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Estate Planning Guide

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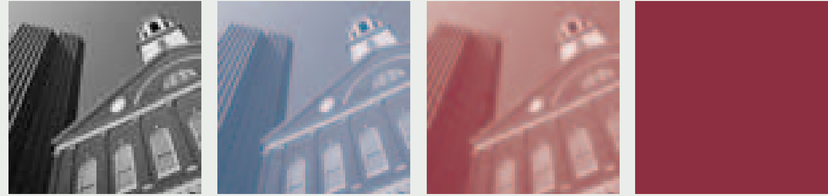

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Why Create An Estate Plan?

You've worked hard over the years and accumulated considerable assets. Enough to live on comfortably and to plan for the futures of those close to you. But without an estate plan, your estate could dwindle as a result of taxes and other wealth transfer costs.

Although estate taxes and probate expenses are a reality, you can drastically reduce them by effective estate planning and pass on a meaningful legacy to those you care about.

This guide will give you a clearer understanding of estate planning – from basic tools to sophisticated planning options. By using this guide and working with your advisors to implement your planning options, you'll be well on your way to preserving the estate you've worked so hard to build.

What Is Estate Planning?

Effective estate planning will ensure that:

- Your assets will be managed competently if you become disabled.
- Your estate will be distributed to your beneficiaries, efficiently and economically.
- You reduce transfer taxes and expenses.
- You preserve asset values.
- You leverage lifetime gifts and make maximum use of your available tax exemptions.

Wealth Transfer Costs

While you're establishing your planning goals and determining how to transfer your assets, you should keep an eye toward the cost of wealth transfers. These costs may include:

- Estate, gift and inheritance taxes
- Income taxes on annuities and retirement assets
- Generation-skipping transfer tax
- Probate costs
- Professional fees

Estate Taxes

For most people, federal estate taxes will take the largest chunk out of their estate — which is why minimizing estate taxes should be a primary estate planning objective.

What Assets Get Counted For Estate Tax Purposes?

Your gross estate includes every asset you own at death, including cash, bank accounts, CDs, stocks, bonds, mutual funds, notes receivable, real estate, business interests, retirement plan assets, annuities, life insurance, automobiles, jewelry, and other personal property. These assets are usually taxed at their fair market value as of the date of death.

The New Era of Estate Planning

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") has brought some recent changes to the estate planning landscape. In 2005, the estate tax exclusion amount is $1,500,000 per person, and the highest tax rate is 47%. The chart below shows the increases in the estate and generation-skipping transfer (GST) tax exemptions.* The gift tax exemption is $1,000,000 per person in 2005, and will remain at that amount.

Although the estate and GST taxes are scheduled to be repealed in 2010, the EGTRRA contains a "sunset provision" that causes all of the Act's provisions to expire after December 31, 2010. Unless Congress and the President extend the effect of the EGTRRA, the estate tax exemption will return to $1,000,000 per person in 2011 and the top estate, gift and GST tax rate will return to 55%.

Year	Estate and GSTT Exemption Amount	Highest Estate, GST and Gift Tax Rate
2005	$1,500,000	47%
2006	$2,000,000	46%
2007	$2,000,000	45%
2008	$2,000,000	45%
2009	$3,500,000	45%
2010	no estate or GST tax	0% **(highest gift tax rate will be 35%)**
2011 (and later)	$1,000,000*	55%

*Assuming the EGTRRA is not extended after 2010.

Wealth Transfer Costs

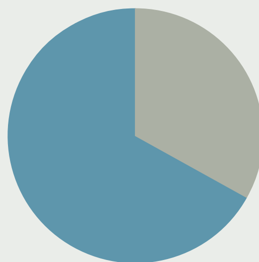
Under the provisions of EGTRRA, the decreases in the estate and gift tax are only temporary and the current law is expected to return in 2011. During 2010, while the estate tax is repealed, the step up in basis for assets owned at death will be replaced by the "carryover basis rule."As a result, many estates will have capital gains tax due instead of estate tax." Estate tax is only one of several costs that you may incur at death, and the next few pages can give you several ideas on how you can maximize the benefits of estate planning.

* In 2010, there will be a $1.3 million exemption for the carryover basis rule and a $3,000,000 exemption for transfers to surviving spouses.

For example:

Even with a $1,500,000 exemption, an estate of $5 million can still be significantly reduced by estate taxes. The chart below shows that at a minimum, $1,635,000 will be lost to federal estate tax, leaving only $3,365,000 to the heirs of the estate.*

$5 Million Estate



Federal Estate Tax $1,635,000*

Amount Passing to Beneficiaries $3,365,000

*This chart assumes that death occurs in 2005 and the individual will take advantage of the maximum applicable exclusion amount.

