Advising the Affluent Client: Estate Planning

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Important Notice – 2010 Status of Estate Taxes

Please Read Before Beginning

Under current law, there is no federal estate tax for 2010, although the gift tax continues. If Congress passes no further legislation, then the estate tax will return in 2011 under the laws that were in existence prior to the Economic Growth and Tax Relief Act of 2001.

At the beginning of 2010, many feel it is unlikely that Congress will allow this to stand. New legislation is anticipated for 2010, and this legislation could potentially be retroactive to the beginning of 2010, thereby reinstating the estate tax for 2010. However, the longer Congress delays, the more likely the repeal will stand. Nonetheless, even if the estate tax repeal for 2010 is allowed to stand, it is likely that there will be an estate tax in 2011, but not with the exclusion limits or tax rates that previously existed.

Given the current uncertainty regarding the estate tax, what is the best way to teach estate and gift taxes in 2010? Furthermore, what are the implications of this uncertainty for clients?

Teaching Methodology

Fortunately, it is not the methodology of estate taxation that is so much in question. If we have an estate tax in the future, it will almost certainly follow rules that are similar to the past, but with potentially different exclusion amounts and tax rates. Therefore, those persons who are familiar with the most recent rules should find it a fairly simple matter to adjust to the new rules once Congress makes its decisions. With this in mind, until such time as Congress passes further legislation in 2010, all of our gift and estate planning coursework will follow these teaching guidelines:

- **Teach the estate and gift tax rules as they existed in 2009**. For this reason, many examples in our estate and gift taxation coursework will deliberately reflect pre-2010 dates so that you can become grounded in the rules that existed in the past and are anticipated to remain methodologically unchanged, or at least similar, in the future.

- **Address the adjustments to the estate and gift tax rules that went into effect on January 1, 2010**. These adjustments include the following:
  - The repeal of the estate tax for 2010.
  - The continuation of the gift tax in 2010
  - The change in the step-up in basis for estate assets of persons dying in 2010.

  For these topics, examples in our coursework will reflect 2010 numbers.

- **Provide 2010 numbers for credits and exclusions that simply adjust for inflation.** Some estate, gift, and income tax numbers associated with estate planning are not on the radar screen for new legislation and only change from year-to-year due to inflation, e.g., the gift tax exclusion amount. Such numbers shall be adjusted, if changed, to reflect 2010.

Implications for Clients

Given that we are in a time of transition, it is very important that clients stay in touch with their estate planning attorneys. If Congress does not pass retroactive legislation, planning opportunities may exist for clients; and if Congress does pass retroactive legislation, this, too, may raise planning issues and/or opportunities. If clients have not had their planning documents recently reviewed, have no documents in place, or have not recently been in touch with their estate planning specialists, now is an especially good time to do so.

Introduction

Top producers are always looking for an idea that can help them distinguish themselves in an increasingly competitive marketplace. One of the most powerful ways to differentiate yourself is by broadening your ability to provide more comprehensive financial advice. The ability to address estate planning issues for clients will give you an edge over the countless others trying to survive by applying a one-dimensional approach. Those who continue to focus on a limited array of solutions will fail to capitalize on significant opportunities to grow their business and will become increasingly vulnerable.

The benefits of being able to address your clients' estate planning needs are significant. Specifically, integrating estate planning into your approach will enable you to expand your reach while increasing production and client retention.

- **Expand Reach -** Expand your current client relationships by:
  - Forming trust relationships with your clients provides an opportunity to develop relationships with their heirs, increasing the continuity of the relationship through an unprecedented era of inter-generational transfers of wealth that will occur from baby-boomers to their heirs.
  - Providing more comprehensive and timely financial advice for your clients.

- **Increase Production -** By addressing estate planning issues, you will be equipped with additional resources to:
  - Target a higher net worth clientele
  - Uncover and capture additional assets with existing clients

- **Increase Retention -** Studies show that most affluent clients prefer to work with a single advisor. Those advisors who are unable to address a comprehensive array of their needs will eventually lose relationships to those who can. Additionally, statistics show that relationships that include a trust have an average lifespan of more than 13 years – over twice that of non-trust related relationships.

Click the icon to learn more.

The Importance of the Estate Planning Discussion

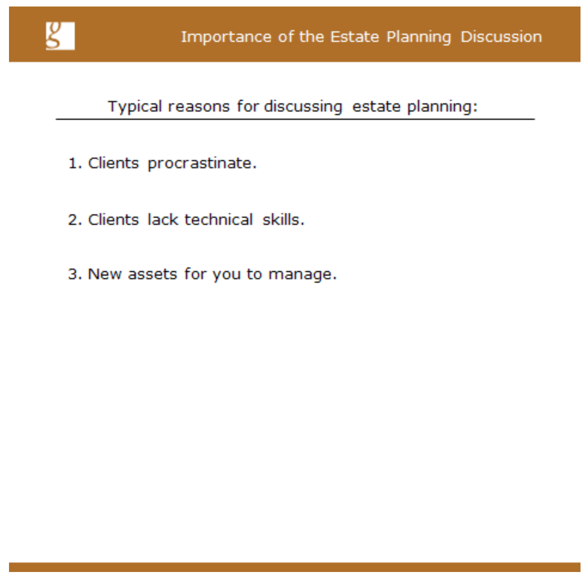
Presented by **Rick Tyler**

A graduate of Vanderbilt University and the Kellogg Graduate School of Management, Rick Tyler is the former Chief Fiduciary Executive for Barnett Banks Trust Company. A frequent speaker, his comments draw upon over 20 years of experience in the Financial Services industry.

Many reasons are often given to stress the importance of helping clients address their estate planning needs. For example,

- Clients tend to procrastinate planning their estates and need someone to motivate them.
- Clients lack the necessary technical expertise to recognize they have a planning need.
- Or, it is an excellent way to identify assets that you are not currently managing.

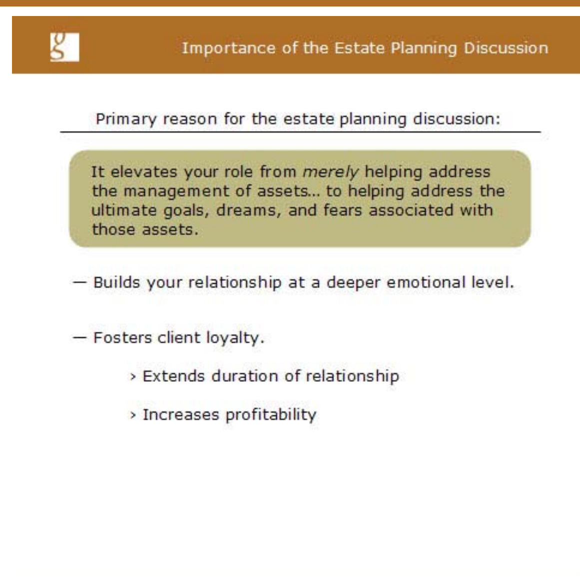
All of these points are true (see graphic on the right).



However, I would like to impress upon you that the primary reason you should address estate planning needs with your clients is because it moves you beyond merely addressing the management of the client's assets to addressing the ultimate goals, dreams, and fears associated with those assets.

The fact is that no other financial conversation you can have with a client takes place at such a deeply emotional level. It is a conversation that allows you to gain insights into what is of ultimate importance to the client.

This results in the client making a significant emotional commitment to your relationship.
Having made that commitment, the client is reluctant to do so elsewhere, particularly when you have done a good job of helping the client address these emotionally charged issues.



This moves the client beyond merely being a "satisfied" client, to becoming a "loyal client." Now creating loyal clients has two payoffs for you: First, it extends the duration of the relationship. Second, it increases the assets clients bring to you. In fact, one recent study, which defined loyal clients as those who had made an emotional commitment to the relationship, found that 90% of loyal clients will contribute new assets every year ***without*** being asked to do so.	

Objectives and Course Structure

The objective of this course is to equip you to help clients address their most common estate planning needs, which are listed on the right.

To accomplish this goal, the course is structured around each of these needs. For each need, the following resolution practice will be discussed.

Common Estate Planning Needs

1. The Need for a Plan
2. Providing Protection (for oneself and for loved ones)
3. Maintaining Control (as to ***who*** will ultimately receive the assets and ***when*** they will receive them)
4. Deciding Who Will Act as Executor/Trustee
5. Minimizing the Impact of Estate and Gift Taxes
6. Maximizing Charitable Intent

Click each technique to learn more.

The context within which a solution can be formed

To identify needs and potential solutions, it is necessary to first understand the environment in which a response is formulated. Depending upon the need being addressed, this may require an understanding of essential vocabulary, legal requirements, taxation, etc. After the needs have been identified, your client should work with his or her legal and tax advisors to design the plan that will address the need. Please note that your work must not replace the advice of the client's legal and tax advisors.

Potential solutions

Once you understand the context, it becomes possible to explore common solutions.

Approaches to take with clients

It is not enough that you understand the need and possible solutions; nothing will happen until your client ***sees*** the need and ***wants*** a solution. Therefore, for each of the primary client needs, we will discuss effective methods you can use to help your client see the need and want a solution.

This last step of getting the client to recognize the need and desire a solution requires some understanding of how people make the decision to "buy," whether they are buying something tangible like a car or a planning solution. Therefore, we will explore this methodology of converting a need to a want on the next page, and then proceed on to addressing each of the six needs listed above.

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Capitalizing on Opportunities

The key to being a successful advisor is not so much about the ability to give advice as it is about the ability to ask questions. In fact, ***the hallmark of a great advisor is asking the right questions at the right time.***

Not all questions are the same. Some questions are for gathering information. These are generally referred to as ***profiling questions***. This is where you begin. By asking a series of fact-finding questions, it becomes possible for an advisor to identify potential needs and establish the framework for applying his or her skill in formulating potential solutions.

Once a client's need is uncovered through profiling, that need must then be turned into a sales opportunity. All too often, advisors attempt to accomplish this by diagnosing a need and immediately telling the prospect how to solve it. In other words, they make the mistake of trying to sell the facts, on the assumption that the mere offering of their diagnosis and solution will be sufficient to motivate the client to action. This seldom works because: ***individuals typically buy what they want, not necessarily what they need.***

Click the icon to view an example.

Purchasing a Car

If the decision of which car to purchase was influenced solely by facts, we would all simply input our specifications into a worksheet and - voila - the most appropriate make and model for you would appear. But we all know the process is much different. In fact, many decide what car they want based upon issues such as appeal of the style, how they feel sitting behind the wheel, or how they feel the car reflects their own personality or sense of status. Then, after deciding what they want, they mentally justify their decision with facts such as "it's a good value" or "it scored well in Consumer Reports."

To get the client or prospect to ***want*** the solution, the advisor must first engender an emotional response that leads people to be unwilling to accept their current situation. This is because: ***people typically buy on emotion, and justify with facts.***

Don't misunderstand this. We're not suggesting that advisors should manipulate emotions. However, we ARE saying that advisors will not bridge the gap between a need and a want until the client or prospect experiences the need on an emotional level. Individuals will not truly want a solution with any degree of urgency until they become concerned and discomforted by the presence of their need.

The best path to engendering this emotional response is by asking another type of questions, which we call ***doubt-raising questions***. Such questions help clients recognize their needs AND foster a sense of urgency within the client to address the need.

Click the icon to view an example.

Creating a Sense of Urgency

Good doubt-raising questions create a sense of urgency that can never be achieved by simply telling a client of a need. To illustrate, consider the following scenario:

> You are walking down the street and see that a piano is about to fall on a bystander. If you tell the person, "You need to move," the person is not going to be very motivated to do so because he or she has no idea WHY there is a need to move. However, if instead you say, "How are you

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going to avoid being crushed by that piano dangling over your head?" you probably should step to the side because the person will be quite motivated to move!

As you begin mastering the skill of asking doubt-raising questions, evaluate your questions relative to the simple criteria listed below.

Click the criteria to learn more.

How…?
Questions that begin with the word "How" are, by their nature, process-oriented. They make the client think through the process of resolving the situation you propose. (Note: This does not mean that every doubt-raising question must begin with "How," but this is a good general rule of thumb, especially as you begin building expertise in asking these types of questions.) For example: • "How have you made the determination that you would prefer to pay more taxes at death than reduce them through lifetime gifts?" • "How have you made the determination that this is the best strategy for saving for college expenses?"
Focus on Consequences
A good doubt-raising question causes a client or prospect to confront the consequences of continuing with the current strategy (or lack thereof). For example: • "How does your current plan provide for the support of you and your family if you should become incapacitated?" • "How have you determined that appointing your sister rather than one of your brothers as your executor will not strain family ties?"
Non-Confrontational
Be careful to avoid embarrassing or confronting your clients when asking a question. One way to do this is by asking your question in a manner that presumes they have good reasons for the decisions they have made. When they don't have a good reason, they will generally have no problem responding with, "Well, I really hadn't thought about that" and they will not feel demeaned by having you point out their failings to them. For example, don't ask: "Why did you buy taxable bonds when you could clearly have increased your after-tax income by purchasing municipals?" Instead, ask the question in this manner: "How have you structured your bond portfolio to optimize your after-tax return?" The first question is confrontational. While the second question may surface the fact that the client or the client's current advisor did NOT take after-tax return into consideration, it is clearly non-confrontational and more likely to solicit an inquiry as to what you might suggest.
Focus on the Advisor
If a prospect is currently working with another advisor, frame the question to focus on the advisor instead of on the individual. For example, "How has your advisor structured your

portfolio to meet your objectives?" This will avoid the risk of embarrassing the prospect, while fostering doubt in the prospect's mind regarding the performance of the other advisor. It will also position the client to be curious as to how your approach might be different.

Know How You Would Answer

There is an old adage that an attorney should never ask a question of someone on the witness stand without first knowing the answer. This is also true for financial advisors. Whenever you ask a doubt-raising question, be prepared for the client to ask how **you** would answer the question you just asked. For example, if you ask "How has your advisor structured your portfolio to meet your objectives," be prepared to explain how **you** would go about structuring the portfolio. In short, be prepared to present your solutions once the client is ready to hear it.

