

ABC's of Estate Planning

**You Can't Predict The Future, But
You Can Plan For It!**

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WHAT IS ESTATE PLANNING?

- **Estate planning means getting your affairs in order –**
- **Before it is too late!**
- **Before death or incapacity occurs!**

I once thought that "estate planning" was for the very rich. You know, those who have a large country estate complete with servants, polo ponies-- and the resources to pay for it all. In reality, estate planning is much more important for those of us who have a small estate, because we don't have the resources to "fix things" once it's too late. In short, estate planning benefits anyone who cares about what happens to them, their loved ones, and their estate should death or incapacity occur.

Without proper estate planning, you may lose your right to decide:

- Who will take care of you
- Who will take care of your financial affairs
- Who will take care of your estate
- Who will make decisions on your behalf
- Who will raise your minor children
- How your estate will be distributed
- How much tax your estate will save

Basic estate planning is accomplished with such legal documents as powers of attorney, a will, or a trust. Properly drafted estate planning documents enable your estate to save taxes and avoid probate. They allow you to appoint a guardian for your minor children and protect the inheritance your loved ones receive from their creditors. Moreover, in the event you are no longer able to take care of yourself, these documents allow someone you trust to make health care decisions for you and manage your financial affairs without a court-appointed guardian.

Basic Estate Planning Tools

Even the simplest estate planning toolbox should include these documents:

- **Power of Attorney for Property.** A power of attorney for property authorizes an agent to write checks, manage your financial affairs and sign documents on your behalf if you are unable to do so.

Without it, the court will appoint a guardian to manage your estate.

- **Power of Attorney for Health Care.** A power of attorney for health care authorizes an agent to make health care decisions for you if you are unable to do so.

Without it, the court will appoint a guardian to make personal care decisions for you.

- **Simple Will.** A simple will distributes your estate according to your wishes (usually all to your spouse or surviving children), names your executor, allows waiver of a surety bond and names a guardian for your minor children.

Without it, the court will appoint a guardian for your minor children and their estate. Remember, a judge's best decision regarding who should raise your children is not nearly as good as your worst decision, because a judge does not know your family dynamic.

Also, without a will, your representative must post a bond every year for one and one-half times the value of your estate (often costing between \$1,600-\$2,000 for a \$300,000 estate) while your estate is being administered.

Estate Planning Documents: An Overview

Power of Attorney: A power of attorney enables you to appoint an agent to take care of your affairs, make health care decisions and act on your behalf should you become unable to do so.

Simple Will: A simple will generally transfers everything you own outright to your surviving spouse, children or other beneficiaries. A simple will does not avoid probate or safeguard your beneficiaries' inheritance from current or future creditors, including a divorced spouse. Once your spouse, children or other beneficiaries receive your estate, their current or future creditors can claim their inheritance.

Comprehensive Will: A comprehensive will establishes one or more testamentary trusts (trusts established upon death) to hold your estate for the benefit of your spouse, children or other beneficiaries. A testamentary trust can protect the inheritance you leave to your loved ones from most current or future creditors. After all, why leave your estate to your loved ones if current or future creditors can take it away? Best of all, your spouse, children or other beneficiaries can be the trustee of the trusts and have full control.

Tax-Saving Will: A tax-saving will is the same as a comprehensive will with the addition of a testamentary credit-shelter trust designed to minimize transfer taxes. A credit-shelter trust can provide lifetime benefits to your spouse and children, without having the trust assets included in their estate for transfer tax purposes.

Living Trust (without tax planning): A living trust is simply a trust established during your lifetime. Much like a comprehensive will, a living trust can protect the inheritance your loved ones receive from most current and future creditors and, in addition, avoid probate if properly funded. During your lifetime you can be the trustee of your trust and have full control over trust assets. However, if you are unable to manage your financial affairs, a successor trustee (usually your spouse) takes over and manages your affairs for you.

Pour-Over Will: A pour-over will is often used in conjunction with a living trust. It collects any assets that were not transferred to your trust during your lifetime and "pours" them into your trust upon death. Your estate will not avoid probate if the assets that "pour" into your trust are worth more than \$50,000.00.

Testamentary Trust: A testamentary trust is a trust established upon death. A testamentary trust offers the same advantages as a living trust, but does not avoid probate or allow a successor trustee to manage your affairs during your lifetime.

Credit-Shelter Trust: A credit-shelter trust assures that your federal estate tax exemption is fully used or "sheltered," allowing you to pass on an estate worth \$2,000,000.00 (Illinois) and \$3,500,000 (Federal) during year 2009 without incurring any transfer taxes. This trust is established either during your lifetime or upon death, depending on whether or not avoiding probate is important to you.

GST or Dynasty Trust: A generation-skipping trust (GST), also known as a dynasty trust, allows generation after generation to benefit from the trust without having trust assets included in any beneficiary's estate for transfer tax purposes. The GST exemption is currently \$3,500,000. Generation-skipping transfers that exceed the exemption are subject to a flat 45% GST tax in addition to estate and gift taxes.

QTIP Trust: A qualified terminable interest property (QTIP) trust is generally used when tax planning is necessary or in a second marriage situation when your spouse is to receive trust income for life, with the remainder distributed to other beneficiaries or children from a prior marriage.

QDOT Trust: A qualified domestic trust (QDOT) allows transfers to a non-citizen spouse to use the marital deduction for transfer tax purposes. Without it, transfer taxes are due on assets worth more than \$125,000 per year passing to a non-citizen spouse.

ILIT Trust: Typically, life insurance proceeds are included in your estate for estate tax purposes even though the proceeds are paid to your spouse, children or other beneficiaries. An Irrevocable Life Insurance Trust (ILIT) prevents life insurance proceeds from being counted as part of your taxable estate.

COMPARISON OF BASIC ESTATE PLANNING ARRANGEMENTS.

Advantages	No Will	Basic Will	Comprehensive Will	Living Trust	Credit-shelter Trust	QTIP Trust
You Select Beneficiary	No	Yes	Yes	Yes	Yes	Yes
You Select Executor	No	Yes	Yes	Yes	Yes	Yes
You Select Guardian	No	Yes	Yes	Yes	Yes	Yes
Avoids Probate Bond	No	Yes	Yes	Maybe	No	No
You Select Trustee	No	No	Yes	Yes	Yes	Yes
May protect inheritance from creditors	No	No	Yes	Yes	Yes	Yes
Avoids Probate	No	No	No	Yes	Yes	Yes
Avoids Guardianship	No	No	Yes (Beneficiaries)	Yes	Yes	Yes
Saves Death Taxes	No	No	Possible	Possible	Yes	Yes
Limits Appointment Powers of Surviving Spouse	No	No	Possible	No	Possible	Yes

Power of Attorney

What is a Power of Attorney and why do you need it ?

Incapacity or illness can affect any of us at any time. A power of attorney (POA) enables you to appoint an agent to take care of your affairs, make healthcare decisions for you and act on your behalf should you become unable to do so.