Other Wealth Transfer Costs May Include:

- Income Taxes on Annuities, IRAs and Qualified Retirement Accounts

Like other assets you own at death, qualified plan accounts, annuities and IRAs are subject to estate taxes. However, qualified plan accounts, annuities, and IRAs are also subject to income taxes after death. The combination of these taxes can drain more than 70% of your account balances at death.

- **Generation-Skipping Transfer Tax**

The generation-skipping transfer tax (GSTT) imposes a tax on transfers to persons two or more generations below the transferor, including certain transfers from grandparents directly to grandchildren. The GSTT can also affect transfers to, and distributions from, certain trusts. The GSTT is imposed on generation-skipping transfers in addition to any estate or gift tax that may be due on the transfer.

- **Legal and Accounting Fees**

Despite the increases in the applicable exclusion amount in the next ten years, there are still many important reasons to create or update your estate plan. In addition to federal taxes (estate, gift, and GST), state inheritance or estate taxes, and probate costs, legal and accounting fees may further deplete your estate. Inflation will reduce the benefit of the increases in the applicable exclusion amount. Consider whether your estate will have enough liquid assets to pay these costs and adequately provide for your beneficiaries. There are also many non-tax reasons to do an estate plan, such as creditor protection, professional management of assets, and equalization of inheritances.

Many estate planners believe that, because of federal budget concerns, the provisions of EGTRRA will not be extended after 2010. As a result, the estate tax repeal could only last for one year. It is important for you to work with your advisors to come up with the estate plan that is right for you and your family.

Basic Estate Planning Tools

Although the costs of transferring your assets can be significant, many estate planning tools do exist to absorb some of the impact of these costs. Your advisors can review these tools with you to see if one or more can apply to your situation. An effective estate plan should minimize transfer costs and arrange for the payment of costs that arise at your death.

Unlimited Marital Deduction

If you're married, you can transfer unlimited assets to your spouse, during your lifetime or at death, without suffering any federal estate or gift tax liability. If your spouse is not a U.S. citizen, other restrictions apply. You can take advantage of the marital deduction by making an outright gift to your spouse or by using a marital trust. A qualified terminable interest property (QTIP) trust is a common type of marital trust that lets you determine the final trust beneficiaries after your spouse dies. However, because marital deduction property is subject to estate taxes at the death of the surviving spouse, you may need to use other cost-saving techniques as well.

Credit Shelter Trust

In 2005, a married couple will be able to transfer $3,000,000 without federal estate tax (the gift tax exemption will remain at $1,000,000 per person). To do so, each spouse must make maximum use of his or her applicable exclusion amount. A credit shelter trust can allow you to take advantage of your applicable exclusion amount and still provide for your surviving spouse and children. Married couples should consider holding some assets individually, so that both spouses can fully use their applicable exclusion amounts, regardless of who dies first. Both a credit shelter trust and a marital deduction trust can be included in a will or a revocable trust document, also known as a "living" trust. A revocable trust is sometimes used as a "will substitute." Like assets passing under a will, assets passing under a revocable trust can be subject to estate tax. However, unlike assets passing under a will, revocable trust assets will avoid the probate process.

Will

Your will is an important document that contains your instructions on who will receive the assets that you own individually. Your will can also establish who the executors of your estate will be, and who will act as guardians of your minor children. A will does not typically affect the transfer of assets that are held jointly, or assets that have beneficiary designations, such as life insurance, annuities and retirement benefits. Assets passing under a will have to be transferred through the probate process.

Living Will/Health Care Proxy

A living will is a document that lets your family members and doctors know what type of care you do or don't want if you become terminally ill or permanently unconscious. The living will becomes effective only when you are incompetent to make your own medical decisions, (i.e., you cannot express your wishes yourself). Some states also allow you to create a power of attorney for health care, or a health care proxy, to appoint another individual to act on your behalf, in accordance with your written wishes.

Durable Power of Attorney

A durable power of attorney is a document that can authorize one or more persons to act on your behalf if you are not able to act on financial, legal and administrative matters, especially if you are not competent to make these decisions for yourself. A durable power of attorney can enable your family members to manage your affairs, without having a guardian or conservator appointed by the Probate Court. There are significant legal, administrative, privacy and cost benefits to executing a durable power of attorney which will take effect if you are absent or mentally incompetent.

The Benefits of Lifetime Giving

If you still expect estate tax liability after applying your basic estate planning options, consider starting a lifetime gifting program to reduce the size of your estate. Gifting during your life can remove assets and their future appreciation from your estate. When deciding which assets to give away, generally you should choose those assets that you believe will appreciate rapidly after the gift, and those assets that you can give away at a discounted gift tax value.

Your advisors can help you determine if you should start a gifting program and what assets you should consider gifting.

