

OVERVIEW OF ESTATE PLANNING

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OVERVIEW OF ESTATE PLANNING FOR CITIZENS AND RESIDENT ALIENS^{1/}

1. *Goals of Estate Planning*

1.1 *Minimizing Estate and Gift Taxes:* Proper tax planning can save hundreds of thousands (or even millions) of dollars in estate taxes if you recognize and take advantage of certain estate planning opportunities. Individuals or married couples with a net worth exceeding \$1 million should be concerned about these taxes.^{2/} There are three types of transfer taxes: estate tax, gift tax, and generation-skipping tax; all of these are discussed below, along with recent tax law changes.

1.2 *Disposition of your estate:* Most people want to pass their property on to their blood heirs; some wish to make charitable or other gifts. A properly drafted will or trust is necessary to ensure that your property will pass in the manner you desire.

1.3 *Avoiding probate:* Costs and delays of probate can be substantial, as discussed below.

1.4 *Other tax considerations:* Under current law, at death, property acquires a stepped-up basis for income tax purposes, resulting in the elimination of any capital gains tax. Proper planning can maximize this tax benefit.^{3/}

^{1/} Unless specifically stated otherwise, this discussion applies to U.S. citizens and resident aliens. The tax rules that apply to nonresident aliens differ substantially and are not addressed in this outline.

^{2/} This is the amount that an individual who died in 2002 can give away or bequeath free of estate and gift tax and is sometimes referred to as his "lifetime exemption." As a result of the Growth and Tax Relief Reconciliation Act of 2001, the lifetime exemption will not necessarily be the same for purposes of the estate and gift taxes. For gift tax purposes, beginning in year 2002, the exemption amount will be static at \$1 million but the exemption for estate tax purposes will increase in stages to \$3,500,000 in 2009 and the estate tax will be repealed for decedents dying in 2010. For estates of decedents dying after 2010, unless Congress takes some other action, the estate tax exemption will revert to \$1 million. See paragraph 3.2.2 of this outline.

^{3/} Effective in 2010, property passing from a decedent's estate takes a carryover basis, meaning it will have the basis of the decedent, but the estate may elect to step up basis by up to \$1.3 million. In addition, an additional \$3 million in basis step-up will be available to property transferred to a surviving spouse so that a total of \$4.3 million of basis step-up can be applied to transfers to a surviving spouse. This change from a full basis step-up to carryover basis is one that will make heirs vulnerable to capital gains taxes on appreciated assets, and will impose complicated record keeping on surviving family members. As mentioned, because of the sunset provision, this would only apply to decedents dying during 2010, but not to those dying in or after 2011 unless Congress acts to extend the repeal.

2. *Estate Tax*

2.1 The idea behind the estate tax is to tax an individual on the fair value of all property he owns at his death (generally up to the value of his interest in the property).

2.2 An individual often wishes to reduce the amount he or she is deemed to own at death. However, people often wish to achieve tax savings by reducing what they own without losing any of the benefits of their property.

3. *Estate Planning Techniques*

3.1 *Estate Planning for Married Couples*

3.1.1 There are two devices that Congress has provided estate planners which, if used properly, can avoid all estate taxes at the death of the first spouse to die. **Further, proper planning will allow husband and wife to pass a total of \$2 million^{4/} and more in the future to their heirs entirely free of estate tax.**

3.1.2 The two devices that can be used to accomplish these results are referred to as the "marital deduction" and the "applicable exclusion amount" (sometimes referred to as the "lifetime exemption") and are discussed below. The goal is to take full advantage of the lifetime exemption of each spouse; if the total estate exceeds either spouse's lifetime exemption (now \$1 million)^{5/} special trust provisions are needed.

3.1.3 The estate plan can be specifically tailored if a couple has children from former marriages, if they have a child with special needs, and for other non-tax related considerations.

3.1.4 If either (or both) of the spouses is not a U.S. citizen, special provisions must be included in the estate plan to avoid additional taxation, as discussed in paragraph 7.

