
Kugler Estate Analyzer™

Software and User Manual (Version 2008.00)
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Table of Contents

| | |
|--|-----------|
| Table of Contents | 2 |
| Getting Started | 6 |
| System Requirements | 6 |
| Installing the Program..... | 6 |
| Welcome to Kugler Estate Analyzer™ | 6 |
| Running the Program for the First Time | 6 |
| The Kugler Estate Analyzer Interface..... | 7 |
| Toolbar..... | 7 |
| File Menu | 7 |
| Edit Menu..... | 8 |
| Help Menu | 8 |
| Function Keys..... | 8 |
| AFR Manager | 9 |
| Download Latest AFRs | 9 |
| Typing in AFRs..... | 9 |
| Configuring the AFR Storage..... | 9 |
| Entering Data | 10 |
| Step 1 – Client Information | 10 |
| Step 2—Assets and Liabilities | 10 |
| Splitting Assets..... | 12 |
| Contributions to Assets | 12 |
| Withdrawals From Assets | 12 |
| Payments to Liabilities | 12 |
| An Example: Entering a Mortgage | 12 |
| Step 3—Techniques | 14 |
| Has Planning Been Done Previously? | 14 |
| Order of Techniques | 14 |
| One Asset Per Technique..... | 14 |
| Available Techniques | 15 |
| Credit Shelter Trust..... | 15 |
| Life Insurance Trust | 16 |
| Marital QTIP Trust..... | 16 |
| GST Trust..... | 16 |
| Fund Estate Costs..... | 17 |
| Income to Spouse | 17 |
| QPRT (Qualified Personal Residence Trust)..... | 17 |
| Grantor Trust..... | 18 |
| GRAT | 19 |
| Minority Discount..... | 19 |
| Rolling GRAT | 19 |
| CRAT | 19 |
| CLAT | 20 |
| CRUT | 22 |
| Sale to Grantor Trust..... | 23 |
| Family Limited Partnership | 24 |
| Special Use Valuation | 24 |
| Outright Gift..... | 24 |
| Annual Exclusion Gifts | 24 |

| | |
|--|-----------|
| Reports: Preparing the Estate Plan | 26 |
| Report Options | 26 |
| Expanded Discussion of Report Elements | 27 |
| Cover Page | 27 |
| Disclosure Page | 27 |
| Both Spouses Die within One Year | 27 |
| Projected Effect Flowchart..... | 27 |
| Asset Details Report..... | 27 |
| Asset Inventory/Current Simple Will Arrangement..... | 27 |
| Analysis of Taxes at Death Report..... | 27 |
| Summary of Planning Results | 27 |
| Technical Support | 28 |
| Brentmark on the Web..... | 28 |
| Kugler on the Web..... | 28 |
| Glossary | 29 |
| §7520 Rate | 29 |
| Applicable Exclusion & Credit Amount for Estate Tax Purposes | 29 |
| Asset Valuation and Valuation Adjustments..... | 29 |
| Business Interest..... | 30 |
| Carryover Basis for Lifetime Gifts..... | 30 |
| Carryover Cost Basis for Year 2010..... | 30 |
| Charitable Deductions | 30 |
| Charitable GRAT | 30 |
| Community Property (Generic Version) | 30 |
| Cost Basis of Assets Acquired from a Decedent at Death..... | 31 |
| Credit Shelter (Bypass) Trust | 31 |
| Credit Shelter Growth | 31 |
| Crummey Withdrawal Power | 31 |
| Deemed Allocation of GST Exemption..... | 32 |
| Direct Skip Gifts..... | 32 |
| Non Direct Skip Gifts | 32 |
| Disclaimer | 32 |
| Donor | 32 |
| Donee | 33 |
| Future Interest Gift..... | 33 |
| Estate Tax Calculations..... | 33 |
| Estate Tax Inclusion Period (ETIP) Rule..... | 33 |
| Executor..... | 33 |
| Extension of Time to Elect..... | 33 |
| Five and Five Trust Withdrawal Power..... | 34 |
| Gift and Estate Taxes Cumulative..... | 34 |
| Gift Splitting | 34 |
| Generation Skipping Transfer Tax (Lifetime/Death)..... | 34 |
| General Power of Appointment | 35 |
| Gift/Sale to Grantor Trust Agreement..... | 35 |
| Gift Tax Annual Exclusion | 35 |
| Gift, Estate and GST Tax for Year 2010 | 35 |
| Generation Skipping Transfer..... | 35 |
| Grantor..... | 36 |
| Grantor Retained Annuity Trust..... | 36 |
| Grantor Trust | 36 |
| Gross Estate | 36 |
| GST Dynasty Trust | 36 |

| | |
|---|----|
| GST Exemption | 37 |
| GST Tax Exemption and Highest GST Tax Rates | 37 |
| Hanging Power of Appointment..... | 37 |
| Heir | 37 |
| Inclusion Ratio | 37 |
| Income in Respect of a Decedent | 37 |
| Income Tax Rate | 38 |
| Inflation Rate..... | 38 |
| Insurance | 38 |
| Intestacy Laws | 38 |
| Intestate | 38 |
| Internal Revenue Code Section 6166 | 38 |
| Inter Vivos (Living) Trust..... | 38 |
| Irrevocable Trust..... | 39 |
| Life Estate..... | 39 |
| Limited or Special Power of Appointment | 39 |
| Liquid Asset | 39 |
| Liquidate Assets at Second Death | 39 |
| Marital Deduction..... | 39 |
| Maximum Annuity GRAT (also referred to as Zero Gift GRAT) | 39 |
| Minority Interest Qualified Personal Residence Trust | 40 |
| Net Income Make-Up with Charitable Remainder Unitrust | 40 |
| Non-Citizen Spouse..... | 40 |
| The Non-Family Gift via GRIT | 40 |
| Non-liquid Asset | 41 |
| Non-Probate Assets | 41 |
| Non-Resident Aliens | 41 |
| Payment Timing..... | 41 |
| Portfolio..... | 41 |
| Portfolio Balance | 41 |
| Portfolio Growth..... | 41 |
| Potential Predeceased Parent Problem for Deferred Gifts | 41 |
| Potential Predeceased Parent Problem for Non GST Trusts..... | 42 |
| Predeceased Parent Rule | 42 |
| Present Interest Gift..... | 42 |
| Prior Gifts..... | 42 |
| Private Annuity | 42 |
| Probate Assets | 43 |
| QDOT | 43 |
| Qualified Plan | 43 |
| Real Estate | 43 |
| Remainder Interest Beneficiary | 43 |
| Required Minimum Distributions (RMDs)..... | 43 |
| Retroactive Allocation of GST Exemption | 44 |
| Reverse QTIP Trust..... | 44 |
| Reversionary GRAT | 44 |
| Rule against Perpetuities..... | 44 |
| Self-Canceling Installment Note (SCIN)..... | 45 |
| Special Use Qualifications..... | 45 |
| Special Use Valuation for Qualified Real Property..... | 45 |
| Split Asset..... | 46 |
| Spousal IRA Rollover | 46 |
| Stepped-Up Cost Basis for Death-Time Transfers..... | 46 |
| Stock Options | 46 |
| Substantial Compliance..... | 46 |
| Survivorship Life Insurance Policy | 46 |

| | |
|---|-----------|
| Tax Exclusive vs. Tax Inclusive..... | 46 |
| Tenancy by the Entirety..... | 47 |
| Tenants in Common | 47 |
| Term Certain GRAT..... | 47 |
| Testamentary Trust | 47 |
| Three-Year Rule IRC Section 2035..... | 47 |
| Transfer-for-Value Rule..... | 48 |
| Transfers with Retained Life Interest (IRC Section 2036)..... | 48 |
| Transferor | 48 |
| Trust..... | 48 |
| Trustee..... | 48 |
| Trust Income..... | 48 |
| Trust Principal..... | 49 |
| Unified Credit Used | 49 |
| Unified Credit | 49 |
| Waiver of Spousal Rights in Qualified Retirement Plans | 49 |
| Index | 50 |
| License Agreement | 52 |

System Requirements

To run Kugler Estate Analyzer on your computer, you must be running a PC with Microsoft Windows and 20 MB of free hard drive space.

Installing the Program

Insert the Kugler Estate Analyzer CD into your CD drive. If the setup program does not start automatically, click Start, choose Run and type “D:\Setup” (where D is the CD drive; this may vary on your computer).

Welcome to Kugler Estate Analyzer™

The Kugler Estate Analyzer has been designed to help you create high quality comprehensive estate plans which are both easy for you to create and easy for your clients to understand.

To build a plan in the software, you perform three steps:

1. Entering Client Information
2. Entering Asset & Liability information
3. Adding the Estate Planning Techniques that you want to illustrate

The program allows you to save and load your files through the File Menu, so you can leave a case and come back to it later.

When you are all done, you'll have a plan that starts with the client's current situation, and builds on that by adding each different estate planning technique you have specified. Each technique will have an explanation of what it is, an illustration of the numbers, and a flowchart showing how it affects the overall plan. At the end of the report, there's a bar graph showing the benefits of the plan you've put together.

To get up and running quickly,

Running the Program for the First Time

The first time you run the Kugler Estate Analyzer, select **Advisor Information** from the Edit menu. Type in your contact information and click OK. This information is saved so that all future plans you generate will be customized with your contact information. If a file is saved, the Advisor Information is saved as part of the file.

Once this has been created, select “New” from the file menu to get started.

The Kugler Estate Analyzer Interface

Toolbar

At the top of the program window the toolbar contains buttons to let you quickly navigate through the software. All of the items on the toolbar can also be reference through the menus.



The left side of the toolbar has buttons for opening a file, saving a file, printing, previewing, and getting help.

The right side of the toolbar lets you quickly switch between the three main screens of the software.

Click the AFRs button to update the Applicable Federal Midterm Rates.

File Menu

Use the File Menu for working with data files and when printing. It contains the following list of commands:

New – Opens a new file.

Open (Shortcut: F3) – Opens existing files. In the Open window: Enter the name of the file to open or select the directory where the file is located and select the file from the files listed.

Reopen File – The program keeps track of the last five files you worked with. Use the Reopen File choice to quickly access these files.

Save – Saves the current data to the currently loaded file. The currently loaded file name is displayed in parentheses in the caption of the main window. To save a file under a new name, use Save As.

Save As (Shortcut: F2) – Saves the current data under a new name. Specify a directory in which to save the file and type in the name of the file to create.

Create Desktop Icon – If you did not create a desktop icon for the program on initial installation, you may do so by clicking here

Location of Data Files – Use this menu choice to specify where you'd like to store your data files. This location is stored so that you only have to enter it once – not once each time you run the software.

Data File Encryption – This is simply a toggle on/off

Print Setup – Specifies a printer and the desired printer settings. You can use the default printer or choose a printer from the list. More printing options or report options are available from the Print Window.

Report Options—Sets the fonts, colors, margins and other specifics for printed reports.

Print (Shortcut: F6) – Click Print when you're ready to print your report. This window also lets you set all of the printing and printer options.

Input Checklist – Links to a Data Gathering Form (in PDF format) to aid in the organization of case data.

Exit – Exits the software.

Edit Menu

Use the Edit menu to navigate through the software. It contains the following commands:

- Client Information** – Go to Step 1: Client Information. See that chapter for more details.
- Assets & Liabilities** – Go to Step 2: Assets & Liabilities. See that chapter for more details.
- Techniques** – Go to Step 3: Techniques. See that chapter for more details.
- Calculation Assumptions** – Edit the calculation assumptions (tax rates, portfolio information, etc.) See the chapter on calculation assumptions for more information.
- Advisor Information** – Edit your contact information (for customizing the reports).
- Liquidation Details** – When the software needs to spend money (for expenses, taxes, or other costs), it takes money from the assets according to the liquidation order that you specify. Use this selection to set the Liquidation Details.
- State Death Tax Manager** – Allows you to download the latest State Death Tax information, and review how the tax works in your particular state.

Help Menu

The Help menu contains several ways for you to search for answers to any questions you may have about the program or any of its calculations. You can browse the contents of the online Help system or search for a specific item.

Function Keys

Here is a list of the Function Keys and what they do. The Function Keys are shortcuts on the keyboard for some of the most commonly used actions in the program.

| Key | Function |
|---------------|--|
| F1 | Access the Help on the current calculation. |
| F2 | Save a previously saved file under another name (Save as). |
| F3 | Open a file. |
| F4 | Access the AFR Rates Manager. |
| F6 | Access the printing options. |
| Alt-F4 | Exit the program. |

AFR Manager

The AFR Manager is a separate application which stores a list of available rates through the present month. The rates are needed for a number of calculations in the program (i.e., Charitable Remainder Annuity Trust or Grantor Retained Annuity Trust).

The Kugler Estate Analyzer interfaces with the AFR Manager to automatically pull up the correct AFR for any calculations that need it. Whenever you see a “30%” in an AFR rate input field, it means that you need to update your AFR Rates.

The Applicable Federal Mid-Term 120% Annual Rate changes monthly and is reported in *The Wall Street Journal*. (See the Federal Interest Rates in the Money and Investing section of the *Journal*, generally between the 18th and 23rd of the preceding month.) This rate can often be found earlier on Brentmark’s web site at <http://www.brentmark.com/AFRs.htm>.

Note: If a §7520 Rate entry field shows 30%, the AFR table must be updated. Thirty percent is the default value that appears when there is not a current AFR available for the chosen Transfer Date. Download or manually update your AFR table.

