ADVANCED ESTATE PLANNING

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I. UNDERSTANDING GIFT AND ESTATE TAXES

Transfer taxes are imposed on the transfer of family wealth, whether during lifetime or at death. Gift and estate taxes are imposed at the same rates. The generation-skipping transfer tax, which applies to transfers to individuals two or more generations below the transferor, is also a transfer tax.

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). In large part, the Act extends the Bush tax cuts stemming from the Economic Growth and Tax Relief Reconciliation Act of 2001. However, provisions of the Act are only effective for two years. In 2012, Congress will need to revisit the estate and gift taxes.

A. The Estate Tax

1. Beginning January 1, 2011, the first $5 million of a taxpayer's estate will be excluded from estate tax. The exemption is indexed for inflation and will increase each year. Every dollar over that amount will be taxed at a rate of 35 percent.

2. Beginning January 1, 2011, spouses will have the right to aggregate their exclusions. If, for example, a husband dies and the value of his estate is $3.5 million, then $1.5 million of his exclusion amount will be unused. If wife elects to do so, she can add that unused amount to her own exclusion amount, increasing it from $5 million to $6.5 million. This new feature has been referred to as "portability." The wife must file an estate tax return at husband's death showing her election to hold on to her husband's unused exclusion amount. Remarrying will not allow the survivor to stack up multiple unused exclusion amounts. The survivor is only allowed to use the unused exemption amount from his or her last spouse.

3. The changes made by the Act automatically expire on December 31, 2012, at which time the top estate tax rate will be 55%, and the amount protected from estate taxes will drop to $1 million.

B. The Gift Tax

1. The Act "reunifies" the gift and estate taxes, allowing taxpayers to give away up to $5 million either during their lifetimes or at their deaths without incurring an estate or gift tax. Since 2002, taxpayers have been able to give away only $1 million during life without incurring a gift tax, even though the estate tax exemption was higher. If you have already used a part of your old $1 million exemption, you now have another $4 million of gift tax exemption available to use.

2. The changes made by the Act automatically expire on December 31, 2012, at which time the top gift tax rate will be 55%, and the amount that can be protected from gift (and estate) taxes will remain at $1 million.

C. The Generation-Skipping Transfer Tax

1. The Act increases the amount a taxpayer can transfer to younger beneficiaries without incurring a generation-skipping transfer ("GST") tax. Beginning January 1, 2011, the first $5 million of such transfers will be exempted from GST tax.

2. As with the estate tax, the provisions of the Act regarding GST expire on December 31, 2012, at which time prior GST rules will be reinstated.

D. Capital Gains Tax on Inherited Assets

When an asset is sold, the profit is taxed by either the income tax or the capital gains tax. For these purposes, "profit" is the excess of the sales price over the owner's tax basis in the property. If the owner bought the property, his or her tax basis generally is equal to what he or she paid for it. Under previous version of these rules, if a beneficiary inherits an asset, the beneficiary's basis is "stepped up" to the value at the time of the deceased owner's death. Because of this "step up" in basis, only the post-death appreciation is subject to income tax if the beneficiary decides to sell the asset. Oddly, the Bush tax cuts severely limited the step-up rules. The Act, however, returns us to the full step-up in basis rules.

E. Exemptions from Transfer Taxes

The following gifts do not utilize gift and estate tax exemption.

1. <u>Annual exclusion gifts: $13,000 per recipient</u>: Currently, every individual may give up to $13,000 per year to as many donees as desired. These gifts do not utilize gift and estate tax exemption. A spouse may consent to being treated as making one-half of the gift without actually contributing any assets, thereby doubling the size of the gift the donor may make. Annual exclusion gifts must be gifts of a "present interest," available to the beneficiary in the year the gift is made.

2. <u>Gifts for Tuition and Medical Expenses</u>: Payment of school tuition (directly to the educational institution) or medical expenses (directly to the health care provider) is not subject to limitation. "Ed/Med" gifts must be gifts of a "present interest," available to the beneficiary in the year the gift is made.

3. <u>Gift and Estate Tax Marital and Charitable Deductions</u>: Assets passing to charity or to a spouse generally escape gift and estate taxes. Special rules apply, however, if a spouse is not a United States citizen.

4. <u>Effective Gift and Estate Tax Rates</u>: The effective tax on lifetime gifts is approximately one-half the effective tax on gifts made at death. This is because the gift tax is imposed on the value of what the donee receives, while the death tax is imposed on the value of what the deceased person

owned. Thus, the death tax is computed in part by including the value of the funds used to pay the tax itself.

