

**USING  
THE KEY TO PRESERVING  
YOUR CASTLE™:  
A GENERAL DISCUSSION OF  
ESTATE PLANNING TECHNIQUES**

**Havens & Miller, P.L.L.C.**

Unfortunately, many people underestimate the need for and value of planning their estate. After retirement, estate planning becomes increasingly more important. The turmoil that arises when a spouse passes away without an organized set of estate planning documents and estate planning data listing all pertinent financial information can be easily avoided if an estate is properly planned. This general discussion addresses basic steps that should be considered by everyone in connection with planning an estate and is most relevant to retirees.

## **I. ESTATE PLANNING QUESTIONNAIRE**

One of the most important steps in planning an estate is completing an estate planning questionnaire (the “questionnaire”) which includes not only a list of assets, liabilities, income, and expenses, but also the following information: family advisors, including your accountant, insurance professional, investment manager, and trust officer; bank accounts and locations; safe deposit box and location; pensions; life and other insurance; and real estate. The questionnaire should also list burial arrangements and should be kept in a place where it can be easily located by family members. It is not uncommon to find a surviving spouse who is not even aware of the location of the family checkbook. The preparation of a questionnaire minimizes the confusion that otherwise occurs upon someone’s death. Questionnaires are frequently reproduced in financial and tax magazines and should be made available by any estate planning attorney.

## **II. DO YOU NEED A WILL?**

### **A. Non-Tax Issues**

The American Bar Association’s and other studies have found that as many as 30% of Americans die without a will. Each state has a statute that specifies how probate property passes if a person dies without a will. Because only probate (*i.e.*, individually-owned and/or estate-designated) property is transferred by a will and properties such as bank accounts held in survivorship accounts (*e.g.*, “John in trust for Mary” or “John or Mary”) typically avoid probate, some people believe that a will is not necessary if a majority of their assets are held jointly or in other forms of “automatic” survivorship. Unfortunately, the disposition of these accounts upon someone’s death is not always in accordance with what initially was anticipated. Having a will is the only way to assure that probate assets will be distributed in accordance with one’s desires, especially if certain unanticipated events occur.

Example 1, below, highlights some of the shortcomings of using joint ownership to pass assets to family members upon the death of the initial owner.

## EXAMPLE 1

Hannah is a 70-year-old widow and has assets valued at \$300,000.00 (all in savings and brokerage accounts). Hannah has three children, Aaron, Mark, and Paul, who are all between the ages of 40 and 50. Hannah was told that she could avoid probate by putting all of her accounts in trust for her children (*e.g.*, Hannah's accounts are titled in the name of "Hannah in-trust-for Aaron, Mark, and Paul"). Each of Hannah's children has two children between the ages of 18 and 22. If, upon Hannah's death, all of her children are alive, then the anticipated result will occur and each of her children will receive \$100,000 by operation of law, without the need for probate. However, what would happen if Aaron predeceased Hannah? Typically, Hannah would want Aaron's two children to share in the \$100,000 that Aaron would have received had he survived Hannah. However, by titling the account as described above, the application of most states' laws would result in Hannah's two surviving sons dividing the entire account upon Hannah's death, and Aaron's children would receive nothing.

Even if Hannah had changed the title to the account after Aaron's death in order to provide for Aaron's children, another unanticipated problem would occur upon Hannah's death. Assuming Aaron's children are ages 18 and 21 at Hannah's date of death, and Hannah established a joint account which resulted in \$50,000 passing to each of Aaron's children upon Hannah's death, each such child would receive \$50,000 outright, without restriction, under most states' laws. Many parents would prefer that their children not receive an outright lump sum distribution of \$50,000 or more when such children attain the age of 18, 21, or even 25 years. Furthermore, under Florida law, any life insurance proceeds, retirement benefits, or jointly-owned bank accounts in excess of \$5,000 passing to a person under 18 years of age must be held subject to Florida's guardianship rules (under the probate court's supervision).

Now assume the facts of Example 1 above, except that the accounts are not held jointly. The accounts then would pass under the terms of Hannah's will. Hannah's will could provide that in the event that Aaron predeceased Hannah, Aaron's children would inherit the share that Aaron would have received; provided, however, that if any beneficiary under Hannah's will is younger than 25 years of age at the time that an outright distribution to such beneficiary would be made (or any other age selected in the will), the personal representative of the will could delay the distribution to such a beneficiary until the beneficiary reaches 25 years of age (or another desired age). Until then, the assets could be held in a trust created under Hannah's will for the benefit of such a beneficiary, under which the trustee could pay to or for the benefit of the beneficiary such amounts as may be required for the beneficiary's health, education, maintenance, and support. Any amount not distributed for those purposes could be distributed outright to the beneficiary when he or she attains age 25 (or another desired age).

