❑
12. Check on credit life insurance with all creditors. ❑
13. Locate personal balance sheet (or similar listing of cash, securities, real estate, personal effects, mortgages, and other liabilities). ❑
14. Locate business disposition agreements (buy/sell agreements, partnership agreements, etc.). ❑
15. Call attorney and arrange for meeting to discuss probate and other matters: ____. ❑
16. As time for filing tax return approaches – call accountant, CPA, or tax preparer. ❑
17. Other: ____ ❑
   ____

EVALUATING THE RISK OF DEATH

One Individual

The following tables provide the odds of death within the next 10 and 20 years for an individual according to age and sex. For example, a male age 38 has a 2.1 percent chance of dying within the next 10 years and a 7.0 percent chance of dying within the next 20 years; whereas a female age 38 has a 1.6 percent chance of dying within the next 10 years and a 5.6 percent chance of dying within the next 20 years.

Odds Of Death Within 10 Years

Age	Male	Female
21	1.1	0.6
22	1.1	0.6
23	1.1	0.6
24	1.1	0.6
25	1.1	0.7
26	1.1	0.7
27	1.2	0.8
28	1.2	0.8
29	1.2	0.9
30	1.2	0.9
31	1.3	1.0
32	1.4	1.1
33	1.4	1.1
34	1.5	1.2
35	1.7	1.3
36	1.8	1.4
37	2.0	1.5
38	2.1	1.6
39	2.3	1.7
40	2.5	1.9
41	2.7	2.1
42	2.9	2.3
43	3.2	2.5
44	3.5	2.7
45	3.8	3.0
46	4.1	3.3
47	4.5	3.7
48	4.9	4.1
49	5.4	4.5
50	5.9	4.9
51	6.5	5.4
52	7.1	5.9
53	7.9	6.4
54	8.7	7.0
55	9.6	7.6
56	10.5	8.2
57	11.6	8.9
58	12.7	9.6
59	13.9	10.3
60	15.2	11.1
61	16.5	12.0
62	18.0	13.0
63	19.6	14.0
64	21.3	15.1
65	23.1	16.4

Odds Of Death Within 20 Years

Age	Male	Female
21	2.4	1.6
22	2.4	1.6
23	2.5	1.7
24	2.6	1.8
25	2.8	2.0
26	2.9	2.1
27	3.1	2.2
28	3.3	2.4
29	3.5	2.6
30	3.7	2.8
31	4.0	3.0
32	4.3	3.3
33	4.6	3.6
34	5.0	3.9
35	5.4	4.3
36	5.8	4.7
37	6.4	5.1
38	7.0	5.6
39	7.6	6.1
40	8.3	6.7
41	9.0	7.3
42	9.9	8.0
43	10.8	8.7
44	11.8	9.5
45	13.0	10.3
46	14.2	11.2
47	15.5	12.2
48	17.0	13.2
49	18.5	14.3
50	20.2	15.5
51	21.9	16.7
52	23.8	18.1
53	25.9	19.5
54	28.1	21.1
55	30.4	22.7
56	32.9	24.5
57	35.6	26.4
58	38.4	28.4
59	41.4	30.5
60	44.6	32.8
61	48.0	35.3
62	51.5	37.9
63	55.2	40.8
64	58.9	43.8
65	62.6	47.0

Source: Calculations are based upon the Commissioners 2001 Standard Ordinary Mortality Table.

(continued on next page)

EVALUATING THE RISK OF DEATH (continued)

Two Individuals

The risk of *at least one of two individuals* dying is substantially greater than the risk of one individual dying. For example, within the next 10 years the risk of a male age 50 dying is 5.9 percent and the risk of a female age 45 dying is 3.0 percent (see page 95, Evaluating The Risk Of Death - One Individual); but the risk of at least one of them dying within the next 10 years is 8.7 percent. And this risk increases considerably with time (i.e., for a male age 50 and a female age 45 the risk of at least one of them dying within the next 20 years increases to 28.4 percent).

Odds Of At Least One Death Within 10 Years

Female Age \ Male Age	20	25	30	35	40	45	50	55	60	65
20	1.6	1.7	1.8	2.2	3.1	4.3	6.4	10.1	15.6	23.5
25	1.8	1.8	1.9	2.3	3.2	4.4	6.5	10.2	15.7	23.6
30	2.0	2.1	2.2	2.6	3.4	4.7	6.8	10.4	15.9	23.8
35	2.3	2.4	2.5	2.9	3.8	5.0	7.1	10.7	16.2	24.1
40	2.9	3.0	3.1	3.5	4.4	5.6	7.7	11.3	16.7	24.5
45	4.1	4.1	4.2	4.6	5.5	6.7	8.7	12.3	17.7	25.4
50	5.9	6.0	6.1	6.5	7.3	8.5	10.5	14.0	19.3	26.9
55	8.6	8.6	8.7	9.1	9.9	11.0	13.0	16.4	21.6	28.9
60	12.1	12.1	12.2	12.6	13.4	14.5	16.4	19.6	24.6	31.6
65	17.3	17.3	17.4	17.8	18.5	19.5	21.3	24.4	29.1	35.7

