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SPECIAL REPORT www.thefrn.com

THE FIVE LEVELS OF ESTATE PLANNING
A Systematic Approach to Estate Planning

By Julius Giarmarco, J.D., LL.M. and Salvatore J. LaMendola, J.D.

Introduction

There are essentially three general strategies for reducing estate taxes. A comprehensive estate plan for persons with large estates must incorporate one or more of these strategies. The first strategy is the leveraging of cash gifts through the purchase of life insurance in irrevocable trusts. The next strategy is to use techniques which reduce or shift the value of assets. The final strategy is to implement programs which take advantage of the income, gift and estate tax deductions for transfers to charity.

Estate planning specialists will tell you that there are two estate tax systems - one for the informed taxpayer and one for the uninformed taxpayer. The less you know, the more the IRS takes. This brochure is intended to help put you in the informed camp - to introduce you to the strategies mentioned above so that you can become a tax-reducer instead of a taxpayer.

LEVEL ONE PLANNING

The Living Trust

Situation

No estate planning is in place, or present planning is outdated or inadequate.

Objectives

- Defer all estate taxes until the death of the surviving spouse.
- For married persons, take advantage of each spouse's $15 million estate tax exemption.
- Avoid the delays, publicity and cost of probate in the event of death or incapacity.
- Make certain that what you have goes to whom you want, when you want and how you want.
- Prevent the intentional or unintentional disinheritance of children and grandchildren by the surviving spouse.
- Protect heirs from their potential inability to plan, their potential disability, their creditors and their predators.
- Decide who will manage the estate (e.g., personal representatives, trustees, attorneys-in-fact, etc.) and be responsible for the distribution of the assets.
- Designate on a separate list who is to receive items of tangible personal property, such as jewelry.

Tools & Techniques

- Pour-over will
- Revocable Living Trust
- Marital-Family Trusts
- Disclaimer Trusts
- Durable power of attorney for property
- Durable power of attorney for health care/living will
- Beneficiary-Controlled Trusts

Disadvantages

None, since the grantor maintains total control over his/her assets and all documents are amendable and revocable.

The Transfer Tax System

Beginning in 2026, the federal estate, gift, and generation-skipping transfer (GST) tax exemption will be $15 million per person (or $30 million per married couple). Similarly, the annual gift tax exclusion for 2025 is $19,000 per recipient (or $38,000 per married couple). Both the exemption and exclusion amounts are indexed for inflation and may increase slightly from year to year. For simplicity and ease of understanding, this brochure uses $15 million as the exemption amount and $19,000 as the annual exclusion amount throughout.

In addition, since 1981, the tax laws have provided for an unlimited marital deduction which allows married persons to leave any amount of property to their spouse (if a U.S. citizen) free from federal estate and gift taxes. The unlimited marital deduction was not affected by the Act.

The donee's basis in property received by gift is the same as the donor's basis (carryover basis). However, the

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beneficiary's basis in most property acquired from a decedent is equal to the property's fair market value at the date of death (stepped-up basis). Thus, before making gifts, consider the impact of capital gain taxes upon the subsequent sale of the gifted property.

Marital-Family Trusts

A revocable living trust becomes irrevocable at death. Often, a married couple will each establish a revocable living trust so that the trust property is divided into two shares at the first death. The exemption amount (assume $15 million) is placed in a Family Trust (Trust B in the diagram on page 5). The balance of the trust property is placed in a Marital Trust (Trust A in the diagram on page 5). No taxes are due at the first death, because the $15 million exemption applies to the Family Trust, and the unlimited marital deduction applies to the Marital Trust. However, if the surviving spouse is not a U.S. citizen, special rules apply concerning the Marital Trust and the taxation of distributions to the surviving spouse.

Upon the surviving spouse's death, the assets in the Family Trust pass estate tax free to the grantor's heirs under the terms established in the trust. The assets in the Marital Trust are taxable, but only to the extent they exceed the surviving spouse's estate tax exemption. Thus, a married couple can leave $30 million to their heirs federal estate tax free.

Prior to 2010, a married couple had to use Marital-Family Trusts to utilize both spouse's estate tax exemptions. However, now the executor of the estate of the predeceased spouse can "transfer" any unused estate tax exemption to the surviving spouse (on a timely-filed estate tax return - Form 706). To prevent "serial marriages", only the most recently deceased spouse's unused exemption may be transferred to the surviving spouse. This law is referred to as "portability".

Non-Tax Advantages of a Living Trust

- The grantor retains the right to revoke the trust, change its terms, and regain possession of the property in the trust. The grantor is typically the trustee of the trust during his/her lifetime.
- A living trust will minimize administration and probate costs arising at the grantor's death or incapacity, since property titled in the name of the trust avoids probate.
- The trust can also protect the grantor's heirs from potential creditors, including divorced spouses.

Advantages of Funding a Family Trust at First Spouse's Death in Lieu of Portability

Despite the relative simplicity of just letting the surviving spouse use the predeceased spouse's unused estate tax exemption, there are several reasons for using a Marital-Family Trust described above, including the following:

- The predeceased spouse's unused exemption is not indexed for inflation.
- The first predeceased spouse's unused exemption will be lost if the surviving spouse remarries and survives his/her next spouse.
- The appreciation in the assets in the Family Trust is removed from the surviving spouse's estate.
- The predeceased spouse (as opposed to the surviving spouse) controls the management and distribution of the assets in the Family Trust.
- There is no transfer to the surviving spouse of the predeceased spouse's unused generation-skipping transfer tax exemption (see page 10).

Disclaimer Trusts

A Family Trust does have some disadvantages. The surviving spouse's access to the assets in the Family Trust, albeit broad, is restricted. And there is no stepped-up basis at the surviving spouse's death for the assets in the Family Trust. The Family Trust also adds complexity to the surviving spouse's life in that separate records for the Family Trust must be maintained, and annual income tax returns (Form 1041) must be filed for the remainder of the surviving spouse's lifetime. Finally, if the first spouse to die has little or no assets other than an IRA, then for income tax purposes it's generally not advisable to use an IRA to fund a Family Trust (and forego a spousal rollover).

Many couples with nontaxable estates, particularly those with children all from the same marriage, will prefer to simply leave their estate to the surviving spouse. But, for the reasons mentioned above, the same couples may want the ability to utilize a Family Trust. The solution may be a disclaimer trust. With a disclaimer trust, a married couple's revocable living trusts leave the deceased spouse's entire estate to the surviving spouse. The Family Trust is then funded only if the surviving spouse disclaims (refuses) part of the deceased spouse's estate. This enables the surviving spouse to decide how much to keep outright (to be taxed at the second death) and the amount to be allocated to the Family Trust (which is shielded from estate tax at the second death).

For married couples who live in states that have their own estate tax, postponing the federal estate tax until the death of the surviving spouse (by using a Marital-Family Trust) could result in a state death tax at the first spouse's death. This can occur if the state's estate tax exemption is less than the federal estate tax exemption. Another factor is whether state law provides for an unlimited marital deduction against the state death tax.

By using a disclaimer trust, the surviving spouse, upon the advice of counsel, will be able to determine whether it is more or less advantageous to fully fund the Family Trust and pay any state death tax.

In making an informed decision to disclaim and how much to disclaim, one must examine the size of the combined estate, the surviving spouse's age and health (which impacts the spouse's need for funds), whether minor children will be beneficiaries of the Family Trust, the potential for appreciation in the assets not disclaimed, the status of the estate tax exemption, and the applicability of a state death tax.

The actual disclaimer must meet certain legal requirements and the surviving spouse must not accept any benefits from the assets to be disclaimed before making the disclaimer.

Beneficiary-Controlled Trusts

Trusts are used to protect beneficiaries from their inability, their disability, their creditors and their predators. Included under "creditors" are estate taxes and divorced spouses. Most traditional trusts distribute the assets when the beneficiary reaches a certain age or ages, with the last distribution terminating the trust. But, once the assets have been distributed to the beneficiary, they are no longer protected from creditors. In contrast, a multi-generational "dynasty trust" protects the beneficiary from creditors, while at the same time allowing the "primary beneficiary" to control the trust as a co-trustee. Such trusts are sometimes referred to as "beneficiary-controlled" trusts. Following are the design features of the typical beneficiary-controlled trust:

- The donor (i.e., parent or grandparent) is the grantor of the Trust.
- The child and his/her descendants are the beneficiaries of the Trust. However, the child is the "primary beneficiary" of the Trust during his/her lifetime and, therefore, the child's needs take priority over the needs of his/her descendants.
- The Trust has two trustees – the primary beneficiary (upon attaining the projected age of maturity) and an independent trustee. The independent trustee can be the primary beneficiary's friend, trusted advisor or a corporate fiduciary.
- The primary beneficiary has the power to remove and replace the independent trustee from time to time, thereby maintaining the beneficiary-controlled feature of this trust design.
- The trustees can distribute to the primary beneficiary (and his/her descendants) income and principal as needed for health, education, maintenance and support.
- The trust agreement also allows the trustees to acquire assets for the primary beneficiary's use and enjoyment (without compensation), such as vacation homes, artwork, jewelry, etc. The trustee could also invest in a business that employs the beneficiary.
- The primary beneficiary can be given a broad non-general power of appointment to "re-write" the trust for future generations.
- At the primary beneficiary's death, the assets remaining in trust pass to his/her children, but in further trust. At that time, the grandchild becomes the new primary beneficiary of his/her separate trust, which now benefits the grandchild and the grandchild's descendants. This arrangement can be repeated for each successive generation for the maximum period permitted under state law.
- To the extent of the grantor's generation-skipping transfer tax exemption (which is the same as the estate tax exemption), plus the future appreciation thereon, there will be no estate taxes due as the trust property passes from one generation to the next.

Beneficiary-controlled trusts can be created at the grantor's death as part of the grantor's living trust, or can be used in irrevocable trusts, including irrevocable life insurance trusts (see Level Two). But the benefits of the beneficiary-controlled trust are only available if someone else, such as a parent or grandparent, sets up the trust.

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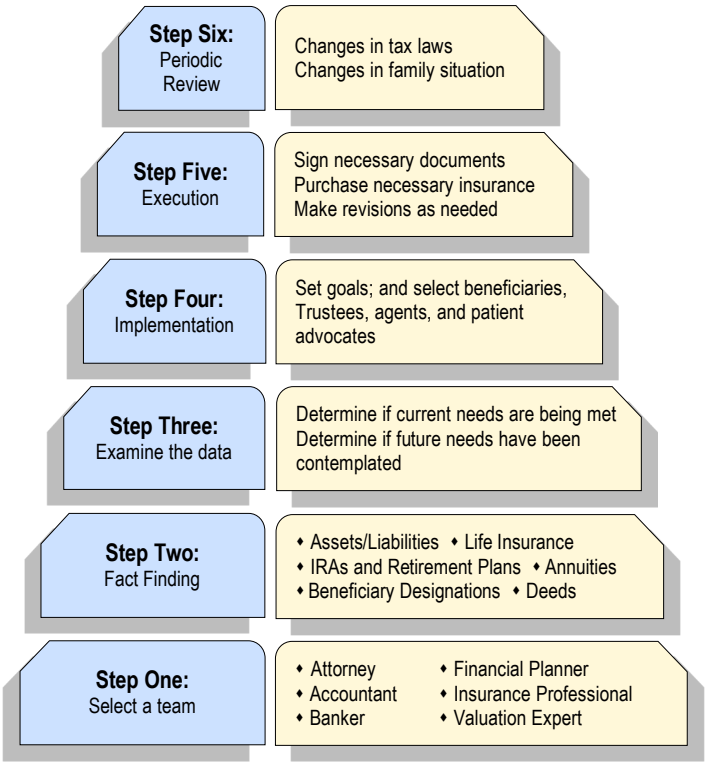
Steps to Successful Estate Planning