Depending on your wishes, this document may be effective from the moment it is signed or when you become incapacitated, but in any event, your power of attorney ends upon your death. It is imperative that you have total confidence in the person named as your agent (your attorney-in-fact), since that person will have the right to act on your behalf in regard to all activities described in the document. **If you do not have total confidence in your agent, do not sign your power of attorney.**

By appointing an agent through a power of attorney, you also can avoid guardianship proceedings. A guardianship proceeding is the legal method used for declaring a person disabled or incompetent and for appointing a guardian to handle that person's medical, business and financial affairs. A guardianship proceeding can be an expensive, time-consuming and humiliating experience.

A Power of Attorney allows you choose who will manage your affairs for you.

There is no need:

- to be publicly declared incompetent
- to have a guardian appointed
- to pay for a bond
- to pay an attorney to annually review your guardian's activities
- to provide an annual accounting

Exercise great care in selecting an agent!

- Choose only a person whom you trust completely
- A relative or a close friend is often a good choice
- Never give this power to someone you do not trust or who may have a conflicting interest to yours

When does a Power of Attorney become effective?

Your power of attorney becomes effective when you sign and acknowledge it. It also may become effective upon the happening of a specific event indicated on the document, i.e., upon certification by your physician that you are unable to take care of your own affairs.

Property Power of Attorney

A power of attorney for property authorizes an agent to write checks, manage your financial affairs and otherwise act on your behalf if you are unable to do so.

Health Care Power of Attorney

The power of attorney for health care appoints an agent to make health care decisions for you if you are unable to do so, including the power to authorize the withdrawal of food, water, and other life-sustaining measures. Your power of attorney for health care may extend beyond your death to permit anatomical gifts, autopsy, or disposition of remains. A copy of your signed power of attorney for health care should be given to your physician so that it will be available as part of your medical record. Remember, neither your attending physician nor any other health care provider may act as an agent under a power of attorney for health care.

Whom Should You Select as Your Agent?

You should exercise great care in selecting an agent. Give this power only to a person whom you trust completely. A relative or a close friend is often a good choice. Never give this power to someone you do not trust or who may have a conflicting interest. Do not put anyone in a position of having to choose between your interests and their own. Although a court will require your agent to choose your interests over his or her own, litigation is an unpleasant, expensive, and time-consuming process.

While many people choose their spouses to handle all decisions, you may divide the responsibility among several agents. You may wish to appoint a business associate to make business decisions, a banker to make financial decisions, and a family member to make medical and personal decisions.

What happens if your agent cannot serve?

There may be times when your agent cannot or will not serve. In such a case, your POA can authorize an alternate agent to serve. The alternate agent can then perform the act that would have been performed by your original agent.

What are your agent's responsibilities?

Your agent may perform all the acts specified in the POA and therefore must always act with your best interests in mind. Consequently, your agent has a fiduciary or legal, entrusted relationship with you. Your agent must always be prepared to show your POA to anyone who questions his or her right to use it. Occasionally problems occur. A bank, title insurance company or a brokerage house may refuse to recognize the authority granted by a POA and may require additional proof of authority or the re-execution of your POA. This additional headache could be eliminated with a fully funded living trust. Remember, when property is held in trust, the trustee is much more than an agent. Your trustee holds title to the property, and his or her authority cannot be questioned.

Who can execute (sign) a Power of Attorney?

Any adult (18 years of age or older) who is not disabled or incompetent can execute a POA. Furthermore, you must be competent when you sign the document. Your POA is not valid if you are declared incompetent by a court of law before signing the document.

How long is a Power of Attorney effective?

Every Power Of Attorney terminates upon any of the following events:

- Death of the principal
- Death of the agent (unless you appoint a contingent agent)
- Revocation of the POA by the principal (if the principal reserved the right to revoke it in the document)
- When specified by the document
- Termination by a court of law
- Bankruptcy of the principal

GUARDIANSHIP

Guardianship may be necessary because our ordinarily tranquil lives are disrupted by unforeseen events. Unexpected events such as illnesses or accidents can happen to us at any time. Occasionally such an event will leave us physically, mentally, or emotionally disabled — perhaps for an extended time or even the rest of our lives.

When is guardianship the only alternative?

If you become unable to sign a power of attorney or trust agreement because you lack mental capacity, a guardianship may be the only alternative. Your guardian manages your income and assets, signs checks and contracts on your behalf, consents to medical treatment and surgery, protects your property from loss or waste, and does whatever must be done to care for you, your family and your property.

You can plan for your own disability by executing a revocable living trust, a power of attorney, an agency agreement, or some other method of handling your personal or business affairs. If this is not done, it may become necessary for members of your family to go to court in order to have you declared “disabled” and have the court appoint one or more guardians to supervise your care, the care of your property, or both.

In some cases, even though you have executed one of the documents mentioned above, it may become necessary for your family to ask the court to appoint a guardian. This generally occurs if you have failed to place all of your property under one of those documents or if you unexpectedly acquire new property.

What is a “disabled person?”

According to the law in Illinois, a “disabled person” is a person at least 18 years old who (a) because of mental deterioration or physical incapacity is not fully able to manage his or her person or property; (b) is mentally ill or developmentally disabled and who because of this disability is not fully able to manage his or her person or property; or (c) because of gambling, idleness, debauchery, or excessive use of intoxicants or drugs so spends or wastes his or her property as to expose himself or herself or his or her family to want or suffering.

How is a person declared “disabled” and how is a guardian appointed?

Before a person is declared “disabled” and a guardian is appointed, a petition asking for the appointment of a guardian and stating the grounds therefore must be filed in court. The presumed disabled person must then be examined by a licensed physician, who must submit to the court a written evaluation of that person. That person must receive notice from the court that there is going to be a court hearing on the question of his or her disability. This notice is given not only to that person but also to that person’s nearest relatives (unless they have waived the notice). The court appoints an attorney as guardian ad litem (a guardian for the purpose of that court hearing only). The guardian ad litem then visits the person, explains the nature of the guardianship proceeding, and makes a determination as to the person’s disability. This guardian ad litem is independent and charged with the duty of protecting the person claimed to be disabled or incompetent.

Furthermore, before a person is declared disabled, he or she must be given a hearing in court. The person who is the subject of the hearing is entitled to a jury trial on the question of his or her disability or competency and must be physically present at the hearing. At the hearing, testimony regarding the person's disability is presented. All witnesses are sworn and are subject to cross-examination. The guardian ad litem presents his or her report and recommendations to the court. Then the court or jury decides whether the person is disabled or incompetent. If necessary, the hearing may be held outside of the courtroom if the person is unable to travel due to his or her disability.

If the court does not find the person to be disabled, that is the end of the case. If the court finds the person to be disabled, it determines the degree or nature of the disability. If a court finds the person lacking sufficient understanding or capacity to make or communicate responsible decisions concerning his or her own care, the person becomes a "ward" of the court and the court may appoint a guardian for that person. If a court finds a person unable to manage his or her estate or financial affairs, then the court may appoint a guardian for the estate. If a court finds that both of these conditions exist, then the court may appoint a guardian of both the person and estate.

The court then decides who should be the guardian of the person, and the degree of authority to be given to that guardian. If the disabled person has property to be administered, the court also decides who should be the guardian of the estate.

What are the costs of guardianship?