Odds Of At Least One Death Within 20 Years

Female Age \ Male Age	20	25	30	35	40	45	50	55	60	65
20	3.7	4.2	5.2	6.8	9.6	14.2	21.3	31.5	45.4	63.2
25	4.2	4.7	5.6	7.2	10.1	14.7	21.7	31.8	45.7	63.4
30	5.0	5.5	6.4	8.0	10.8	15.4	22.4	32.4	46.1	63.7
35	6.5	6.9	7.8	9.4	12.2	16.7	23.6	33.4	47.0	64.2
40	8.8	9.3	10.2	11.7	14.4	18.8	25.5	35.1	48.3	65.1
45	12.4	12.8	13.7	15.2	17.8	22.0	28.4	37.6	50.3	66.5
50	17.4	17.8	18.6	20.0	22.5	26.4	32.5	41.2	53.2	68.4
55	24.5	24.9	25.6	26.9	29.1	32.7	38.3	46.2	57.2	71.1
60	34.4	34.7	35.3	36.4	38.4	41.5	46.4	53.3	62.8	74.9
65	48.2	48.5	49.0	49.8	51.4	53.9	57.7	63.1	70.6	80.2

Source: Calculations are based upon the Commissioners 2001 Standard Ordinary Mortality Table.

FACTS ABOUT ...

Facts About Fathers

Father's Age When Child Is Born	Fathers Who Will Die Before Child Enters College	Graduates
25	1 in 43	1 in 30
30	1 in 33	1 in 22
35	1 in 23	1 in 15
40	1 in 15	1 in 10

Facts About Mothers

Mother's Age When Child Is Born	Mothers Who Will Die Before Child Enters College	Graduates
25	1 in 61	1 in 43
30	1 in 44	1 in 29
35	1 in 29	1 in 19
40	1 in 19	1 in 12

Facts About Children

The Cost of Raising a Child to Age 18

Family Income	Costs
less than $61,530	$176,550
$61,530 - $106,540	245,340
more than $106,540	407,820

The Annual Costs of a College Education

Year	Amount
2015	~~$37,848~~
~~2018~~	~~48,305~~
2025	~~61,651~~
2030	~~78,684~~

Source of facts about fathers and mothers: Calculations based upon the Commissioners 2001 Standard Ordinary Mortality Table (see pages 591-592), and assume that the child enters a 4-year college at age 18.

Source of costs of raising a child to age 18: U.S. Department of Agriculture, Expenditures on Children by Families, 2013, Table 1;Calculations based upon data from the 2005-06 Consumer Expenditure Survey updated to 2013 using the Consumer Price Index table on page 317. College costs are not included.

Source of the annual costs of a college education: Author research of college Internet sites during the month of December 2014, supplemented by direct inquiry when required. College costs are for the 2014-2015 year, and are based upon a representative sampling of 42 state and private colleges in 39 states (see page 101). Projections are based upon cost increases of 5 percent per year. In recent years actual college costs have increased more than 5 percent.

(continued on next page)

FACTS ABOUT … (continued)

Facts About The Value Of An Education

Having an education will often determine the economic opportunities available over a lifetime. Persons with a bachelor's degree or more on the average earn 3 times more than those who have completed less than 9th grade, and 2 times more than those who have completed only high school.

	Median Annual Income		
	Less than 9th grade	High school graduate	Bachelor's degree or more
Men	$32,385	$44,803	$81,066
Women	21,644	34,951	57,242

Facts About Funerals

According to the last available survey conducted by the National Funeral Directors Association, in 2001 the average adult funeral cost $6,130. Updated by the consumer price index this would cost $7,944 in 2014. However, the ultimate costs will depend upon the specific items and services.

Item/Service	Cost
Professional service charges	$1,213
Embalming	420
Other preparations (Cosmetology, hair, etc.)	150
Visitation/Viewing	275
Funeral at Funeral Home	350
Transfer of remains to funeral home	154
Hearse (local)	185
Service Car/Van	85
Acknowledgement cards	18
Casket	2,330
Vault	950
Total	$6,130

Source of Facts About The Value Of An Education: U.S. Census Bureau, Current Population Survey, 2014 Annual Social and Economic Supplement Table PINC-04, Educational Attainment-People 18 Years Old and Over, by Total Money Earnings in 2013, Age, Race, Hispanic Origin, and Sex (at www.census.gov/hhhes/www/cpstables/032014/perinc/pinc04_000.htm).

Source of Facts About Funerals: The National Funeral Directors Association. These costs do not include cemetery charges, such as a grave space, opening and closing grave, crypts and mausoleum, monument or marker.

FACTS ABOUT … (continued)

Facts About The Cost Of Child Care

According to the U.S. Census Bureau weekly child care expenses in the year 1999 averaged $94 per week ($4,888 per year) for children under age 5 and $75 per week ($3,900 per year) for children age 5 to 14. As adjusted in ~~2015~~ for inflation, this would be $131 per week ($6,834 per year) for children ~~aged 5-14.~~

According to the Children's Defense Fund in the year 2000 for a 4-year-old child:

(1) In *rural* child care centers annual costs ranged from $3,574 in Nebraska to $9,997 in Alaska (from $3,574 to $9,997 in 2014 as adjusted for inflation).

(2) In *urban* child care centers annual costs ranged from ~~$5,014~~ in Arkansas to ~~$9,997~~ in Massachusetts (from $5,089 to ~~$10,851~~ in 2014 as adjusted for inflation). In all states but Vermont, the cost of child care in an urban area center was more than the cost of public college tuition (in over one-quarter of states the average cost of child care was more than *twice* the cost of public college tuition).

