Do You Need an Estate Plan?

Anyone who owns property — a home, a car, a bank account, investments, business interests, a retirement plan account, collectibles, personal belongings, etc. — needs an estate plan. An estate plan allows you to direct how and to whom your property will be distributed after your death. If you have no estate plan at all, your property could be distributed according to your state's intestacy laws without regard to family needs or your desires.

Estate planning is an ongoing process. For a young, single person, an estate plan may consist of simply a Will. A couple just starting out might have Wills and own a modest home and bank accounts in their joint names. When children arrive, naming a guardian and arranging to provide for them and your spouse in the event of unexpected death or incapacity become estate planning concerns. And, once an individual starts to realize his or her financial goals, asset preservation and avoiding taxes become important factors in estate planning.

Although the Economic Growth and Tax Relief Reconciliation Act of 2001 phases out the estate tax — with full repeal slated for 2010 — in the interim, many people who consider themselves of comfortable means may still have estates that will be subject to estate tax at their deaths.

Moreover, repeal might be in effect only for one year. The Act contains a sunset provision that would cause the law's changes to expire after 2010 unless Congress takes further action. So tax planning continues to have a place in estate planning.

This booklet is designed to show you the need for estate planning and the estate-planning tools and strategies available to help you ensure your loved ones' future financial security and keep transfer taxes to a minimum. The booklet is not intended to take the place of professional advice. You'll want to consult with us and your other professional advisors before implementing any of the strategies discussed.

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Preliminary Considerations

Building and Conserving Your Estate

The first step in estate planning is building your estate. Do you own mutual funds or other investments, participate in an employer-sponsored retirement plan, or regularly put money away for a new home or for a child's college education? If so, you already have a financial plan in place for building your estate.

Having an effective financial plan is an important part of estate planning. So, you may want to take time now to review your financial plan. How well is it meeting your current objectives? Will it continue to meet your future needs? Can you improve your investment program so that it will better build the estate you desire? The answers to these questions will help you in your estate planning.

Conserving the assets you've built is another important part of estate planning. Taxes, inflation, and unanticipated expenses can diminish the value of your estate. To protect the value of your assets, you have to plan for unexpected expenses, such as a prolonged illness, for anticipated but out-of-the-ordinary expenses, such as retirement or a child's education, and for ordinary living expenses, taxes, and inflation. Otherwise, your estate plan may not accomplish your objectives.

Why You Need a Will

You've worked hard to build your estate. You deserve

the right to determine who will receive your assets after your death. This is where a Will comes in. A Will is a legal document that allows you to direct how your estate will be administered and distributed. By exercising your privilege of making a Will, you can accomplish numerous personal and financial objectives.

If you die without a Will, a state court will choose an administrator for your estate or, if needed, a guardian for your minor children. The court's choice may or may not be individuals whom you would have selected. The court-appointed administrator will distribute your property according to the state intestacy laws, regardless of any desires you may have expressed during life. Your children, grandchildren, or other heirs who are minors at the time of your death may automatically receive their shares of your estate outright when they reach the age of majority, whether or not they are experienced enough to manage their inheritances wisely.

A Will is the cornerstone of estate planning. If you don't have a Will, we strongly recommend that you make one.

A Will Is a Powerful Planning Tool

Through a properly drawn Will, you can:

- Protect your family by making provisions to meet their present and future financial needs,
- Minimize taxes that might reduce the size of your estate,
- Name an experienced executor or personal representative who will ensure that your wishes are carried out,
- Name a guardian for your minor children,
- Establish trusts to manage the inheritances of any beneficiaries who may be minors or are otherwise inexperienced in asset management,
- Make sure your assets will be managed prudently (by appointing a qualified trustee of a trust created in your Will, for example),
- Avoid the delays and the added expense that intestacy proceedings may involve, and
- Secure the peace of mind of knowing your family and other heirs will be well taken care of according to your desires.

If you do have a Will, you should review it regularly to make sure it is still meeting your needs. Once your Will is written, you may exercise the right to revoke and replace the document at any time, for any reason.

Choosing an Executor

When you write your Will, you'll need to name an executor or personal representative. Your executor will administer your estate and distribute your assets to your beneficiaries, as you've directed in your Will.

You can choose almost anyone who is an adult and is legally competent to serve as executor — your spouse, sibling, friend, business associate, or financial or legal advisor, for example. You can also name a corporate executor, such as a bank trust department.

People who have never served as an executor

Duties of an Executor or Personal Representative

The terms executor and personal representative are interchangeable and vary from state to state. The duties and responsibilities, however, are basically the same. An executor generally must:

- Collect and provide safekeeping for the estate's assets;
- Notify creditors and pay all valid debts;
- Collect any sums owed the estate;
- File claims for pension and profit-sharing plan benefits, Social Security benefits, and veterans' benefits;
- Manage the estate's assets;
- Sell assets, as directed by Will or required by state law, to pay estate expenses or legacies;
- Keep detailed records of all estate transactions and submit records to beneficiaries and/or the probate court;
- Distribute assets to beneficiaries;
- File the decedent's final federal income-tax return;
- Choose a tax year for the estate;
- File the estate's income-tax returns;
- File state death-tax returns; and
- Complete and file the federal estate-tax return.

Before choosing someone to serve as your executor or personal representative, give serious consideration to how well he or she will be able to handle the duties and responsibilities of the job.

frequently don't know what they are getting into when they agree to serve and subsequently find themselves overwhelmed by the duties required of them. So, although you have wide latitude in whom you can select, you may want to give serious consideration to naming a professional as your executor or naming a professional to serve as co-executor with a family member or friend.

Using "Will Substitutes" To Avoid Probate

Despite what you may have read or heard, a living trust can't always fully replace a Will. Neither is trying to place all of your property in joint ownership with your spouse an effective replacement for a Will. You'll find it difficult to transfer *all* of your property to a trust or title *all* of your property in both your and your spouse's names. Any property you miss will be distributed under state intestacy law if you die without a Will.