- **Annual Exclusion Gifts**

You can take advantage of the annual exclusion from gift tax by giving up to $11,000 in cash or other assets each year to as many individuals as you wish without paying any federal gift taxes.[1] If both spouses use their annual exclusions, a married couple can transfer $22,000 per year to each recipient. Well-planned gift giving may dramatically reduce your estate tax liability.

- **Trusts with "Crummey" Powers**

Gifts to a trust can also qualify for the annual gift tax exclusion if the trust provides its beneficiaries with the right to withdraw gifts from the trust for a certain time after the gifts are made. These withdrawal powers are known as "Crummey" powers. "Crummey" trusts can also be established to benefit minors and to provide for their future expenses, such as education.

- **Gifts Paid Directly To Medical or Education Providers**

If you are interested in paying certain educational or medical expenses on behalf of another individual, such as a child or grandchild, consider paying the provider directly. Qualifying payments do not count against the annual gift tax exclusion or your applicable exclusion amount and are not subject to gift tax or GSTT.

- **Applicable Exclusion Gifts**

Using your applicable exclusion amount, you may wish to consider making gifts in excess of $11,000 per person, so that future appreciation and income on the gifts are not included in your estate. Lifetime gifts up to the current applicable exclusion amount will not result in any gift tax being due. In some instances, gifts in excess of the lifetime applicable exclusion may be beneficial.

Annual Exclusion Gifting

For example:

Thomas and Rita Lee are considering making annual exclusion gifts to their children and grandchildren. They are both age 70 and they have a combined estate of $4,000,000. They would like to use their available annual exclusions by making gifts with "Crummey" withdrawal powers to an irrevocable trust. They are considering investing the trust assets in securities or having the trust buy survivorship UL life insurance. Assuming that their estate grows at an after-tax growth rate of 5% and the trust assets grow at an after-tax growth rate of 5%, this example shows the difference after 21 years between: 1) no gifting 2) gifting to an irrevocable trust and investing and 3) gifting to an irrevocable trust that buys $2,000,000 of survivorship life insurance.[2] The $31,870 annual life insurance premium is less than their combined annual exclusions.

	No Gifting	Gift to Trust and Invest	Gift to Trust and Buy Insurance
Total Estate Value	$9,867,569	$6,061,100	$6,061,100
Estate Taxes*	$4,722,163	$2,628,605	$2,628,605
Trust Value	$0	$3,806,468	$2,611,177
Net to Heirs	$6,360,912	$8,454,470	$9,259,179

*Assuming a $1,000,000 estate tax exemption and a top estate tax rate of 55%.

Gifting and Life Insurance

Outright Gifts of Insurance

If you own or possess certain rights over life insurance on your own life, consider giving the policy or your rights in the policy away to eliminate the insurance proceeds from your gross estate. Keep in mind that a special estate tax rule provides that you must survive such a gift by three years, or the proceeds of the policy will be included in your gross estate.

Irrevocable Life Insurance Trusts (ILITs)

An ILIT is an irrevocable trust created to own life insurance. If the trust is drafted and administered properly, the life insurance proceeds received by the trust should not be subject to income or estate taxes upon the death of the insured(s). An existing life insurance policy can also be transferred to an ILIT.

An ILIT can help you:

- Provide cash for your beneficiaries, usually free of income and estate taxes, to fund estate taxes and other transfer costs.
- Create a pool of assets to increase what your beneficiaries receive.
- Protect the trust assets from your beneficiaries' creditors.
- Provide for the effective management of insurance proceeds after your death.
- Take advantage of the annual gift tax exclusion.
- Effectively use your generation-skipping transfer tax (GSTT) exemption.

GSTT and the Dynasty Trust

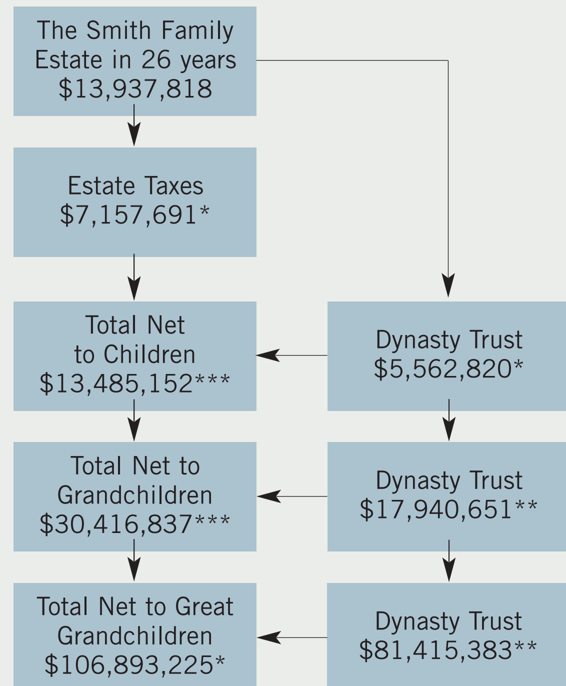
In 2005, the GSTT exemption is $1,500,000 per person. This exemption presents a tremendous tax planning opportunity, particularly when it is used for gifts to a type of ILIT called a Dynasty Trust. The Dynasty Trust is typically drafted so that the assets remaining in the trust are not subject to estate tax at the death of each child and grandchild. All states allow the creation of Dynasty Trusts that last for several generations. Some states allow the creation of Dynasty Trusts that can protect trust assets from estate, gift and GST tax for an unlimited duration.[3]