Facts About The Value Of A Homemaker

In valuing a homemaker's services two basic methods are used. The "opportunity cost" method seeks to determine the wages that homemakers might have demanded had they opted to follow an alternate career (e.g., a full-time homemaker who is a trained nurse has foregone a nurse's salary). Under the "replacement cost" method, also called the "market alternative" method, valuation is based upon the prevailing wage rates for similar services, taking into consideration the time spent on each task and the wage rates paid for similar jobs in the marketplace, such as:

	Hourly Wage		Hourly Wage
Maid	$ 10.64	Private Household Cook	$ 13.15
Dishwasher	9.22	Lodging Manager	26.83
Child Care Worker	10.33	Concierge	14.39
Interior Designer	26.06	Taxi Driver	12.12
Teacher's Assistant	14.05	Licensed Practical Nurse	20.63
Recreation Worker	12.29	Nonfarm Animal Caretaker	10.82

Source of Facts About The Cost Of Child Care: U.S. Census Bureau, PPL Table 6 (Average Weekly Child Care Expenditures by Employed Mothers), revised to January 2014; and *The High Cost of Child Care Puts Quality Care Out of Reach for Many Families*, Children's Defense Fund, 2000, revised to January 2014.

Source of Facts About The Value Of A Homemaker: Bureau of Labor Statistics, Washington, D.C., National Occupational Employment and Wage Estimates using Standard Occupational Classification (SOC) system, May 2013. See http://www.bls.gov/oes/current/oes_nat.htm. Hourly wage of a teacher's assistant is estimated by dividing average annual wage of $25,570 by assumed 1,820 annual hours.

FACTS ABOUT … (continued)

Facts About Human Life Value in the Courtroom

A study of wrongful death case files selected at random revealed the following:

- The average amount of loss was $1,290,000 but the amount of life insurance was only $302,308.
- The average percent of the families' losses covered by life insurance was only 28 percent.
- Only 15.3 percent of the families had more than 50 percent of their loss covered by life insurance.
- Only 53.8 percent of families had more than 25 percent of their loss covered by life insurance.
- The largest percentage of any one family's loss covered by life insurance was 65 percent.

Note: Those cases which contained no life insurance were excluded from the study. The life insurance amounts are net of accidental death benefits and credit card related benefits.

Source of *Facts About Human Life Value in the Courtroom*: Study conducted in 1996 by Litigation Analytics Inc. of Ridgefield, Connecticut, as reported by John E. Scarbrough, PhD, in "Measuring Human Life Value From the Courtroom to the Living Room," *Journal of the American Society of CLU and ChFC* (January 1998), page 68.

COLLEGE COSTS PROJECTED

Yearly Tuition, Fees, Supplies, Room & Board

NAME OF INSTITUTION	LOCATION	Assuming Increases of 5% Per Year 2015	2020	2025	2030
Auburn University	Auburn, Ala.	23,578	30,092	38,406	49,017
Bowdoin College	Brunswick, Maine	59,568	76,026	97,030	123,838
Brigham Young University	Provo, Utah	23,484	29,972	38,253	48,822
Bucknell University	Lewisburg, Pa.	60,140	76,756	97,962	125,027
The Citadel	Charleston, S.C.	26,374	33,661	42,960	54,830
Colorado State University	Ft. Collins, Colo.	21,440	27,363	34,924	44,572
Columbia College	New York, N.Y.	61,962	79,081	100,930	128,815
Dartmouth College	Hanover, N.H.	63,213	80,678	102,967	131,415
De Paul University	Chicago, Ill.	38,135	48,671	62,118	79,280
Drake University	Des Moines, Iowa	41,516	52,986	67,625	86,309
Duke University	Durham, N.C.	63,530	81,082	103,484	132,074
Emory University	Atlanta, Ga.	59,052	75,367	96,189	122,765
Florida State University	Tallahassee, Fla.	17,720	22,616	28,864	36,389
George Washington Univ.	Washington, D.C.	62,085	79,238	101,130	129,070
Hamline University	St. Paul, Minn.	45,492	58,061	74,102	94,575
Harvard College	Cambridge, Mass.	59,807	76,331	97,419	124,334
Jackson State University	Jackson, Miss.	14,228	18,159	23,176	29,579
Kansas State University	Manhattan, Kans.	17,500	22,335	28,506	36,381
Loyola University Chicago	Chicago, Ill.	47,280	60,343	77,014	98,292
Marquette University	Milwaukee, Wis.	46,930	59,896	76,444	97,564
Michigan State University	E. Lansing, Mich.	24,264	30,968	39,523	40,443
Middlebury College	Middlebury, Vt.	60,160	76,781	97,994	125,068
Ohio State University	Columbus, Ohio	21,703	27,699	35,352	45,119
Oral Roberts University	Tulsa, Okla.	34,178	43,621	55,672	71,054
Purdue University	W. Lafayette, Ind.	21,242	27,111	34,601	44,161
Rutgers College	New Brunswick, N.J.	25,096	32,030	40,879	52,173
St. Lawrence University	Canton, N.Y.	57,147	72,936	93,086	118,805
Salem International Univ.	Salem, W.Va.	21,910	27,963	35,689	45,549
Seattle University	Seattle, Washington	50,535	64,497	82,316	105,059
Southern Methodist Univ.	Dallas, Tex.	60,586	77,325	98,688	125,954
Stanford University	Stanford, Calif.	62,289	79,498	101,462	129,494
Texas A & M University	College Sta., Tex.	19,702	25,145	32,092	40,959
Tulane University	New Orleans, La.	62,061	79,207	101,091	129,020
University of Arkansas	Fayetteville, Ark.	18,036	23,019	29,379	37,496
University of California	Berkley, Calif.	28,616	36,522	46,612	59,491
University of Louisville	Louisville, Ky.	18,946	24,180	30,861	39,387
University of New Mexico	Albuquerque, N.Mex.	16,445	20,988	26,787	34,188
University of Rhode Island	Kingston, R.I.	25,458	32,492	41,468	52,925
University of Virginia	Charlottesville, Va.	21,796	27,818	35,503	45,312
Vanderbilt University	Nashville, Tenn.	60,324	76,990	98,261	125,409
Yale University	New Haven, Conn.	63,250	80,725	103,028	131,492
Yeshiva University	New York, N.Y.	48,130	61,427	78,399	100,059
Average Cost		39,879	50,897	64,958	82,905