3.2 *Unified Credit*

3.2.1 Under the current law, for federal estate and gift tax purposes, every individual is entitled to a "unified credit", currently, \$345,800.^{6/} This means that the first \$1 million of a person's taxable estate is not taxed. Above that amount, the marginal estate tax rates are significant, as shown by the table set forth below which reflects the 2002 rate structure:

^{4/} **For married couples, the changes made by the Growth and Tax Relief Reconciliation Act of 2001 mean that combined applicable exclusion amounts for a couple will increase per the following schedule: \$2,000,000 in 2002 and 2003; \$3,000,000 in 2004 and 2005; \$4,000,000 in 2006 through 2008; and \$7,000,000 in 2009. The estate tax is repealed for decedents dying in 2010. Unless Congress takes some action to extend this repeal, however, the exemption for a married couple would revert to \$2.0 million for decedents dying after 2010.**

^{5/} See paragraph 3.2.2.

^{6/} See paragraph 3.2.2 for scheduled increases in the applicable exclusion amount..

Amount of taxable estate:	A	B	C
	Estate Tax on amount in Col. A		Marginal tax rate on excess of amount in Col. A:
\$ 675,000	0		37%
\$ 750,000	\$ 27,750		39%
\$1 million	\$ 125,250		41%
\$1,250,000	\$ 277,750		43%
\$1,500,000	\$ 335,250		45%
\$2,000,000	\$ 560,250		49%
\$2,500,000	\$ 805,250		50%

3.2.2 The lifetime exemption currently represents an amount that can pass free of estate or gift taxes. It is not indexed for inflation. Any gifts made in excess of the annual gift tax exclusion during a person's life will cause a reduction in the lifetime exemption available at that person's death. As a result of the Growth and Tax Relief Reconciliation Act of 2001, the amount that can pass free of estate tax (but not gift tax) will increase according to the schedule below:^{2/}

Year	Applicable Exclusion Amount
2002 - 2003	\$ 1,000,000
2004 - 2006	\$ 1,500,000
2007 - 2008	\$ 2,000,000
2009	\$ 3,500,000

3.2.3 The importance of using the lifetime exemption to its fullest advantage can be illustrated by the following examples:

Example 1:

In 2002, husband ("H") and wife ("W") had, together, a combined community property estate of \$2.0 million. Under the community property laws, \$1.0 million of that estate is attributable to H, and \$1.0 million is attributable to W. If H died in 2002 leaving a Will that provides for his property to pass to W outright, or if H dies intestate so that the property, by operation of law, passed to W outright, there will be no estate tax on H's death. However, upon W's later death, W will be deemed to own \$2.0 million; i.e., her \$1.0 million of the community property and the \$1 million portion that she inherited from her husband. If W died in 2003, W's lifetime exemption will only be available to shelter from estate tax \$1.0 million of the community property. A tax will

^{2/} For gifts made and decedents dying between 2002 and before 2010, the maximum rate of tax will be as follows:

<i>In calendar year:</i>	<i>The maximum rate is:</i>
2002	50 percent
2003	49 percent
2004	48 percent
2005	47 percent
2006	46 percent
2007, 2008, and 2009	45 percent.

be imposed on the \$1.0 million that W inherited from H. This will amount to a tax of \$435,000.

Example 2:

If H had died leaving the property to W in a properly drafted trust (either a living trust or a testamentary trust), the result would be strikingly different upon W's death. At H's death, \$1 million would be exempt from estate taxes. However, on W's later death, W would not be deemed to own the property in the trust established by H; the trust would be deemed to own that property. Therefore, that property would not be taxed at W's death. W's lifetime exemption would be available to shelter the \$1 million portion of the property that W owned at her death. H and W could pass their entire combined estate to their children without incurring any estate taxes. **The tax savings would be \$435,000.**

3.3 *Unlimited Marital Deduction*

3.3.1 The marital deduction basically allows for estate taxes to be deferred on the death of one spouse for all property passing to the surviving spouse. The property might pass to the surviving spouse outright, or it might pass to the survivor in a trust that qualifies for the marital deduction. A legal life estate in property may also qualify for the marital deduction.