Of all of the methods of handling a person's property during disability, guardianship can be the most expensive to create and operate over a period of years. In addition to court costs, physician's examination fees, and guardian ad litem fees, there are attorney's fees. Often people litigate over who will be the guardian. Even when there is no litigation involved and everyone agrees that the person for whom the guardianship is being created is disabled, attorney's fees can be considerable to open a guardianship estate.

Other guardianship expenses recur year after year during the life of the guardianship. An individual guardian must present a bond to the court in the amount of one and one-half times the value of the personal property in the estate, unless the guardian can find two individuals who meet all of the following qualifications:

- They are willing to sign the bond;
- They are approved by the court;
- They have real estate in the county of the guardianship in the amount of twice the value of the personal property in the estate of the ward; and
- Said property is free and clear of all liens

Corporate bond premiums can be expensive. For a \$50,000 estate, a \$75,000 corporate surety bond costs about \$360 annually; on a \$200,000 estate, a \$300,000 surety bond premium is \$1,160 annually. These bond premiums are paid out of the ward's estate. If a bank is named as guardian, it will charge an annual guardian's fee of about six percent of the income of the ward's estate. An individual who is appointed guardian is entitled to similar guardian's fees, but if that individual is a close relative, the fee is usually waived and only expenses are charged to the ward's estate.

Since annual reports to the court are required, there will be attorney's fees payable annually by the ward's estate for the preparation and filing of the report and for obtaining the court's approval of the document.

Who is permitted to serve as a guardian?

Any person who:

- Is at least 18 years of age;
 - Of sound mind;
 - Has not been judged a disabled person;
 - Has not been convicted of a crime rendering him or her infamous; and
 - The court finds is capable of providing an active and suitable program of guardianship,
- may be appointed guardian of the person and, if he or she is a resident of Illinois, of the estate.

Any public agency or not-for-profit corporation found capable by the court of providing the required services may be appointed guardian of the person, of the estate of the disabled person, or both. However, the court shall not appoint as guardian an agency that is directly providing residential services to the disabled person. One person or agency may be appointed guardian of the person, and another person or agency may be appointed guardian of the estate. Any corporation qualified to accept and execute trusts in Illinois may be appointed guardian of the estate of a disabled person.

What are the duties of a guardian of the person?

To the extent ordered by the court and under the direction of the court, the guardian of the person shall have custody of the disabled person and his or her minor and adult dependent children and shall take responsibility for their support, care, comfort, health, education, and maintenance and such professional services as are appropriate. However, the disabled person's spouse may not be deprived of the custody and education of the minor and adult dependent children without his or her consent unless the court finds that the spouse is not fit and competent to have such custody and education. The guardian will assist the disabled person in the development of maximum self-reliance and independence. The guardian of the person may petition the court for an order directing the guardian of the estate to pay an amount periodically for the provision of the services specified by the court order.

What are the duties of a guardian of the estate?

The guardian of the estate is responsible to:

- Oversee the care, management, and investment of the estate, for the comfort and suitable support and education of the disabled person, minor children, and dependent persons;
- Carry out any contracts of the disabled person that legally existed at the time of the commencement of disability;
- Execute and deliver any bill of sale, deed, or other instrument;
- Represent the disabled person in all legal proceedings;
- Do whatever the court deems appropriate.

Filing Requirements

The guardian of the person must file with the court, at least annually, a report that states:

1. The current mental, physical, and social condition of the ward and his or her minor and adult dependent children;
2. Their present living arrangements, a description and address of every residence where they lived during the reporting period, and the length of stay at each place;
3. A summary of medical, educational, vocational, and other professional services given to them;
4. A resume of the guardian's visits with and activities on behalf of the ward and his or her minor and adult dependent children;
5. Any recommendation as to the need for continued guardianship;
6. Any other information requested by the court or useful in the opinion of the guardian

PROBATE

- **Validates your will**
- **Distributes your estate under court protection**
- **Cuts off creditors claims in 6-months**
- **Saves time & money**

What is Probate?

Probate simply means proving your will and settling your probate estate (i.e., assets that do not pass by reason of law or contract, such as life insurance, joint property, pension plans, etc.) in a court of law. A judge makes sure that your heirs are notified, your debts and taxes are paid, and your estate is distributed according to your will (if you made one), or, if you die without a will (intestate), according to state law.

In Illinois, you have four probate options depending on:

- The value of your probate estate;
- Whether your probate estate owns real estate; and
- Whether your heirs are satisfied with the administration of your probate estate.

How much does it Cost?

Attorney fees, court costs, and publication fees for a basic probate estate should cost between \$1,500 - \$3,000. An attorney has to prepare court documents for the opening and closing of the estate, creditors and heirs have to be notified, and the attorney has to go to court two times: once to open and once to close the estate. That's it! Best of all, all of this can be accomplished in as little as 6-months.

To Reduce Estate Settlement Costs

Keep up-to-date records of:

- Your heirs
- Your assets
- Your creditors
- Your receivables

The real expense in any estate or trust administration depends on the amount of time and effort spent on settling the decedent's estate and who does it. Whether your assets are in your estate or in your trust estate the settlement procedures are the same. Your assets need to be collected, your bills need to be paid, and your estate, whether in a living trust or not, needs to be distributed. The time and effort spent on this estate settlement process is often blamed for the "costs of probate," but in reality is chargeable to any estate, whether probated or not. If your affairs are in order, meaning your representative has a detailed understanding of where your assets are, who your creditors are, and who receives your estate, less time is needed to settle your estate. If you as representative or as trustee do your job without the assistance of an attorney or other professional, estate settlement cost will be dramatically reduced. Common sense tells you that the estate settlement bill will be higher if you employ an attorney or other professional to do YOUR job.

Option #1. Small Estate Affidavit. If you own no real estate and the gross value of your estate is \$100,000 or less, probate may be avoided altogether with a small estate affidavit. A small estate affidavit allows your personal representative to state under penalties of perjury that the statutory requirements for the affidavit are met, and that your estate can then be distributed without formal probate proceedings.

Option #2. Summary Administration. Summary administration allows your estate to be distributed if it is \$100,000 or less and a small estate affidavit cannot be used. For example, if a bank or other institution refuses to honor a small estate affidavit, summary administration may be used instead. With the consent and appearance of all heirs and legatees (people who inherit via a

will), much of the probate process may be accomplished during the first court appearance. If no one files claims or objections, the court orders the distribution of your estate.

Option #3. Independent Administration. Independent administration is the newest and most popular form of probate in Illinois and has been available since 1980. It removed the hassle and expense associated with the probate process and made probate in Illinois a viable alternative to a living trust. Unless an interested party objects or your will specifically forbids, independent administration may be used to settle your estate. It grants your legal representative significant powers and allows for the administration of your estate with minimal publicity and court involvement. In most circumstances only two court appearances are necessary (one to open your estate and one to close it). A judge makes sure that the terms of your will are complied with and that all your debts are paid. Best of all, creditors of your estate only have six months to file a claim (instead of two years under a living trust). The entire process should take 6-10 months and cost from **\$1,500 to \$3,000**. Since few estates qualify for summary administration and the disadvantages outweigh the advantages, independent administration is usually the better option.