Explanation of Table. Costs for public schools assume the student is a resident of the state. Costs (i.e., tuition) for out-of-state students are generally substantially more than shown. Costs for supplies are included when available. Costs for transportation are not included. Since over the past decade college costs have more than kept pace with the rate of inflation, it seems highly likely that costs will continue to escalate in the years to come. In this regard, see the Consumer Price Index on page 317. Source of 2014-2015 college education costs: Author research of college internet sites during the month of November 2014, supplemented by direct inquiry when required.

HUMAN LIFE VALUE

The value of $10,000 in annual earnings, discounted by 5 percent, according to the number of "working years to retirement" and rates of projected growth.

Working Years	Projected Growth In Earnings				
To Retirement	4%	5%	6%	7%	8%
1	10,000	10,000	10,000	10,000	10,000
2	19,905	20,000	20,095	20,191	20,286
3	29,719	30,000	30,290	30,576	30,862
4	39,436	40,000	40,578	41,157	41,745
5	49,062	50,000	50,960	51,943	52,935
6	58,597	60,000	61,444	62,935	64,444
7	68,037	70,000	72,032	74,136	76,286
8	77,389	80,000	82,721	85,550	88,467
9	86,655	90,000	93,509	97,177	100,995
10	95,828	100,000	104,397	109,025	113,880
11	104,913	110,000	115,392	121,100	127,135
12	113,912	120,000	126,489	133,408	140,770
13	122,826	130,000	137,692	145,947	154,790
14	131,656	140,000	149,003	158,728	169,214
15	140,404	150,000	160,424	171,754	184,049
16	149,067	160,000	171,953	185,025	199,306
17	157,647	170,000	183,589	198,548	215,001
18	166,146	180,000	195,339	212,331	231,144
19	174,564	190,000	207,197	226,375	247,747
20	182,902	200,000	219,171	240,687	264,826
21	191,159	210,000	231,258	255,273	282,393
22	199,339	220,000	243,461	270,135	300,460
23	207,449	230,000	255,779	285,277	319,044
24	215,465	240,000	268,217	300,714	338,160
25	223,413	250,000	280,773	316,442	357,823
26	231,286	260,000	293,447	332,468	378,045
27	239,081	270,000	306,239	348,797	398,843
28	246,802	280,000	319,152	365,438	420,235
29	254,452	290,000	332,193	382,400	442,242
30	262,028	300,000	345,353	399,680	464,873
31	269,532	310,000	358,643	417,294	488,159
32	276,966	320,000	372,061	435,246	512,112
33	284,330	330,000	385,605	453,538	536,748
34	291,622	340,000	399,281	472,179	562,087
35	298,846	350,000	413,086	491,177	588,153
36	306,000	360,000	427,021	510,535	614,958
37	313,088	370,000	441,091	530,264	642,535
38	320,104	380,000	455,289	550,360	670,887
39	327,056	390,000	469,624	570,842	700,054
40	333,938	400,000	484,092	591,708	730,046