3.3.2 If the property passes in trust, it must be to a trust that qualifies for the marital deduction. The terms of such a trust must provide that the surviving spouse receive all of the income from the property. The trust will qualify for the marital deduction on the death of the first to die if, for example, the survivor has the power to give all of the property to whomever he or she desires (a "general power of appointment trust"). If the first spouse to die wishes to control the disposition of the property remaining in the trust at the surviving spouse's death, the trust must be drafted with other limiting provisions to allow it to qualify as a qualified terminable interest trust, or "Q-TIP trust."

3.3.3 If the surviving spouse is not a U.S. citizen, the marital deduction may be lost unless special steps are taken. See paragraph 7 of this outline.

3.4 *A-B-C Trust*

3.4.1 Using the techniques set forth above, estate planners typically recommend for their clients as a standard approach the use of an "A-B-C" Trust.

3.4.2 Generally, the A-B-C approach provides that the amount of the lifetime exemption will be held in trust for the benefit of the surviving spouse (the "A Trust") for his or her lifetime. The balance of the decedent's share of the property is distributed either outright to, or in trust (the "B Trust") for, the surviving spouse. The amount of the lifetime exemption held in trust will be sheltered from estate tax on both the death of the first spouse and the death of the second spouse (as illustrated in Example 2 of paragraph 3.2.3, above). The amounts in the B Trust (or passing outright to the surviving spouse) will qualify for the marital deduction, and estate taxes on those amounts will be deferred until the second spouse's death. The balance of the trust (the "C Trust") is often called the "Survivor's Trust" and consists of the surviving spouse's one-half interest in the couple's community property plus the survivor's separate property. This trust remains revocable and amendable during the lifetime of the surviving spouse, and it usually provides the surviving spouse with a general power of appointment.

4. *Gift Tax*

4.1 Without a gift tax, the estate tax would be ineffective. People would simply give away everything they owned just before they died so that they would not be deemed to own anything at death.

4.2 The gift tax was first enacted in order to tax people, generally, on their lifetime gifts to the same extent that they would have been taxed had they owned the property when they died.

4.3 However, Congress understood that people like to give gifts to others, and believed that there should be some allowance for making gifts free of tax. Therefore, the gift tax laws include provisions which allow each individual to give to an unlimited number of other individuals an amount equal to \$11,000 each year. This \$11,000 amount is referred to as the "annual exclusion." Husband and wife can join together to give \$22,000 to an unlimited number of individuals each year. There have been proposals in Congress to limit the number of annual exclusions available to a donor, but so far these proposals have not been enacted, and the annual exclusion was not affected by the Growth and Tax Relief Reconciliation Act of 2001. The annual exclusion is indexed for inflation to account for cost of living adjustments from 1997 but only adjusts in increments of \$1,000.

4.4 The gift tax rates are currently the same as the estate tax rates set forth in the table appearing in paragraph 3.2.1, above. In other words, a person can give away \$1 million (over and above the annual exclusions) during his lifetime without having to pay any gift tax, but if he does so, that amount of his lifetime exemption is not available at his death

4.5 As a result of the Growth and Tax Relief Reconciliation Act of 2001, the gift tax will continue to have an exemption of \$1 million whereas the exemption for estate tax purposes will exceed \$1 million for years after 2003. The same rates of tax apply for estate and gift tax purposes until 2010 when the estate tax is repealed.^{8/} These changes, together with the prospect of reinstatement of the current regime after 2010, will probably limit gift planning as a means of reducing anticipated estate taxes.