Dynasty Trust

For example:

John (age 67) and Alison Smith (age 62) have a combined $5,000,000 estate. They want to create a Dynasty Trust to purchase a Survivorship UL policy.[4] After reviewing the projected premiums, their advisors tell them that, because of their combined GSTT exemptions, their entire gift to the trust will be exempt from GSTT (see page 2 for increases in the exemption). After both John and Alison are deceased, the entire death benefit can be held in the Dynasty Trust for the benefit of their descendants. Because they allocated GSTT exemptions to their lifetime gifts to the trust, the entire trust (including the full death benefit) can be exempt from GSTT and estate tax for several generations.

Proposed Dynasty Trust



*Assumes that EGTRRA will not be extended after 2010, and that in year 26, there will be a $1,000,000 estate tax exemption with a top estate tax rate of 55%.

**Dynasty Trust includes net death benefit payable to the Dynasty Trust as well as any side fund values.

***Assumes Dynasty Trust proceeds are available to each generation and grew to 5%, but no trust distributions occur prior to trust's termination. The estate value is assumed to grow at 5%.

	Net to Heirs Without an ILIT	Net to Heirs With a Dynasty Trust
Children	$ 9,132,464	$ 13,485,152
Grandchildren	$13,916,593	$ 30,416,837
Great Grandchildren	$28,419,323	$106,893,225

Estate Planning with Annuities, IRAs and Qualified Plan Assets

Annuities and retirement plan assets can be powerful tools to help you save for retirement because they grow on a tax-deferred basis and are generally not subject to income tax until they are distributed. If your income tax bracket decreases after you retire, the advantages of using annuities and retirement plans can increase.

Because of the severe taxes applied to qualified retirement assets and the complex rules governing their distribution, it's important to coordinate them with your estate plan.

Like your other assets, annuities and retirement assets remaining at your death may be subject to estate tax. However, because distributions will also be subject to income tax, the combination of the income tax on distributions and the estate tax can consume more than 70% of your retirement assets.

Coordinate Retirement Assets with Your Estate Plan

Your goals, asset structure, age, income needs, and other factors will influence how you will handle distributions from, and beneficiary designations for, your qualified plans. Discuss these options with your advisors:

1. Defer Distributions as Long as Possible

Because retirement assets grow income tax deferred, you may choose to structure your estate plan to spread asset distributions over the longest possible period. But deferral opportunities are limited — you must ordinarily accept required minimum distributions from qualified plans or IRAs once you reach age 70½. The balance of the assets that remain at your death may be subject to estate tax, as well as income tax.

You can defer taking distributions on a deferred annuity for as long as you choose. Deferred annuities generally do not require that the annuitant take distributions during life.

2. Start Distributions Prior to Age 70½

You may choose to start taking distributions between ages 59½ and 70½ to satisfy your retirement income needs, thereby reducing your retirement asset balances. If you take distributions from an annuity or retirement plan prior to age 59½, you will ordinarily have to pay a 10% penalty for early withdrawal.

3. Purchase Life Insurance in an Irrevocable Trust

You may use a portion of your distributions to purchase single life or survivorship life insurance to:

- Pay the estate and income taxes on your qualified plan assets.
- Create a death benefit that can pass to your beneficiaries free of the income tax and estate tax.
- Replace the value of assets going to charity.
- Reduce the size of your taxable estate.

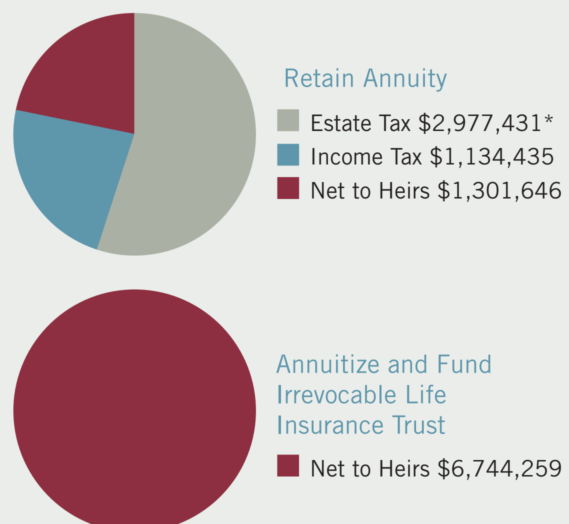
Annuity Maximization

For example:

