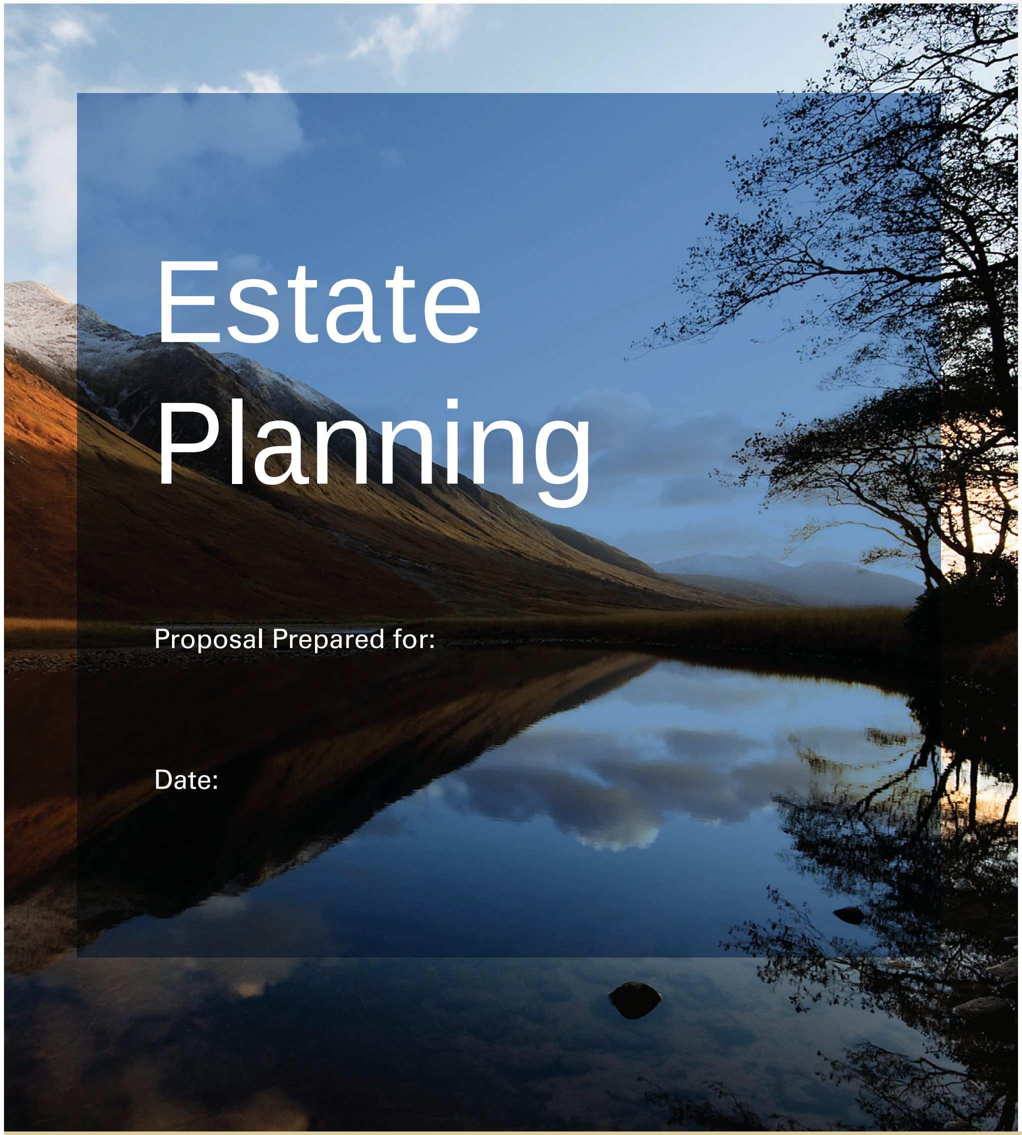

Estate Planning

Proposal Prepared for:

Date:

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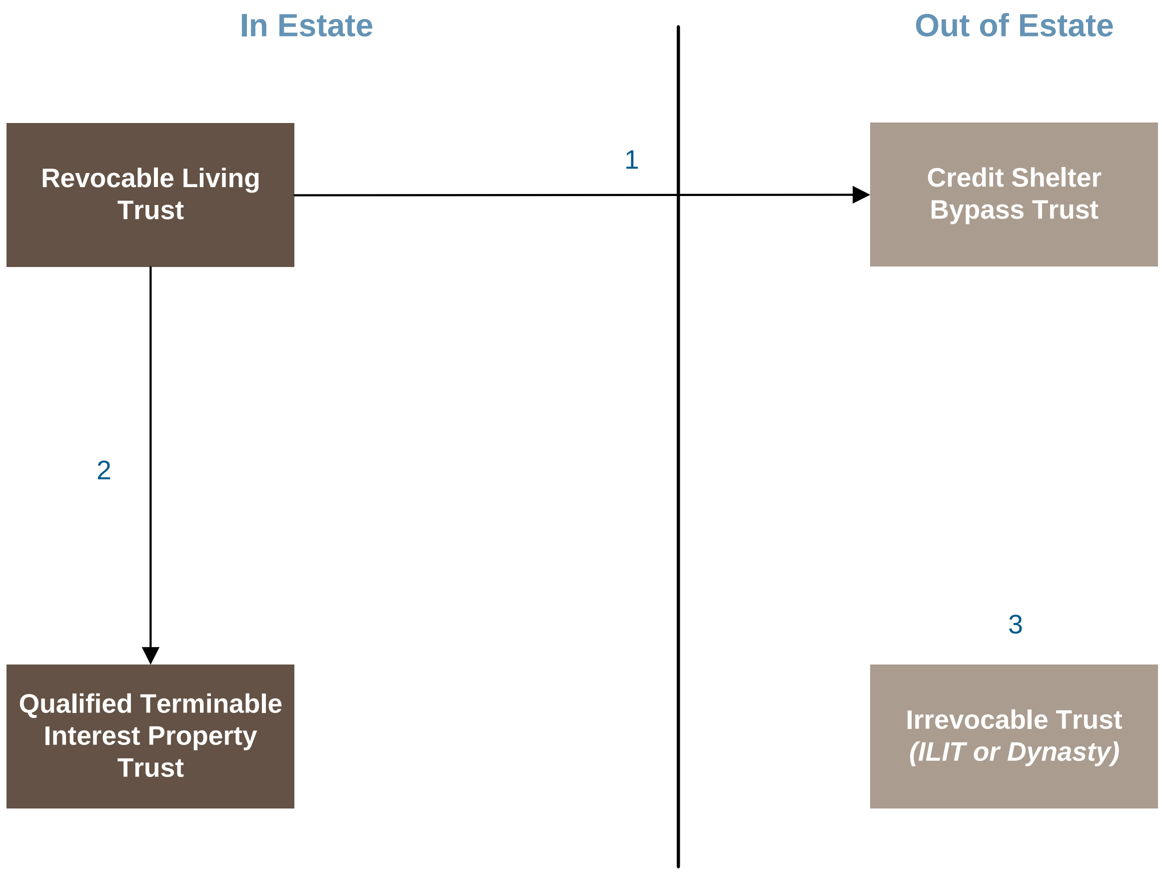
Prepared by:

Estate Strategy Schematic

Prepared for

Estate Planning Strategy Schematic



Schematic Description

1. At first death, assets are contributed to a Credit Shelter Bypass Trust.
2. At first death, assets are contributed to a Qualified Terminable Interest Property Trust.
3. Life insurance is owned by an Irrevocable Trust (Irrevocable Life Insurance Trust or Dynasty Trust).

Supporting Documentation

Prepared for

Revocable Living Trust (RLT)

Revocable Trusts can offer professional asset management and avoidance of probate, while you retain full control over the assets.

Revocable Trusts, also called Living Trusts, can be used for better management and control of assets during life and at death. Because the trusts are revocable, the grantor is not committed to the trust if the situation changes.

Mechanics of Revocable Trusts

The grantor creates a revocable trust, names the trustee and the beneficiaries, and contributes property to the trust. The grantor or a third party can act as the trustee. Property can be added or removed from the trust at any time, and the terms of the trust can be amended or the trust can be terminated at any time by the grantor. Upon the grantor's death, the trust becomes irrevocable and trust assets are transferred to trust beneficiaries as defined in the trust document.

Because the grantor can revoke the trust, trust assets are included in the grantor's gross estate for estate tax purposes. Also, all income and deductions attributable to the trust property flow back to the grantor. On the other hand, retained control means that contributing assets to the trust will not trigger gift tax. However, a gift will occur if the grantor gives up power to revoke or amend the trust.

