

# **ESTATE PLANNING HANDBOOK FOR CLIENTS**

**of**

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Lawyers become so used to working with complex terminology and concepts that we tend to forget that our clients have no prior exposure and may get lost in the flood of new information. Consequently, I have prepared this short summary of basic terminology and concepts to assist you in making appropriate choices.

***Note: This handbook is intended for general informational purposes and should not be relied upon for specific situtaion. In compliance with regulations issued by the Internal Revenue Service, we inform you that any Federal tax advice contained in this communication, was not written to be used and may not be used by any person to avoid any penalties under the Internal Revenue Code.***

### **TERMINOLOGY**

#### **People - Roles:**

**Executor:** Your executor is the person (or entity) who is responsible for the administration of your estate after your death. That is, he or she files your Will with the Probate Court, determines what assets were owned by you at the time of your death, files a list of those assets with the Probate Court, makes sure all creditors have been paid, files all appropriate tax returns, prepares an accounting of all assets received and all payments made, and distributes the remainder of the estate in accordance with your Will. Although the executor is responsible for the administration, most individual executors work closely with an attorney. An executor has no power or authority prior to your death. The job of an executor involves a lot of responsibility and hard work. It is important to name someone who will see that the job gets done and who will seek help from professionals when appropriate.

**Administrator:** An administrator does the same job as an executor in estates where an executor is not appointed in the Will or where there is no Will.

**Trustee:** A trustee oversees the administration of any trusts you have established. The trustee's job is similar to the executor's job. However, the trustee's role continues until the trust is distributed, which can be a very long time. In addition, the trustee usually is given more discretion than an executor as to when, to what extent and to whom distribution of income and principal are to be made.

**Guardian:** A guardian takes care of personal and financial affairs of a minor child. A parent is the child's natural guardian. If no parent survives, the Court will appoint a guardian. A guardian should be named in your Will if you have minor children to insure that your children will be cared for by the persons you want and to insure that no family battles over custody will take place after your death. It is possible to appoint different people to act as the guardian of the persons and of the estates of your children. (A guardian also can be named for mentally retarded adults. However, this is a separate provision with a different procedure.)

**Conservator:** A conservator does the same thing for an adult person who is unable to handle his own affairs due to disability or incompetence as a guardian does for a child. In some states a conservator is also referred to as a guardian.

**Fiduciary:** This is a general term referring to anyone in a position of trust, including executors, administrators, trustees and guardians.

**Grantor / Settlor:** Either of these terms can be used to describe the person who established a living or irrevocable trust.

### **Estate Planning Documents:**

**Will (Also Known as Last Will and Testament):** Your Will is your formal instruction to those who survive you as to how your assets should be administered and distributed.

**Testamentary Trust:** A testamentary trust is established in your Will to take affect after your death. The trust allows property to be held for the benefit of a person (the beneficiary) while giving the control over investment and distribution to another person (the trustee). The provisions of the trust are set by you to conform to your desires as to how the property should be administered. The important thing to remember is that, with certain limitations, a trust can include any provisions you want.

**Living Trust (Also Known as a Revocable Trust):** This type of trust is established during your lifetime by a separate instrument. The trust can be revoked (i.e. terminated) or amended at any time. It is possible to set up the trust but fund it with only a small amount of cash during your life. A Will (known as a "pour-over Will") is also written which provides that the any of your assets not transferred to the trust during your life will be transferred to the trust upon completion of the probate process.

**Irrevocable Trust:** Like the revocable trust, an irrevocable trust is established during your lifetime. Unlike the revocable trust, the irrevocable trust cannot be revoked or amended. An irrevocable trust can be used to make an immediate gift of property to a child or other person where you prefer that someone other than the beneficiary manage the property.

**Living Will:** A living Will is a separate document from your last Will and testament. As the name implies, a living Will has effect only while you are alive. The living Will directs your doctors not to use life support systems if you are terminally ill or are in an irreversible coma and unable to make decisions at that time. The statute that authorizes living Wills provides protection for medical personnel and institutions that rely on the living Will. You may appoint a health care agent who is given authority to see that the terms of your living Will are followed.

Note: There were significant changes to the living will statute in Connecticut that took effect on October 1, 1991. Consequently, living Wills executed before 1992 should be reviewed and new living Wills executed where appropriate.