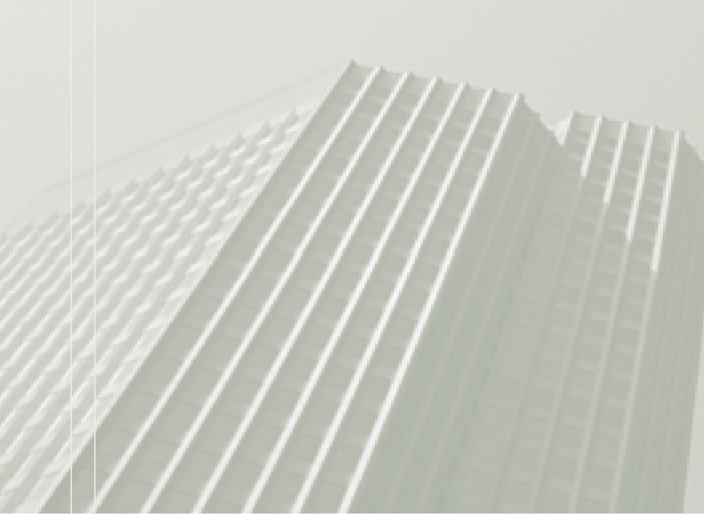
Wayne (age 64) and Fran Kershner (age 61) have a combined $7,500,000 estate, including a $1,450,000 deferred annuity. If they allow the annuity to grow in their estate at an annual rate of 5%, without taking any withdrawals from it, after 27 years the net to heirs from a $5,413,512 annuity will be $1,301,646 (after estate and income taxes). If they "annuitize" the annuity over their joint lives, they can use the after tax distributions to make gifts to an irrevocable trust. The trust can use the gifts to buy life insurance policy with an initial face amount of $5,163,087. In year 27, the net to their heirs from the trust will be $6,744,259.[5] If the trust is set up properly, the life insurance proceeds will be free of estate and income tax.

Comparison of Net to Heirs at Life Expectancy at Year 27

Keep Annuity vs. Annuitize and Purchase Life Insurance



*Assumes that EGTRRA will not be extended after 2010, and that in year 27, there will be a $1,000,000 estate tax exemption with a top estate tax rate of 55%.



Spousal ILITs and DIGITs

With the changing estate planning landscape, you may be looking for greater flexibility in your estate plan.Four concepts that can provide flexibility are Spousal ILITs, DIGITs, Premium Financing and Private Financing.

Spousal ILITs

A Spousal ILIT, sometimes known as a Smart Trust, is an irrevocable life insurance trust (ILIT) that names one of the spouses as a beneficiary of the ILIT, and allows that spouse to have access to the policy cash value. One of the spouses in a married couple is the grantor of the trust, who creates and makes gifts to the ILIT. The other spouse is the beneficiary spouse, who can receive distributions from the trust subject to an "ascertainable standard," such as health, education, maintenance and support. The beneficiary spouse can "gift-split" with the grantor spouse, but cannot make separate gifts to the trust.

A Spousal ILIT can be set up using either a single life or a survivorship life insurance policy. It can be a good way to supplement retirement income or provide emergency cash, while at the same time getting the estate tax benefits of owning life insurance inside an irrevocable trust. A Spousal ILIT can also be a way to hedge against the possibility of tax law changes by providing financial security for your family through the ILIT, as well as flexibility and access to the insurance policy.

Single Life Spousal ILIT

With a Single Life Spousal ILIT, the beneficiary spouse is able to access the policy cash values, and have a source of supplemental lifetime income. In most states, the non-grantor spouse can be a beneficiary as well as a trustee of a Single Life Spousal ILIT, as long as distributions to the beneficiary spouse are subject to an ascertainable standard. The trust beneficiaries will receive the death benefit free of estate and income tax.

Survivorship Spousal ILIT

With a Survivorship Spousal ILIT, neither spouse may be a trustee. One of the spouses can be a beneficiary of the trust (usually the spouse with the longer life expectancy) and the other spouse can be the grantor of the trust. Adult children can act as the trustees of a Survivorship Spousal ILIT and will usually receive the proceeds of the trust tax-free, after the second spouse's death.[6]

If you want the tax benefits of an ILIT, but you don't want to give up family access to the policy cash value, then a Spousal ILIT can be a great option. As long as the trust is properly drafted and administered, the proceeds of the policy will be received free of estate and income tax. A Survivorship Spousal ILIT may be appropriate if you are not going to have an estate tax liability on the first spouse's death due to the unlimited marital deduction, and you want to take advantage of the lower costs of survivorship life insurance.