Download Latest AFRs

If you run the AFR Manager, and it doesn’t have the current rate, it will prompt you to download the latest rates. If you choose not to do the download, you can always go back and download the rates by clicking the **Download Latest AFRs** button.

Note: If you have internet access through a dial-up service, you must establish a connection before selecting this option from the menu. If you are connected through a network or a cable modem, your internet connection is already established.

Typing in AFRs

There are many situations that could cause the download not to work. For example, your corporate firewall might prevent the AFR Manager from communicating with the internet.

In this case, simply click the button with the picture of the world on it and select “Go to AFR web page”. We keep the rates updated there. If this doesn’t work (for example, if your internet connection is down), give us a call and we’ll tell you the latest rates.

To type the new rate in, click on the appropriate box in the grid. For example, to enter the rate for January, 2007, scroll down to 2007 and click in the box in the “Jan.” column. Then just type in the rate and press the Enter key. When you exit the AFR manager, the rates will be automatically saved.

Configuring the AFR Storage

If you’d like to have the AFR rates stored in another location (a network drive, for example), click the folder tree button and enter the location where you’d like the rates file to be stored

Entering Data

The Kugler Estate Analyzer is designed to help you create estate plans that your clients can have confidence in. In order to create the plan, of course, you have to enter your client's data. This is a fairly straightforward three step process.

First you enter the client's contact information. Next, you enter the client's assets. Finally, you select which estate planning techniques you'd like to illustrate.

Of course, there are a lot of details to each of these steps. The software has help screens (and this manual) to help you with the process. Once you're done, you'll have a printout that steps the client through each of the estate planning techniques that you have illustrated.

Step 1 – Client Information

Step 1 is where you enter information about the people involved in the plan. Enter the contact information for both spouses (or indicate that the client is not married), and then use the heirs box to enter information about the heirs.

First, indicate whether or not the client is married by checking or unchecking the **Is the Client Married** check box. For married clients, you'll be able to enter contact information for both spouses. Note the Gender checkbox for each spouse – this lets you handle cases where the wife is the primary client.

You also need to enter the correct state of residence so that any state death taxes may be properly calculated. Certain states use beneficiary classes that differ from the federal table. For example, New Jersey taxes assets going to nieces and nephews at a higher rate than assets going to children. If the state selected has different beneficiary classes, a box called "inheritance tax" will appear. You should then click on this box to review the beneficiary classifications.

When entering years of death, you can click the little computer icon next to the data field to have the software fill in the year of death based on life expectancy.

The last portion of Step 1 is entering the heirs. To enter heirs, click the Add button next to the list of heirs. The Edit button lets you edit the information for any heirs you've already added, and the Delete button lets you delete them.

It's important that you finish entering the Client Information before moving on to entering assets because when you enter assets, you'll be indicating both ownership and named beneficiaries for each asset.

Step 2—Assets and Liabilities

Before entering any other data on Step 2 (Assets & Liabilities), enter the Valuation Year. This year is the first year of the analysis. The values of the assets and liabilities that you enter are all assumed to be correct as of the Valuation Year.

Step 2 is divided into three columns: Assets, Liabilities, and Estate Value.

The Assets lists let you add edit and delete assets. Use the buttons below the list to perform each of these functions. When you add an asset, you can select which type of asset to add:

- **Qualified Plans** are assets with required minimum distributions. If withdrawals are subject to income taxes answer Yes to Are Withdrawals Subject to Income Tax?. Use this asset type for IRAs, 401(K)s, Pension Plans and so forth.
- **Insurance** includes both single life and survivorship policies. Indicate the ownership on the asset window. If the insurance is owned by an irrevocable trust, make sure to select the appropriate trust for the ownership. For joint life insurance on a married couple which is owned by a trust, you should select trust ownership based upon whichever spouse is assumed to die second.
- **Business Interest Assets** include both voting and nonvoting interests in businesses.
- **Real Estate** is land, including all the natural resources and permanent buildings on it.
- **Liquid Assets** are those that can be readily converted to cash.
- **Non-liquid Assets** includes all assets that don't fit into one of the other categories and are not generally available for taxes and expenses.
- **Stock Options** are a form of compensation provided by corporations. A stock option is the right to buy a fixed number of shares at a specific price for a specific period of time.

When you add or edit an asset, a window appears to let you enter information about that asset. For most asset types, this includes a descriptive name, the balance of the asset (as of the Valuation Year), the basis, the appreciation rate, the after tax income rate, the type of ownership, and who the beneficiary is. There are a couple of subtleties in the asset entry that are worth mentioning:

- **Name** Each asset must have a unique name
- **Balance** is the current value of the asset
- **Basis** is not relevant to results calculated. It is only relevant if the estate tax is repealed
- **The Appreciation Rate is separate from the After-Tax Income Rate.** If you enter an Appreciation Rate of 5% and an After Tax Income Rate of 3 %, the asset will increase in value by 5% each year and generate income of 3%. The total growth on the asset would thus be 8%.
- **Reinvest Income in <<asset name>>?** Answering Yes to this question causes the income generated by the asset to be reinvested in itself. If you answer No, the income gets invested in the Portfolio.
- **Community Property Checkbox** is used to indicate which assets are owned through Community Property. You may want to consider splitting these assets in half (half owned by each spouse) if you are going to use them in techniques.
- **Beneficiary** is the current named beneficiary. The program does not override any named beneficiary that you enter. When setting up the Credit Shelter Trust, for example, the software does not use any assets with named beneficiaries.
- **Allow Death Value to be Place in Trust?** This question only applies to insurance assets. Answering “Yes” allows the death value to be placed in an ILIT.
- **Contributions and Withdrawals:** If you want to model contributions being made to an asset, click the Contributions button. Likewise, if you want to model withdrawals from an asset, click the Withdrawals button.

If you wish to divide an asset into two smaller assets, click the Split Asset button located on the bottom right hand corner of the screen.

The **Liabilities** list functions in the same manner as the **Assets** list. Click Add, Edit, or Delete to add edit or delete liabilities. Note that in this program, individual liabilities are not tied to individual assets.

The Estate Value column is simply a quick summary of where the client stands. It shows you the taxable estate, taxes, and net estate for each spouse.

When you've finished this step, proceed to Step 3: Techniques.

Splitting Assets

The Kugler Estate Analyzer assumes that each Technique uses 100% of the asset funding it. However, it is not uncommon to fund a technique with only a portion of a given asset.

Press the Split Asset button to split an existing asset into two portions. Splitting an asset creates two identical assets (you'll have to give the new piece a new name), each of which is a percentage of the original asset. Once it has been split, the new asset can be used by any technique.

For example, if you wanted to take a portion of an asset and put it in a GRAT, you would split the asset by the percentage you want to move.

Splitting the asset may be the only way to fund certain techniques.

Contributions to Assets

When you click the Contributions button on the Asset Window, the contributions window appears. Enter the annual amount, the growth rate, the year contributions should begin, and the last year that contributions should be made. You can enter up to five streams of contributions. Contribution amounts in overlapping years are added together. Click OK when you have completed the data entry.

Withdrawals From Assets

When you click the Withdrawals button on the Asset Window, the withdrawals window appears. Enter the annual amount, the growth rate, the year withdrawals should begin, and the last year that withdrawals should be made. You can enter up to five streams of withdrawals. Amounts in overlapping years are added together. Click OK when you have completed the data entry. Withdrawals from assets are not reinvested.

Payments to Liabilities

When entering Liabilities, you can click the Payments button to indicate that payments are being made to reduce the liability amount. Enter the annual amount, the growth rate, the year payments should begin, and the last year that payments should be made. Click OK when you have completed the data entry.

An Example: Entering a Mortgage

To enter a mortgage on a piece of property, add a liability with payments and add withdrawals to the appropriate asset. For example, to illustrate a \$300,000 house with a mortgage that is being paid off at \$25,000 a year from a Savings Account.

1. Click the Add button under the Assets list and add a Real Estate asset. Call it "House" and enter the appropriate information.

-
2. Click the Add button under the Assets list and add a Liquid Asset. Call it “Savings Account” and enter the appropriate information.
 3. Click the “Withdrawals” button on the Savings Account Asset Window and indicate a \$25,000 a year withdrawal for the duration of the payments.
 4. Click the Add button under the Liabilities list. Name the liability “House Mortgage”, enter the appropriate interest rate and balance, and then click the “Payments” button and indicate a \$25,000 a year payment for the duration of the payments. If you’d like to have the mortgage get paid off at the first death, answer “Yes” to the “Satisfy Debt at First Death?” question.

To illustrate a mortgage that is being paid from other sources (a salary instead of an asset, for example), skip steps 2 and 3 above.

Step 3—Techniques

In this step, you select the estate planning techniques that you wish to illustrate to your client. Before selecting the techniques, however, decide what style of flowchart you'd like to use. If your client has already done some planning, check the **Has Planning Been Done Previously** checkbox. Checking this box causes the flowcharts to include information about techniques that have already been implemented. When you check the box, a **Previous Planning** item appears in the Selected Techniques list. Click it to set up the details of the previous planning that has been done.

Now you are ready to select the estate planning techniques to include in the analysis. Select the planning techniques by double-clicking on them in the Available Techniques list. When you double-click some items (like GRAT), a window may appear prompting you for details about the technique being illustrated. If you want to edit a technique later, either double-click it in the Selected List or click it once and then click the Edit button.

You can illustrate more than one instance of the same technique. For example, to put multiple assets into an FLP, multiple FLPs to the analysis, each with its own asset funding it.

The Assumptions button (located on the bottom right corner of the screen) is very important. This is where you indicate basic planning assumptions for the client. Once you have completed adding the techniques to illustrate, click the Preview button to see what the final report looks like.

See the Glossary for additional descriptions of the terms in this step.

Has Planning Been Done Previously?

Checking the **Has Planning Been Done Previously** checkbox changes the flowchart to show more detail at each spouse's death. It's a more complex illustration that is appropriate for the clients that have already done some planning. If your client has not already started planning, do not check this box, as you will probably want to illustrate some of the more common and more basic techniques, like Credit Shelter Trusts and Life Insurance Trusts.

When this box is checked, the number of techniques shorten, and an item called "Previous Planning" appears in the Selected Techniques list. Click this item to customize the previous planning that has been done.

Order of Techniques

Whenever possible, the techniques are illustrated in the order that they are listed in the Selected Techniques list. This isn't always possible. A credit shelter trust, for example, is always set up at the death of the first owner and uses whichever assets are available at that time. The order of the techniques can be important to your illustration. For example, if one technique uses up the equivalent exemption, it won't be available in subsequent techniques.

One Asset Per Technique

The program only allows one asset per technique, and once an asset is used in one technique it cannot be used in any others. If you'd like to have an asset used in multiple techniques, use the Split Asset button on the Assets screen to split it up. If you'd like to have multiple assets in one technique, add the technique multiple times (once for each different asset).

Available Techniques

There are several estate planning techniques available for illustration in the software, including:

| | | |
|----------------------|--------------|------------------------------|
| Credit Shelter Trust | QPRT | Sale to Grantor Trust |
| Life Insurance Trust | GRAT | Family Limited Partnership |
| Marital QTIP Trust | Rolling GRAT | Special Use Valuation |
| GST Trust | CRAT | Testamentary Charitable Gift |
| Fund Estate Costs | CLAT | Outright Gift |
| Income to Spouse | CRUT | Annual Exclusion Gifts |

Credit Shelter Trust

The amount passing to the trust at the death of the estate owner is the unused applicable exclusion amount for estate tax purposes. The bequest to the trust is estate tax free because the estate owner's unified credit covers the tax on the exclusion amount. Example: Assume estate owner has made \$500,000 of taxable gifts during lifetime and dies in a year when the applicable exclusion amount for estate tax purposes is \$2,000,000. The trust would then be funded to \$1,500,000 (assuming no part of the \$1,500,000 applicable exclusion amount remaining at death is used for other transfers at death that are subject to estate tax).

When this technique is selected, a popup box appears. You can select any amount up to \$3,500,000 to fund the credit shelter trust. In certain situations you may wish to fund an amount less than the full credit shelter trust. For example, assume the client is a New York resident, where a state death tax may be applicable for transfers over \$1,000,000. Fully funding the credit shelter trust will result in a state death tax at the first death. To avoid this tax, you would only fund the credit shelter trust to \$1,000,000.

Note that the credit shelter trust can only be funded with available probate assets. Pension plans, jointly-held assets, life insurance and assets with listed beneficiaries are not normally available to fund a credit shelter trust. If the total amount of available assets is less than the credit shelter amount, the lesser amount will be used to fund the trust. For example, if a client's estate is made up entirely of joint property, the credit shelter trust amount will be \$0.

The trust will typically have two classes of beneficiaries. The income beneficiary will receive all income earned by the trust each year. The definition of income may be structured to include actual earned income and, if desired, all or a portion of trust appreciation. Typically at the death of the income beneficiary (assume the surviving spouse), the trust principal will be paid to the remainder beneficiaries (children). Since the income beneficiary would have the use (trust income) but not the actual ownership of the trust principal, no portion of the trust principal (including appreciation after death of estate owner) should be included in the surviving spouse's estate. Thus, the trust is referred to as a credit shelter trust because the trust principal is sheltered from estate tax at the demise of the estate owner and surviving spouse.

Life Insurance Trust

Select the technique “Life Insurance Trust” to illustrate the effect of moving the insured client's life insurance policies into an Irrevocable Life Insurance Trust. No data entry is required.

