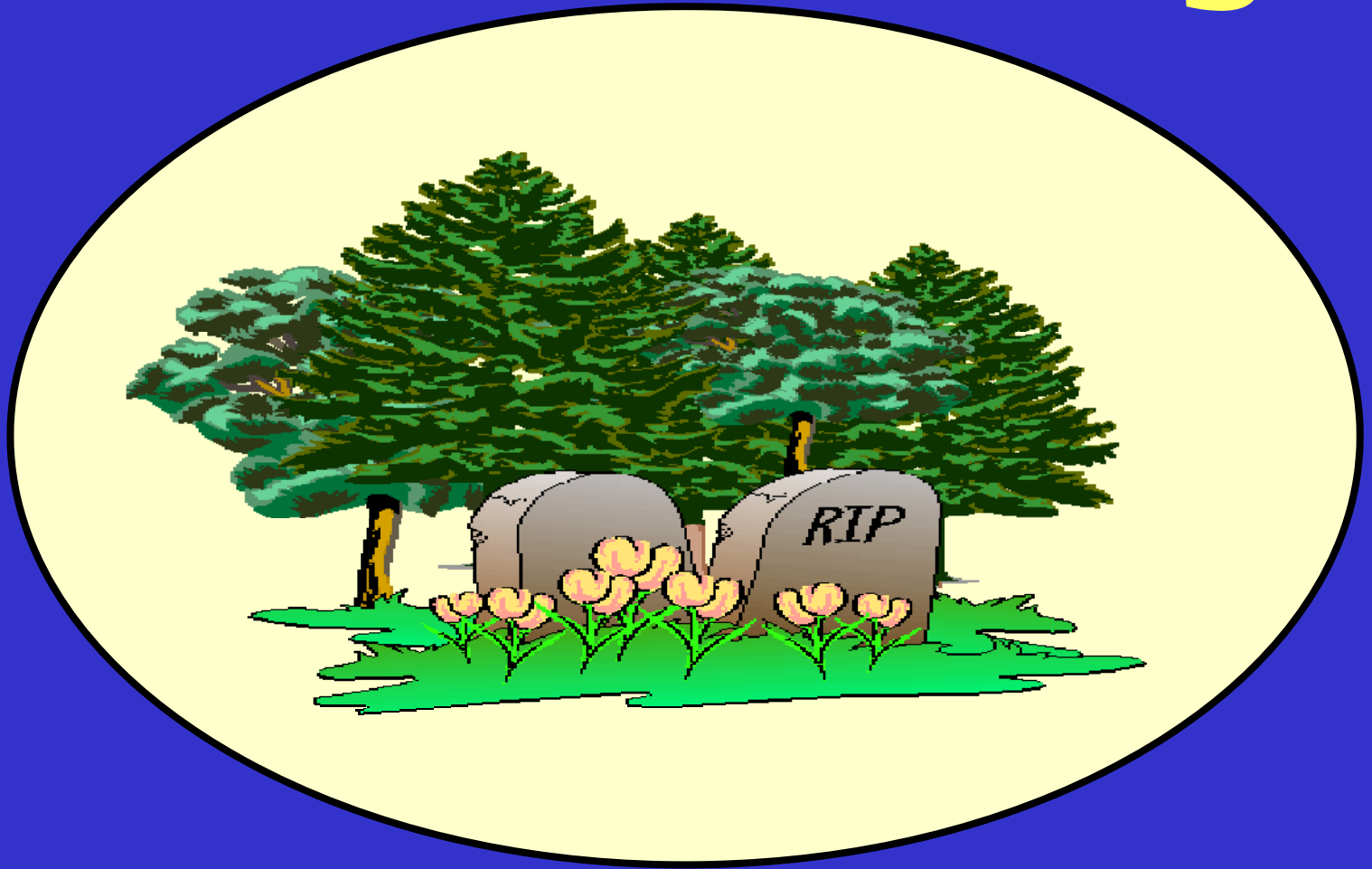


Estate Planning





Why Estate Planning?

1. Pre- and post-retirement security
2. Security, comfort of surviving spouse
3. Equitable treatment of children
4. Continuity of forest enterprise
5. Minimize transfer costs
6. Flexibility, durability of plan

Forestland and Estate Planning

Advantages:

- Value is not volatile
- Relatively low maintenance
- Both timber and land accrue value
- Returns are independent of the stock market
- Returns are taxable as capital gains

Forestland and Estate Planning

Disadvantages:

- Not a very liquid asset
- Income is irregular
- Timber prices may not keep pace during periods of high inflation
- Management knowledge is not readily available
- Can be difficult to obtain credit



Essential Steps in Estate Planning

1. Take stock
 - ✓ Of your heirs
 - ✓ Of your assets
2. Select a team
3. Develop your plan
4. Review it periodically

Taking Stock

1. Your heirs

- ✓ Lifestyle and financial needs
- ✓ Interest in participating in management of the forestland