5. *Generation-Skipping Tax*

5.1 The generation-skipping tax was also enacted as a backup to the estate tax. The idea behind the generation-skipping tax was to impose a tax on each generation of family members regardless of the ability of estate planners to otherwise keep the decedent's property from being deemed to have been owned by him upon his death.

5.2 The following examples illustrate what is meant by the generation-skipping:

Example 3:

Assume that an individual ("A") dies leaving property outright to his son ("B"). Upon B's death, B's Will leaves his property to his daughter ("C"). The property will be subject to estate tax at A's death when the property passes to B, and again at B's death when the property passes to C.

^{8/} Until the estate tax is repealed, the gift tax rates will be the same as the estate tax rates, as specified in footnote 7. For 2010, the gift tax rates will be capped at the highest individual income tax rates; but as with the other provisions of the new law, this provision will sunset on 12/31/10.

Example 4:

Again assume that A dies leaving property to his son B. However, instead of leaving the property outright, A leaves the property in trust for B during B's lifetime. Upon B's death, A's Will (or living trust) provides that the property is to pass to granddaughter C. If the trust established upon A's death has been drafted properly, the trust property will not be deemed to be owned by B upon B's death. The property will be taxed at A's death when the property passes in trust to B, but there will be no estate tax on B's death when the property passes to C.

5.3 The result in Example 4, above, seemed inequitable to Congress. An individual who could afford to pay an estate planner to establish fancy trusts for him could avoid estate taxes on the assets used to fund those trusts on the deaths of his heirs for generations to come, while the families of someone who did not establish such trusts would be subject to estate taxes at each generation. To eliminate this perceived inequity, the generation-skipping tax was enacted. In Example 4, above, the generation-skipping tax would impose a tax roughly equivalent to the estate tax on the trust assets passing to C upon B's death. The generation-skipping tax, in effect, deems B to own the property in the trust upon B's death. (Note that the law also imposes a generation-skipping tax on gifts directly from A to C.)

5.4 There is a "generation-skipping tax exemption" for each individual. For calendar year 2002, this exemption is \$1,100,000 and is indexed for inflation using 1997 as the base year. To take advantage of this exemption, special provisions need to be drafted into the individual's will or living trust.^{2/}

6. *Other Planning Techniques*

6.1 *Lifetime Gifts:*

6.1.1 *Family Gifts:* An individual can reduce the size of his or her taxable estate by transferring assets to children and grandchildren. The basis of the property for income tax purposes carries over to the donee, so consideration must be given to the income tax effects if it is anticipated that the property will be sold.

6.1.1.1 *Annual Exclusion Gifts:* Each donor may transfer \$11,000 annually to an unlimited number of donees, without incurring any gift tax. This \$11,000 figure is subject to cost-of-living adjustments in \$1,000 increments. These gifts may be in trust if certain provisions (called "Crummey" powers) are included giving the donees a very limited right of withdrawal over the property transferred.

6.1.1.2 *Tuition, Medical Expenses:* In addition, a donor may directly pay tuition and medical expenses for any other person, without incurring any gift tax.

6.1.1.3 *Gifts Above Annual Exclusion:* In addition to the annual exclusion, a donor may transfer up to \$1 million (as of 2002) without incurring any gift tax (thereby using up his lifetime exemption). With proper planning, it may be possible to leverage the amount of the annual exclusion and lifetime exemption; for example, when gifts are made of

^{2/} For years after 2001, the generation skipping transfer tax exemption will be the same amount as the estate tax exemption, as specified in paragraph 3.2.2.

shares of a family business, the value of the shares may be discounted due to the lack of marketability and minority interest.^{10/}

6.1.1.4 *Non-Unified Credit Gifts:* In the past, when auditing estate tax returns, the IRS took the position that it was entitled to revalue the decedent's lifetime gifts for purposes of determining the rate of tax that should apply to the estate (which depends on the size of the estate after adding back lifetime gifts). This was so even if the gifts were adequately disclosed on timely filed gift tax returns and the gift tax statute of limitations (generally 3 years after the return is filed) had expired. Anticipating this issue, many practitioners previously suggested paying some gift tax, as this might preclude future revaluation by the IRS. The law has been changed to provide that the IRS may not revalue gifts made after August 5, 1997 if the gift tax statute of limitations has expired assuming the gift and its value were adequately disclosed on the gift tax return. Starting with gifts made in 1998, the gift tax statute of limitations will not start to run with respect to a gift that is not adequately disclosed, even if a gift tax return is filed for other transfers in the same year.