II. TRADITIONAL ESTATE PLANNING TOOLS

An estate plan is brought into effect by the use of various tools to assure that the result is as intended by the client and his/her estate plan. Each of those tools serves a particular purpose, and the estate planner must be familiar with each and its use to achieve the desired result.

A. Wills

The keystone of the estate plan is the client's Will. Because it takes effect at the moment of the client's death and can be freely changed up to that point (as long as the client remains competent) the Will is usually the critical document. The person making a Will is often referred to as the "testator."

The primary function of the Will is to govern what disposition will be made of the testator's property. As noted above, the Will operates only to dispose of the property that is included in the client's probate estate. That property may be left to designated beneficiaries outright or in trust.

In addition, the Will serves several secondary functions as the final statement of the client's intention on various matters. For example, the Will may appoint guardians for the testator's minor children, or may exercise powers of appointment granted to the testator under trusts previously established by others.

The requirements for creating a valid Will are established by the applicable state law. In general, a Will must be in writing, must be subscribed (i.e. signed) by the testator, and must be witnessed by at least two adult witnesses who are neither beneficiaries under the Will nor related to the testator (so potential intestate heirs). In addition, the testator must be competent and of the prescribed minimum age (which may be the legal age of majority or a younger age). The function of the witnesses is to testify later, if called upon, that the decedent appeared competent and aware of what was transpiring as the Will was executed. Few states allow notarization of the signatures of the testator and the witnesses as a streamlined method of establishing the validity of the Will in the absence of any challenge. A female making a Will is referred to as a "testatrix."

The basic structure of a Will includes the following elements:

1. Exordium Clause - This states who the testator is, declares his or domicile, states that the instrument is indeed the testator's Last Will and Testament, declares that this Will supersedes all prior Wills and declares them invalid.

2. Payment of Debts - This clause directs payment of the testator's funeral expenses, debts, and expenses of administering the estate. It directs in addition what sources are to be used for such payments, and may specify the manner of payment of secured debts; for example, a mortgage on real estate may not be paid, but instead the property may be bequeathed to a beneficiary subject to the mortgage.

3. <u>Tax Payment Clause</u> - This directs what source shall be used to pay the taxes due from the testator's estate. The taxes pay all be paid from the residue, or they may be apportioned pro rata among all (or only some) bequests made under the Will. Normally, the taxes are paid out of the taxable bequests under the Will, thus maximizing the amounts of the marital and charitable bequests; this in turn maximizes the marital and charitable deductions and minimizes the estate taxes due.

4. <u>Tangible Personal Property</u> - The Will should specify the disposition of the testator's tangible personal property, such as automobiles, artworks, jewelry, furniture, and the like. If such property is actually held as community property, or is owned by the decedent spouse, it may be helpful to so state in the Will.

5. <u>Bequests</u> - The Will provides for specific bequests of cash or property to designated beneficiaries. Amounts may be bequeathed outright or in trust. The Will should include, after the various specific bequests desired by the testator, for an ultimate bequest of the <u>residue</u> of the estate (i.e., everything that is left over after those bequests are fulfilled. That amount may be left to a beneficiary, transferred to a trust created under the Will (i.e., a "testamentary" trust) or "poured over" to an existing trust created earlier.

6. <u>Appointment of Fiduciaries</u> - The Will must specify who will serve as executor (in some states, called a "personal representative") to administer the estate, and as trustee under any trusts created by the Will. It will also be necessary to identify successors to serve if any of the designated fiduciaries are unable or unwilling to serve, or subsequently die or resign, etc. This may be done by actually naming the successors, or by providing a clearly defined mechanism for successors to be appointed. If successors are not provided for, it will be necessary for the estate or trust to incur the expense of a court proceeding to name the successor. In addition the Will may waive, or limit, the requirement that a bond or other security be posted by the named fiduciaries. The Will may also address the question of the appropriate compensation for the fiduciaries. If the testator has minor children, the Will should designate the person or persons to serve as guardians of the children and of their property, in the event they have no surviving parent.

7. <u>Common Disaster Provision</u> - The Will can provide whether the testator or his/her spouse shall be deemed to survive in the event they perish in a common disaster.

