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Monday, March 1, 1999

NOEL C. ICE
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BOARD CERTIFIED ESTATE PLANNING AND PROBATE LAW
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Our File No.
ICE09/00009

CERTIFIED MAIL
RETURN RECEIPT NO.: sdf

Mr. and Mrs. Moore Money
2525 Mars Hotel
999 West L.A. Freeway
New Minglewood, TX 76999
(817) 999-9999

RE: Estate Plan of Lotta Money and Moore Money
The Crummey Money Family Trust

Dear Moore and Lotta:

Enclosed is a draft of an insurance trust, without signature pages. This trust can serve as the receptacle of any insurance policies that Lotta now owns and wishes to irrevocably transfer. However, for tax reasons (explained below) it is preferable to have the trust purchase any life insurance, rather than have insurance that you already owned transferred to it.

The beneficiaries of the trust are Moore and your "descendants by right of representation." This is a convenient way of designating your children, so long as they survive.

Because Lotta is not a beneficiary, you must be prepared to part with the proceeds of any policies contributed as well as any cash values, irrevocably. However, because the donor is not a beneficiary, the estate tax consequences are easier to contend with. **Because Moore is a beneficiary, it is imperative that you never contribute any community or separate property in which he has an interest.** So long as the contribution is less than the annual exclusion available under IRC¹ §2503(b)² (considering all other taxable gifts made by you to the same beneficiary during the calendar year), there should be no need to file a gift tax return, and the gift can be ignored for estate tax purposes too. Contributions exceeding the annual exclusion will be adjusted taxable gifts, and a gift tax return should be filed.

The reason the annual exclusion is available is because the beneficiaries have demand rights. That is, they have the right to demand a distribution of any amounts contributed to the trust, within limits. **Therefore, if you contribute or the trust purchases life insurance policies, you should make sure that there are sufficient liquid assets in the trust to satisfy the demand rights even after the premium payments are made.** If the policies have cash value, this value can be considered as available for this purpose. If the policy is a term policy, then the unearned premium can be considered if the policy is transferable. Otherwise you should consider keeping enough cash on hand in the trust to satisfy the demand right. Note that there is no reason to limit this trust to insurance policies alone. The trust can invest in anything. Any assets contributed to or purchased by the trust are likely to be excludable from your estate, except that any life insurance policies already owned by Lotta Money will probably be includible should your death occur within three years of the transfer.

Because the trust may invest in life insurance, the insured may not serve as trustee. Moore Money is named as trustee under the enclosed draft. **The trust should never own life insurance on Moore's life.**

The trust gives the beneficiaries the right to withdraw contributions made to the trust, within limits. To the extent that a gift to the trust either (i) is not subject to a withdrawal right on behalf of a beneficiary or (ii) exceeds the applicable annual exclusions (cumulatively \$10,000 per donor/ per donee/ per calendar year counting all present interest gifts, not just to this trust) the *donor* will have made a taxable gift for gift tax purposes. Further, since we do not want the trust estate to be includible in Moore's estate, his withdrawal right has been capped at \$5000, rather than \$10,000 or 5%. The reason that a \$5,000 lapse does not result in the lapsed property being included in the beneficiary's estate is because of a special rule that will be explained later.

After the trust is signed, I will send you another letter detailing the income tax requirements applicable to the trust, and describing the notices that must be given when contributions are made.

¹All references herein to the "IRC" are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

²Currently, the annual exclusion is \$10,000 per donor per donee, for present interest gifts. This would be \$20,000 per year per child for joint gifts made by husband and wife together.

As was the case under your Will and Living Trust, there is a general outline of the trust plan found at the beginning of Part I of the trust. This general outline is just slightly over one page. Reading this one page overview carefully should go a long way toward helping you understand how the trust is to work. Part I should be no longer than 20 pages, and Part II is similar to the Part II of your Will and Living Trust, with which you are now familiar. Although Part II is important, most of the variable terms are found in Part I. Part II is devoted mainly to definitions and administration provisions.

Please review the trust carefully, paying particular attention to spelling of names, fiduciaries selected, and any other information originally provided by you and upon which we must necessarily rely. If there are any changes to make, please be sure and tell us before our next meeting. You can call my secretary, Cindy Lee, directly at (817) 878-2944 with any changes of a typographical nature.

Note that under Section 1.2 of Part II, Moore is only a beneficiary so long as you are married.