It's important to note that the **Life Insurance Trust** technique moves only those insurance assets that you've explicitly marked as being available to be placed in a trust. On the asset screen for each insurance asset that you'd like to have included, answer **Yes** to the **Allow Death Value to be Placed in Trust** question.

When a life insurance policy is owned by someone other than the insured (irrevocable trust or spouse) the program assumes that the policy owner is always the beneficiary. If the spouse is the owner and dies before the insured, the program assumes the policy is left to the insured spouse. If the spouse wants to gift the policy, the program assumes the policy is first gifted to the insured, and then from the insured to an irrevocable life insurance. Note that this technique only covers **existing** life insurance policies. To illustrate the purchase of a **new** life insurance policy, see “fund estate costs” below.

Marital QTIP Trust

Generally, a transfer (gift/estate) will not qualify for the marital deduction if the spouse receives only a life estate or other terminable interest and an interest in the property passes to another person who may enjoy the property after the spouse's interest ends. A marital deduction will, however, be available where property passes from the decedent spouse to (1) a power of appointment trust where the surviving spouse has the right to all income for life and has the power to appoint trust property to him/herself or his/her estate; (2) a qualified charitable remainder trust where the spouse is the only non charitable beneficiary (although in some cases certain ESOP remainder beneficiaries are permitted) or (3) a QTIP trust for which the decedent's executor elects marital deduction treatment.

Such transfers are typically structured in an estate plan via a QTIP Trust. The trust must provide that the spouse 1) be the sole beneficiary during lifetime 2) be entitled to all trust income and 3) have the right to direct the trustee to invest in income producing assets. In addition, no person can have the right to appoint trust property to anyone other than the surviving spouse during his/her lifetime. However, at the death of the surviving spouse, the transferor spouse would have previously designated the subsequent beneficiaries to receive the trust principal. Under the QTIP arrangement, trust principal will be included in the surviving spouse's estate for estate tax purposes even though the spouse does not have a general power of appointment over the trust principal.

GST Trust

A generation skipping transfer occurs when an individual makes a gift to:

1. lineal descendants of his/her grandparents or lineal descendants of a spouse's grandparents who are at least two generations below the transferor or transferor's spouse (i.e., grandchildren and their issue; a brother's or sister's grandchildren and their issue; an aunt's or uncle's great grandchildren and their issue) **or**
2. persons who are not lineal descendants and are more than 37½ years younger than the transferor.

There are three types of generation skipping transfers:

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1. **Direct Skip Gifts**—Transfers made directly to “skip persons” or to a trust that benefits only skip persons (e.g., grandchildren, etc.) In addition to direct skip gifts, there are deferred types of generation-skipping transfers. These are usually GSTs that involve an irrevocable trust.
 2. A **Taxable Termination** occurs when an interest in property is held in a GST trust, and the interest of the last member of a non-skip generation (e.g., the donor’s children) in the trust terminated, and only skip persons remain as trust beneficiaries for that interest in the trust.
 3. A **Taxable Distribution** occurs when a GST trust makes a distribution to a skip person that is not considered a direct skip or taxable termination.

Fund Estate Costs

Select this technique to illustrate the effect of creating another asset to fund the estate tax. The Fund Estate Costs technique shows how much insurance would be needed to pay the settlement costs at the second death of the owner and spouse. You may select any amount of new insurance up to the calculated total amount of settlement costs, net of existing insurance. A popup box appears in this technique to show the calculated total amount of settlement costs, which is based upon the assets, assumed year of death, techniques selected, and assumed estate tax calculation.

Income to Spouse

Select this technique if you want to illustrate using some estate assets to provide income to the spouse. When you select this technique, you’ll be asked what portion of the assets should be converted to income producing assets, and what income rate they can produce. The illustration of this technique includes a flowchart breaking down the income sources for the surviving spouse.

QPRT (Qualified Personal Residence Trust)

A QPRT is an arrangement whereby the grantor gifts a personal residence to an irrevocable trust and retains the use of the residence for a stated period of years. At the end of the trust period, the residence passes to the remainder beneficiary (e.g., grantor’s children or to a trust for their benefit.) The grantor must report the present value of the remainder interest as a future interest gift. Should the grantor die during the term of the trust, the residence is included in his/her estate with credit for any gift taxes paid and/or unified credit attributable to the QPRT.

When you put cash or assets into the trust, you make what is called a “future interest” gift. The value of that gift is the excess of the value of the property you transferred over the value of the interest you kept. The value of your retained interest is found by multiplying the principal by the present value of an annuity factor for the number of years the trust will run.

For example, assuming a 7.6% federal discount rate, if the trust will run for ten years and \$100,000 is initially placed into the trust subject to a reversion, the value of the (nontaxable) interest retained by a 65 year old would be \$63,460.

The value of the (gift taxable) remainder interest would be the value of the capital placed into the trust (\$100,000) minus the value of the nontaxable interest retained by the grantor (\$63,460), or \$36,540. Therefore, the taxable portion of the grantor retained income trust gift would be \$35,410. This remainder interest, by definition, is a future interest gift and will not qualify for the annual exclusion. The donor will have to utilize all or part of the remaining unified credit (or if the credit is exhausted, pay the appropriate gift tax).

The longer term you specify the larger the value of the interest you have retained - and the lower the value of the gift you have made. Theoretically, if the term you select is long enough, the value of your retained interest approaches actuarially 100 percent. This essentially eliminates any meaningful gift tax liability.

The advantage of the QPRT is that it is possible for you to transfer assets of significant value to family members without incurring significant gift tax. In the example above, the cost of removing \$100,000 from the gross estate (plus all appreciation from the date of the gift) is the use of \$35,410 of your constantly growing unified credit.

The QPRT is a “grantor trust.” This means all income, deductions, and credits are treated as if there was no trust and these items were attributable directly to the grantor.

The entire principal (date of death value) must be included in the estate of a grantor who dies during the term of the trust since he has retained an interest for a period which, in fact, did not end before his death. If any gift tax had been paid upon the establishment of the trust, it would reduce the estate tax otherwise payable. If the unified credit was used, upon death within the term, the unified credit used in making the gift will be restored to the estate (if the grantor's spouse consented to the gift, his or her credit will not be restored). So the trick is to select a term for the trust that you are likely to outlive.

Quite often, the estate's beneficiary (possibly through gifts you make) will purchase life insurance on your life. Then, if you should die during the term of the trust, the tax savings you tried to achieve will be met through the life insurance and there would be sufficient cash to pay any estate tax.

The regulations under §2702 allow two different kinds of trusts to hold personal residences, a “personal residence trust” (PRT) and a “qualified personal residence trust” (QPRT). A PRT is very limited and inflexible, because it must not hold any assets other than the residence and must not allow the sale of the residence. A QPRT can hold limited amounts of cash for expenses or improvements to the residence, and can allow the residence to be sold (but not to the grantor or the grantor's spouse). However, if the residence is sold, or if the QPRT ceases to qualify as a QPRT for any other reason, either all of the trust property must be returned to the grantor or the QPRT must begin paying a “qualified annuity” to the grantor (much like a grantor-retained annuity trust, or GRAT).

Grantor Trust

An estate owner may want to create an irrevocable trust and intentionally retain certain rights in the trust which will cause the trust to be classified as a so-called “grantor trust.” As a grantor trust, the grantor will be taxed on the trust income even though it is not distributed to him. Thus, for income tax purposes, the grantor is treated as though he still owns the trust principal. However, by carefully selecting the appropriate retained powers (IRC Sections 673-677), the trust may be effective for gift and/or estate tax purposes and thus not includable in the grantor's estate.

There are situations where being taxed on the trust income may be consistent with the grantor's overall estate objectives. Bear in mind that the grantor may be paying income taxes on trust income that could be accumulated for or distributed to the trust beneficiaries (his heirs). This situation is enhanced because under current law the grantor need not report a gift for the payment of income taxes on trust income. Also, in situations where the grantor sells assets to the trust, the income tax consequences (capital gains, etc.) may be disregarded because the trust does not exist

for income tax purposes. GRITS, GRATS and QPRTS are automatically classified as grantor trusts because of the grantor's retained interest.

GRAT

Under the maximum annuity GRAT the annuity payout is structured to return to the grantor close to 100% of the initial value of the gifted asset plus interest at the IRS rate. This is the maximum annuity payout allowed by the IRS. This arrangement would normally produce a near-zero remainder interest value and either a minimum reportable gift for a reversionary GRAT or a zero gift for the term certain GRAT.

However, for the term certain GRAT, the grantor may want to set the annuity payout just below the maximum so there will be a small remainder value, which will in turn cause a very small reportable gift. By filing the required gift tax return for this small gift and providing full disclosure, the 3-year statute of limitations will commence. This will limit the period for the IRS to challenge the gift value and term certain arrangement.

Note that for reversionary GRATs, the system allows any annuity payment up to the calculated maximum amount. The system calculates the maximum annuity payment based upon Revenue Ruling 77-454. It does not calculate the maximum annuity based upon the "Taxable Gift or Residual Interest in Trust" method, which normally results in a higher maximum annuity.

The user has the option to vary the annuity payment. This may be done by selecting the "vary annuity payments" checkbox, then clicking on the "edit" button. Note that based upon IRS regulations, the maximum annual increase allowed in the annuity payment is 20%.

Minority Discount

A minority interest discount may be applicable to the value of the asset being gifted. Generally, due to issues of control, a minority interest in an asset will be worth something less than its proportional share of the overall asset value. For example, a 1/3 interest in a limited partnership will not be worth 1/3 of the overall value, because someone who owns 1/3 of the limited partnership lacks control over any distributions or investment-related decisions.

The discount can be obtained when the asset is gifted to multiple beneficiaries.

Rolling GRAT

"Rolling GRAT" is a term used to describe a situation where the grantor sets up a series of short term GRATs, where each subsequent GRAT is funded by payouts from the prior ones. The Kugler Estate Analyzer illustrates this technique using 2 year maximum annuity GRATs. It does not allow the Rolling GRAT technique to be illustrated beyond the grantor's death.

CRAT

A CRAT is an irrevocable trust to which the grantor gifts assets and retains a fixed annuity payout for a term of years or until the death of the grantor. If desired, the grantor can name other beneficiaries to receive the income payout (a reportable gift). The charity receives the remainder interest at the end of a specified term or at death of the grantor. Depending on the terms of the CRAT, should the grantor die during the trust term, the trust principal may or may not be included in the grantor's estate; however, an offsetting charitable deduction should eliminate any estate tax liability. An income tax deduction is given for the present value of the remainder

interest (must be at least 10%) which passes to the charity. The ideal asset to fund the trust is one that has a low cost basis and is not generating an income to the owner. In order to make the asset income-producing, it would have to be sold and this would trigger a substantial capital gain. The capital gain tax will not be currently applicable if the asset is sold after it is transferred to the charitable remainder trust.

This calculation determines the value of the non-charitable beneficiary's annuity (nondeductible) and the value of the charitable remainder interest (deductible) for a gift made through a charitable remainder annuity trust.

When a charitable remainder annuity trust is established, a gift of cash or property is made to an irrevocable trust. The donor (and/or another non-charitable beneficiary) retains an annuity (fixed payments of principal and interest) from the trust for a specified number of years or for the life or lives of the noncharitable beneficiaries. At the end of the term, the qualified charity specified in the trust document receives the property in the trust and any appreciation.

Most gifts made to a charitable remainder annuity trust qualify for income and gift tax charitable deductions (or in some cases an estate tax charitable deduction). A charitable deduction is permitted for the remainder interest gift only if the trust meets certain criteria.

A trust qualifies as a charitable remainder annuity trust if the following conditions are met:

- The trust pays a specified annuity to at least one non-charitable beneficiary who is living when the trust is created. Annuities can be paid annually, semiannually, quarterly, monthly, or weekly.
- The amount paid, as an annuity, must be at least 5%, but less than 50% of the initial net fair market value of the property placed in the trust. The charity's interest at inception must be worth at least 10 percent of the value transferred to the trust.
- The annuity is payable each year for a specified number of years (no more than 20) or for the life or lives of the noncharitable beneficiaries.
- No annuity is paid to anyone other than the specified non-charitable beneficiary and a qualified charitable organization.
- When the specified term ends, the remainder interest is transferred to a qualified charity or is retained by the trust for the use of the qualified charity.
- The Internal Revenue Service has also ruled that a trust is not a charitable remainder annuity trust if there is a greater than 5% chance that the trust fund will be exhausted before the trust ends.
- The annuity paid must be a specified amount expressed in terms of a dollar amount (e.g., each non-charitable beneficiary receives \$500 a month) a fraction, or a percentage of the initial fair market value of the property contributed to the trust (e.g., beneficiary receives 5% each year for the rest of his life).

The grantor will receive an income tax deduction for the present value of the remainder interest that will ultimately pass to the qualified charity. Government regulations determine this amount which is essentially calculated by subtracting the present value of the annuity from the fair market value of the property and/or cash placed in the trust. The balance is the amount that the grantor can deduct when the grantor contributes the property to the trust.

CLAT

A charitable lead annuity trust (CLAT) is an irrevocable trust to which the grantor gifts assets. The trust pays an annuity of a determinable amount to the designated charity for a stated period of

years (a term certain). At the end of the trust period, the remaining trust principal is paid to the remainder beneficiaries (e.g., grantor's children). The grantor must report the present value of the remainder interest as a future interest gift. Should the grantor die during the term of the trust, the trust continues for the term certain. The trust principal would not be included in the grantor's estate because the grantor does not have any retained interest in the trust.