8. <u>Testimonium and Attestation</u> - This clause states that the testator was familiar with the instrument and intended that it be his/her Last Will and Testament. It will usually state the date upon which the testator is signing the Will, and is followed by the signature of the testator and witnesses' attestations in accordance with local law.

B. <u>Revocable Trusts (or "Living" Trusts)</u>

Revocable trusts are sometimes referred to colloquially as "living trusts." They are more accurately "inter vivos" trusts, because they can only be created during the decedent's lifetime. The client creating such a trust (variously referred to as the "grantor" or "settlor" or "trustor") executes a trust instrument and transfers property into the trust. In most cases, the grantor reserves the right to amend or revoke the trust at any time. Typically, the grantor will serve as the initial trustee of his/her own trust, and this leads to confusion between the grantor's property owned outright and the property in the trust. Accordingly, it is necessary to provide for a clear transfer from the grantor to the trust. The manner of effecting this transfer will vary according to the type of property involved, but it is important that the transfer be properly completed. This may require deeds in the case of real estate, changing the account titles in the case of stock brokerage accounts, bank accounts, certificate of deposit and the like, and retitling of such things as motor vehicles, boats, etc.

If desired, the grantor may name another person (or a bank or other corporate trustee) as trustee of the trust, rather than serving as trustee personally. More often, however, the grantor will name himself/herself as the initial trustee, with another person, bank or corporate trustee named as successor to assume office upon the death or disability of the grantor.

The role of the revocable trust is particularly important in the case of a disability of the grantor. Unlike a Will, which takes effect only upon the actual death of the testator, a revocable trust can provide for administration of the grantor's property while he or she is still alive, but unable to act. This can be particularly important in the case of an elderly or infirm client, since modern medicine can often prolong the life of such a person past the time when he or she is able to attend to business affairs.

A useful example to keep in mind in this respect is the case of Groucho Marx. When the comedian's physical condition declined in his later years, a protracted legal battle broke out between family members and his manager as to which should be appointed guardian to oversee Groucho's affairs. A properly structured and funded revocable trust could have prevented the expense, uncertainty and publicity experienced by the parties.

The revocable trust is structured much like a Will, in that it provides for the distribution of the grantor's property after his or her death. The primary difference, of course, is that it also provides for administration of the property while the grantor remains alive. For virtually all tax purposes, the property in an inter vivos revocable trust remains the property of the grantor. Thus, the grantor remains liable for all income taxes on the income earned by trust property. There are no gift taxes payable on the amounts placed in the trust because, due to the grantor's retained power of revocation, the transfer is incomplete for gift tax purposes. Finally, when he grantor dies, the property in the trust is included in the grantor's taxable estate for federal estate tax purposes. Despite some perceptions to the contrary, there are no tax savings realized through the use of an inter vivos revocable trust.

In some states, a revocable trust may be used as the primary means of transferring a decedent's estate, with such trust holding and passing virtually all of the grantor's property. (The grantor still needs a Will, since it is virtually impossible to get all property, especially tangible personal property, into the trust.) This is usually the result of some burdensome or expensive aspect of the probate rules in the particular state. Where the state has a streamlined probate process, however, the revocable trust is often not necessary although it may still be useful, particularly in the case of an older grantor who is concerned about providing for disability as described above.

Revocable trusts are often promoted as an absolute necessity for every individual, and this is seldom true. In comparing the use of a revocable trust with the use of a Will, the following factors may be taken into account:

1. Avoidance of Probate - A Will must be probated, and the revocable trust avoids this. The importance of this factor depends upon the nature and cost of probate in the particular jurisdiction. The client should be made aware that, while probate is avoided, many of the same expenses are incurred in transferring property to the revocable trust and, upon the grantor's death, administering the property in accordance with the terms of the trust. Some individuals are comforted by the fact that a revocable trust avoids the publicity which is inherent in the probate process, since a decedent's Will and all the papers filed in the probate process become public documents available for inspection at the local court house. In practice, this feature is probably not important as it may seem in the case of an average, non-celebrity citizen.

2. Taxes - As pointed out above, it is important to remember that the use of a revocable trust does absolutely nothing to reduce estate taxes. In fact, the use of a trust can increase the tax burden, particularly the income tax burden, on an estate as compared to the burden resulting from the use of a Will.

3. Management and Administration - The use of a revocable trust assures uninterrupted administration of the grantor's property through any period of disability. Moreover, competent management can be assured more readily through a professional trustee or other competent individual as trustee, without delay or interruption.