2. Your assets

- ✓ Forestland and other
- ✓ Including legal description, form of ownership, value

Selecting Your Team

1. YOU
2. Attorney
3. CPA
4. Trust officer
5. CLU
6. Forester



Selecting Your Team

- 1. You:** Set objectives and ensure they are met
- 2. Attorney:** Coordinates process; provides legal expertise; drafts will and other legal documents
- 3. CPA:** Knows how income, gift, and estate taxes interact; files returns and other tax documents

Selecting Your Team

4. **Trust officer:** Knows trust options; provides expertise for you and survivors
5. **Chartered Life Underwriter:** Knows insurance options; expertise for you and survivors
6. **Forester:** Prepares management plan tailored to estate planning objectives





Developing Your Plan

1. Make sure your estate plan meets your needs and the needs of your heirs – cost-effectively
2. Best done in discussion with your heirs – your plan shouldn't be a total surprise to them

Reviewing Your Plan

1. Make sure the plan continues to meet your needs and the needs of your heirs
2. At least following changes in
 - ✓ Your holdings
 - ✓ Your family situation
 - ✓ The tax law



Uses of Wills

- 1. Appoint your personal representative (executor)**
- 2. Provide for the needs of your spouse, minor children, and/or special needs children**
- 3. Ensure that particular assets go to the people you want to have them (codicil)**



Uses of Wills

4. Provide for continuity of management for the forestland
5. Facilitate continuity of the forest enterprise
6. Make charitable bequests
7. Minimize taxes and probate expenses



Uses of Insurance

1. Provide funds for final expenses
2. Provide funds for income and/or estate taxes
3. Bypass probate proceedings
4. Provide funds in a way that is generally non-contestable
5. Protect business partners

Uses of Trusts

1. Retain management rights and/or income during lifetime while passing ownership to others
2. Ensure proper management after death
3. Reduce income, property taxes
 - ✓ To donor (you)
 - ✓ To heirs



Estate Planning Tools

General:

- Annual exclusion for gifts
- Bequests (“stepped up” basis)
- Marital deduction
- Effective exemption amount for large gifts
- Effective exemption amount for estates



Estate Planning Tools

Specific:

- “Special use” valuation
- Exclusion for land subject to a qualified conservation easement

Estate Planning Toolkit



[CartoonLibrary\RollingItOver.ppt](#)

Adapted from GTR SRS-112

“Estate Planning for Forest Landowners ... ,”

by Siegel, Haney, and Greene

Estate Planning Toolkit

- ▶ **Just an introduction to a complex area of law**
- ▶ **Intent is to familiarize you with some basic estate planning tools – won't make you one-person estate planning team**
- ▶ **Focus is on tools of special interest to forest landowners**

Other options may be better suited to other types of assets

Gifts

- ▶ **The giving of money or property by one person to another during the donor's lifetime**
 - ✓ **Gifts of money or property are not taxable to recipients at the federal level, but they may be taxable to the donor**
 - ✓ **NOTE: Gifts of income or income from gifts of money or property ARE taxable to recipients**

Gifts

- ▶ **Gifts with a value less than or equal to the annual exclusion are not taxable to the donor and do not count toward the effective exemption amount for gifts (IRC sec. 2503(b))**
 - ✓ **TRA indexed exclusion to the Consumer Price Index after 1998, with increases in \$1,000 increments**
 - ✓ **From 2006–2008 was \$12,000 per year (\$24,000 for married couples making a “split gift”)**

Gifts

- ✓ For 2009–2010 is \$13,000 per year (\$26,000 for married couples making a “split gift”)
- ▶ You – and your spouse – can make excludable gifts to as many different persons each year as you wish
- ▶ You also can make as many larger gifts as you wish, but they will count against the effective exemption amount for gifts

Gifts

- ▶ **In addition, there is an UNLIMITED exclusion for qualifying gift payments of educational or medical costs (IRC Sect. 2503(e))**
 - ✓ **Educational – Only for tuition paid to a qualifying educational organization; you must pay the organization, not the student**
 - ✓ **Medical – Only for qualifying medical costs not reimbursable by insurance; you must pay the provider, not the patient**

Gifts

- ▶ **And an UNLIMITED exclusion for gifts to qualifying charitable organizations (IRC Sect. 2522)**
 - ✓ **Units of federal or state government;**
 - ✓ **Religious, charitable, scientific, literary, or educational organizations**
 - ✓ **Veterans' organizations incorporated by act of Congress**
 - ✓ **Units of state government and fraternal societies (for qualifying gifts)**

Gifts

▶ Advantages:

- ✓ Permits you to transfer ownership of assets to persons of your choice during your lifetime
- ✓ Enables you to transfer – and fix the value of for gift tax purposes – assets that are appreciating rapidly in value

Gifts

▶ Disadvantages:

- ✓ May be hard to divide some assets – like forest land – into small enough pieces
- ✓ The recipient does not get a step-up in basis, as with inherited assets
- ✓ Some gifts made within 3 years of death may be pulled back into the estate – incomplete gifts, gifts of life insurance policies

Bequests

- ▶ **The giving of money or property by one person to another after the donor's death, through a will or under intestacy** ② [CartoonLibrary\BadHeirDay.ppt](#)
- ✓ **Bequests of money or property are not taxable to recipients at the federal level, but may be taxable to the decedent's estate**
- ✓ **NOTE: Bequests of income or income from bequests of money or property ARE taxable to recipients**

Bequests

- ▶ **A recipient's basis in an inherited asset is its fair market value on the valuation date (IRC sec. 1014 (a)(1))**
 - ✓ **Usually results in a "stepped-up" basis**

Bequests

- ▶ **Valuation date is decedent's date of death OR earlier of 6 months after death or the date any estate asset is sold (alternate valuation date)**
 - ✓ **Alternate valuation date may be used if it lowers the estate value AND the estate tax due**
 - ✓ **But if used, it must be used for ALL estate assets, not just some**

Bequests

▶ Advantages:

- ✓ If done using a will, the ability to designate the recipients of specific assets
- ✓ Stepped-up basis, which results in less taxable income to the recipients if the assets are sold

Bequests

- ▶ **Disadvantage:**

- ✓ **Inability to guide or train the recipient in managing the asset**

Marital Deduction

- ▶ **An unlimited deduction allowed for the value of all property passed from one spouse to the other, whether as lifetime gifts or a bequest (IRC sec. 2056(a))**
- ▶ **Advantages:**
 - ✓ **Recognizes role of both spouses in contributing to the family's assets**
 - ✓ **Permits assets to pass untaxed to the surviving spouse**

Marital Deduction

▶ **Disadvantage:**

- ✓ **Does not eliminate or reduce estate tax, but simply postpones it to the time of the second spouse's death**

Considerable disadvantage if the assets appreciate greatly in value during the time between the two deaths

Effective Exemption Amount

- ▶ **PART I: From 1971 through 2001, the federal estate and gift taxes were combined into a “unified” tax on the value of a decedent’s estate, plus the value of any lifetime gifts above the annual exclusion that he or she made**

Effective Exemption Amount

The “unified credit,” a credit against tentative estate tax due, effectively exempted a portion of the combined values from federal tax (IRC sec. 2010)

- ✓ The effective exemption – \$600,000 through 1997 – shielded all of smaller estates and a portion of larger estates from the federal tax

Effective Exemption Amount

- ▶ **PART II: EGTRRA set separate effective exemption amounts for gifts and estates**

Set the effective exemption amount for lifetime gifts at \$1 million beginning in 2002

- ✓ **No provision for increases or adjustments for inflation**

Effective Exemption Amount

- ✓ **Once cumulative value of gifts above the annual exclusion that a taxpayer makes reaches \$1 million, he or she will owe federal gift tax on any additional gifts above the annual exclusion they make, year-by-year**

Effective Exemption Amount

- ▶ **EGTRRA also set the effective exemption amount for estates at \$1 million beginning in 2002, but scheduled it to increase in steps**
 - ✓ **Shielded amount increased to \$1.5 million for 2004–2005**
 - ✓ **\$2 million for 2006–2008**
 - ✓ **\$3.5 million for 2009**
 - ✓ **\$∞ so far this year, but WILL CHANGE**

Bipartisan Estate Tax Bills

- ▶ **Currently 27 estate tax bills in House and Senate**
- ▶ **H.R. 3905 – Would gradually decrease top estate tax rate to 35% and increase effective exemption amt. to \$5 million, with inflation adjustments after 2010, but no “portability” (17 cosponsors)**
- ▶ **S. 2784 – Would set top estate tax rate at 45% and effective exemption amt. at \$3.5 million – with inflation adjustments after 2010 – with “portability” (2 sponsors)**

Effective Exemption Amount

- ▶ **NOTE: Although gifts and estates have separate effective exemptions amounts, they are still tied together**

Effective exemption amount for estates is reduced by any portion of effective exemption amount for gifts a decedent used during his or her lifetime

Effective Exemption Amount

- ▶ **As well, EGTRRA decreased the top rates for federal estate and gift taxes in steps until they reached 45% in 2007**
 - ✓ **In 2010, it repealed the federal estate tax, set the top tax rate for gifts equal to the top tax rate for individual income, and put in place complex rules and limits for stepped-up basis**
 - ✓ **But EGTRRA itself is scheduled to “sunset” after 2010, returning us to a \$1 million unified exemption amount and a 55% top tax rate**

Effective Exemption Amount

▶ Advantages:

- ✓ The amount shielded from the federal estate tax increased through 2009
- ✓ Permits at least part of a family's assets to pass untaxed from one generation to another
- ✓ Reduces the pressure to fragment holdings or liquidate timber in order to pay federal taxes

Effective Exemption Amount

▶ **Disadvantage:**

- ✓ **Families headed by married taxpayers have the opportunity to use the effective exemption amount for estates at the death of each spouse, but often miss it due to inadequate planning**

Special Use Valuation

- ▶ **Under certain conditions, an executor may elect to reduce the value of an estate for federal estate tax purposes by valuing estate assets used for farming or in a trade or business according to their value in actual use rather than their highest and best use (IRC sec. 2032A)**

Special Use Valuation

- ✓ Before 1998 the amount by which special use valuation could reduce the taxable value of an estate was set at \$750,000 for many years
- ✓ TRA indexed the amount to the Consumer Price Index after 1998, with changes made in \$10,000 increments

Special Use Valuation

For 1999 the amount was \$760,000

For 2000 the amount was \$770,000

...

For 2008 the amount was \$960,000

For 2009 the amount was \$1,000,000

For 2010 it is \$...

Special Use Valuation

▶ Advantages:

- ✓ Reduces the federal estate tax due
- ✓ Reduces pressure to fragment holdings or liquidate timber, and helps ensure the passing of a family enterprise intact from one generation to another

Special Use Valuation

▶ Disadvantages:

- ✓ There are stringent requirements to qualify for and remain under the provision, including the inability to harvest special use-valued timber for 10 years
- ✓ Separate elections – on separate forms – are required for land and timber:

Special Use Valuation

Elect to use special use valuation by checking the “Yes” box on Form 706

Elect to special use-value timber by checking the woodlands election box on Schedule A-1, Part 2

Special Use Valuation

▶ **To be valid:**

- ✓ **The decedent must have been a U.S. citizen or resident, and the property must be located in the U.S.**
- ✓ **The property must be transferred to a qualified heir: ancestor, spouse, or lineal descendent of the decedent, or of the decedent's parents, spouse, or lineal descendent**

Special Use Valuation

- ✓ **The property must have been owned by the decedent and/or a member of his or her family for at least 5 of the last 8 years before the decedent's death**
- ✓ **The property must have been used for farming – including timber production – or a closely-held business purpose and must have been devoted to that use at the time of the decedent's death**

Special Use Valuation

- ✓ **The decedent, or a member of his or her family, must have held an equity interest and materially participated in the operation of the property at the time of the decedent's death and for at least 5 of the last 8 years before the decedent's death**

The 8 years before the decedent became disabled or began receiving Social Security ...

Special Use Valuation

... benefits may be substituted for the 8 years before death, as long as payments continued until the decedent's death

NOTE: Property that has been under a cash lease may not meet this requirement

Special Use Valuation

- ✓ **The total property qualifying for special use valuation must constitute 50 percent or more of the decedent's estate, when valued at its fair market value**
- ✓ **25 percent or more of the adjusted value of the gross estate must be qualified real property and must have passed from the decedent to a qualified heir**

Special Use Valuation

- ✓ **Non-qualified property cannot have been gifted by the decedent within 3 years of his or her death in order to meet the 50- or 25-percent tests**
- ✓ **All heirs with an interest in the qualifying property must sign an agreement to use special use valuation, which must be filed with the estate tax return**

Special Use Valuation

- ✓ **For 10 years following the decedent's death (or 12 years if the full allowable 2-year grace period is used):**

The decedent's family or qualified heir must retain full ownership of the property, except in the event of an involuntary conversion or like-kind exchange

Special Use Valuation

At least one heir must materially participate in management of the property in at least 5 of every 8 years

The qualified heir must retain an equity interest in the property, and it must be managed and used for the qualified use

Special Use Valuation

- ▶ **The estate tax saved is subject to recapture if:**
 - ✓ **The qualified use is discontinued within 10 years of the decedent's death**
 - ✓ **Any special use-valued asset is sold within 10 years of the decedent's death**
- This includes the sale of special use-valued timber, even if the sale is made ...**

Special Use Valuation

... in accordance with an existing management plan

NOTE: EGTRRA specified that the net cash lease of special use-valued property by a lineal descendent of the decedent does not invalidate special use valuation

Now THAT was clear, WASN'T it?