However, living trusts and joint ownership each have a place in many estate plans, for several reasons. One popular reason is to avoid probate. Probate is the court-supervised process of proving and administering a Will. This process is often time consuming and can be expensive, depending on the size and complexity of your estate. Probate also exposes your assets to public scrutiny. When your Will is probated, its terms generally become public record.

Living Trusts. A living trust is probably the best strategy to avoid probate and protect your financial privacy. A living trust is a legal agreement under which you transfer assets to the trust to be managed by a trustee for the

benefit of one or more people, generally you and your spouse. The trustee is responsible for administering the trust and managing the trust assets. You can serve as your own trustee during your lifetime or you may want to choose another person or organization to serve as your trustee.

A living trust can hold all types of assets — from your investment portfolio to collectibles to your closely held business. Unlike your Will, a living trust is not a matter of public record. If your trust agreement provides for your trust to continue after your death, the assets in the trust at your death will escape probate and any ensuing publicity.

Pour Over Provisions. Living trusts have other estate-planning advantages, as well. You can use a living trust to unify your estate's assets under one manager and provide continuing asset management for your family and other heirs after you're gone. How? In your Will, you can direct that any assets not held in your living trust be "poured over" to the trust at your death to be managed along with the other trust assets. Be aware, though, that the assets placed in the trust at your death will be subject to probate.

Joint Ownership. Property you and your spouse own jointly with rights of survivorship will pass privately to your spouse outside of probate at your death. Using joint ownership for the family home and a modest bank account or

investment portfolio is a simple way to help your family's lives go on as normally as possible while your estate is being settled. Be aware, though, that using joint ownership precludes the use of other estate-planning techniques that may help to save estate taxes and may have other ramifications for your estate plan.

Community Property. Community property doesn't pass automatically to your spouse. If your state has a community property law, you and your spouse each own a one-half interest in assets acquired during your marriage. So, when one spouse dies, the survivor continues owning half of the assets. The deceased spouse needs a Will to transfer the other half. Also, during your marriage, you may have acquired assets that you own separately — gifts and inheritances. You need a Will to determine what will happen to this non-community property.

Beneficiary Designations. You may have significant assets that can pass outside of probate by beneficiary designation rather than by Will. Life insurance proceeds, qualified retirement plan benefits, annuities, and Individual Retirement Accounts can go directly to beneficiaries instead of through probate. Check to make sure you've designated beneficiaries and secondary beneficiaries.

Understanding the Federal Estate Tax

Unless you plan for taxes, they can take a large part of your estate. Figuring estate tax is complex, and the phaseout of

Highest Tax Rates (Gift and Estate)

Year	Rate*
2002	50%
2003	49%
2004	48%
2005	47%
2006	46%
2007–2009	45%
2010	35%**

* The generation-skipping transfer tax is assessed at a flat rate equal to the top gift- and estate-tax rate.

**Gift tax only. Estate and generation-skipping transfer taxes (discussed later) are repealed in 2010.

the tax through decreases in the top estate-tax rate (see table above) and increases in the gift- and estate-tax credits, discussed below, make the computation even more complicated. However, to effectively plan your estate, you need at least a basic understanding of how the tax works.

The Federal Estate- and Gift-Tax Exclusions. Every individual is allowed a credit that permits a certain amount in assets to pass free of estate and gift tax. So, if your total taxable estate and lifetime gifts are less than or equal to the applicable credit exclusion amount, no federal estate tax will be due. (See *The Estate-Tax Exclusion Amount* table. The gift-tax exclusion amount is $1 million for 2002 and later years.) To illustrate: In 2007, the credit will offset $780,800 in estate taxes. If you die in 2007 with a *taxable estate* of $2.1 million, having made no taxable gifts during life, the tentative estate tax will be $825,800. However, assuming your estate has no adjustments other than the estate-tax credit, the actual tax will be $45,000 ($825,800 – $780,800).

The Estate-Tax Exclusion Amount

Year	Credit	Exclusion Amount
2002–2003	$345,800	$1,000,000
2004–2005	555,800	1,500,000
2006–2008	780,800	2,000,000
2009	1,455,800	3,500,000

Estate Value. For a general idea of how much tax, if any, will be due on your estate, estimate the current value of your estate. Our worksheet should help. Then subtract allowable deductions. These deductions may include, but aren't limited to:

- Estate administration fees;
- Funeral expenses;
- Valid debts, such as your mortgage and unpaid property or income taxes;
- Transfers for public, charitable, and religious uses; and
- Bequests to your surviving spouse (see *Unlimited Marital Deduction*, discussed in next section).

Next, add in the value of any taxable lifetime gifts you have made. Check this amount against our tax table to get an idea of the amount of tax your estate would owe if you should die in 2007 – 2008.

Potential Estate Tax*

Taxable Estate	Tax (Top rate = 45%)
$ 2,000,000	– 0 –
2,500,000	$ 225,000
3,000,000	450,000
3,500,000	675,000
4,000,000	900,000
4,500,000	1,125,000
5,000,000	1,350,000
5,500,000	1,575,000
6,000,000	1,800,000
6,500,000	2,025,000
7,000,000	2,250,000
7,500,000	2,475,000
8,000,000	2,700,000
8,500,000	2,925,000
9,000,000	3,150,000
9,500,000	3,375,000
10,000,000	3,600,000

Note: An additional tax — the generation-skipping transfer tax (discussed in next section) — may apply if your gifts and bequests to beneficiaries more than one generation younger than you exceed $1.1 million (adjusted annually for inflation).

* This table reflects an estate-tax exclusion amount of $2,000,000, available in 2006 – 2008. For purposes of the above calculations: (1) an estate-tax credit of $780,800 is taken into account; (2) the state death-tax deduction is not taken into account.

What Is Your Estate Worth?

$200,000? $500,000? $1 million? More? Most people underestimate the value of their estates. Completing the following worksheet can help you estimate the value of your gross estate. (Note that other items also may be included.)