6.1.2 *Charitable Gifts:* Outright gifts to charity are exempt from estate and gift tax. There are a number of techniques for making charitable gifts which may result in both income tax and estate tax savings. "Split interest" gifts can be used to transfer property to a charity, while retaining a lifetime interest in the property donated. For example, an individual can donate property to a charity while retaining an income interest for life (a charitable remainder trust), or the individual can give the charity an income interest for a term of years, with the remainder going to the individual's heirs (a charitable lead trust). In either case, the individual may be entitled to a current income tax deduction for the portion of the assets passing to the charity. These trusts must have very specific provisions in order to qualify for the charitable deduction. Private foundations can also be established to receive charitable contributions.

6.2 *Irrevocable Life Insurance Trusts:*

6.2.1 Life insurance which is owned by the insured is subject to estate tax. In the larger estate, ownership of the life insurance policy by an irrevocable trust can result in very substantial estate tax savings, since it can entirely eliminate the estate tax on the proceeds of the policy. This can also be an effective way of ensuring that there will be liquid funds available to pay estate taxes through loans to the estate or purchasing illegal estate assets.

6.2.2 Life insurance which is applied for and owned by the trustee of an irrevocable trust is not included in the taxable estate of the insured, as long as the insured has no incidents of ownership in the policy (such as the ability to change the beneficiaries). Existing life insurance can also be transferred to such an irrevocable trust, although the insured must live for at least three years after the transfer in order to avoid taxation. Payments of premiums are considered taxable gifts to the trust unless special provisions are included to make the premium payments fall within the \$11,000 annual exclusion, as referred to in paragraph 4.3 above.

Example 5:

^{10/} Under the Growth and Tax Relief Reconciliation Act of 2001, the gift tax will have an exemption limited to \$1 million, even though the estate tax exemption is higher. Until the estate tax is repealed, the gift tax rates will be the same as the estate tax rates, as specified in footnote 8. For 2010, the gift tax rates will be capped at the highest individual income tax rate; but as with the other provisions of the new law, this provision will sunset on 12/31/10.

H and W have a \$5 million estate, most of which is in the form of a family residence and a closely-held business. As with previous examples, we assume that current law applies. Upon the death of the first to die, a \$1 million Exemption Trust is established. Following is a simplified comparison of the estate plan with and without an irrevocable life insurance trust (not attempting to take into account inflation and other outside factors):

Without Irrevocable Trust: Upon the death of the both H and W, there is a taxable estate of \$4.0 million, and the estate tax would be approximately \$1.4 million (possibly requiring the sale of the residence or the business). **The after-tax amount passing to the children is \$2.6 million plus \$1.0 million Exemption Trust set aside on the first death, for a total of \$3.6 million.**

With Irrevocable Trust: H and W create an irrevocable trust for the benefit of their four children. The trust purchases a life insurance policy which will pay \$1.6 million upon the death of the second to die, the premiums on which are \$80,000 per year for five years. H and W contribute a sufficient amount to the trust to pay the premiums; because the children have a limited right of withdrawal, such payments qualify for the annual gift tax exclusion. Upon the death of the second to die of H and W, the taxable estate is \$3.6 million (since the size of the estate has been reduced by the payment of the insurance premiums) and estate taxes are \$1.2 million. The irrevocable trust collects the death benefit of \$1.6 million, none of which is subject to estate tax, and purchases \$1.2 million in assets from the estate, giving the estate liquidity to pay the estate taxes, and pays the remaining \$400,000 to the beneficiaries. **The after-tax amount passing to the children is \$3.6 million from the estate plus \$1.0 million set aside on the first death plus \$400,000 from the trust, for a total of \$5.0 million.**