**Health Power Of Attorney:** A health power of attorney designates a person to act as your "attorney-in-fact" to make health care decisions for you if you are not capable of making your own decisions. A health power of attorney covers many more situations than a living Will. For instance, a living Will gives no guidance in the situation where you are terminally ill and develop an unrelated problem where surgery is normally recommended. (For example, doctors might recommend heart bypass surgery for someone terminally ill with cancer.)

Connecticut's law authorizing health powers-of-attorney does not allow the attorney-in-fact to make decisions to disconnect life support systems, so this document should be used in conjunction with a living Will and a health care agent appointed in connection with the living Will.

**Health Directives:** In 1993, the Connecticut legislature approved a form which combines all disability planning relating to health, including the living Will, appointment of agent for health care, appointment of attorney in fact for health care, designation of conservator of the person and anatomical gifts. This can be a useful approach since it allows health care providers to have all pertinent information in one document.

**Authorization to Release Medical Information (HIPAA Release):** Due to federal restrictions, medical providers cannot release your medical information without written authorization from you. It is important to have the authorization in place so that your family and designated decision makers can get the information necessary to determine whether you are capable of handling your own affairs and to make medical decisions for you if you are no capable.

**Financial Durable Power of Attorney:** (This document is sometimes referred to simply as a power of attorney.) A power of attorney authorizes a person or persons to act in your behalf in connection with your financial affairs. The statutory short form power-of-attorney, which is the form most commonly used, is very broad in scope, giving your attorney-in-fact the power to do almost anything with your assets. The power can be limited in scope if desired.

**Springing Power of Attorney:** As of October 1, 1993, it is possible to use a "springing power of attorney" in Connecticut. A springing power of attorney is like any other power of attorney except that it specifies that it will not take effect until you are incapable of making your own decisions (or until the occurrence of some other specified event). This provides some protection against your attorney-in-fact taking over your finances while you are still capable of managing your own affairs. The only evidence of your incapability that is required is an affidavit signed by a person you designate in the document. The affidavit can be signed by the designated attorney-in-fact or any other persons you name, and may also require the written concurring opinion of your attending physician.

If you own assets located outside of Connecticut, the springing power should be used with caution since it may not be accepted in some other states.

**Designation of Conservator:** The living Will, health power of attorney and regular power of attorney all help avoid the need for a conservatorship. However, in some situations a conservatorship may still be required (especially if you choose not to utilize all of those documents). You can gain some control over the conservatorship process by naming the person you would want to act as your conservator if it is ever needed.

Designating a conservator can actually prevent the need for a conservatorship since it reduces the possibility of someone other than your designated attorney-in-fact from trying to take over your finances by having a conservatorship established.

You can also waive bond for your conservator. In other words you can direct the Probate Court not to require your conservator to purchase a probate surety bond. A surety bond amounts to an insurance policy to cover errors and wrongful acts of the conservator. The cost depends on the value of your assets and must be paid every year.

Generally a designation of conservator of your estate (i.e., a person to handle your financial affairs) is included in our powers of attorney and a designation of conservator of your person (i.e., a person to make health and personal care decisions) is included in our health power of attorney and health directives.

## **USING POWERS OF ATTORNEY:**

### **Advantages of Powers of Attorney**

1. Powers of Attorney can significantly reduce administration expenses which would be incurred if a conservatorship had to be established. It can cost thousands of dollars just to establish a conservatorship, and the annual costs and effort to maintain it can provide a significant drain on your assets.
2. Powers of Attorney avoid the emotional trauma of a court determination of incapability, where often children must testify in the presence of their parents that they are incapable of managing their affairs and the parents are confronted with a family that appears to have turned against them.
3. Powers of Attorney are more flexible than conservatorships. For instance, you can give your attorney-in-fact powers to make gifts to your family and/or charities, to support family members who are dependent on you, and to restructure your assets when it appears that you may need nursing home care. plan for your loved ones However, they should be used with caution. Some reasons for caution follow:

### **Disadvantages of Powers of Attorney**

1. A power of attorney takes effect immediately. This is necessary since your bank or person relying on the power has no way of knowing whether you are capable of making your own decisions. Although you do not give up your own power to act, your attorney-in-fact can also act and can do so without your knowledge.

Note, however that this problem can be alleviated in two ways:

- by using a springing power of attorney, or
  - giving the document to someone other than the person named as your attorney-in-fact and request that person not to deliver the document until he determines that you should not be handling your own affairs.
2. A power of attorney is difficult to revoke since photocopies of the document can be utilized. Consequently, even if the original is returned to you, there is no guaranty that the holder of the power has not retained a copy. (In order to effectively revoke a power of attorney, copies of the revocation should be sent to every institution where you have assets and should also be recorded in every town where you have real estate.) (Note, however, that it is even more difficult to terminate an involuntary conservatorship.)
  3. Although your attorney-in-fact is supposed to act in a fiduciary capacity (that is, he is supposed to act for your best benefit) no one oversees his activities and it is difficult to reverse his actions.