Assets	**Market Value**
Certificates of Deposit, Money Market Accounts, and Other Cash	$ _____
Stocks, Bonds, and Mutual Funds	_____
Mortgages and Other Debts Owed to You	_____
Other Investments	_____
Employer-Sponsored Retirement Plan Benefits	_____
Individual Retirement Accounts	_____
Personal Residence	_____
Vacation Home/Time Share	_____
Other Real Estate	_____
Business or Partnership Interests	_____
Life Insurance Proceeds	_____
Automobiles and Recreational Vehicles	_____
Jewelry	_____
Collectibles	_____
Other (furniture, personal belongings, etc.)	_____
TOTAL GROSS ESTATE	$ _____

Are you surprised at the result? If you're married, you may be in for an even greater surprise. Consider what your estate will be worth if your spouse dies first and all of his or her assets are added to yours.

The Unlimited Marital Deduction. The marital deduction generally allows you to give your spouse an unlimited amount of assets free of both estate and gift tax. The assets may pass either outright or in trust. So, if you leave your entire estate to your surviving spouse, no estate tax will be due on your estate.

If you're a resident of a community property state and you have only community property, the marital deduction generally isn't needed unless your assets are more than double the estate-tax credit exclusion amount (for example, $2 million in 2007). Assuming you've made no taxable gifts, your credit will eliminate all estate taxes on your estate — *regardless of who inherits your assets.*

While the idea of passing all your assets to your surviving spouse tax free may sound attractive, this planning approach isn't always tax-wise, especially if the value of your combined estates is greater than the estate-tax credit exclusion amount. Even though the marital deduction will let your assets pass tax free to your surviving spouse, when your spouse dies, the assets will be included in his or her estate for tax purposes. Other strategies might better accomplish your objectives.

The Generation-Skipping Transfer Tax. Another possible concern for the near future is the generation-skipping transfer (GST) tax. This tax could come into play if you want to leave your assets in a way that will benefit your grandchildren or other persons more than a generation younger than you. The GST tax rate is steep — equal to the highest federal estate-tax rate (see table on page 6). GST tax, which is being phased out on the same schedule as the estate tax, must be paid *in addition to* estate and gift tax.

The purpose of the GST tax is to prevent families from sidestepping a generation's worth of estate taxes by transferring assets to grandchildren, rather than to children. GST tax applies both to indirect transfers made in trust (for example, a trust that benefits your child first and, then, your grandchild after your child's death) and to "direct skips," transfers made directly from you or from a trust you create to a grandchild or another person two or more generations below your generation.

A cumulative $1.1 million GST tax exemption (adjusted annually for inflation) gives you leeway to transfer up to that amount to your grandchildren or others free of the GST tax. If you and your spouse agree to split gifts, together you can give your grandchildren up to $2.2 million (as adjusted for inflation) without incurring the GST tax. Starting in 2004, this exemption will track the estate-tax exemption amount (see table on page 6).

The GST tax does not apply to direct transfers and certain transfers from trusts you make to a grandchild whose parent — your child — is deceased. GST-tax-free transfers to "collateral" heirs (such as a grandniece or grandnephew) may also be possible under limited circumstances.

Capital Gains Tax. Currently, capital gains taxes are more of a financial planning consideration than an estate planning one. But this is likely

to change in the future. With the estate-tax repeal comes a change in the way capital gain on inherited property is taxed.

You pay capital gains tax on gains realized when you sell property that has increased in value while you've owned it. Your gain (or loss) for capital gains tax purposes is usually determined by using your "basis" in the property. Basis generally refers to the amount you paid to acquire the property, plus or minus various adjustments that may be required after acquisition (for items such as depreciation, reinvested dividends, and the cost of capital improvements). Your gain is the value of the property in excess of your basis.

When you give someone assets during your lifetime, your basis (or the fair market value of the assets, if less) on the gift date is carried over and becomes the recipient's basis. If the recipient later sells the gift assets, he or she is liable for capital gains tax on the assets' appreciation both *before* and *after* you made the gift.

Inherited property is treated differently. It usually receives a "step-up" in basis to its fair market value at the time of the owner's death. So, if you leave property to your son and he later sells it, he'll be responsible for capital gains tax only on the appreciation generated after your death. However, as of 2010, new rules apply for determining inherited property's basis. The new rules limit basis step-ups and, in many cases, will result in significantly higher capital gains taxes on the sale of inherited property.

In 2010, each estate generally will be able to increase the basis of property transferred only up to a total of $1.3 million. The basis of property transferred to a surviving spouse may be increased by an additional $3 million for a total of $4.3 million. These amounts will be adjusted annually for inflation.

Some property — tax-deferred money in retirement plans and Individual Retirement Accounts, for example — won't be eligible for even the limited step-up. Any property that isn't allocated a basis step-up will pass to your heirs and beneficiaries with a "carryover" basis equal to the *lesser* of (1) your adjusted basis in the property or (2) the property's fair market value on the date of death.

For example, let's say your father dies in 2010 and you inherit closely held stock from him that he bought for $10 a share. The stock is worth $500 a share at the time your father dies. Under the new carryover basis rules, if you sell the stock for $500 a share, you could have a capital gains tax bill of $98 on each share sold (20% tax rate × $490 appreciation). Before 2010, there would be no capital gains tax because of the basis step-up for property included in an estate.

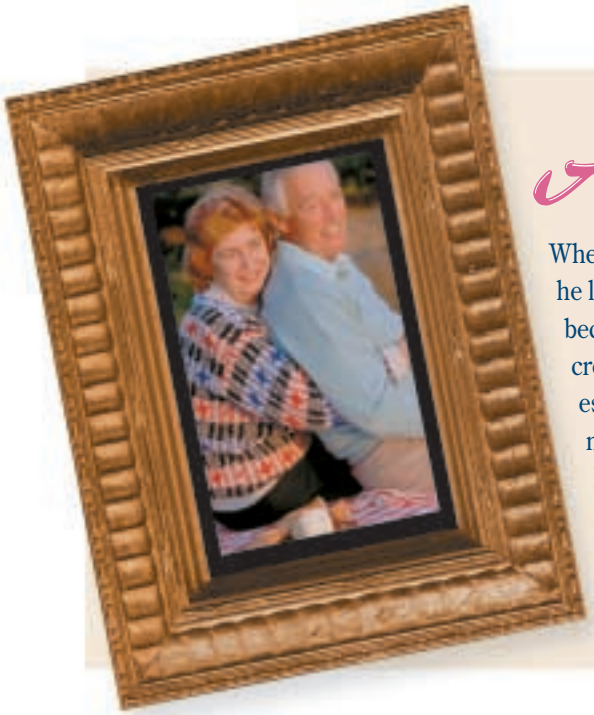
Planning Strategies

Now that you have a basic understanding of estate planning preliminaries and the estate tax, let's look at some ways you can plan for your assets to pass to the people you want in the manner you want at the least federal estate-tax cost.