4. Disability - The revocable trust provides an efficient means of minimizing problems encountered during the life of the decedent as a result of medical or physical disability, since the trust assets can be administered by the successor trustee without serious interruption upon disability of the grantor.

5. Rights of Creditors and Heirs - The use of a revocable trust may, depending upon local law, enable a grantor to cut off any rights of a surviving spouse or children (including illegitimate children) to elect against the Will. However, it provides the grantor with no creditor protection during his or her life.

6. <u>Certainty of Result</u> - The probate process offers an opportunity for interested parties to challenge the validity of a Will; the revocable trust is not subject to the rules of probate and any attack must be based upon the more difficult showing that the grantor acted under duress or undue influence. This would be difficult to establish if the trust has been in operation for a significant period prior to the grantor's death.

7. <u>Overall Costs</u> – Wills are generally less expensive than revocable trusts to prepare, but you must consider the costs of administering each document in determining the "real" cost difference. Law firms often charge by the hour to help administer a trust after someone has died, and although lawyer's hourly rates seem high, the statutory fees for probate set by the California legislature usually far exceed hourly billings. For example, a surviving spouse may incur several thousand dollars of hourly fees for an estate worth $1 million, but the statutory probate fees for a $1 million probate estate come to almost $25,000.

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Will vs. Living Trust At A Glance			
	With No Will	**With A Will**	**With A Living Trust**
At Disability	*Conservatorship:* Court appoints conservator who oversees your care, must keep detailed records & reports to the court. Court controls all your finances and assets, approves all expenses.	*Conservatorship:* Same as with no Will.	*No Conservatorship:* Your back-up trustee manages your financial affairs according to your instructions for as long as necessary. (Separate agent required for health care decisions.)
Court Costs	You pay all court costs, legal fees.	Same as with no Will.	None.
At Death	*Probate:* Court orders your debts paid and possessions distributed according to state law, which may not be what you would have wanted.	*Probate:* After verifying your Will, court orders your debts paid and possessions distributed according to your Will.	*No probate:* Debts are paid & possessions immediately distributed to beneficiaries by back-up trustee according to your written instructions.
Court Costs	Your estate pays all court costs and legal fees (often estimated at 5-10% of the gross value of your estate, higher if your Will is contested).	Same as with no Will.	None.
Time	Usually 1-2 years or more before heirs can inherit.	Same as with no Will.	Usually 4-6 weeks for smaller estates; up to 9 months for larger ones.
Flexibility and Control	*None:* Your property is controlled and distributed by probate court according to state law. Very easy for anyone to contest.	*Limited:* You can change your Will any time, but it can easily be contested. Family has no control over probate costs or delays.	*Total:* You can change your trust at any time, even discontinue it. Your property remains under your total control. Hard to contest.
Privacy	*None:* Probate proceedings are public record. Exposes family to unscrupulous solicitors and greedy heirs.	*None:* Same as with no Will.	*Total:* Privacy preserved. No probate. Living trusts are not public record.

C. Advance Health Care Directive

An Advance Health Care Directive designates someone else to make health care decisions for the principal if he or she is unable to give informed medical consent due to incapacity. It allows the principal to express preferences regarding artificial life support and other medical treatments and issues.

In California, the equivalent document used to be called a Durable Power of Attorney for Health Care. As of July 1, 2001, they are called Advance Health Care Directives.

In California, health care documents executed before January 1, 1992, expire. A Durable Power of Attorney for Health Care executed in 1992 or later is valid unless and until expressly revoked.

D. Durable Power of Attorney for Asset Management

A Durable Power of Attorney for Asset Management authorizes the principal's "agent" or "attorney-in-fact" to handle financial matters for him. This authority may be currently effective or triggered by the principal's incapacity (as evidenced by one or two doctors' letters). A Durable Power of Attorney can authorize the agent to fund the principal's revocable living trust and/or make gifts on his behalf, as well as file the principal's tax returns and deal with assets not transferred to the principal's living trust.

This document is extremely important for aging parents who may become incapacitated. Even if a parent has a revocable living trust, assets that pass by beneficiary designation, such as life insurance, qualified retirement plans and IRAs, are not transferred to the living trust since they will not be subject to probate anyway unless payable to the owner's estate. A Durable Power of Attorney is even more important if the primary estate plan document is a Will. Without one, no one could manage the individual's financial affairs if he or she became incapacitated, unless a guardian or conservator were appointed.