## **B. Tax Issues**

### 1. General Concepts of the Federal Transfer Tax System

Basic estate planning generally provides for the use of your estate tax credit or "estate tax advantage" (referenced in the Internal Revenue Code as the "applicable exclusion amount").

This year, each person has an “estate tax advantage” of \$1.5 million, *i.e.*, each person can transfer \$1.5 million without incurring estate tax. This amount, however, is in a state of flux due to the 2001 tax act, as described in more detail below.

In every estate plan for married couples, we try to accomplish two basic techniques. First, we provide for the use of each person’s “estate tax advantage” by using the applicable exclusion amount. Typically, your plan will hold this amount in a “Family Trust” for the benefit of the surviving spouse during his or her lifetime, with any remaining trust assets distributable to children and/or grandchildren (or other beneficiaries).

The Family Trust is generally *exempt* in the surviving spouse’s taxable estate. Therefore, it is very important to preserve the trust assets of the Family Trust. The surviving spouse therefore usually only distributes income from the Family Trust to himself or herself -- to preserve the Family Trust’s assets for descendants.

Second, we provide for the use of each married person’s “marital advantage” by using the “marital deduction.” For single persons, the value of assets in excess of the “estate tax advantage” is subject to the estate tax. However, for married couples, the “marital advantage” basically allows deferral of the payment of any estate tax payable at the first spouse’s death. In essence, the federal government is willing to wait until the surviving spouse passes away in order to collect any estate tax that would have been payable on the first spouse’s death. Your plan typically holds the “marital advantage,” which would be assets in excess of \$1.5 million, in a “Marital Trust” for the sole benefit of the surviving spouse during his or her lifetime. The Marital Trust is generally *not exempt* in the surviving spouse’s taxable estate. Therefore, if the surviving spouse needs to “dip” into the trust assets of the Family Trust or the Marital Trust, he or she should distribute trust assets from the Marital Trust first.

The use of the “estate tax advantage” and the “marital advantage” is often referenced as “A-B” planning or the use of “A-B” trusts. Very helpful one-page summaries of this technique and the advantages related to its use are available via the Capital Trust Company of Delaware’s website: <http://www.ctcdelaware.com/documents/planning.html>. We find that pictures literally convey 1,000+ words in the estate planning area!

## 2. The Impact of the 2001 Tax Act on the Federal Transfer Tax System

On June 7, 2001, President George W. Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA” or the “2001 tax act”). It significantly changes the transfer tax system, which includes the federal estate tax, gift tax, and generation-skipping transfer (“GST”) tax. Beginning in 2002, the 2001 tax act increases the “estate tax advantage” and decreases the estate and GST tax rates. It does not eliminate the gift tax, but does lower the gift tax rates and increases the gift tax applicable exclusion amount. The 2001 tax act eliminates the estate tax and the GST tax altogether in 2010. However, on January 1, 2011, the provisions of the 2001 tax act “sunset,” and all transfer taxes are reinstated as they had existed before the 2001 tax act. The chart below illustrates the changes resulting from the 2001 tax act. These changes are also summarized on the American Bar Association’s “Estate Planning Answers” page: <http://www.abanet.org/rppt/public/home.html> (which Jason helps to maintain).

Calendar Year	Highest Estate & Gift Tax Rate	Estate Tax Applicable Exclusion Amount	Gift Tax Applicable Exclusion Amount	GST Tax Rate	GST Exemption
2001	55%*	\$675,000	\$675,000	55%*	\$1,060,000**
2002	50%	\$1,000,000	\$1,000,000	50%	\$1,100,000**
2003	49%	\$1,000,000	\$1,000,000	49%	\$1,100,000**
2004	48%	\$1,500,000	\$1,000,000	48%	\$1,500,000
2005	47%	\$1,500,000	\$1,000,000	47%	\$1,500,000
2006	46%	\$2,000,000	\$1,000,000	46%	\$2,000,000
2007	45%	\$2,000,000	\$1,000,000	45%	\$2,000,000
2008	45%	\$2,000,000	\$1,000,000	45%	\$2,000,000
2009	45%	\$3,500,000	\$1,000,000	45%	\$3,500,000
2010	35%†	N/A	\$1,000,000	N/A	N/A
2011	55%*	\$1,100,000	\$1,100,000	55%*	\$1,100,000

\* 60% for amounts from \$10,000,000 to \$17,184,000

\*\* Adjusted for inflation.

† Gift tax only.

Accordingly, if the combined family wealth (*i.e.*, husband and wife) in 2002 is \$1 million or less, you generally need not be concerned about federal estate taxes because the “estate tax advantage” should eliminate the entire federal estate tax liability (assuming that the combined family wealth does not appreciate above \$1 million as of the surviving spouse’s date of death). If taxable gifts have been made (*i.e.*, annual gifts in excess of \$10,000 per donee prior to 2002 or \$11,000 per donee for 2002+ as adjusted for inflation), those gifts will reduce the size of the taxable estate that can pass free from estate taxes.