Defective Irrevocable Grantor Income Trusts (DIGITs)

A DIGIT is a defective irrevocable grantor insurance trust in which trust income is attributed to the grantor instead of the trust. A DIGIT, like an irrevocable life insurance trust (ILIT), keeps assets outside of the taxable estate; the major difference between the two is who pays the income tax for the trust. With an ILIT, the trust pays the income tax, and with a DIGIT, the grantor pays the income tax for the trust. As a result, a DIGIT combines the income tax benefits of a grantor trust with the estate tax benefits of an irrevocable trust. As long as the ILIT is drafted so that the grantor trust rules are taken into account, the ILIT will be a "defective" grantor trust and transactions between the grantor and the trust will not have any income tax consequences.

The grantor trust status can enable the grantor to sell appreciating or income-producing assets to the trust without adverse income tax consequences and will allow the trust to accumulate greater income. Since the grantor is responsible for paying the trust income tax, rather than the trust, the grantor is able to make additional gifts to the trust (through the income tax payments), without using his or her gift exemption.

Premium Financing

Premium financing allows individuals who have a life insurance need to defer using their liquid assets to fund a life insurance policy. In a premium financing arrangement, the individual can take out a loan from a third party lender to pay the premiums on a life insurance policy. Premium financing can be an attractive alternative to collateral assignment split dollar, particularly for people who are heavily invested in business or real estate or who are concerned about making gifts to an irrevocable life insurance trust (ILIT) to pay large premium payments.

How does it work?

The borrower will apply for a John Hancock Universal Life Insurance product, and once an underwriting offer has been made, the borrower will apply for premium financing. The third party lender will set an interest rate as well as a payment schedule for the loan. The lender will also require collateral for the loan, usually from the life insurance policy as well as additional liquid assets. The loan may typically be repaid in a lump sum, over time, or at the death of the insured. In most cases, the borrower may only borrow premiums under this program, and must pay interest annually on the loan.

Interest Rates

The interest rates available on premium financing with a third party lender may vary depending on the age of the insured, the size of the premium, the collateral available and other related factors. Most lenders will offer premium financing with a fixed spread added onto the LIBOR or PRIME rates (adjusted annually). With the self-financing approach, the interest rate will need to be at or above the Applicable Federal Rate (AFR), to avoid IRS scrutiny and potential taxation on imputed interest.

Profile

The typical candidates for premium financing are usually individuals age 55 and over whose net worth is approximately $5 million or more, and who need a life insurance policy with a minimum annual premium of $100,000 or more. These individuals may be business owners, or may have the majority of their assets tied up in other investments. The expected return on the investments is usually greater than the interest rate on the loan for life insurance. Premium financing tends to be used for people who need to fund their irrevocable trusts with large life insurance policies, but it can also be used in business planning techniques such as deferred compensation, buy-sell arrangements and key person life insurance.

Private Financing

If you have sufficient cash to pay life insurance premiums, but do not want to incur gift tax costs or enter into a commercial premium financing arrangement, you (or an existing trust) can enter into a loan arrangement with your ILIT, also known as private financing. In many cases, private financing can provide greater flexibility than commercial premium financing arrangements while still reducing or eliminating the need to make gifts. You can either lend the ILIT the annual premium amount or you can lend a lump sum amount in the first year, which will grow inside the trust. The interest on the loan must be at or above the Applicable Federal Rate (AFR), and the type of rate will depend on the term of the loan: short-term loans are 0–3 years, mid-term loans are 3–9 years and long-term loans are 10 years or longer.

As with premium financing, the repayment of the loan can occur either during lifetime or at death. If the grantor makes the loan and the loan is still outstanding at the grantor's death, the loan balance will be an asset of the taxable estate. As long as the ILIT is a grantor trust for income tax purposes, the interest income will not be taxable and there will be no income tax consequences to a loan transaction between the grantor and the trust.

Charitable Giving

You can transfer an unlimited amount of assets to qualifying charitable organizations during your lifetime or at death without paying any estate or gift taxes.

Outright Gifts to Charity

Charitable gifts that you make directly to a charity during your lifetime will usually qualify for an income tax deduction. Although this deduction is limited in a single tax year, you may be able to use the excess deduction in the following five tax years.

Charitable Remainder Trust

You can also create a charitable remainder trust (CRT) during your lifetime or at death. You can irrevocably transfer an asset to the CRT, and retain the right to receive payments from the CRT for a certain period — perhaps for your lifetime and your spouse's lifetime. At your death (or after you and your spouse are deceased), the assets remaining in the CRT will be transferred to one or more charities that you name in the trust.