Applying any type of rigid formula to the sales process is misguided. However, using the above rules as reference tools can ensure that you master the art of asking effective doubt-raising questions. Throughout this course, we will make frequent reference to applying the art of asking the right questions.

Need #1 – Lack of an Estate Plan

Estate planning is primarily about planning for the transfer and application of assets. This is an important issue for everyone who owns assets because all of us are mortal and will eventually die. That means the assets we own *will* someday transfer to someone, whether we plan for the event or don't. Those assets will also be applied to achieving someone's goals. Without planning, they may serve someone else's goals, not our own.

Far and away the most common estate planning mistakes individuals make is failing to put in place any plan at all. In fact, a recent survey sponsored by LexisNexis found that the majority of Americans (58%) do not have a basic will. The powerful message contained within this staggering statistic is simple - a significant opportunity to distinguish yourself by suggesting appropriate solutions and capture assets exists with many of the affluent individuals you encounter every day.

Potential Implications

Understanding that many people fail to engage in thoughtful planning, let's examine the potential implications. Although the consequences of not planning are far too numerous to list completely, the following are a few that should be considered.

Click each consequence to learn more.

Paying Unnecessary Taxes
Simple planning can eliminate or defer estate taxes for many individuals. Therefore, estate taxes could be considered a choice - either choose to plan or, if by default you have a taxable estate, choose to pay taxes.
Failure to Protect Loved Ones
Lack of planning can result in unduly burdening family with managing complex financial matters, providing them large sums of money they are not ready to handle, or, in the case of minor children, possibly leaving them in the hands of the courts.
Failing to Maximize Charitable Intent
Rather than waiting until death to give money to charities, proper planning may enable individuals to enjoy the emotional benefits of their gift during their lifetime while enabling them to capitalize on significant financial benefits as well.

Another important issue that many affluent clients fail to properly address is how their property is titled. For those that do have an estate plan, improper titling of property can potentially undermine their plan. The importance of properly titling assets is illustrated in the following case:

The Case of "What's Mine is Yours, and What's Yours is Mine"

Jim and Mary Jones, with an estate valued at $6 million, went to an attorney to draw up their estate plan. Rather than leaving everything to the surviving spouse when the first spouse dies, they executed wills that would fund a trust upon the death of the first spouse. The purpose of this trust was to reduce estate taxes (this will be explained later in this course). However, for the plan to work, Jim and Mary needed to divide their property, with each of them owning property in their individual names.

Unfortunately, upon completing the plan, Jim and Mary never took the time to re-title their property, leaving everything titled as Joint Tenants with Right of Survivorship (JTWROS). Therefore, when Jim died, the full $6 million of jointly-held property passed directly to Mary, bypassing Jim's will. Assuming Jim and Mary died in 2009, this seemingly simple mistake could potentially cost the Jones family $1,125,000 in unnecessary estate taxes.

Recognizing the importance of properly titling assets, it is important for advisors to be aware of the importance of making thoughtful decisions regarding the titling of assets (including annuities, brokerage assets, homes, insurance policies, etc.) and beneficiary designations.

Each of these implications, and others, are addressed in greater detail within this course. Suffice it to say, failure to plan or, as in the above case, failure to implement a plan is highly common and has significant financial and emotional consequences.

Doubt-Raising Questions

When you encounter a client that has not done proper planning or does not review their plan periodically to ensure it is appropriate, ask the client the following questions.

Click the icon to view example questions.

- What process did you use to construct an effective estate plan for you and your family?
- How have you reviewed your estate plan in light of recent tax law changes?
- How have you titled your property to ensure you do not undermine your estate plan?

Need #2 - Providing Protection

One of the most powerful estate planning tool for providing protection for an individual and the individual's family is a trust. This is because a trust can continue functioning, in accordance with the purposes and guidelines with which it was established, despite the incapacity or death of the person who established it. This makes it possible to provide some degree of financial protection against the possibility of a period of incapacity, without the need of a court-appointed guardian of the property. It also makes it possible to provide post-death financial protection for family members. To better understand how this is accomplished, let's first elaborate on the nature of a trust.

Overview	A trust is a fiduciary relationship whereby one party, the trustee, takes title to property for the sole purpose of managing it for the benefit of a designated party, the beneficiary(ies). **To learn more about the definitions of the underlined terms, click each heading.**
Fiduciary	The term "fiduciary" is derived from Roman law, and applies to a person or entity that has accepted a responsibility that must be performed in the best interests of another person or entity. In other words, action cannot be based on self-interest; the interest of another must come first.
Relationship	As a "relationship," it must be freely entered into. Just because someone is named to assume this obligation (as trustee), does not obligate him or her to act in this capacity. It is always possible to "disclaim the appointment." But once accepted, the responsibility is legally binding.
Party	The parties to the relationship may be individuals or institutions.
Title	The party acting in this fiduciary capacity is called a **Trustee**. Unlike someone who has a power of attorney or someone who is acting as an agent or custodian, the trustee actually takes legal title to all property held in the trust.
Property	Trusts are created for the purpose of managing property and utilizing it for specific purposes. Without property, there is no effective trust. All too frequently people create trust documents, only to fail to properly fund them.

While trusts can be created verbally, this course will only deal with trusts that are created by written agreement. Under such agreements, property is transferred only when the receiving party agrees to abide by the terms of the agreement.

In drafting trust agreements, care must be taken to make sure there is no conflict with the will. This is important because assets owned by the trust will be administered by the terms of the trust. Unless the trust is required to distribute assets to the estate, the will has no authority over trust assets. For this reason, wills and trust agreements are customarily treated as complementary tools in estate planning.

Types of Trusts

Trust agreements are extraordinarily flexible, and can be tailored for virtually any purpose. They may be **revocable,** meaning the person who created the trust can alter or cancel it at any time. Or they may be **irrevocable,** meaning they cannot be altered or canceled after their creation.

They may be created during life, which is known as a ***living trust,*** or by a person's will, which is known as a ***testamentary trust.*** Since the person who created the will is dead when a testamentary trust is funded, it is by its very nature irrevocable.

Trust Types:

- Revocable
- Irrevocable
- Living
- Testamentary
- Non-discretionary
- Discretionary

They may bind the **trustee** to do only what the trustee is explicitly directed to do by the grantor or the terms of the trust, which is called a ***non-discretionary trust.*** Or they may allow the trustee to use his or her own discretion in deciding what investment changes to make and/or how to distribute income or principal to the beneficiaries, which is known as a ***discretionary trust.***

The trustee is the person or institution that administers the trust per the terms of the trust document.

Click the icon to learn more.

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Flexibility of Trusts

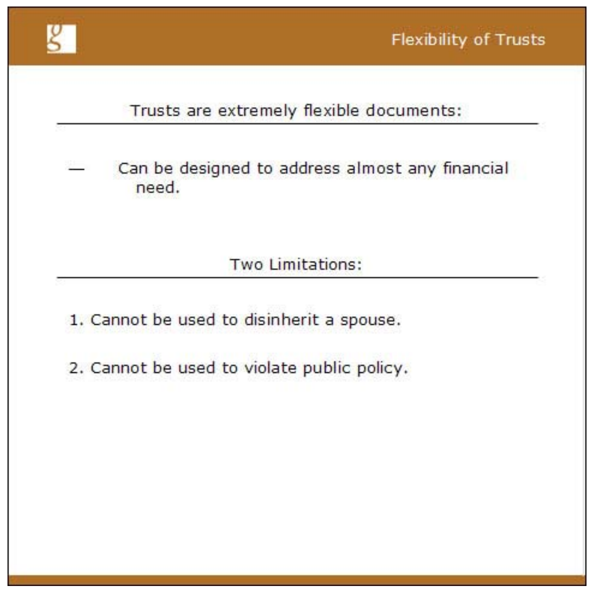
Presented by Rick Tyler

A graduate of Vanderbilt University and the Kellogg Graduate School of Management, Rick Tyler is the former Chief Fiduciary Executive for Barnett Banks Trust Company. A frequent speaker, his comments draw upon over 20 years of experience in the Financial Services industry.

A trust is a very flexible document. For virtually any need that can be addressed through finances, a trust can be created. However, this flexibility is not without limits.

Here are a couple of things you cannot do with a trust:

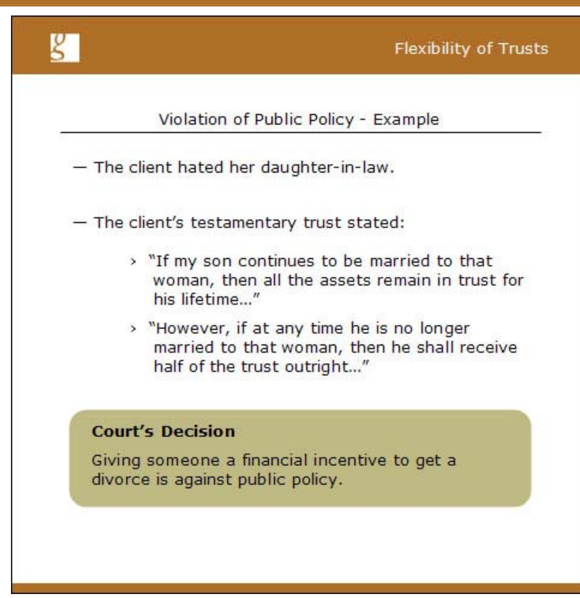
1. First, you cannot use a trust to disinherit a spouse. Every state in the country has laws that prevent this.
2. Second, you cannot use a trust to violate public policy.



Perhaps the best way to explain what I mean by public policy is to illustrate with a story that involved one of my clients. My client absolutely hated her daughter-in-law. When my client died, she left everything in trust and the trust document stated, “If my son continues to be married to ***that*** woman, then all the assets remain in trust for his lifetime and can only be used for his medical emergencies.

However, if at any time he is no longer married to ***that*** woman, then he shall receive half of the trust outright and the remainder shall stay in trust for his health, education, maintenance, and support.”

The son took this to court and the judge ruled that the terms of the trust served as an incentive for the son to get a divorce. Since public policy is to support marriage, not incent people to absolve marriages, the judge ruled that this was against public policy. As a result, the court directed us to ignore this requirement



and to distribute half the assets outright to the son and to use the balance of the trust assets for his health, education, maintenance, and support.	

Three Key Roles

The specific terms and purposes of the agreements are infinite in their variety. But despite these differences, all trusts consist of three parties, as diagramed below:

Click each named party for more information.

Grantor
This is the person who creates the trust. Alternatively, this person is referred to as the trustor or settlor. Any legally competent adult can create a trust by having a trust agreement drafted and transferring assets into the trust. The grantor can be distinct from the beneficiary and trustee, but can simultaneously be either the beneficiary or trustee, or both. For example, it is quite common for people to establish a living trust in which the grantor acts as the trustee and receives all the benefits while alive.
Trustee
This is the person or institution that takes title to the property, agrees to be governed by the trust document, and agrees to act on behalf of the beneficiary. If there is more than one trustee, they are referred to as ***co-trustees***. In fulfilling the duties, the Trustee may have as much or as little power as the grantor chose to relinquish, as stated in the terms of the agreement. Any legally competent adult can be a Trustee.
Beneficiary
The beneficiary is the person(s) or entity(ies) for whom the benefit of the trust is intended. Some beneficiaries may be **current beneficiaries**, meaning they receive a current benefit, such as income, from the trust. Others may be **future beneficiaries**, meaning they will not receive any benefit until some future point in time. Quite often, the future beneficiaries are to receive the assets of the trust upon the death of the current beneficiaries. For example, a trust may exist to pay income for the lifetime of a surviving spouse (the current beneficiary), but terminate upon the surviving spouse's death and distribute the assets to the surviving children (future beneficiaries).

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Protection Benefits of Trusts

Trusts can be written to provide a number of protection benefits, such as the following.

Click each benefit below to learn more.

Protection against Incapacity

Unlike brokerage accounts and investment management accounts, which may terminate upon being notified of the incapacity of the account owner, trusts continue. This enables the trustee to continue managing the assets for the benefit of a grantor, following the grantor's dictates, while avoiding the need to involve the court in a guardianship.

Sarah's Story

Sarah Henderson is an 80-year-old widow who lives in South Florida, which is almost a thousand miles away from her children. She is currently in good health and is fiercely independent. She is adamant that she never wants to be placed in a nursing home, preferring to be cared for at home so long as her assets make this possible. She is equally insistent that she never wants to be a burden to her children. Therefore, Sarah appointed a corporate bank to act as the trustee of a revocable living trust. As a revocable trust, Sarah retains full control over the assets while she is alive and competent, directing the trustee to make distributions to her as she needs. In case she becomes unable to handle her own affairs, the trust document instructs the trustee to apply the funds toward maintaining her in her home, so long as there are sufficient assets to make this possible. Upon her death, the trust terminates and the remaining assets are distributed to her children.

Protection for Adult Beneficiaries

For those who cannot properly handle money, a trust provides the ability to give beneficiaries the benefit of money without turning control over to them. This is advisable protection for those who lack investment expertise, who might be subject to outside influence, or who are spendthrifts.

The Stephens

Tom and Elizabeth Stephens are both in their seventies. Tom has always handled the investments and Elizabeth feels uncomfortable handling any financial matters beyond her checking account and credit cards. Knowing that men typically have shorter life spans than women, Tom decided to put a plan in place to provide security and peace of mind for his wife in the event that he predeceases her. Tom accomplished this by transferring his assets into a living trust and appointing a corporate trustee. This gives Tom an opportunity to evaluate the skills of the trustee while he is alive and thereby to reassure his wife that she will be in good hands if he should die before her.

Protection for Minor Beneficiaries

The use of a trust should be considered whenever a minor child is involved. Without a trust, a child will receive access to an inheritance upon reaching the age of majority, which is age eighteen in most states. Since no one can predict the child's level of maturity at that age, there is inherent risk in having a plan that leaves everything to a child at such a young age. Will the newfound funds be squandered on a spending spree? Will the child feel empowered by the funds to skip college? Will the child be involved in experimentation with drugs and use the funds for that purpose?

By using a trust, it becomes possible to defer some or all of the funds until the child is older. Typically, this is done in installments, thereby giving the child a chance to grow in responsibility. If the child fails to properly manage the money after the first distribution from trust, then at least there is a chance that the child will learn from that mistake and do better with the next one.