Proper planning generally utilizes both spouses’ “estate tax advantage.” Although some spouses want to distribute all of the assets of the first spouse to pass away to the surviving spouse, the primary disadvantage of using the “marital advantage” in this truly unlimited fashion is that the first spouse’s “estate tax advantage” is wasted. Example 2 below shows how additional estate taxes are likely to be incurred where, in a taxable estate situation, the first spouse to die leaves all of his or her assets outright to his or her surviving spouse.

## EXAMPLE 2

Assume the combined family wealth of David and his wife, Martha, is \$2 million, of which \$1 million is held solely by David and \$1 million is held solely by Martha. If David’s will provides an outright bequest of all of his assets to Martha under the unlimited “marital advantage,” there will be no federal estate tax incurred in 2002, David’s assumed year of death. However, David would not have used any portion of his \$1 million “estate tax advantage.”

With proper estate planning, \$1 million could have been placed upon David’s death in a Family Trust for the benefit of Martha during her lifetime, and thereafter to David’s and Martha’s children. If the Family Trust is properly drafted and administered in an “arm’s-

length” manner, the Family Trust’s assets would not be included in Martha’s estate, despite the fact that the Family Trust could provide Martha, during her lifetime, with (1) all of its income (payable annually or more frequently); (2) any additional amount from the Family Trust’s assets that Martha needs for her health, education, maintenance, and support; (3) the right to demand and be paid by the trustee of the Family Trust the greater of \$5,000.00 or 5% of the value of the Family Trust’s assets on an annual (non-cumulative) basis; and (4) a special power of appointment, *e.g.*, the power to designate among which of David’s and Martha’s descendants and/or any qualified charities will receive the assets of the Family Trust upon Martha’s death, which would allow Martha a “second bite at the apple” whereby she could reallocate the “default” distribution pattern of the Family Trust. Furthermore, in many states including Florida, Martha could serve as sole trustee of the Family Trust, even with the trust terms described above.

If David’s will did not provide for a Family Trust and all of his assets passed outright to Martha, then Martha’s estate would be increased by an additional \$1 million that could have passed free from estate taxes in both David’s and Martha’s estates with proper planning. If Martha passed away later in 2002 having a taxable estate of \$2 million, compared to the \$1 million that she would have if a Family Trust had been established by David’s will, the additional amount of estate tax that would be incurred upon Martha’s death (which could have been avoided with proper planning -- but still may be reduced with post-mortem planning techniques) is approximately \$435,000. *Please note that this exact example would be accurate in 2011+ under the 2001 tax act.*

### 3. The Federal Taxable Estate: Much More than Just the Probate Estate

In determining the value of a person’s taxable estate for federal estate tax purposes, the Internal Revenue Code includes much more than your “probate estate.” Your taxable estate generally includes three categories of property. First, as described above under “Non-Tax Issues,” your probate estate, which passes under your will or under Florida’s intestacy rules and is supervised by a Florida probate court, includes only property that you own individually or that is designated to your estate when you pass away. Second, your taxable estate also comprises any trusts over which you still possess control, which includes revocable trusts, or even “strings,” which includes numerous grantor trusts. Third, your taxable estate includes “automatic” assets that pass “automatically” (*i.e.*, by operation of law).

The third category generally includes the value of any life insurance, including “second-to-die” (or “joint-and-survivor”) policies, if a person owns those policies or has certain rights over those policies such as the right to name the beneficiary of the policy. In addition, you must include the value of any retirement (*i.e.*, pension, profit sharing, and other tax-deferred) benefits payable as a result of your death.

### 4. Planning under the 2001 Tax Act in Relation to the Three Asset Categories

If the combined family wealth exceeds \$1 million in 2002, an estate tax projection should be prepared to determine the amount of estate taxes which would be payable. You can then determine whether it would be advantageous to revise the estate plan in order to utilize both

spouses' "estate tax advantage" to pass assets of \$2 million to family members (or other beneficiaries) free from estate taxes (assuming both spouses were to pass away in 2002 or 2011+) -- increasing to \$7 million under the 2001 tax act (assuming both spouses pass away in 2009). If both spouses die in 2010, their entire estate would pass free from estate and GST taxes, *but* would be *subject to a new income tax system* known as a "carry-over basis" regime.

You did not really think that Congress would actually give up all of these tax revenues, did you?! Although a detailed description of the "carry-over basis" system is beyond the scope of this discussion, the 2010 wealth transfer tax system purports to tax beneficiaries on the taxable gain (appreciation) of inherited property. The "carry-over basis" system still contains exemptions for a surviving spouse (\$3 million of taxable gain) and beneficiaries other than the surviving spouse (\$1.3 million of taxable gain). This type of tax system has been attempted twice in the United States and repealed both times soon after its enactment, due primarily to administrative difficulties. For example, could you substantiate the tax basis of the clock that you inherited from your grandmother?