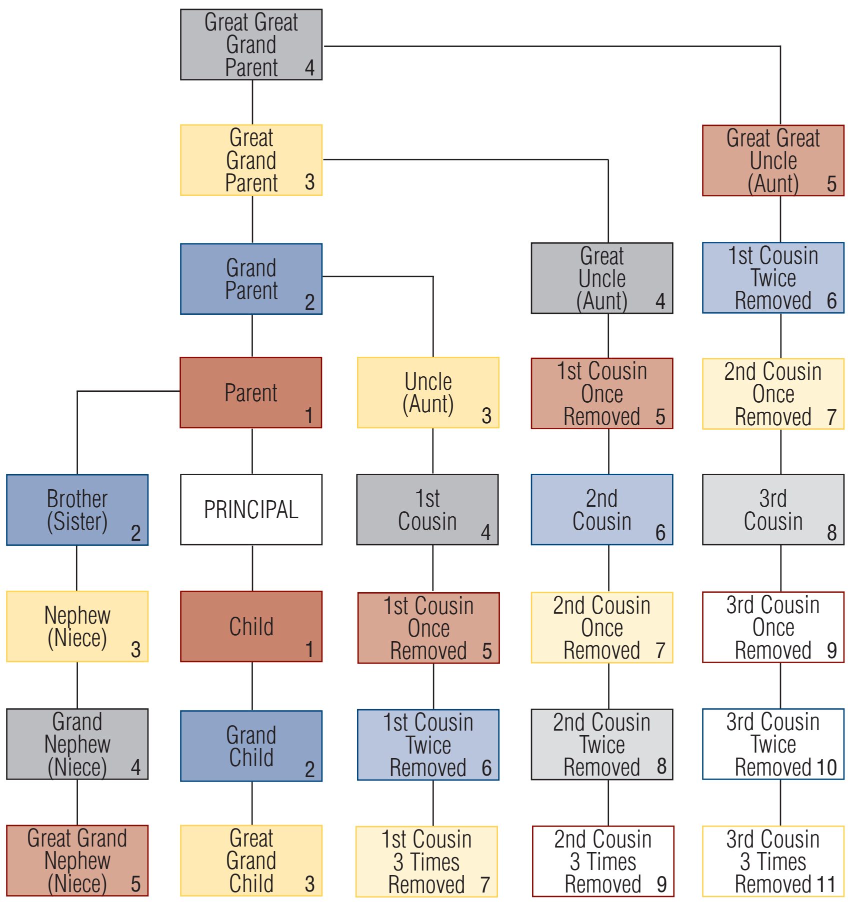
Explanation of Table. Footnote 4 on page 17 contains an explanation of how to use this table to calculate human life value.

TRUSTS AND THEIR USES

		TAX IMPLICATIONS		
TYPE	CHARACTERISTICS	Income	Gift	Estate
Revocable	Created during grantor's life. If unfunded, acts as a will substitute. If funded, can manage property for benefit of grantor, spouse, and other beneficiaries. See chart, page 29.	Trust income taxable to grantor.	No gifts, since grantor retains control of property.	No estate tax advantages, but payment of insurance proceeds to trust can provide greater flexibility than settlement options.
Irrevocable	Created during grantor's life. Grantor gives up all control over assets in order to gain estate tax advantages (chart, page 51). Also, see Dynasty Trust, page 387.	Trust pays tax if income accumulated in trust. Beneficiaries pay taxes if income distributed. Income taxed to grantor if certain strings retained.	When property placed in trust there is a gift. With "Crummey powers," gifts are considered present interest gifts that qualify for the annual exclusion (chart, page 47).	Generally not included in estate, except proceeds of life insurance given to trust within 3 years of death (pages 405-406), or if grantor retains interest in trust.
Testamentary	Created upon death pursuant to a will (chart, page 25, and page 473).	None, trust created at death.	None, trust created at death.	Taxable in testator's estate.
Minor's Trust (Section 2503(c))	Created during grantor's life. Trust's accumulated income and principal must be paid to beneficiary upon attaining age 21 (further discussion, page 576).	Trust pays taxes if income accumulated in trust. Beneficiaries pay taxes if income is distributed.	When property placed in trust there is a gift that qualifies for the annual exclusion.	Not included in grantor's estate, except life insurance given within 3 years of death.
Income Trust (Section 2503(b))	Created during grantor's life. Trust must distribute income annually, but principal need not be paid to beneficiary (further discussion, page 576).	Beneficiaries pay taxes when income is distributed.	When property placed in trust there is a gift that qualifies for the annual exclusion.	Not included in grantor's estate, except life insurance given within 3 years of death.

DEGREES OF KINDRED

Solid lines indicate the paths of direct descendancy. Full cousins are to the right of the principal. Cousins above the principal are "cousins in the ascendancy." Cousins below the principal are "cousins in descendancy." Numbers in lower right corners indicate the degree of kindred to principal (e.g., uncle and nephew are both in the 3rd degree of kindred and therefore would likely inherit in equal amounts, if the principal died intestate without any heirs in the 1st or 2nd degree, and no other heirs in the 3rd degree).



INTESTATE'S "WILL"

Being of sound mind and memory, I ________________________________, do hereby publish this as my Last Will and Testament:

First

I give my wife [husband] only one-third of my possessions, and I give my children the remaining two-thirds.

I appoint my wife [husband] as guardian of my children, but as a safeguard I require that she [he] report to the Probate Court each year and render an accounting of how, why, and where she [he] spent the money necessary for the proper care of my children.

As a further safeguard, I direct my wife [husband] to produce to the Probate Court, a performance bond to guarantee that she [he] guarantee that she [he] exercises proper judgment in the handling, investing, and spending of my children's money. As a final safeguard, my children shall have the right to demand and receive a complete accounting from their mother [father] of all her [his] financial actions with their money as soon as they reach legal age.

When my children reach age 18, they shall have full rights to withdraw and spend their share of my estate. No one shall have any right to question my children's actions on how they decide to spend their respective shares.

Second

Should my wife [husband] remarry, her [his] second husband [wife] shall be entitled to one-third of everything my wife [husband] possesses. Should my children need some of this share for their support, the second husband [wife] shall not be bound to spend any part of his [her] share on my children's behalf.

Such second husband [wife] shall have sole right to decide who is to get his [her] share, even to the exclusion of my children.