Joseph and Ruth

Joseph and Ruth Abrams are in their late twenties, with twin sons who are five years old. Their estate is approximately $800,000. They went to an attorney to have wills drawn so that they could name guardians in case they were to die in a common accident. The attorney suggested that their estate plan should include the funding of a trust for their minor children.

The attorney explained that the trust, which would be created by their will, would direct the trustee to provide funds for the care and education of the children. Upon reaching age 18, the children would begin to receive the income from the trust. At age 21, they would receive 1/3 of the assets, at age 25 they would receive ½ of the balance, and at age 30 the trusts would terminate and the children would receive the remaining balance.

Protection for Persons with Special Needs

People with "special needs," such as a physical or mental disability, are often eligible for government assistance, e.g., through Social Security and/or Medicaid. Leaving an inheritance to someone who has such a need can jeopardize the person's government assistance. Therefore, instead of transferring the funds directly to the person, a "special needs" trust can be established that names the special needs person as the beneficiary. This trust can provide assistance that goes beyond the government assistance, providing for supplemental living expenses and paying for medical assistance that might be beyond that provided by government programs.

Jane's Situation

Jane has an adult daughter who, because of a fall, suffers partial paralysis. The daughter currently receives government assistance. Jane would like to leave her home to her daughter so that she will always have a place to live, but fears that giving it to her daughter will jeopardize her daughter's government assistance. Instead, upon Jane's death the home will be placed in trust and the daughter will be allowed to live in the home free of rent. Additional funds will be placed in the trust to provide for its maintenance and to pay utilities. Upon the daughter's death, the home will be sold and the assets will be distributed to Jane's two other children.

Privacy

When property is transferred via the will, the disposition of the property becomes a matter of public record. Anyone who desires to see a copy of the will can go to the courthouse and obtain one.   This is often undesirable, particularly when someone is a public figure or where there is concern that there can be family strife if certain relatives learn the particulars of one's estate. One virtue of a living trust is that it is not generally covered by the will. Only those persons who are named as beneficiaries will be entitled to any specific information regarding the terms of the trust.

Mr. Williamson

Phillip Williamson has been mayor of a small country town for over twenty years. He has three grown children and over twenty close relatives who all live in the same community. He is concerned that upon his death the local newspaper might reveal information regarding

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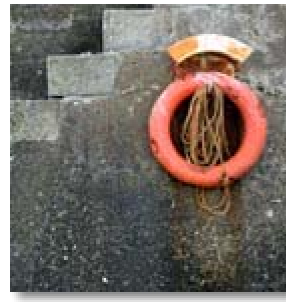
his estate, particularly how he decides to divide his assets among his children and relatives.

To prevent this, his attorney created a revocable trust, which Phillip funded with one dollar. His attorney also created a "pour-over will," which "pours" Mr. Williamson's entire estate over into the trust upon his death. The trust will contain all the information as to how assets are to be used for or distributed to his three children. All anyone will be able to learn by going to the courthouse is that his will distributed everything to his trust, the terms of which remain private.

Helping Clients See the Need for Protection



In working with a client or prospect, any number of factors may lead you to identify that protection is a relevant need. For example, the person may be elderly and in poor health, with no nearby relatives; the person may reveal concern regarding a special needs child; or the person may have minor children. Once you identify that a need for protection may exist, it is not sufficient that *you* see it; you must help your *client* see the need. Until the client sees the need and feels some sense of urgency to resolve the need, no action will be made.

The best way to help the client identify the need and feel motivated to action is to ask open-ended questions that deal with the repercussions of failing to adequately plan for the need. For example, to help your clients/prospects see a need to plan to provide greater protection for themselves and their loved ones, you might ask them the following questions.

Click the icon to view example questions.

- How have you protected yourself and your family against the possibility of your incapacity?
- How have you prepared your spouse to take over management of your financial assets upon your death?
- How have you planned to protect your children from possibly being harmed by a large inheritance when they are too young to handle it?

Review Exercise

Before proceeding, check your familiarity with trust terminology by answering the following True-False questions.

Select the correct answer to the following questions.

1. The grantor, trustee, and beneficiary must be three distinct persons.

   ○ True

   Incorrect. One person can fulfill all three roles, naming in the trust document a remainder beneficiary (or beneficiaries) to receive the trust proceeds after the grantor's death, if the trust is to terminate upon the grantor's death; or, if the trust is to continue after the grantor's death, naming a beneficiary (or beneficiaries) to be the successor beneficiaries of the trust.

   ● False

   Correct. One person can fulfill all three roles.

2. To fund a trust with real estate, the property must be retitled.

   ● True

   Correct. To fund the trust, it is necessary to re-title real estate into the trust.

   ○ False

   Incorrect. To fund the trust, it is necessary to re-title real estate into the trust.

3. A discretionary trust is one where the trustee is empowered to use his/her discretion, subject to the terms of the trust, in deciding how to make investment changes and/or how to make distributions to the beneficiaries.

   ● True

   Correct. This is the definition of a discretionary trust.

   ○ False

   Incorrect. This is the definition of a discretionary trust.

4. Testamentary trusts are typically revocable.

   ○ True

   Incorrect. Since the creator of the trust is deceased, they are irrevocable.

   ● False

   Correct. Since the creator of the trust is deceased, they are irrevocable.

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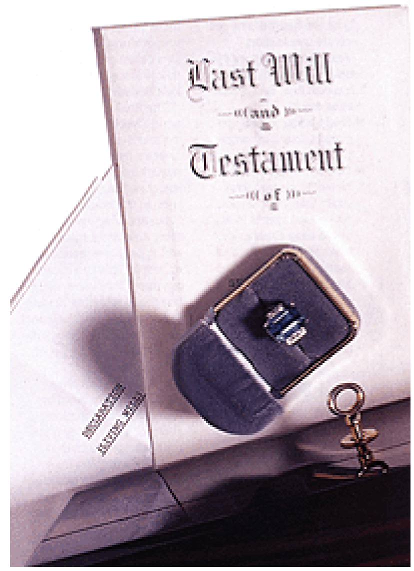
Need #3 - Maintaining Control



The primary instrument for providing control over ***who*** receives assets upon death is the will. By complementing the will with one or more trusts, created either while alive or at death, it also becomes possible to control ***when*** people receive assets. Together, these form the core of an effective estate plan. We've already discussed trusts and illustrated how they can provide control over the timing of transfers. Let's now examine the will.

Most people do not have wills. They either assume their estates are too small to bother or they procrastinate planning for their own demise. Yet a will is the most basic of estate planning documents.

A will is an instrument by which a **person** declares instructions for the disposition of his or her property at death. While some property may transfer by virtue of its title (e.g., property held in joint tenancy), by virtue of being held in a trust, or by contract (e.g., life insurance proceeds), the remaining property must be transferred through the will and be administered (probated) through the court. The most common form of will is the Simple Will, also known as an "I Love You Will." Here, all assets owned by the first spouse pass free of income and estate taxes to the surviving spouse using the unlimited marital deduction.

testator - *male*
testatrix - *female*

Overview	Wills also have uses beyond the transfer of property. **To learn more about these uses, click each heading.**
Establishing domicile	A will helps establish the testator's state of residency, also referred to as the testator's domicile. While moving to another state does not invalidate a will, it is usually desirable for the will to reflect the current domicile. This clarifies where the estate will be administered and what laws will govern. It also helps to establish residence for state income tax purposes.
Naming guardians	A will is frequently used to nominate guardians for minor children. Unless it is a surviving parent, this will probably require approval of the court after the death of the testator.
Creation of Trusts	Wills are useful in establishing trusts (testamentary trusts) that continue after the lifetime of the testator.

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Intestacy

Intestate - Having died without a will.

What happens when a person dies **intestate**? Essentially, state law will decide how assets are distributed. These statutes vary from state to state, but there is typically some split of assets between the spouse and the children. If there is no surviving spouse or children, then the assets typically go to the parents, then brothers and sisters, then cousins and nephews, etc.

Note: In community property states (e.g., Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin), **community property** goes to the surviving spouse, with the remaining **separate property** owned by the deceased passing by state law in a manner similar to all other states.

Generally, **separate property** is:

- Property that an individual acquired prior to marriage
- A gift or inheritance specifically given to an individual spouse
- Compensation for personal injuries of an individual spouse
- Individually owned property acquired prior to moving to a community property state

Generally, **community property** consists of income earned while married and property purchased with such earnings. Upon death, 50% of community property is included in the deceased spouse's estate.

While these statutes are equitable, taking into consideration the interests of both the spouse and children, they rarely accomplish what the decedent would have preferred.

Click the icon to view more information.

The diagram on the right illustrates what happens in most states when a person dies without a will and is survived by a spouse and children.

If survived by a spouse and children, most states split the assets between the surviving spouse and the children, with the spouse receiving 1/3 or 1/2 of the assets. This is true regardless of the age of the children.

Note: In community property states, such distributions would only pertain to separately owned property, since all community property would go to the surviving spouse.

The example above may not be what the client wants to happen. However, the pitfalls of intestacy are quite significant:

Click each pitfall below to learn more.

Reduced funds for surviving spouse
Under any number of scenarios, the surviving spouse is left with only part of the assets. This conflicts with the desire of most spouses for the surviving spouse to have the full benefit of all the assets for his or her lifetime.
Minor children
Because children cannot own property, their inheritance may require the appointment of a guardian to handle the property. While the property is administered in a guardianship, accountings to the court may be required and court approval may be needed for the sale of assets or their use on behalf of the children. Therefore, alternative planning that does not involve a court-monitored guardianship is typically preferred. For example, a trust could be created to hold the funds for the children and a trustee could be empowered to use his or her own discretion (not the court's) in making distributions for their health, education, maintenance, and support. The trust might further direct that the children start receiving the trust income at age 18, receive one-third of the principal at age 21, one-half of the balance of the principal at age 25, and the balance of the funds at age 30.
Early inheritance
As previously discussed, allowing a child to receive his or her inheritance upon reaching the age of majority is not necessarily a desirable strategy. Under intestacy laws, however, this result is inevitable.
Inability to provide unequal distribution
There may be variations in need among the beneficiaries that the decedent would want considered. For example, one child may be physically handicapped, with a higher anticipated need for financial assistance throughout the child's life. But the rules of intestacy are blind to such differences, and each child would be treated the same.
Escheat to the state
While this rarely happens, if the decedent left behind no living relatives, the assets would **escheat** to the state. It is highly doubtful that anyone would want the government to be the sole heir.
No distributions outside the family
Most people have friends and charities to whom they would like to leave something behind. Intestacy does not recognize any beneficiaries outside the decedent's family.

A reversion of property to the state if there is no heir to inherit.

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Naming Someone to Settle Your Estate

A will also allows you to select the person or institution that will be empowered by the court to settle your estate. Depending upon the state, the person who is designated to settle the estate is referred to as the **executor** or **personal representative**, and the court that has jurisdiction over the proceeding is referred to as the **probate *(adj.)* court** (in some jurisdictions, it may be referred to as the **surrogate court**).

executor - *male*
executrix - *female*

The process of settling an estate through the court is referred to as **probate *(n.)***, and to go through that process is to **probate *(v.)*** the estate. That this is done as a court-monitored process reflects the fact that the will is viewed as a legally enforceable document, the instructions of which are binding upon the personal representative. Being a legal document, it should be drafted by an attorney.

Helping Clients Achieve the Control Benefits of Wills and Trusts

Now that you have the context of wills and the probate process, it should be apparent that everyone needs a will. Failure to have a will is to allow state laws to settle your estate for you, rather than you determining who receives your estate. When one or more trusts are coupled with the will, the combination can actually give control that extends beyond the grave. Such a plan makes it possible to provide directions that will govern the management and use of the funds long after death of the testator/grantor.

When you encounter clients or prospects who have not done proper planning or do not review their plans periodically to ensure they are appropriate, ask them an open-ended question that leads them to face the consequences of inaction:

- What process have you used to construct an effective estate plan that serves your needs and goals?
- How have you made sure your estate plan remains current with your present needs and goals?
- How have you made plans to name guardians for your minor children if you and your spouse die in a common accident?
- How have you planned your estate to make sure your assets continue to accomplish your goals after your death?

Need #4 – Deciding Who Will Act as Executor/Trustee

Although common, it is often a mistake to name an individual to serve as trustee or executor. Since the trustee/executor is responsible for handling all of the affairs of the estate after one's death, most people choose a family member or close friend to serve in this capacity. While it may be viewed as an honor to be named as someone's executor or trustee, it can be a difficult and time-consuming task. There is the further potential that the executor may be placed in the middle of a family squabble over the estate, which is particularly troubling if the executor is a family member. The same is true for a trustee, whom the beneficiaries may resent as standing between them and "their money." There is much to consider in both the selection of an executor/trustee and in accepting such an appointment.

Click each of the links below to review a list of considerations each individual should consider when making such an important decision.

Criteria for Choosing a Trustee/Executor

- A professional money manager
- Totally impartial when making decisions on behalf of beneficiaries
- Someone who will manage the day-to-day activities of the trust or estate, keep good records, and provide periodic accountings to beneficiaries
- Knowledgeable about fiduciary law
- Possesses deep resources to make the account or beneficiaries whole if there is a loss due to error or negligence
- Capable of not acting in a self-interested manner
- Someone who is never sick and will not die during the course of administration

Considerations for the Individual Chosen

- Do you desire to be in a position to decide how a beneficiary will or will not be cared for?
- Do you want to be in a position where beneficiaries who are friends or relatives can become angry and take sides because of your actions?
- Do you consider it a privilege to have responsibility for all investment decisions, bill payments, tracking activity, and making periodic reports to beneficiaries?
- Do you want the responsibility of dealing with legal documents and taxes?
- Do you want to be in a position where every decision you make will be second-guessed by the beneficiaries?
- Do you want to be personally liable if ever accused by beneficiaries and judged by a court as having been negligent or having not acted in the best interest of the beneficiaries?