4. A power of attorney does not terminate the power of the signor of the power to also act. This can be an advantage and a disadvantage. In many case it is good that both the grantor of the power and the attorney-in-fact have power to manage affairs, because it allows them to work together on a as-needed basis. However, if the grantor refuses to accept his own disabilities and works against the attorney-in-fact the co-power aspect of a power of attorney can be a disadvantage, sometimes resulting in the necessity of a conservatorship in spite of having a power of attorney in place.

Note that power of attorney terminates on the appointment of a conservator. Both a power of attorney and conservatorship terminate upon your death.

**Making Gifts with Powers of Attorney:** A standard short-form power of attorney does not include the power to make gifts. A power to make gifts should be added in two situations:

1. If your estate is large enough to be concerned about death taxes, a power limited to the annual gift tax exclusion (currently \$13,000 per year per person) will allow for an ongoing gifting program or death-bed gifting to reduce estate taxes.
2. If you want your family to be able to transfer your assets to avoid spending your lifetime savings on nursing home costs, a broader power should be included.

In either case, you should list the persons who may receive gifts. For instance, you could state that gifts can be made to “my descendants and their spouses”. If you want your attorney-in-fact to be able to make transfers to himself, you must specifically state that in the document.

**However, gift powers should be used only with extreme caution**, both to prevent the holder of the power from taking your assets at an inappropriate time and to prevent taxes against the estate of your attorney-in-fact. The following provisions should be considered, especially if the power is not limited to \$13,000 per year per person:

1. It is best to use a springing power, so you can control gifts as long as you are competent.
2. It is best to name someone other than the person who will receive gifts to hold the power. For instance, you might name a niece to exercise a power to make gifts to your children.
3. If you want to give the power to your children and you want your children to be able to make gifts to themselves, you should name all of them and require that they agree on all gifts.

Gift powers must be drafted carefully. Only an attorney with an expertise in estate planning should draft any document that contains gift powers.

## **OWNERSHIP ISSUES**

### **The manner in which you own your assets has a huge effect on your estate plan,**

- **Neither your Will nor your trust will have any effect on property owned in a manner that will cause it to pass directly to a co-owner or beneficiary at the time of your death.** For example, property owned jointly with rights of survivorship, whether it be your house or your bank account, will automatically pass to the surviving owner at your death. The same is true for any asset that has a named beneficiary, such as insurance policies and retirement account. It often (but not always) makes sense to own property in this manner, but it is essential to consider the effects of such ownership on your overall plan. Too often a client will establish a

Will which gives property equally to children, and then adds one child's name to his bank accounts. The result of that is that one child gets all of the bank accounts, plus half of everything else.

- **If you establish a living trust, in most cases the trust should own your assets prior to your death and should be named as beneficiary of your life insurance.** If assets are not owned in this manner, they will be subject to probate, or even worse pass directly to beneficiaries in a manner that upsets the intent of your plan. However, this issue is complicated and the advice of your attorney as to whether specific assets should be owned by your trust should be requested.
- **It is important to have a named beneficiary for retirement assets.** There are income tax advantages that are not available to your loved ones unless they are named as beneficiaries of your IRA, 401(k) and other retirement accounts. Generally these accounts should never pass to your probate estate, which is what will happen if you do not name a beneficiary. Sometimes it makes sense to name your trust as beneficiary, but it usually makes sense to name a beneficiary directly rather than naming the trust. Again, the advice of your attorney on this issue is essential.

### **DECISIONS YOU NEED TO MAKE:**

In order to establish an appropriate plan for you, you must decide a number of issues.

**ALL CLIENTS:** Some issues are applicable to everyone:

1. Who do you want to act as executor and who do you want to act as successor executor if your first choice cannot serve? (Names and address.)
2. Who do you want to benefit in your Will? (Names and addresses). What do you want to give to each beneficiary, specific items or a percentage of your estate?
3. Do you also want to make charitable gifts? If so, which charities and how much?
4. If you give a specific item and do not own that item at death, should the beneficiary of that item get anything?
5. If a beneficiary fails to survive you, should his share pass to his children?
6. Who (or what charity) do you want your estate to pass to if your primary beneficiaries die before you? (Names and addresses.)
7. If you have minor children, who should be named as their guardian? (Names and addresses.)
8. Do you want a living Will?
9. Do you want to allow your representatives to make anatomical gifts if medically appropriate?
10. If you want a health power of attorney, financial power of attorney, and/or designation of conservator, who should be named to act on your behalf initially and as successors? (Names and addresses.)