The income taxation of withdrawal trusts is complex and uncertain. If the grantor is taxed on the income under the "grantor trust" rules, the existence of the trust as a separate entity is ignored. One advantage of having the grantor taxed on the income is that it can be argued that payment of the income tax is not subject to gift tax. A disadvantage with grantor trust treatment is that this liability could stay with you for life. So long as the trust only invests in life insurance, the income tax will not be much of an issue, but the trustee is, of course, free to invest in other income producing assets.

A disadvantage to having the trust taxed as a separate entity is that the marginal income tax rates for trusts climb more quickly and sharply than for individual taxpayers. A trust that is treated as a separate taxpayer is, however, entitled to a deduction to the extent distributions are made during the year, with the income being picked up and recognized commensurately by the distributee (beneficiary). Distributing the income of a nongrantor trust is sometimes used as a technique for ameliorating the effect of the high marginal rate for trusts.

Because Moore is a beneficiary, Moore (and Lotta, so long as Moore is living and you are married) will be taxed on the income of the trust. This tax result is presently mandated under the "grantor trust" rules and cannot easily be avoided. However, it is possible to draft the instrument in a way that could increase the likelihood that Lotta would not be taxed on the trust following Moore's lifetime. I intentionally drafted the enclosed document to **increase** the likelihood of grantor trust treatment being continued in the future, but I could change that result should you request it. Just let me know. The considerations involved are set forth in the two preceding paragraphs of this letter.

Yours very truly,

Noel C. Ice

NCI/ice

Enclosure: First Draft of The Crummey Money Family Trust, without signature pages.

cc: G. O. Numbers, C.P.A.
3141592 Golden Road
Unlimited Devotion, TX 76999
(123) 456-7899

Monday, March 1, 1999

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Our File No.
ICE09/00009

PLEASE READ VERY CAREFULLY
Keep This Letter for Future Reference

CERTIFIED MAIL
RETURN RECEIPT NO.: dfgdsfg
Mr. and Mrs. Moore Money
2525 Mars Hotel
999 West L.A. Freeway
New Minglewood, TX 76999
(817) 999-9999

Re: Funding and Administering The Crummey Money Family Trust
Original of The Crummey Money Family Trust

Dear Moore and Lotta:

Please excuse the fact that this letter is being mailed certified mail. So that I need not rely exclusively on my memory, it is worth \$3 to have a record of receipt in my file, for future reference.

If there is or becomes any reason that you (Moore Money) might be unable or unwilling to accept or continue in the office of trustee, please let me know so that we may make other arrangements.

Note that the trust is irrevocable and unamendable. (However, in some cases, future contributions may be made subject to special conditions different from the existing trust terms.)

It is intended that the entire value of the trust will be exempt from estate taxes in Lotta's and Moore's estates, but this will only be the case if the instructions set forth in this letter are strictly adhered to. Even then, as you must know, the tax and other rules governing matters such as these are frequently changed by Congress, the state legislature, the Internal Revenue Service and the courts. Accordingly, while we have attempted to draft documents that comply with the current tax, trust and other laws, we can give you no assurance that Congress or the legislature or the IRS or the courts will not change some of these rules. Hence, Lotta should periodically have the plan reviewed, and it would be prudent to check with us or a tax accountant before making transfers to the trust.

The Trust Tax Return

Note that neither I nor my law firm will be overseeing or filing any tax returns, notices, or reports with respect to the trust. This responsibility must be assumed by you or your other advisors (e.g., your CPA). However, if the trust holds only life insurance, or if it otherwise has no income, so that no income tax return is required to be reported in any event, then you may be able to ignore much of the following discussion regarding this issue.

The Crummey Money Family Trust is an irrevocable annual withdrawal trust. This type of trust is probably a grantor trust under the "Grantor Trust Rules" (IRC §§674-678). If a person is treated as the "grantor" of a trust under the Grantor Trust Rules, that person is taxed **for all income tax purposes** *as if* the assets in the trust belonged to the grantor instead of to the trust!

Who is the Grantor? i.e., Who Pays the Tax on the Trust?