Benefits of a Corporate Executor/Trustee

The considerations on the prior page make a strong case for considering the appointment of a corporate trustee or executor. The benefits of a corporate trustee or executor are quite significant:

- Experience
- Expertise
- Impartiality
- Continuity

If you work for an institution that offers estate settlement or trust services, you may be in a position to guide your client to a more appropriate solution. Therefore, if a client/prospect has selected an individual as trustee or executor, help him or her assess the appropriateness of such a selection by asking questions such as the following:

- How have you determined that your current executor (or trustee) has the expertise necessary to settle your estate (or administer your trust)?
- How have you protected against your estate becoming a source of division in your family after your death?

Review Exercise

Select the correct answer to the following questions.

1. In addition to transferring assets, a will is useful in accomplishing all the following EXCEPT:

   ○ Establishing domicile

   Incorrect. Try again.

   ○ Creating a trust

   Incorrect. Try again.

   ● Establishing intestacy

   Correct. Intestacy refers to dying without a will. A will helps ***avoid*** intestacy.

   ○ Naming guardians

   Incorrect. Try again.

2. If a client dies intestate (without a will), ALL of the following are possible EXCEPT::

   ○ Assets may be split between the surviving spouse and children.

   Incorrect. Try again.

   ● Distributions from the estate to non-family members with close ties to the deceased will be considered.

   Correct. If a person dies intestate, state laws of intestacy will preside and non-family members will receive nothing from the probate estate, regardless of how close their ties to the deceased were.

   ○ Charities will be excluded from receiving part of the estate.

   Incorrect. Try again.

   ○ Minors will receive full control of assets upon reaching the age of majority (18 in most states).

   Incorrect. Try again.

3. In some states, the executor is called the:

   ○ Estator

   Incorrect. Try again.

   ○ Trustee

   Incorrect. Try again.

   ○ Probator

   Incorrect. Try again.

   ● Personal Representative

   Correct.

   ○ Surrogate

   Incorrect. Try again.

4. In selecting an executor or trustee, you should look for all of the following EXCEPT:

- ○ Knowledge of fiduciary law

  Incorrect. Try again.

- ○ Impartiality

  Incorrect. Try again.

- ○ Professional money management expertise

  Incorrect. Try again.

- ● Someone who will maintain absolute privacy and only provide an accounting upon termination of the estate/trust

  Correct. The trustee/executor should provide periodic accountings.

Need #5 - Minimizing the Impact of Estate and Gift Taxes

To understand how to minimize the effects of estate and gift taxes, you need to first understand some of the fundamentals regarding this form of taxation.

A Tax on the Transfer of Assets

The Estate and Gift Tax System is commonly referred to as the "Transfer Tax System" because it deals with the taxation applied to the transfer of assets. Although there are exceptions, some of which will be addressed in this training, any transfer of assets from one party to another is potentially a taxable event. Knowing when these taxes apply is crucial.

There is also a Generation Skipping Transfer Tax for very large cumulative transfers ($3,500,000 in 2009) to lineal descendents that skip a generation or go to non-related individuals 37½ years younger than the donor. This too is part of the Transfer Tax System, but further details regarding this tax shall be beyond the scope of this course.

Estate and Gift Taxes Have Much In Common

At one point in our history, lifetime transfers (gift taxes) were taxed under a system that was totally separate from the taxation of transfers upon death (estate taxes). But in recent years prior to 2010, that has not been the case because the estate tax and gift tax have been "unified" and have shared many common elements, the most important of which has been a unified tax rate schedule.

Click the icon to learn more about the history of transfer taxes

The History of Transfer Taxes

Presented by **Rick Tyler**

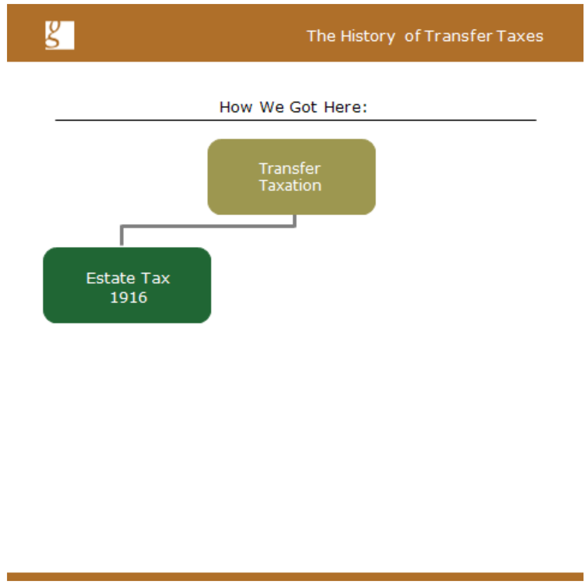
A graduate of Vanderbilt University and the Kellogg Graduate School of Management, Rick Tyler is the former Chief Fiduciary Executive for Barnett Banks Trust Company. A frequent speaker, his comments draw upon over 20 years of experience in the Financial Services industry.

Prior to the 20th century, an estate tax was implemented numerous times, always as a temporary measure of short duration. It was used to help pay for the Civil War, to help build the Navy, and to help pay for the Spanish-American War.

In the 20th century, in 1916 as the United States was nearing entry into World War I, Congress passed an estate tax as a “temporary measure”.

This tax has been with us ever since. As the public began to realize that this tax was not going away, an easy solution was to not own anything when you die; just give it away while you're alive.

This led to a rise of “death-bed-transfers.” Before you die, you call your doctor and you call your attorney.



To address the growing attempts to avoid the estate tax through lifetime gifts, in 1924 Congress passed the Gift Tax.

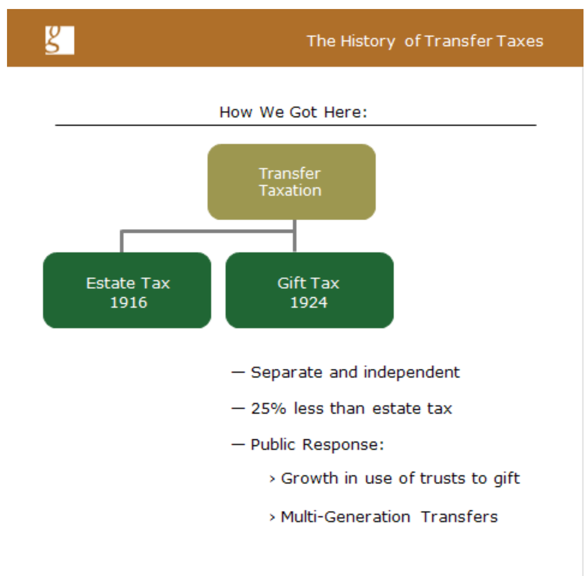
This tax was separate and independent from the estate tax. Both the estate tax and the gift tax were calculated without consideration of the other.

The gift tax rate was also 25% lower than the rate for estates, so there remained an incentive to give lifetime gifts rather than be taxed on assets at death.

In time, the public began to find ways to take advantage of this structure and became more creative with its use of lifetime gifts.

There was a growing use of trusts as a vehicle by which to transfer assets. For example, I could place an asset in trust, thereby no longer owning it, yet retain all the benefits of ownership. I might retain the right to all the income, retain the right to use the asset, or retain the right to continue voting the stock.

There was also an interest in multi-generation transfers. If the IRS was going to tax transfers in each generation, then I could achieve a considerable tax savings by transferring assets directly to my grandchildren, rather than first transferring them to my children where they would be taxed upon my children’s death.



To address these issues, in 1976 Congress implemented a Unified Estate and Gift Tax.

It was a unified system in that both the estate tax and the gift tax used the same tax rate schedule. Whether the transfer was made in life or at death, the same tax rates would be applied.

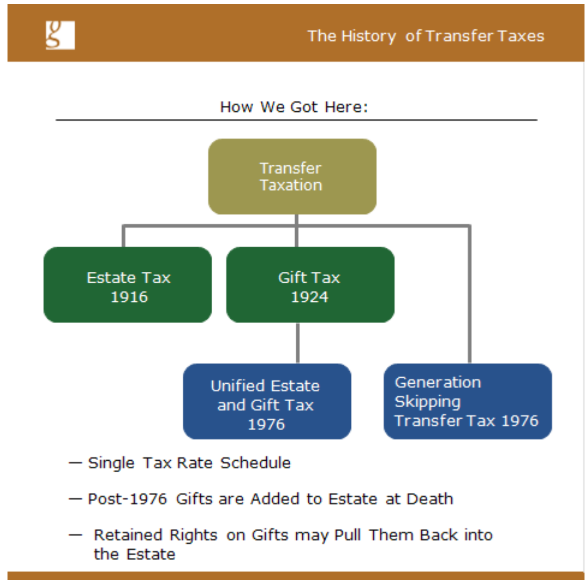
It was also unified in the sense that the estate tax and the gift tax would no longer be calculated independently. Instead, there would be consideration of lifetime gifts when computing estate taxes.

Here was the premise: the IRS would charge the same tax regardless of when the transfer occurred. To accomplish this, when you die, all post-1976 taxable gifts will be added back to your estate. The result is that you would compute your estate tax as if you had never given these amounts away.

A final thing the unified system did was address some of those transfers where people were retaining power over assets as if they still owned them outright. Essentially, the new rules said that if you made transfers in which you retained too much power, then they were considered incomplete transfers and the assets would be added back to your estate upon your death.

The final thing Congress did in 1976 was address the strategy to avoid the estate tax by skipping generations. Congress addressed this with a totally independent tax known as the “Generation Skipping Transfer Tax.” Essentially, this legislation said that sizeable transfers that skip a generation will be subject to an additional tax, assessed at the highest rate on the Unified Estate and Gift Tax Schedule.

Although there have been some reforms along the way, and we will talk about those, the 1976 legislation is essentially the tax system we have today. This course will flesh out more of the details as to how this system of taxation works.



Unified Transfer Tax Rates

The unified transfer tax schedule that was in place in 2009 was for either the taxable estate ***or*** for taxable gifts. But developing a common rate schedule that could be used for either was a bit tricky, as illustrated in the following example:

Mr. Jones' Story

Mr. Jones made a taxable gift during his lifetime (after 1976) of $800,000. He died in 2009 with an estate valued at $3,200,000. How do you take into account his lifetime gift in computing his estate tax?

Click the icon for the answer

First, add together his lifetime taxable gifts (made after 1976) and his final estate value, deriving a total of $4 million. Then compute the tax on $4 million, deriving his tentative estate tax.

If he paid any prior tax on his lifetime gift (a likelihood if the gift was made prior to 2002 when the amount that could be gifted without paying a tax was much smaller), give him a credit in that amount against his estate tax.

2009 Unified Transfer Tax Rates

Size of Taxable Estate or Aggregate Taxable Gifts		Tax on Amount in Column I	+	Marginal Rate on Excess of Column I
From: I	To: II	III		IV
$0	$9,999	-		18%
10,000	19,000	$1,800		20
20,000	39,999	3,800		22
40,000	59,000	8,200		24
60,000	79,000	13,000		26
80,000	99,999	18,200		28
100,000	149,999	23,800		30
150,000	249,999	38,800		32
250,000	499,999	70,800		34
500,000	749,999	155,800		37
750,000	999,999	248,300		39
1,000,000	1,249,999	345,800		41
1,250,000	1,499,999	448,300		43
1,500,000 and up	-	555,800		**45**

The maximum rate on the table is 45%. This is achieved on amounts over $1.5 million. While this is a decrease from the 55% maximum rate of 2001, it continues to provide strong incentive for taking advantage of every opportunity to avoid estate taxes through proper estate planning.

Try It

To develop some comfort in working with this schedule, compute the tentative tax (before adjustments) on estates below.

Enter your results in the blank space provided and click the Submit button.

Tentative Tax on an estate of $750,000 = $ 248,300

Correct! The answer is $248,300

Incorrect. To find the correct tax, follow these steps:

Step 1. Locate the row where $750,000 falls within the range given in the first two columns. This occurs in the range of $750,000 to $999,999.

Step 2. The third and fourth columns indicate the tax would be $248,300 plus 39% of any amount over that listed in Column I ($750,000). Since our estate is exactly $750,000, there is nothing further to calculate, so the tentative tax is $248,300.

Tentative Tax on an estate of $1,100,000 = $ 386,800

Correct! The Answer is $386,800.

Incorrect. To find the correct tax, follow these steps.

Step 1. Locate the row where $1,100,000 falls within the range listed in columns I and II. The appropriate range is $1,000,000 to $1,249,999.

Step 2. Columns III and IV indicate that the tax is $345,800 plus 41% of any amount over $1,000,000. That leads to the following tax calculation:

Tentative Tax = 345,800 + .41(1,100,000 - 1,000,000) = 345,800 + 41,000 = $386,800

Next, identify the marginal rates for the following amounts:

Marginal rate on an estate of $1,350,000 = 43 %

Correct! The answer is 43%.

Incorrect. To find the correct answer, follow these steps:

Step 1. Locate the row where $1,350,000 falls within the range given by columns I and II. The appropriate range is $1,250,000 to $1,499,999.

Step 2. Column IV gives the marginal rate being charged on every dollar over $1,250,000 as 43%. Thus, the marginal rate for $1,350,000 is 43%.

Marginal rate on an estate of $4,500,000 = 45 %

Correct! The answer is 45%.

Incorrect. To find the correct answer, follow these steps:

Step 1. Locate the row where $4,500,000 falls within the range given by columns I and II. The appropriate range is in the last row, which includes everything from $1,500,000 and above.

Step 2. Column IV gives the marginal rate being charged on every dollar over $1,500,000 as 45%. Thus, the marginal rate is 45%.

Unified Transfer Tax Rate Changes Through 2009

The preceding tax rate schedule has declined in recent years. The Economic Growth and Tax Relief Reconciliation Act of 2001 (the Tax Relief Act) lowered the top marginal rate of the Unified Transfer Rate schedule from 55% in 2001 to the rates shown in the table below:

Maximum Unified Transfer Tax Rate

Year	2001	2002	2003	2004	2005	2006	2007,2008,2009
Maximum Rate	55%	50%	49%	48%	47%	46%	45%

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Applicable Credit/Exclusion Amount

In recent years leading up to 2010, each individual had a lifetime credit against estate and gift taxes. This credit could be used to offset part or all of the tentative estate tax liability at death, but a portion of this credit was also available during life to offset gift taxes that would otherwise be due upon lifetime transfers. This credit is typically referred to as the "applicable credit amount." It is also referred to as the "unified credit."