Unless you know when you are going to pass away, you must plan flexibly and generally with the "worst-case" scenario in view. Until Congress takes further action, the 2001 tax act dictates that you plan on a \$1 million "estate tax advantage" if you plan to live beyond the year 2011 (and that is our hope for you!). Hopefully, Congress will provide further "relief" that establishes some concrete advantages around which we can plan more comfortably.

#### *a. Problems with Jointly-Owned Property*

Even if you have a properly-drafted will that uses the "estate tax advantage" and the "marital advantage," a problem frequently occurs that is a trap for the unwary. Most properly-drafted wills (that contain tax planning) provide for an amount equal to the "estate tax advantage" to pass either (a) outright to beneficiaries other than the surviving spouse or (b) into a trust similar to the Family Trust described in Example 2 above. As indicated above, this estate planning device generally results in no estate tax being paid upon the death of the first spouse, and the amount passing outright to beneficiaries other than the surviving spouse or to the Family Trust is not included in the surviving spouse's taxable estate upon his or her death.

Frequently, however, substantially all of the family's property is owned jointly between spouses with right of survivorship (*e.g.*, the family residence, bank accounts, and investment accounts). Any assets owned by spouses as "joint tenants with right of survivorship" or as "tenants by the entirety" pass by operation of law to the surviving spouse, despite a contrary provision in a will. As a result, even with properly-drafted wills, if the husband's assets are all or substantially all owned jointly with his wife, then his wife will receive a more substantial portion of the husband's estate than would otherwise be desired to minimize the family's potential overall estate tax.

#### *b. Dividing Property between Spouses in Taxable Estate Situations*

If your will provides for an amount passing outright to beneficiaries other than the surviving spouse or to the Family Trust, then certain jointly-owned assets should be divided so

that both spouses own enough assets in his or her own name to use the “estate tax advantage.” By splitting up certain jointly-owned assets, upon the death of the first spouse, the assets held solely by that spouse will pass under his or her will either (a) outright to beneficiaries other than the surviving spouse or (b) to the Family Trust -- rather than outright to the surviving spouse by operation of law, as would be the case if all assets were owned jointly between spouses. Accordingly, each spouse will take advantage of his or her “estate tax advantage.”

### *c. Using Caution in Transferring Assets*

Estate planning attorneys frequently advise clients about the benefits of transferring assets between spouses so that each spouse has enough assets in his or her own name to utilize both spouses’ “estate tax advantage.” Unfortunately, we hear about situations where one spouse transfers assets to another spouse to take advantage of estate planning benefits, but the other spouse takes and squanders the assets or separates from the spouse who transferred the assets. Therefore, the non-tax factors of transferring substantial assets between spouses must be considered before any transfers are made. Other non-tax considerations should be analyzed, such as the impact of changing the title of Florida homestead property or the disadvantage of owning assets solely in your own name if a lawsuit is likely. Accordingly, most professionals, such as architects, developers, and doctors, should consider the safest manner to title their assets, considering estate and gift tax savings opportunities as well as asset protection objectives.

## **III. OTHER ESTATE PLANNING DOCUMENTS THAT SHOULD BE CONSIDERED**

### **A. Revocable Inter Vivos Trust.**

A revocable inter vivos trust (or “living trust”) should be considered for at least two reasons. First, a properly-funded revocable trust avoids probate administration. For example, if Jacob has assets of \$1 million and transfers all of his assets into a revocable trust, then upon Jacob’s death, the assets included in his revocable trust will not be included in his probate estate. As a result, probate administration fees and costs can generally be saved. However, a revocable trust does not have any estate tax benefits that are not otherwise achieved using a will.

Second, a revocable trust should also provide that in the event that the person creating the revocable trust (the “settlor” or “grantor”) becomes incapacitated and is unable to take care of his or her financial affairs, the successor trustee named in the revocable trust (typically a family member and/or a professional trustee) will use the assets in the revocable trust in order to provide for the settlor.

The revocable trust would provide that upon the death of the settlor, the assets remaining in the revocable trust would be distributed to the settlor’s beneficiaries in a manner similar to the distributions that would be made using a “standalone” will. The settlor can be the sole trustee of the revocable trust during his or her lifetime or may serve with his or her spouse; a trusted friend, relative, or family advisor; or a financial institution.