Assuming this is a grantor trust, the next question is “**who is the grantor?**” The answer to this question is important because the grantor reports the trust income on the grantor’s own Form 1040, as if there were no trust. Under IRC §678, each person having withdrawal rights probably ought to be treated as a grantor for income tax purposes, to the extent of the power, at least for so long as the power is outstanding and perhaps for good. However, since Moore is a beneficiary, §677 mandates that Lotta be treated as the grantor, at least so long as still married and both alive. Further, because of certain powers purposively retained by Lotta, §674 mandates that Lotta be treated as the grantor. **Which provision of the Internal Revenue Code trumps the other is unclear**, but a recent IRS Private Letter Ruling¹ clearly implies that Lotta will be treated as the grantor, rather than the withdrawal power holders. This is not all bad, because at the present time it is arguable that paying someone else’s taxes under this circumstance is not a gift subject to gift tax. **Of course, if the trust does not have any income, none of this makes much difference.** Again, if a trust is a “grantor trust,” the existence of the trust is essentially ignored for tax purposes, and the “grantor” is taxed as if there were no trust. This is why it is important to determine who, if anyone, will be treated as the grantor. **My best guess, based on PLR 9321050, is that Lotta is the grantor for income tax purposes, despite the existence of withdrawal rights in others.** However, you might be justified in taking a contrary position, should you choose.

Under the 1996 regulations, there are *at least* three alternative methods for meeting the income tax reporting obligations for a grantor trust.

Alternative 1. Ordinarily, a trust is required to file a tax return each year (April 15) on Form 1041. However, in the case of a trust or a portion of a trust that is treated as owned by the grantor or another person (*as is the case with The Crumme Money Family Trust*), then the items of income, deduction, credit, etc., that are treated as so owned “are not reported by the trust on Form 1041, but are shown on a separate statement to be attached to that form.”² This procedure is always available.

However, under regulations amended in 1996, you may not have to file a return if no more than one person is treated as grantor of the trust. For this purpose, however, a husband and wife who file a joint tax return for the year are considered to be one person.³

Alternative 2. If there is only one grantor (or if the only grantors are a husband and wife who file a joint tax return), then the trustee need not file the Form 1041 if—

(a) “the **grantor** or other person treated as the owner of the trust **provides to the trustee** a complete **Form W-9** or acceptable substitute Form W-9 signed under penalties of perjury”;¹ **and**

¹PLR 9321050.

²Treas. Reg. §1.671-4(a).

³Treas. Reg. §1.671-4(b)(8).

(b) the trustee furnishes “the name and taxpayer identification number (TIN) of the grantor or other person treated as the owner of the trust, and the address of the trust, **to all payors** during the taxable year.”²

If the grantor is not a trustee or co-trustee (**which is not the case here**), then the trustee must furnish the grantor or other person treated as the owner of the trust with a statement that sets forth certain additional information described in Treas. Reg. §1.671-4(b)(2)(iii)(B). **Because the trustee is not the grantor, I suggest you employ a C.P.A. to assist you with this job, at least initially.**

Alternative 3. If there is only one grantor (or if the only grantors are a husband and wife who file a joint tax return), then the trustee need not file the Form 1041 if—

(a) the trustee furnishes “the name, TIN, and address of the trust to all payors during the taxable year”;³ **and**

(b) the trustee files with the IRS “the appropriate **Forms 1099**, reporting the income or gross proceeds paid to the trust during the taxable year, and showing the trust as the payor and the grantor or other person treated as the owner of the trust as the payee. The trustee has the same obligations for filing the appropriate Forms 1099 as would a payor making reportable payments, except that the trustee must report each type of income in the aggregate, and each item of gross proceeds separately.”⁴

If the grantor is not a trustee or co-trustee (**which is not the case here**), then the trustee must furnish the grantor or other person treated as the owner of the trust with a statement that sets forth certain additional information described in Treas. Reg. §1.671-4(b)(2)(ii). **Because the trustee is not the grantor, I suggest you employ a C.P.A. to assist you with this job, at least initially.**

An advantage of the third alternative is that the trustee need not give the payors any information about the grantor.

The multiple grantor trust reporting requirements are found in Treas. Reg. §1.671-4(b)(3). Since these regulations are somewhat recondite, I will put a copy in the green book, under a separate tab all its own, where it may be consulted if in doubt. This regulation should simply be read and followed, if applicable.⁵ As discussed above, it may be that each person having withdrawal rights is treated as an owner of the trust, and thus, the more complicated filing rules may apply.

¹Treas. Reg. §1.671-4(b)(1).

²Treas. Reg. §1.671-4(b)(2)(i)(A).

³Treas. Reg. §1.671-4(b)(2)(i)(B).