Size of Taxable Estate		Tax on Amount in Column I	+	Marginal Rate on Excess of Column I
From: I	To: II	III		IV
$0	$9,999	-		18%
10,000	19,000	$1,800		20
20,000	39,999	3,800		22
40,000	59,000	8,200		24
60,000	79,000	13,000		26
80,000	99,999	18,200		28
100,000	149,999	23,800		30
150,000	249,999	38,800		32
250,000	499,999	70,800		34
500,000	749,999	155,800		37
750,000	999,999	248,300		39
1,000,000	1,249,999	345,800		41
1,250,000	1,499,999	448,300		43
1,500,000	1,999,999	555,800		45
3,500,000 and up	-	**1,455,800**		45

For 2009, the estate tax applicable credit amount is $1,455,800. What amount of assets can be "excluded" from taxes by the estate tax applicable credit amount? For the answer, check out the chart to the right. Note this chart has an additional row from the previous one seen in this lesson. We have added the row in this table to show you the applicable credit amount of $1,455,800 at the $3.5 million taxable estate level.

The tax on a $3,500,000 estate would be $1,455,800. Therefore, having a credit of $1,455,800 would effectively "exclude" $3,500,000 from estate taxation. For 2009, up to $345,800 of this credit can be applied to lifetime taxable gifts. Looking at the chart, you can see that this $345,800 credit will cover $1,000,000 of gifts. We will have more to say about this on the next page.

The credit would "exclude" an amount equivalent to $3,500,000 from estate taxes (which also includes $1,000,000 of lifetime gifts, if any). This excluded amount is known as the **"applicable exclusion amount,"** or sometimes as the "unified credit effective exemption amount."

The applicable credit amount and applicable exclusion amount are important terms and should be committed to memory before continuing. To avoid confusion, it is helpful to remember that each term has an alternate title that is sometimes used.

Applicable Credit Amount	=	**Unified Credit**
Applicable Exclusion Amount	=	**Unified Credit Effective Exemption Amount**

When speaking of the portion of the credit or exclusion amount that may be applied to lifetime gifts, you will typically see these terms preceded by the words “gift tax”, e.g., “gift tax applicable credit amount,” “gift tax unified credit,” etc.

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Increase of Applicable Exclusion Amounts

Estates and gifts fully shared the same Applicable Exclusion Amount of $1,000,000 for 2002 and 2003, which could be used in life or at death; but thereafter, a divergence began to take place. For estates, the Tax Relief Act of 2001 directed the expansion of the Applicable Exclusion Amount to $3.5 million by 2009. However, the lifetime value of gifts that could be excluded through application of the Applicable Exclusion Amount remains capped at $1 million.

This schedule for the remaining years addressed by the Tax Relief Act of 2001 are shown below.

Click each of the highlighted headings to learn more.

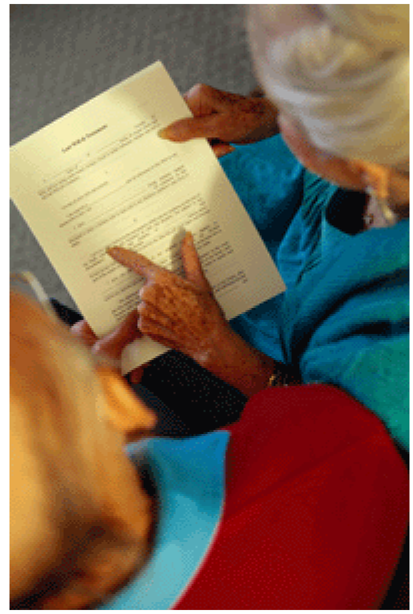
Calendar Year	Estate Tax Applicable Exclusion Amount	Gift Tax Exclusion Amount	-Max Estate Tax Rate -Max Gift Tax Rate
2009	$3,500,000	$1,000,000	45%
2010	N/A (estate taxes repealed)	$1,000,000	35% (gift taxes only)
2011*	$1,000,000	$1,000,000	55%

*This row shows what will occur if Congress does not pass further legislation by 2011.

Estate Tax Applicable Exclusion Amount
The applicable exclusion amount for estates increased from $2,000,000 to $3,500,000 in 2009. In 2010, the estate tax is repealed and, unless Congress takes further action, there is no estate tax for persons dying in 2010. However, unless Congress passes further legislation, the entire process will revert back in 2011 to the laws that were in effect for 2001. Thus, as things currently stand, estates in excess of $1,000,000 will be subject to paying an estate tax in 2011.

Gift Tax Exclusion Amount
The lifetime gift tax exclusion amount will remain at $1,000,000 for each of the years. Remember that this is a subset of the estate tax exclusion amount; if you use part or all of the gift tax exclusion amount, then the amount available to protect transfers occurring at death will be reduced by the amount used in life. Also, note that the gift tax is NOT repealed in 2010. The tax rate applied for taxable gifts in 2010 will be a flat rate of 35%.

Deductions: Unlimited Marital and Charitable



Unlike the applicable credit amount, which is applied after the tentative tax on the gift or estate is calculated, there are certain deductions that actually reduce the taxable amount of the gift or estate ***before*** the tentative tax is calculated. Two important deductions that are available for both gift and estate taxes are:

1. **The Unlimited Marital Deduction**--Transfers of assets between spouses are non-taxable events regarding transfer taxes. This is true for lifetime gifts or for inheritances.

> Beware, however, if a spouse is not a U.S. citizen. Non-U.S. citizen spouses are not automatically entitled to the Unlimited Marital Deduction and additional planning must be done in order to get them in a position to receive assets free of estate taxes.

2. **Charitable Deductions**--Transfers to qualified charities, during one's lifetime or at death, are not subject to transfer taxes.

Click the icon to learn more about the optimal use of the unlimited marital deduction..

Optimal Use of Marital Deduction

Presented by **Rick Tyler**

A graduate of Vanderbilt University and the Kellogg Graduate School of Management, Rick Tyler is the former Chief Fiduciary Executive for Barnett Banks Trust Company. A frequent speaker, his comments draw upon over 20 years of experience in the Financial Services industry.

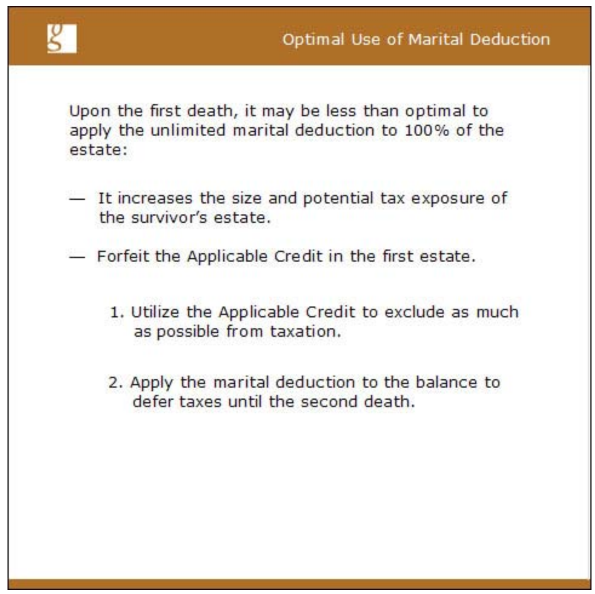
At first sight, it might appear best upon the first spouse's death to always leave everything to the surviving spouse. After all, with the unlimited marital deduction there is no transfer tax.

Be aware, however, that the unlimited marital deduction is merely a deferral of the estate tax. Full use of the marital deduction to cover all assets in an estate is not always optimal for two reasons.

First, upon the death of the surviving spouse, the estate tax will be calculated on what is remaining of the entire combined estate. That means the second spouse's estate may be larger because of use of the unlimited marital deduction upon the first death.

Second, if everything is left to the surviving spouse, then only one spouse - the surviving spouse - will end up using his or her applicable credit amount to offset some of the taxes in the estate. This opportunity is forfeited when the first spouse dies.

Therefore, for large estates, it is generally better to first utilize the applicable credit when the first spouse dies. This allows a significant amount to be excluded from taxation. We will explore a common technique for accomplishing this while still making it possible for the surviving spouse to receive benefits from the excluded assets. Then, once the applicable credit amount is used upon the first death, the marital deduction can be applied to the remaining assets to defer any potential taxes until the second death.



Annual Gift Tax Exclusion

In addition to the credit for transfers to a spouse or charity, which results in no transfer taxation for such gifts in life or transfers at death, there are also three types of gifts that are excluded from consideration for transfer taxes. The first of these is known as the ***annual gift tax exclusion***. For 2009 and 2010, gifts of a **present interest** in the amount of **$13,000 or less** can be made **annually to any individual,** and are **excluded** from the gift tax. Note that the gift tax exclusion is not limited to gifts to family members; it applies to gifts to ANY INDIVIDUAL.

> The recipient enjoys an immediate benefit and the unrestricted right to use, possess, and enjoy the property.

This provides a significant ability for individuals to effectively transfer assets out of their estates without incurring a transfer tax. Given sufficient **donees** and sufficient years to make transfers, sizeable amounts can effectively avoid taxation.

> Person or institution to whom a gift is made.

Overview	To learn more about other factors to keep in mind, **click each heading on the left.**
Gift Splitting	A husband and wife can “elect to” or “consent to” split gifts between them for a combined $26,000 (in 2009 and 2010) to any individual, and the entire amount qualifies for the annual gift tax exclusion. This is true even if the source of the funds is from one spouse.
There is No Limit to the Number of Gifts in a Year	An individual can make $13,000 annual gifts to as many people as desired.
It is Not Cumulative	In other words, it is either used or lost. If a year is skipped, the individual is not allowed to carry it forward into a subsequent year.
Indexed for Inflation	Beginning in 1999, the exclusion was set at $10,000 and indexed for inflation using 1997 as the base year. The indexing is rounded down to the next lowest multiple of $1,000, meaning it may be a number of years between changes. For 2009 and 2010, it is $13,000.

Other Gift Tax Exclusions

The other two gift exclusions with which you should be familiar are direct payments for tuition and medical care.

For the basic characteristics of each, click on each item below.

Direct Payment of Tuition

- It is limited to tuition (books, dormitory, student fees, etc. do not qualify).
- Payment must be made directly to the school (it cannot be given to the student with the intent that the student would pay the tuition).
- There is **no limit** on the amount.
- This is in addition to the annual gift tax exclusion.
- Payment can be for anyone.

Direct Payment of Medical Care

- The IRS defines specific expenses that qualify, but in general they cover the expenses of diagnosis and treatment.
- It is not allowed for amounts reimbursed by insurance.
- Payments must be made directly to the doctor or health care facility providing the care.
- There is **no limit** on the amount.
- This is in addition to the annual gift tax exclusion.
- Payment can be for anyone.

Review Exercise

For the following statements, click on the correct response.

1. For transfers in 2009, gift taxes are computed using the same rate schedule as for estates:

   - ● True

     Correct. The Estate and Gift tax use the same rate schedule.

   - ○ False

     Incorrect. The Estate and Gift tax actually do use the same rate schedule.

2. The amount that can be transferred between spouses without incurring a transfer tax is:

   - ○ Limited

     Incorrect. The amount that can be transferred between spouses without generating a transfer tax liability is unlimited.

   - ○ 50%

     Incorrect. The amount that can be transferred between spouses without generating a transfer tax liability is unlimited.

   - ● Unlimited

     Correct. There is no limit to the amount spouses can transfer between each other without generating a transfer tax liability.

3. When computing the estate tax, lifetime gifts made after 1976 are added back to the estate value before computing the tentative estate tax:

   - ● True

     Correct. This makes it possible to have a unified estate and gift tax system.

   - ○ False

     Incorrect. The estate tax calculation is inclusive of lifetime transfers after 1976.

4. Transfers to charities DO NOT avoid estate or gift taxation:

   - ○ True

     Incorrect. They do in fact avoid estate and gift taxes.

   - ● False

     Correct. In fact, they do avoid estate and gift taxes.

For the following choices, enter the letter corresponding to the most appropriate match. Each letter may be used more than once or not at all.

1. The applicable estate tax exclusion amount for 2009:___
2. The date when the estate tax is repealed is:___
3. Maximum marginal rate of the Unified Transfer tax table in 2009:___
4. Date when the gift tax is repealed:_____.

Answers
A. $2,000,000
B. 18%
C. $345,800
D. 2010
E. $3,500,000
F. 60%
G. 45%
H. 55%
I. 2009
J. 2011
K. Not Applicable to Gifts
L. Not Applicable to Estates

Show me the correct answers

1. E 2. D 3. G 4. K

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Strategies for Minimizing Transfer Taxes

Now that you have an understanding of the fundamentals of estate and gift taxes, we can begin to illustrate some of the techniques available for minimizing the impact of these taxes. The best way to do this is through a couple of case studies, which will illustrate and explain these techniques as they might be applied in real life scenarios. To illustrate a number of techniques, the second case study is of a rather large estate; smaller estates might require fewer, if any, of the techniques illustrated.

Techniques for Minimizing Tax Impact

As you go through the case, pay close attention to:

- The importance of titling property in such a manner that the plan works independent of which spouse dies first.
- The use of trusts to help defer or reduce the impact of transfer taxes.
- The use of transfer strategies to reduce the size of the taxable estate while still alive.

Important Compliance Issues

The following pages of this course contain case studies designed to help you understand the issues involved in quantifying a client's potential estate tax liability and other pertinent factors related to the estate planning process. The content also identifies some practical ways you can engage your clients in effective conversations that help the client understand their need to develop or update their estate plan. While these case study exercises are designed to help you develop a deeper understanding of the topic and more confidence, you must remember that **your work must not replace the advice of the client's legal and tax advisors**. Your role is to help your clients ***realize*** the need for proper planning and identify ***potential*** solutions; not to offer legal or tax advice.

Case Study - Joe and Martha Average

Using the following information, begin planning the Average's estate needs.