Credit Shelter or By-Pass Trusts

A credit shelter or by-pass trust can help both you and your spouse take advantage of the estate-tax credit and transfer up to $2 million in assets in 2002–2003 to your children or other heirs free of federal estate tax. (The amount of assets you and your spouse together can transfer tax free using the estate-tax credit exclusion amount increases to $3 million in 2004–2005, $4 million in 2006–2008, and $7 million in 2009.) To underscore the value of this planning strategy, see our simplified example, *A Case for a Credit Shelter Trust*. It shows what can happen when both spouses' credits aren't used.

One way to make the most of your and your spouse's estate-tax credits is to arrange for your estate to be divided into two parts at your death. One part would pass outright to your spouse. The second part of your estate is placed in a trust created by your Will. This trust can pay your surviving spouse a lifetime income and then benefit your children or other named beneficiaries after your spouse's death. You can even give your spouse a limited power to withdraw trust assets. Some people limit the amount in the credit shelter trust to the credit exclusion amount so that any tax on the trust will be offset by the credit.



A CASE FOR A CREDIT SHELTER TRUST

When Gordon died, he had a taxable estate of $2.5 million which he left to his wife, Katherine. His estate paid no federal estate tax because of the unlimited marital deduction. Gordon's estate-tax credit wasn't used. On Katherine's death in 2007, her taxable estate also is worth $2.5 million. Because Katherine didn't marry again, the marital deduction is unavailable to her estate. Katherine's estate claims an estate-tax credit, but this credit effectively exempts only $2 million of her property from tax. Katherine's estate is subject to an estate tax of $225,000. Using a credit shelter trust in Gordon's estate plan could have eliminated the tax on Katherine's estate.

At your death, your estate-tax credit will be applied against the assets in the credit shelter trust. If those assets are less than or equal to the credit exclusion amount, no estate tax will be due. And no tax is due on the assets passing to your spouse, either, because of the unlimited marital deduction. At your spouse's death, the credit shelter trust assets will pass to your children or other trust beneficiaries. The assets won't be taxed as part of your spouse's estate. The assets that passed to your spouse under the unlimited marital deduction will be included in your spouse's estate. However, your spouse's credit will be available to offset tax on some or all of those assets.

The Two-Trust Estate Plan

The two-trust estate plan is another planning strategy for couples that uses a credit shelter trust and one other trust. This plan saves estate tax in the same way a credit shelter trust alone does. But with a two-trust estate plan, the assets that pass to your spouse under the marital deduction are also placed in a trust, rather than left to your spouse outright. This "marital" trust may be a QTIP trust (explained below), or it can be another trust qualifying for the marital deduction.

In general, for property in the marital trust to qualify for the marital deduction:

- All of the income must be payable to your spouse at least as frequently as annually.
- If you don't use a QTIP trust as your marital trust, you also must give your surviving spouse a general power to distribute the trust property.

You may give your spouse a lifetime power to distribute trust property, or you can give your spouse the power to distribute property only by Will. Other types of marital trusts also may be used along with the credit shelter trust.

QTIP Trusts

With a Qualified Terminable Interest Property (QTIP) trust, you can give your surviving spouse a life income *and* choose who will

A PLANNING TOOL FOR TODAY

Today's "blended" families can cause additional estate planning concerns. Consider David and Anna, for instance. He has four children from a former marriage. While David wants Anna to be financially secure if he dies first, he also wants his children to eventually receive what he feels is their fair share of his estate. A good strategy for David may be to create a Qualified Terminable Interest Property (QTIP) trust in his Will. With a QTIP trust, he can give Anna a life income and ensure his children will receive the property in the trust at Anna's death. His estate can claim the marital deduction for the trust property if his executor so elects.

receive the property in the trust after your spouse's death — your children or grandchildren, for instance. Your personal representative can elect to claim the marital deduction for the trust property. For the trust property to be eligible for the QTIP election:

- You must give your surviving spouse a qualifying income interest for life.
- Your spouse may not transfer that income interest to anyone else during life or at death.
- The assets may not be distributed to anyone other than your spouse while your spouse is alive.

QTIP trust assets will be included in your spouse's estate, and your spouse's estate may have to pay estate tax on the assets. But the assets themselves must be distributed as you have directed in your QTIP trust agreement. Thus, you retain ultimate control over who receives them.

Planning for 2010

While these trust strategies will help save estate taxes before repeal takes effect in 2010, will they still be beneficial *after* repeal? It depends. Most trust strategies do more than save taxes — they also ensure that estate assets will be managed carefully for the beneficiaries' financial security. And family issues may make trusts the most beneficial way to transfer an estate. Moreover, unless Congress acts, repeal may only be effective for 2010. Clearly, continuing professional guidance is essential.

Life Insurance

Life insurance plays a part in most estate plans. Make sure you have sufficient coverage on your life for family members to maintain their current lifestyle after you're gone. For larger estates that may be subject to tax even when family trusts are used, life insurance can provide the funds needed to pay estate taxes without liquidating estate assets.

If you have a substantial amount of life insurance, you may want to create an irrevocable life insurance trust to help beneficiaries manage the proceeds and potentially reduce estate taxes.