6.3 *Grantor Retained Interest Trusts:*

6.3.1 *GRATs and GRUTS:* An individual may transfer property to an irrevocable trust for a term of years, retaining an annuity (called a Grantor Retained Annuity Trust, or "GRAT") or a fixed percentage interest (called a Grantor Retained Unitrust, or "GRUT") in the trust. At the end of the term of years, the property passes to the designated beneficiaries and is not included in the Grantor's estate. (If the Grantor does not survive for the full term, a portion of the trust is includible in his or her estate.) This can be a way of "freezing" the value of the transferred property; if the actual income from the property transferred exceeds the amount of the annuity or unitrust interest retained by the Grantor, such growth of the trust is also excluded from the Grantor's estate, thereby leveraging the gift tax lifetime exemption, particularly when interest rates are low. While these techniques will still work under the 2001 reforms, they will probably be used for short term planning.

6.3.2 *Personal Residence Trust:* An individual may also create a "Qualified Personal Residence Trust" (or "QPRT") which owns a personal residence; if the transferor survives to the end of the term, the residence is then transferred to the transferor's beneficiaries at a value which is "frozen" at its value at the time of the transfer to the trust. If such a personal residence is sold during the term of the trust, then to the extent the sales proceeds are not reinvested in a personal residence within two years, the trust must either terminate and distribute all of its property to the term holder or be converted to a GRAT. An individual may create a QPRT for his or her principal residence and for one additional residence.

6.4 *Family Limited Partnerships and Family Limited Liability Companies:* A limited partnership is a partnership formed by two or more persons having one or more general partners who manage and control the partnership and one or more limited partners who are

essentially passive investors. Established in a family context, it allows senior family members (parents) to retain control and management of family assets while transferring wealth to junior family members (children) by giving them limited partnership interests at substantially discounted values for estate and gift tax purposes. Among the benefits of the family limited partnership are (1) substantial reductions in the estate and gift tax value of the partners' interests, (2) protection of family assets from a partner's creditors, (3) maintenance of management and control in the general partner, including the power to determine cash flow to the limited partners, (4) the ability to provide for management succession on the death or disability of the general partner, and (5) protection of family assets when a partner dies, becomes disabled, or has a marital dissolution. The Family Limited Liability Company (or "LLC") provides similar benefits utilizing an LLC in lieu of a limited partnership.

6.5 *Special Circumstances:* If an individual is a shareholder in a family business, business transactions such as cross-purchase or redemption agreements, purchase of split-dollar life insurance policies, and techniques to freeze the value of the stock should be investigated. For the larger estate, such techniques as private annuities, and generation skipping trusts, also known as "dynasty trusts," may be appropriate. If a major part of an estate consists of an interest in a closely held business, Internal Revenue Code §6166 permits estate taxes to be paid in installments over a period of up to ten years and new §2057 (which will be repealed in 2004) provides an additional deduction for certain qualified family-owned businesses. The additional deduction means that up to \$1,300,000 in value of such a business can be transferred without estate or gift tax (taking into account the decedent's lifetime exemption), but the maximum benefit of \$1,300,000 will not increase as the lifetime exemption increases. Special planning may be required to make sure that these benefits are available when needed.

7. *Special Considerations When Spouse Is a Non-U.S. Citizen*

7.1 *Marital Deduction Denied:*

7.1.1 As a general rule, the marital deduction is denied where property is left to a spouse who is not a U.S. citizen, unless the property is left to a "qualified domestic trust" ("QDT") and it otherwise qualifies for the marital deduction (e.g., is left in a Q-TIP trust - see paragraph 3.3.2 above). Alternatively, the spouse can preserve the marital deduction by becoming a U.S. citizen prior to the filing date of the federal estate tax return.