The Story of Mr. and Mrs. Average

Joe and Martha Average, both U.S. citizens, are a married couple in their early 60's, with three grown children. Their combined taxable estate is $3,700,000. Their current plan is to leave everything to the surviving spouse; then upon the death of the second spouse to leave everything to their children.*

**The characters and scenarios in this case study are fictitious and purely for purposes of illustration.*

Step 1 - Estimate the Potential Estate Tax Liability

Let's assume that planning is taking place in 2009. Since their current estate plan is to leave everything to the surviving spouse, we will ignore the first spouse's death and assume there is no tax due to the unlimited marital deduction. What is the estimated tentative estate tax liability upon the second spouse's death **before credits and deductions**? In deriving your answer, assume that one of them died in 2009, followed later in 2009 by the death of the other spouse. Click **here** for additional information, enter your answer, and click **Submit.**

Enter your answer in the box below.

Potential tax liability ***before credits and deductions***: $ 1,545,800

Correct.

Incorrect. The tentative tax on $3,700,000 is $1,545,800. It is calculated as follows:

Tax on $1,500,000 =	$555,800
Tax on next $2,200,000 @ 45% =	$990,000
Estimated Potential Tax	$1,545,800

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2009 Unified Transfer Tax Rates

Size of Taxable Estate or Aggregate Taxable Gifts		Tax on Amount in Column I	Marginal Rate on Excess of Column I
From: I	To: II	III	IV
$ 0	$ 9,999	....	18 %
$ 10,000	$ 19,999	$ 1,800	20%
$ 20,000	$ 39,999	$ 3,800	22%
$ 40,000	$ 59,999	$ 8,200	24%
$ 60,000	$ 79,999	$ 13,000	26%
$ 80,000	$ 99,999	$ 18,200	28%
$ 100,000	$ 149,999	$ 23,800	30%
$ 150,000	$ 249,999	$ 38,800	32%
$ 250,000	$ 499,999	$ 70,800	34%
$ 500,000	$ 749,999	$ 155,800	37%
$ 750,000	$ 999,999	$ 248,300	39%
$ 1,000,000	$ 1,249,999	$ 345,800	41%
$ 1,250,000	1,499,999	$ 448,300	43%
$ 1,500,000 & up	---	$ 555,800	45%

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Step 2 - Utilize the Applicable Credit Amount

Now apply the applicable credit/exclusion amount to the potential estate tax of the surviving spouse. Again assume both deaths are in 2009. **Click here for additional information and select your answer.**

After calculating your answer, select it from the dropdown menu below:

$0
$54,800
$64,000
$90,000
$713,300
$1,426,600
$1,545,800
$1,665,000

Applicable Credit/Exclusion Amounts

Year	Applicable Credit Amount	Applicable Exclusion Amount
2009	$1,455,800	$ 3,500,000

$0

Incorrect. On first sight, it might appear that they could each use their applicable credit amount. Since each of them can use the credit to offset $3,500,000 in their estate, that would be sufficient to prevent the payment of taxes. *But note that their current plan is for the surviving spouse to inherit everything*. Thus the first spouse to die loses the benefit of the applicable credit amount, choosing instead to transfer everything to the surviving spouse through the unlimited marital deduction. That leaves $3.7 million in the estate of the surviving spouse. Try again for the answer.

$54,800

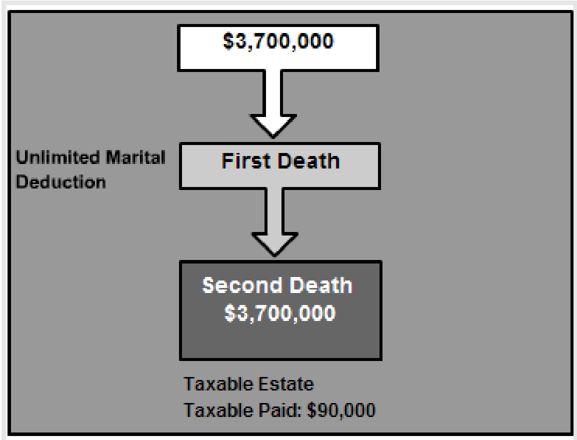
Incorrect. It appears that you first subtracted the $3,500,000 applicable exclusion amount, and then computed the tax on $200,000. *But remember that the applicable exclusion amount is not used in the tax calculation*. Instead, the tax is computed on the entire amount, and then the tax is reduced by the amount of the credit. Try again for the answer.

$64,000

Incorrect. It appears that you first subtracted the applicable exclusion amount from the $3.7 million, then applied the marginal rate times the entire balance. That is incorrect on two points. First of all, the applicable exclusion amount is not used in the calculation; only the credit amount is used. You must first compute the tax on the entire amount, and then you subtract the credit amount. Second, when computing the tax, note that the marginal rate is only used on the excess over column I, not the entire amount. Try again for the answer.

$90,000

Correct. The following diagram depicts the scenario.



The tax is calculated in the following manner:

Tentative Tax on $3,700,000:	$1,545,800
Less the Applicable Credit Amount of the second estate:	(1,455,800)
Tax due:	$90,000

$713,300

Incorrect. It appears that you figured the tax on $1,850,000 (half of the total). The final estate is double this amount. Try again for the answer.

$1,426,600

Incorrect. You are apparently attempting to split the estate between them and compute the tax on each separate estate. Recognize that the entire $3.7 million will be in the estate of the surviving spouse. Compute the tax using that estate value. Try for the answer again.

$1,545,800

Incorrect. You appear to be computing the tax on the entire $3.7 million without reducing it by the applicable credit amount that is available for the surviving spouse. Try again for the answer.

$1,665,000

Incorrect. You appear to be applying the marginal rate to the entire $3.7 million. Remember that the marginal rate is only applied to the excess amount over the figure in column I. Also remember to reduce your answer by the applicable credit amount. Try again for the answer.

What went wrong in this scenario?

Click the icon to view the answer.

Each spouse had an applicable exclusion amount of $3,500,000. Combined, that totals $7,000,000, more than enough to cover the $3,700,000 of their combined estate. Yet they ended up owing a sizeable estate tax bill when the second spouse died.

This scenario highlights the fact that the single biggest mistake couples make in their estate plans is to leave everything to the surviving spouse. While this works when estates are relatively small, it is not usually optimal once the combined estates are larger than the applicable exclusion amount. In larger estates, as we have just seen, it causes the loss of the applicable credit amount in the estate of the first to die. For Joe and Martha Average, this failure to utilize both applicable credit/exclusion amounts results in a tax bill of $90,000. Had their estate been larger, this avoidable bill could have been even higher.

Note that if the estate tax is allowed to return in 2011 with an applicable exclusion amount of $1,000,000, this issue will be applicable to many more couples.

Preserving the Applicable Credit/Exclusion Amount in the First Estate

There are two rules-of-thumb to avoiding this loss of the applicable credit amount in the first estate.

Overview	To learn more about these rules, **click each heading.**
Rule 1	**Divide up the estate if the combined estate is larger than the applicable exclusion amount.** Each spouse must have sufficient assets in their respective estate to take advantage of their applicable credit/exclusion amount. For Joe and Martha, this would involve splitting their assets equally so that regardless of which one dies first, there would be $1,850,000 in his or her estate.
Rule 2	**Don't plan to transfer all assets to the surviving spouse if the combined estate is larger than any potential applicable exclusion amount.** Instead, apply the applicable credit amount in the first estate and prevent those assets against which it is applied from going into the estate of the surviving spouse. This can be done in one of two ways: • **Name other heirs.** The only trouble with this approach is that it denies the surviving spouse the benefit of the assets, which is something that Joe and Martha Average wished to avoid. • **Transfer the assets into a Credit Shelter Trust**. To learn more about the credit shelter trust, click here. This topic is discussed next.

Click the icon to learn more.

Identifying Key Planning Segments

Presented by **Rick Tyler**

A graduate of Vanderbilt University and the Kellogg Graduate School of Management, Rick Tyler is the former Chief Fiduciary Executive for Barnett Banks Trust Company. A frequent speaker, his comments draw upon over 20 years of experience in the Financial Services industry.

When working with married couples, your primary goal in estimating the size of their taxable estate is to identify into which of three wealth segments they fall.

The first segment is the amount that can be fully covered by a single applicable exclusion amount. In this segment, there is no federal estate tax liability because all assets can be covered by the applicable exclusion amount of the last spouse to die.

The next segment consists of wealth that is greater than a single applicable exclusion amount, but less than their combined applicable exclusion amounts. In this second segment, it is possible to totally avoid estate taxes through proper planning that makes optimal use of each spouse's applicable credit.

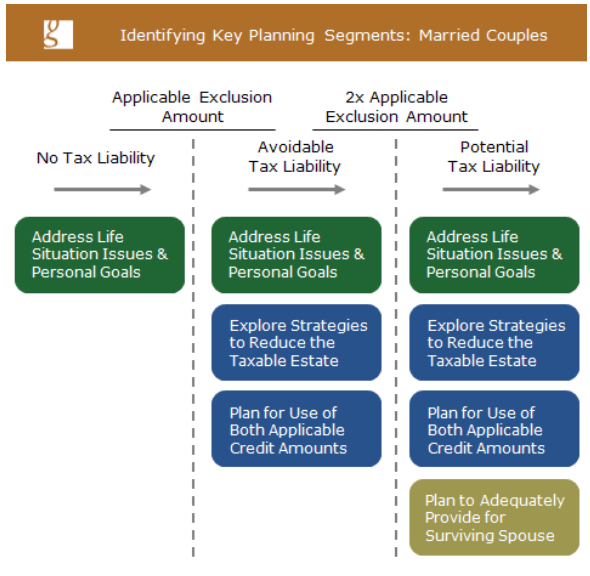
The third segment represents clients whose wealth exceeds both spouse's combined exclusion amounts. For these clients, there is potential federal estate tax liability even if they both make optimal use of their combined applicable credits.

Once you have identified the appropriate segment, it then becomes possible to help them address their needs. Let's examine each segment to see how this might be done.

For clients in the lowest segment, you need not be concerned about federal estate taxes. For them, estate planning should address their life situation issues.

For example, if they are elderly, they may wish to consider the use of living trusts to help provide some security and preserve their independence if one or both of them becomes incapacitated. Planning should also address their personal goals.

For example, they may have a charitable interest and wish to develop a strategy for supporting charity in



their wills.

For clients in the second segment, addressing life situation issues and personal goals remains a priority, but they will also need to adopt a strategy to make optimal use of each spouse's applicable credit amount. They will also typically desire that the surviving spouse have the benefit of all their combined assets. Both these goals are typically accomplished through use of Credit Shelter and Marital Trusts, which are discussed in this course.

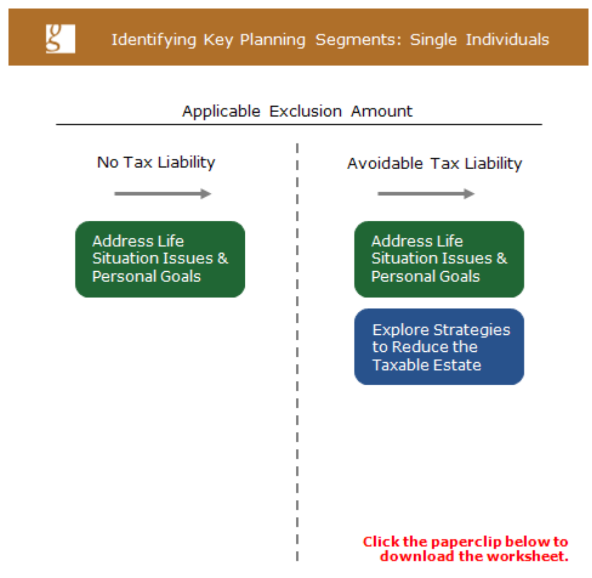
Finally, for clients in the top segment of wealth, they will want to address all the issues of the previous segments, but in addition, they will also want to explore lifetime transfer techniques that will allow them to reduce the size of their taxable estates upon death. This course discusses several such techniques, including lifetime annual exclusion gifts and the creation of charitable remainder trusts.

Now, let's examine the situation for single individuals where we only have the benefit of a single applicable exclusion amount. This results in two segments.

Below the applicable exclusion amount, their wealth is completely protected from federal estate taxes. If their wealth exceeds that amount, then they have potential federal estate tax liability.

For the first segment, we need only be concerned about addressing life situation issues and personal goals.

For the second segment, we must also consider lifetime strategies to reduce the size of their taxable estate.



Introducing the Credit Shelter Trust

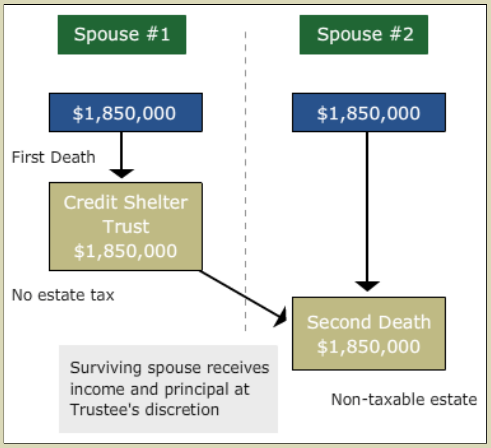
A Credit Shelter Trust (since the Taxpayer Relief Act of 1997, increasingly referred to as the Applicable Exclusion Trust; also known as a "By-Pass Trust" or "Family Trust) is typically created upon the death of the first spouse.   Here is how it works when the first spouse dies:

- The applicable credit amount is generally applied against as much of the estate as possible.
- These "sheltered" assets are transferred into a "credit shelter trust."
- The remaining assets, which are not covered by the applicable credit amount, are transferred to the surviving spouse (or, as we shall explore in the following case study, into a trust for the surviving spouse).
- The surviving spouse generally receives income from the credit shelter trust and, if the document allows, can receive principal at the trustee's discretion.
- The Credit Shelter Trust can also be used for the children. For this reason, it is often referred to as a "**family trust**." In fact, after the death of the surviving spouse, the trust can continue for the benefit of the children.
- Since the surviving spouse cannot control the credit shelter trust, it is not included in the surviving spouse's estate.
- The end result is that both applicable credit amounts are utilized and the surviving spouse does not have to forego benefit of all the assets.

Credit Shelter Trust Example

If Joe and Martha Average divided their assets equally and utilized the credit shelter trust technique in their estate planning documents, the end result would be **no estate taxes**, at a savings of $90,000 (if they both died in 2009), as illustrated in the diagram on the right.