Lifetime Gifts to Family and Friends

You don't have to wait until your death to make tax-saving transfers. In fact, a well-planned program of lifetime gifts to family, friends, and charity can save estate and gift taxes, preserve more of your assets for your family and other heirs, and ensure your property goes to the people you want to have it.

The Gift-Tax Annual Exclusion. Each year, you can give any number of people up to $11,000 each in assets ($22,000 if your spouse joins in the gift) without triggering any federal transfer tax — gift, estate, or generation-skipping. This annual tax exclusion is available in addition to your gift-tax credit exclusion amount and is adjusted for inflation.

Suppose you make annual gifts of $11,000 to each of your three children and seven grandchildren. Over a five-year period, you can give them $550,000 tax free. Having your spouse join in your gifts will raise your tax-free gift total over five years to $1.1 million and reduce the assets includable in your estate for estate-tax purposes by $1.1 million — or more if the assets appreciate between the time you make the gifts and your death.

As estate-tax repeal draws near, you also may want to consider lifetime giving strategies that use the gift-tax annual exclusion and unlimited marital deduction to help family members make the most of the new $1.3 million step-up available to all estates in 2010. If your mother, for example, has a small estate relative to yours, consider using the gift-tax annual exclusion to transfer appreciated assets to her so that her estate can eventually allocate the basis step-up to the assets before passing the assets back to you. Note that you must make the transfer more than three years before your mother's death.

You can use a similar strategy if your spouse's estate is not large enough to fully use the $4.3 million basis step-up available to surviving spouses. Here, the unlimited marital deduction would allow you to make your transfer all at once without any gift-tax consequences, and the three-year rule wouldn't apply (since it doesn't apply to spousal transfers).

Before choosing assets to give, talk with us. We can help you weigh the potential estate-tax savings against possible capital gains tax (discussed previously) so that you can provide your family with the greatest after-tax benefit.

Exclusion for Medical and Tuition Payments. The tax law also allows you an unlimited exclusion for certain tuition and medical payments made on behalf of others. To qualify for this exclusion, you must make the tuition or medical payments directly to the educational institution or medical facility. Payments for medical insurance qualify for the exclusion. Payments for dormitory fees,

Benefits of Giving Appreciating Assets

Making gifts of appreciating assets in which you have a high basis can be an advantageous planning move. Instead of giving their two children cash, James and Elizabeth give each of them mutual fund shares worth $11,000 every year for five years — total gifts valued at $110,000. Let's say the shares double in value in the years before James and Elizabeth die. By making the gifts, they avoid both gift and estate taxes on $220,000 (the original share value plus appreciation). Assuming a federal estate-tax rate of 45%, the gifts would save James and Elizabeth's estates up to $99,000 (45% × $220,000) in estate taxes.

books, supplies, and similar school expenses do not qualify for the exclusion.

Gifts to Minors Trusts. Many people don't feel comfortable giving large sums to children or grandchildren. A living trust that will hold and manage those sums until the child is more mature may seem like a good idea. However, gifts of "future interests" (gifts the recipient isn't able to use or enjoy until some time in the future) don't qualify for the annual exclusion. Gift tax is imposed regardless of the amount of the gift.

A better strategy is to create a gifts to minors trust. Gifts to these trusts qualify for the annual exclusion. With a gifts to minors trust, you direct your trustee to use the trust income and assets for the child's benefit — to finance his or her college education, for instance — until the child reaches age 21. Then, the child must be given the right to all the trust income and assets. However, you can incorporate *Crummey* powers in the gifts to minors trust that will give the child only a limited time to withdraw from the trust when he or she reaches age 21.

Crummey Powers. These powers, in effect, convert a future interest in trust property into a present interest eligible for the annual exclusion. *Crummey* powers are commonly used to make annual exclusion gifts in trust to children without giving them present rights to the trust property. For example, you could create a trust that gives your adult children no present interests in the trust property *other than the right to withdraw each year amounts equal to the gift-tax annual exclusion.* Your children *would not* have to exercise the right. Just their having the *right to withdraw* would be sufficient to allow the annual exclusion for your transfers to the trust.

You must notify the trust beneficiaries, or their legal representatives, of the existence of the power. However, you can limit the period during which the power can be exercised. You might, for instance, limit this period to 30 days after you make a contribution to the trust.

Charitable Gifts

Making charitable gifts during your lifetime or at your death can help reduce estate taxes. You can make these gifts either outright or in a charitable trust. If you make a charitable gift in your Will, your estate can claim an estate-tax deduction for the value of that gift.

But, rather than waiting until your death, you may want to consider making your charitable gifts now. Lifetime gifts to qualified charities can provide income-, gift-, and estate-tax savings, as well as help further the work of

organizations you believe in. Using a charitable trust to make lifetime gifts can give you a current income-tax deduction in addition to removing assets from your taxable estate.

Charitable Remainder Trusts. With a charitable remainder trust, you transfer property to a trust set up for the charity of your choice. The trust pays you, you and your spouse, or someone else you've chosen an income for life or a period of years. The trust ends at the death of the last income beneficiary (or earlier if that's what the trust specified), and the charity receives the property.

Charitable remainder trusts may have another advantage after the estate-tax repeal. A charitable remainder trust funded with appreciated low-basis property allows the trust beneficiary to benefit from the trust's sale of the property without paying capital gains tax. Replacing the value of the property given to charity with insurance payable to a family member or other loved one (see example below) would allow you to make a tax-advantaged gift to charity without "shortchanging" your family or passing along a high capital gains tax liability.

Charitable Lead Trusts. If you are currently making regular gifts to a favorite charity — or would like to make regular gifts to a charity — you may find it to your advantage to use a charitable lead trust for those gifts. A charitable lead trust pays income to the charity of your choice for a set period. At the end of that period, the trust assets pass to the person you've named as the trust's remainder beneficiary — your child or grandchild, for instance. Again, both the charity and your heirs benefit.