Common Mistakes in Designing Living Trusts

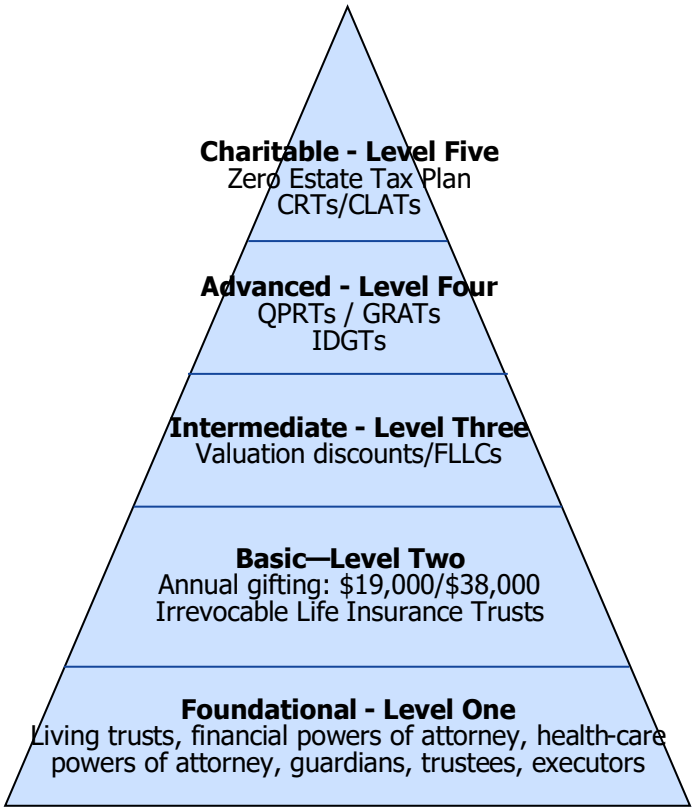
People often execute revocable living trusts without really understanding their trust's provisions. For example, is the Marital Trust a so-called Qualified Terminable Interest Property (QTIP) Trust? If not, then the surviving spouse can intentionally or unintentionally disinherit the children. Does the Family Trust allow income to be "sprinkled" to children and grandchildren? If not, the opportunity to shift income to lower tax brackets is lost. Does the trust agreement permit the trustee to postpone distributions to beneficiaries (beyond their required distribution dates) for good cause? If not, it may be impossible to protect trust assets from the beneficiaries' creditors, including divorced spouses. Do the Marital and Family Trusts give the surviving spouse a testamentary limited power to appoint trust property among children and grandchildren? If not, considerable flexibility to reduce the income and estate taxes of the children is lost. For these and many other issues too numerous to cover here, it is advisable to have one's estate planning documents reviewed by an estate planning specialist periodically.

Planning for Non-Taxable Estates

With the estate tax exemption set at $15 million, fewer decedents will have taxable estates. Nevertheless, there are many reasons for people to prepare wills, trusts and powers of attorney beyond minimizing estate taxes. Estate planning is about people and their desire to provide for their loved ones, to provide for their favorite charities, to assure the survival of a family business, and to protect assets from creditors.

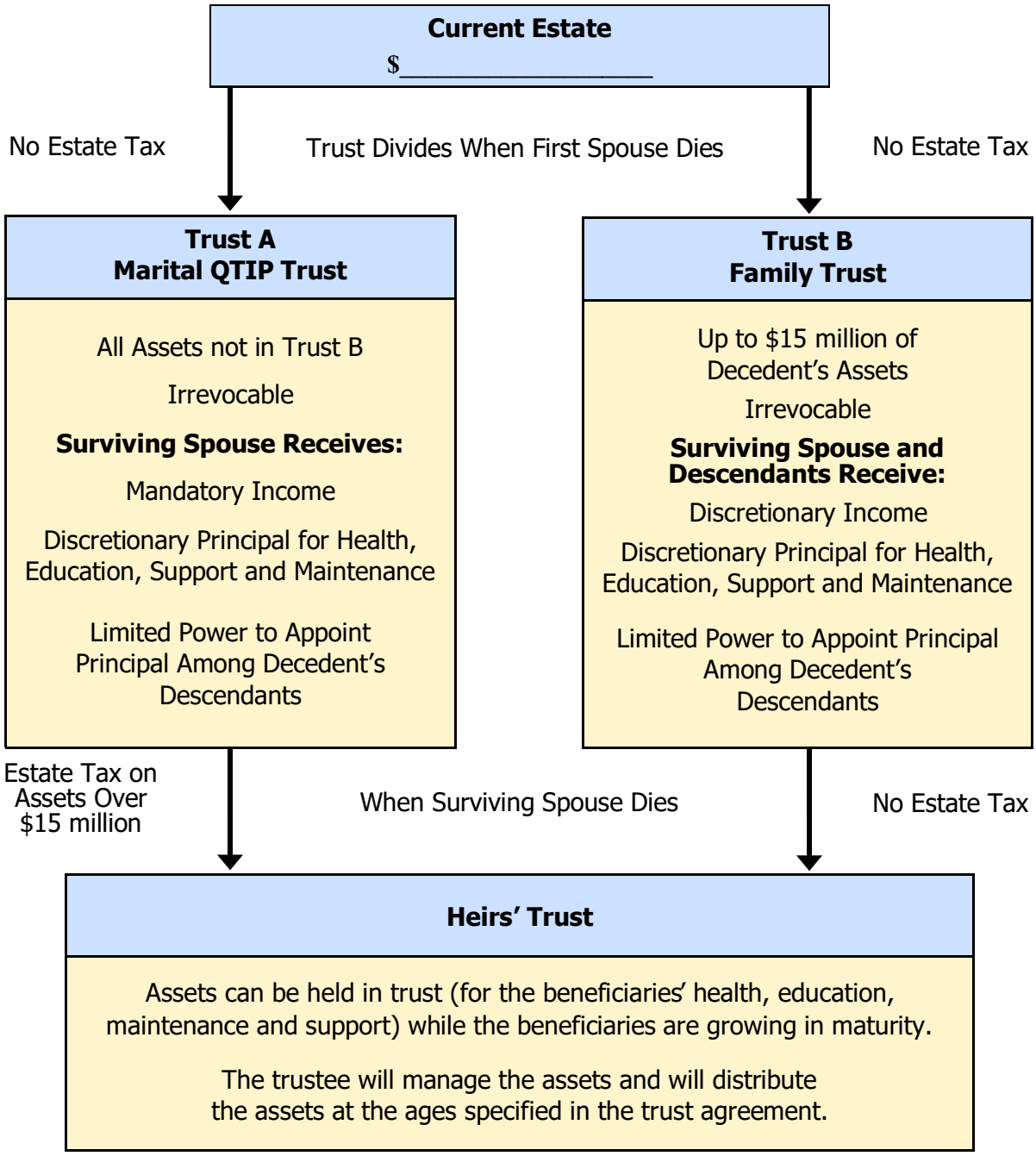
Titling assets in the name of a living trust avoids the costs, delays and publicity associated with probate upon death or incapacity. Determining at what ages, and in what increments, minors and young adults will receive their inheritance is critical. Guardians for minor children must be named. Only with advanced planning can one deal with special circumstances such as blended families, elderly parents, special needs children, and family businesses. Advanced planning can also address end-of-life decisions, mental incapacity, and long-term care issues. Finally, life insurance will continue to play an important role in non-taxable estates, including providing capital to replace the income lost when a breadwinner dies prematurely (see page 6).

Estate Planning Pyramid



Living Trust Diagram

The Marital-Family type of plan is designed to make certain that the $15 million estate tax exemption of each spouse is used, while allowing the surviving spouse to have use of all of the deceased spouse's assets during the remainder of the surviving spouse's lifetime. The Family Trust (Trust B) is generally not taxed at either death. The Marital Trust (Trust A) is generally taxed at the surviving spouse's death (less the surviving spouse's estate tax exemption).



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Special Section

Using Life Insurance in Non-Taxable Estates

Estate planners commonly use life insurance as a method of creating liquidity to pay estate taxes. But with a $15 million estate tax exemption ($30 million for married couples), for most decedents, the federal estate tax has been "repealed". Nevertheless, for the reasons described below, life insurance can still play a significant role in a non-taxable estate.

Replace Lost Income.

Life insurance has long been used to protect young families from the disastrous effects of a breadwinner's untimely death.

Wealth Replacement.

Charitable remainder trusts (CRTs) are often used by people who wish to sell highly-appreciated assets without generating any immediate capital gains tax liability. A CRT is also a great tool for obtaining a charitable income tax deduction (see page 12) These benefits are derived from the fact that upon the death of the donor and the donor's spouse, the assets remaining in the CRT must pass to charity. A life insurance policy can be purchased for the benefit of the donor's heirs to "replace" the wealth passing to charity.

Estate Equalization.

Most parents want to treat their children equally when dividing up their estate. But this may prove impossible with family businesses in which only the children active in the business are to receive the business. If the value of the business exceeds the active children's equal share of the estate, it is impossible to treat all the children equally. A simple solution is to use a life insurance policy as an estate equalizer. The non-active children (or a trust for their benefit) will be the beneficiaries of the policy.

Creditor Protection.

The cash surrender value of a life insurance policy and/or the death proceeds from a policy may be protected from creditors. The availability of protection and any dollar limits thereon varies from state to state, and may be dependent upon who the beneficiaries of the policy are. For example, some states only protect a policy's cash surrender value and death proceeds if the insured's spouse and/or children are the beneficiaries of the policy.

Second Marriages.

When children from a previous marriage are involved, estate planning becomes more complicated. Take the example of a second marriage in which the husband has children from a previous marriage. The husband establishes a living trust that, upon his death, provides his wife with income and principal as needed to maintain her accustomed standard of living, with the remainder passing to his children at his wife's subsequent death. This approach has two problems. First, the children have to wait until their stepmother's death to inherit their father's wealth. Second, as the remainder beneficiaries of the trust, the children have legal rights to challenge the distributions from the trust to their stepmother if those distributions exceed (in the children's opinion) the amount called for by the trust. A solution to these problems is life insurance on the husband's life. By naming his wife as the beneficiary of the life insurance, the husband can leave his estate to his children at his death (either outright or in trust).

Special Needs Children.

Upon reaching age 18, a developmentally disabled individual is usually eligible for Supplemental Security Income (SSI), a federally-funded program administered by the states. SSI eligibility generally is accompanied by eligibility for Medicaid, a state-administered federal program which primarily provides medical assistance. Many parents are skeptical about the future and/or level of the SSI and Medicaid programs. A solution to this potential problem is for the parents to purchase a second-to-die life insurance policy. The policy will be owned by the parents and will be payable to a "special needs trust" for the benefit of the disabled child at the surviving parent's death. A special needs trust is designed to "supplement" SSI and Medicaid without disqualifying the child from those programs' coverage. Upon the death of the disabled child before the complete distribution of the trust property, the assets remaining in the trust can pass to the other children.

Annuity Arbitrage.

Many people who are adverse to the stock market's daily fluctuations prefer to invest in municipal bonds or certificates of deposit (CDs). In exchange for this security, the yield on these investments is quite low. A better alternative to municipal bonds and CDs in many cases is a single-premium immediate annuity contract. Not only is the annuity a safe investment (based on the strength of the carrier), it invariably will produce a significantly higher yield than muni-bonds or CDs. The problem with an annuity is that the payments cease when the annuitant dies. Accordingly, unlike the case with muni-bonds or CDs, the annuity owner's children will not inherit the annuity. The solution is to purchase a life insurance policy to "replace" the wealth lost when the annuitant dies. The cash to pay the premiums is generated from the increased cash flow from "converting" the muni-bonds and CDs into an immediate annuity.

Medicaid Planning.

For a person to become eligible for long-term care Medicaid benefits (i.e., nursing home care), income

and assets must be below frightfully low levels. But, what about those persons with substantial assets who are not financially eligible for Medicaid? What options are available to them to protect their assets from the high cost of nursing home care? Long-term care (LTC) insurance can be purchased to pay for such care. However, LTC insurance premiums increase dramatically for persons over age 65. A better answer may be to purchase life insurance. If the insured needs long-term care and, therefore, must use private funds to pay for such care, the insurance proceeds will eventually "replace" the assets spent on long-term care. Life insurance assures that the insured's heirs are not "disinherited" by the high cost of long-term nursing home care. In the event that the insured never requires long-term care, then, upon the death of the insured, the heirs will receive a larger inheritance.

Charitable Planning.

Even without transfer taxes, many charitably-inclined persons will want to make lifetime gifts to their favorite charities. The advantages of naming a charity as the owner, beneficiary, and premium payer of a life insurance policy are numerous. First, the insurance proceeds eventually will provide the desired capital gift for a comparatively small outlay in the form of premium payments. Second, each year, if the donor-insured itemizes, he/she may be entitled to an income tax deduction equal to the premium payments gifted to the charity (subject to income limitations). Finally, because only the purchase of life insurance is involved, there are no complex details to be handled.