Due to the probate avoidance benefits of a revocable trust and the fact that a revocable trust can provide for the settlor in the event of the settlor’s incapacity, avoiding the need to have

a guardian appointed to take care of the settlor, a revocable trust should be considered by anyone in his or her retirement years. A typical estate plan using a revocable trust should also include a short will, known as a “pour-over” will, which controls the distribution of any probate assets. Typically, the pour-over will serves as a “back-stop” and transfers any probate assets into the revocable trust (to be distributed according to the terms of the revocable trust). More information on using revocable trusts is available via our law firm’s Internet site on our “Frequently-Asked Questions” page: <http://www.havensmiller.com/faq.htm>.

## **B. Durable Power of Attorney**

A durable power of attorney is a document that everyone should consider in estate planning, regardless of age (although of particular importance to those of retirement age). Essentially, the person giving the power of attorney (*i.e.*, the principal) grants to the person named in the power of attorney (*i.e.*, the attorney-in-fact, who is an agent of the principal) the right to take various actions on behalf of the principal, such as the right to withdraw funds from bank accounts, sell stocks, sell real estate, sign tax returns, and make gifts if advantageous for the principal’s overall estate plan. Although a normal power of attorney terminates if the principal becomes incapacitated, a durable power of attorney remains valid in most states unless an action is brought to have the principal adjudicated incompetent or until the principal dies.

## **C. Health Care Surrogate**

A health care surrogate, known in other states as a durable power of attorney for health care, is more specific than a durable power of attorney. The health care surrogate gives the surrogate the power to make health care decisions on behalf of the person giving the power in the event that he or she cannot make those decisions. For example, if a person is temporarily incapacitated due to a car accident and the doctors need to know which of two procedures to perform, the health care surrogate can “stand in the shoes” of the principal and direct the doctors which procedure to perform.

## **D. Living Will**

Many states, including Florida, have adopted statutes which allow a person to direct, through a written instrument known as a “living will” (or “death with dignity” agreement), his or her doctor not to artificially prolong his or her life by using life support equipment (including, if specifically provided, tubal feeding devices and hydration) if the possibilities of any reasonable recovery from a “terminal illness” are minimal. This is the most specific of the three disability planning documents (*i.e.*, the durable power of attorney, the health care surrogate, and the living will). The living will is only effective in the event of a “terminal illness,” which is defined by the Florida Statutes. As part of the estate plan, every person should consider signing a living will or similar document.

## **E. Irrevocable Life Insurance Trust (“ILIT”)**

An ILIT is a trust used for estate tax purposes to own life insurance with the objective of avoiding and potentially “offsetting” estate taxes. For example, if Lydia owns a \$1 million life

insurance policy and names her spouse as the beneficiary, then upon Lydia's death, the \$1 million of insurance is included in Lydia's estate, but her estate obtains a marital deduction for the amount passing to her husband. Accordingly, there is no increased estate tax upon Lydia's death. However, Lydia's husband now has an additional \$1 million in his estate that will become subject to estate tax upon his death.

If instead, Lydia transferred her life insurance to an ILIT and survived for three years after the transfer, the \$1 million life insurance benefit would be excluded not only from Lydia's estate but also from the estate of Lydia's husband, and Lydia's children would receive the entire \$1 million free from estate taxes. The ILIT could provide that upon Lydia's death, the insurance proceeds would be held for the benefit of Lydia's husband during his lifetime, and upon his death, the assets in the ILIT could be distributed to Lydia's children. An even better scenario is to create the ILIT in advance and allow the trustee to apply for and obtain the life insurance policy on Lydia's life, which avoids the requirement that Lydia survive for three years in connection with transferring an existing policy.

A useful one-page summary on the "Life Insurance Trust" is available via the Capital Trust Company of Delaware's website: <http://www.ctcdelaware.com/documents/planning.html>. You may also visit Jason's personal website under "Irrevocable Life Insurance Trusts (ILITs)": <http://www.jasonhavens.net/advanced.htm>. Another excellent resource for trustees of ILITs is available at [http://www.lifeinsuranceadvisorsinc.com/articles\\_trustees.html](http://www.lifeinsuranceadvisorsinc.com/articles_trustees.html).

#### **IV. DOMICILE**

There are many people of retirement age who have two residences. One residence is the principal residence, while the other is a vacation home. As someone approaches retirement, it is likely that the amount of time spent in a vacation home increases. For example, many folks from the Southeast have vacation homes along Florida's Emerald Coast. Upon retirement, it is common that these part-time residents will maintain a personal residence elsewhere in the Southeast but spend an increasingly greater amount of time in their Florida vacation home.

It is important to consider establishing your residence for state estate and income tax purposes. Florida has extremely favorable estate tax laws and does not have an individual income tax. Consequently, it is often advantageous to establish your Florida domicile.