11. Do you want to be an organ donor if medically appropriate? If so would the donation be only for transplantation and therapy, only for research or for both?

**CLIENTS WHO ESTABLISH TRUSTS:** In addition to the decisions listed above, you may also want to establish a trust (testamentary or revocable) for your beneficiaries. Some reasons to establish a trust include:

- you have children or other beneficiaries who cannot wisely manage their money (even if they are old enough to legally manage it),
- you have a disabled beneficiary,
- your estate is large enough to require tax planning, or
- you own out of state real estate and want to eliminate ancillary probate proceedings.

### **Living Trust versus Testamentary Trust**

#### **Advantages to a living trust:**

1. The trust is not filed with the probate court, and therefore the provisions of the trust remain private.
2. The trust is not subject to probate court jurisdiction. In Connecticut this does not reduce probate fees in connection with the administration of a decedent's estate, but it may reduce administration expense connected with the preparation of formal accounts and other probate documents, provided that the trust is fully funded prior to your death. It also will reduce the ongoing probate fees and administration costs for the administration of the trust if the trust is expected to continue after the settlement of the decedent's estate.
3. If you own out-of-state real estate, that property can be transferred to the trust, thus avoiding probate proceedings in those states (known as "ancillary probate").
4. A trust can be used to administer your property while you are alive, but incapable, thus avoiding the need for a conservatorship.
5. If insurance proceeds are payable to the trust and/or other assets are owned by the trust, cash will be available almost immediately for the benefit of your family.
6. It is highly recommended that the trust is funded with the bulk of your assets.

In spite of the benefits of a revocable trust, in many situations it is better to use a testamentary trust.

#### **Advantages of a testamentary trust:**

1. If you do not expect the trust to ever be used, it is not worth the cost of establishing a separate trust. For instance, if trust provisions are being included in the will only to provide a mechanism for handling funds for young children if both spouses should die, the likelihood is that the trust will never be used, since it is unusual for both parents to die while the children are young.

2. If you are concerned that your funds will be exhausted on convalescent care for yourself or your spouse and want to be able to qualify for Medicaid (Title 19) assistance, only a testamentary trust will give some protection for your assets against the claims of the State.
3. If you are concerned that your chosen trustee may need some oversight, a testamentary trust is a better choice, since the Probate Court will retain jurisdiction over the trust until its termination.
4. It generally is less expensive at the planning stage to create a trust in your Will because when you establish a living trust you still need to have a Will and a living trust is more complicated and longer than a testamentary trust.

### **Trust Provisions**

Regardless of whether you elect to have a living trust or testamentary trust (or irrevocable trust), you will need to consider the provisions to be included in those trusts. Some issues to consider are:

1. Who do you want to act as trustee and who do you want to act as successor trustee if your first choice cannot serve? (Names and addresses.)
2. What will be the trust provisions for your beneficiaries? Some examples follow:
  - a. One trust is established for all children until age 18, at which time separate trusts are established.
  - b. Separate trusts are established at outset.
  - c. The trustee is given discretion to distribute income and principal among children as he determines necessary for their support and education.
  - d. Provisions are made to charge certain distributions (such as graduate school) against the share that beneficiary will receive.
  - e. At a specified age, all income will be distributed to children.
  - f. At a specified age the beneficiary will have the right to demand distribution of a portion of the principal, with the balance to be distributed at a later age.
  - g. The trustee is given discretion to pay out principal to help the beneficiary establish a business or profession or the purchase a house.
  - h. The trustee is given discretion to pay out all or a portion of the principal prior to the age set for distribution if he determines that the beneficiary is capable of handling the money wisely.
  - i. Special provisions are made for the benefit of your children's guardians.

**FAMILY MEMBERS WITH SPECIAL NEEDS:** If any of your beneficiaries are disabled due to either a physical or mental disability, you need to consider special provisions for them. If such beneficiaries receive or expect to receive government benefits that are asset or income sensitive, in general you should not give those beneficiaries their shares outright. Rather, a special needs trust drafted to comply with government regulations should be utilized.