⁴Treas. Reg. §1.671-4(b)(2)(iii)(A).

⁵Treas. Reg. §1.671-4(b)(3).

The due date for filing the tax return (Form 1041) or, if the alternative is applicable, the information required by the regulations, is April 15.¹ Your tax preparer should refer to the latest version of Treas. Reg. §1.671-4 for guidance (a 1996 copy is found under a separate tab all its own in the notebook), **and should not simply rely on this letter.** If you or the return preparer have any questions, I will be glad to answer them. I suggest that you give whoever is going to prepare the tax returns a copy of this letter.

Administrative Duties

Moore Money is the trustee. The trustee should keep records of all contributions to and distributions from the trust, and should see to it that all assets that belong to the trust are properly titled and accounted for.

Funding

The trustee should open up a trust account with a bank or brokerage firm or both, and contributions should be deposited to the account. The account should identify the trust and show the trustee, as trustee, as the account owner.

Tax Identification Number for the Trust

The trust should have a separate tax identification number. The taxpayer identification number for the trust is believed to be **75-9999999**. However, the IRS should send you written confirmation of the number.

Unless you receive written confirmation of the number, you should not rely that it is, in fact, the number just represented. It is very easy to get this number wrong, and that is why we insist that you check it against the IRS written confirmation. As soon as you receive it, please send me a photocopy.

Each beneficiary has an equal undivided interest in the trust, in the form of a separate share. If unequal distributions are ever made, this will change a beneficiary's fractional interest proportionately. (Initially, however, there is only one beneficiary: Moore Money, although the trust is designed to allow the class of beneficiaries to open with respect to future contributions at a later date.) The terms of the trust are spelled out in detail in the trust instrument itself, and I invite you to review them at your leisure.

Gift Tax Exclusion for Contributions to the Trust

A gift to an annual withdrawal trust should qualify for the \$10,000 per year/ per donor/ per donee annual transfer tax exclusion. The reason for this is that the beneficiary has the absolute right to the property contributed to the trust, at least for a limited period. If the beneficiary does not exercise the right to withdraw the gift, the right will eventually lapse. (An annual withdrawal trust is also known by the odd name of *Crummey* Trust, after the name of the case establishing the right to the annual exclusion.)

¹Treas. Reg. §1.671-4(d).

In order for the right to be considered meaningful, each beneficiary must be given notice of the right.¹ **The giving of notice is absolutely essential to qualifying the gift for the annual exclusion. A copy of each signed and dated notice should be securely kept, because it is virtually certain that the IRS will want to see the notices in order to establish that the donors were entitled to an annual exclusion from the gift tax.**

If the annual contribution to the trust does not exceed \$5000, it is probable that no one other than Moore has a right of withdrawal, in which case notice need be given to Moore alone. If the contribution exceeds \$5000, notice will have to be given to any other persons having withdrawal rights.

The Crummey Money Family Trust provides something similar to the following with regard to the giving of notice:

(j) **Notice of Withdrawal Right.** Each powerholder shall be notified that this instrument grants the powerholder withdrawal rights that will lapse if not exercised and shall further be notified of the manner in which and conditions under which the power may be exercised. If the powerholder is legally incapacitated, such notice shall be given to as many Special Representatives as is reasonable in order for the withdrawal power to be meaningful; provided, however, that such notice shall be given to at least one Special Representative who is **not**: (a) a person who has contributed property giving rise to a withdrawal right on behalf of an incapacitated person, or (b) a person who is or may be entitled to distributions from the trust to which the contribution is made.

The extent of the notice and the frequency with which additional notice is given shall be whatever is reasonable and sufficient so that the powerholder or his Special Representatives could easily exercise the withdrawal power if in the least so inclined. The sufficiency of the notice(s) shall depend on the circumstances, including the length of the withdrawal period to which the right relates, the ease with which the right may be exercised, and the knowledge that is required in order for the withdrawal powerholder to effect the withdrawal.

The actual terms of the trust regarding notice were made intentionally open ended with respect to the frequency and extent of the notice; however, my advice is that actual notice be given each time a contribution is made.

Notice must be given to all beneficiaries, or the IRS will not treat the gift as a present interest gift eligible for gift tax exclusion. **I am enclosing a sample notice form. I am enclosing a sample notice form to give to an adult beneficiary.** Please make sure that the appropriate notices are given to each beneficiary each time a contribution is made to the trust **and that a signed receipt of each notice is retained as part of the trust records.** If you need additional notice forms and don't have ready access to a copying machine, simply give my secretary a call at 878-2944 and she will be happy to provide you with plenty of copies.