A reversionary charitable lead annuity trust (CLAT) is an irrevocable trust to which the grantor gifts assets. The trust pays an annuity of a determinable amount to the designated charity for a specified term of years or prior death of grantor (or certain other family members who may be designated as the measuring life). At that time, the remaining trust principal is paid to the remainder beneficiaries (e.g., grantor's children). The grantor must report the present value of the remainder interest as a future interest gift. Should the grantor die during the term of the trust, the trust principal is not included in the grantor's estate (no retained interest).

For calculations involving a term, the length of the economic schedule is limited to that term. Otherwise, the economic schedule illustrates the trust for life expectancy. If the number of lives is greater than one, then the length of the economic schedule will be determined by the joint life expectancy of the first two ages provided by the user. Single life cases will use the single life expectancy. The economic schedule will end if the trust is depleted of funds prior to the end of the schedule.

Individuals establishing a lead trust receive an immediate income tax deduction and a lower gift tax for transferring the trust assets to the remainderman. A lead trust may also be established at death as a form of bequest. Both corporations and individuals may establish lead trusts.

A lead annuity trust pays a specified percentage of the initial trust value to one or more charities. Income, gift, and estate tax deductions are only permitted for transfers to lead trusts if one of the following requirements is met:

- The income interest is paid out in the form of a guaranteed annuity.
- The income interest is a fixed percentage of the fair market value of the trust's assets (calculated annually) and is paid at least annually.

Income tax rules also require the donor to be the owner of the income earned by the trust. In other words, the donor receives an immediate, large income tax deduction, but in later years, must report the income of the trust as it is received. Consequently, the typical lead trust produces little if any net income tax deductions since future income taxes are likely to counterbalance the initial deduction.

Despite future tax obligations, however, the charitable lead trust can be beneficial. For example, if a donor is in a high-income year, but in future years is expecting a drop in income, his tax bracket will most likely also drop. Consequently, deductions are received in a high bracket year, and taxes are paid in low bracket years. This premise also applies if a drop in income tax rates is expected.

Another advantage of the charitable lead trust is that it allows a discounted gift to family members. Under present law, the value of a gift is set at the time the gift is complete. The family member remainderman must wait for the charity's term to expire; therefore, the value of that remainderman interest is discounted for the cost of waiting. In other words, the cost of making a gift is lowered because the value of the gift is decreased by the value of the income interest donated to charity.

When the assets in the trust transfer to the remainderman, any appreciation on the value of the assets is free of estate taxation in the client's estate.

CRUT

A CRUT is an irrevocable trust to which the grantor gifts assets and retains a payout each year for a specified term of years or until the death of the grantor. The annual payout is equal to a stated percentage (minimum 5% and maximum 50%) of the net fair market value of trust assets determined annually. A designated charity receives the remaining trust principal at the end of the specified term or at the death of the grantor. Depending on the terms of the CRUT, should the grantor die during the trust term, the trust principal may or may not be included in the grantor's estate; however an offsetting charitable deduction should eliminate any estate tax liability. An income tax deduction is given for the present value of the remainder interest (must be at least 10%) which passes to the charity.

This calculation determines the donor's deduction for a contribution to a charitable remainder unitrust. Specify whether the trust lasts for a term of years, a single life expectancy, or a joint life expectancy (up to five ages). It also calculates the deduction as a percentage of the amount transferred.

When a charitable remainder unitrust is established, a donor transfers cash and/or property to an irrevocable trust but retains (either for himself or for one or more non-charitable beneficiaries) a variable annuity (payments that can vary in amount, but are a fixed percentage) from that trust. At the end of a specified term, or upon the death of the beneficiary (or beneficiaries, and the donor and the donor's spouse can be the beneficiaries), the remainder interest in the property passes to the charity the donor has specified.

For calculations involving a term, the length of the economic schedule is limited to that term. Otherwise, the economic schedule illustrates the trust for life expectancy. If the number of lives is greater than one, then the length of the economic schedule will be determined by the joint life expectancy of the first two ages provided by the user. Single life cases will use the single life expectancy. The economic schedule will end if the trust is depleted of funds prior to the end of the schedule.

The principal difference between a charitable remainder unitrust and a charitable remainder annuity trust is that a unitrust pays a varying annuity. In other words, the amount paid is likely to change each year. The payable amount is based on annual fluctuations in the value of the trust's property. As it goes up, so does the annuity paid each year. If it drops in value, so will the annuity.

A gift to a charitable remainder unitrust will qualify for income and gift tax charitable deductions (or an estate tax charitable deduction) only if the following conditions are met:

- A fixed percentage (not less than 5% or more than 50%) of the net fair market value of the assets is paid to one or more non-charitable beneficiaries who are living when the unitrust is established. The charity's actuarial interest must be at least 10% of any assets transferred to the trust.
- The unitrust assets must be revalued each year, and the fixed percentage amount must be paid at least once a year for the term of the trust, which must be a fixed period of 20 years or less, or must be until the death of the non charitable beneficiaries, all of

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- whom must be living at the beginning of the trust.
 - No sum can be paid except the fixed percentage during the term of the trust and at the end of the term of the trust, the entire balance of the trust's assets must be paid to one or more qualified charities.

The donor receives an immediate income tax deduction for the present value of the remainder interest that will pass to the charity at the end of the term.

Because a charitable remainder unitrust is exempt from federal income tax (the income and gains of the trust are only taxed when they are distributed to the noncharitable beneficiaries as part of the fixed percentage of trust assets distributed each year), they are frequently used to defer income tax on gains about to be realized. For example, if a donor has an appreciated asset, the donor can give the asset to a charitable remainder unitrust, reserving the right to receive a fixed percentage of the value of the trust for life, and for the life of the donor's spouse as well, the asset can then be sold by the trust and the proceeds of sale reinvested without payment of any federal income tax on capital gains. The capital gains will be taxable to the donor (or the donor's spouse) only as they are distributed to the donor as part of the annual distributions from the trust.

A variation of the CRUT (which pays a fixed percentage of the value of the trust assets, regardless of income) is the net-income-with-makeup CRUT, or "NIMCRUT," which pays either the fixed percentage or the income actually received by the trust, whichever is less. However, if the income is less than the fixed percentage, the deficiency can be paid in a future year, as soon as the trust has income, which exceeds the fixed percentage. An additional variation is a "flip" unitrust, which is a trust that changes from a NIMCRUT to a regular CRUT upon the occurrence of a specific event, such as the sale of a specific asset that was contributed to the trust and was not expected to produce much income. However, both NIMCRUTs and "flip" CRUTs are valued in the same way as a regular CRUT for the purpose of determining the income, estate, and gift tax charitable deduction.

Sale to Grantor Trust

Under the gift/sale to grantor trust arrangement, the transferor usually wants to transfer an interest in an asset to family members (e.g., children). The transferor (grantor) will establish an irrevocable trust and intentionally structure the trust with provisions which cause it to be classified as a so-called grantor trust. The grantor trust status causes the grantor to be treated as the owner of the trust principal for income tax purposes (not estate tax purposes). The transferor will gift an interest in an asset (10% or more) to the grantor trust. The gift provides economic substance to the trust. The grantor will then sell the remaining interest in that asset to the grantor trust. The sale will typically call for payback via a balloon note (e.g., interest only for ten years with the note paid off at the end of ten years). If trust principal (portion of the original asset) is used to pay off the note, the grantor would not report any capital gain because he/she is already deemed to own the trust principal for income tax purposes.

Generally, the advantages of this type of transfer evolve from the following: 1) The asset growth rate is expected to be greater than the interest on the note and 2) the grantor trust rules and Revenue Ruling 83-13 may allow the grantor to ignore the trust for income tax purposes. Thus, if trust principal (portion of the original asset) is used to pay off the note, the grantor would not report any capital gain because he/she is already deemed to own the trust principal for income tax purposes.

Family Limited Partnership

A limited partnership where members of a family are the general and limited partners. Generally, general partners run the partnership and limited partners are the passive owners. General partners have unlimited personal liability for partnership. An FLP is normally used to provide a minority interest discount on the assets gifted to the limited partners.

Typically, the partnership is formed by the estate owner, who is the general partner, for the benefit of the children, who are usually the limited partners. However, we also allow the opposite arrangement, where the parents are the limited partners and the children are the general partners.

Special Use Valuation

For Federal estate tax purposes (not gift tax), an executor may elect to have qualified real property (farm and trade or business property) valued on its “actual use” rather than the “highest and best use” for the property. The reduction in value may not be greater than \$960,000 (for 2008, plus future inflation adjustments in \$10,000 increments). To qualify, the requirements under IRC Section 2032A must be satisfied. The following is a summary of some of the major requirements:

1. The net value of the property used in the business or farm operation (real and personal) must equal at least 50% of the gross estate (net of indebtedness on property).
2. Qualified real property must be at least 25% of the gross estate.
3. The real property must have been owned and used for the qualified use (material participation) by the decedent (or family member) for five of last eight years prior to death.
4. The property must pass to a “qualified heir”: spouse; ancestors of the decedent; lineal descendants of the decedent or decedent’s spouse or parent; or a spouse, widow or widower of any such lineal descendant.

The tax benefits obtained via the special use valuation will be recaptured if within 10 years the qualified heir:

1. Disposes of the property (except to other family members)
2. Terminates the “qualified use requirement,” or fails the material participation test.

Outright Gift

This case assumes that the client wishes to gift an individual asset directly to a beneficiary during lifetime. A simple gift is made of an asset (or portion of an asset) to one of the estate beneficiaries. It is assumed that the gift will be made in a lump sum prior to death. Gift taxes may result.

Annual Exclusion Gifts

This case assumes that the client wishes to gift an individual asset directly to a beneficiary during lifetime without paying gift tax. It is assumed that a portion of an asset will be given to a beneficiary or set of beneficiaries each year. As of 2008, the amount of the Annual Exclusion is \$12,000 per donee. This amount is indexed annually for inflation.

In this case the user inputs the amount available for annual exclusion gifts. This is based upon the number of available donees. For example, a client with three children and no grandchildren would

probably wish to gift up to \$36,000 (\$72,000 if married and using gift splitting). In that case, \$36,000 of the selected asset would be liquidated each year until the asset is exhausted.

Reports: Preparing the Estate Plan

The Kugler Estate Analyzer generates a report which has been designed to help your clients understand the techniques you are illustrating. It includes five different sections:

1. **Cover and disclosure page**
You can opt not to include either or both of these by checking the appropriate boxes on the Report Options window. Use the Advisor Information window (accessed through the Edit Menu) to customize the Cover Page.
2. **The client's current situation**
The next two pages (or three if you've checked Previous Planning) illustrate the current breakdown of the estate if the client and spouse were to both die right away.
3. **The Asset Inventory or Current Simple Will Arrangement**
This report illustrates a more detailed breakdown of the client's current situation, and is followed by a flowchart illustrating what will happen if no additional planning is done.
4. **Technique illustrations**
An illustration is added for each technique that you've selected. Each illustration includes one or more pages explaining the technique to the client, and a page illustrating the effect of the technique on the overall estate. Some techniques (like Rolling GRATs) will also include flowcharts and calculation pages to clarify the calculations.
5. **Summary of Planning Results**
The last page of the report is a bar chart, illustrating the effects of planning.

As you can see, the report takes your client from "where you are now" to "where you'll be if you implement these estate planning techniques." To preview a report, click the Preview button on the Techniques section (or click the preview button on the Toolbar).

To customize the reports, select Report Options from the File menu.

Report Options

The Report Options window lets you change the fonts, printer margins, and colors which are printed. It also lets you type a Heading line which will be printed at the top of each page.

There are also a series of checkbox options that you can select:

- **Print Page Numbers:** Check the box to have "Page x of yy" on the bottom of each page. Doing this ensures that no pages are lost from the analysis, and that they are always presented in order.
- **Print Time:** Check the box to include the time on the top right corner of each page.
- **Print Date:** Check the box to include the date on the top right corner of each page.
- **Monochrome:** Check the box to force the printouts to being black and white. If you have a black and white printer, and some of the text is tough to read, then check this box.
- **NT Printing:** Only check this box if you're having problems printing. Some printers support one style of printing (what we call "NT Printing") and some support another.
- **Print Cover Page:** Check this to include the cover page in the printout.
- **Print Details:** Check this to include additional calculation details in the report. A table of asset balances will be included after each technique illustration as will a page showing the calculation of death taxes at the second death.
- **Print Disclosure:** Check this to include the disclosure page in the printout.

Expanded Discussion of Report Elements

Cover Page

The cover page only prints when you have checked Print Cover Page on the Report Options window. You can customize the contents of the cover page by selecting Advisor Information from the Edit menu.

Disclosure Page

To include a disclosure page on your report, check the Print Disclosure checkbox on the Report Options window. The disclosure page is a simple one page report which appears after the Cover Page, and lets your client know that the report is simply an illustration and not a guarantee of future results.

Both Spouses Die within One Year

The first flowchart that prints, this report shows your client what would happen under his current situation - before any planning has been done.

Projected Effect Flowchart

After the narrative for each technique, a flowchart is presented illustrating the projected effect of the technique on the estate. The flowcharts include all prior techniques, so that as the report is read each projected effect flowchart builds upon the previous one. The projected effect flowchart looks quite different if the Has Planning Been Done Previously checkbox is checked.