Third

Should my wife [husband] predecease me or die while any of my children are minors, I do not wish to exercise my right to nominate the guardian of my children. Rather than nominating a guardian of my preference, I direct my relatives and friends to get together and select a guardian by mutual agreement. In the event that they fail to agree on a guardian, I direct the Probate Court to make the selection. If the court wishes, it may appoint a stranger acceptable to it.

Fourth

Under existing tax law, there are certain legitimate techniques open to me to lower death taxes. Since I prefer to have my money used for government purposes rather than for the benefit of my wife [husband] and children, I direct that no effort be made to lower taxes.

IN WITNESS WHEREOF, I have set my hand to this my LAST WILL AND TESTAMENT this ________ day of ____________________, 20________.

____

STATE LAWS ON INTESTATE SUCCESSION

When someone dies without a will, state law effectively provides a "one-size-fits-all" will through intestate succession statutes. It is important to remember, though, that just as a will may not control all of a decedent's property, state intestate succession statutes may not determine how all of a decedent's property is distributed at his death. Determining how the law will divide the property of a decedent who dies without a will can be complex. Property may pass by title (e.g., joint ownership with rights of survivorship), by contract (e.g., a life insurance beneficiary designation), or by some state statute other than the intestate succession statute.

These "other" statutes include dower and curtesy statutes, homestead statutes, right of election statutes, family allowance and support statutes, and statutes in common law states preserving the community property nature of property previously acquired by a married couple in a community property state. These statutes can be significant in determining the ultimate disposition of an intestate decedent's property.

Nonetheless, the statutes of intestate succession are quite important. The following briefly summarizes the shares into which the various states' intestate succession statutes divide the intestate estate when a decedent dies without a will and *leaves a surviving spouse and child(ren) but no other issue* (i.e., no grandchildren, no great grandchildren, etc.). Special rules may determine whether certain individuals – such as adopted, step or illegitimate children of the decedent – will qualify as "children" of the decedent for purposes of intestate succession.

Unless separately stated, community property includes "quasi-community property" (generally defined as property acquired in another state that would have been considered community property had it been acquired within the community property state). See discussion of community property on pages 355-356. Unless otherwise noted, property passing to the decedent's children is divided equally among them.

One final note of caution! Because state laws can change, the reader should consult local counsel for current law.

Alabama

If all children are issue of the surviving spouse also: spouse gets first $50,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Ala. Code §43—8-41

Alaska

If all children are issue of the surviving spouse and the decedent leaves no other surviving descendants or parents: all to spouse.

If any child is not issue of the surviving spouse: spouse gets first $100,000 plus ½ of balance; remainder to child(ren). Alaska Stat. Ann. §13.12.101

Arizona

If all children are issue of the surviving spouse also, spouse gets entire estate.

If any child is not issue of surviving spouse: spouse gets ½ of decedent's *separate* property, and none of decedent's share of *community* property; remainder to child(ren). Ariz. Rev. Stat. Ann. §14-2102

Arkansas

All property to child(ren). Ark. Code Ann §28-9-214

California

Community property: all to spouse or domestic partner.

Separate property: if one child, then ½ to spouse or domestic partner and ½ to child; if more than one child, then ⅓ to spouse or domestic partner and ⅔ to children. Cal. Prob. Code §6401

Colorado

If all children are issue of the surviving spouse also and there are no other issue of the surviving spouse: all to the spouse.

If all of the children are issue of the surviving spouse also but the surviving spouse has one or more surviving issue who are not also issue of the decedent: first $225,000 plus ½ of any balance to the spouse; the rest to the decedent's child(ren).

If one or more of the children is not also issue of the surviving spouse: the first $150,000 plus ½ of any balance to the spouse; the rest to the decedent's child(ren). Colo. Rev. Stat. Ann. §15-11-102

Connecticut

If all children are issue of the surviving spouse also: spouse gets first $100,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Conn. Gen. Stat. Ann §45a-437

Delaware

If all children are issue of the surviving spouse also: spouse gets first $50,000 of the *personal* estate, plus ½ of balance of the personal estate, plus a life estate in the *real* estate; rest to child(ren).

If any child is not issue of surviving spouse: spouse gets ½ of *personal* estate, plus a life estate in the *real* estate; rest to child(ren). Del. Code Ann. Tit 12, §502

References

District of Columbia

If all children are issue of the surviving spouse or domestic partner and the surviving spouse or domestic partner has no other descendants, ⅔ to spouse or domestic partner.

If surviving spouse or domestic partner has one or more surviving descendants who are not descendants of the decedent or if the decedent has one or more surviving descendants who are not descendants of the surviving spouse or domestic partner, spouse or domestic partner takes ½. D.C. Code §19-302

Florida

If all children are issue of the surviving spouse also: all to spouse.

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Fla. Stat. Ann. §732.102

Georgia

Spouse shares equally with child(ren); but spouse entitled to at least ⅓. Ga. Code Ann. §53-2-1

Hawaii

If all children are issue of the surviving spouse also and there are no other issue of the surviving spouse: all to spouse.

If all children are issue of the surviving spouse also but the surviving spouse has one or more surviving issue who are not the issue of the decedent: first $150,000 plus ½ of balance to spouse; the rest to the decedent's child(ren).

If one or more of the children is not also issue of the surviving spouse: the first $100,000 plus ½ of balance to surviving spouse; the remainder to the decedent's child(ren). Haw. Rev. Stat. §560-2-102

Idaho

Community property: all to spouse.