The steps to take in order to establish domicile in a particular state are beyond the scope of this discussion. Excellent resources are available on the Internet. For example, one of Jason's favorite sites is the "Planning Guide for the Florida Snowbird," available freely at <http://www.alipman.com/snowbirdguide/> and created by Florida attorney Alan R. Lipman, Esq. (which contains a discussion of other estate planning topics). This and other sites are listed on Jason's personal website under "Florida" resources: [http://www.jasonhavens.net/state\\_specific.htm#F\\_K](http://www.jasonhavens.net/state_specific.htm#F_K).

Anyone spending substantial amounts of time in two different states must consider whether it would be advantageous to change his or her domicile. Furthermore, if it is unclear in which state you permanently reside, it is possible to have a legal battle involving multiple

jurisdictions, each claiming that a taxpayer was domiciled there. As a result, it is important to establish domicile in one state to avoid these problems.

## V. ESTATE PLANNING TECHNIQUES TO CONSIDER SOONER -- NOT LATER

### Technique #1: Annual Gifts

Without question, anyone with substantial assets should take advantage of an exclusion that allows annual gifts of \$11,000 to any donee. As of January 1, 2002, the annual gift tax exclusion amount was increased from \$10,000 to \$11,000 per year to any donee, which is increasing under the 1997 tax act based on the Consumer Price Index ("CPI"). In a second marriage, if one spouse has no interest in making gifts of his or her own property to the children of the other spouse, a "gift splitting" election is available where gifts of one spouse are treated as if made one-half by the other spouse, regardless of whether all funds came from one spouse's bank account. For example, a married couple having a combined net worth of \$5 million can pass approximately \$2.4 million to their children and grandchildren free from estate, gift, and GST taxes if the couple made gifts of \$11,000 per donee to each of their 3 children and 8 grandchildren for a period of 10 years (disregarding adjustment for inflation based on the CPI).

Despite the substantial potential estate tax savings, many affluent clients are reluctant to follow a perennial gifting campaign. Many complain that their children will waste the money. For those who are concerned that their beneficiaries are not mature enough to handle outright annual gifts, the gifts can be made into an irrevocable trust. The irrevocable gift trust is separate from the revocable trust. A properly-drafted irrevocable gift trust will qualify as a recipient of gifts under the annual gift tax exclusion, but will still achieve the donor's goal that the beneficiary will not be entitled to mandatory distributions from the trust until a later date (usually at an age that the donor believes appropriate as stated in the irrevocable trust document). Most estate planning attorneys suggest providing for mandatory trust distributions over at least 3 time intervals, *e.g.*, one-third at age 30, one-third at age 35, and one-third at age 40.

Using this technique limits the potential loss that a naïve or unprepared beneficiary might incur after he or she receives the first mandatory distribution, and hopefully will serve as a learning process if the beneficiary does make an imprudent investment. Surely the beneficiary will be more cautious when the next mandatory trust distribution is received. Until the beneficiary receives mandatory distributions, the trustee can have discretion to invade the trust to provide for beneficiary's health, education, or support for other broader purposes.

In addition to annual gifts of \$11,000 per beneficiary, each person can make an unlimited amount of additional tax-free gifts by paying for another person's (a) tuition, but *only if* paid *directly* to a qualified educational institution; or (b) medical expenses, but *only if* paid *directly* to the qualified health care provider. This frequently-overlooked gift tax advantage often dwarfs the amount that a parent, grandparent, or other donor can give to their intended beneficiaries on an annual basis. For example, a child attending Vanderbilt University might have tuition bills of \$30,000 per year and medical expenses of \$3,000 per year. In addition, the student's room and board could exceed \$15,000 per year. A grandparent or other donor could pay (a) the child's tuition (\$30,000) directly to the college; (b) medical expenses (\$3,000) directly to the health care

provider; and (c) give the child an additional \$11,000 per year. All such gifts would be non-taxable if paid as described above. However, room and board (\$15,000) is not covered by these gift tax advantages, even if they are paid directly to the educational institution.

Internal Revenue Code Section 529 plans should also be considered, especially in light of the 2001 tax act's provision that allows 529 plan assets used to pay qualified education expenses, including room and board, to avoid all income tax on items such as interest, dividends, and capital gains. The 529 plan allows the donor to maintain significant control over the assets conveyed to the 529 plan that otherwise would not be permitted if the assets were to be excluded from the donor's estate. Lastly, 529 plans generally allow the donor to aggregate 5 years of annual gift tax exclusion amounts in a single contribution.

For more information on gifts, you may visit Jason's personal website under "Gifts": <http://www.jasonhavens.net/basic.htm>. For more information on 529 plans, you may visit Jason's personal website under "College Savings": <http://www.jasonhavens.net/retiremt.htm>. Jason's favorite 529 plan site is <http://www.savingforcollege.com/>.