E. Irrevocable Trusts

As its name suggests, an irrevocable inter vivos trust is a trust created during the grantor's lifetime and not subject to change or revocation by the grantor. As a general matter (subject to many qualifications) an irrevocable trust is designed to bring about a complete transfer for tax purposes. Thus, a gift tax would normally be due on the value of shares in the trust transferred to persons other than grantor. Thereafter, the trust or its beneficiaries would bear the income tax liability on the income earned by the transferred assets. Moreover, upon the grantor's death, the property would normally not be subject to estate tax. An irrevocable trust is normally used to deal with the situation where the grantor desires to make a transfer that is complete when made, but the beneficiaries are either under age or are not considered able to handle the property without the assistance of a trustee. Thus, such a trust may be used to hold assets transferred to benefit a minor child, or a beneficiary who is viewed as impressionable, financially naive, or otherwise unable to deal effectively with the property if it were transferred outright to him or her.

There are a number of special-purpose irrevocable trusts. For example, a grantor may create a trust to utilize the $5,000,000 exemption from the generation skipping transfer tax. A trust for a spouse may be structured to qualify for the marital deduction, and hence is known as a marital deduction trust. A charitable remainder trust, if established during the grantor's lifetime, is necessarily an irrevocable trust.

An irrevocable trust, unlike a revocable trust, is generally fully subject to the federal income tax. While assets in a revocable trust are considered owned by the grantor for tax purposes, and he or she is taxed on the income therefrom, an irrevocable trust is a separate taxable entity. In general terms, its taxable income is computed like that of an individual, with the important exception that amounts distributed to beneficiaries qualify for the distribution deduction and are reported on the beneficiaries' individual income tax returns.

The tax rates imposed under Revenue Reconciliation Act of 1993 create a serious income tax problem for trusts. Under the revised rate schedule applicable to trusts, taxes on trust income reach the top income tax bracket of 35% at a very low level of taxable income ($11,200). By contrast, married individuals filing joint returns and single individuals reach the 35% bracket at $373,650. This situation can increase the burden on the trustee since, to the extent income that might be distributed is retained by the trust, it will be subject to very high income tax rates.

III. <u>PROPERLY STRUCTURING A LIVING TRUST TO MINIMIZE TAXES</u>

The appropriate living trust structure for our client will depend upon the size of the estate -- including IRAs, retirement plans and life insurance on the client's life which is owned by the client, or by the client and his or her spouse. The appropriate tax planning varies depending upon whether the estate of an individual exceeds the $5 million exemption amount or the estate of a couple exceeds $10 million ($5 million per spouse).

A. <u>The AB Trust</u>

1. <u>How It Works</u>

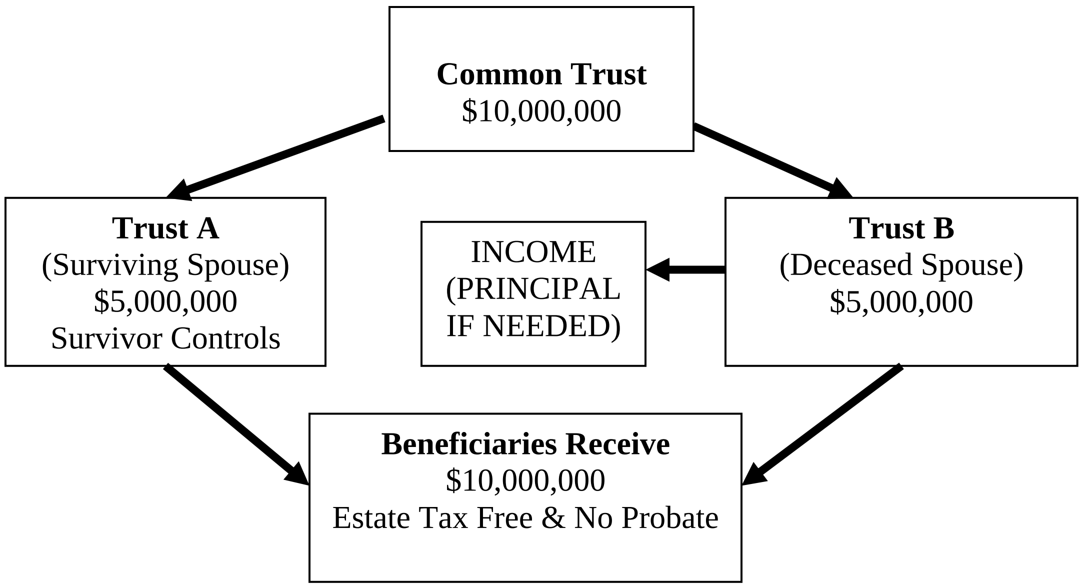
Upon the death of one spouse, the common living trust automatically divides into two separate trusts - Trust A for the surviving spouse and Trust B for the deceased spouse.