Avoiding Income Taxes on Traditional Retirement Plans.

Contributing to a traditional retirement plan or traditional IRA is perhaps the best way to accumulate wealth because of the combination of tax-deductible contributions and tax-deferred savings. Such plans, however, are the worst way to distribute wealth because of the double tax (estate and income taxes) imposed on the distributions. Even without an estate tax, upon the death of the surviving spouse, the children must begin taking distributions and incurring income taxes. A better strategy for a charitably-inclined traditional IRA owner might be to withdraw cash from the IRA or pension plan, pay the income tax, and use the after-tax proceeds to purchase a life insurance policy for the benefit of the participant's heirs. The policy will have a face value equal to the IRA's projected value at the death of the participant. After the participant has died, the heirs will receive the insurance proceeds income tax free, and the balance in the retirement plan could pass to charity or to a private foundation — income tax free! For a married participant, a survivorship policy can be used. The only "loser" in this scenario is the IRS.

Conclusion.

For the many reasons described above, life insurance is uniquely suited to handle many non-estate tax issues commonly confronted in estate and financial planning. Moreover, life insurance is likely to remain tax-favored and a good hedge if the insured does not live until his/her life expectancy. As such, life insurance deserves a place in one's overall asset allocation.

Insurance Comparison Chart

Insurance Type	Premium	Death Benefit	Access to Cash Value?	Market Participation?
Level Term Insurance	Relatively low; fixed	Fixed during the term, then zero	No	No
Renewable Term Insurance	Relatively low; increasing	Fixed	No	No
Decreasing Term Insurance	Relatively low; decreasing	Decreasing during the term, then zero	No	No
Whole Life Insurance	Relatively high; fixed	Fixed minimum amount, some upside	Yes	No
Universal Life Insurance	Relatively high; flexible	Variable	Yes	No
Variable Whole Life Insurance	Relatively high; fixed	Fluctuates with investment performance	Yes	Yes
Variable Universal Life Insurance	Relatively high; flexible	Fluctuates with investment performance	Yes	Yes

Please Note: This chart is intended to assist the reader in selecting life insurance coverage and is not a recommendation.

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LEVEL TWO PLANNING

The Irrevocable Life Insurance Trust

Situation

The projected estate is larger than the federal estate tax exemption.

Objectives

- Remove life insurance proceeds from the insured's gross estate while still providing benefits to the surviving spouse and descendants.
- Take advantage of the $19,000 ($38,000 for married couples) annual gift tax exclusion (per donee) as indexed for inflation.
- Leverage the annual gift tax exclusion through the purchase of life insurance, including second-to-die life insurance.
- Use the tax-free death benefit to provide liquidity to the estate through the purchase of assets from the estate or loans to the estate.

Tools & Techniques

- Irrevocable Life Insurance Trusts
- Dynasty Trusts

Disadvantages

- Grantor-insured cannot act as the trustee of an irrevocable trust.
- Trust is irrevocable and, therefore, cannot be amended or revoked.
- Grantor cannot directly reach trust property (i.e., cash values) during lifetime. However, the trustee can use cash values for the benefit of the grantor's spouse and descendants during grantor's lifetime.

The "Crummey" Trust

This type of irrevocable life insurance trust is a popular device used in making gifts that qualify for the $19,000/ $38,000 gift tax annual exclusion. Most other forms of gifts that qualify for the annual exclusion require an immediate or at least a very early (i.e., age 21) distribution of the assets to the beneficiary. Since 1998, the gift tax annual exclusion has been indexed annually for inflation. The "Crummey" Trust takes its name from a court case upholding this type of trust and supporting its tax benefits.

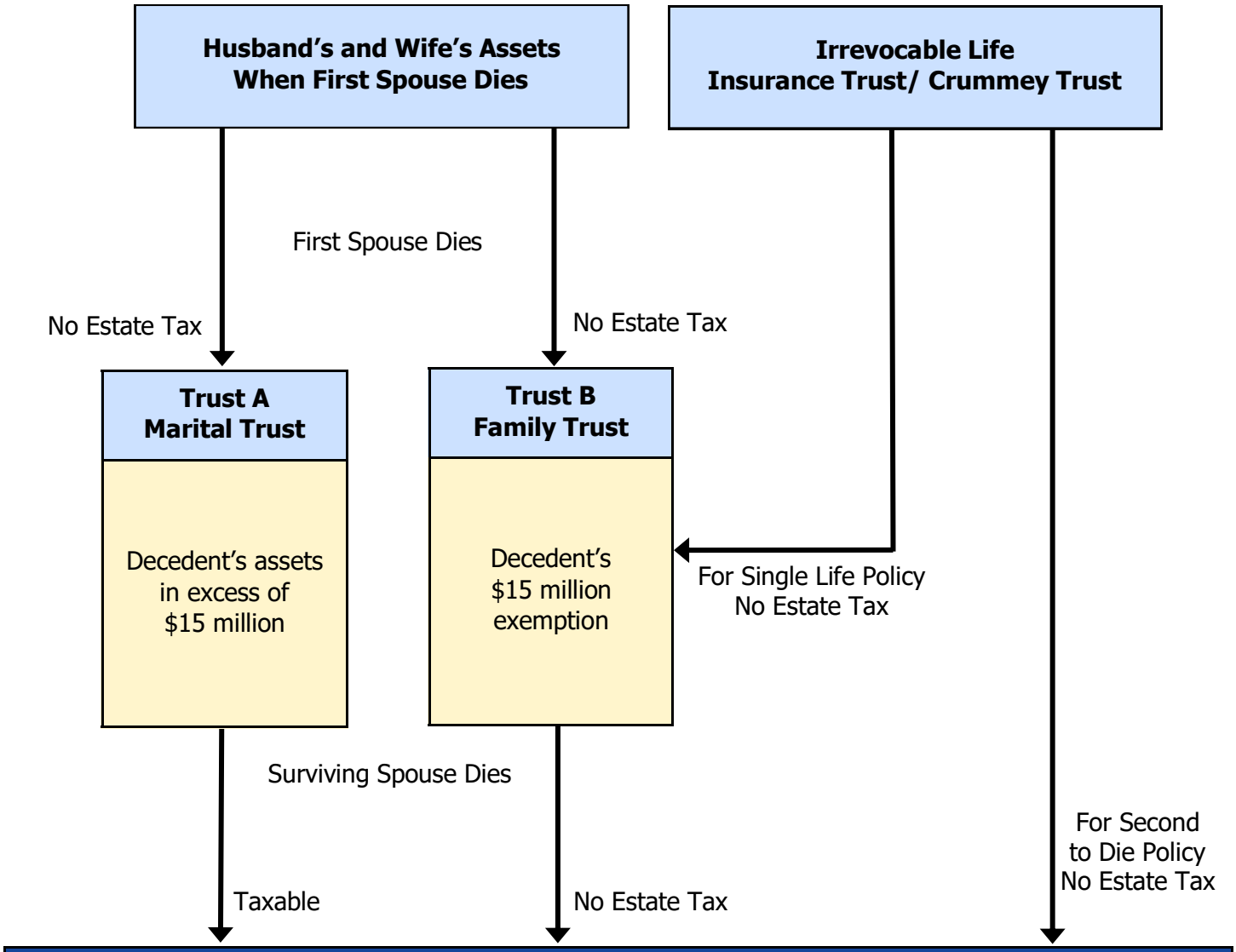
Each time a contribution is made to a Crummey Trust, a temporary right (usually 30 days) to demand withdrawal of that contribution from the trust is available to the beneficiaries. If the demand right is not exercised, the contribution remains in the trust for management by the trustee.

Because the right of withdrawal is not usually exercised, the trustee may use the funds (income and/or principal) for some purpose desired by both the trust grantor and the beneficiaries. Paying premiums on insurance on the life of the grantor is its typical use. With a single life policy, when the grantor-insured dies, the insurance proceeds are used to provide benefits to the surviving spouse, children and/or grandchildren. Properly structured, the insurance proceeds are not taxed in the estate of the grantor nor in the estate of the grantor's spouse. Moreover, when both spouses have died, the insurance proceeds can then be used to help pay the federal estate tax that may be due. This is accomplished by having the Crummey Trust purchase assets from, or loan money to, the estate(s) of the grantor and/or the grantor's spouse as allowed in the trust agreement. A married couple with no need for liquidity at the first spouse's death can purchase a second-to-die policy to provide the liquidity to pay estate taxes at the surviving spouse's death.

The main advantage of an irrevocable life insurance trust is the reduction of the gross estate by the annual gifts to the trust and the exclusion of the death benefit from the estate. As long as the grantor-insured establishes an irrevocable trust and retains no powers over the policy or the trust that could be construed as ownership, the death benefit received by the trust will be excluded from the grantor's gross estate. For an existing policy transferred to the trust, the grantor-insured must survive at least three (3) years from the transfer of the policy to the trust. Otherwise, the death benefit will be included in the grantor's estate. This three-year rule can be avoided for a new policy by having the trust apply for the policy as the initial owner.

In funding the Crummey Trust, the vehicle of choice is invariably life insurance because: (i) it increases substantially in size upon the grantor-insured's death – generally, both federal income and estate tax free; (ii) it can usually be funded with gifts qualifying for the $19,000/$38,000 gift tax annual exclusion (per donee); (iii) the cash value of a permanent policy permits funding flexibility since the cash values can be used to pay the premiums after a period of years; and (iv) the death benefit can eventually be used to provide liquidity to help pay the grantor's estate taxes. In essence, the Irrevocable Life Insurance Trust allows estate taxes to be paid *for* the estate rather than *from* the estate.

Living Trust with Life Insurance Trust



Assets Pass to Children or Other Heirs

1. Assets from "Trust A" are taxable if they exceed the surviving spouse's $15 million exemption.
2. Assets from "Trust B" are not estate taxable.
3. Life insurance in the Irrevocable Life Insurance Trust is not estate taxable.

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Generation-Skipping Transfer Taxes

A generation-skipping transfer ("GST") tax applies to lifetime or death-time transfers to a member of a generation more than one generation younger than the donor (i.e., grandchildren). The GST tax is in addition to the gift or estate tax. However, there is an exemption against the GST tax that is the same as the estate tax exemption ($15/$30 million, and the GST tax rate is the same as the highest estate tax rate (40%).

Dynasty Trusts - Leveraging The GST Exemption

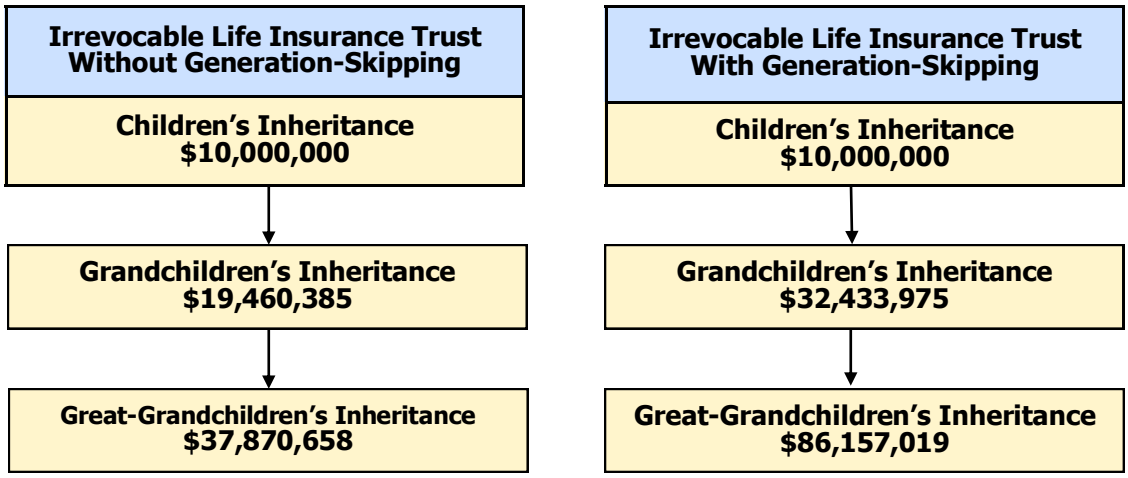
A Crummey Trust funded with life insurance can leverage a grantor's GST tax exemption. For example, a married couple can gift up to $30 million to a Crummey Trust using their $19,000/$38,000 annual gift tax exclusion (per donee), and their $30 million GST tax exemption. The trustee could, in turn, use these gifts to purchase a second -to-die life insurance policy on the grantors' lives.