This is one of the most powerful estate planning techniques available for couples, and its features should be second nature to the planner.



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Case Study - George and Wilma Diamond

In Joe and Martha's situation, they could each cover their estate tax exposure by use of the Credit Shelter Trust. Let's now look at what strategies can be employed if the first estate exceeds the amount that can be protected in a Credit Shelter Trust. While in 2009 this requires an estate in excess of $3,500,000 (assuming no lifetime taxable gifts were made), keep in mind that such planning may be appropriate for smaller estates in anticipation of market value appreciation. Furthermore, such planning might be appropriate for smaller estates in consideration of the possibility that in 2011 the applicable exclusion amount could revert to $1,000,000.

Using the following information, begin identifying the Diamond's estate needs.

The Story of Mr. and Mrs. Diamond

George and Wilma Diamond are both in their early 70's. They recently celebrated their 50th wedding anniversary. George is in poor health and is concerned that he will predecease Wilma, who has never handled any of the financial affairs, and he fears she will be overwhelmed by having to handle things herself. They have four grown children, all of whom are married, and twelve grandchildren. One son is handicapped, and George and Wilma still provide some supplemental support for this son and his family. Mr. Diamond expressed a desire to somehow give his handicapped son priority treatment over the other children after he and Wilma die, making sure that he is adequately supported during his lifetime.

George and Wilma's combined estate is currently valued at $7.8 million. This includes a $500,000 life insurance policy with very low cash value that George owns on his own life. Their income is lower than they would like, in part caused by equity holdings that pay little if any dividends. Those equity holdings have an extremely low basis, and the Diamonds are reluctant to sell them to reinvest for greater income because they do not want to pay the capital gains tax.

Their current wills call for everything to be left with the survivor between them. After both deaths, the wills direct that everything should be distributed equally between the four children.

** The characters and scenarios in this case study are fictitious and purely for purposes of illustration.*

Step 1 - Estimate the Potential Estate Tax Liability

Again, let's assume that we are looking at their situation in 2009. Their current estate plan calls for them to leave everything to the surviving spouse. That means the survivor between them will be left with $7,800,000 (assuming no change in values). Utilizing the table that can be viewed by clicking **here**, what is the tentative estate tax liability on that amount before credits and deductions if they both die, with the second death taking place in 2009?

Enter your answer in the box below.

Potential tax liability before credits and deductions: $ 3,390,800

Correct.

Incorrect. The tentative tax on $7,800,000 is $3,390,800. It is calculated as follows:

Tax on $1,500,000 =	$555,800
Tax on next $6,300,000 @ 45% =	$2,835,000
Estimated Potential Tax	$3,390,800

2009 Unified Transfer Tax Rates

Size of Taxable Estate or Aggregate Taxable Gifts		Tax on Amount in Column I	Marginal Rate on Excess of Column I
From: I	To: II	III	IV
$ 0	$ 9,999	....	18%
$ 10,000	$ 19,999	$ 1,800	20%
$ 20,000	$ 39,999	$ 3,800	22%
$ 40,000	$ 59,999	$ 8,200	24%
$ 60,000	$ 79,999	$ 13,000	26%
$ 80,000	$ 99,999	$ 18,200	28%
$ 100,000	$ 149,999	$ 23,800	30%
$ 150,000	$ 249,999	$ 38,800	32%
$ 250,000	$ 499,999	$ 70,800	34%
$ 500,000	$ 749,999	$ 155,800	37%
$ 750,000	$ 999,999	$ 248,300	39%
$ 1,000,000	$ 1,249,999	$ 345,800	41%
$ 1,250,000	$ 1,499,999	$ 448,300	43%
$ 1,500,000 & up	---	$ 555,800	45%

Step 2 - Utilize the Applicable Credit/Exclusion Amount

The preceding analysis demonstrated a significant estate tax exposure. We know from the previous case study that they should consider doing two things to preserve both applicable credit/exclusion amounts:

1. Split assets.

2. Utilize Credit Shelter Trusts in their estate plans.

Let's assume the Diamonds take both these steps, splitting their assets so that each has at least $3,500,000 in his/her own name. For simplicity, let's suppose they split everything equally, giving each of them $3.9 million. Unlike the previous scenario, they are still left with a taxable estate because the ability for each of them to exclude $3,500,000 ($7,000,000 combined) from taxation is simply not sufficient to cover all their assets.

Step 3 - Utilize the Unlimited Marital Deductions

No tax will be due when the first spouse dies because the Credit Shelter Trust will escape taxation and the unlimited marital deduction will be applied against the remaining assets transferring to the surviving spouse. Thus, when the first spouse dies, $3,500,000 will go into the credit shelter trust and $400,000 will transfer to the surviving spouse's estate. **If this is done, what is the estimated tax liability upon the second spouse's death?** Ignore deductible fees and expenses or market value changes. For purposes of this calculation, use the tables that can be viewed by clicking **here**, and assume that **both die in 2009.**

Enter your answer in the box below.

Estimated tax liability upon second death: $ 360,000

Correct. Note the value of allocating the exclusion amount of $3.5 million to a Credit Shelter Trust when the first spouse dies. This strategic design removes $3,500,000 of assets from the second estate, which would have been taxed at the 45% bracket if it had been included in the survivor's estate. This ultimately saved $1,575,000 (45% of $3,500,000) in federal estate taxes.

Incorrect. Here is the proper calculation:

First spouse's death:

Amount in first estate	$3,900,000
Less amount placed in credit shelter trust	(3,500,000)
Amount to transfer to surviving spouse	$400,000

Surviving spouse's death:

Amount transferred from first estate	$400,000
Balance in surviving spouse's estate	$3,900,000
Total estate of surviving spouse	$4,300,000

Estate tax on surviving spouse's estate:

Tentative tax on $4,300,000	$1,815,800
Less applicable credit amount	(1,455,800)
Estimated tax liability	$360,000

Applicable Credit/Exclusion Amount for 2009

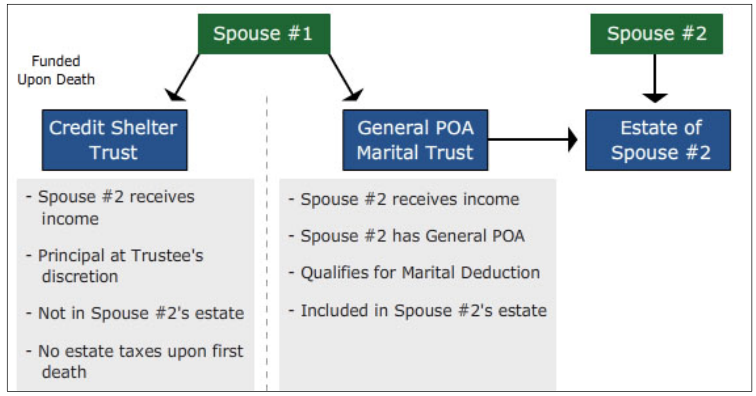
Credit Amount	Exclusion Amount
$1,455,800	$ 3,500,000

Unified Transfer Tax Rates

Size of Taxable Estate or Aggregate Taxable Gifts		Tax on Amount in Column I	Marginal Rate on Excess of Column I
From: I	To: II	III	IV
$ 0	$ 9,999	…….	18 %
10,000	19,999	$ 1,800	20
20,000	39,999	3,800	22
40,000	59,999	8,200	24
60,000	79,999	13,000	26
80,000	99,999	18,200	28
100,000	149,999	23,800	30
150,000	249,999	38,800	32
250,000	499,999	70,800	34
500,000	749,999	155,800	37
750,000	999,999	248,300	39
1,000,000	1,249,999	345,800	41
1,250,000	1,499,999	448,300	43
1,500,000 & up	----	555,800	45

Thus, by simply splitting their assets, revising their wills to include a credit shelter trust, and only transferring to the surviving spouse the amount that cannot be held in the credit shelter trust, we have saved $1,575,000 in estate taxes (assuming both spouses die in 2009). However, it is not always advisable to transfer assets directly to the surviving spouse. An alternative is to use a second trust, known as the ***marital trust***, which is discussed in more detail on the following pages.

Marital Trusts

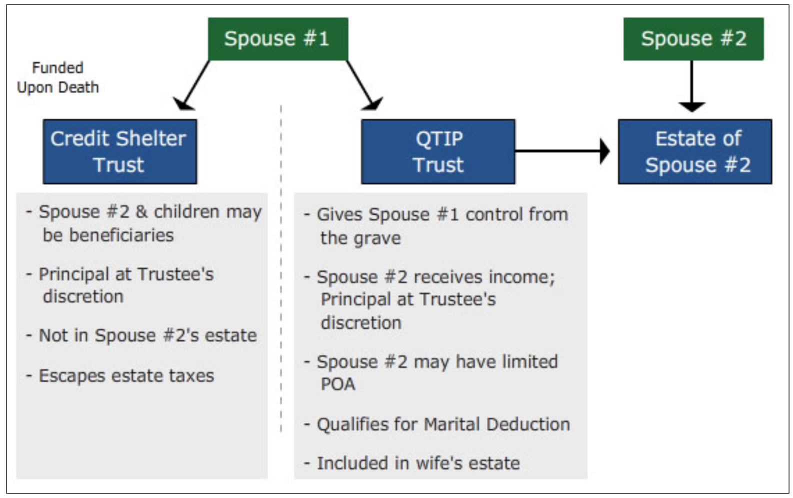


While transferring assets that do not qualify for the credit shelter trust directly to a U.S. citizen surviving spouse is one means of applying the unlimited marital deduction to avoid taxes when the first spouse dies, it is actually more common to see these assets transferred to a marital trust. This two-trust arrangement of a credit shelter trust and a marital trust is commonly referred to as A - B Trusts, where the A trust is the marital trust, and the B trust is the credit shelter trust.

In this arrangement, the surviving spouse receives the income from the trust and also has a ***General Power of Appointment*** over the assets in the marital trust. What that means is that the spouse can appoint those assets to whomever he/she chooses, even to himself/herself.

This arrangement would certainly address Mr. Diamond's concern that his wife be protected from the burden of handling the finances, since the assets can be handled by a competent trustee. The terms of the trust (as well as the terms of the credit shelter trust) could also read that upon the death of the surviving spouse, the trust is to continue for the benefit of the handicapped son until his death, then to terminate and be distributed to the surviving children or their surviving families.

Introducing the QTIP Marital Trust



One problem with the General Power of Appointment Marital Trust is that it may leave too much power with the surviving spouse. For example, Mr. Diamond's desire for the ongoing support of his handicapped son could be defeated if Mr. Diamond dies first and the surviving spouse exercises her power of appointment otherwise. While this may seem unlikely, it is conceivable that another family member might influence her to do exactly that. The fact is that there are many situations where a surviving spouse might alter the intent of a deceased spouse. For example, a surviving spouse might remarry, and there might be children involved from both marriages. The ultimate result might be that children unrelated to the deceased spouse would ultimately receive some or all of the assets left by the deceased spouse. For reasons such as this, the ***QTIP (Qualified Terminal Interest Property) marital trust*** has become increasingly popular.

A ***terminal interest*** in property is one that will terminate upon death. For example, if a person receives income from a trust during life, but at death the assets are distributed to other beneficiaries according to the terms of the trust, then that person has an interest that terminates upon his death. Such "terminal interests" are not ordinarily included in a person's estate. But as long as certain technicalities are met, a marital trust can be constructed with a terminal interest, yet be included in the surviving spouse's estate and thereby qualify for the marital deduction.

In other words, it is possible for George Diamond to plan for a marital trust that will direct the ultimate disposition of the assets to his children, prevent the surviving spouse from changing the distribution, and still qualify the trust for the marital deduction. That is truly control from the grave!

Among the technicalities is the requirement that the surviving spouse **must** receive income from the trust. But unless the donor desires to give the surviving spouse a ***limited power of appointment*** (for example, limiting the ultimate distribution to the children, but allowing the surviving spouse to decide how it is to be prorated among them), **it is the donor who will decide how the assets ultimately transfer, not the surviving spouse**.

George and Wilma Diamond (Continued)

Since use of credit shelter trusts and marital trusts cannot entirely eliminate the estate tax for George and Wilma Diamond, we take one more step to see what further reductions can be obtained.

Step 4 - Make Lifetime or Charitable Transfers

Heretofore, we have concentrated on planning for actions to take place upon death that would reduce estate taxes. Now we move into actions that can be taken during life. These strategies are designed to reduce the size of the taxable estate while alive, thereby reducing or eliminating the remaining potential estate tax liability. In particular, we will discuss four commonly considered lifetime strategies for reducing the size of one's taxable estate.

Click each strategy to learn more.

Make Annual Exclusion Gifts

Since Mr. and Mrs. Diamond plan to ultimately leave everything to their children, why not make transfers during their lifetimes? While there is always some risk of later needing assets that are given away, this risk is mitigated somewhat by the size of their estate. It is also minimized in good family situations where there is some assurance that children are willing to see to the care of their parent(s).

We know that together they can transfer $26,000 per year (in 2009 and 2010) to each child without generating a gift tax liability. Since all the children are married, they could also transfer an additional $26,000 each year to each of their children's spouses. Thus, in a single year, they could make 8 transfers totaling $208,000 with no transfer taxes. Using the applicable 45% marginal estate tax rate that would apply to those assets if retained in their combined estates (if they both died in 2009), in a single year they could reduce their estate tax liability by $93,600. A multi-year program of gifting could potentially eliminate their estate tax bill.

Make Direct Payments for Tuition or Medical Expenses

In addition to, or in lieu of, annual exclusion gifts, the Diamonds might also elect to make direct payment of medical expenses and tuition for their children and grandchildren. In this manner, they could help their children and grandchildren while alive without suffering any gift tax liability. This might be particularly appealing if their handicapped son has medical expenses that exceed what they could give him through annual exclusion gifts.

Create an Irrevocable Life Insurance Trust

When you own life insurance on your own life, the full face value of the policy is included in your estate when you die. This is true even when the policy itself has no current cash value. George currently owns a $500,000 life insurance policy. Simply by transferring that policy into an irrevocable trust, which becomes the new owner of the policy, he can remove $500,000 from his taxable estate. However, to prevent making such transfers from their death bed, the IRS requires that George must live for three years after the transfer. If he does not live that long, the insurance proceeds are includable in his estate.