If the common trust is $10,000,000 or less, half of the assets are placed in Trust A and half in Trust B. If the common trust is over $10,000,000, usually only $5,000,000 of the deceased spouse's assets are placed in Trust B since this is the amount of the federal estate tax exemption - the rest is transferred to Trust A using the marital deduction to postpone estate taxes on the deceased spouse's share allocated to Trust A.

No estate tax is paid when the first spouse dies. Trust A is taxed when the surviving spouse dies. In the meantime, the surviving spouse has complete control over Trust A, and can receive the income (and principal if needed for certain living expenses) from Trust B.

When the surviving spouse dies, the assets in both trusts are distributed to the beneficiaries.

Common AB Living Trust



2. **<u>Advantages of an AB Trust</u>**

(a) Reduce/Eliminate Estate Taxes - With an AB living trust, a husband and wife can each use the $5,000,000 federal estate tax exemption. This lets them pass on to their beneficiaries up to $10,000,000 estate tax-free and with no probate - saving federal estate taxes and probate fees.

(b) Provide for Surviving Spouse - The surviving spouse has complete control over Trust A. In addition, he/she can receive the income (and principal, if needed for certain living expenses) from Trust B.

(c) Control for First to Die - The trust can be designed so that, after the first spouse dies and the common trust has been divided into Trust A and Trust B, no changes (or only limited changes, such as to benefit children and grandchildren) can be made to the provisions of Trust B - giving the first spouse to die complete control over who will eventually receive the assets in Trust B.

(d) Estate Tax-Free Appreciation of Trust B - The assets placed in Trust B are valued only when the first spouse dies. There will be no revaluation or estate taxes paid on any appreciation of these assets later when the surviving spouse dies and the assets in Trust B are distributed to the beneficiaries.

(e) Protection of Assets if Catastrophic Illness Strikes - In the event of catastrophic illness or injury of the surviving spouse, the trust can be written to protect the assets in Trust B - so only the assets in Trust A will need to be "spent down" to qualify for valuable government assistance.

B. The ABC Trust

1. How It Works

Upon the death of one spouse, the common living trust is divided equally. Half of the estate goes into Trust A for the surviving spouse. The other half (the deceased spouse's share) is divided between Trust B and Trust C. Usually only $5,000,000 in assets are placed in Trust B since this is the amount of the federal estate tax exemption; the excess is placed into Trust C.

No estate tax is paid when the first spouse dies. Trust A and Trust C are taxed when the surviving spouse dies. In the meantime, the surviving spouse has complete control over Trust A, and can receive income (and principal, if needed for certain living expenses) from Trust B. In addition, he/she <u>must</u> receive all the income from Trust C, and <u>can</u> receive principal, if needed, for certain living expenses.

When the surviving spouse dies, the assets in all three trusts are distributed to the beneficiaries.