Option #4. Supervised Administration. Supervised administration involves the probate court in all aspects of the administration of your estate and is most often referred to as a "nightmare." Supervised administration usually takes longer, is much more costly, and requires considerably more work by the attorney because issues are often contested.

Probate Myths

Myth #1. Probate Is Very Expensive. Before January 1, 1980, probate in Illinois was indeed an expensive and cumbersome process because the only probate option available was "Supervised Administration." This meant that court approval was needed for each step in the probate process.

On January 1, 1980, the legislature overhauled the Illinois Probate Act with the addition of "Independent Administration." Independent Administration alleviates the time and expense required in supervised administration by allowing the personal representative of the probate estate to administer the estate with minimal court involvement. What was once an expensive and time-consuming ordeal was transformed into a relatively inexpensive and straightforward procedure. If everything goes according to plan, only two court appearances are necessary and creditors have only six months to file a claim. Best of all, a judge makes sure that the terms of your will are carried out. This is a tremendous benefit to you! If you do your job as the representative of the estate, a simple probate estate should cost no more than \$1,500 - \$3,000. If real estate is included in your estate the \$1,500 - \$3,000 is often recouped by avoiding a 2% "bond in lieu of probate" required by your title company in order to sell the decedent's real estate. A savings of \$8,000 on a \$400,000 house.

Myth #2. Probate Serves No Purpose. Quite the opposite is true. The court's extensive experience in probate matters and procedures assure the proper administration of your estate. The court plays no favorites and makes sure that your wishes are respected for an orderly distribution of your estate. The statute of limitations cuts off creditor claims in six months. Without probate the creditors of your estate have two years to file a claim.

Myth #3. Probate Means Assets Are Tied Up For A Long Time. The statutory minimum for creditor claims during independent or supervised administration is six months. Creditors who are notified by letter or publication only have six months to file a claim or are forever barred. Once the claims period is over, your assets may be distributed. If probate is avoided, creditors have two years or more to file a claim .

Myth #4. Probate Is Public. Probate is as public as any other court proceeding. No matter whether your estate is distributed by way of will or trust, if litigation ensues your affairs will be part of the public record. However, only during supervised administration or by court order is an itemized inventory of your estate filed with the court.

Options to Avoid Probate

Joint Tenancy: A form of owning title together with your spouse or other individual. Upon death the ownership passes automatically to survivor. Although convenient, joint tenancy with anyone other than your spouse is not advisable because of adverse tax consequences, loss of control and the ability of creditors of either joint tenant to reach the entire asset.

Totten Trust: Special savings account which is payable to a given beneficiary at death.

Life Insurance & Retirement Assets: Contracts that have beneficiary designations bypass probate unless the decedent's estate is named as beneficiary.

Revocable Living Trust: Is generally considered the best method of avoiding probate as long as the trust is fully funded.

If you die without a Will, Illinois will distribute your estate as follows:

Rules of Descent and Distribution for Illinois.

Many people assume that if you die without a will, your property passes to the state. This is false. If you die without a will, or if your will is found to be invalid, you are deemed to have died intestate (without a valid will). Your intestate property, whether real or personal, will then be distributed as follows:

1. If your spouse and descendants survive:

1/2 of the estate to your spouse, and
1/2 of the estate to your descendants, per stirpes.

2. If only your descendants survive:

the entire estate to your descendants, per stirpes.

3. If only your spouse survives:

the entire estate to your surviving spouse.

4. If your spouse or descendants do not survive, but your parent, brother, sister or descendants of your parent, brother or sister survive:

the entire estate to your parents, brothers and sisters in equal shares, with the descendants of **your** deceased brother or sister receiving the portion which **your** deceased brother or sister would have taken if living, per stirpes. If only one parent survives you, the surviving parent receives two shares of the estate.

5. If only your grandparent(s) or descendants of your grandparent(s) survive:

1/2 of the estate to your maternal grandparent(s) or to their descendants per stirpes, and
1/2 of the estate to your paternal grandparent(s) or to their descendants per stirpes.

If only one side survives **you**, then all to the surviving side.

6. If only your great-grandparent(s) or descendants of your great-grandparent(s) survive:

1/2 of the estate to your maternal great-grandparents or to their descendants per stirpes, and
1/2 of the estate to your paternal great-grandparents or to their descendants per stirpes.

If only one side survives you, then all to the surviving side.

7. If none of the above survive you:

your entire estate in equal shares to your nearest kindred in equal degree, without representation.

8. If no known kindred survives you:

your real estate transfers to the county in which it is located and your personal estate transfers to the county of which you were a resident.

The “Living Trust”

- Avoids probate in Illinois and other states
- Enables asset management by a trustee
- Avoids Guardianship of the estate

What is a trust?

A trust is a legal entity, much like a corporation, created when one person (the trustor or grantor) transfers to himself, another person or a corporation (the trustee) a property interest to be held for the benefit of himself or others (the beneficiaries). A “living trust” is simply a trust established during your lifetime rather than at death. The living trust has become a popular estate planning vehicle which offers certain benefits that a testamentary trust cannot offer. A properly funded and structured living trust avoids probate and guardianship and protects the inheritance (from most creditors) that your spouse, children or other beneficiaries receive.

Advantages of a Living Trust

Probate Avoidance. A properly funded living trust avoids probate because it owns all your assets, leaving no probate estate to administer. To properly fund your living trust, all probate assets must be transferred to your living trust before death. This means re-titling your real estate, accounts, and other assets in the name of your living trust so that your probate estate is less than \$100,000 at death. It is this author's opinion that probate in Illinois is a relatively quick and inexpensive process providing many benefits to the estate and should rarely be avoided. On the other hand, if you own real estate in a state other than Illinois, probate avoidance may be of primary benefit.

Management and Guardianship Avoidance. If you are unable to manage your financial affairs, a court will appoint a guardian to handle your affairs for you. This may be an expensive, humiliating and time-consuming process. A living trust allows you to select other individuals or institutions to act as successor trustee in the event you cannot handle your financial affairs and thus avoids the need for a guardian.

Privacy. A will must be filed with the probate court within 30 days after death. Once the will is filed it is subject to public view and scrutiny. A living trust is a “private document” which ultimately distributes your estate to beneficiaries without public disclosure.

Fiduciaries. You may choose a successor trustee regardless of where your trustee resides. This allows for much greater flexibility in selecting the person or institution ultimately responsible for the management of your assets or the orderly administration of your estate.

Spousal Share. Illinois law allows your spouse to renounce your will and, instead, claim an elective share of your probate estate. Your spouse may elect to receive either one-third of your probate estate if you have children or one-half of your probate estate if you have no children. However, if your assets are owned by a living trust, no such election is possible and your spouse is effectively disinherited.

Disadvantages of a Living Trust

Creditor Claims. Creditors may not be cut off as quickly as they are in probated estates. In Illinois, creditors have six months to file a claim against a probate estate and two years to file a claim against a trust. Moreover, a Federal court recently determined that in some circumstances creditors are never cut-off from filing a claim against a living trust.