Advantages of Revocable Trusts

There are no estate or income tax advantages gained by establishing a revocable trust. However, there can be some real financial and administrative advantages, including:

- **Avoiding the time and expense of probate –** Probate can take several months or years
- **Avoiding probate in multiple states –** Revocable trusts can be used to hold assets in multiple states and avoid probate in multiple places
- **Privacy –** Probate proceedings are public record while trusts are not
- **Relief from financial responsibility –** A professional trustee likely has asset management skills and tools that the grantor does not possess
- **Revocable –** If the grantor is unhappy, the assets can be removed from trust

Credit Shelter Trust (CST)

A Credit Shelter Trust allows a married couple to minimize their estate taxes while still allowing the surviving spouse to have access to the entire estate.

The Credit Shelter Trust (CST) is also referred to as Bypass Trust or B Trust in an A-B Trust Plan. The CST is appropriate for clients who expect to face estate taxes, and is an alternative to using the unlimited marital deduction for all assets in order to reduce total estate taxes.

When using the unlimited marital deduction on all property of the first to die, the two estates are essentially merged into one larger estate that will be subject to estate tax at the second death. At the survivor's death, his/her estate can claim his/her unified credit to offset a portion of the taxes.

In order to use both unified credits, estate assets can be left to non-spousal heirs at the first death as well as the second death. The disadvantage of leaving assets directly to non-spousal heirs at the first death is that the surviving spouse does not receive that money. Many people are uncomfortable with that and fear the spouse may someday need that money. The CST solves this dilemma.

Mechanics of a CST

The CST is funded with assets from the estate of the first to die. During the surviving spouse's lifetime, he/she can receive income from the CST assets and, subject to certain limitations, even invade principal if needed. At the survivor's death, trust assets are generally not included in the survivor's estate, and are passed to the non-spousal heirs as outlined in the trust. Thus, the surviving spouse is not put at financial risk, and yet the trust assets are not counted as part of his/her estate.

The first to die typically puts an amount of assets into the CST equal to the exemption equivalent in the year of death. Any more assets than that, and estate taxes would be due although some planners recommend paying some taxes at the first death in order to avoid a higher estate tax marginal rate upon the death of the surviving spouse. By funding a CST with assets up to the exemption amount, the couple successfully uses both unified credits and minimizes total estate taxes.

A CST can only be funded with assets individually owned by the first to die. Therefore, each half of the married couple should own enough assets in his/her name to fund a CST upon death. If one person does not own enough assets to fully fund a CST, a retitling of specified assets is needed.

Qualified Terminable Interest Property (QTIP)

QTIPs allow you to make your assets available to your surviving spouse and yet still allow you to control the disposition of the assets upon the second death.

The unlimited marital deduction is often used to reduce taxes at first death. By using the unlimited marital deduction, assets are placed into the estate of the survivor, along with control of the ultimate disposition of those assets.

For many couples, this is not an issue. But for some people, the disposition of the assets upon the second death could be a sensitive issue. Consider a marriage where one spouse is in a second marriage and has children from both the second marriage and the prior marriage. If the first to die is the individual with two families, and he/she leaves all assets to the surviving spouse via the unlimited marital deduction, the surviving spouse may then leave all assets at his/her death to the second family and disinherit the first family. A QTIP solves this dilemma.

Mechanics of a QTIP

Upon the first death, selected assets are contributed to a QTIP trust. QTIP assets qualify for the unlimited marital deduction, and thus create no estate tax at the first death. During life, the surviving spouse receives any income generated by the trust (trust assets must be income producing property). Upon the survivor's death, the remaining trust assets are transferred to heirs according to the wishes of the first to die. Thus, the current spouse is not disinherited, and any chance of the first family being disinherited is removed.

Who Could Benefit?

Clients who may benefit from a QTIP trust include:

- Clients with prior marriages and who want to make sure certain assets are received by certain heirs
- Clients with infirm or elderly spouses
- Clients who fear that a surviving spouse may remarry (often a concern with spouses who are much younger)

Irrevocable Life Insurance Trust (ILIT)

An Irrevocable Life Insurance Trust (ILIT) creates a pool of money outside of the estate to offset estate taxes and provide more efficient wealth transfer between generations.

An ILIT is a very popular estate-planning tool designed to own life insurance outside the estate of the grantor(s). The trust makes life insurance death benefits available to pay estate taxes. This way, valuable estate assets do not need to be liquidated to generate cash, and family wealth is not eroded.