Separate property: spouse gets ½ of estate and ½ goes to child(ren). Idaho Code Ann. §15-2-102

Illinois

½ to spouse; ½ to child(ren). 755 Ill. Comp. Stat. Ann 5/2-1

Indiana

½ to spouse; ½ to child(ren). If no child is a child of the surviving spouse, such spouse takes ½ of personal property, remainder of personal property to child(ren); spouse takes ¼ of fair market value of decedent's lands; ¾ to child(ren). Ind. Code Ann §29-1-2-1

Iowa

If all children are issue of the surviving spouse also: spouse gets all of *real* property, plus all *personal* property that was exempt from execution in hands of decedent as head of family at death, plus all of remainder not necessary for payment of debts and charges.

If any child is not issue of surviving spouse: spouse gets ½ of *real* property, plus all *personal* property that was exempt from execution in hands of decedent as head of family at death, plus ½ of remaining *personal* property not necessary for payment of debts and charges; remainder to child(ren) (but spouse entitled to minimum of $50,000 in value from entire net estate). Iowa Code Ann §633.212

Kansas

½ to spouse; ½ to child(ren). Kan. Stat. Ann. §59-504

Kentucky

All to child(ren). Ky. Rev. Ann. §391.010

Louisiana

Community property: decedent's share to children, but subject to usufruct in favor of surviving spouse (beneficial use until remarriage, unless decedent spouse specifies such use shall be for life or a shorter period).

Separate property: all to children. La. Civ. Code Ann. Art. 889-890,894-895

Maine

If all children are issue of the surviving spouse or surviving registered domestic partner also: spouse or surviving registered domestic partner gets first $50,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Me. Rev. Stat. Title 18-A §2-102

Maryland

If a surviving minor child: ½ to spouse; ½ to child(ren).

If no surviving minor child: spouse gets first $15,000, plus ½ of balance; remainder to child(ren). Md. Code Ann., Est. and Trusts §3-102

Massachusetts

If all issue are children of the surviving spouse: spouse takes entire estate.

If all issue are not children of the surviving spouse, or surviving spouse has child(ren) not issue of decedent: spouse takes first $100,000, then half of balance; remainder to child(ren). Mass. Gen. Laws Ann. 190B §2-102

Michigan

If all children are issue of the surviving spouse also: spouse gets first $150,000 plus ½ of balance; remainder to children.

If at least one, but not all, child(ren) are not issue of surviving spouse, or if the surviving spouse has at least one, but not all child(ren) who are not issue of decedent: the first $150,000 plus ½ of balance to spouse; remainder to children.

If none of decedent's surviving children are issue of the surviving spouse: the first $100,000 plus ½ to the spouse. Mich. Comp. Laws Ann. §700-2012

Minnesota

If all children are also children of the surviving spouse: spouse takes entire estate.

If one or more surviving children are not also issue of the surviving spouse, or surviving spouse has children not issue of decedent: first $150,000 plus ½ balance of estate to spouse, remainder to children. Minn. Stat. Ann. §524.2-102

Mississippi

Spouse shares equally with each child. Miss. Code Ann. §91-5-25

Missouri

If all children are issue of the surviving spouse also: spouse gets first $20,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Mo. Ann. Stat. §474.010

Montana

If all children are issue of the surviving spouse also and the surviving spouse has no other surviving issue: all to spouse.

If all children are issue of the surviving spouse but the surviving spouse has any surviving issue who is not also issue of the decedent: the spouse gets first $150,000, plus ½ of any balance; the rest to decedent's child(ren).

If any child is not also issue of the surviving spouse: spouse gets first $100,000, plus ½ of balance; the rest to the decedent's child(ren). Mont. Code Ann. §72-2-112

Nebraska

If all children are issue of the surviving spouse also: spouse gets first $100,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Neb. Rev. Stat. §30-2302

Nevada

Community property: all to spouse.

Separate property: if one child, then ½ to spouse and ½ to child; if more than one child, then ⅓ to spouse and remainder to children equally. Nev. Rev. Stat. Ann. §134.040

New Hampshire

If all children are issue of the surviving spouse also: spouse gets first $250,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: the first $100,000 + ½ to spouse; remainder to child(ren). If surviving spouse has issue that are not issue of decedent, first $150,000 + ½ to surviving spouse; remainder to child(ren). N.H. Rev. Stat. Ann. §561:1

New Jersey

If all children are issue of the surviving spouse also and the surviving spouse has no other surviving issue who are not also issue of the decedent: spouse gets entire estate.

If all children are issue of the surviving spouse but the surviving spouse has one or more surviving issue who are not issue of the decedent: the first 25% of the intestate estate, but not less than $50,000.00 nor more than $200,000.00, plus one-half of the balance of the intestate estate.

If there are children who are not issue of the surviving spouse: the first 25% of the intestate estate, but not less than $50,000.00 nor more than $200,000.00, plus one-half of the balance of the intestate estate. N.J. Stat. Ann. §3B:5-3

New Mexico

Community property: all to spouse.

Separate property: ¼ to spouse; ¾ to child(ren). N.M. Stat. Ann. §45-2-102

References

New York

$50,000 plus ½ of the balance to spouse; the rest to child(ren). N.Y. Est. Powers & Trusts Law §4-1.1

North Carolina

If only one child: *real* property goes ½ to spouse and balance to child; with respect to *personal* property, spouse gets first $60,000 plus ½ of balance, and remainder to child.