Time-Consuming. Funding the trust may be a time consuming, expensive, and cumbersome process. In order to avoid probate, title to all assets must be changed to the trustee of the trust.

Title Policy Requirements. If your trust owns real estate, title insurance companies require that the title policy be assigned to the trustee (even if the trustee is you) or that the trustee be named as an additionally insured on the policy, which may cost several hundred dollars more.

Living Trust Myths

Myth #1. A Living Trust Protects Your Assets From Creditors. Although a properly structured trust (or will) established for the benefit of your spouse, children or other beneficiaries can protect your beneficiary's inheritance from your beneficiary's creditors, your living trust will not insulate you from creditors.

Myth #2. A Living Trust Reduces Estate Taxes. Unless your trust (or will) incorporates tax-planning, your estate may incur transfer taxes when you die. (A testamentary trust established by your will reduces transfer taxes as effectively as a living trust does, without the nuisance of properly funding the living trust).

Myth #3. A Living Trust Avoids Probate. Your estate will not avoid probate unless your trust is properly funded during your lifetime. This means transferring your probate assets to your trust before death.

Myth #4. A Living Trust Reduces Income Taxes. Since you will have full control over your trust, your trust is ignored as a separate entity for income tax purposes. Income taxes are neither increased nor decreased by reason of your living trust.

Myth #5. A Living Trust Eliminates the Need for a Will. If you have minor children a will is necessary to appoint a guardian to raise your children. Otherwise, a court may appoint a stranger to raise your children. Furthermore, a "Pour-Over" will is used in conjunction with your living trust to "pour" into your trust any assets that have not been transferred to your trust during your lifetime. Finally, a will can waive the bond otherwise required when you do not have a will.

Myth #6. A Living Trust Prevents an Estate Contest. A living trust will not prevent a claim against your estate or trust. The only difference may be the court in which a claim is filed. Typically, probate court is the proper forum to file suit involving a will and chancery court is the proper forum to file suit involving a trust. If someone wishes to sue, they will.

Myth #7. A Living Trust Funds Itself. In order for a living trust to achieve the objective it was designed for (probate avoidance or spousal disinheritance), it must be properly funded during your lifetime. This means changing title to your living trust of all your real estate, property and accounts.

Myth #8. A Living Trust Will Automatically Change Beneficiary Designations. If you transfer your home to your living trust you must add your trustee as an "additionally insured" to your homeowner's insurance policy and your title insurance policy in order to be covered by those policies.

Myth #9. A Living Trust Shortens The Time it Takes to Settle Your Estate. The settlement of your trust estate cannot be completed until you as the trustee have distributed the trust estate to the beneficiaries. Since you are personally liable as trustee, you cannot distribute the trust estate until you are sure that no claims can be made against the trust estate. Since the claims period for trusts is at least two years (only 6 months for probate), it would not be wise to distribute the trust estate before the claims period has expired.

A great number of living trusts are completely unfunded because title was never changed. In order to achieve your initial goals (probate avoidance, guardianship avoidance, estate management, etc.) all of your assets must show title in the name of your trust. The trust must be the legal owner of your estate.

- Bank accounts are easily re-titled with a new ownership form.
- Real estate is transferred by having an attorney prepare a new deed.
- Promissory notes and deeds of trust are assigned to the trust.
- Personal effects, furniture, furnishings, clothing, jewelry and items that have no certificate of ownership can be transferred with an assignment of personal property.
- A stockbroker can assist you in transferring your securities.
- Certificates of limited partnership must be examined for instructions and requirements for making the transfer.
- Close corporation stock must be changed into the trustee's name. If there is a buy-sell agreement, it must be reviewed for any prohibition against this type of transfer. Also, if the corporation is either an S corporation or a professional corporation, special rules must be followed.
- General partnership interests can be put into the trust if the partnership agreement permits such transfers.
- Sole proprietorships require a bill of sale or an assignment of interest, which includes the goodwill of the business.
- Life insurance proceeds made payable to the living trust will be managed for the benefit of your heirs along with the other assets in the trust until such time as they are to be distributed.

Protecting Your Beneficiaries' Inheritance

Protecting Your Beneficiaries' Inheritance

You can protect the assets that you pass on to your spouse, children or other beneficiaries from current or future creditors by establishing a testamentary trust to receive a beneficiary's inheritance. After all, why give your estate to a beneficiary if his current or future creditors can take it away? However, the degree of creditor protection depends on how much control that you or your beneficiaries are willing to give up to achieve creditor protection. Giving up total control to a 3rd party trustee will yield the best creditor protection.

Are all creditors covered?

Under current law, a properly drafted trust prevents current or future creditors from attaching trust assets for all but the most egregious acts committed by your beneficiaries. For example, a judge will most likely find some creative way to circumvent creditor protection provisions in order to make sure that a beneficiary satisfies his or her obligation for child support.

How does it work?

The law does not allow you to escape your debts and financial obligations, including any judgments levied against you. However, the law does allow you to place restrictions on assets that you give to others. For example, you have every right to create a trust that prevents trust assets from being used for anything other than your beneficiary's health, support or education. If some time in the future a judgment is entered against your spouse, children or other beneficiaries, the creditor is prevented from seizing trust assets since the trust assets can only be distributed, for example, for the health care, support or education of your beneficiary. **In order to achieve creditor protection recent court decisions require at least one disinterested party to be co-trustee.**

What if my beneficiaries do not have creditors?

That's good, but unless you have a crystal ball that can predict the future, your beneficiaries may be vulnerable to creditors in the future.

For example, let's say your spouse, child or other beneficiary is involved in a serious automobile accident and injures a young child who is permanently paralyzed and requires around-the-clock nursing care for the rest of her life. It is later determined that your beneficiary was at fault and that a \$3 million judgment is appropriate given the child's age and injuries. Unfortunately, your beneficiary's automobile insurance is completely inadequate to meet the judgment imposed. In order to satisfy the judgment, plaintiff's attorney will most likely attach every asset that your beneficiary owns, including the estate your beneficiary inherited outright by means of a simple will. If instead your beneficiary inherited your estate through a living or testamentary trust, your estate should be protected from most judgment creditors. Your beneficiary can even be the trustee of his or her own trust as long as your beneficiary does not have full control over the trust estate.

Can my beneficiary purchase a house with his or her inheritance?

Your beneficiary can purchase a house or any other asset as trustee of his or her trust and thus, protect the house from most judgment creditors.

Tax Planning

Your estate may be subject to income tax, gift tax, estate tax, and generation-skipping tax. These taxes are generally referred to as transfer taxes and can be avoided or minimized with careful planning.

The Federal Estate Tax

The federal estate tax is an excise tax on the right to transfer property at date of death. The gross estate includes the fair market value of all assets owned by the decedent as of the date of death, including life insurance policies. The current top estate tax bracket is 45% on estates over \$3,500,000 (Federal) and \$2,000,000 (Illinois).