A CRT may be particularly beneficial if you have any assets — such as stock or real estate — that have appreciated greatly since you acquired them. The benefits of a CRT may include:

- Avoidance of capital gains tax.
- Charitable income tax deduction.
- Reduced estate taxes.
- Increased income stream.
- Substantial benefit to charity.

Wealth Replacement Trust

To replace the assets going to charity, the CRT is often coupled with an irrevocable life insurance trust known as a wealth replacement trust. You can use a portion of the income stream from the CRT to make gifts to the wealth replacement trust. The trustee can then purchase life insurance on you, or survivorship insurance on you and your spouse, to benefit your family.

Charitable Lead Trust

A good vehicle for people who wish to make current gifts to charity is a charitable lead trust (CLT). A CLT provides an income stream to a selected charity or charities during the donor's life or for a specified time period. After the trust term ends, the remaining trust assets pass to the donor or to beneficiaries named in the trust.

Private Foundations

You can also consider establishing a private foundation and funding it with appreciated assets, life insurance or cash. Donations to private foundations will receive an income tax charitable deduction within certain income limitations. Most foundations are required to pay out a percentage of their income each year to selected charities, allowing them to last for several generations. Family members can become involved in the management of the foundation and the selection of charities.

If you are interested in making charitable gifts, talk with your advisors about your charitable giving options.

Sophisticated Planning Options

Family Limited Partnerships

You can use a family limited partnership (FLP) or a limited liability company (LLC) to consolidate ownership and management of family assets and shift income or appreciation to other family members. These entities allow parents to make discounted gifts of limited partnership interests to children and grandchildren, or to trusts for their benefit, without surrendering control of a business or property.

Such gifts may qualify for gift tax discounts on their valuation because they are not marketable assets and are often minority interests subject to transfer restrictions.

Grantor Retained Annuity and Qualified Personal Residence Trusts

The grantor retained annuity trust (GRAT) and the qualified personal residence trust (QPRT) are sophisticated estate planning tools that can help you reduce or avoid gift and estate taxes on certain assets.

A GRAT is an irrevocable trust into which you transfer assets, such as stock, and retain the right to receive a fixed dollar amount from the trust each year. You establish the trust for a term of years and, at the end of the trust term, the assets pass to your beneficiaries.

QPRTs are similar to GRATs, except that the asset you transfer into the trust is a personal residence or a vacation home. You retain the right to live in the residence for a specific number of years. If you survive the trust term, the residence passes to your beneficiaries at the end of the term, free of estate tax. With both GRATs and QPRTs, because you have retained an interest in the trust assets, there is a substantial gift tax discount on the original transfer to the trust. Any appreciation on the trust assets that occurs during the trust term will also pass to the beneficiaries, free of estate or gift tax.

However, if you die during the term of one of these trusts, its value will be included in your gross estate for estate tax purposes. Life insurance can help offset this potential increase in estate tax.

Estate Planning and the Family Business

If you own a family business, coordinating your estate planning and business planning is critical. Because many business owners fail to plan for the future, only one in three family businesses make a successful transition to the next generation.

Provide for Key Employees

As a business owner, you need to structure competitive compensation and benefit packages to attract and retain key employees. Due to annual contribution limits, many highly compensated executives find that they cannot save enough in IRAs and qualified plans. Nonqualified deferred compensation is an excellent way to provide supplemental retirement savings to select employees.

Plan for Your Successor

At your retirement, disability, or death, who will run the business? Have you designated your successor? Does your successor have the maturity, training, experience, and desire to run the business? These are important questions to answer as part of your estate planning process.

Decide How to Transfer Ownership

Will your successor own all or part of the business? How will ownership be transferred — through gift or sale?

If you wish to sell all or part of your business to provide cash for yourself or for other beneficiaries, you should create a buy-sell agreement, which designates the date, method, and price for the future purchase of your business.

Plan for Estate Taxes

How much is your business worth? How will your estate pay the estate taxes when your business is transferred at your death, or after the death of you and your spouse? Many estates don't have enough liquid assets to pay estate taxes, and generating cash by selling assets in an emergency can destroy a business. Talk with your advisors now to determine how to minimize your projected estate tax liability, and how to pay the remaining estate taxes.

The Role of Life Insurance

Life insurance is widely used in estate and business planning because it provides an important source of liquidity when it's needed most — at the death of the insured. Death benefits are usually received free of income tax. And, with proper estate planning, insurance proceeds can be free of estate tax as well. Whether it is used for personal, business, or charitable reasons, life insurance can help you plan for the future.

Personal Uses of Life Insurance

- Supply family members with an income source after the death of an income earner or caregiver.
- Provide cash to pay estate taxes.
- Pay mortgages and other expenses at death.
- Create an estate for your beneficiaries.
- Equalize inheritances among children.
- Leverage your annual gift tax exclusion, applicable exclusion amount, and generation-skipping transfer tax exemption.