Asset Details Report

When the Print Details checkbox on the Report Options window is checked, each technique is followed by an Asset Details report that illustrates the balances of the assets through the years. As with the flowcharts, this report includes all previous techniques.

Asset Inventory/Current Simple Will Arrangement

The Asset Inventory page, called the Current Simple Will Arrangement when no previous planning has been done (see Has Planning Been Done Previously), lists your clients assets along with pertinent information about the current situation.

Analysis of Taxes at Death Report

The Analysis of Taxes at Death report appears just before the Summary of Planning Results in the report. It illustrates the taxes that would be due at the death of each client. There are no income taxes shown on the qualified plans unless Liquidate Assets at Second Death is checked on the Calculation Assumptions window.

Summary of Planning Results

The Summary of Planning Results is a bar graph at the end of the report. It illustrates the affect that your planning has had on the client's situation. This bar chart helps you illustrate the benefits of the planning you've done.

Make sure you point out to your clients that this bar chart is not the complete picture! Several of the Techniques also cause income to be generated to the heirs. The Summary of Planning Results does not illustrate the benefit of amounts.

Technical Support

If you need help, it's easy to find. Click the question mark wherever it appears in the program and a Help topic appears for the screen in which you are working. Also, use the Help menu and the program's Help system.

The most effective way to receive technical support is to contact Brentmark by e-mail. An e-mailed technical support request will usually result in a more detailed answer to your question by the most appropriate person.

Limited telephone support is available in special circumstances. If you choose telephone support, your request will be handled by Brentmark staff in a reasonable amount of time given the volume of requests and the availability of staff. Except in cases of unusual urgency, contacting Brentmark by e-mail will lead to the best support.

Other technical support alternatives include fax and postal mail.

E-mail

For assistance via e-mail, e-mail support@brentmark.com.

Telephone

Call **(407) 306-6160** (this is an Orlando, Florida number) and select the appropriate support option. If your call goes to voice mail, please leave a message and be sure to let us know how to contact you. Telephone support is normally available Monday through Friday from 10:00 AM to 5:00 PM Eastern Time (voice mail messages may be left at other times). Please have the **name of the Brentmark product and version number** available when calling.

Fax

Send your fax to **(407) 306-6107**. This is an Orlando, Florida phone number. Be sure to let us know how to contact you. We recommend that you include both an e-mail address and a telephone number.

Mail

You can always mail us questions as well. Send them to:
Brentmark Software
3505 Lake Lynda Dr., Ste. 212
Orlando, FL 32817-8327

Brentmark on the Web

Access Brentmark's web site by choosing **Brentmark on the Web**, or running your internet browser and navigating to www.brentmark.com

Kugler on the Web

Kugler's web site is at www.kuglersystem.com.

§7520 Rate

The rates under §7520 are the AFRs for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest. The §7520 rates (or the precise 120% Annual Mid-Term AFRs, which are then automatically rounded by the program) are entered in the rates table found in Brentmark programs.

Applicable Exclusion & Credit Amount for Estate Tax Purposes

The unified credit provides a credit toward the payment of the Federal gift/estate tax. The amount of the unified credit (the applicable credit amount) covers the tentative tax generated by the applicable exclusion amount. The unified credit, to the extent not used during lifetime, is available at death.

Example: Assume a lifetime taxable gift of \$1,000,000 for year 2006 (no previous gifts). Since the gift tax AEA is \$1,000,000, the \$345,800 gift tax would be paid via the unified credit. Assume further that the estate owner dies with a \$5,000,000 estate in year 2008 when the estate tax AEA is \$2,000,000. The estate tax calculation would be for a \$6,000,000 estate (\$5,000,000 and \$1,000,000 lifetime gift). The \$780,800 unified credit from the \$2,000,000 AEA would provide a credit against the estate tax. The \$5,000,000 estate ends up paying estate tax on \$4,000,000 (45% rate). The end result is that if the estate owner has used the \$1,000,000 AEA for lifetime gifts, the \$2,000,000 AEA for estate tax purposes is in effect reduced by \$1,000,000 and the estate's tax bracket is determined by the value of the estate at death (\$5,000,000) plus the taxable lifetime gifts (\$1,000,000).

| Year | Applicable Exclusion Amount (AEA)* | Applicable Credit Amount (Unified Credit) | Highest Estate Tax Rates |
|------|------------------------------------|---|--------------------------|
| 2008 | 2,000,000 | 780,800 | 45% |
| 2009 | 3,500,000 | 1,455,800 | 45% |
| 2010 | No estate tax | ----- | 0% |

For Both Gift and Estate Taxes for Year 2011 and Beyond: Use the Calculation Assumptions window (by clicking Calculation Assumptions on the Edit menu) to indicate how you want the estate tax to be calculated in years after 2011 (when the current estate tax law is supposed to sunset).

Asset Valuation and Valuation Adjustments

When assets are transferred, they must be valued for transfer (gift and estate) tax purposes. The transferred assets must be valued at "fair market value" (assumes hypothetical willing buyer and willing seller). If the ownership of the transferred asset is structured in such a way that control and/or marketability are reduced, a valuation adjustment discount may be applicable. A qualified appraiser should be used to determine the appropriate value.

Business Interest

Enter a descriptive name of the interest, the balance of the asset, the basis, the appreciation rate, the income rate, who the owner is and what type of owner (voting or non-voting) he or she is, and who the beneficiary is. Indicate the voting percentage in the interest.

Carryover Basis for Lifetime Gifts

For lifetime gifts, the cost basis of the donor carries over to the donee, with some adjustment allowed for any gift taxes paid on the transfer.

Carryover Cost Basis for Year 2010

A modified carry over basis rule will replace the stepped-up basis rule. Under the carry over basis rule, the cost basis of inherited property will be the lesser of the decedent's cost basis or the fair market value at date of death. However, the decedent's estate is allowed to increase cost basis by up to \$1,300,000. The basis of property transferred to a surviving spouse will be allowed an additional \$3,000,000 increase in cost basis.

Charitable Deductions

Any gift to charity that results in an income tax deduction. Current income tax law limits charitable tax deductions for certain high-income individuals. A charitable remainder annuity trust will often result in a charitable deduction; a charitable lead annuity trust will not.

Charitable GRAT

A so-called "charitable GRAT" is simply a GRAT in which the grantor utilizes the annuity payout from the GRAT for a subsequent tax deductible gift to a charity. It is often used in lieu of a CLAT as it provides similar benefits to both the charity (annuity payout) and grantor (remainder interest to grantor's family). However, the grantor receives an income tax deduction for the subsequent gift to the charity. Under the CLAT, normally there is no income tax deduction for the annuity payout to the charity.

Community Property (Generic Version)

Community property is property acquired by married individuals living in a community property state (except property acquired by one spouse by gift or inheritance or property spouses designate under state law as separate property). Each spouse owns an undivided one-half interest in the community property. Should the estate owner move to a non-community property state, the community property assets will remain as community property.

At death, the estate owner may leave his/her one half interest to whomever he or she chooses. At the death of the first spouse there is a step-up in income tax basis for both halves of community property assets. Thus, the surviving spouse receives a new cost basis for his/her half of community assets when the other spouse predeceases.

There are ten community property states and substantial differences exist concerning the technical aspects of community property for each state. Community property states: Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

For purposes of this program, life insurance and Qualified Retirement Plans or IRAs are not considered as community property assets.

Cost Basis of Assets Acquired from a Decedent at Death

For years 2002 through 2009, the income tax basis of property acquired from a decedent at death generally steps up (or down) to the value of the property in the estate.

Credit Shelter (Bypass) Trust

Credit Shelter (Bypass) Trust – The amount passing to the trust at the death of the estate owner is the unused applicable exclusion amount for estate tax purposes. The bequest to the trust is estate tax free because the estate owner's unified credit covers the tax on the exclusion amount.

Example: Assume estate owner has made \$500,000 of taxable gifts during lifetime and dies in a year when the applicable exclusion amount for estate tax purposes is \$2,000,000. The trust would then be funded to \$1,500,000 (assuming no part of the \$1,500,000 applicable exclusion amount remaining at death is used for other transfers at death that are subject to estate tax).

The trust will typically have two classes of beneficiaries. The income beneficiary will receive all income earned by the trust each year. Depending on applicable state law, the definition of income may be structured to include actual earned income and, if desired, all or a portion of trust appreciation. Typically at the death of the income beneficiary (assume the surviving spouse), the trust principal will be paid to, or to a trust for the benefit of, the remainder beneficiaries (children). Since the income beneficiary would have the use (trust income) but not the actual ownership of the trust principal, no portion of the trust principal (including appreciation after death of estate owner) should be included in the surviving spouse's estate. Thus, the trust is referred to as a credit shelter trust because the trust principal is sheltered from estate tax at the demise of the estate owner and surviving spouse.

Credit Shelter Growth

This is a net growth rate; no tax is applied to the growth of the credit shelter.

Crummey Withdrawal Power

Effect on donor

Gifts to an irrevocable life insurance trust would normally be considered future interest gifts and thus not qualify for the gift tax annual exclusion. However, the grantor of the trust will usually provide the primary trust beneficiaries with a so-called "Crummey" withdrawal power. This power typically gives the beneficiaries the right each year to withdraw their portion of the annual gift up to the annual exclusion amount for a 30 to 60-day period. The Crummey withdrawal right solves the grantor/donor's gift tax problem by allowing the gift to qualify as a present interest gift and in turn qualify for the gift tax annual exclusion.

Effect on donee

However, the Crummey withdrawal right creates a potential problem for each beneficiary (donee). A trust beneficiary may lapse up to the greater of \$5,000 or 5% of trust principal without being considered to have made a gift back to the trust. For example, assume the original donor's gift to the trust was \$11,000, each beneficiary had the right to withdraw \$11,000, and each beneficiary is allowed to lapse \$5,000. The lapse of the \$6,000 excess withdrawal amount would create a subsequent gift problem for the beneficiary. The \$6,000 excess amount would be considered a gift by the beneficiary back to the trust, and in effect to the other trust beneficiaries.

If gift splitting is utilized, the annual exclusion amount would be \$22,000, and the allowable lapse amount would remain at \$5,000.

Deemed Allocation of GST Exemption

Any unused portion of a transferor's GST exemption is automatically allocated to lifetime direct skips to the extent necessary to produce the lowest possible inclusion ratio for the property. If a transfer is made during the ETIP inclusion period, the deemed allocation rule will apply as if the transfer occurred at the end of that period.

In general EGTRRA extends the deemed allocation rule to transfers to a trust which is primarily for the benefit of skip persons.

Direct Skip Gifts

Direct skip gifts are calculated on a "tax exclusive" basis. Such transfer may also qualify for the GST annual exclusion if made directly to the skip person or to a trust for the benefit of one skip person where no trust corpus or income can be distributed to any other individual during the lifetime of that skip person and the trust will be included in the estate of that skip person if he or she dies before the trust terminates. A pre-deceased parent exception will be allowed if a member of the "middle" generation (child, or if no lineal descendants, then collateral heir, i.e., niece/nephew) is dead at the time of the transfer. Absent a timely and effective allocation by the transferor, the GST exemption is automatically applied first against direct skip gifts.

Non Direct Skip Gifts

For non-direct skip gifts (taxable terminations/distributions), the GST annual exclusion (\$11,000) is *not* applicable; GST Tax is calculated on a "tax inclusive" basis.

Also, for non-direct skip gifts, the "predeceased parent exception" is allowed if the child or collateral heir is deceased at the time the gift is completed.

Prior to EGTRRA, the GST exemption was not automatically allocated to lifetime non-direct skip gifts. The exemption may be allocated at a later date by filing a "late" gift tax return for GST purposes. Generally, the allocation would be effective and the gift would be valued on the filing date of the return, *not* the date of gift.

Disclaimer

A refusal to accept a bequest of property or an interest in property. The refusal must be in writing, complete and unqualified. For gift tax purposes, a person who makes a "qualified disclaimer" is not treated as having made a gift to the person who receives the interest in property as a result of the disclaimer. A qualified disclaimer must be an irrevocable and unqualified refusal to accept the property, made in writing, within 9 months after the transfer creating the interest takes place or within 9 months after the day the disclaiming party reaches age 21. The disclaiming party must not have accepted the disclaimed interest or any of its benefits. Generally, the disclaimed interest must pass to a person other than the disclaiming party without any direction on his or her part. However, if the disclaiming party is the spouse, the disclaimed interest may pass to the spouse under another provision of the will or trust, or under state law.

Donor

The individual making the gift.

Donee

The recipient of the gift.

Future Interest Gift

The deferred right to the use or enjoyment of the gifted asset.

Estate Tax Calculations

Recent changes in estate tax law have resulted in higher exemption amounts and other changes affecting estate tax calculations.

The Kugler System allows you to select between three potential scenarios.

- 2011 Sunset
- 2010 Repeal in 2010+
- 2009 Rates in 2009+ (program default)

These choices will affect program computations for 2010 and later years only.

2011 Sunset (current law with sunset): Assumes repeal occurs in 2010 and prior law returns in 2011 with a 55% top rate and \$1 million exemption. This is the way the tax law is currently written. This may be a reasonable assumption if one believes that no changes to the current law are likely and that the sunset provisions will prevail. One of the other two choices may be a better assumption if one believes that the sunset provisions will not be implemented due to future law changes.