¹Rev. Rul. 81-7, 1981-1 C.B. 474.

Since Moore is a beneficiary, **community property should never be contributed to the trust.** One way of acquiring separate property with which to make gifts is to **partition money out of a community property bank account. The partitioned property should be deposited into two other special checking accounts: one of which should be styled as Lotta Money's sole and separate property account, and the other should be styled as Moore Money's sole and separate property account.** A form of partition agreement partitioning funds in a bank account is enclosed. Unless you have separate property of your own that can still be clearly traced years from now, it is very important to closely adhere to this procedure, because if it is not carefully followed, the trust proceeds could be includible in Moore's estate for federal estate tax purposes, where they could be subject to a tax ranging from 38% to 55%. Copies of the canceled checks used should be saved so that in the future it will be possible to demonstrate that community property was not used to fund the trust.

- **Step One.** Unless Lotta already has separate property of her own, separate property will need to be created, since the trust cannot be funded with community property. If separate property needs to be created, then the first step is to complete the partition agreement that I provided you, by filling in all of the blanks, signing it, and simultaneously writing two equal checks out of your preexisting joint checking account. **This procedure will need to be repeated each time a contribution is made to the trust, unless Lotta has separate property of her own so that the need to partition community property is obviated.** Each check should be in an amount at least large enough to allow you to fund the trust and to cover any insurance premiums you anticipate will be due. The amount need not (and probably should not) equal the precise premium, because there is no requirement that the trust invest solely in insurance policies, and further, you will want to have enough money in the trust so that future premiums can be made **after any withdrawal rights lapse.**

- **Step Two. Three new bank checking accounts need to be established:** (a) one in Lotta's name, identified in the form of the account as her sole and separate property; (b) one in Moore's name, identified in the form of the account as his sole and separate property; and (c) one in the name of the trust, in the name of the trustee "as trustee," using the taxpayer identification number assigned to the trust.

- **Step Three.** Lotta should deposit her check into her separate property account, and Moore should deposit his check into his separate property account.

- **Step Four.** Lotta should write a check out of her separate property account, made payable to "The Crummey Money Family Trust," and should deliver that check to the trustee (Moore Money).

- **Step Five.** Since Moore is the trustee, Moore should deposit, into the trust checking account, the check that was made payable to the trust.

- **Step Six.** Written notice should be given to each person having withdrawal rights. The notice should be thorough and informative. The withdrawal power holder should acknowledge in writing the receipt of the notice, but should not waive the right to withdraw. (A waiver is not a lapse, and does not have the favorable tax consequences of a lapse.) A sample Notice(s) is attached to this letter. So long as the gifts to the trust do not exceed \$5000, Moore is the only one who needs to receive a notice, because in that case he is the only person having withdrawal rights. Copies of the notices should be retained forever, as part of the records of the trust. Since Moore is trustee, I would think that the notice to him could be dispensed with, at least so long as he remains in that office. However, the cautious approach would be to sign and retain notices to him anyway.

- **Step Seven.** The trustee (Moore Money) should invest the trust account in a prudent manner. The trust specifically authorizes the trustee to invest in life insurance, but you are advised that the trust language does not offer absolute protection to the trustee if such investment is manifestly imprudent under the circumstances. If at all possible, the trust should maintain sufficient assets to satisfy any outstanding withdrawal rights, if investments in nonliquid assets are to be made, until such rights lapse.

- **Step Eight.** The titled owner of any trust investments should be The Crummey Money Family Trust. If the trust owns a life insurance policy—which preferably should not take place until after the lapse of any withdrawal rights, unless other assets not subject to withdrawal are sufficient for that purpose—, it should be on the life of somebody other than Moore, and the beneficiary of death benefits (as well as all other incidents of ownership) should be the trust itself.

To the extent that a gift to the trust either (i) is not subject to a withdrawal right on behalf of a beneficiary or (ii) exceeds the applicable annual exclusions (cumulatively \$10,000 per donor/ per donee/ per calendar year—counting all present interest gifts to the withdrawal power holder during the year, not just to this trust)— the *donor* will have made a taxable gift for gift tax purposes. **Further, since we do not want the trust estate to be includible in Moore's estate, his withdrawal right has been capped at \$5000, rather than \$10,000 or 5%.** The reason that a \$5000 lapse does not result in the lapsed property being included in the beneficiary's estate is because of a special rule that will be explained shortly.