Let's assume this results in a $10 million second-to-die life insurance policy being purchased on a couple's lives. Assume further that the premiums paid totaled $2 million and that the couple used their $38,000 annual gift tax exclusion to cover the premiums gifted to the Crummey Trust. Upon the death of the surviving spouse, the following benefits will be realized:

- The entire death benefit will generally be received by the Crummey Trust income tax free.
- The entire death benefit will be estate tax free because the grantors did not possess any "incidents of ownership" over the policy.
- There will be no GST tax because a portion of the grantors' $30 million GST tax exemption was used against the $2 million of gifts to make the trust 100% "GST tax exempt". Moreover, the couple will still have $28 million of GST exemption remaining and $30 million of gift and estate tax exemption remaining.
- The beneficiaries will receive the income from the trust plus any principal needed for their health, education, maintenance and support.
- Upon the death of the children, the trust property (including any appreciation) will pass estate tax free to the grandchildren and perhaps to even more remote descendants depending upon state law.
- The assets in the Crummey Trust will be outside the reach of the beneficiaries' creditors, including divorced spouses.

Dynasty/Crummey Trust

Assumptions:
1. Amount of insurance at death of surviving spouse is $10 million.
2. Growth rate after taxes and distributions to beneficiaries is 4% annually.
3. One generation = 30 years.
4. Federal Estate Tax = 40%
5. Great-Grandchildren's Inheritances are net of a 20% federal capital gains tax.



The insurance shown above is for illustrative purposes only.
The death benefit and premium are hypothetical and do not represent any particular company or product.
Investment and insurance values are projections only, not guarantees.

Special Section

The Three Levels of Business Succession Planning

One of the chief concerns facing family business owners is how to effect an orderly and affordable transfer of the business to the next generation and/or key employees. Failure to properly plan for a smooth transition can result in monetary losses and even loss of the business itself. Following are ways to help keep the family business in the family.

There are essentially three levels to a business succession plan. The first level is **management**. The day-to-day management of the business may be left to one child, while ownership of the business is left to all of the children (whether or not they are active in the business).

The second level of a business succession plan is **ownership**. Business owners must assess the most effective means of transferring ownership and the most appropriate time for the transfer to occur. They must also examine ways to leave their businesses to those children who are active in the business, while still treating all of their children fairly (if not equally).

The third level is **transfer taxes**. Estate taxes alone can claim up to 40% of the value of the business, frequently resulting in a business having to liquidate or take on debt to keep the business afloat. To avoid a forced liquidation or the need to incur debt to pay estate taxes, there are a number of lifetime gifting strategies that can be implemented by the business owner to minimize (or possibly eliminate) estate taxes.

LEVEL ONE - MANAGEMENT.

In the typical family business, the future leader is likely to be one of the business owner's children. If so, steps must be taken to assure that the future leader has the support of the key employees. Among the commonly used techniques to assure that key employees remain with the business during the transition period are employment agreements, nonqualified deferred compensation agreements (a so-called "private pension plan"), stock option plans and change of control agreements.

LEVEL TWO - OWNERSHIP.

Often, a major concern for family business owners with children who are active in the business is how to treat all of the children fairly (if not equally) in the business succession process. Other concerns for the business owner include when to give up control of the business and how to guarantee sufficient retirement income. Simultaneous with the gifting and/or selling of business interests, new owners should enter into a buy-sell agreement with current owners.

LEVEL THREE - TRANSFER TAXES.

The transfer tax component of business succession planning involves strategies to transfer ownership of the business while minimizing gift and estate taxes. The gift and estate-tax consequences deserve special attention. Unanticipated federal estate taxes can be so severe that the business may need to be liquidated to pay the tax.

For business owners with large estates, a gifting program can be used to reduce estate taxes. For lifetime gifts or a sale of the business, non-voting shares are typically usually used for two reasons. The first is to allow the business owner to retain control of the business until a later date (i.e., the owner's death, disability or retirement). The second reason is to reduce the gift tax value of the shares through possible valuation discounts for lack of control and marketability (see page 13).

Tax-free gifts of business interests up to $19,000 ($38,000 for married couples) can be made annually to as many donees as the business owner desires. Beyond the $19,000/$38,000 annual gift tax exclusion, the business owner can gift $15 million ($30 million for a married couple) tax free. While the use of the $15 million/$30 million gift tax exemption reduces (dollar for dollar) the estate tax exemption at death, such gifts remove the income and future appreciation on the gifted property from the business owner's estate. While a business owner can gift shares in the business outright, consideration should be given to making the gifts in trust to protect the children from creditors, ex-spouses, and estate taxes.

Life insurance plays an important role in a business succession plan. For example, some business owners will wait until death to transfer all or most of their business interests to one or more of their children. If the business owner has a taxable estate, life insurance can provide the children receiving the business the cash necessary for them to pay the estate taxes on the business. A business owner can use life insurance to provide those children who are not involved in the business with equitable treatment. Life insurance is also commonly used to informally fund the business's obligations under nonqualified deferred compensation plans for key employees. Finally, life insurance is usually the most economic way to provide the cash necessary for the business or the surviving owners to purchase a deceased owner's interest pursuant to the terms of a buy-sell agreement.

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Special Section

Charitable Remainder Trusts

A Charitable Remainder Trust ("CRT") enables an individual to make a deferred gift to charity(ies), usually of appreciated assets such as marketable securities, real estate, or closely-held stock, while retaining a lifetime right to payments from the CRT. Since the CRT is a tax-exempt trust, when it sells the appreciated assets it does not pay any capital gains tax. This results in increased cash flow to the donor (and the donor's spouse). Moreover, the donor is entitled to an immediate charitable income tax deduction resulting in further reduced taxes. Finally, upon the death of the donor (and the donor's spouse), the assets in the CRT pass to the designated charity(ies) estate tax free!

The CRT can be a unitrust or an annuity trust. A unitrust's payments to the donor will vary since they are based on a set percentage (at least 5% but not more than 50%) of the CRT's annually revalued principal. Conversely, an annuity trust's payments to the donor will not vary as they are based on a set percentage (at least 5% but not more than 50%) of the initial value of the CRT. Either type of CRT can require that payments be made for the lives of the donor and one or more persons, such as the donor's spouse.

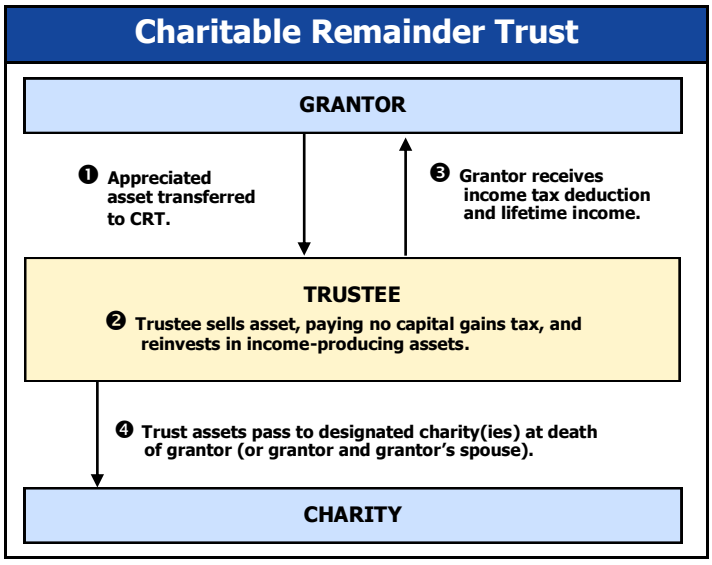
The donor (and the donor's spouse) can act as the trustee(s) of the CRT, and can control and manage the trust corpus. If non-marketable assets (i.e., land or closely-held business interests) are contributed to the CRT, an independent co-trustee is required. In managing the trust assets, the trustee(s) cannot be obligated by a pre-existing contract to sell the donated assets.

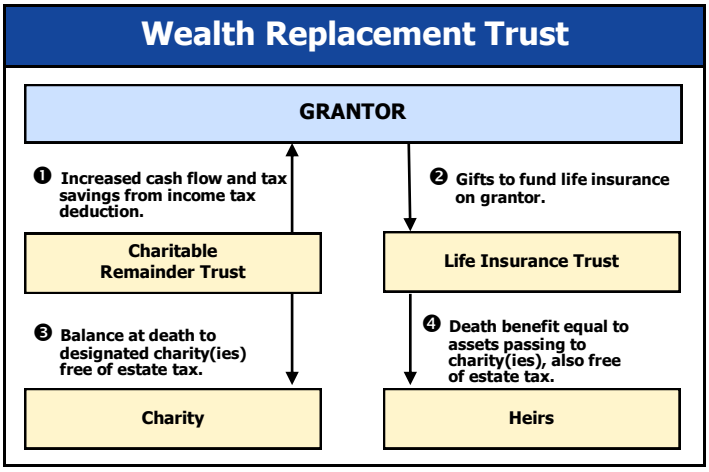
Property subject to verbal pre-existing contracts might also be viewed as obligating the trustee(s) to sell, and are generally not appropriate assets for a CRT. The trustee(s) has a fiduciary duty to manage the trust assets, not only for the benefit of the income beneficiaries (donor(s)), but also the charity(ies).

The income tax deduction is the present value of the remainder interest passing to charity (which must be at least 10% of the initial fair market value of the trust's assets), and is based on the age of the donor (and, if a beneficiary, the donor's spouse), the selected payout, the amount contributed to the CRT and the IRS's assumed rate of return (published monthly). For example, an older donor and a smaller payout will result in a larger charitable income tax deduction, and vice-versa. Upon the death of the surviving spouse, assuming there are no other income beneficiaries, the balance in the CRT passes to the designated charity(ies) free of estate tax because of the unlimited charitable estate tax deduction. Thus, at first blush, it would appear that the donor's children are being disinherited. However, simultaneous with the creation of the CRT, the donor will usually establish an irrevocable life insurance trust for the benefit of his/her children. This is sometimes called a "Wealth Replacement Trust."

A married donor will typically use a second-to-die life insurance policy in his/her Wealth Replacement Trust. The donor will use the tax savings from the charitable income tax deduction and the increased cash flow resulting from the use of the CRT to make gifts to the Wealth Replacement Trust, thereby providing for the "replacement" of the property eventually passing to charity.

In summary, by using a CRT in conjunction with a Wealth Replacement Trust, the donor can increase spendable income; reduce or eliminate income, capital gains and estate taxes; secure a tax-free inheritance for his/her heirs; and leave a lasting legacy.





LEVEL THREE PLANNING

Family Limited Liability Companies and Valuation Discounts

Situation

There is a projected federal estate tax liability that exceeds the life insurance inside irrevocable trusts.

Objectives

- Use the federal gift tax exemption to make lifetime gifts. Thus, the future appreciation on the gifted property is effectively removed from the estate.
- Take advantage of valuation discounts (for lack of control and marketability).
- Maintain control over the gifted property.
- Shift income to children and/or grandchildren who may be in lower income tax brackets.

Tools & Techniques

- Family Limited Liability Companies ("FLLCs")
- Valuation Discounts

Disadvantages

- Transfers to FLLCs are irrevocable.
- The donor loses the income allocated to the new FLLC members.
- The donor's heirs lose stepped-up basis on appreciated property transferred to the FLLC.

Family Limited Liability Companies

A family limited liability company ("FLLC") is typically established as follows and will provide the following benefits:

- A donor transfers income-producing assets (e.g., building or equipment) to an FLLC. The donor may use multiple FLLCs to further limit liability (i.e., one FLLC for real estate, and another for marketable securities).
- The donor is the "manager" and, in that capacity, owns a small (1%-5%) voting membership interest in the FLLC.
- The donor's spouse, children and/or grandchildren (or trusts for their benefit) are gifted the non-voting membership interests, and, in that capacity, own the balance (95%-99%) of the FLLC.
- The Tax Court recognizes a minority discount from the full value of the membership interests gifted to children and grandchildren because such interests do not have any control over the FLLC and lack marketability.
- Discounts of 25% to 40% are typical, but must be determined by a qualified appraiser.
- The FLLC can lease equipment or buildings to the donor's corporation (at fair market value), or to any other person or entity.
- As manager, the donor has exclusive control and management of the FLLC's business and assets. The operating agreement permits the manager to accumulate (as opposed to distribute) profits for business purposes, and the operating agreement also permits the manager to receive a reasonable management fee.
- If the non-voting membership interests are gifted to a grantor trust established by the donor for the benefit of his/her descendants, then the donor/grantor will be responsible for paying the trust's income taxes. The donor/grantor's payment of the trust's income taxes is essentially a tax-free gift to the beneficiaries of the trust. (See page 17.)
- Only the value of the donor/manager's membership interest is included in his or her gross estate - despite the fact that he or she managed the FLLC.
- The initial assets transferred to the FLLC, plus any after-tax earnings and appreciation thereon, are removed from the donor/manager's gross estate (except to the extent of the donor/manager's membership interest).
- Assets in the FLLC are difficult for the creditors of a member to reach.
- The FLLC's profits are allocated to the members in proportion to their ownership interests, even if not distributed. If the members are in a lower tax bracket than the donor/manager, an income tax savings will result.
- The donor/manager's irrevocable life insurance trust can be made a member. Thus, the FLLC's cash flow can be used to pay life insurance premiums without having to use any of the donor/manager's annual gift tax exclusion, or gift tax exemption.