2010 Repeal in 2010+ (current law modified to remove sunset and make repeal permanent): Assumes repeal becomes effective in 2010 and stays effective thereafter. This is what was originally intended by the tax writers, but ultimate repeal remains uncertain due to the inclusion of sunset provisions. This may be a reasonable assumption if one believes that the sunset provisions will not be implemented and repeal will ultimately prevail.

2009 Rates in 2009+ (current law modified to continue estate tax with no repeal): Assumes repeal never occurs and last scheduled rates are used in future years.

Estate Tax Inclusion Period (ETIP) Rule

Under the estate tax inclusion period (ETIP) rule, an individual cannot utilize his GST exemption to cover GST gifts if the gifted property would be included in his or his spouse's estate (because there is a retained interest). However, for gifts to a trust, the ETIP rule will not apply where the spouse has a "five and five" Crummey withdrawal right, so long as the right lapses within 60 days.

Executor

The individual or institution named by an estate owner in his/her will to settle the estate.

Extension of Time to Elect

In general, where a late allocation is made, the value of the property at the date of the allocation must be used to determine the inclusion ratio. However, EGTRRA directs the IRS to issue regulations under which an extension of time can be granted where the failure to allocate GST

exemption or elect out of a deemed allocation was inadvertent. Where relief is granted, the value of the property at the time of transfer may be used to determine the inclusion ratio.

A transferor may elect not to have the automatic allocation rules apply.

Five and Five Trust Withdrawal Power

It is common to provide the income beneficiary of a trust with a limited right to withdraw trust principal. Normally, if a beneficiary has this right and fails to take down the withdrawal, he/she would be making a deemed gift to the remainder beneficiaries of the trust. However, a beneficiary is allowed to lapse any withdrawal right up to the greater of \$5,000 or 5% of trust principal each year without gift tax consequences (IRC Section 2514).

Gift and Estate Taxes Cumulative

An individual must consider previous taxable gifts in calculating the tax due. For example, assume an individual makes a \$1,250,000 taxable gift in the year 2005 when the AEA is \$1,000,000 (no previous taxable gifts). He would owe a gift tax of \$102,500 (\$448,300 minus the unified credit of \$345,800, which equals the tentative tax on the \$1,000,000 AEA for lifetime gifts). Assume in the following year (2006) he makes a taxable gift of \$250,000. Since the AEA is \$1,000,000, he would calculate the \$555,800 gift tax for his cumulative taxable gifts of \$1,500,000 and subtract the \$448,300 tax already paid. The resulting gift tax payable would be \$107,500.

At death, the taxable lifetime gifts are again added back into the estate tax calculation. A credit is then given for any gift taxes paid, and for the amount of the unified credit (called the applicable credit amount), which is the amount of tentative tax that would be due on the AEA for estate tax purposes for the year of death. The estate tax exemption and gift tax exemptions are no longer unified, as the estate tax AEA increases from \$2,000,000 in 2008 to \$3,500,000 in 2009, while the gift tax AEA remains at \$1,000,000.

Gift Splitting

When one spouse makes a gift to a third person, if the other spouse consents, it may be treated as having been made one half by each. Thus, they can now give together up to \$24,000 per year via annual exclusion gifts to each donee and can use the unified credits of both spouses. The consent must relate to all gifts made by both spouses during the year and both spouses must be U.S. citizens or residents.

It should be mentioned that if one spouse uses his/her sole assets for the gift, the other spouse will not be treated as a donor for estate tax purposes. This allows gift splitting to be used in situations where the gift is to a trust and the non-donor spouse is a beneficiary. Gift splitting is applicable for gift tax and GST Tax calculation purposes only.

Answer yes to assume that the donor and the donor's spouse are both signing the gift tax return, indicating that half the gift is being given by each spouse. If you enter no, the technique will not be employed.

Generation Skipping Transfer Tax (Lifetime/Death)

The generation skipping transfer tax (GST Tax) is designed to assure that direct or indirect wealth transfers are taxed at every generation. Subject to the allocation of the GST exemption, the GST Tax is imposed on generation-skipping transfers (e.g., a gift from a grandparent to a grandchild).

The GST tax rate is equal to the maximum estate tax rate at the time of the transfer multiplied by the “Inclusion Ratio” applicable to the transferred property.

General Power of Appointment

The power or right to dispose of the property (usually in a trust) that is subject to the power. If the appointment may be to anyone the power holder desires, including himself or herself, his/her estate or his or her creditors or the creditors of his/her estate--it is classified as a general power. Since the holder of a general power has unlimited control over the disposition of the trust principal, the value of the trust will be included in the power holder’s estate for tax purposes, whether or not the power is exercised.

Gift/Sale to Grantor Trust Agreement

Under the gift/sale to grantor trust arrangement, the transferor usually wants to transfer an interest in an asset to family members (e.g., children). The transferor (grantor) will establish an irrevocable trust and intentionally structure the trust with provisions which cause it to be classified as a so-called grantor trust. The grantor trust status causes the grantor to be treated as the owner of the trust principal for income tax purposes (but not for gift or estate tax purposes). The transferor will gift an interest in an asset (10% or more) to the grantor trust. The gift provides economic substance to the trust. The grantor will then sell the remaining interest in that asset to the grantor trust. The sale will typically call for payback via a balloon note (e.g., interest only for ten years with the note paid off at the end of ten years). If trust principal (portion of the original asset) is used to pay off the note, the grantor would not report any capital gain because he/she is already deemed to own the trust principal for income tax purposes.

Generally, the advantages of this type of transfer evolve from the following: 1) The asset growth rate is expected to be greater than the interest on the note and 2) the grantor trust rules and Revenue Ruling 83-13 may allow the grantor to ignore the trust for income tax purposes. Thus, if trust principal (portion of the original asset) is used to pay off the note, the grantor would not report any capital gain because he/she is already deemed to own the trust principal for income tax purposes.

Gift Tax Annual Exclusion

\$12,000 annual limit (in 2008, indexed for inflation in \$1,000 increments) per donee (person receiving gift); must be a present interest gift (immediate right to possession or enjoyment of gifted asset) to qualify for annual exclusion. Gifts over the annual limit are applied against the applicable exclusion amount.

Gift, Estate and GST Tax for Year 2010

The gift tax rate is 35%. The estate and GST taxes are repealed (0%).

Generation Skipping Transfer

A generation skipping transfer occurs when an individual makes a gift to: 1) lineal descendants of his/her grandparents or lineal descendants of a spouse’s grandparents who are at least two generations below the transferor or transferor’s spouse (i.e., grandchildren and their issue; a brother’s or sister’s grandchildren and their issue; an aunt’s or uncle’s great grandchildren and their issue), or 2) persons who are not lineal descendants and are more than 37 ½ years younger than the transferor.

There are three types of generation skipping transfers:

1. **Direct Skip Gifts**-- transfers made directly to "skip persons" or to a trust that benefits only skip persons (e.g., grandchildren, etc.) In addition to direct skip gifts, there are deferred types of generation-skipping transfers. These are usually GSTs that involve an irrevocable trust.
2. A **Taxable Termination** occurs when an interest in property is held in a GST trust, and the last member of a non-skip generation (e.g., children) has his or her interest in the trust terminated, and only skip persons remain as trust beneficiaries for that interest in the trust.
3. A **Taxable Distribution** occurs when a GST trust makes a distribution to a skip person that is not considered a direct skip or taxable termination.

Grantor

An individual who creates a trust. Also referred to as the creator of the trust or settlor of the trust.

Grantor Retained Annuity Trust

A GRAT is an irrevocable trust in which the grantor gifts assets to the trust while retaining the right to receive fixed annuity payments. If the annuity payments must continue for the entire trust term, the GRAT is a Term Certain GRAT. If the annuity payments will terminate if the grantor dies before the end of the term the GRAT is a Reversionary GRAT. When the GRAT terminates the trust principal passes to the remainder interest beneficiary (typically the grantor's children).

Grantor Trust

An estate owner may want to create an irrevocable trust and intentionally retain certain rights in the trust which will cause the trust to be classified as a so-called "grantor trust." As a grantor trust, the grantor will be taxed on the trust income even though it is not distributed to him. Thus, for income tax purposes, the grantor is treated as though he still owns the trust principal. However, by carefully selecting the appropriate retained powers (IRC Sections 673-677), the trust may be effective for gift and/or estate tax purposes and thus not includable in the grantor's estate. There are situations where being taxed on the trust income may be consistent with the grantor's overall estate objectives. Bear in mind that the grantor may be paying income taxes on trust income that could be accumulated for or distributed to the trust beneficiaries (his heirs). This situation is enhanced because under current law the grantor need not report a gift for the payment of income taxes on trust income. Also, in situations where the grantor sells assets to the trust, the income tax consequences (capital gains, etc.) may be disregarded because the trust does not exist for income tax purposes.

GRITS, GRATS and QPRTS are automatically classified as grantor trusts because of the grantor's retained interest.

Gross Estate

The value of all assets the deceased estate owner had an interest in that would make up his/her total estate.

GST Dynasty Trust

An irrevocable trust that extends benefits for multiple generations.

GST Exemption

There is a \$2,000,000 exemption (for 2008, indexed for inflation in \$10,000 increments) available per transferor..

The exemption will be equal to the estate tax applicable exclusion amount for years 2008 through 2009. The GST Tax is fully repealed for the year 2010, but it is reinstated in the year 2011, when the provisions of EGTRRA terminate. At that time, the exemption amount will be \$1,120,000 plus future increases for inflation indexing.

GST Tax Exemption and Highest GST Tax Rates

| Year | GST Tax Exemption | Highest Estate And GST Tax Rates |
|------|-------------------|--|
| 2008 | 2,000,000 | 45% |
| 2009 | 3,500,000 | 45% |
| 2010 | No GST tax | 0% |

Hanging Power of Appointment

To solve the problem of deemed gifts that can result from the lapse of a Crummey withdrawal power, the grantor could structure a Crummey withdrawal right as a so-called "hanging" power. The hanging power provides that the gift in excess of the "five and five" withdrawal amount will not lapse. The excess hanging power amounts are carried forward by each Crummey beneficiary and allowed to lapse in subsequent years when the \$5,000 or 5% amounts may not be needed for current gifts.

The accumulated hanging amounts may begin to lapse when 1) gifts are no longer required because premiums may be paid from policy dividends and cash values (not guaranteed), or 2) when trust principal exceeds \$100,000 and the 5% lapse amount becomes a factor (e.g., the insured's death will significantly increase the trust principal and subsequent 5% lapse amount).

Heir

Person designated to inherit assets from the estate of the deceased.

Inclusion Ratio

The inclusion ratio refers to the percentage of the GST that is subject to GST Tax. The actual tax rate imposed on a GST is multiplied by the inclusion ratio. A zero inclusion ratio means that the generation-skipping transfer is exempt from GST Tax.

Income in Respect of a Decedent

Income in respect of a decedent (IRD) is any income that the decedent earned but did not receive prior to death. The primary IRD item is usually accumulated qualified and non-qualified retirement benefits. The present value of all IRD items will be included in the decedent's estate for estate tax purposes. There is no step-up in basis for IRD. However, the IRD beneficiary is allowed an income tax deduction for any Federal estate tax paid on IRD.

To see the amount of IRD that is calculated, you must select “Print Details” under the Report Options menu. Then, the client must own assets under the “Qualified Plan” classification. In addition, you must answer yes to the question “Are Withdrawals Subject to Income Tax,” and the heirs must have an income tax rate greater than zero. The IRD calculation can be found on the second-to-last page of the output, which is called “Analysis of Taxes at Death.” It is listed as “Income Tax at Death” If there is no IRD, this heading will not appear on the page.

Income Tax Rate

This is the rate that the program uses to tax money pulled out of assets. It is used several places in the program.

Inflation Rate

The rate at which the general level of prices is rising. In this program, the inflation rate is used to determine the indexed future values of some key considerations, such as the Gift Tax Annual Exclusion or the GST Tax Lifetime Exemption.

Insurance

Enter a descriptive name of the life insurance asset. Enter the current cash value and the value upon death of the insured. Second-to-Die box is also known as survivorship life. It is a life insurance policy on the lives of two people, often a husband and wife. Premiums are normally lower than a single life policy for the same amount, but are payable as long as either one of the insureds is still living. Death benefit is not payable until both insureds have died. If you indicate that the ownership of the asset is not joint, the Community Property box may be checked to indicate that community property rules will apply.

There is a technique called **Life Insurance Trust** that lets you show the effect of moving life insurance into an irrevocable life insurance trust. A policy can be placed in trust by answering Yes to “Allow Death Value to be placed in Trust.”

Intestacy Laws

State laws that spell out the distribution of assets of an individual who dies without a valid will.

Intestate

A term used for an individual who died without a valid will.

Internal Revenue Code Section 6166

IRC Section 6166 allows the Federal estate tax attributable to a closely held business interest to be paid over a 14-year period (only interest is payable for the first four years). To qualify, the decedent’s business interest must exceed 35% of the adjusted gross estate and meet several additional requirements.

Inter Vivos (Living) Trust

A trust that is created and operational during the grantor’s lifetime.

Irrevocable Trust

A trust which owns life insurance, typically on the grantor and/or grantor's spouse, which will be utilized for the trust beneficiaries (e.g., children). The grantor does not retain any rights to change, revoke or terminate. The trust principal should not be included in the grantor's estate for estate tax purposes. Such a trust may own any kind of assets, not just life insurance.