Life Insurance and Business Planning

- Fund deferred compensation arrangements.
- Provide death benefits to a key employee's family.
- Finance the replacement of a key employee.
- Replace lost revenues after losing a key employee.
- Finance the purchase of the business (buy-sell planning).

Life Insurance and Charitable Giving

- Leave a substantial benefit for your favorite charity.
- Replace assets not passing to your family as a result of a charitable remainder trust or an outright charitable gift.
- Allow your charitable gifts to continue after death.

Re-examine Your Plan Periodically to Make Sure it Stays Current

Maintaining your estate plan is as important as creating it. You should review your estate plan periodically with your advisors to make sure it still meets your goals, especially if a change in any of the following has occurred:

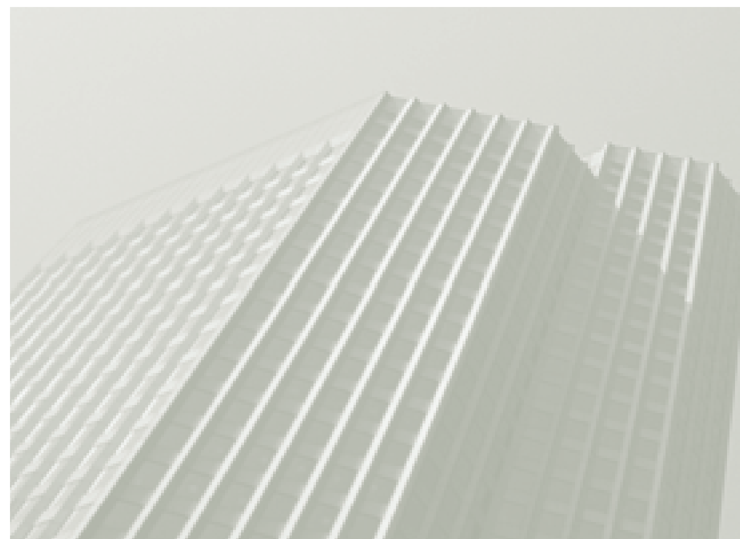
- Your marital status
- Your immediate family (such as a birth, marriage, or death)
- Your business arrangements
- Tax laws
- Your residence (especially if you've moved to a new state)
- The amount or type of your assets

Building Your Advisory Team

Your team of advisors should work together to achieve your estate planning goals. Your team may include:

- Attorney
- Accountant
- Financial Advisor
- Life Insurance Representative
- Trust Officer

Your advisors can help you understand what type of insurance can help you satisfy your estate planning needs. We hope this reference guide has provided the information you need to begin reviewing your estate plan.



1 The Taxpayer Relief Act of 1997 provided that the annual gift tax exclusion would be indexed annually for inflation in increments of $1,000. In 2005 it is $11,000. Consult your legal or tax advisors after 2005 to determine the annual gift tax exclusion amount.

2 This hypothetical example assumes the purchase of a $2,000,000 Survivorship Universal Life (SUL-G) policy. The example assumes that both insureds are age 70, preferred non-smoker class, and California residents. The illustration assumes a crediting rate of 5.50%, which is not guaranteed, and illustrates annual premiums of $31,870 for 30 years which will endow the contract at age 100 at the current scale (non-guaranteed).

3 Twenty-two states have abolished the Rule against Perpetuities and trusts can either have unlimited duration or last for a longer term of years. These states currently include Alaska, Arizona, Colorado, Delaware, Idaho, Illinois, Maine, Maryland, Missouri, Nebraska, New Hampshire, New Jersey, Ohio, Rhode Island, South Dakota, Virginia, Washington, D.C., Wisconsin, Wyoming (trusts can last for 1000 years), Utah (1000 years), Florida (360 years), and Washington (150 years).

4 This hypothetical example assumes the purchase of a $2,500,000 Survivorship Universal Life (SUL-G) policy. The example assumes that both insureds are preferred non-smoker class, and Florida residents. The illustration assumes a crediting rate of 5.50%, which is not guaranteed, and illustrates annual premiums of $27,647 for life which will carry the contract to age 100 (not guaranteed). The estate and trust are projected at a 5% after tax growth rate.

5 This hypothetical example assumes using the net after-tax income of $60,480 from annuitizing the annuity to purchase a $5,163,087 Survivorship Universal Life (SUL-G) policy. The example assumes that both insureds are preferred non-smoker class, and Florida residents. The illustration assumes annual premiums of $60,479 for 39 years which will keep the policy inforce until age 100. The Estate and ILIT assets are projected with a 5% after tax growth rate.

6 Private Letter Ruling 9748029 illustrates the concept of a Survivorship Spousal ILIT. A PLR is only binding authority to the taxpayer to whom it is issued.

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