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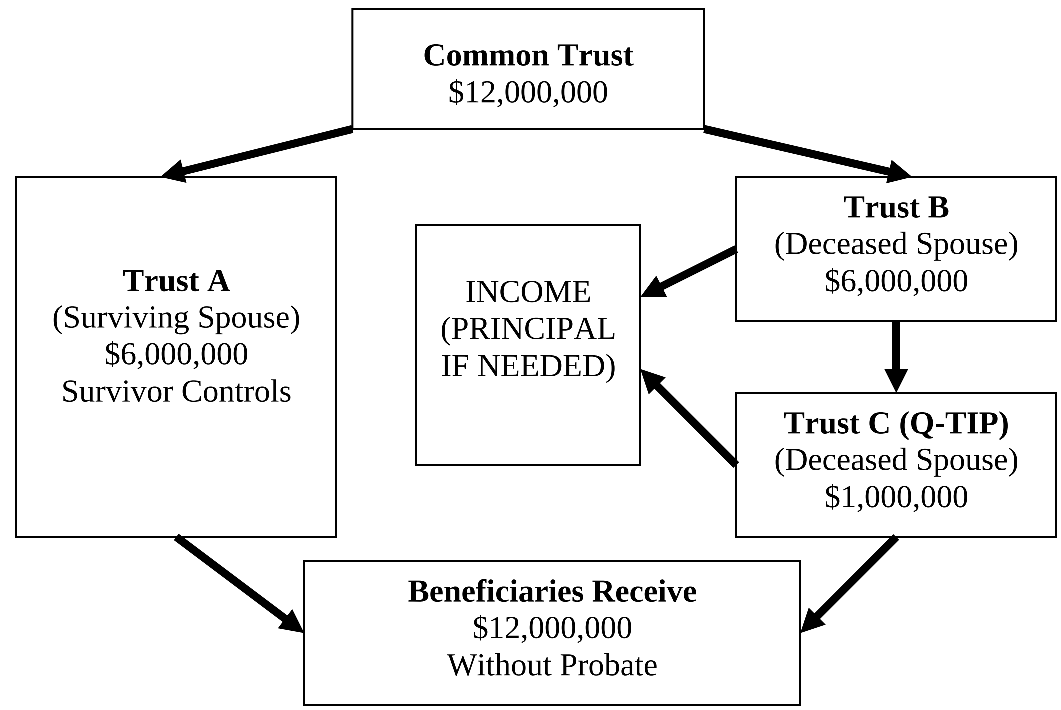
Common ABC Living Trust



2. <u>Advantages of an ABC Trust</u>

(a) Reduce/Eliminate Estate Taxes - With an ABC living trust, a husband and wife can each use his or her $5,000,000 federal estate tax exemption. This lets them pass on to their beneficiaries up to $10,000,000 estate-tax free and with no probate - saving federal estate taxes and probate fees.

(b) Provide for Surviving Spouse - The surviving spouse has complete control over Trust A and receives all income from Trust C. In addition, he/she can receive the income from Trust B and can have access to the principal of Trust B and Trust C.

(c) Control for First to Die - The trust can be designed so that, after the first spouse dies and the common trust is divided into Trusts A, B and C, no changes (or only limited changes, such as to benefit children and grandchildren) can be made to the provisions of Trust B and Trust C - giving the first spouse to die complete control over who will eventually receive the assets in Trust B and Trust C.

(d) Estate Tax-Free Appreciation of Trust B - The assets placed in Trust B are valued only when the first spouse dies. There will be no revaluation or estate taxes paid on any appreciation of these assets later when the surviving spouse dies and the assets in Trust B are distributed to the beneficiaries.

(e) Estate Taxes Delayed on Trust C - The assets placed in Trust C are taxed only when the surviving spouse dies. This leaves the estate intact until then, so a larger amount is available to provide income (and principal, if needed) to the surviving spouse during his/her lifetime.

(f) Protection of Assets if Catastrophic Illness Strikes - In the event of catastrophic illness or injury of the surviving spouse, the trust can be written to protect the assets in Trust B and Trust C - so only the assets of Trust A will need to be "spent down" to qualify for valuable government assistance. However, the surviving spouse's right to receive all of the income from Trust C will be included in his or her assets when application for benefits is made.