## **Technique #2: Other Existing Estate Tax Advantages**

### **A. Qualified Personal Residence Trust ("QPRT")**

During 1988, the House of Representatives tried to close an estate and gift tax technique known as a grantor-retained income trust ("GRIT") that can save affluent individuals millions in estate taxes. In 1990, the GRIT door was closed and, as a result, is generally limited to planning for remote family members (*e.g.*, nieces and nephews, but not children or grandchildren). However, planning with a personal residence, whether a primary residence or a vacation home, is still available both for family members and non-family members. The QPRT is still a planning technique that should be considered for owners of personal residences that most likely will appreciate in value.

Consider the following example: John, an affluent 65-year-old individual, has a waterfront house in Niceville, Florida. His house is currently valued at \$1 million. John is not prepared to make an outright gift of his house to his children and grandchildren because he wants to retain the right to live in his house for about 10 years. John agreed to establish a QPRT under which he transferred title to his house into the trust and retained the right to live in the house for a period of 10 years. After 10 years, the house will be distributed to John's children. Because John retained the use of the house for 10 years, the Internal Revenue Service allows John to discount the value of the gift going to this trust. Assuming that the gift was made in December 2001 to a 10-year QPRT, the discount results in a gift of \$1 million being treated as a gift of approximately \$476,000. Because John made no prior taxable gifts, he did not have to pay any gift tax when he created this trust. For the next 10 years, John can live in the house, and after 10 years, his children receive the house without any additional gift or estate tax (assuming John survives the 10-year term). Even if the house appreciates to \$5 million, John will not have to pay any additional gift or estate taxes in this example, assuming that he survives the 10-year term of the QPRT. The savings could be in millions of tax dollars that neither John nor his family ever

has to consider. If John dies during the 10-year term, the house is brought back into his estate and the applicable exclusion amount that he used when he made the gift is restored.

## **B. Family Limited Partnership (“FLP”) or Limited Liability Company (“FLLC”)**

Although the Internal Revenue Service continues to launch its attacks on the FLP concept, FLPs continue to provide excellent estate planning and asset protection opportunities. Family limited partnerships offer the possibility of centralized family wealth management, as well as a certain level of control in the parents. Gifts of limited partnership units can be made to family members, taking advantage of annual gift tax exclusions as well as minority and/or lack of marketability discounts. If someone dies owning interests in an FLP, valuation discounts generally apply. Therefore, when properly planned and formed, and when business purposes other than strict tax avoidance are reflected, the FLP or FLLC is an excellent planning technique to minimize estate and gift taxes. For more information, please visit the Capital Trust Company of Delaware’s website: <http://www.ctcdelaware.com/documents/strategies-inside.html#discounting>. You may also visit Jason’s personal website under “Family Limited Partnerships (FLPs)”: <http://www.jasonhavens.net/advanced.htm>.

The use of an FLP or FLLC can be coordinated with a sale to a grantor trust. The sale technique is often described as a sale to an “intentionally-defective” grantor trust, which is irrevocable. The unique aspect of this sale technique is that it is considered complete for estate and gift tax purposes, but incomplete for income tax purposes. In other words, the estate and gift tax objectives of removing an asset from your taxable estate via an installment sale are achieved; however, due to the grantor status of the trust, the Internal Revenue Service still considers you as the owner and liable for the income tax attributable to the grantor trust. Superb articles on this topic are available via the website of Steven J. Oshins, Esq., which is list on Jason’s personal website under “Grantor Trusts”: <http://www.jasonhavens.net/advanced.htm>. A graphical illustration is available on the Capital Trust Company of Delaware’s website: <http://www.ctcdelaware.com/documents/strategies-inside.html#sales>.

## **C. Charitable Gifts**

Gifts to charity may be made outright or in trust to the charity during a person’s lifetime or upon a person’s death via his or her will or trust. All charitable gifts are eligible for some type of charitable deduction and vary depending primarily on the structure of the gift, the type of property transferred, and the timing of the gift.

Gifts made to a charitable trust can be structured with the charity receiving either a present or a future interest in the property donated to the charitable trust. Both of these techniques are described on Jason’s website, which includes numerous links related to charitable planning: <http://www.jasonhavens.net/charitable.htm>. Both types of trusts, known as charitable lead trusts (“CLTs”) and charitable remainder trusts (“CRTs”), are illustrated with superb flowcharts on the Capital Trust Company of Delaware’s website: <http://www.ctcdelaware.com/documents/charitable.html>.

Affluent clients with substantial assets should consider the use of a private (or “family”) foundation as well. Private foundations can be coordinated with charitable trusts, which can provide the funding for the private foundation. Although private foundations can potentially eliminate estate taxes, they must be created and administered with utmost care. Probably the most important of the numerous rules governing private foundations is the requirement to distribute 5% per year to public charities. One of Jason’s favorite descriptions of a private foundation is available via the law firm website of friend and distinguished practitioner Charles Ian Nash, Esq.: <http://www.fnhlaw.com/CM/OurPublications/OurPublications30.asp>. Jason’s personal website also includes links to other resources on private foundations: <http://www.jasonhavens.net/charitable.htm>.