EVERYONE CAN BENEFIT

Stan and Sophie own stock valued at $120,000. As they move closer to retirement, they are looking for additional sources of income. They also would like to make a significant contribution to a charity they actively support, but they don't want to "shortchange" their children in favor of the charity. They set up two trusts: (1) a charitable remainder trust that will pay Stan and Sophie the trust income for life and then transfer the securities to the charity at the surviving spouse's death and (2) a life insurance trust to benefit their children. The life insurance trust purchases a $120,000 insurance policy on Stan and Sophie's lives to replace the securities the charity will eventually receive. Everyone benefits. The charity will receive a substantial gift. The children will receive the $120,000 insurance proceeds income- and estate-tax free. Stan and Sophie receive a retirement income and an income-tax deduction for their charitable gift, and they remove the value of the securities and any future appreciation from their estates for estate- and capital gains-tax purposes.

Disability Planning

Who will manage your assets and make health-care decisions for you if you become incapacitated and can no longer handle these responsibilities yourself? Unless you plan ahead, the answer is a guardian or conservator appointed by a state court.

Living Trusts

A living trust avoids this situation. Your trustee simply continues managing your assets as your trust agreement directs. But not everyone is ready to delegate asset management responsibilities while they are still healthy.

Standby Trusts. If you prefer to manage your assets yourself, a standby living trust may be the strategy for you. With a standby trust, your trustee takes over management of your assets only if a predetermined event, such as your incapacity, occurs. You may reassume management of your assets if and when you recover from your incapacity.

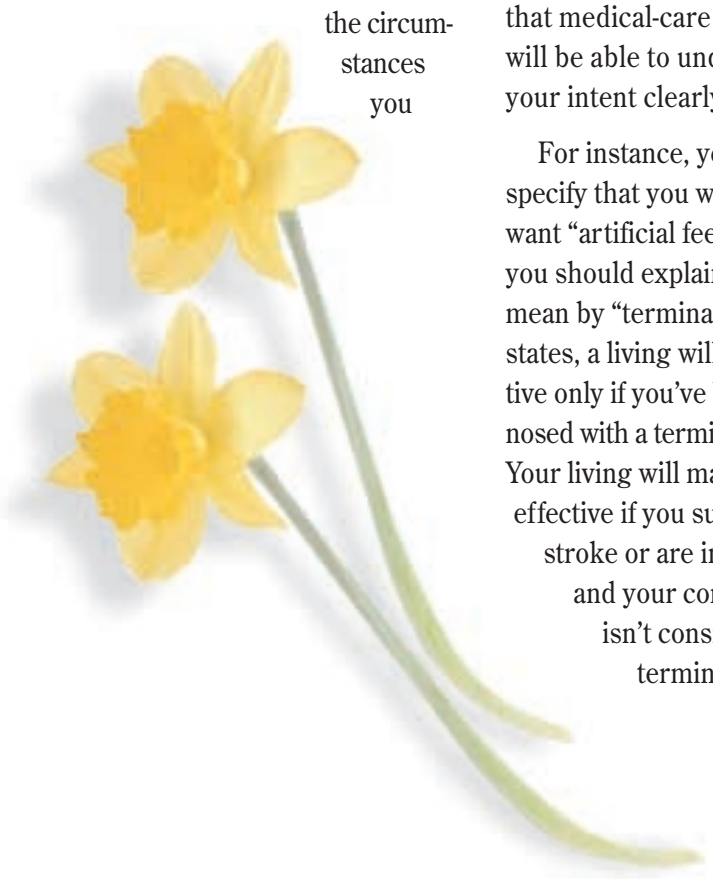
Self-Trusteed Trusts. An alternative might be to serve as trustee of your living trust, making sure you've named a successor trustee to take over management of your assets while you're incapacitated. That way, your assets will continue to be managed as you want with no interruption.

Health-Care Provisions

In addition, you may want to include disability and long-term-care insurance in your

estate plan to help preserve assets for your family and other heirs in the event you become incapacitated. A living will or durable power of attorney for health care helps ensure your wishes are carried out if you are unable to make health-care decisions yourself.

Living Wills. Basically, a living will speaks for you when you are unable to do so. Usually, the purpose of a living will is to express your desire not to receive extraordinary medical treatment. You determine the kind of medical care you want under the circumstances you describe. You should express your wishes in as much detail as possible so that medical-care providers will be able to understand your intent clearly.



For instance, you might specify that you would not want "artificial feeding" and you should explain what you mean by "terminal." In some states, a living will is effective only if you've been diagnosed with a terminal illness. Your living will may not be effective if you suffer a stroke or are in a coma and your condition isn't considered terminal.

Durable Powers of Attorney for Health Care. A durable power of attorney for health care — sometimes called a health-care proxy — designates someone else to make decisions for you if you are unable to make those decisions yourself. The scope of a durable power of attorney generally goes beyond that of a living will. While a living will usually is concerned with the withdrawal or withholding of life-support treatment in the event you become terminally ill, a durable power of attorney for health care can address nearly any health decision.

For Business Owners Only

Whatever type of business you own, you need to arrange in advance for the transfer of your business or partnership interest at your retirement, incapacity, or death. If family members will continue the business after your death, make sure enough cash will be available to cover estate tax (if applicable) and expenses. Otherwise, they may have to sell part or all of the business. Will your partners or fellow

shareholders buy your interest? A buy-sell agreement can help avoid unexpected surprises and make the transaction smoother.

Valuing Your Business

One of the first steps in business succession planning is to determine the value of your business — or revalue it if you haven't done so in a while. Your business may be the most valuable asset in your estate. Without proper planning, estate taxes may take a heavy toll at your death. Because of the lack of an open market, arriving at an appropriate value for stock in a closely held business can be a complex undertaking. Usually, the opinion of one or more independent appraisers is necessary.

What do business appraisers look at? The following are among the factors they consider when valuing closely held businesses:

- The nature of the business and its history,
- The financial condition of the company,
- The economic outlook of the industry in general,
- The book value of company stock,
- The company's earnings capacity,
- The dividend-paying capacity, and
- Stock prices of similar companies that are publicly held.