Exclusion for Interest in a Family-Owned Business

- ▶ **For estates of decedents dying after 1997, if 50% or more of the estate consisted of interest in a qualified family-owned business, the executor could elect to exclude up to \$1.3 million of the interest from the value of the estate for estate tax purposes (IRC sec. 2033A)**

The provision was eliminated in 2004, when the effective exemption amount for estates increased to \$1.5 million

Exclusion for Land Subject to a Qualified Conservation Easement

- ▶ **For the estates of decedents dying after 1997, the executor may elect to exclude from the value of the estate for federal estate tax purposes up to 40 percent of the value of land subject to a qualified conservation easement (IRC sec. 2031(c))**
 - ✓ **Another provision added by TRA**

Exclusion for a Qualified Conservation Easement

- ✓ **Amount of the exclusion is capped:**
TRA set it at \$100,000 for 1998, but scheduled it to increase in steps until it reached \$500,000 in 2002
- ✓ **Further, the 40% max percentage exclusion is reduced by 2% for each for each percentage point (full or part) by which the value of ...**

Exclusion for a Qualified Conservation Easement

... the easement is less than 30% of the value of the land

Determined without regard to the value of the easement

and

Reduced by the value of any retained development right

Exclusion for a Qualified Conservation Easement

▶ Advantages:

- ✓ Reduces the estate tax due
- ✓ Reduces the pressure to fragment holdings or liquidate timber, and helps ensure the passing of a family enterprise intact from one generation to another

Exclusion for a Qualified Conservation Easement

▶ **Disadvantage:**

- ✓ **The basis in excluded land is not stepped up, but remains the same as the decedent's basis**

Exclusion for a Qualified Conservation Easement

▶ **To be valid, must be:**

✓ **Donated to a qualified organization:**

- **Unit of Federal, State, or local gov't**
- **Publicly-supported charitable, religious, scientific, educational, or similar organization**
- **Organization controlled by, operated for exclusive benefit of a unit of gov't or publicly-supported charity**

Exclusion for a Qualified Conservation Easement

- ✓ **For one of four conservation purposes:**
 - **Preservation of areas for outdoor recreation by or education of the general public**
 - **Protection of a relatively natural habitat for fish, wildlife, plants, or a similar ecosystem**
 - **Preservation of open space – including forest and farmland – for scenic ...**

Exclusion for a Qualified Conservation Easement

... enjoyment by the general public, or pursuant to clear conservation policy of the Federal, State, or local government

- Conservation of an historically important land area or certified historic structure**

Exclusion for a Qualified Conservation Easement

- ✓ **And must consist of a qualified real property interest:**
 - **Your entire interest in real estate other than a mineral interest**
 - **A remainder interest**
 - **A perpetual restriction on how the property may be used**

Exclusion for a Qualified Conservation Easement

- ✓ **TRA required that the land subject to the conservation easement be located within 25 miles of a metropolitan area, national park, or wilderness area, or within 10 miles of an urban national forest (never defined)**
- ✓ **EGTRRA eliminated this requirement, so any land subject to a conservation easement qualifies, regardless of location**

Disclaimer

- ▶ **An unqualified and irrevocable refusal by a recipient to accept a donor's gift, or by a beneficiary to accept property during probate (IRC sec. 2518)**

Disclaimer

▶ Advantage:

- ✓ Lets the transferee – for example, a surviving spouse – permit property he or she does not need pass on to others – for example, children – without the property entering his or her estate

▶ Disadvantage:

- ✓ The transferee loses all control over or benefit from the disclaimed property

Disclaimer

▶ **To be valid:**

- ✓ **The refusal must be in writing**
- ✓ **It must be received by the transferor or his or her representative within 9 months after the date of transfer or the date the transferee becomes 21 years of age**
- ✓ **For transfers at death, the 9 month period begins on the date of death, not the date of probate**

Disclaimer

- ✓ **The transferee must not have accepted the property or any of its benefits**
- ✓ **Merely taking delivery of title does not indicate acceptance, but doing any of the following DOES:**
 - **Using the property or an interest in it**
 - **Accepting dividends or interest**
 - **Accepting rents from property**

Disclaimer

- **Directing others to act with respect to the property or an interest in the property**
 - **Directing who the property is to go to other than him or herself**
- ▶ **NOTE: A disclaimer of property held in joint tenancy with the right of survivorship must be made within 9 months of entering the joint tenancy (That is, in this case, disclaimer is not available to long-married couples)**

Deferral and Extension of Estate Tax

- ▶ **If interest in a closely-held business accounts for more than 35 percent of a decedent's estate, the estate tax on the business portion of the estate can be deferred for 4 years after the estate tax return is filed, with only interest payments due, then paid in up to 10 annual installments (IRC sec. 6166)**

Deferral and Extension

- ✓ **No deduction is allowed for the interest payments, either as an estate administration expense or as an income tax deduction**
This eliminates the need to file supplemental estate tax returns

Deferral and Extension

- ✓ **TRA and EGTRRA did not directly change the deferral and extension provisions for the federal estate tax**
- ✓ **But TRA reduced the interest rate on the amount of deferred estate tax, to 2% for the first \$1 million in taxable value of the business interest and 45% of the rate applied to tax underpayments for any additional amounts**

Deferral and Extension

- ✓ **And EGTRRA increased the maximum number of partners or stockholders to qualify for a closely-held business from 15 to 45**

EGTRRA also made the extension provision available to closely-held lending and financing businesses – but for 5 years, not 10