**CLIENTS WITH ESTATES IN EXCESS OF ESTATE TAX EXEMPTIONS:** If the combined estates of you and your spouse (including the face amount of any life insurance) are in excess of the federal or state tax exemption, you need to consider a more complex estate plan. The current exemption for federal estate tax is \$3,500,000. That is scheduled to expire this year, but it is unlikely that Congress will allow it to go below that amount. Any amount over the exemption is taxed at the rate of 45%.

Connecticut taxes apply only if your combined assets exceed \$2,000,000. Although the Connecticut rates are lower than the 45% federal rate (ranging from 5.09% to 16%) unlike the federal tax, if the assets exceed \$2,000,000, all of the assets are taxed, not just the portion over \$2,000,000. Consequently, there is no estate tax if your assets are less than \$2,000,000, but if the taxable assets are \$2,000,001, there would be a Connecticut estate tax of \$101,701!

In addition to the exemption, any amount passing to a spouse, no matter how large, passes free of both federal and Connecticut estate tax. For example, if you have \$3,700,000 and your spouse has \$300,000 and you leave everything to your spouse, there will be no estate tax on the first death. The problem arises on the second death. By leaving everything to your spouse you have increased his or her estate to \$4,000,000 and on your spouse's death a federal tax of \$98,982 (after taking a deduction for the state tax) plus a Connecticut tax of \$280,400, for total estate taxes of \$379,382.

**Formula Credit Shelter Trust.** If on the other hand, you left \$2,000,000 in a properly drafted trust (known as a "family trust", "bypass trust", "B trust", credit shelter trust" or "exemption equivalent trust") that amount would be excluded from your spouse's estate even if your spouse was the sole beneficiary of the trust during his or her life. Any balance of your estate could be left to your spouse, either outright or in a separate trust, usually referred to as a "marital trust". The result in this example is that no federal or Connecticut estate taxes would be paid either on your death or on the death of your spouse.

**Disclaimer Trust.** A variation on this concept is to use a "disclaimer trust". Instead of providing a formula by which the first \$2,000,000 of your assets is automatically left to a credit shelter trust, you could provide that all assets be left to your spouse unless your spouse disclaims (refuses to accept) the assets. Any disclaimed assets would pass into the trust. This device is useful if you are not sure whether the combined estates of you and your spouse will exceed the allowed exemption. The surviving spouse can then decide the appropriate amount to put into the trust when the amount of assets is known. The disadvantage to a disclaimer trust is that the surviving spouse cannot be given the right to make gifts from the trust or a power to change the ultimate disposition through her will. Furthermore, sometimes surviving spouses are overwhelmed with a sense of insecurity, or do not receive good advice and fail to make disclaimers within the allowed time (within nine months after the date of death) even when appropriate.

If you need this type of plan several additional decisions need to be made.

1. Do you want to use a disclaimer or a formula to fund the trust?
2. Do you want to establish a separate revocable trust or utilize a testamentary trust?
3. Should your spouse's share of your estate pass to him or her outright or be held in a marital trust?
4. Who will be the beneficiaries of the credit shelter trust? This trust can be for the sole benefit of the surviving spouse or can be for the benefit of spouse and children or only for your children (or any other persons you wish to benefit).

5. If your spouse is a beneficiary, either all income is paid to your surviving spouse, or so much of the income as the trustee determines to be advisable. If the spouse serves as his or her own trustee, all income will be taxed to your spouse regardless of whether it is distributed.
6. If the surviving spouse is trustee, principal can be distributed with a limited standard such as "for support, maintenance and health". If your spouse is not the trustee, more flexibility is allowed.
7. Your spouse (or any other beneficiary) can be given a power to withdraw the greater of 5% or \$5,000 of the principal each year (known as a "5 and 5 power").
8. Your spouse can be given the power to distribute principal to children and/or grandchildren, or if desired, to their spouses. This power can be effective during the spouse's life (a life time power of appointment) or through the spouse's will or trust (a testamentary power of appointment). These powers may not be used for any amounts that were disclaimed by the spouse.
9. Who should be named as trustee and successor trustee? If an independent trustee is utilized, the trustee can be given the power to distribute (or "spray") income and principal to spouse, children, grandchildren, etc. with or without a standard.

**CLIENTS WITH LARGE ESTATES:** If the combined estates of you and your spouse are more than double the amount of the exemptions, you may want to consider an even more complex estate plan. To calculate the size of your estates, you need to include the face amount of any life insurance, plus your interest in all other assets, such as real estate, stocks, IRA's, 401(k)'s and deferred annuities. Some devices that can reduce estate taxes are briefly discussed below.