Buy-Sell Agreements

If you plan to sell your business to a family member, partner, employee, or an outside party, give serious consideration to using a buy-sell agreement. A buy-sell agreement:

- Provides for an orderly transfer of the business,
- Permits present co-owners and family members to continue in their business roles,
- Allows a fair market price for the business (or a formula for determining it) to be agreed upon today,
- Provides funds for the purchase, and
- Lets you plan your estate and taxes ahead of time.

Life insurance is a popular way to provide the cash needed to complete the buy-out. You also can use life insurance to provide your family with the funds needed to pay estate or capital gains tax.

Once the carryover basis rules are in place in 2010, the automatic sale of a business interest due to a buy-sell agreement will likely result in an immediate capital gains tax for the deceased owner's estate. Consequently, if you have a buy-sell agreement, you'll want to review it as the years count down to 2010.

Minority Discounts

Consider transferring stock in your closely held business to family members in small, non-controlling blocks. For gift- and estate-tax purposes, the value of minority interests may be discounted. The reason? Shares representing a controlling interest in a company are typically more valuable than minority interests. Individual minority shareholders generally can't influence the company's management.

How does the discount work? Let's assume you own all 100 shares of Company. An appraiser determines Company could be sold for $1 million. You give 20 shares of Company stock to each of your four children and keep 20 for yourself. Instead of valuing each gift at $200,000 (one fifth of the value of Company), a lower valuation may be possible. If a 25% discount is allowed on the transfers, some $90,000 in gift taxes could be saved (assuming a 45% gift- and estate-tax rate).

Be aware that if you transfer the stock in blocks that have a "swing vote" value, you may lose all or part of the discount. For example, if you give your two sons 30 shares each of Company stock and your two daughters 20 shares each, the boys' 30-share blocks may be considered more valuable because they could put their shares together and have a majority voting interest.

Minority discounts can be an effective way to transfer business interests at a lower tax cost. However, before attempting to use the strategy for your business interests, we strongly recommend you contact us for professional advice.

Family Limited Partnerships

In general, a family partnership strategy is most attractive to owners of unincorporated businesses. You might, for example, form a limited partnership with your children or other family members and continue to operate the business as the general partner. You could give limited partnership interests to the children or other family members tax free, using the gift-tax annual exclusion to avoid tax on the transfers, or you could avoid gift tax on the transfers by selling the interests to family members for adequate consideration.

As limited partners, your children would have no control over the business' management and would have limited legal liability for partnership debts and actions. For income-tax purposes, all partnership income, expenses, gains, losses, deductions, and credits would pass through to you and the limited partners. For estate-tax purposes, the value of the interests transferred to family members and any appreciation on those interests would be removed from your estate. Since the IRS closely examines these arrangements, professional advice is essential.

Family-Owned Business Deduction

For the time being, special estate-tax treatment is available for qualified "family-owned business interests" that make up more than 50% of a person's estate if certain other requirements are met. After 2003, the family-owned business deduction is repealed.

In general, estates that include such family-owned business interests may claim

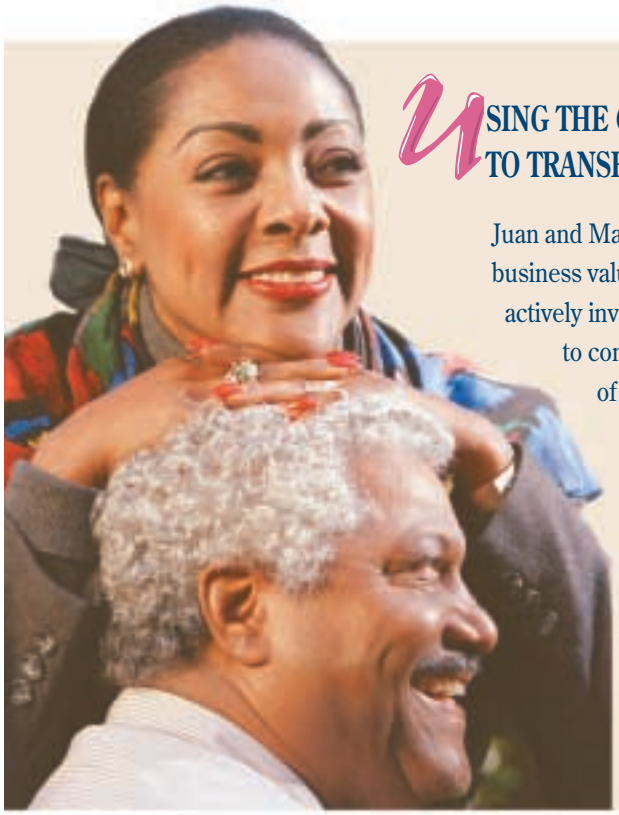
a deduction of up to $675,000 and an estate-tax credit exclusion amount of $625,000 (regardless of the year the business owner dies). Estates with business interests worth less than $675,000 can increase their credit exclusion amount dollar-for-dollar up to the exclusion amount in effect for the year of death.

To qualify, your business must have its principal place of business in the United States and be owned at least 50% by one family, 70% by two families, or 90% by three families. If owned by more than one family, your family must own at least 30% of the business. Your family also must continue the business. Other requirements apply. And, if your family sells the business to an outsider or another triggering event occurs within ten years of your death, additional taxes will be imposed to "recapture" a portion of the tax benefits of the deduction.

Trusts To Hold S Corporation Stock

If you're an S corporation shareholder, your stock may comprise a substantial portion of your total estate. When you die, your family or other heirs may not have the desire or expertise to manage your business. In this situation, you may want to create a trust in your Will to manage your business interest for your family or other heirs. Alternatively, you may transfer S corporation stock to a living trust that will continue after your death.

In either case, great care must be exercised in structuring the trust, since only certain types of trusts are eligible to hold S corporation stock. If you transfer your S corporation stock to a nonqualifying trust, the corporation's S status may be terminated with severe federal income-tax consequences. Thus, professional advice is highly recommended.