Life Estate

A life estate is an interest in property (typically in trust) that continues for the lifetime of the individual owning the interest (life estate). The interest terminates at death (e.g., income from trust for life), and the trust principal would not be included in the estate of the owner of the life estate.

Limited or Special Power of Appointment

The holder of the power has limitations on the right to dispose of the assets subject to the power. (e.g., the limited power may provide the holder the right to appoint the assets to only descendants of the grantor.) The power holder cannot have the power to appoint the assets to himself or herself, his or her creditors, his or her estate or the creditors of his or her estate. Usually the assets would be in a trust. This limited power should not cause trust principal to be included in the estate of the power holder.

Liquid Asset

A liquid asset can be readily converted into cash.

Liquidate Assets at Second Death

Upon the second death of the estate owner, certain assets, such as a qualified plan, can either be converted to cash, for which income tax would then be due, or can have withdrawals made from them each year, in which case the amount taxed annually would be smaller.

Answer yes to this question to have income taxes calculated on the Analysis of Taxes at Death Report.

Marital Deduction

Unlimited tax-free property transfer between spouses for both gift and estate tax purposes. If recipient spouse is not a U.S. citizen, limitations apply. See "Non-Citizen Spouse" later in this glossary.

Maximum Annuity GRAT (also referred to as Zero Gift GRAT)

Under the maximum annuity GRAT the annuity payout is structured to return to the grantor 100% of the initial value of the gifted asset plus interest at the IRS rate. Thus, the annuity is for the maximum amount allowed by the IRS. This arrangement would normally produce a zero remainder interest value and 1) a minimum reportable gift for a reversionary GRAT or 2) a zero gift for the term certain GRAT.

However, for the term certain GRAT the grantor may want to set the annuity payout just below the maximum so there will be a small remainder value, which will in turn cause a very small reportable gift. By filing the required gift tax return for this small gift and providing full

disclosure, the 3-year statute of limitations will commence. This will limit the period for the IRS to challenge the gift value and term certain arrangement.

Minority Interest Qualified Personal Residence Trust

Under a minority interest QPRT, the grantor transfers a minority interest in the residence to a separate irrevocable trust for each remainder interest beneficiary. The grantor retains the use of the residence for the trust period, and the minority interest in the residence then passes to the respective remainder beneficiary (e.g., grantor's children) at the end of the trust period. The grantor must report the present value of the remainder interest as a future interest gift (no annual exclusion). Should the grantor die during the trust period, the residence is included in his/her estate with credit for any gift taxes paid and/or unified credit attributable to the minority interest QPRT.

Net Income Make-Up with Charitable Remainder Unitrust

A NIMCRUT is a charitable remainder unitrust (CRUT) with a net income make-up provision. Under the NIMCRUT the grantor receives a payout each year equal to the lesser of 1) the trust's net accounting (cash) income, or 2) a stated percentage of trust assets (minimum 5%, maximum 50%), determined annually. The net income make-up provision provides that if the trust earns less income than the stated percentage, the trust will only pay out what is earned. If in subsequent years the trust earns more than the stated percentage, it will make up the earlier shortfall to the extent the trust income exceeds the stated percentage. At the termination of the trust (stated period or death of grantor), the charity receives the remaining trust principal. Since the grantor's estate does not have a retained interest in the trust principal, it is not included in his/her estate. The grantor receives an income tax deduction for the present value of the remainder interest (must be at least 10%) which passes to the charity.

Non-Citizen Spouse

Lifetime and death-time transfers from a U.S. citizen to a non-citizen spouse will not qualify for the marital deduction. However, a lifetime gift may qualify for the special \$128,000 (for 2008, plus future inflation adjustments in \$1,000 increments) gift tax annual exclusion, which is allowed for gifts to a non-citizen spouse. A transfer at death to a "qualified domestic trust" (QDOT) will qualify for the estate tax marital deduction.

The Non-Family Gift via GRIT

Under a non-family Grantor Retained Income Trust the grantor gifts income producing assets to an irrevocable trust and retains the trust income for a specified term of years or until the prior death of grantor. At that time, the trust principal passes to the remainder interest beneficiaries (e.g., nieces and nephews) who are not the grantor's spouse, ancestors or lineal descendants of the grantor or his/her spouse, or siblings of the grantor (or spouses of such persons). The grantor must report the present value of the remainder interest as a future interest gift. Should the grantor die during the term of the trust, the trust principal is included in his/her estate with credit for any gift taxes paid or unified credit attributable to the GRIT.

Non-liquid Asset

A non-liquid asset cannot be converted into cash quickly.

Non-Probate Assets

Non-probate assets are assets that pass outside the estate owner's will or, if applicable, outside the intestacy laws. Example: Assets in an inter vivos (living) trust, jointly owned assets, life insurance or qualified retirement benefits payable to a designated beneficiary (other than the estate).

Non-Resident Aliens

Individuals who have a domicile in another country but live temporarily in the United States and are not U.S. citizens are classified as non-resident aliens (NRA's) for purposes of estate, gift and GST Taxes. (Other tests apply in determining whether an alien is a resident for income tax purposes.) The NRA's are subject to estate, gift and GST taxes on transfers of their U.S. property (certain assets are excluded). The applicable exclusion amount for NRA's is just \$60,000. This provides an applicable credit of just \$13,000 (IRC Section 2102).

Non-Resident aliens are not covered in this program.

Payment Timing

The Payment Timing input on the Calculation Assumptions window is used to determine when CRAT, CLAT, and GRAT payments are made. It also determines when liabilities are paid each year and when contributions are made to assets.

Portfolio

The portfolio is a liquid fund of client assets. It is normally zero when the case is started, unless an amount is entered in "portfolio balance" below. Subsequent to the initial input, items that may be added into the portfolio include insurance on the life of the first spouse to die (if payable to estate), Required Minimum Distributions that come out of a pension plan, or payments that come back to the client when a GRAT or charitable trust is used.

Portfolio Balance

The portfolio balance is a liquid fund for paying taxes. When assets generate income, it can either be reinvested in the asset or put the income in the portfolio balance.

Portfolio Growth

This is a net growth rate; no tax is applied to the growth of the portfolio.

Potential Predeceased Parent Problem for Deferred Gifts

When a grantor/donor makes a deferred gift via a trust and retains an interest in the trust (GRAT, QPRT, etc.), a potential GST problem exists. For example, if the grantor names a child as the remainder interest beneficiary and a grandchild as the contingent beneficiary (typically a per stirpes designation), the trust will become a GST trust if the child dies (taxable termination)

during the term of the trust. Since the trust was created and funded while the child was alive, the predeceased parent (grantor's child) exception will not be applicable.

Normally in this situation the grantor would want to file a retroactive allocation of GST exemption for the year of the child's death. However, because the grantor has a retained interest in the trust, the ETIP Rule becomes applicable. Under ETIP, the grantor is prohibited from allocating GST Exemption if the grantor's death would cause the trust to be included in his or her estate. This would be the case for GRATS and/or QPRTS. As a result, the GST allocation must be made at the conclusion of the trust period when the retained interest terminates. At that time the trust principal may have substantially appreciated, and the trust value may exceed the applicable GST exemption amount. This could result in a GST tax on a trust that was not initially intended to be a GST trust.

Potential Predeceased Parent Problem for Non GST Trusts

If a grantor/donor creates a non GST trust for the benefit of his or her child with a per stirpes bequest for the child's issue (grantors grandchildren), a potential GST problem exists. For example, if the child dies before the insured grantor, this would cause a taxable termination, and the trust would become a GST trust.

Since the trust was created while the child was alive, the predeceased parent (grantor's child) rule will not be applicable to gifts made prior to the child's death. As a result, a late allocation of GST exemption must be filed to exempt the trust from future GST tax.

Predeceased Parent Rule

In situations where the grantor/donor (or estate owner) makes a transfer to a grandchild after the grandchild's parent (donor's child) has predeceased, the transfer will not be considered a GS transfer for GST tax purposes. This so-called predeceased parent exception (also known as the predeceased child exception) in effect allows the grandchild to move up to child's generation. This predeceased parent rule also applies to lineal descendants of the grantor/donor's parent, except that for this portion of the exception, all the lineal descendants of the grantor must be deceased.

Present Interest Gift

The immediate right to the use or enjoyment of the gifted asset.

Prior Gifts

Any gifts made by the client or spouse, prior to the date of the analysis, which were in excess of the Annual Exclusion amounts. These amounts are factored in when the estate tax is calculated.

Private Annuity

A private annuity is a sales arrangement whereby the seller transfers an asset to the purchaser (e.g., children) in return for an unsecured promise of an annuity for the life of the seller. Since the arrangement must be unsecured (the annuity payments are not funded via an actual annuity purchase), the annuity payout becomes a general obligation of the purchaser. Any portion of the annual annuity payout attributable to interest is not income tax deductible to the purchaser.

Probate Assets

Probate assets are assets that pass in accordance with the estate owner's will or, if applicable, the intestacy laws. Example: individually owned assets.

QDOT

Qualified Domestic Trust

A QDOT is a trust that will qualify for the estate tax marital deduction in a situation where the surviving spouse (sole lifetime beneficiary) is not a U.S. citizen (typically he or she is a U.S. resident). The trust essentially guarantees that the non-citizen surviving spouse will not remove the trust principal from the U.S. unless the U.S. trustee pays the estate tax.

Except for hardship distributions, any lifetime distribution of trust principal to the surviving spouse would be subject to estate tax calculated at the rate applicable to the deceased spouse's estate.

QDOTS are not currently covered in this program.

Qualified Plan

Enter a descriptive name of the plan, the balance of the plan, the basis, the appreciation rate, the income rate, the type of ownership, and who the beneficiary is. Answer yes or no to whether withdrawals are subject to income tax. If you indicate that the ownership of the plan is not joint, the Community Property box may be checked to indicate that community property rules will apply.

Real Estate

Real estate is land, including all the natural resources and permanent buildings on it.

Remainder Interest Beneficiary

A future interest in property (usually in a trust) that passes to the beneficiary after the interests of prior beneficiaries are terminated is a remainder interest (e.g., if the spouse has an income interest for life and the trust principal passes to the children at the spouse's death, the children are remainder interest beneficiaries).

Required Minimum Distributions (RMDs)

Many individuals would like to minimize annual retirement distributions so they can continue to take advantage of the tax-deferred accumulation of assets inside a qualified plan or IRA.

Generally, when a qualified retirement plan participant or IRA owner (other than Roth IRA) reaches his/her required beginning date (RBD), typically age 70 ½, the individual must commence taking annual minimum distributions from the plan or account. Failure to do so will usually result in a 50% excise tax. The distributions are a specified percentage of the assets in the account. The percentage increases each year. At death, a new RBD and new RMDs would be applicable to the designated beneficiaries.

Retroactive Allocation of GST Exemption

Generally, GST exemption is allocated to a transfer on a timely filed gift tax return for the year of the gift. In certain circumstances, the grantor is allowed to make a retroactive allocation of GST exemption on a gift tax return. If the tax return is filed for the year of the child's death, the past gifts to the trust may be used for allocation purposes rather than the current value of the trust assets. If the tax return is not filed for that year, the current value of the trust assets must be used for GST allocation purposes. Under certain limited circumstances, the IRS will grant an extension of time within which to allocate GST exemption to a transfer.

The problem is particularly severe in situations involving a life insurance trust for the benefit of the grantor's child with the grandchild as the contingent beneficiary. If the late allocation of GST exemption is made after the insured grantor dies, the death proceeds may become a GST transfer.

Reverse QTIP Trust

A so-called "reverse QTIP" is a marital QTIP trust that is structured as a GST or dynasty trust. Normally, GST exemption is allocated by the transferor to exempt the trust principal from GST taxes. The first spouse to die creates the QTIP trust. Since it is a marital trust, it is included in the surviving spouse's estate for estate tax purposes. This makes the surviving spouse the transferor for GST Tax purposes; however, in a reverse QTIP trust, the first spouse to die is treated as the transferor for GST Tax purposes, and the GST exemption of the first spouse to die is allocated for GST exemption. Thus, the first spouse to die is using his/her GST exemption on a trust that is includable in the surviving spouse's estate. Therefore, it is referred to as a "reverse QTIP" trust.

Reversionary GRAT

A reversionary GRAT is an irrevocable trust to which the grantor gifts assets and retains the right to receive annuity payments for a specified term of years or earlier death of the grantor. If the grantor dies before the end of the GRAT term, the GRAT payments are terminated and the trust principal reverts to the grantor's estate. If the grantor survives the GRAT term, the trust principal passes to the remainder interest beneficiary (e.g., grantor's children or to a trust for their benefit). The grantor must report the present value of the remainder interest as a future interest gift. This gift amount will be increased because the retained annuity value must factor in the probability that the grantor may die during the GRAT period.

This serves to decrease the value of the retained annuity, which in turn increases the value of the remainder interest. The present value of the remainder interest is the reportable gift amount. Should the grantor die during the term of the trust, the trust principal is included in his/her estate with credit for any gift taxes paid and/or taxable gifts attributable to the GRAT.

Rule against Perpetuities

Duration of GST Trust

A trust may continue for the lives of individuals (usually trust beneficiaries) then living (grandchildren, etc.) plus 21 years—the so-called rule against perpetuities. In states where this rule has been repealed, the trust may continue in perpetuity.