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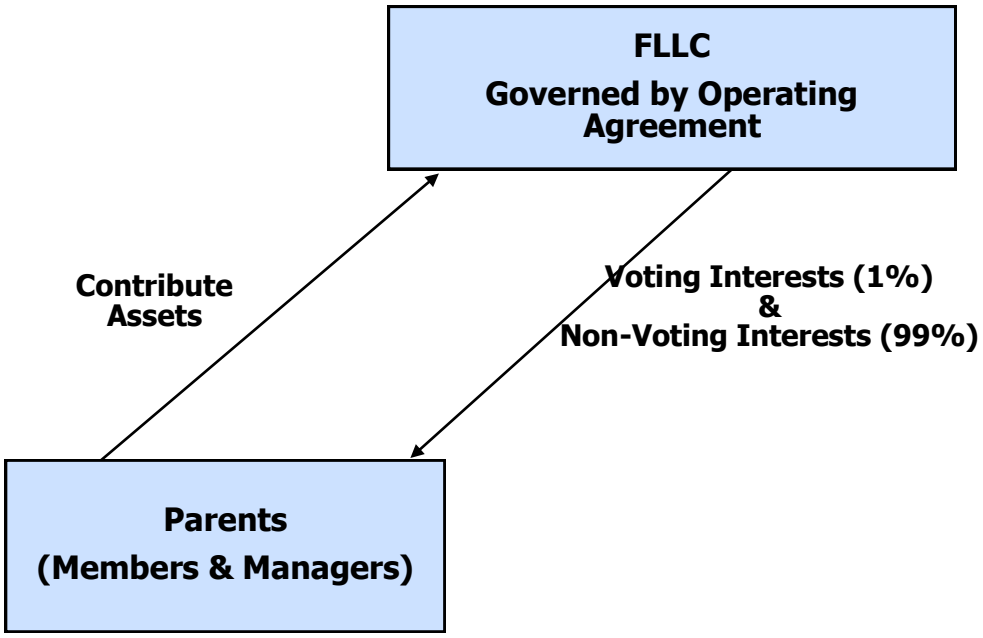
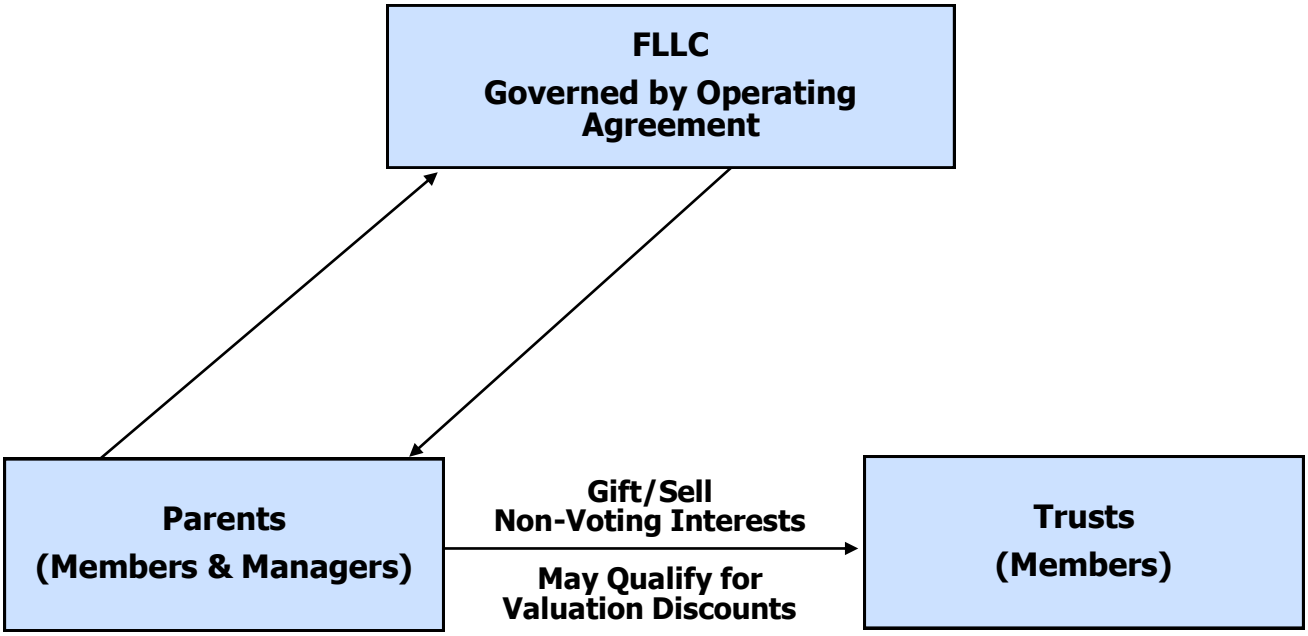
Step 1: Create Family LLC



Step 2: Make Transfers of Family LLC



LEVEL FOUR PLANNING

QPRTS, GRATS and IDGTs

Situation

The further need to make gifts when the federal gift tax exemption has already been used for other transfers.

Objectives

- Remove property from the grantor's estate.
- Permit the grantor (and the grantor's spouse) to continue using the property or the property's income for a fixed term.
- Make substantial gifts at little or no gift tax cost.
- Freeze the value of the property transferred.
- Permit the grantor to pay beneficiaries' income taxes (gift tax free).

Tools & Techniques

- Qualified Personal Residence Trust ("QPRT")
- Grantor Retained Annuity Trust ("GRAT")
- Installment Sale to an Intentionally Defective Grantor Trust ("IDGT")

Disadvantages

- Trust is irrevocable.
- The grantor loses access to property at end of fixed term.
- Heirs lose stepped-up basis on appreciated property.
- With QPRTs and GRATS, if the grantor dies during the fixed term, the property in trust is included in the grantor's estate.

Qualified Personal Residence Trusts

A Qualified Personal Residence Trust ("QPRT") is typically established as follows and provides the following benefits:

- The grantor's residence (or second home) is transferred to a trust, but the grantor retains the right to use the residence for a specified number of years.
- After the fixed term ends, the property passes to the beneficiaries named in the QPRT, usually the grantor's children.
- The creation of the QPRT involves a gift to the grantor's children of only the remainder interest. IRS valuation tables are used to compute the value of the grantor's right to remain in the residence for a certain number of years, and the value of that retained interest is subtracted from the value of the residence.
- For example, assume a vacation home owned by a grantor age 70 is worth $3,000,000 and the IRS's assumed interest rate is 5.2% for the month of the transfer.

  If the grantor establishes a 15-year QPRT for his or her children, the total value of the grantor's retained interest is $2,255,220. Thus, the taxable gift is only $744,780 ($3,000,000 - $2,255,220). This taxable gift can be offset by the grantor's $15 million gift tax exemption.

  Assuming the grantor survives the 15-year term, and the residence appreciates at 5% per year to $6,236,785, the potential estate tax savings at a 40% estate tax rate will be $2,196,802! (See Diagram on page 18.)
- The longer the term for the grantor's retained interest, the smaller the gift to the grantor's children and/or grandchildren. However, if the grantor does not survive the fixed term, the fair market value of the residence is included in the grantor's gross estate just as if the QPRT had not been created.
- If the grantor wants to continue using the residence after the fixed term expires, the grantor can lease it from his or her children at fair market rental rates, which saves more estate tax by removing additional funds from the grantor's estate. While the rent would be taxable income to the children, the net effect is that the grantor is transferring assets (i.e., rent) to his/her children at potentially lower income tax rates. However, if the trust is a "grantor" trust for income tax purposes, the rent will not be taxable income to the children (nor to the grantor). Essentially, the rent payments would be tax- free gifts to the children.
- A QPRT works best for a residence and/or second home that the grantor expects to hold for the foreseeable future or replace if sold.
- A common hedge against death during the term is to insure the grantor's life for an amount equal to the estimated estate tax on the value of the residence. An insurance policy held by an irrevocable life insurance trust is an ideal hedging strategy.

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Grantor Retained Annuity Trusts

A grantor retained annuity trust ("GRAT") is typically established as follows and provides the following benefits:

- Either Subchapter S stock that pays significant dividends, or a partnership or LLC interest with good cash flow, is transferred to a GRAT. However, virtually any asset can be used.
- The GRAT pays the grantor a fixed payment (an annuity), at least annually, for a fixed term of years.
- After the fixed term ends, the trust property (plus the appreciation thereon) passes to the beneficiaries named in the GRAT, usually the grantor's children.
- Only the value of the remainder interest is subject to gift tax. The value of the remainder interest and, therefore, the value of the gift, can be reduced by a longer term, a larger annuity, an older grantor, or a lower assumed interest rate (published monthly by the IRS).
- For example, if a 70-year-old were to transfer $5,000,000 of marketable securities to a GRAT with a term of 10 years, and retain a 10% annuity interest ($500,000 per year) during the term of the trust, the taxable gift will only be $1,176,350 (assuming the IRS's interest rate is 5.2% for the month of the gift). The reason for the reduced gift is that the children are not receiving the trust property for 10 years. This taxable gift can be offset by the grantor's $15 million gift tax exemption. If the assets in the GRAT generate 2% income and 6% growth during the 10-year term, there will be $3,590,793 remaining in the GRAT after the term. (See Diagram on page 18.)
- If the grantor dies during the GRAT term, the IRS's position is that a portion of the GRAT assets are included in the grantor's estate. The portion so included is the amount necessary to produce the retained annuity in perpetuity (as if the annuity amount were the annual income of the GRAT's assets) using the IRS's assumed interest rate in effect in the month of death. Generally, if a GRAT's assets have substantially appreciated, there will be a significant tax-free transfer of wealth even if the grantor dies during the term.
- A common hedge against death during the term is to insure the grantor's life for an amount equal to the estimated estate tax on the value of the property in the GRAT. An insurance policy held by an irrevocable life insurance trust is an ideal hedging strategy.

Installment Sales to Intentionally Defective Grantor Trusts

An installment sale to an intentionally defective grantor trust ("IDGT") can provide valuable income, gift and estate tax benefits. If the assets sold produce a total return (income and appreciation) in excess of the interest rate on the note, substantial wealth can be removed from the seller's gross estate – gift and estate tax free. The IDGT is one of the most popular wealth transfer planning techniques being used today.

Design.

Following is a summary of the basic structure of an installment sale to an IDGT (see Diagram on page 18):

- The grantor creates an irrevocable trust for the benefit of his/her descendants. The trust is specifically designed so that the grantor is taxed on the trust's income, but the trust assets are not taxed in the grantor's estate. In other words, the grantor owns the trust assets (and income thereon) for income tax purposes, but not for estate tax purposes.
- The grantor makes a gift to the IDGT. For estate tax purposes, this gift (or so-called "seed" money) should be equal to at least 10% of the combined value of the assets to be sold to the trust and the gift itself. This gift will use up a portion of the grantor's $15 million ($30 million for married couples) gift tax exemption. The gift can be made in cash or with the same assets to be sold to the IDGT.
- If the IDGT is designed as a Dynasty Trust, the grantor must allocate a portion of his/her generation-skipping transfer (GST) tax exemption to the trust to cover the amount of the seed money gift. The GST tax exemption is the same amount as the estate tax exemption, and the allocation is reported on a gift tax return (Form 709). (See page 10.)
- The grantor then sells assets to the IDGT that are expected to outperform the interest rate on the note. Typically, there is no down payment, interest is payable annually on the note, and a balloon payment will be due at the end of a set term ranging generally from 9 to 20 years. Ideally, the assets sold to the trust will generate income (to make the interest payments) and will also qualify for valuation discounts for lack of control and lack of marketability. For example, non-voting interests in a family LLC or a Subchapter S corporation are often good assets to sell to a grantor trust. (A grantor trust is also an eligible Subchapter S stockholder.)
- The interest rate on the note is fixed for the entire note term at the lowest rate allowed under the tax law. This rate is known as the Applicable Federal Rate ("AFR") and is published monthly by the IRS. There are rates for loans of three years or less, for loans between three and nine years, and for loans over nine years.