There is a possible exception to the rule that the donor makes a taxable gift if the power holder can withdraw more than \$10,000 in new gifts per year, if the power holder is a spouse of the donor. It is barely arguable that if the spouse has a withdrawal right, the gift qualifies for the unlimited marital deduction. This is an aggressive position to take but it does have support by analogy to other cases where a marital deduction was allowed for a gift to a spouse under a will even though the gift was to lapse if not exercised within a specified period of time. The IRS can be expected to argue that a spouse's withdrawal right is a terminable interest because the gift can lapse. We would argue that because the power is unrestricted for a period of time that the terminable interest rule is inapplicable.¹ This is not a technique on which I routinely rely.

From a different perspective, the *beneficiary* may be treated as having made a gift to the remaindermen when the withdrawal right lapses. To the extent that all such lapses from all gifts to the beneficiary during the year do not exceed the "5 & 5" limit of IRC² §2514(e), the lapse is not treated as a transfer by the beneficiary. Thus, it is not a gift. This keeps the property out of the beneficiary's estate as well. The "5 & 5" limit is the greater of \$5000 or 5% of the aggregate value of the assets of which or the proceeds of which the exercise of the lapsed powers could be satisfied. \$5000 is an easy concept to understand and reckon with; the 5% alternative is very tricky and hard to figure. **Usually, \$5000 is the relevant limit.** In order for the 5% figure to be greater, the trust corpus (or very possibly only the trust corpus subject to withdrawal by the beneficiary) would have to exceed \$100,000 in present value. So long as a power holder is living, the trust restricts the size of the withdrawal right that is allowed to lapse to an amount within the 5 & 5 limit. Consequently, there should be no problem with the gift tax in this trust.

The beneficiaries have retained powers of appointment over the trust. If a beneficiary has been granted a general testamentary power of appointment, the trust estate over which such power could be exercised will be includible in the beneficiary's estate for estate tax purposes. But if the power is a "nongeneral power," then it will be excluded from the beneficiary's estate. The fact that the trust may be excluded from the beneficiary's estate for estate tax purposes means that it may become subject to the Generation Skipping Transfer (GST) Tax if a person in a generation lower than the child level ever receives a distribution. This could happen on the death of a child.

For this reason

¹It appears that there are two lines of cases. One line, represented by Treas. Reg. §20.2056(b)-5(f)(8) and §20.2056(b)-5(f)(6), last clause, *McGehee v. Commissioner*, 260 F.2d 818 (5th Cir. 1958), *Estate of McCabe v. United States*, 475 F.2d 1142 (Ct. Cl. 1973), *Hoffman v. McGinnes*, 277 F.2d 598 (3rd Cir. 1960), and *Estate of Benjamin v. Commissioner*, 44 T.C. 598 (1965), tells us that if the spouse has an absolute power of withdrawal (appointment?) **during her life**, the interest qualifies under §2056(b)(5) as a deductible terminable interest, even though the spouse does not have a testamentary power of appointment and even though there is no requirement that all of the income be distributed (unless the spouse asks for it).

The other line is that an elective bequest is not a terminable interest at all. This line is represented by *Estate of Mackie v. Commissioner*, 545 F.2d 883 (4th Cir. 1976), *Estate of Tompkins v. Commissioner*, 68 T.C. 912 (1977), *acq.*, 1982-1 C.B. 1; *Estate of Neugass v. Commissioner*, 555 F.2d 322 (2d Cir. 1977), *rev'g*, 65 T.C. 188 (1975); and to some extent by Rev. Rul. 82-184, 1982 C.B. 215. In *Tompkins* the spouse had 60 days to elect to take a \$40,000 cash legacy, otherwise the gift passed to a trust that did not qualify for the marital deduction because the spouse's interest terminated upon remarriage. The Commissioner has acquiesced in this decision. *Cf.*, Treas. Reg. §20.2056(e)-2(c).

²All references herein to the "IRC" are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

you should weigh the alternatives of allocating or not allocating her GST tax exclusion to the trust.