7.1.2 If the marital deduction is denied because of the non-U.S. citizenship of the surviving spouse and the property is still in the spouse's estate at the time of his or her death, the estate may receive a credit for all or a portion of the tax previously paid. However, failure to create a QDT upon the death of a U.S. citizen or resident with a non-U.S. citizen spouse could, effectively, cause a significant portion of a couple's assets to pass to the government upon the first spouse's death. This could leave the survivor in a desperate financial situation.

7.2 *Qualified Domestic Trust:*

7.2.1 A QDT requires a trust where at least one of the trustees is a citizen of the U.S or a domestic corporation, approval of the U.S. trustee or domestic corporation is required before principal may be distributed to the non-U.S. citizen spouse, and an election is made by the executor of the decedent (irrevocably) on the decedent's Federal Estate Tax Return to treat the trust as a QDT. In that circumstance, estate tax is deferred until the death of the surviving spouse, the date that the trust ceases to qualify as a QDT, or the date upon which distribution is made from the trust (except where the distribution is of income). If the value of the QDT assets exceed \$2,000,000, additional special provisions apply (including, e.g. a requirement that a bank be the U.S. trustee). As a result of the changes made by the Growth

and Tax Relief Reconciliation Act of 2001, no estate tax will be due if the surviving spouse dies after December 31, 2009 (but as with the other provisions of the new law, this one sunsets on December 31, 2010).

7.2.2 Any distribution from a QDT, other than a distribution of income, is taxed at a rate based on the decedent's estate tax rate, with certain adjustments. Where the decedent's estate tax has not yet been determined, the tax on a transfer from a QDT is at the top rate in effect for the year of the deceased spouse's death. Later, a claim for refund can be made. The tax is due on the 15th day of the 4th month after the transfer is made. Under the Growth and Tax Relief Reconciliation Act of 2001, no estate tax will be imposed on any distribution to the surviving spouse after December 31, 2020.

7.3 *Gifts:* The unlimited marital deduction is also denied as to lifetime gifts to a spouse who is not a U.S. citizen. No QDT exception applies. However, the annual exclusion for gifts made from a U.S. citizen or resident to his or her non-U.S. citizen spouse is \$110,000 for 2002 and this is indexed for inflation using 1997 as the base year.

7.4 *Foreign citizen domiciled or holding property in U.S.:* A foreign citizen domiciled in the United States is generally subject to the same federal estate tax rules as a U.S. citizen. A non-resident alien may be subject to estate taxes on U.S.-situs property. A complete discussion of the taxation of non-resident aliens is beyond the scope of this outline.

8. *Dispositions of Property at Death*

8.1 Property owned by an individual passes under his or her Will at death. If the person has no Will, it passes by intestacy under the laws of succession. Probate is the court procedure to transfer title to the decedent's assets pursuant to the will or by intestacy.

8.2 There are a number of ways of holding property so that it passes outside of probate. For example:

8.2.1 *Living Trust:* If all of the assets of a person (called the "trustor" or "settlor") are held by the trustee of a revocable inter vivos (or "living") trust, there is no need for a court proceeding upon the death of the trustor. The trustee named in the trust has the power to manage and distribute the trust estate according to the terms of the trust. The trustor of the trust usually acts as trustee during his or her lifetime.

8.2.2 *Joint Tenancy:* Property held in joint tenancy passes to the surviving joint tenant without any court action. There are income tax disadvantages to holding property in joint tenancy, since the surviving joint tenant does not get a stepped-up basis on the entire property. If the property passes outright to a spouse, it does not utilize the lifetime exemption of the decedent.

8.2.3 *Community Property:* Property held as community property may be confirmed to a surviving spouse by a relatively simple court proceeding, or can be held as community property with right of survivorship. This will result in a full stepped-up basis on the entire property, but does not utilize the lifetime exemption of the decedent. For a combined estate well under the lifetime exemption amount, this is probably the most cost-effective method of holding property.