The top estate & gift tax bracket will reduce as follows:

Year	Bracket	Amount
2002	50%	\$1,000,000
2003	49%	\$1,000,000
2004	48%	\$1,500,000
2005	47%	\$1,500,000
2006	46%	\$2,000,000
2007-08	45%	\$2,500,000
2009	45%	\$3,500,000
2010	0%	\$0
2011	55%	\$1,000,000

To avoid transfer taxes your combined estate should be less than the applicable exclusion amount. This amount is the dollar value of assets protected from federal estate tax. It is scheduled to change as follows:

Exclusion Amount	Year
\$1,000,000	2002 and 2003
\$1,500,000	2004-2005
\$2,000,000	2006-2008
\$3,500,000	2009
zero	2010
\$1,000,000	2011

- The estate tax applies only to taxable estates that exceed the applicable exclusion amount in 2009 (\$2,000,000 Illinois) and (\$3,500,000 Federal). Under the Tax Act of 2001, the federal estate tax is gradually phased out until its final repeal in the year 2010. However, if Congress does not change the tax laws, the estate tax will automatically revert back to the rates in effect during the year 2001 (an exemption for the first \$1,000,000 of assets only).
- Transfers between spouses generally qualify for the unlimited marital deduction and are free of current tax.
- The estate tax return (Form 706) and any taxes due are generally payable nine months after date of death. In some situations, a portion of the taxes may be paid to the IRS in installments.
- If the value of the estate assets declines during the first six months after death (which often happens if the decedent owned a business), the value (for all assets) as of six months after death may be used on the tax return.
- Lifetime gifts that exceed the annual gift tax exclusion (\$12,000 per donee per year) will also reduce the estate owner's applicable exclusion amount.

Some transfers made during one's lifetime may be brought back into the decedent's estate for transfer tax purposes. A few examples are listed below:

- Transfer of life insurance policies within three years prior to death.
- Transfer of an asset from which the donor retains an income for his or her life.
- Transfer of an asset where the donor retains the right to alter or terminate the transfer.
- Assets placed in joint tenancy with another are included in the gross estate.

Basic Federal Estate Tax Reduction

The federal estate tax, which is imposed on taxable estates (see page 17), may be reduced through various tactics. Often used are:

- **Lifetime gifts:** Each person can make annual gifts of \$12,000 (\$24,000 per couple, if married) to any number of donees; e.g., children, grandchildren, nieces, nephews, without incurring a gift tax.
- **Marital transfers:** Generally, neither lifetime gifts nor bequests at death to one's spouse are subject to death taxes. This in effect defers the tax until the surviving spouse dies. Special rules apply to non-citizen spouses.
- **Credit-Shelter Trusts:** The credit-shelter trust makes certain that the estate tax exemptions of both spouses are used and not wasted. This can bring significant savings to many estates!
- **Life Insurance Trusts:** By transferring small amounts of the estate (equal to the insurance premium) to an Irrevocable Life Insurance Trust, an estate owner can reduce his or her current estate while creating a much larger asset outside the estate. The proceeds of the policy will not be subject to income taxes or federal estate taxes at the estate owner's death.
- **Private annuity:** Generally, a private annuity is the sale of an asset to a younger generation in exchange for an unsecured promise to pay annual amounts for the seller's lifetime. This removes the assets from the estate; however, the payments, if accumulated, could build up over the seller's life expectancy to the size of the asset that was transferred.
- **Charitable transfers:** Bequests at death or lifetime charitable gifts can reduce the estate size and thus reduce the death tax. Charitable gifts made during life provide the added benefit of an income tax deduction. Gifts can be of a partial interest; for example, one can retain the right to income for life.

The Credit-Shelter Trust

A credit-shelter trust assures that your federal estate tax exemption is fully used or "sheltered" and allows you to give or bequest an estate worth \$2,000,000, during year 2008, without incurring any transfer taxes. This trust can be established during your lifetime or upon death depending on whether you want to avoid probate or not.

The Problem - If you don't plan now!

John and Mary are married to each other and have a combined estate worth \$2,000,000 in the year 2008. John dies and in his will John leaves his half of the estate (\$1,000,000) to Mary outright. Although John's estate does not incur any transfer taxes because of the unlimited marital deduction, John's federal estate tax exemption is wasted. When Mary later dies in 2011, her estate must pay Uncle Sam \$345,800 federal estate tax. This is because upon John's death Mary's estate increased to \$2,000,000 and Mary can only use her own exemption towards reducing transfer taxes.

Mary's estate at death	\$2,000,000
Federal estate tax	\$780,000
Mary's exemption	<u>\$345,800</u>
Federal estate tax due	\$435,000

The Solution

To preserve the federal estate tax exemption of the first spouse to die, many couples use a credit-shelter trust (also called an exemption or by-pass trust). Upon the death of the first spouse, up to \$2,000,000 is placed into the credit-shelter trust. Although the trust may appreciate greatly in value during the surviving spouse's lifetime, it will not incur transfer taxes upon the death of the surviving spouse. The surviving spouse, however, can have access to the income from the trust for life and can use the principal if necessary for health, education, support and maintenance. **The surviving spouse can even be the trustee of the credit-shelter trust, and thus, have full control over trust assets.**

Credit-Shelter Trust Diagram

Current Estate of Both Spouses \$3,000,000

- Death of first spouse
- Trust shelters estate tax exemption



**Spouse's Trust
\$1,000,000**

Funded with the assets not in credit-shelter trust

Spouse:

- Can be trustee
- Receives all income and principal
- Has full or limited control
- Has limited or unlimited power to appoint principal
- Is included in spouse's estate for estate tax purposes

**Credit-shelter Trust
\$2,000,000**

Funded with tax sheltered amount

- Becomes irrevocable at death
- Not included in spouse's estate for estate tax purposes
- Spouse can also be trustee and have full control
- Spouse and beneficiaries can receive income and principle for health, support and education
- Limited power to appoint
- Saves estate \$780,800 in estate tax.

- Death of surviving spouse
- Spouse uses own exemption



Child's Trust

Child:

- May receive all income and principal.
- May be trustee and have full control of trust.
- Has limited or unlimited power to appoint principal.
- Is included in child's estate for estate tax purposes

The federal estate tax exemption of the first spouse to die is preserved in the credit-shelter trust, saving the estate up to \$780,800 in estate taxes.

Generation-Skipping Transfer Tax

One useful way to preserve wealth for future generations is to skip the transfer taxes that would ordinarily be due at death of each generation of heirs. This is done by establishing a Generation-Skipping Transfer (GST) Trust, which preserves an individual's federal generation-skipping exemption (currently \$3,500,000). Generation-skipping tax is a particularly nasty tax because generation-skipping transfers that exceed the exemption amount are subject to a flat tax of 48% of the value transferred, in addition to any estate tax and gift tax otherwise imposed. It is important to understand that a GST trust does not skip a generation of heirs. Rather, it skips the transfer taxes that would ordinarily be due. Beneficiaries of the trust (usually children and future generations) may benefit from a GST trust by receiving distributions, but not have trust assets included in their estate for estate tax purposes.

GST Tax:

50% in 2002;
49% in 2003;
48% in 2004;
47% in 2005;
46% in 2006;
45% in 2007-2009;
0% taxes in 2010; and
55% in 2011.

How can you reduce the impact of the generation-skipping transfer tax?