Tax Advantages.

Following is a summary of the tax benefits this technique provides:

- The grantor recognizes no gain or loss on the sale. However, the trust's basis in the assets purchased is not the purchase price paid for the assets, but instead the grantor's basis.
- The grantor is not taxed separately on the interest payments the grantor receives. Instead, the grantor is taxed on all of the trust's income. In essence, the grantor is making a tax-free gift to the trust's beneficiaries by paying the trust's income taxes. Moreover, if the trust makes payments in kind (by returning some of the assets purchased), the grantor recognizes no gain.
- If the total return on the assets sold to the trust exceeds the interest rate on the note, assets are transferred tax free to the trust's beneficiaries. The transfer tax benefits are enhanced by the grantor's payment of the trust's income taxes. These "excess" trust assets can be reinvested as the trustee decides, including purchasing life insurance on the grantor and/ or grantor's spouse's lives.
- If designed as a Dynasty Trust, the assets in the trust can escape estate taxation in the estates of the grantor's children, grandchildren, and possibly more remote descendants, depending on state law.
- The future growth (equity) in the trust provides additional equity with which to support future installment sales within the 10% guideline referred to above.

GRATs vs IDGTs.

The IDGT has several advantages over a GRAT. With a sale to an IDGT, there is no mortality risk. With a GRAT, the death of the grantor prior to the expiration of the term causes the assets in the GRAT to be included in the grantor's estate. Another advantage of a sale to an IDGT is that the interest rate is lower (i.e., the applicable federal rate as opposed to 120% of the mid-term applicable federal rate). Since the grantor receives a lower rate of return, more value is ultimately passed on to the beneficiaries. The sale to an IDGT is also a better vehicle for generation-skipping, since the GST tax exemption cannot be allocated to a GRAT until the expiration of its term (see page 10). Finally, whereas a GRAT generally requires equal annual annuity payments, a sale to an IDGT allows for interest only with a balloon payment. Thus, more value remains in the trust longer.

The GRAT, however, offers two important gift tax advantages. With a GRAT, the annuity can be expressed in terms of a percentage of the initial amount transferred so that any undervaluation is automatically corrected. In comparison, with a sale to an IDGT, an incorrect valuation may result in an unintended gift tax. In addition, a sale to an IDGT generally requires the grantor to make a seed gift equal to at least 10% of the combined value of the assets to be sold to the trust and the gift itself. With a GRAT, it's possible to "zero-out" the gift by setting an appropriate term and annuity amount.

Special Section

Conduit Trusts, IRAs, and the SECURE Act: Why It's Time to Revisit Your Estate Plan

If your estate plan names a trust as the beneficiary of your IRA or other retirement accounts, recent changes in the law may mean your plan no longer works as intended. The SECURE Act, passed in 2019, brought sweeping changes to how inherited retirement accounts are treated. Most notably, it requires that nearly all non-spouse beneficiaries withdraw the entire balance of inherited retirement plans within 10 years of the original account holder's death - a major shift from the previous rules that allowed distributions over the beneficiary's lifetime.

Prior to this law, estate plans commonly used conduit trusts as the designated beneficiaries of retirement accounts. These trusts allowed required minimum distributions to pass through to the trust's beneficiary over the course of their life expectancy – a strategy that aligned well with the then-permissible long payout periods. This helped manage the flow of inherited assets, provided creditor and divorce protection, and protected beneficiaries who might not be able to properly manage large sums.

However, the SECURE Act has turned this planning approach on its head. Under the new rules, because conduit trusts must distribute all funds received from a retirement plan directly to the beneficiary, the entire account now gets pushed out within that 10-year window. In effect, the law has amended many estate plans to require that large sums of money be paid out - often to young or financially unprepared beneficiaries—much faster than originally intended.

Example

Imagine Susan, a widowed mother, leaves her $800,000 IRA to a conduit trust for her 22-year-old son, Daniel. Under the old rules, Daniel could have received modest annual distributions stretched over his entire life expectancy, while the remainder stayed protected and growing tax-deferred in the IRA. Under the SECURE Act, however, the trustee must now distribute all $800,000 within 10 years of Susan's passing - possibly pushing Daniel into the highest tax bracket, and exposing the funds to potential misuse, creditors, divorced spouses, or other risks. This is likely not what Susan intended.

It's Time to Reevaluate

That's why it's critical to revisit your estate plan. If your plan still relies on conduit trusts to receive retirement accounts, it's time to evaluate whether that structure still achieves your goals. In many cases, a different kind of trust - such as an accumulation trust or a charitable remainder trust - may offer better protection, more control, and improved tax outcomes for your heirs.

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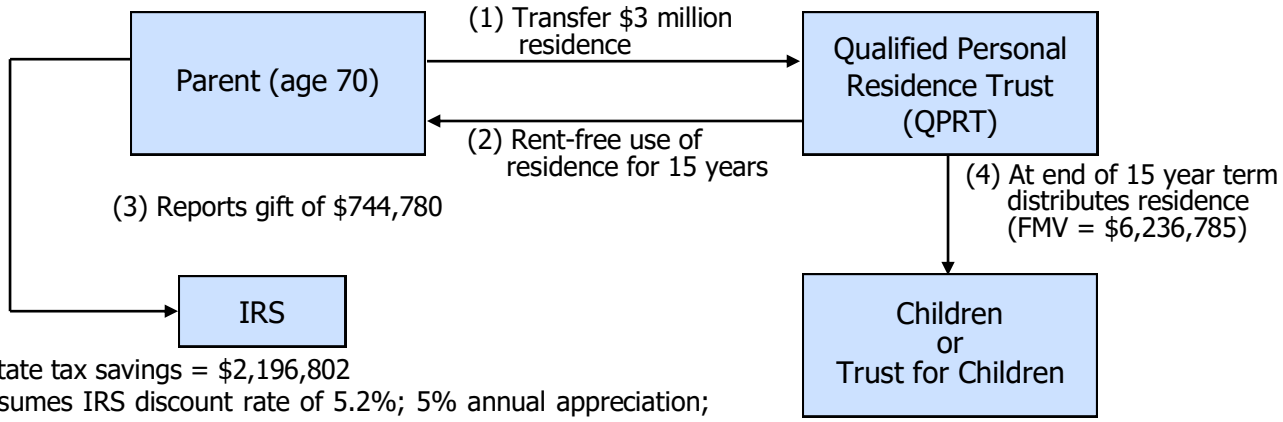
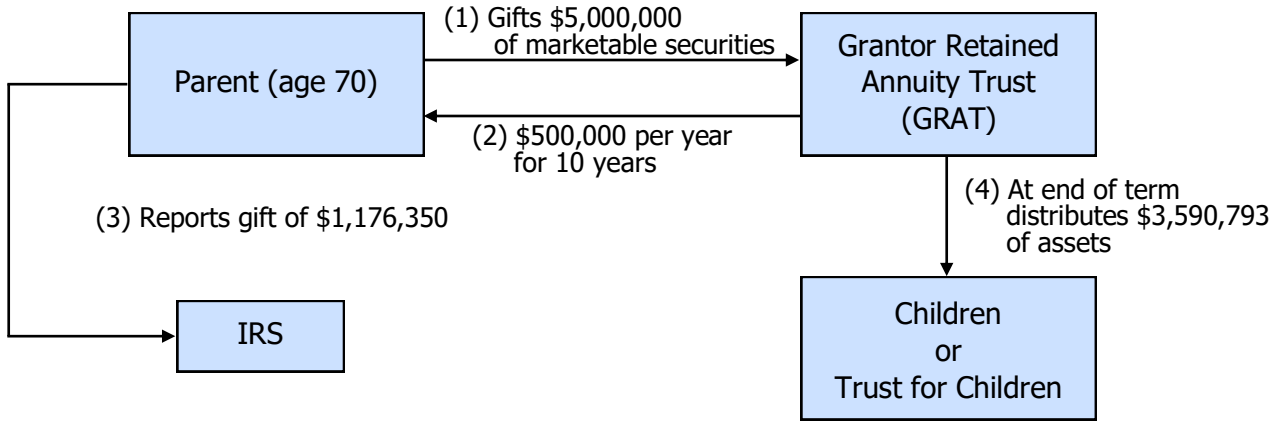
Qualified Personal Residence Trust



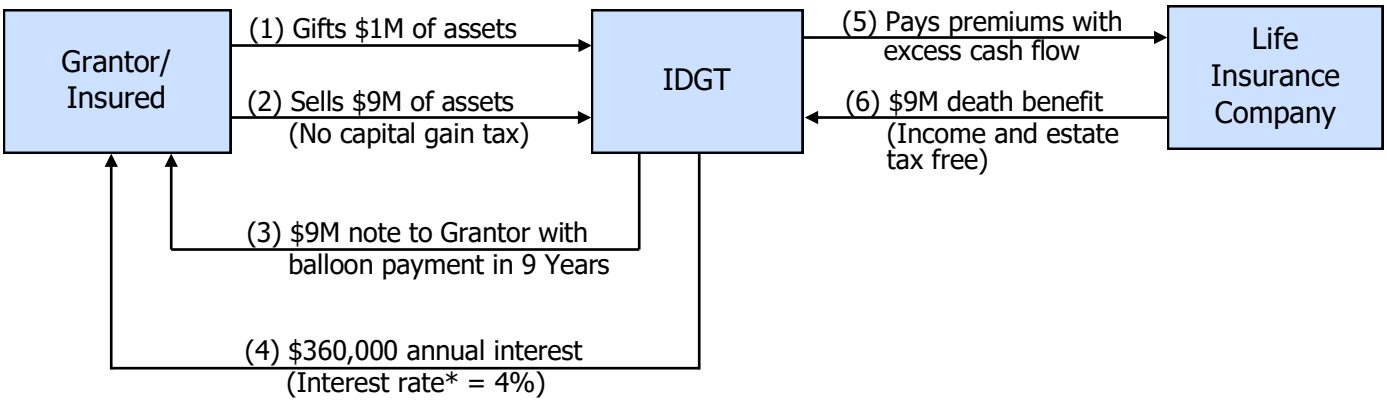
Estate tax savings = $2,196,802
Assumes IRS discount rate of 5.2%; 5% annual appreciation; and 40% estate tax rate.

Grantor Retained Annuity Trust



Assumes IRS discount rate of 5.2% and 2% income and 6% growth.

Installment Sale to IDGT



*Assumed Mid-Term AFR

LEVEL FIVE PLANNING

Charitable Planning

Situation

Desire to disinherit the IRS, and to choose children and charity over Congress.

Objectives

- Avoid being an "involuntary philanthropist" (i.e., paying estate taxes and letting Congress control those funds), and instead become a "voluntary philanthropist" (i.e., not paying estate taxes and letting the heirs control those funds).
- Make entire estate available to the surviving spouse during his or her lifetime, while providing the children and grandchildren with a desired minimum inheritance.

Tools & Techniques

- Use Crummey/Dynasty Trust funded with a second-to-die life insurance policy to provide children and grandchildren with desired inheritance - generally, federal income and estate tax free.
- Use Marital-Family Trust to provide for surviving spouse.
- Upon death of surviving spouse, distribute that portion of the estate over the couple's combined federal estate tax exemption to charity.

Disadvantages

- The grantor-insured cannot act as the trustee of an irrevocable trust.
- Crummey/Dynasty Trust is irrevocable and, therefore, cannot be amended or revoked.
- The grantor cannot directly reach trust property (i.e., cash values) during lifetime. However, the trustee can use cash values for the benefit of the grantor's descendants during the grantor's lifetime.

The "Zero Estate Tax Plan"

The "Zero Estate Tax Plan" is an approach to estate planning which results in no federal or state death taxes being paid. There are several ways to achieve a zero estate tax, including using the Charitable Lead Annuity Trust described on page 23. Following is an example of the simplest zero estate tax plan. Assume a married couple, both age 60, with a $40 million estate and no growth or depletion of their estate. Also assume that the estate tax exemption is $15 million per spouse, with a 40% estate tax rate.