**Irrevocable Insurance Trust:** An irrevocable trust is often set up as an insurance trust. Enough money is transferred to the trust to allow the trustee to purchase insurance on your life. The benefit is that the insurance proceeds will be available upon your death to provide liquidity to your estate for taxes and administration expenses without increasing the value of your taxable estates. This type of trust is often used to purchase second-to-die insurance for situations where the insurance is needed only for liquidity purposes after both spouses have died.

**Qualified Personal Residence Trust ("QPRT"):** Under a QPRT either your primary or secondary residence is transferred to the trust. During a specified term of years (the "income term"), you retain the right to use the residence. After the income term is over, the trust can hold the residence for your spouse or lease it to you or distribute it to your children.

There are two advantages of this trust. First the value of the gift of the residence to your children is reduced due to the fact that you retain the right to use the house for the income term. For example, if a 60 year old transferred his \$300,000 house to a QPRT (when the applicable federal interest rate is 7%), retaining the use of the house for a period of 10 years, the value of the gift to the children is only \$124,311.

The second advantage is that the future appreciation of the house is removed from your estate. In the same example as above, if a 4% growth in the property is assumed and the estate is in the 50% bracket, the potential estate tax savings is \$159,881.

The benefits of this type of trust change with the interest rate, the age of the donor and the term of the trust. Although a longer income term results in more savings, too long of a term should not be selected since there is no benefit at all if the donor fails to outlive the income term.

**Grantor Retained Annuity Trust ("GRAT"):** A GRAT is similar in concept to a QPRT, but instead of transferring a home to the trust, other assets are transferred. The Grantor retains an annuity of a specified percentage of the assets each year for a term of years. At the end of the term, the asset passes to the remainder beneficiary of the trust (usually a child). As with the QPRT, the advantage of the GRAT is that the value of the gift is reduced and the growth of the asset is removed from your estate. Also like a QPRT, the savings varies with the age of the donor, the length of the term and the applicable interest rate. This type of trust works best if the trust assets produce income and/or appreciate in value at a rate in excess of the applicable federal rate.

**Charitable Remainder Trust ("CRT"):** In a CRT you reserve an annuity interest either to yourself or your beneficiaries, or both, either for a term of years or for life. Once the annuity interest terminates, the balance of the trust goes to charity. There will be a charitable deduction for estate tax purposes for the portion of the trust that goes to charity. If you set up the trust during your life and take an annuity interest, with the remainder passing to the charity upon your death, you also get an income tax deduction. This device works best when the property that is transferred to the trust has greatly appreciated in value. The trust can sell the property without paying capital gains tax and the entire proceeds can be invested, thereby increasing the funds available to you. You will pay income tax on the income and capital gains portions of the annuity as you receive it. It is common to use a portion of the annuity payment to purchase life insurance to replace the asset that has been transferred to the trust.

**Family Limited Partnership ("FLP"):** A partnership is established and assets are transferred to it. You can make yourself the general partner of the FLP, thereby retaining control of the assets. Once the assets are in the FLP you can transfer limited partnership shares to your children. Since they are limited partners, they have no vote in the management of the assets. Furthermore, since the limited partnership shares have no control over the property and would be difficult to sell, the IRS may allow a discount in the value of the shares. For example, if the value of the assets transferred to the FLP totaled \$500,000, and a 30% limited partnership interest was transferred to your child, instead of valuing the gift at \$150,000 (30% of \$500,000), it might be possible to value the gift between \$90,000 and \$105,000, for a reduction in the gift of about \$50,000. It is necessary to have the limited partnership share valued by an appraiser to determine the actual discount, which can be expensive. A limited liability company ("LLC") may also be used in this manner.

In considering the use of a FLP or LLC, especially where the use of valuation discounts is contemplated, it is important to keep in mind that the IRS has been increasingly hostile to FLP's and LLC's, and you should not be surprised if the IRS challenges this type of arrangement. Such challenges can be very time consuming and costly. The arrangement is less likely to be challenged by the IRS if the assets held by the FLP (or LLC) are business assets and if there is a valid business purpose for the arrangement. It also is essential that your beneficiaries have a real and present interest in the entity for this to work. If the person who establishes the FLP or LLC retains too much control or puts too many restrictions on the transfer of interests both the discounts and the annual gift tax exclusion will be lost.

Hopefully this information will answer some questions and help you think about what other questions and concerns need to be discussed with us when formulating your estate plan.

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