- Consider making full use of the annual gift tax exclusion of \$12,000 to any number of donees; e.g., children, grandchildren, in-laws, etc.
- Encourage children or grandchildren (or trusts for their benefit) to purchase and own large life insurance policies on the parent or grandparent. At death, the insurance proceeds would not generally be subject to federal estate tax or the generation-skipping transfer tax.
- Married couples should consider a generation-skipping trust plan. The first spouse to die could allocate the allowable portion of his or her GST exemption to a credit-shelter trust (usually equivalent to the applicable exclusion amount). A GST trust allows each generation to receive benefits from the trust without having the trust assets included in the beneficiaries' estates for federal estate tax purposes. The remaining assets could pass to a marital trust.

GST Exemption:

\$1,100,000 in 2002–2003;
\$1,500,000 in 2004;
\$2,000,000 in 2006;
\$3,500,000 in 2009;
zero in 2010; and back to
\$1,000,000 in 2011 (with
an adjustment for inflation).

Potential Generation-Skipping Transfer Tax Problem

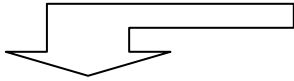
Each person who transfers assets during lifetime or at death has an exemption (currently \$3,500,000) from the generation-skipping transfer tax. For example, you can transfer \$2,000,000 to your grandchildren and not pay the tax even though a generation of heirs (your children) is skipped. Initially, assets in the credit-shelter trust usually qualify for \$3,500,000 of the decedent spouse's generation-skipping transfer tax exemption. However, once the surviving spouse passes on and trust assets are distributed to children or other beneficiaries, the generation-skipping transfer tax exemption is lost because children or other beneficiaries either receive their inheritance outright or through the use of a general power of appointment trust.

Solution

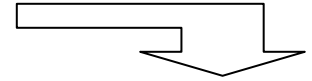
One solution to this potential problem is to create a Generation-Skipping Trust (GST). A GST preserves your generation-skipping transfer tax exemption without having trust assets included in your children's or other beneficiaries' estate for estate tax purposes. It allows each generation of beneficiaries to receive income or principal from the generation-skipping transfer tax trusts for health, support and education while excluding the value of the trusts in the beneficiaries' estate for estate tax purposes.

Consider an example where a couples' combined estate is \$3,000,000 and the husband dies in 2008.

Current Estate of First Spouse \$3,000,000



Upon death of the First Spouse:
Trusts shelter Estate Tax and GST Tax exemptions



GST Exempt Credit-Shelter Trust \$2,000,000

Funded with tax-sheltered amount.

- Spouse and children can be beneficiaries
- Irrevocable at death
- Income and principal for health, support and education
- Spouse may be trustee and have control
- Limited power to appoint principal
- Not included in spouse's estate for estate tax purposes
- Trust principal grows tax-free

Marital Trust \$1,000,000

Funded with remainder:

- Becomes irrevocable at death
- Included in spouse's estate for estate tax purposes
- Spouse can also be trustee (full control)
- Beneficiaries can receive income and principle for health, support and education
- Unlimited power to appoint

Upon death of surviving spouse,
surviving spouse's own exemptions used



Children's GST Exempt Trusts

Children:

- Receive income and principal for health, support and education.
- May be trustee and have full control of trust.
- Have limited power to appoint principal.
- Not included in children's estate for estate tax purposes.

Children's Non-Exempt Trusts

Children:

- Receive all income and principal.
- May be trustee and have full control of trust.
- Have limited or unlimited power to appoint principal.
- Included in children's estate for estate tax purposes.

Lifetime Gifts

Lifetime gifts and transfers at death are taxed using a tax schedule with cumulatively progressive rates. Each taxable transfer, including the final transfer at death, begins in the tax bracket attained by the prior gift.

Prior to the 2001 tax act, both lifetime gifts and transfers at death were taxed under a unified estate and gift tax system. Against this tax each taxpayer had a “unified credit” which could be used fully or in part during lifetime, with any remaining portion available at death. For 2001, for example, the unified credit was \$220,550, equivalent to \$675,000 of assets. The 2001 tax law change however, introduced a “split” in the amount of assets exempt from tax, beginning in 2004. The table below shows how the exemption amount (the applicable exclusion amount) will change.

Because of a “sunset” provision in the 2001 tax act, if Congress does not act to repeal the federal estate tax for years following 2010, the law will automatically revert to its state in 2001 with an exemption for the first \$1,000,000 of assets.

Annual Gift Tax Exclusion

Each taxpayer is allowed to give a certain amount of assets each year, without concern for gift taxes. This “annual exclusion amount” is currently \$12,000 per donor and a gift of this amount can be given to each of any number of donees. If husband and wife agree, they can “split” gifts and give twice the amount to each of any number of children, grandchildren, etc. By following a consistent program of annual lifetime gifts to children, grandchildren, etc., an estate owner can dramatically reduce his or her taxable estate.

Calendar Year	At-death Exemption	Gift Tax Exemption
2002	\$1,000,000	\$1,000,000
2003	\$1,000,000	\$1,000,000
2004	\$1,500,000	\$1,000,000
2005	\$1,500,000	\$1,000,000
2006	\$2,000,000	\$1,000,000
2007	\$2,000,000	\$1,000,000
2008	\$2,000,000	\$1,000,000
2009	\$3,500,000	\$1,000,000
2010	No Tax	\$1,000,000
2011	\$1,000,000	\$1,000,000

Also, you may pay for school tuition or medical expenses for an individual without incurring gift tax consequences. However, the payments must be made directly to the institution or health care provider in order to be exempt from gift tax.

Advantages of Making Gifts

- Gifts remove future appreciation from your estate.
- Gift tax paid reduces your taxable estate.
- Gifting income-producing assets may reduce current income taxes.
- Probate administration is not necessary for gifted assets.
- Donor observes the beneficiaries enjoy the assets while still living.

Marital Deduction

In the case of separate or community property passing from one spouse to another, there is an unlimited marital deduction. Transfers to spouses who are not U.S. citizens are not protected by the gift tax marital deduction, but a non-citizen spouse is entitled to an \$125,000 per year special annual gift tax exclusion if such gift would qualify for the marital deduction were the spouse a U.S. citizen.

Gift Tax Returns

These returns are filed annually on April 15 of the year following the gift for amounts in excess of the annual gift tax exclusion (\$12,000 in 2008). Gifts or gift taxes are not deductible for income tax purposes unless contributed to a qualified charity.

Gifts Includible in the Estate

- Gifts made within three years of death are not considered in the computation of the taxable estate. However, if they exceed the annual gift tax exclusion, they may be added to the taxable estate as adjusted taxable gifts. This, in effect, pushes the assets remaining in the taxable estate into the higher tax brackets; however, the appreciation on the assets from date of gift until date of death is not brought into the computation.
- Gifts of life insurance policies are still included in the computation of the taxable estate if made within three years of death. Certain incomplete transfers (e.g., retained life estates, revocable transfers, etc.) will also be included in the gross estate without regard to when they were made.
- All taxable transfers made within three years (except gifts that qualify for the annual gift tax exclusion) will be included for determining whether an estate qualifies for an IRC Sec. 303 stock redemption, the IRC Sec. 2032A special use valuation, or the IRC Sec. 6166 deferral of estate tax payment. Restrictions on gifts also apply to the IRC Sec. 2057 qualified family-owned business interest deduction.