Mechanics of Revocable Trusts

Typically, the grantor(s) create the ILIT which then purchases life insurance on the lives of the grantors. If the grantors are a married couple, survivorship (second-to-die) insurance is usually the product of choice because of its affordability and the likelihood (in many instances) that the greatest need for cash will occur upon second death. For an unmarried grantor, single life products are used.

The ILIT is the applicant, owner and beneficiary of the life insurance policy. The grantor(s)' heirs are beneficiaries of the ILIT, and the grantor(s) are typically the insured(s). The trustee must not be the grantor(s) but can be a trusted individual or an institution. It is very important that all incidents of ownership of the life policy belong to the trust and not to the insured(s) so as to avoid estate inclusion at the insured(s) death.

The trust should have its own checking account, and the trustee writes premium checks from that account. The ILIT generally receives the money to fund that account through annual gifts from the grantor(s). These gifts are typically excluded from gift taxes by the annual gift tax exclusion if the trust provides the beneficiaries with special withdrawal rights called "Crummey Powers."

Upon the Death of the Insured(s)

At the grantor(s)' death, the ILIT, as beneficiary of the policy, receives the death benefit. The ILIT, operating for the benefit of the children, can purchase desired assets from the grantor(s)' estate thus enabling the children to own those assets while also providing the estate with cash for estate taxes. The ILIT could also loan money to the estate to pay estate taxes. This way, the estate can avoid forced liquidations. In essence, the ILIT uses the death proceeds to provide liquidity to the estate so as to avoid a forced liquidation of estate assets to non-family members.

In a classic ILIT, once money is gifted into the trust, it cannot be recovered by the grantor(s). Many grantor(s) are comfortable with this loss of access, but for those grantor(s) who desire some level of access to trust assets, other options should be considered.

For the creation of any type of ILIT, a qualified estate-planning attorney is required.

Dynasty Trust

A dynasty trust is designed to avoid or minimize estate taxes being applied to great family wealth with each transfer to subsequent generations.

Dynasty trusts are a very popular planning technique for large estates. By holding assets in the trust and making well-defined distributions to each generation, the entire wealth of the trust is not subject to estate taxes with the passage of each generation.

Dynasty trusts in the United States are the combined result of the imposition of the generation-skipping transfer tax (GSTT) upon trusts that attempted to bypass transferring all assets to children, and the repeal of the rule against perpetuities by states attempting to attract the great wealth of such trusts.

Rules Against Perpetuities

The "rule against perpetuities" is a law prohibiting trusts from lasting forever. The rule does not require the trust to last for its maximum legal duration; it permits the trust to last for that period.

Under the common law rule, a trust can be drafted to last 21 years after the death of all of the donor's descendants who are living at the date of creation of the trust. Some states have adopted relaxed rules against perpetuities. It has become common to consider establishing trusts that will be exempt from GSTT in those jurisdictions.

Advantages of Dynasty Trusts

The beneficiaries of a dynasty trust are often the settlor's children, grandchildren, and future descendants. A dynasty trust is usually drafted so that each generation has the rights to certain distributions of income and principal but does not have any rights that would cause the trust assets to be included in any member of that generation's taxable estate for estate tax purposes. The result of this is that although gift or estate tax may be imposed on the settlor when the trust is created, no estate or gift tax is imposed again as long as the assets remain in trust. This can result in substantial estate tax savings—not in the estate of the settlor, but in the estates of the settlor's descendants. These estate tax savings are realized only if the family has enough wealth that future generations are anticipated to have taxable estates.

The dynasty trust may also result in state income tax savings. Assuming that the beneficiaries live in a state with an income tax, state taxes may be imposed to the extent that income is distributed to beneficiaries. In many cases, however, income that is not distributed will be subject only to the income tax of the state where the trustee is located. If a trustee doing business in a state without an income tax is chosen, the trust assets not distributed may avoid state income taxes.

The settlor has great discretion in drafting the terms of a dynasty trust, and the trust can be used to spread the benefits of the funds over the generations rather than giving all assets to one or two generations and nothing to future descendants. For instance, the trust can provide incentives to encourage each generation to work or to contribute to society by tying distributions to certain behaviors. A dynasty trust also provides all the advantages of having assets in trust—protection from creditors and financial predators; professional management; and control over the distribution of assets to beneficiaries.