8.2.4 *Beneficiary designation:* Life insurance, annuities, retirement plans, IRA accounts, and some bank and stock accounts may have beneficiary designations allowing distribution on death without any need for a court proceeding.

8.3 *Will or Trust?* All of the tax planning methods described above can be implemented either in a Will (creating a "testamentary trust") or in an inter vivos trust. Both have advantages and disadvantages, as discussed below.

8.3.1 *Initial cost:* The cost of preparing a Will with a testamentary trust is similar to the cost of preparing an inter vivos trust; however, there can be substantial legal work needed to transfer all of the assets to the trust (called "funding" the trust). This cost will vary according to the nature of the assets.

8.3.2 *Cost at death of trustor:* Statutory attorneys' fees in a \$1 million probate estate are \$23,000. For estates exceeding \$1 million, additional statutory fees are 1% of the next \$9 million in assets, 1/2 of 1% of assets above \$10 million and less than \$25 million and, in the case of estates worth over \$25 million, additional statutory fees are in the court's discretion. The attorney or accountant is entitled to additional fees for preparation of estate tax returns. If all of the assets are properly held in a trust, there should be relatively little legal work required in order to transfer assets at the death of a trustor, other than preparation of the estate tax return, resulting in substantial savings in attorney's fees.

8.3.3 *Delay:* A probate involves a delay in distribution of the estate of anywhere from six months to several years. A trustee of a living trust can act immediately to make support payments, pay debts of a decedent, distribute personal property, and manage the estate according to the terms of the Trust.

8.3.4 *Privacy and security:* The assets and disposition of a probate estate are open to public inspection, while a trust is a more private document. On the other hand, the supervision of a probate estate by the court protects the assets from possible misappropriation. Care should be taken to name a fair and trustworthy trustee.

8.3.5 *Creditors' claims:* In the past, some attorneys have not recommended living trusts because they did not afford the same protection against creditors as an estate that passes through probate. Changes in the law, however, have largely eliminated this advantage of probate. All claims against a decedent are barred one year after death.

8.3.6 *Administrative issues:* It takes some effort to keep a living trust properly funded; for example, the trustors must remember to take title to property in the names of the trustees, and some lending institutions may require additional documentation in order to make a loan secured by property held in a trust.

8.3.7 *Planning for Incapacity:* The trustee of a living trust can manage the Trust property in the event the trustor becomes incapacitated. This eliminates the need for a court-appointed conservator.

9. *Estate Planning Related Documents*

9.1 *Pourover Will:* If the estate plan is implemented through the use of a living trust, the trustor should execute a "pourover" Will, which directs that any assets not transferred to the trust during the trustor's lifetime are to be transferred to the trust at the trustor's death, to be administered according to the terms of the trust.

9.2 *Durable Power of Attorney:* A Durable Power of Attorney gives an agent broad powers to manage the principal's assets. It is effective even if the principal becomes incapacitated.

9.3 *Durable Power of Attorney for Health Care:* A Durable Power of Attorney for Health Care gives an agent the power to make health care decisions in the event the individual is unable to do so. It can specify the individual's desires concerning medical treatment, such as whether the individual would want to be maintained on life support if he or she is suffering from a terminal illness.

9.4 *Community Property Agreement:* When property is held as community property, upon the death of one spouse the property is entitled to a step-up in the basis for income tax purposes on the entire property; when it is held in joint tenancy, on the other hand, only the deceased spouse's one-half is entitled to a step-up in basis. Thus, if the surviving spouse desires to sell the property, he or she could be subject to a substantial capital gains tax on property acquired by joint tenancy survivorship, which tax could be avoided simply by holding the property as community property. A Community Property Agreement confirms the community property nature of a couple's assets; it can also confirm that some property is the separate property of a spouse.