Under the Tax Act of 2001, the federal estate tax is gradually phased out until its final repeal in the year 2010. If Congress does not act at that time to repeal it for the years following, it will automatically revert back to the rates in effect during the year 2001, with an exemption for the first \$1,000,000 of assets. If there is a possibility that the federal estate tax will be permanently repealed in 2011, it may not be prudent to make lifetime gifts that incur a gift tax, unless they fall within the applicable exclusion amount for gifts (\$1,000,000 in 2002 and thereafter).

How Are Death Taxes Paid?

If you have a taxable estate, federal death taxes are due and payable in cash within nine months after your death. A taxable estate means having an estate valued at:

- \$1,000,000 during 2002-2003
- \$1,500,00 during 2004-2005
- \$2,000,000 during 2006-2008
- \$3,500,000 Fed during 2009
- \$2,000,000 IL during 2009
- Unlimited during 2010
- \$1,000,000 during 2011 and beyond.

Using Life Insurance to Pay Estate Costs

Shortly after your death, your executor will be responsible for paying the costs of settling your estate. These costs include probate administration fees, accounting fees, attorney's fees, federal estate taxes, executor fees, and appraisal fees.

You can use life insurance proceeds to pay these expenses without having the proceeds included in your estate for estate tax purposes by using an Irrevocable Life Insurance Trust (ILIT). Life insurance passing through an ILIT is not subject to income or estate taxation. Best of all, premium payments further reduce your taxable estate.

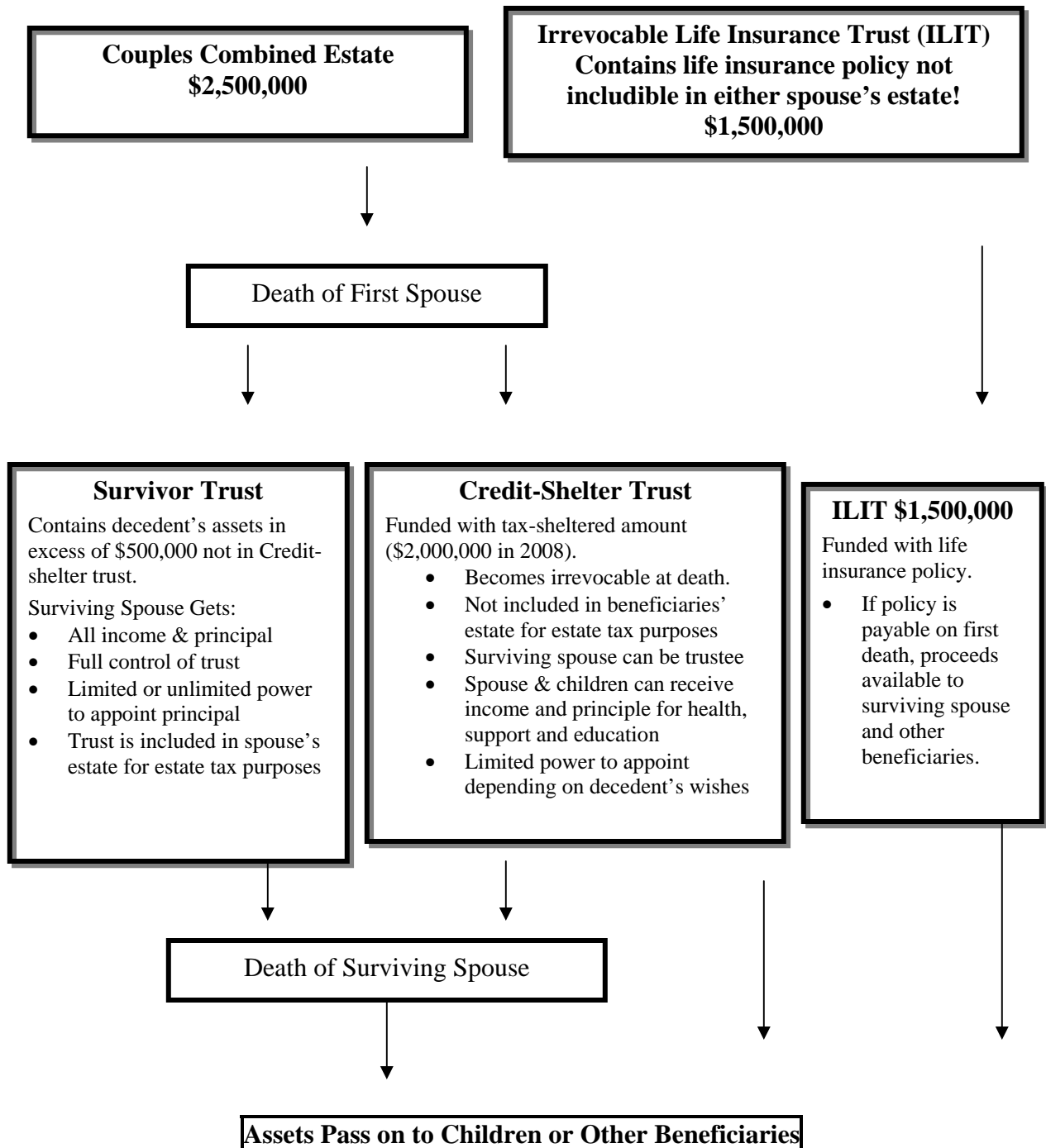
Generally, this trust is irrevocable unless you appoint a special trustee with the authority to terminate the trust and distribute trust principal. However, this is of little concern if the only trust asset is a term insurance policy. Since the trustee will purchase or renew the life insurance policy with trust assets, the trust must be funded. To fund the trust, you can make annual gifts to the trust that qualify for the annual gift tax exclusion (currently \$12,000 per beneficiary of the trust). If you fund the trust with an existing life insurance policy and you die within three years of the transfer, the policy proceeds will be included in your estate for estate tax purposes. If this is a concern, the trustee could purchase your existing policy for fair market value.

The following is an example of a typical estate plan that includes a irrevocable life insurance trust.

Five Common Ways to Provide Money for Death Taxes

- **Borrow the cash.** However, this only defers the problem, since the money will have to be repaid with interest. This includes installment payments to the government.
- **Pay in cash.** However, rarely does a person accumulate large sums of cash. If he or she does, he or she probably will forego many profitable investment opportunities in order to keep the estate in a liquid position.
- **Sell Investments.** This may be a wise choice if the market is "up" and investments are ripe for conversion to cash. However, if the market is "down" investments may not yield enough cash.
- **Estate Sale.** This is a common way to provide cash assuming a ready, willing and able market exists for the items in the estate.
- **Life Insurance.** Probably the easiest way to provide ready cash for estate settlement costs.

Irrevocable Life Insurance Trust for a Married Couple



- Assets in survivor's trust are taxable if they exceed tax-sheltered amount (\$1,000,000 in 2011).
- Assets in credit-shelter trust are not taxable because first spouse's federal exemption preserved.
- Assets in life insurance trust are not taxable because outside of either decedent's estate.