Charitable gifts represent some of the most powerful estate planning techniques available under the Internal Revenue Code because they can afford valuable income, estate, and gift tax benefits. Nevertheless, they require careful financial and legal planning. Charitable trusts created during the transferor’s lifetime in which the transferor retains the interest, must be considered in light of the transferor’s exposure to the income tax and alternative minimum tax.

#### **Technique #4: Protection from Creditors**

No estate should be planned without first determining the extent of potential liability to creditors. Special care is required when planning estates for architects, developers, doctors, lawyers, and anyone else who has or intends to sell a business where personal liability could become an issue. For example, if a wife has substantial assets and her husband is a brain surgeon with substantial potential malpractice liability, it would be better for the physician’s wife to leave any of her assets and life insurance to a spendthrift trust for her husband rather than outright to her husband. The same techniques should be considered for any other potential inheritances by the doctor from his family. Otherwise, once the doctor inherits outright sums, those assets become immediately available to potential creditors.

In addition, you might want to consider long-term (“dynasty”) trusts for the your children and grandchildren, which are now possible due to the extension of Florida’s rule against perpetuities (the “term limit” of a trust, which was extended from essentially 90 years to 360 years). Due to the litigious world in which we live, many clients consider the use of long-term trusts that last beyond the death of the surviving spouse, when the Family Trust could be distributed outright to children and/or grandchildren. For example, at the surviving spouse’s death, the Family Trust (and any remaining assets of the Marital Trust after the payment of estate taxes (if any)) could be divided equally among living children. Each of the “Trusts for Children” could be structured as a “discretionary” (spendthrift) trust.

“Discretionary” trusts for children can be structured so that they do not terminate at a certain age. For example, instead of allowing children to receive all of their respective trust’s assets at age 30, each of the Trusts for Children continues indefinitely for the lifetime of the child. These trusts would generally still be available on a discretionary basis to each child, and each child would serve as a co-trustee of his or her trust. However, an Independent Co-Trustee would be appointed by each child and serve with him or her, which will generally result in two primary advantages. First, each trust will generally be protected from a child’s creditors. Second, your estate tax advantages will be maximized because each child’s trust can “cascade”

or descend to your grandchildren (and down the line of descendants if appropriate). These discretionary trusts do not have to “lock up” the assets, in that the Independent Co-Trustee is directed to distribute assets to your child unless a good reason exists not to do so. For balance, your child could also retain the power to remove and replace the Independent Co-Trustee with another Independent Co-Trustee.

### **Technique #5: Post-Mortem Planning**

With proper planning, significant estate, gift, and GST tax savings can be achieved even after death. However, this type of planning must begin almost immediately after death. This planning requires a thorough understanding of techniques including disclaimers, qualified terminable interest property (“QTIP”) elections, the use of certain estate tax credits, and other complex estate planning techniques.

## **VI. PLANNING FOR DISABLED BENEFICIARIES**

Families that have disabled or “special needs beneficiaries” should consider the need to establish a special needs trust (“SNT”). If a special needs beneficiary receives an outright inheritance or gift in a trust that does not contain certain provisions, the funds could result in disqualifying the special needs beneficiary from any federal or other public assistance benefits that otherwise might be available. An SNT specifically provides that the trustee is to pay for the special needs beneficiary’s luxuries and for items not covered by public assistance, such as (a) speech, behavioral, music, occupational, and other therapies for which no public or private funds are otherwise available; (b) discrepancies in the cost between housing for shared and private rooms in institutional settings or to allow the special needs beneficiary to reside in a private residence along with one or more companions; (c) travel, companionship, and cultural matters; (d) allowances for family members who wish to visit the special needs beneficiary from time to time as determined by the trustee; (e) the purchase of equipment such as radios and televisions; and (f) other similar expenditures for the special needs beneficiary. Only with careful and creative drafting can a family be assured that the special needs beneficiary will indeed benefit from assets marked for his or her benefit.

## **VII. CONCLUSION**

Each person should ask, “Do I want to leave my assets to family members (and potentially charities) or to the Internal Revenue Service?” Most people do not like to address estate planning issues, especially if we are young and healthy. However, planning advantages could be curtailed or eliminated, and failure to plan now could result in substantial additional estate, gift, GST, and even income taxes. With a relatively minimal amount of time investment now, you can structure asset ownership and estate planning documents so as to maximize your assets during and after your lifetime to benefit you and those whom you hold dear. If a current estate plan is limited to a will and trust without considering some of the additional techniques described above, additional estate and gift taxes at rates of up to 50% could be incurred.