Deferral and Extension

▶ Advantages

- ✓ Reduces the pressure to fragment holdings or liquidate timber, and helps ensure the passing of a family enterprise intact from one generation to another
- ✓ Reduces the need to disrupt an established forest management plan in order to pay the federal estate tax

Deferral and Extension

- ✓ **The interest imposed on deferred payments is sharply reduced compared to 4% or more as under the previous law**
- ▶ **Disadvantage:**
 - ✓ **None, but both the original House and Senate versions of TRA would have permitted payments to be extended over 20 years**

Other Tools

- ▶ **Estate planning professionals have developed a variety of other tools – not specifically provided in the IRC – to facilitate intergenerational transfers of family assets**
- ▶ **Detailed discussion is beyond the scope of this workshop, but a brief sampling will illustrate the variety of tools available**

Other Tools

- ▶ **Forms of business organization**
 - ✓ **Family Limited Partnership (FLP)**
 - ✓ **Limited Liability Company (LLC)**
- ▶ **Trusts**
 - ✓ **Lifetime: revocable, irrevocable**
 - ✓ **Testamentary**
- ▶ **Generation-skipping transfer**
- ▶ **Retained life estate**

Forms of Business Organization

- ▶ **Two forms of organization are becoming popular as means to transfer ownership of forestland and create interest in its continued management:**
 - ✓ **Family Limited Partnership (FLP)**
 - ✓ **Limited Liability Company (LLC)**

Family Limited Partnership

- ▶ **A type of limited partnership, a pass-through entity for income tax purposes**
 - ✓ **The general partners – for example, parents – retain management rights, but can transfer ownership to the limited partners through gifts, which can be discounted for minority interest and/or lack of marketability**

Family Limited Partnership

- ✓ **The limited partners – for example, children – are not personally liable for partnership debts; their total liability is limited to their investment in the partnership**
- ✓ **NOTE: There is no step-up in the basis of forestland or timber transferred to limited partners by means of an FLP**

Limited Liability Company

- ▶ **A hybrid between a corporation and a partnership**
 - ✓ **Like a corporation, members' liability is limited to their investment**
 - ✓ **Like a partnership, an LLC is a pass-through entity for income tax purposes**

Limited Liability Company

- ✓ **But unlike a corporation, state law usually permits an LLC to customize allocation of profits and losses to its members**
- ✓ **Also, neither the LLC nor the member recognizes gain or loss if the LLC distributes appreciated property to the member**

Limited Liability Company

- ✓ Unlike a partnership, an LLC member can materially participate in management – so that income and losses passed through to him or her are active rather than passive – without risking unlimited liability as a general partner
- ✓ NOTE: Again, there is no step-up in the basis of forestland or timber transferred to members by means of an LLC

Lessons Learned

- ▶ **But BE AWARE the IRS is attacking FLPs and LLCs under IRC section 2036(a) as tax avoidance devices that lack economic substance**
- ▶ **The lessons learned in the cases – for example, Harper (2002), Strangi II (2003), Kimbell (2004), Thompson (2004) – include:**

Lessons Learned

- ▶ **The FLP/LLC must be able to show “substantial business and other non-tax reasons” for formation:**
 - ✓ **FLP/LLC assets should be monitored and actively managed;**
 - ✓ **Management should be consistent with the purposes set forth when the FLP/LLC was set up;**
 - ✓ **All required tax returns should be filed**
 - ✓ **It is better that the FLP/LLC manage operating business assets than passive assets**

Lessons Learned

- ▶ **The partners/members should give actual consideration in return for their interest in the FLP/LLC:**
 - ✓ **Non-cash assets should be re-titled to the FLP/LLC, with all i's dotted and t's crossed;**
 - ✓ **Each partner/member's share of the overall interest, their earnings, and their tax implications should be proportional to the amount of consideration they give**

Lessons Learned

- ▶ **The FLP/LLC must be maintained as a separate entity:**
 - ✓ **The partners/members should retain assets outside the FLP/LLC sufficient for their support over their expected lifetime;**
 - ✓ **There can be no commingling of personal and FLP/LLC assets**

Trusts

- ▶ **An arrangement by which a person or entity called the trustee holds legal title to designated property in trust and manages it for the benefit of one or more beneficiaries**
 - ✓ **A trust is a separate legal entity under both federal and state law**
 - ✓ **The rules governing administration of the trust come from federal law, state law, and the provisions of the trust instrument**

Trusts

- ▶ **You can create a trust during your lifetime or upon your death**

Lifetime Trusts

- ▶ **A LIFETIME TRUST is created during your lifetime, and can be revokable or irrevokable**
 - ✓ **Major use of a revokable trust is to try out provisions and make changes**
 - ✓ **Because you can change or terminate the trust at any time there are no tax savings, although the trust property is not subject to probate**