Note - If a new policy is being purchased, the three-year rule will not apply if the policy is issued to the trust rather than being transferred from an owner to the trust. Thus, if George is still insurable, it might be preferable to have the trust apply for and purchase a new policy.

Make Charitable Transfers

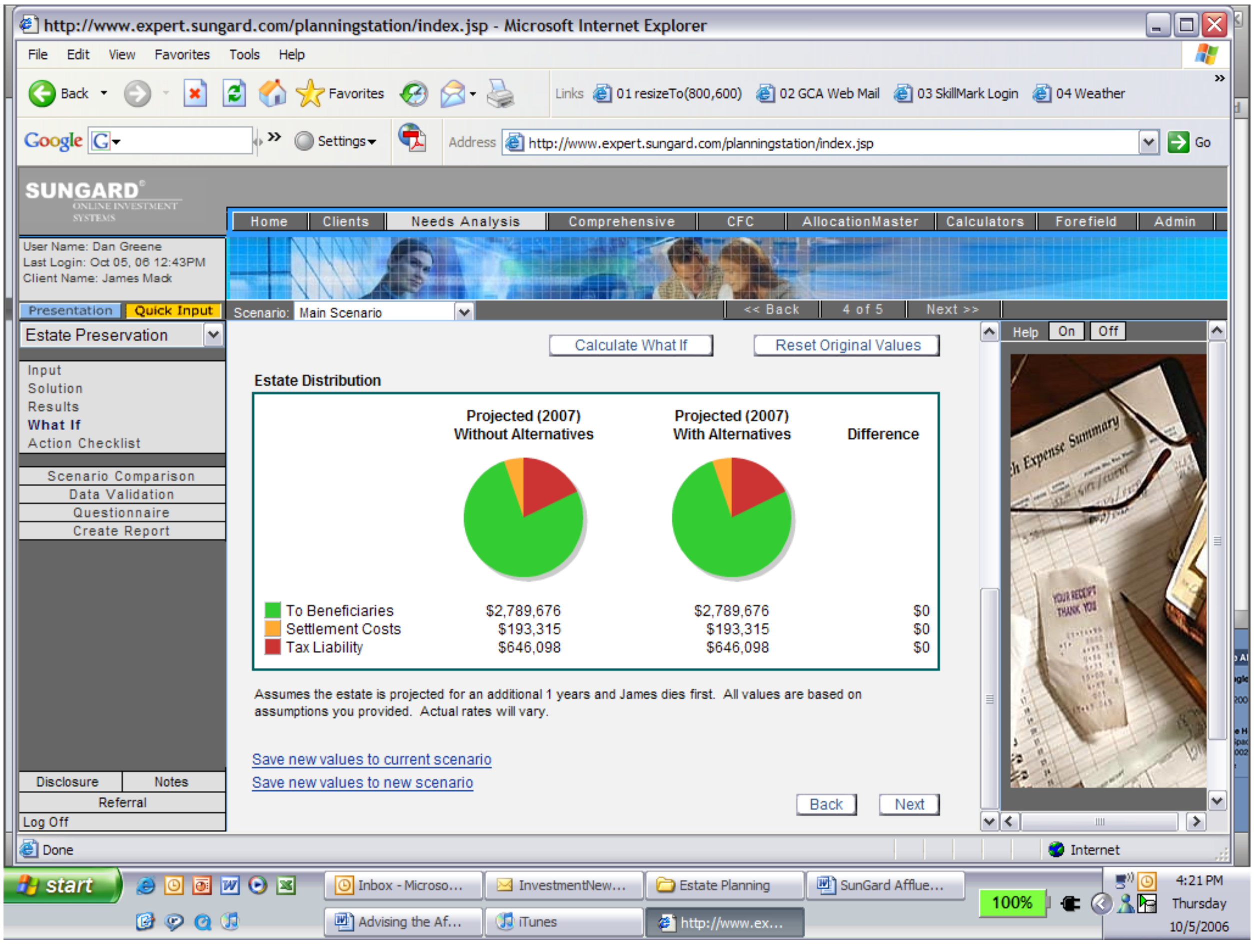
A charitable remainder trust is an irrevocable trust for a qualified charity and is not subject to transfer taxes. In such an arrangement, the grantor retains an income interest in the trust, while naming a charity to receive the remainder of the trust upon termination. The income interest is stated as a percentage (at least 5% but no more than 50%) of the market value of the trust. This can be calculated and fixed at the start of the trust, or can be recalculated annually, in which case it will vary with changes to the market value of the underlying assets.

If the Diamonds have any significant charitable intent, then this might be a consideration. Of course, they could also wait until death to make the charitable bequest, thereby receiving a charitable deduction on their estate tax return. However, by making the transfer in their lifetime they could:

- Remove the contributed assets from their taxable estates.
- Diversify some of their low income-producing assets, while deferring capital gains. No capital gains are realized when the assets are contributed to the trust; nor does the grantor recognize any capital gains when the assets are sold in the trust. The trust inherits the grantor's cost basis. As sales occur and capital gains are realized, they are accumulated and distributed to the grantor only if ordinary income is insufficient to make the required percentage payout. Only as it is paid out to the beneficiary will there be a capital gains impact to the beneficiary.
- Defer and sometimes avoid capital gains taxes on the appreciation of contributed assets. The grantor receives capital gain income only when and if it becomes necessary for the trust to distribute accumulated capital gain income to cover the annual percentage payout.
- Increase their income while alive.
- Receive a charitable deduction on their income tax return. The deduction would be equal to the present value of the remainder interest passing to the charity, as determined at the time of funding the trust.
- Have the satisfaction of helping a charity while they are alive.

PlanningStation:
Demonstrating the Importance of Effective Planning

Often, one of the practical challenges that advisors face when engaging clients in estate planning conversations is helping them truly understand the consequences of failing to plan. Simply quantifying the risks of not planning can be enough to get the client's attention and compel them to seek counsel in this area. When this is the case, PlanningStation can be a very effective tool, enabling you to quickly create a clear picture of how a client's assets will pass to heirs upon their death. An example of the output from this analysis is shown below:



Helping Clients Minimize Estate and Gift Taxes

Even the most sophisticated client can be guilty of paying unnecessary taxes upon death. For example, it would be reasonable to expect an accountant to know how to minimize taxes. Yet the accountant Alwin Ernst, of Ernst & Ernst, left an estate of $12.6 million and lost over $7 million to taxes and costs—approximately 56% of his total estate. In contrast, William Randolph Hearst left an estate of $53 million and lost only $3 million to taxes—less than 6% of his total estate.* As this comparison shows, it is not the size of the estate, but the planning behind it that determines the amount of taxes paid.

The three most common causes of paying excess estate taxes are listed below.

Click each cause to learn more.

Leaving everything to the surviving spouse.

By leaving all of their assets to their spouse, individuals forfeit the Applicable Credit/Exclusion amount in the first estate, thereby increasing the tax exposure of the surviving spouse. This tax trap is most often the result of placing everything in joint name with right of survivorship or the result of simple wills.

Failure to recognize that the taxable estate includes EVERYTHING they own.

Some individuals just do not realize that, when they add up the total value of their estate, they have a tax liability. Most often overlooked is the value of insurance policies. An immediate signal that an individual may be a good trust prospect is ownership of a sizeable insurance policy with their spouse as beneficiary.

Failure to take advantage of lifetime strategies to transfer assets out of their estates.

For very large estates, it is prudent to engage in lifetime strategies that take advantage of transfer techniques that can diminish the size of the taxable estate without incurring gift taxes. Such strategies include charitable gifting programs and gifts to loved ones.

Doubt-Raising Questions

When you encounter clients or prospects who have not done proper planning or do not review their plans periodically to ensure they are still appropriate, ask them an open-ended question that raises some doubt about their current situation.

Click the icon to view example questions.

- What assets have you instructed your heirs (or executor) to sell to cover your estate tax liability?
- How have you structured your estate plan to ensure it minimizes/eliminates your estate tax liability?
- How have you titled property between you and your spouse to ensure it does not undermine your estate plan?

"Consider Your Choices for Estate Taxes," by Scott Keffer, Physician's News Digest, March, 2000, www.physiciansnews.com/finance/300.html.

Need #6 – Maximizing Charitable Intent

A sizeable portion of charitable gifts are made at death rather than during life because many people, while desiring to support charities, fear that making gifts to a charity during their lifetime may result in them outliving their assets. However, in many situations, that fear is unfounded. In fact, making lifetime gifts, as mentioned in the last case study, can be a far superior means of realizing their charitable intent, while increasing their lifetime income. This is illustrated in the following situation.

Situation*:* Suppose an elderly client has $4.5 million, of which $1 million is in an asset with a basis of $30,000. The client receives a dividend yield on the asset of approximately 1.5%, or $15,000 per year. The client would like more income, but doesn't want to pay the capital gains tax for selling the asset. The client plans to give $1 million to a university upon his death.

Click the icon to view the solution.

A solution is to create a ***Charitable Remainder Trust*** and fund it with the $1 million appreciated asset. A Charitable Remainder Trust is a trust where the grantor receives an income benefit during life, with the asset going to the charity upon death. Here is a possible result for taking this step:

- The client receives an immediate income tax deduction for the charitable gift. This deduction can be spread over 5 years of income tax returns.
- The trust is structured to provide an annuity to the grantor for life, or for a specific number of years (up to 20). In this case, let's suppose it is a 6% annuity, or $60,000 per year, significantly increasing his income.
- The charity will be free to liquidate the asset to reinvest in income-producing securities, without suffering the impact of capital gains taxes. The asset can then be reinvested to generate higher income, thereby minimizing or totally eliminating (depending upon market conditions) the need to use principal to make the annuity payments.
- No capital gains are paid when making the gift.
- Upon his death (or at the end of the designated number of years), the trust terminates and the university receives the principal outright.

Through use of a Charitable Remainder Trust, or a ***Pooled Income Fund*** which operates similarly but is designed for smaller accounts, people can not only reduce their estate tax exposure, but often improve their current income situation by making the charitable transfer while alive rather than waiting until they are dead.

Doubt Raising Questions

To help a client/prospect understand the immediate benefits of a charitable gifting strategy, ask them the following questions.

Click the icon to view example questions.

- How have you assessed the benefits of gifting to charities while alive rather than waiting until your death?
- How have you structured your estate plan to maximize the impact of your charitable intent?

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Review Exercise

Select the correct answer for each of the following questions.

1. For insurance to be removed from your estate, how long must you live after transferring ownership to a trust?

   ○ One year

   Incorrect. Try again.

   ○ Two years

   Incorrect. Try again.

   ● Three years

   Correct.

   ○ Five years

   Incorrect. Try again.

2. Which of the following is NOT true of a Credit Shelter Trust?

   ○ In 2009, it can be used to shelter up to $3,500,000 of assets.

   Incorrect. Try again.

   ● The surviving spouse can have a general power of appointment over the trust.

   Correct. If the surviving spouse has a general power of appointment over the trust, then it will be included in the surviving spouse's estate. This would defeat the purpose of the credit shelter trust.

   ○ The surviving spouse can receive income from the trust.

   Incorrect. Try again.

   ○ The trust can be used for the benefit of both the surviving spouse and the children.

   Incorrect. Try again.

3. Which of the following transfers can be made without gift tax liability?

   A. Annual exclusion Gifts

   B. Direct payment of tuition or medical expenses

   C. Gifts to a spouse

   D. Gifts to charities

   ○ A only

   Incorrect. Try again.

   ○ A and D only

   Incorrect. Try again.

   ○ A, B, and C only

   Incorrect. Try again.

   ○ A, C, and D only

   Incorrect. Try again.

   ● A, B, C, and D

Correct.

4. What is the primary advantage of a QTIP Marital Trust over a General Power of Appointment Marital Trust?

- ● The QTIP Marital Trust directs the final distribution of the assets, not the surviving spouse.

  Correct.

- ○ The QTIP Marital Trust provides income to the surviving spouse.

  Incorrect. Try again.

- ○ The QTIP Marital Trust qualifies for the unlimited marital deduction.

  Incorrect. Try again.

- ○ The QTIP Marital Trust is NOT included in the surviving spouse's estate.

  Incorrect. Try again.

5. There is no capital gains impact to the grantor upon funding a Charitable Remainder Trust.

- ● True

  Correct.

- ○ False

  Incorrect.

Conclusion

This concludes the material for this subject. At this time you may return to any sections in which you feel the need for further study. At the start of this course, we introduced you to six common estate planning needs. The following is a summary of the primary solutions that were offered for each need.

Click each need to review the solution.

The Need for a Plan

- Development of a planning strategy
- Execution of appropriate documents, such as wills and trusts

Providing Protection

- Living trust to protect against incapacity
- Trust to protect adult beneficiaries (e.g., financially unsophisticated, easily influenced, spendthrifts, etc.)
- Trust for minors (to prevent them from inheriting at too young an age)
- Special needs trust for persons whose private or government assistance might be jeopardized by an outright inheritance
- Trust with a "pour-over-will" to provide privacy regarding dispositions

Maintaining Control

- A will to direct disposition of probate assets and avoid intestacy
- A will in conjunction with a trust to provide "control from the grave"

Deciding Who Will Act as Executor/ Trustee

- A corporate executor/trustee to provide professional expertise and avoid the possibility of family conflict that can be caused by decisions of a family member acting in such a role

Minimizing the Impact of Estate and Gift Taxes

- Credit shelter trust to allow both spouses to make full use of the applicable exclusion amount.
- QTIP marital trust to qualify assets in excess of the applicable exclusion amount for the marital deduction, while maintaining control over the final disposition of the trust assets.
- Annual exclusion gifts to make lifetime gifts that will reduce the size of the taxable estate
- Direct payment of tuition and medical expenses that will reduce the size of the taxable estate
- Irrevocable life insurance trust to remove life insurance from the estate

Maximizing Charitable Intent

- Charitable remainder trust to remove assets from the estate, help the charity, and provide current income and tax benefits to the grantor