IV. LIFE INSURANCE

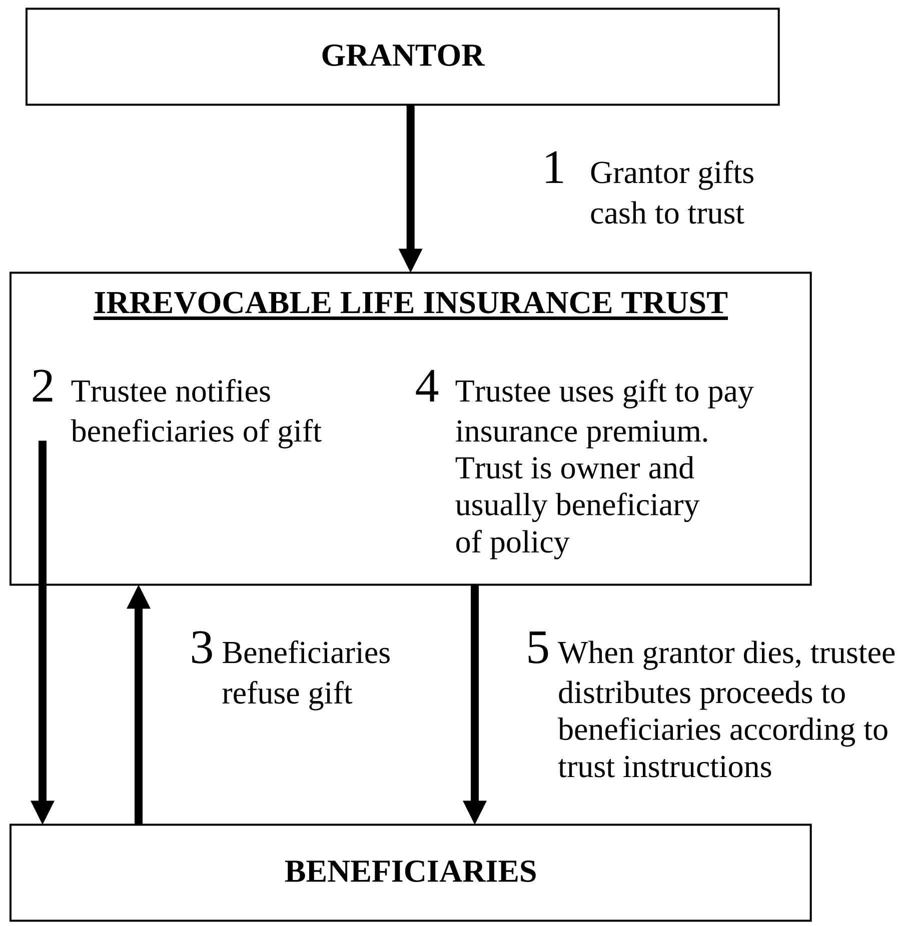
A life insurance policy offers several unique characteristics as an estate planning tool. First, it can provide a dependable and liquid source of funds, in large amounts, at a time when such funds are most needed. Thus, on the death of a breadwinner, the surviving family members can continue their accustomed lifestyle through the use of insurance proceeds. The education of a decedent's children can be assured. In this fashion, life insurance can provide an estate for the person who would not otherwise leave one for his/her survivors. Business owners can use life insurance to provide a certain source of liquidity upon the loss of a key business owner or employee. Funds can be made available, free of estate tax, to enable survivors to meet death tax and estate administration costs.

From an estate planning standpoint, the primary objective is normally to assure that the proceeds of the decedent's life insurance are excluded from the taxable estate to the extent possible. This is normally achieved by creating an irrevocable life insurance trust which then takes out and holds the policies. (Life insurance is generally subject to estate tax only if it is either payable to the estate or if the decedent possessed at his or her death any "incident of ownership" or with a policy (such as a right to change beneficiaries, cancel or assign the policy, pledge it for a loan, etc.).

Single life coverage provides liquidity for a surviving spouse or to pay taxes on bequests worth more than the estate tax exemption made to individuals other than one's surviving spouse, or it insures an unmarried person. Second-to-die coverage pays proceeds at death of second spouse to die and, by providing proceeds for the children, provides cash to pay estate taxes or illiquid assets and/or replaces assets left to charity.

An irrevocable life insurance trust lets the grantor's beneficiaries benefit from the insurance proceeds and keeps the policy from being included in the grantor's taxable estate. Neither the grantor nor his or her spouse may act as trustee.

Irrevocable Life Insurance Trust



V. <u>FAMILY PARTNERSHIP OR LIMITED LIABILITY COMPANY</u>

A family limited partnership or limited liability company allows one to transfer business or investment assets to children or others at values that are substantially discounted for gift tax purposes. The client may retain control of the asset or may transfer control to a child or children. Both family limited partnerships (FLPs) and limited liability companies (LLCs) are "conduits" for tax purposes. All income, gains, losses, credits and deductions flow through to the partners in the FLP or the LLC members. The FLP protects only the limited partners' interests from their creditors. The LLC protects all members' interests from their creditors.

Because there are limitations on the ability to transfer interests to initial entities, their value is discounted for lack of marketability. Because the donee cannot control the entity, there is also a minority interest or “lack of control” discount.

VI. LARGE RETIREMENT PLANS AND IRAs

Retirement plans and IRAs that pass to an heir other than one’s spouse are severely eroded by double taxation at death. Plan and IRA balances are hit with both estate tax and income tax. Sophisticated planning can allow the heirs to defer income taxes on this asset. If the estate plan includes a charitable gift, it should be funded on death from the retirement plan or IRA. Charities receive retirement assets free of both estate and income taxes.