Diagram I on page 20 illustrates the standard Marital-Family Trust (described on page 2 of this brochure).

Diagram II on page 21 illustrates how the children can receive the same $36 million they inherit in Diagram I, but with no estate taxes being paid. By gifting $2.6 million ($130,000 annual exclusion gifts for 20 years) to a Crummey/Dynasty Trust (described on page 10 of this brochure) funded with a $6 million second-to-die life insurance policy, it is possible to leave the children $36 million while leaving charity $7.4 million. The unlimited estate tax deduction for charitable bequests leaves the IRS with nothing.

In Diagram III on page 22, by increasing the gift to the Crummey/Dynasty Trust to $4 million ($200,000 annual exclusion gifts for 20 years), the entire $40 million passes to the children, while $6 million goes to charity and, most importantly, no estate taxes are due.

In summary, by implementing the Zero Estate Tax Plan (Diagram III versus Diagram I), the children receive $40 million instead of $36 million; charity receives $6 million instead of nothing; and the IRS receives nothing instead of $4 million! Moreover, the inheritance the children receive in Diagram I (net of their own exemptions) will be taxed again at their deaths; whereas, the $40 million the children receive in Diagram III, will not be taxed in the estates of the children and possibly more remote descendants, depending on state law (if GST exemption is allocated to the gifts made to the Crummey/Dynasty Trust).

The Charity of Choice: Private Family Foundations

While the Zero Estate Tax Plan works with any qualified charity, the charity of choice is typically the donor's own private family foundation. In the context of the Zero Estate Tax Plan, upon the death of the surviving spouse, the private family foundation will receive that portion of the estate in excess of the estate tax exemption. The foundation will carry the name of the donors and can be managed (in perpetuity) by the donors' descendants.

The private family foundation must make only minimum disbursements (i.e., 5% of its value) each year to qualified charities. As such, the foundation will likely grow in value over the years. As directors of the foundation, the donors' descendants will learn to be altruistic and philanthropic, and will enjoy the self-esteem and public recognition that comes from benefiting charity. Finally, the directors are entitled to reasonable and customary salaries for carrying out the administrative duties of the foundation.

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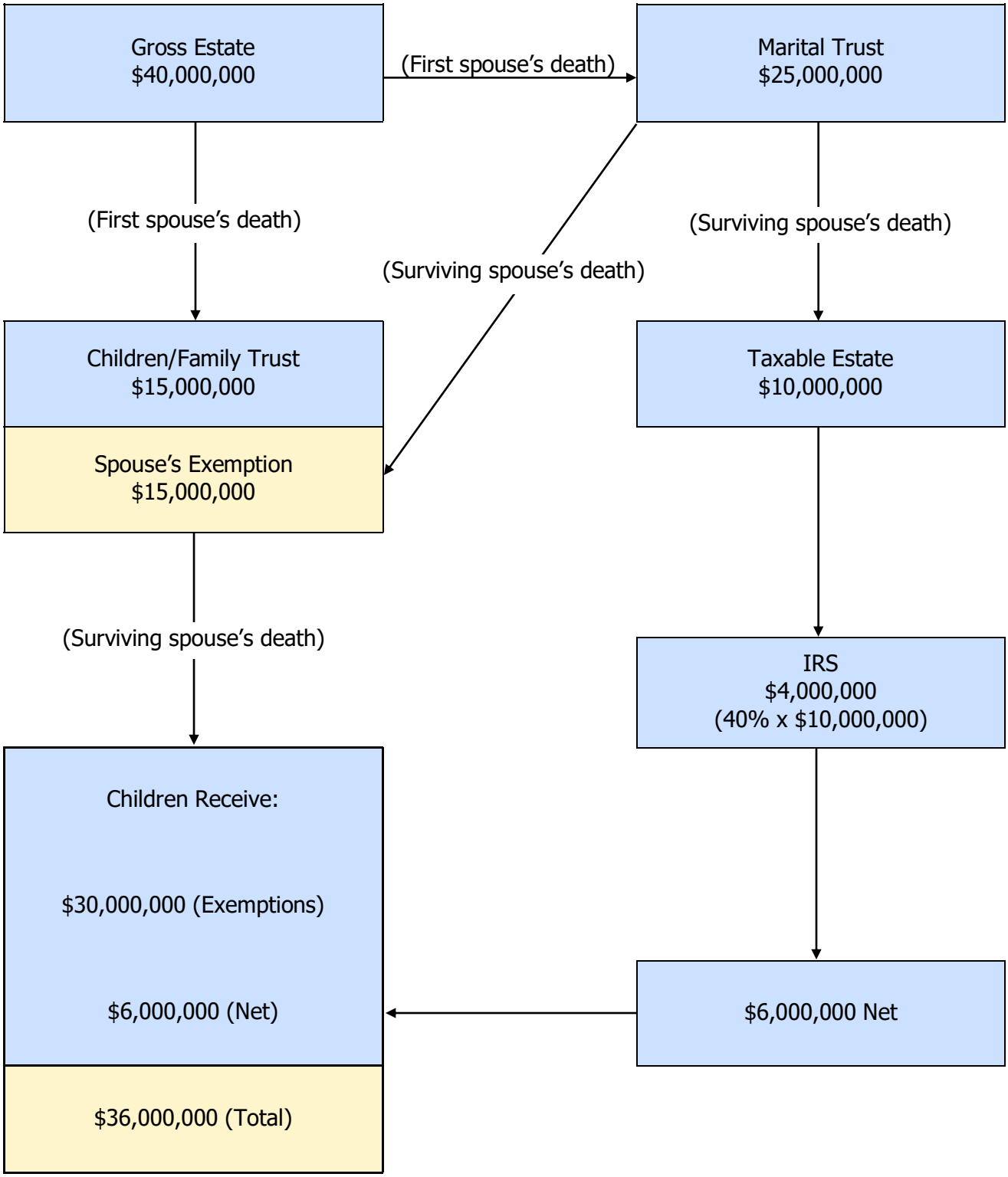
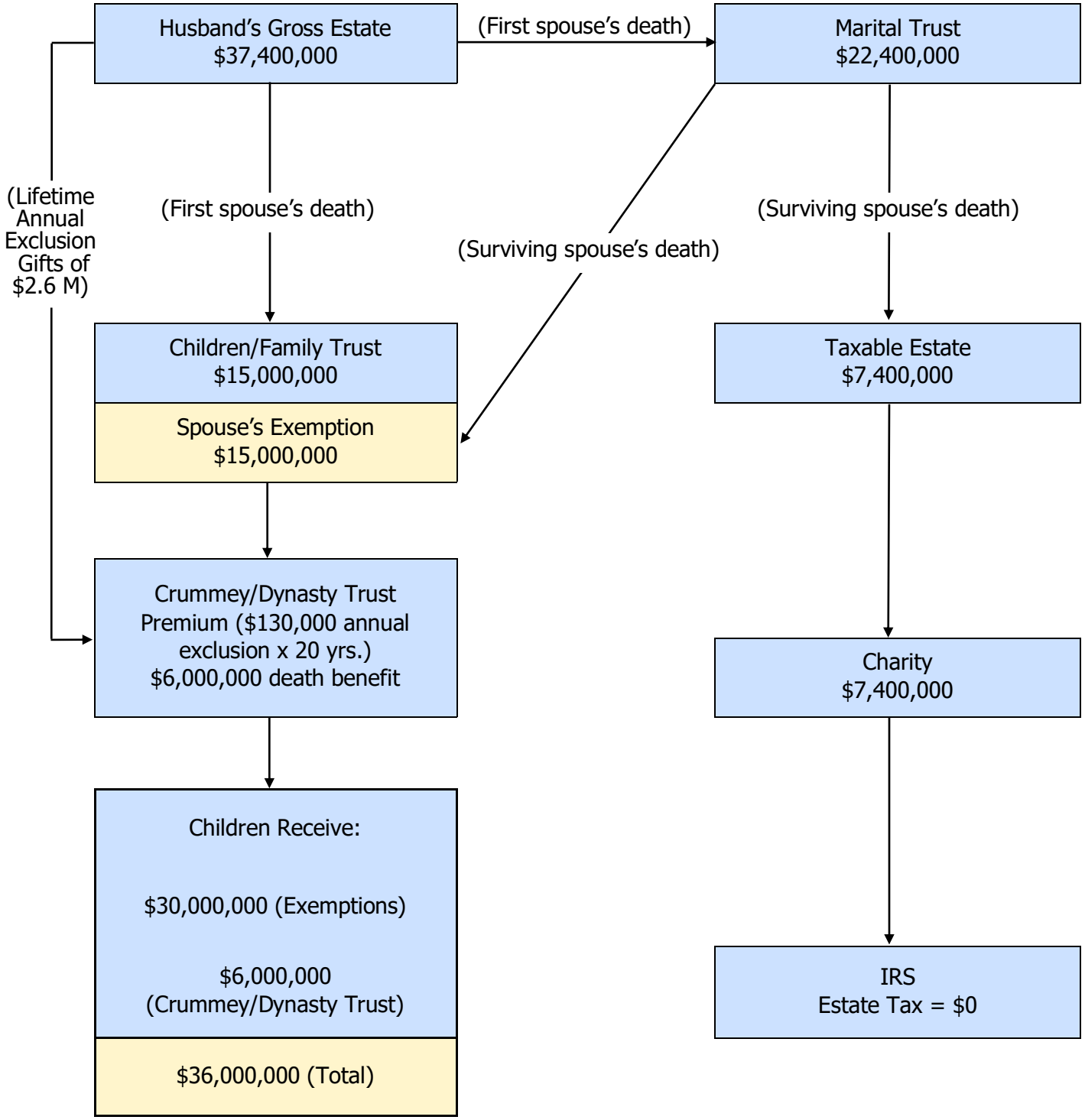
I. Marital-Family Trust



Results based on $40 million starting amount with no growth.

II. Zero Estate Tax Plan



The insurance shown above is for illustrative purposes only and assumes annual exclusion gifts/premiums of approximately $130,000 for 20 years and will vary depending on medical underwriting.

The death benefit and premium are hypothetical and do not represent any particular company or product.

Investment and insurance values are projections only, not guarantees.

Results based on $40 million starting amount with no growth.

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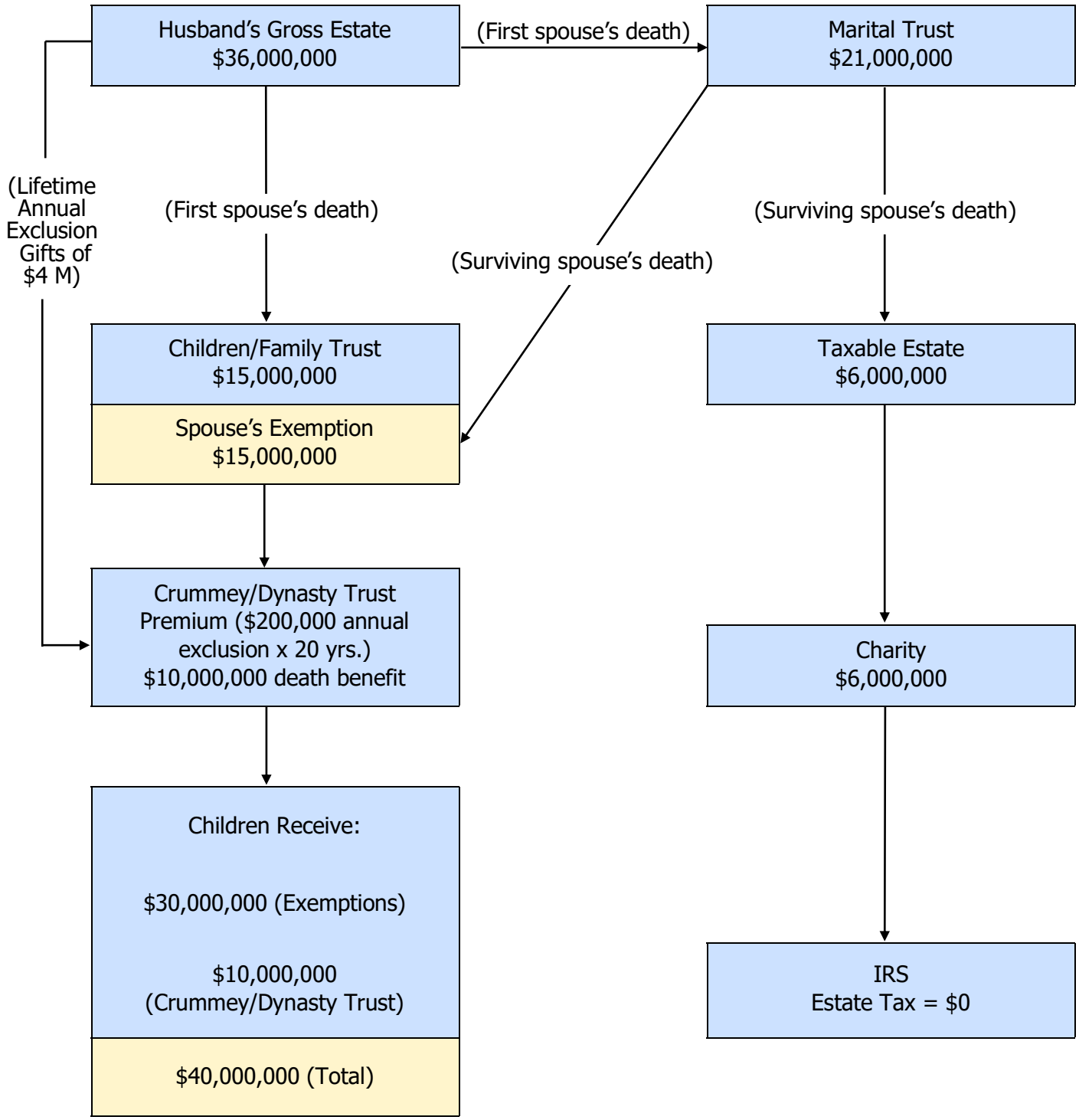
III. Zero Estate Tax Plan