USING THE GIFT-TAX ANNUAL EXCLUSION TO TRANSFER BUSINESS INTERESTS

Juan and Maria, a married couple, are sole owners of a business valued at $900,000. Their son and daughter are actively involved in operating the business and plan to continue their involvement. Taking advantage of the gift-tax annual exclusion (and the gift-splitting election), Juan and Maria give each of their children $22,000 in company stock annually for six years, tax free. These tax-free gifts reduce Juan and Maria's combined estates by at least $264,000 because both the $264,000 in stock and any subsequent appreciation on that stock are removed from their estates.

When To Review Your Estate Plan

Everyday personal and family changes can make yesterday's well-devised estate plan wholly inadequate today. Consequently, you should be aware of events that may signal the need for an estate plan review and possible revision. Here are some to look out for:

- **Births.** You probably will want to consider the needs of a new child or grandchild in planning your estate.
- **Deaths.** The death of your spouse or another beneficiary can greatly affect your plan. So, too, can the death of your executor, your children's guardian, or your trustee.
- **Marriages.** If you marry, you most certainly will want to review your estate plan. When your children marry, you may want to revise your plan.
- **Divorces.** Most people review their estate plans if they divorce. But many fail to consider the effects of a beneficiary's divorce on that beneficiary's inheritance. For example, if your Will gives your son and his wife joint ownership in your home, think of the problems that could arise if they divorce and you don't revise your Will.
- **Moves Out of State.** If you move to a new state, your estate will be settled according to the laws of that state. Certain provisions of your estate plan that are valid in your current state of residence could be invalid under the laws of the new state. Also, having your executor and witnesses to your Will residing in a state hundreds or even thousands of miles away could hamper the administration and settlement of your estate.

- **Changes in Estate Composition.** A substantial increase or decrease in the value of your estate since you designed your estate plan may throw your plan out of kilter and make a review or revision necessary.
- **Business Changes.** Certain business changes signal time for an estate plan review. These changes include starting, buying or selling a business; entering into a buy-sell agreement that provides for the sale of your business interest when you die; changing your business' legal form; and the death of a business partner or another important member of your firm.
- **Tax Law Changes.** On average, the tax law changes every couple of years. Any changes in the law may make your estate plan outdated. The phaseout and eventual repeal of the estate and generation-skipping transfer taxes are prime examples.

The best way to keep your estate plan up-to-date is to review it on a regular basis. We would be happy to help. We can review your plan with you and your other professional advisors to determine whether changes are needed. We also can tell you more about the estate-planning strategies we've discussed here and how you can use them to help ensure your loved ones' future financial security.

Check Yourself

Are you on track with your estate planning? Use the following ten-point checklist to find out. Just answer each question "Yes" or "No." Does your estate plan:

1. Include an up-to-date Will?
2. Name a guardian for your minor children?
3. Name an executor (or personal representative) and trustee you are confident will carry out your wishes?
4. Take into consideration any special medical or educational needs certain family members may have?
5. Include provisions for long-term health care for you and your spouse and/or other dependents should the need arise?
6. Take advantage of the benefits of lifetime gifts?
7. Include charitable gifts?
8. Provide investment assistance for family members who may need help managing their inheritances?
9. Minimize taxes?
10. Provide for a smooth and tax-advantaged transfer of your business interests at your retirement or death or if you become disabled?

Every "No" answer may indicate a gap in your estate planning.

Glossary of Estate Planning Terms

Administrator
Person appointed by a court to manage the estate of a person who dies without a Will.

Beneficiary
A person designated to receive the income, principal, or proceeds of a trust, estate, insurance policy, or retirement plan.

Charitable trust
A trust having a charitable organization as a beneficiary.

Corporate fiduciary
An institution which acts for the benefit of another. One example is a bank acting as trustee.

Estate tax
The tax paid by the administrator or executor of a person's estate out of the estate's assets.

Executor (or personal representative)
Someone appointed by a person in a Will to carry out the Will's provisions. A "co-executor" acts as executor with another or others.

Fiduciary
A person in a position of trust or confidence. The fiduciary is bound by a duty to act in good faith. Examples: trustees, executors, and administrators.

Future interest
A property interest which cannot be currently possessed, used, or enjoyed.

Gift tax
Tax on gifts generally paid by the person making the gift rather than the recipient.

Gift-tax annual exclusion
The provision in the tax law that exempts the first $11,000 (as adjusted for inflation) in present-interest gifts a person gives to each recipient during a year from federal gift taxes.

Gross estate
The total value of an individual's property for estate-tax purposes.

Guardian
A person legally appointed to manage the rights and/or property of a person incapable of taking care of his or her own affairs. A "guardian ad litem" is appointed by the court to prosecute or defend an action for a minor. Also known as a "conservator."

Heir
A person entitled to inherit a portion of the estate of a person who has died without a Will.

Interest
Any right in property.

Intestate
Dying without a Will.

Joint ownership
The ownership of property by two or more persons, usually with the right of survivorship.

Life insurance trust
A trust that has the proceeds of a person's life insurance policy as its principal.

Living trust
A trust that goes into effect while the trust creator is still living.

Power of appointment
The authority given by one person to another under a trust agreement or Will to decide who will receive and enjoy an interest in property.

Power of attorney
A document which authorizes a person to act as another person's agent.

Probate
The proving of the validity of a Will.

Probate court
A court with the power to probate Wills and settle estates.

Probate estate
Those estate assets which fall within the jurisdiction of the probate court before being transferred to another person. Life insurance proceeds, for example, are not generally part of the probate estate.

Successor trustee or executor
An individual or institution which takes the place of a trustee or executor who can no longer hold office.

Testator
A person who makes or has made a Will.

Testamentary trust
A trust established in a Will which begins after the testator's death.

Trust
A legal relationship where property is transferred to and managed by another person or institution for the benefit of another person.

Trust agreement
The document which creates a trust and establishes the rules which control the trust's management.

Trustee
The person or institution entrusted with the duty of managing property placed in the trust. A "co-trustee" serves as trustee with another. A "contingent trustee" becomes trustee upon the occurrence of a specified future event.

Will
A legally executed document which explains how and to whom a person would like his or her property distributed after death.

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FX2002-0129-0004 REV. 1/02