Self-Canceling Installment Note (SCIN)

A SCIN is an arrangement whereby an individual sells an asset and takes back an installment note for the sales price. The note would have interest at the applicable federal rates. A provision is added to the note stating that if the seller dies during the term of the note, the installment payments terminate and the note is cancelled. To make the cancellation feature a bona fide transaction (not a gift), the seller must receive increased payments on the note. Either the amount of the note or the interest payments must be increased to reflect the risk for the probability of the seller's death during the term of the note. If the seller does die, the note should not be included in the estate, although the estate would have to recognize the capital gain.

Special Use Qualifications

1. The net value of the real property and associated equipment must equal at least 50% of the gross estate (net of debt on property).
2. The qualified real estate property must equal at least 25% of the gross estate.
3. The real property must have been owned and used for qualified use by the decedent (or a family member) for at least five out of the last eight years.
4. The property must pass to a "qualified heir", spouse, ancestors of the decedent, lineal descendants of the decedent or decedent's spouse or parent or spouse, widow or widower of any such lineal descendant.

Special Use Valuation for Qualified Real Property

Farm and trade or business property IRC Section 2032A

For Federal estate tax purposes (not gift tax), an executor may elect to have qualified real property (farm and trade or business property) valued on its "actual use" rather than the "highest and best use" for the property. The reduction in value may not be greater than \$960,000 (for 2008, plus future inflation adjustments in \$10,000 increments). To qualify, the requirements under IRC Section 2032A must be satisfied. The following is a summary of some of the major requirements:

The net value of the property used in the business or farm operation (real and personal) must equal at least 50% of the gross estate (net of indebtedness on property).

Qualified real property must be at least 25% of the gross estate.

The real property must have been owned and used for the qualified use (material participation) by the decedent (or family member) for five of last eight years prior to death.

The property must pass to a "qualified heir": spouse; ancestors of the decedent; lineal descendants of the decedent or decedent's spouse or parent; or a spouse, widow or widower of any such lineal descendant.

The tax benefits obtained via the special use valuation will be recaptured if within 10 years the qualified heir:

- Disposes of the property (except to other family members), **OR**
- Terminates the "qualified use requirement," or fails the material participation test.

Split Asset

You can split an asset into other vehicles with a new name and use other techniques on those vehicles. Select the asset to split on the Assets screen and click the Split Asset button.

Spousal IRA Rollover

If the surviving spouse is the sole outright beneficiary of a decedent's IRA or qualified retirement plan, then the spousal beneficiary may roll over the death proceeds (without paying current income tax) into a new IRA and become the new IRA owner. Under EGTRRA, an employee's surviving spouse will be allowed to roll over an eligible rollover distribution into any eligible retirement plan (i.e., into an IRA, a qualified employer-sponsored retirement plan, a 403(b) qualified annuity, or a governmental 457 plan) under the same rules as if he or she were the employee.

Stepped-Up Cost Basis for Death-Time Transfers

In general, the cost basis of appreciated property "steps up" (or "steps down") to the fair market value on date of death. For example, assume that an individual buys raw land for \$100,000, and the value appreciates to \$1,000,000. A lifetime sale would result in capital gains tax on the \$900,000 gain. However, under IRC Section 1014, the cost basis steps up at death to \$1,000,000. A subsequent sale will result in a capital gain only if it is sold for more than \$1,000,000.

However, items classified as "income in respect of a decedent" (for example, pensions, IRAs and annuities) do not receive a step-up in basis.

Where appreciated property that the decedent had acquired by gift within one year of death passes from the decedent to the donor of the property or donor's spouse, the property does not receive a step-up in basis.

Stock Options

Stock options are a form of compensation provided by corporations. A stock option is the right to buy a fixed number of shares at a specific price for a specific period of time.

Substantial Compliance

GST exemption may be treated as allocated where the transferor has substantially complied with the requirements for allocating the exemption.

Survivorship Life Insurance Policy

Life insurance policy insuring two lives (typically husband and wife) with death benefit payable at death of the last to die.

Tax Exclusive vs. Tax Inclusive

Although the Federal gift and estate tax rates are generally the same (unified tax rates, except for year 2010 when the estate tax is repealed and the gift tax rate is 35%), the method of calculating the tax is substantially different. For example, assume an individual in the 45% gift and estate tax bracket wants his child to receive \$1,000,000. For gift tax purposes, he could make a taxable gift of \$1,000,000 and pay a \$450,000 gift tax. The gift tax is excluded from the \$1,000,000 gift. Thus it took \$1,450,000 to transfer \$1,000,000 to the child.

However, for gifts taking place at death (estate transfer), the estate owner must have \$1,818,182 to transfer \$1,000,000 to the child. The estate tax is tax inclusive; the \$818,182 of estate tax is included in the \$1,818,182 subject to tax. Therefore the \$1,818,182 results in an estate tax of \$818,182 (45%), and the child receives \$1,000,000.

The tax exclusive calculation used for gift transfers will always be more favorable than the tax inclusive estate tax calculation. However, this advantage is lost if the transferor dies within three years of the date of the gift, since the gift tax paid will be a gift within three years and be included in the estate under the three year rule.

Also, the fact that the AEA for estate tax purposes will exceed the AEA for gift tax purposes for the years 2008 through 2009 and that the estate tax is repealed for the year 2010 must be considered before making lifetime gifts in excess of \$1,000,000.

Tenancy by the Entirety

Tenancy by the entirety refers to the joint ownership of assets by spouses. Neither spouse may dispose of the asset during lifetime without the consent of the other spouse. Each spouse is considered to own a 50% interest in the asset. Upon death of the first spouse, the asset passes to the surviving spouse by operation of law. (Non-probate asset)

Tenants in Common

Individuals may hold property as "tenants in common," which is similar to joint tenancy or tenancy by the entirety, except that each spouse is free to dispose of his or her 50% interest in the property during life or at his or her death. (Probate assets)

Term Certain GRAT

A term certain GRAT is an irrevocable trust to which the grantor gifts assets while retaining the right to receive annuity payments for a specified term of years. At the end of this term certain, the trust principal passes to the remainder interest beneficiary (e.g., grantor's children). Should the grantor die during the term of the GRAT, the annuity payout continues to the grantor's estate or designated beneficiary for the balance of the GRAT period. As a result, the present value of the retained annuity is not reduced for the probability of the grantor dying during the term of the GRAT. This results in a smaller remainder interest and means a smaller reportable gift.

The term certain GRAT follows the procedure utilized in *Walton v. Comm.*, 115 T.C. 589 (2000) (Acquiesced IRS notice 2003-44).

Testamentary Trust

A trust created under the terms of the decedent's will.

Three-Year Rule IRC Section 2035

Generally speaking, since gift and estate taxes are unified and cumulative, no special consideration need be given to gifts in contemplation of death. However, for gifts of life insurance, the gift value (generally, the interpolated terminal reserve value plus unearned premium) is normally substantially less than the death benefit. Also, gift taxes paid on any lifetime gift could remove the cash used to pay the tax from the estate. As a result, the subsequent estate tax can be reduced if an estate owner gifts a life insurance policy on his life, or

pays a gift tax. Therefore, to prevent a gift in contemplation of death, a special three-year rule is applicable if the estate owner dies within three years of the transfer (gift of life insurance and/or any gift taxes paid). This rule will cause the gift tax paid or life insurance transferred within three years of death to be included in the gross estate for estate tax purposes.

Transfer-for-Value Rule

Normally, life insurance death proceeds are exempt from income tax under IRC Section 101. However, if a policy is transferred for "valuable consideration," the gain on the death benefit over the new owner's cost basis will be subject to income tax under the so-called "Transfer-for-Value Rule." This rule will apply in all cases unless it is specifically exempted. The following transfers are considered exempt:

- Transfer to the insured
- Transfer to a partner of the insured
- Transfer to a partnership in which insured is a partner
- Transfer to a corporation in which the insured is a stockholder or officer
- Transfers where the basis for determining gain or loss in the hands of the transferee is calculated in whole or in part by reference to the basis of the transferor (for example, transfers within a corporation in a tax-free re-organization, gifts, or transfer between spouses). This exception does not apply where a policy loan exceeds the transferor's basis.

Transfers with Retained Life Interest (IRC Section 2036)

Transfers with retained life interest typically involve situations where an individual makes a gift and retains the right to use, possess or enjoy the gifted asset or receive the income from the asset. This will cause the asset to be included in the donor's estate (e.g., parent gives residence to children and retains right to live there without paying rent).

Transferor

Individual transferring an asset (i.e., by gift or bequest (donor) or sale (seller)).

Trust

A fiduciary arrangement under which the legal title to assets is held and managed by the trustee for the benefit of the trust beneficiaries.

Trustee

The holder of the legal title to the assets in a trust for the use or benefit of the trust beneficiaries.

Trust Income

Income derived from trust principal. Trust income may be defined to include all or a portion of income and appreciation of trust principal (total return). Also, many states provide their own definition of trust income which may be applicable.

Trust Principal

Assets that are owned by the trust make up the trust principal or trust corpus.

Unified Credit Used

The total amount of Unified Credit that was used when any prior gifts were made, if applicable. This amount is factored in when the estate tax is calculated.

Unified Credit

The unified credit provides a credit toward the payment of the Federal gift/estate tax. The amount of the unified credit (the applicable credit amount) covers the tentative tax generated by the applicable exclusion amount (AEA) applying the above unified tax rate table. The following gift/estate tables show the year-by-year reduction of the highest gift/estate tax rates and the phase-in of the applicable exclusion amounts and the corresponding unified credit for estate transfers.

Applicable Exclusion Amount and Applicable Credit Amount for Gift Tax Purposes

| Year | Applicable Exclusion Amount (AEA) | Applicable Credit Amount (Unified Credit) | Highest Gift Tax Rates |
|-------------|--|--|-------------------------------|
| 2008 | 1,000,000 | 345,800 | 45% |
| 2009 | 1,000,000 | 345,800 | 45% |
| 2010 | 1,000,000 | 330,800 | 35%* |

**Based on graduated income tax rates*

Waiver of Spousal Rights in Qualified Retirement Plans

Qualified retirement plans that are subject to minimum funding requirements, such as money purchase and defined benefit plans, must generally pay benefits in the form of a life annuity. Married participants are required to take a qualified joint and survivor annuity. The non-participant spouse must provide a valid written waiver of this joint and survivor annuity to allow the plan participant to change the beneficiary.

Index

| | | | |
|--|----|---|--------|
| A | | Gift Estate and GST Tax for Year 2010 | 35 |
| AFR Rates | 9 | Gift and Estate Taxes are Unified and Cumulative Gift Splitting | 34 |
| Applicable Exclusion and Credit Amount | 29 | Gift Tax Annual Exclusion Grantor Trust | 36 |
| B | | GST Tax Exemption and Highest GST Tax Rates | 37 |
| Brentmark on the Web | 28 | H | |
| Business Interest | 30 | Hanging Power of Appointment | 37 |
| C | | Help Menu | 8 |
| Carryover Cost Basis for Year 2010 | 30 | I | |
| Charitable Deductions | 30 | Inclusion Ratio | 37, 38 |
| Community Property contributions | 12 | Income in Respect of a Decedent | 38 |
| Credit Shelter | 31 | Income Tax Rate | 38 |
| Crummey Withdrawal Power | 31 | Inflation Rate | 38 |
| D | | Insurance | 38 |
| Deemed Allocation of GST Exemption | 32 | Inter Vivos Living Trust | 39 |
| Direct Skip Gifts | 32 | Intestate | 38 |
| Donor | 33 | J | |
| E | | Joint Tenancy by the Entirety | 47 |
| Edit Menu | 8 | L | |
| Enter desired payments | 12 | License Agreement | 52 |
| Estate Tax Calculations | 33 | Life Estate | 39 |
| Executor | 33 | M | |
| F | | Marital Deduction | 39 |
| File Menu | 7 | Maximum Annuity GRAT | 40 |
| Function Keys | 8 | Minimum Required Distributions MRDs | 44 |
| Future Interest Gift | 33 | Minority Interest Qualified Personal Residence Trust | 40 |
| G | | Mortgage | 12 |
| General Power of Appointment | 35 | | |
| Generation Skipping Transfer | 36 | | |
| Generation Skipping Transfer Tax | 35 | | |

| | | | |
|---|----|--|----|
| N | | Reverse QTIP Trust | 44 |
| Net Income Make-Up with Charitable Remainder Unitrust | 40 | Reversionary GRAT | 44 |
| Non-Citizen Spouse | 40 | S | |
| Non-Probate Assets | 41 | Save | 7 |
| Non-Resident Aliens | 41 | Special Use Qualifications | 45 |
| P | | Special Use Valuation for Qualified Real Property | 45 |
| Portfolio Growth | 42 | Split Asset | 46 |
| Potential Predeceased Parent Problem for Non GST Trusts | 42 | Substantial Compliance | 46 |
| Predeceased Parent Rule | 42 | T | |
| Present Interest Gift | 42 | Tax Exclusive vs. Tax Inclusive | 47 |
| Prior Gifts | 43 | Term Certain GRAT | 47 |
| Private Annuity | 43 | Toolbar | 7 |
| Probate Assets | 43 | Transferor | 48 |
| Q | | Trust Income | 49 |
| QDOT | 43 | Trust Principal | 49 |
| Qualified Plan | 43 | U | |
| R | | Unified Credit | 49 |
| Retroactive Allocation of GST Exemption | 44 | W | |
| | | Waiver of Spousal Rights in Qualified Retirement Plans | 49 |
| | | Withdrawals | 12 |

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