The insurance shown above is for illustrative purposes only and assumes annual exclusion gifts/premiums of approximately $200,000 for 20 years and will vary depending on medical underwriting.
The death benefit and premium are hypothetical and do not represent any particular company or product.
Investment and insurance values are projections only, not guarantees.
Results based on $40 million starting amount and zero growth.
Percentages based on $20 million starting amount.

Special Section

Testamentary Charitable Lead Annuity Trusts (CLATs)

A Strategic Tool for Reducing Estate Tax and Supporting Charitable Causes

A testamentary Charitable Lead Annuity Trust (CLAT) is an estate planning technique that directs a portion of a decedent's estate to charity while significantly reducing federal estate tax. It is particularly suited for individuals with taxable estates and a strong charitable intent.

How It Works

A testamentary CLAT is created at death through a will or revocable trust. It provides a fixed annual payment to one or more qualified charitable organizations for a set number of years. After the charitable term ends, the remaining assets are distributed to non-charitable beneficiaries, usually the decedent's children. Importantly, the annuity payments may be directed to the decedent's own private family foundation. This allows family control over the charitable impact of the funds while still obtaining a full estate tax deduction for the charitable interest.

Estate Tax Reduction

The estate receives a charitable deduction equal to the present value of the annuity stream payable to charity. Only the remainder interest - the projected value of what will remain in the trust at the end of the term - is subject to estate tax. That remainder is calculated using IRS actuarial assumptions and the IRS's prescribed interest rate in effect at the time of death. With appropriate structuring, the remainder interest can be reduced to zero, thereby eliminating estate tax on the assets contributed to the CLAT.

Example

Robert and Elaine have an estate valued at $40 million. Having used their combined $30 million estate tax exemption to leave assets outright to their children, the remaining $10 million would otherwise be subject to estate tax.

Their estate plan provides that this $10 million be transferred at death into a CLAT. The trust pays their private foundation an annual annuity beginning at $114,645, increasing by 20% annually, over a 20-year term. If the IRS's prescribed interest rate at death is 5.2%, the present value of the annuity payments to the foundation is sufficient to eliminate any taxable remainder interest. As a result, no estate tax is due on the $10 million transferred to the CLAT.

If the trust achieves a 6% annual return, over $21 million will have been distributed to their foundation, and over $3.3 million will remain at the end of the term to be distributed to their children - free of estate and gift taxes.

Additional Considerations

Because the CLAT is funded at death, the assets receive a step-up in basis, eliminating capital gains on pre-death appreciation. The growth of the trust after the charitable payments accrues for the beneficiaries free of additional transfer tax.

A potential drawback is that heirs must wait until the end of the trust term to receive distributions. To address this, irrevocable life insurance trusts can be established to provide liquidity. If grandchildren are designated beneficiaries, generation-skipping transfer (GST) tax may apply unless GST exemption is properly allocated.

CONCLUSION

With a $15 million federal estate and gift tax exemption per person and $30 million per couple, the Bill has effectively eliminated the estate tax for over 99.8% of Americans, at least until congress passes new legislation. The increased estate tax exemption may encourage some people to cancel their life insurance. But it's important to keep in mind that the estate tax laws can change, particularly considering the government's likely need to raise taxes in the future.

Equally key to what is in the Act is what is not in the Act. As seen in Level Three Planning, valuation discounts are often used with various estate planning techniques (such as family LLCs). While there have been proposals to limit the ability to discount the value of assets in estate planning transactions, the Act does not include such limits. As a result, valuation discount planning continues to be an effective estate planning tool, and individuals may want to take advantage of such techniques now in case Congress limits them in the future.

Another proposal would have instituted a minimum term for Grantor Retained Annuity Trusts ("GRATs") discussed in Level Four Planning. This would have greatly reduced the planning opportunities associated with GRATs by increasing the mortality risk. However, no such provision was included in the Act. Thus, short-term GRATs (e.g., two to three years) appear likely to be viable, at least for the immediate future.

It has also been proposed to subject Dynasty Trusts, discussed in Level Two, to estate taxes after 90 years, and to limit the benefits of Intentionally Defective Grantor Trusts (IDGTs), discussed in Level Four. However, neither of these proposals are in the Act. But Congress could embrace any or all of these ideas at almost any time. Thus, high net worth individuals are well advised to take advantage of these techniques while they are still available.

In summary, the Act brings opportunity, complexity and uncertainty that can be managed with advanced planning. With proper planning, perhaps now more than ever, it is possible to "disinherit" the IRS.

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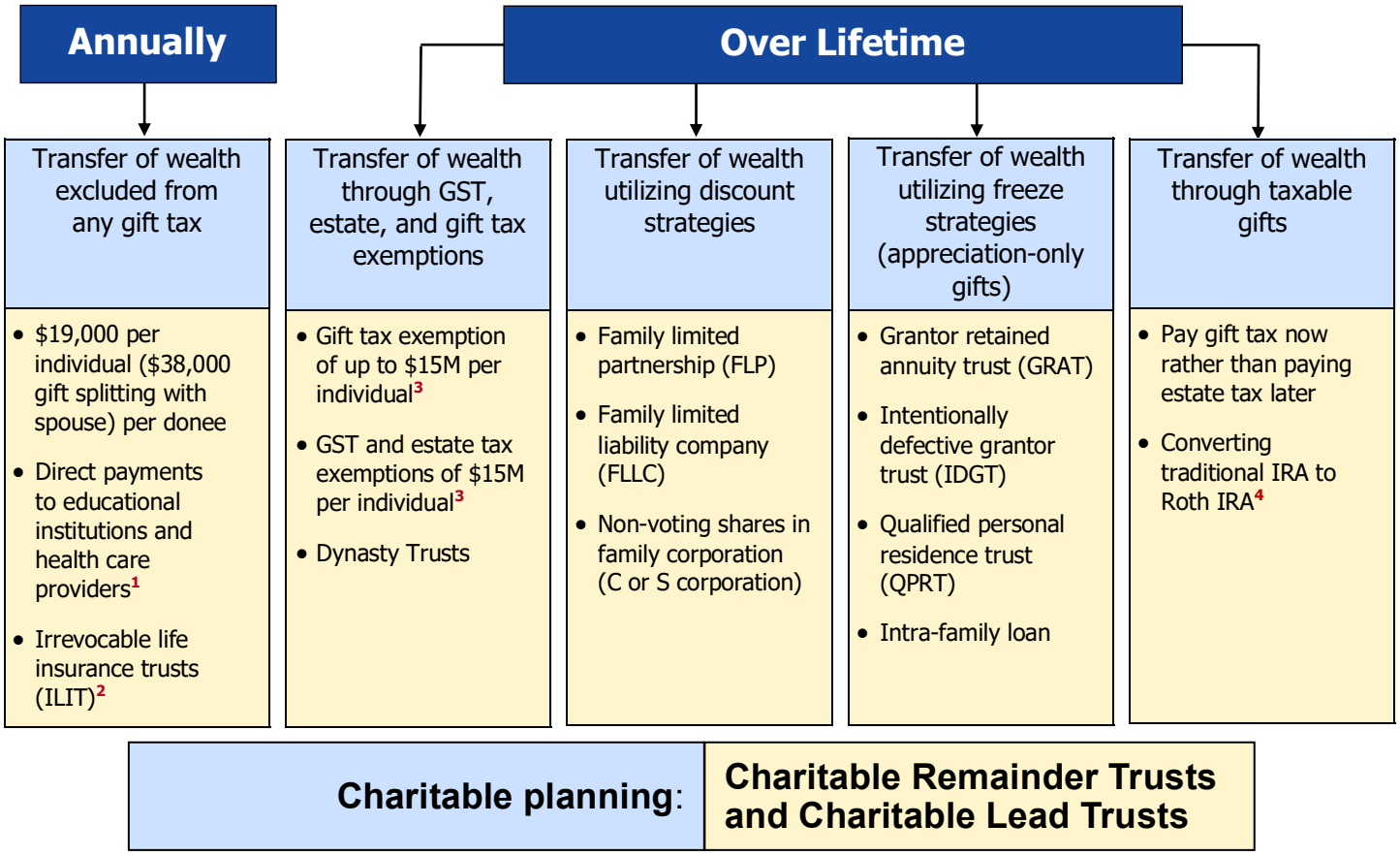

[1] To qualify for the exclusion, gifts of tuition and medical expenses must be made directly to the education or health care provider.
[2] Often can be structured as a Crummey Trust for annual exclusion gifting.
[3] Adjusted annually for inflation.

About the Authors

Julius H. Giarmarco, J.D., LL.M. is chair of the firm's Trusts and Estates Practice Group. Julius received his law degree from Wayne State University, and his master of laws from New York University. He is licensed to practice law in both Michigan and New York. Julius's primary practice areas include estate planning, business succession planning, wealth transfer planning, asset protection planning and life insurance applications. He was a former instructor in both the Chartered Life Underwriter (CLU) and Certified Financial Planner (CFP) programs. Julius lectures frequently on a national basis and has published a number of articles on estate planning appearing in professional journals such as the Estates, Gifts and Trusts Journal (BNA), The Practical Tax Lawyer (ALI-ABA), the Journal of Practical Estate Planning (CCH), the Journal of Financial Service Professionals, the Michigan Bar Journal and Advisor Today magazine. He is also the author of the nationally-acclaimed brochure, *The Five Levels of Estate Planning*, and is the author of the chapters on *Succession Planning in Advising Closely Held Businesses in Michigan* and *The Michigan Business Formbook* published by the Institute of Continuing Legal Education (ICLE). Julius has been selected by his peers as a Michigan Super Lawyer, Leading Lawyers, Best Lawyers in America and as a "Top Lawyer" by dBusiness magazine. He also enjoys the highest possible rating in both legal ability and ethical standards by Martindale-Hubbell.

Salvatore J. LaMendola, J.D. has been a member of the Trusts and Estates Practice Group at Giarmarco, Mullins & Horton, P.C. since 1996. Sal received his J.D. from the Notre Dame Law School and holds a B.B.A. from the University of Notre Dame. His main practice areas are general estate planning; amending irrevocable trusts through trust decanting, exercises of power of appointment, and other techniques; pre-death and post-death planning for IRAs and other retirement plans; and charitable planning with charitable remainder trusts, charitable lead trusts, and private foundations. Sal is a member of the Probate & Estate Planning Section of the State Bar of Michigan. He is also a regular continuing education presenter for legal education webinar providers Rossdale of Miami, FL and Strafford of Dallas, TX. He also serves on Strafford's Estate Planning Advisory Board and on the InterActive Legal Practice Advisory Board.