If two or more children: *real* property goes ⅓ to spouse and balance to children; with respect to *personal* property, spouse gets first $60,000 plus ⅓ of balance, and remainder to children. N.C. Gen. Stat. Ann. §29-14

North Dakota

If all children are issue of the surviving spouse also and the surviving spouse has no other surviving issue: all to spouse.

If all children are issue of the surviving spouse also but the surviving spouse has one or more surviving issue who are not issue of the decedent: the first $225,000 plus ½ of any balance to the spouse; the rest to the decedent's child(ren).

If any child is not issue of the surviving spouse also: the first $150,000 plus ½ of any balance to the spouse; the rest to the decedent's child(ren). N.D. Cent. Code Ann. §30.1-04-02

Ohio

If spouse is natural or adoptive parent of all child(ren): spouse takes entire estate.

If there is only one child, and the surviving spouse is not the natural or adoptive parent: spouse takes first $20,000, plus ½ of balance, remainder to child.

If there is more than one surviving child, and the spouse is the natural or adoptive parent of one, but not all: spouse takes first $60,000, or $20,000 if the spouse is the parent to none, and 1/3 of balance, remainder to children. Ohio Rev. Code Ann. §2105.06

Oklahoma

If all children are issue of the surviving spouse also: an undivided ½ interest in the property of the estate to spouse; the balance in undivided equal shares to child(ren).

If any child is not issue of surviving spouse: an undivided ½ interest in property acquired by joint industry of husband and wife during marriage to spouse; the spouse and the child(ren) take equal undivided shares in the property of the decedent not acquired by the joint industry of the husband and wife during marriage; the remainder of estate in undivided equal shares to the child(ren). Okla. Stat. Ann. Title 84, §213

Oregon

If all children are issue of the surviving spouse also, spouse gets entire estate.

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Or. Rev. Stat. Ann. §112.025

Pennsylvania

If all children are issue of the surviving spouse also: spouse gets first $30,000, plus ½ of balance; remainder to child(ren).

If any child is not issue of surviving spouse: ½ to spouse; ½ to child(ren). Pa. Stat. Ann. §20 Pa. C.S.A. §2102

Rhode Island

Real property: Estate descends to the surviving spouse for their natural life, then all to child(ren). R.I. Gen. Laws Ann. §33-1-5

Personal property: ½ to spouse; ½ to child(ren).R.I. Gen. Laws Ann. §33-25-2

South Carolina

½ to spouse; ½ to child(ren). S.C. Code Ann. §62-2-102

South Dakota

If all children are issue of the surviving spouse also, spouse gets entire estate.

If any child is not issue of the surviving spouse: spouse gets first $100,000 plus ½ of any balance, remainder to child(ren). S.D. Codified Laws §29A-2-102

Tennessee

Spouse shares equally with child(ren); but spouse entitled to at least ⅓.Tenn. Code Ann. §31-2-104

Texas

Community property: if all children are also issue of the surviving spouse, then all to the surviving spouse; if any child is not issue of the surviving spouse, then ½ of the community estate is retained by the surviving spouse and ½ passes to child(ren).

Separate property: with respect to *personal* property, ⅓ to spouse and balance to child(ren); with respect to *real* property, spouse takes life estate in ⅓, remainder to child(ren) [Presumably by "remainder" the statute means the remainder interest in the spouse's life estate *and* the fee interest in the remaining ⅔ of the real estate] Texas Estates Code Ann. §201.003

References

Utah

If all children are issue of the surviving spouse also, spouse gets entire estate.

If any child is not issue of surviving spouse: spouse gets first $75,000 plus ½ of any remaining balance. Utah Code Ann. §75-2-102

Vermont

If all of the decedent's surviving descendants are also descendants of the surviving spouse, spouse gets entire estate.

If one or more of the decedent's descendants are not also descendants of the surviving spouse; ½ to spouse. Vt. Stat Ann Title 14, §311

Virginia

If all children are issue of the surviving spouse also, spouse gets entire estate.

If any child is not issue of surviving spouse: ⅓ to spouse; balance to child(ren). VA Code Ann. §64-2-200

Washington

Community property: all to spouse or state registered domestic partner.

Separate property: ½ to spouse or state registered domestic partner. Wash. Rev. Code Ann. §11.04.015

West Virginia

If all children are issue of the surviving spouse also and the surviving spouse has no other surviving issue, spouse gets entire estate.

If all children are issue of the surviving spouse also but the surviving spouse has any surviving issue who is not also issue of the decedent: 3/5 to spouse; 2/5 to decedent's child(ren).

If any child is not issue of the surviving spouse: ½ to spouse; ½ to decedent's child(ren). W. Va Code Ann. §42-1-3

Wisconsin

If all children are issue of the surviving spouse also, spouse gets entire net intestate estate.

If any child is not issue of surviving spouse: spouse gets ½ of net intestate estate consisting of decedent's property other than marital property (i.e., property acquired during marriage) or property that the decedent and the surviving spouse held as tenants in common; remainder to child(ren).

Wyoming

½ to spouse; ½ to child(ren). Wyo. Stat. Ann. §2-4-101