Each grantor has \$1 million that can be allocated at death or during life to trusts that may someday otherwise attract a GST tax. The allocation can be made during life on a timely filed gift tax return, based upon the value at the time of the gift, or on a later return, based upon the value of the trust at that time. Alternatively, the allocation can be made at death, on an estate tax return using values at date of death. If life insurance is in the trust, it may make sense to make the allocation during life (if it is going to be made at all with respect to the trust), but this can sometimes be a hard call to make, because there are tradeoffs.

If a grantor (a person contributing property to the trust) wishes to make a GST exemption allocation to the trust, or if a grantor makes a contribution in excess of the annual gift tax exclusion available, the grantor will need to file and have prepared a gift tax return (form 709). I will not be responsible for preparing or filing any gift tax returns, but I should review any return prepared by your CPA prior to filing.

For the reasons indicated, the lapse limit has been limited to the greater of \$5000 or 5% of the aggregate value of the assets out of which or the proceeds of which the exercise of the lapsed powers could be satisfied. This is called a “hanging power” and it is an aggressive technique designed to keep all lapsed powers from being taxable gifts or being included in the estate of the power holder. Be advised that the IRS may not agree with it. But if it works, it may prove to have been worth the try.

It is extremely important that any insurance owned by the trust be acquired by the trustee directly from the insurance company rather than from the insured, if feasible. Sometimes this is impossible or not practical. If an insurance policy in which the donor had an incident of ownership is transferred to the trust, then, if the donor dies within three years from the date of transfer, the policy is likely to be included in the donor’s estate for estate tax purposes. (This is the “three year rule”.) In any event, once the policy is considered to be owned by the trust, all documents should reflect that the insured has no incidents of ownership in the policy at all, including the power to borrow against the policy, and the policy documents should clearly reflect that the “owner” and the beneficiary of the policy is the trustee, in trust of The Crummey Money Family Trust. In an attempt to avoid the application of the three year rule, the trust provides that Moore will receive all of the income at least annually from any insurance proceeds with respect to which the three year rule applies. To this extent it is hoped that the trust will qualify as a “QTIP Trust”¹ and therefore, if the proceeds are includible in the insured’s estate under the three year rule, the estate will be entitled to a marital deduction as a direct offset.

¹IRC 2056(b)(7).

IMPORTANT: If, contrary to my general recommendation, a grantor has no other satisfactory alternative but to contribute an existing insurance policy to the trust, then, in addition to the above procedure, the grantor will need to partition the insurance policy into separate property, and then (assuming Lotta is the grantor) Moore will need to transfer his interest in the policy to Lotta in exchange for cash that is likewise partitioned. I will prepare a special form to use in this case, should you request it (for an additional charge).

Please note that the trust prohibits owning life insurance on the life of the trustee. **So, as long as Moore is trustee, the trust should not own life insurance on his life.**

We will **not** assume responsibility or liability for seeing to it that the trust is properly designated as the owner or beneficiary of life insurance contracts and proceeds, though we will agree to offer whatever assistance you ask for short of that. Therefore, you should assure yourself, with the assistance of your insurance agent, that the ownership and beneficiary of any policies in which the trust has an interest are properly recorded by the issuing company. The trust should be the designated **owner and beneficiary** of any policies transferred to the trust. It is the responsibility of the trustee to see to it that this is accomplished.

Further, you and the trustee will need to look to your insurance professional or another source for advice on insurance and financial matters and should monitor the performance and financial strength of the insurance policy and the company that issues the policy on an ongoing basis. As you know, some insurance companies have experienced financial difficulties. Various independent rating services, such as A.M. Best Company, Moody's, Standard & Poors and other services may be helpful to you in this regard. You understand that we are not offering you financial advice with respect to the purchase of any insurance and we are not evaluating the insurance product.

I understand that Moore Money will keep the original . If you have any questions, please feel free to call.

Note that under Section 1.2 of Part II, Moore is only a beneficiary so long as you are married.

Yours very truly,

Noel C. Ice

NCI/ice

Enclosures:

Model Notice to Adult Beneficiary of Withdrawal Right (with Relevant Portion of Trust Attached)

Model Notice to Spouse of Withdrawal Right Held Spouse (with Relevant Portion of Trust Attached)

Form to Partition Bank Account

Copy of Treas. Reg. §1.671-4

cc: G. O. Numbers, C.P.A.
3141592 Golden Road
Unlimited Devotion, TX 76999
(123) 456-7899

CANTEY & HANGER
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