Lifetime Trusts

- ✓ **Under an irrevokable trust you permanently relinquish control of the trust property**
- ✓ **There may be gift tax implications, but the trust property is removed from your estate**

Testamentary Trusts

- ▶ **A TESTAMENTARY TRUST is created at your death, according to instructions in your will**
 - ✓ **Generally, you would use a testamentary trust if you are unwilling to give up control of the trust property during your lifetime**
 - ✓ **The cost of retaining control is that the full fair market value of the trust property is included in your estate**

Testamentary Trust

- ✓ **The advantage of a testamentary trust is that it can protect the trust property from successive estate tax levies while the income is utilized by successive generations of beneficiaries**

Four Kinds of Trusts and What They Do

- ▶ **Irrevocable Life Insurance Trust (ILIT): Removes a life insurance policy from your ownership without giving control of it to a beneficiary**
- ▶ **Pourover Trust: Receives and accumulates payments from various sources as they occur over time following your death**

Four Kinds of Trusts

- ▶ **Marital Deduction Trust: Provides for the surviving spouse while directing assets up to the effective exemption amount that he or she does not need to other heirs – for example, children – permitting use of the effective exemption amount at the death of both spouses**

REMEMBER: The effective exemption amount was \$3.5 million for 2009

Four Kinds of Trusts

- ▶ **Qualified Terminal Interest Property (Q-TIP):** A type of marital deduction trust that provides for the surviving spouse while controlling disposition of the trust property remaining after his or her death – useful with blended families



Other Tools

- ▶ **There are many more types of trusts and other tools available for you to use in estate planning, including:**
 - ✓ **Crummey Trust**
 - ✓ **Charitable remainder trust**
 - ✓ **Grantor Retained Interest Trust (GRIT)**
 - ✓ **Grantor Retained Annuity Trust (GRAT)**
 - ✓ **Grantor Retained Unitrust (GRUT)**

Other Tools

- ✓ **Generation-skipping transfers**
- ✓ **Conservation easements**
- ✓ **Retained life estate**
- ▶ **Your estate planning team will help you understand and apply them**

Economic Advantage of Estate Planning

Adapted from GTR SRS-112

“Estate Planning for Forest Landowners ... ,”

by Siegel, Haney, and Greene

Economic Advantage of Estate Planning

- ▶ **We will use an example to show the benefit of using – or the cost of not using – estate planning**
- ▶ **The example follows a hypothetical family with forestland as its primary asset through the death of both parents, to show the full cost of transferring family assets from one generation to another**

Hypothetical Family

- ▶ **The family consists of a husband and wife, 3 children, and 5 grandchildren**
- ▶ **The husband and wife are in their 80s, retired, and living from their investments in forest management and stocks**

Family Assets

- ▶ **The couple's joint estate consists of:**
 - ✓ **A house and lot with a fair market value of \$300,000**
 - ✓ **A forest holding consisting of 2,000 acres of land – the fair market value of the land alone is \$3 million, but its value in its current use is only \$1 million, plus**
 - ✓ **Timber valued at \$5 million**

Family Assets

- ✓ A \$500,000 insurance policy on the husband with a cash value of \$200,000
- ✓ A \$200,000 insurance policy on his wife with a cash value of \$100,000
- ✓ Stocks valued at \$1 million

Hypothetical Family

- ▶ **In addition, it is assumed:**
 - ✓ **All assets – plus \$700,000 in business debts – are in the husband's name**
 - ✓ **\$75,000 in deductible hospital and funeral expenses are incurred at each death**
 - ✓ **Administrative costs equal to 5% of the gross estate, minus debts and final expenses are incurred at each death**

Hypothetical Family

- ✓ **The couple's objectives are to ensure that the surviving spouse is well cared for and to keep the land in timber for the children and grandchildren**
- ✓ **The wife does not remarry**
- ✓ **The children's marriages are sound, and**
- ✓ **The family works together harmoniously**

Hypothetical Family

- ▶ **Say the husband dies in 2008 and the wife in 2009**

How much estate tax is due over both deaths?

Scenario I: An “I Love You” Will

- ▶ **Each spouse has a will specifying that if they are the first to die, all their assets go to the other spouse**
 - ✓ **Probably is the most common arrangement for married couples**
 - ✓ **Ensures that the surviving spouse has full use of and benefit from all assets in the joint estate**
- BUT**

“I Love You” Will

- ✓ **Is a guaranteed worst-case scenario if the value of the joint estate exceeds the amount shielded from federal estate tax by the effective exemption amount**

“I Love You” Will

- ▶ **At the husband’s death all assets in the joint estate go directly to the wife, which maximizes the tax base at her death when the assets go to the children**
 - ✓ **The federal estate tax due at the husband’s death is \$0**
 - ✓ **The federal estate tax due at the wife’s death is \$2,098,828 – over 20% of the joint estate**

Value of the Joint Estate at the Husband's Death

House and lot	\$ 300,000
2,000 acres of land	3,000,000
Timber on 2,000 acres	5,000,000
Insurance policy on husband	500,000
Insurance policy on wife	100,000
Stocks	<u>1,000,000</u>
Total	\$ 9,900,000

Federal Estate Tax Payable at the Husband's Death

Husband's gross estate	\$ 9,900,000
Business debts	700,000
Hospital and funeral expenses	75,000
Administrative cost	456,250
Adjusted gross estate	8,668,750
Marital deduction	8,668,750
Tentative tax base	0
Tentative estate tax	0
Effective exemption amount	<u>780,800</u>
Estate tax payable	\$ 0

Federal Estate Tax Payable at the Wife's Death

Wife's gross estate	\$ 8,668,750
Business debts	0
Hospital and funeral expenses	75,000
Administrative cost	429,688
Adjusted gross estate	8,164,063
Marital deduction	0
Tentative tax base	8,164,063
Tentative estate tax	3,554,628
Effective exemption amount	<u>1,455,800</u>
Estate tax payable	\$ 2,098,828

Scenario II: Balanced Estate Plan

- ▶ **The husband and wife divide ownership of their assets and debts equally between themselves**
And they take advantage of two general estate planning tools and one specific one:
 - ✓ **The effective exemption for gifts**
 - ✓ **The effective exemption for estates**
 - ✓ **“Special use” valuation**

Balanced Estate Plan

- ▶ **The effective exemption amount for gifts:**
 - ✓ **They use the exemption to immediately transfer ownership of both insurance policies to the children**
 - ✓ **The transfer directly reduces the joint estate AND prevents the difference between the face amount and cash value of each policy from entering a decedent's estate at their death**

Balanced Estate Plan

- ✓ **The result of the transfer is to reduce the effective exemption amount for the first spouse to die by \$228,000**
- ✓ **They could have could have transferred the policies entirely by using the annual exclusion for gifts, OR**
- ✓ **They could have placed the policies in an irrevocable life insurance trust (ILIT)**

Balanced Estate Plan

- ▶ **The effective exemption amount for estates:**
 - ✓ **The spouses structure their wills so that at the death of the first spouse, the surviving spouse receives at least \$1 million and the children receive the rest, up to the full amount shielded by the effective exemption amount**

Balanced Estate Plan

- ✓ **The size of a family estate it is possible to transfer tax free by making full use of the effective exemption amount varies year-by-year:**

For 2006–2008 it was \$ 4 million

For 2009 it was \$7 million

Balanced Estate Plan

▶ Special use valuation:

- ✓ The spouses arrange that the land and timber be special use valued at both deaths
- ✓ It would have been preferable to special use value the land only, but the 50% test made this impossible
- ✓ The result is to reduce the joint estate by an additional \$960,000

Balanced Estate Plan

- ▶ **The husband's estate is reduced by gifting, the amount that goes into the wife's estate is reduced by the bequest to the children, and both estates are reduced by special use valuation of the land and timber**
 - ✓ **The federal estate tax due at the husband's death still is \$0**
 - ✓ **The federal estate tax due at the wife's death is \$971,083 – less than 10% of the joint estate**

Value of the Joint Estate at the Husband's Death

House and lot	\$ 300,000
2,000 acres of land	2,640,000
Timber on 2,000 acres	4,400,000
Insurance policy on husband	0
Insurance policy on wife	0
Stocks	<u>1,000,000</u>
Total	\$ 8,340,000

Federal Estate Tax Payable at the Husband's Death

Husband's gross estate	\$ 4,170,000
Business debts	350,000
Hospital and funeral expenses	75,000
Administrative cost	187,250
Adjusted gross estate	3,982,750
Marital deduction	2,210,750
Tentative tax base	1,772,000
Tentative estate tax	678,200
Effective exemption amount	<u>678,200</u>
Estate tax payable	\$ 0

Federal Estate Tax Payable at the Wife's Death

Wife's gross estate	\$ 6,380,750
Business debts	350,000
Hospital and funeral expenses	75,000
Administrative cost	297,788
Adjusted gross estate	5,657,963
Marital deduction	0
Tentative tax base	5,657,963
Tentative estate tax	2,426,883
Effective exemption amount	<u>1,455,800</u>
Estate tax payable	\$ 971,083

Additional Strategies

- ▶ **Still other tax-reducing strategies were available to the family, including:**
 - ✓ **Gifts to the children's spouses and/or the grandchildren**
 - ✓ **Donation of a conservation easement**
 - ✓ **Deferral and extension of the estate tax**
 - ✓ **Use of a form of business to transfer ownership of the forestland to the ...**

Additional Strategies

... children and/or grandchildren through excludable gifts discounted for minority interest and lack of marketability

- ▶ **But this example shows the benefit of deliberate estate planning, even after EGTRRA**