FUNDAMENTALS OF THE TRANSFER TAX

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Moderating the Complexity

Without question, the subject of federal (and state) transfer tax can be quite complicated. In fact, it's been my observation that most general estate planning practitioners cannot answer much more than the elementary questions concerning this area of taxation. It is a complex area of tax law that can involve customized estate planning to properly address, particularly for the wealthy. The objective of this material then is to provide a general understanding of transfer tax law and to present clear answers to the many questions asset owners often have, particularly when trusts are involved.

What Actually is a Transfer Tax?

We start with an interesting fact. If you are a taxpayer with assets, the federal government (and most state governments) have a literal split-interest claim over every dollar you transfer whether during lifetime or upon your decease. Transfers made by the taxpayer/asset-owner during his lifetime are deemed as gifts and therefore subject to the federal "gift tax" table. Transfers made upon the taxpayer's death are deemed as distributions from his estate and therefore subject to federal "estate tax" table. Both gift tax and estate tax are statutorily *bundled* and are ultimately imposed as a federal transfer tax.

There is also an applied graduated scale to the federal transfer tax table, which currently starts at the 18% level and increases to 40%. And, conversely, there is an exemption available against the transfer tax. The exemption amounts have significantly increased over the years. As of this writing, the current maximum *exemption amount* is $12.92 million for a single transferor and $25.84 million for a married couple. If federal transfer tax obligations are still owed *after* the entire transfer tax credit has been applied, then a large estate is obviously involved. And the maximum (40%) taxable rate will be applied against any transfers exceeding the federal exemption equivalent amount.

Applications of the Transfer Tax

For federal taxation purposes, and under current transfer tax law, transfers made during lifetime and upon decease are "unified" or, in other words, the values of all such transfers are combined and utilize essentially the same rate schedule. Federal transfer tax obligations can also be reduced or eliminated when applying certain exemptions.

To that end, each taxpayer/transferor is allowed a transfer tax "credit" that can be utilized either during lifetime and/or when making transfers upon decease through his estate. The transfer tax credit is directly correlated with the exemption equivalent amount table.

That means that any lifetime transfers made by an asset-owner may effectively reduce (or, in some cases, eliminate) what he is able to transfer upon decease without incurring a transfer tax obligation. However, there are several applications that factor into the ultimate calculation of transfer taxes that an asset owner may, or may not, apply.

The Transfer Tax Credit

When getting clarity concerning the transfer tax laws, one important point to understand is that the application of *the transfer tax credit is directly correlated with the exemption equivalent amount* or the amount of exemption from transfer taxation. For example, if a decedent's estate was transferring a combined value – including adjustments made for lifetime gifts to natural persons (non charities), if any – of (say) $10 million dollars, the actual transfer tax obligation would be approximately $4 million when calculating the estate tax to be paid using the graduated transfer tax scale. With that said, each transferor's estate is "allowed" a *transfer tax credit* that can be applied against the estate tax obligation the effect of which – under current taxpayer laws – eliminates most American estates, at least in this current environment, from having to pay transfer/estate taxes upon the estate owner's decease.

The transfer tax credit is applied similarly as tax credits would be taken by certain income tax payers against their adjusted gross income, after deductions, when reporting on a Form 1040. In other words, the transfer tax credit is a dollar-for-dollar credit against the ultimate estate (or gift) tax otherwise owed. If a large gift is being made during the transferor's lifetime, he would file a Form 709 (gift tax return) and show the transfer tax credit against the tax obligation. In the same way, a Form 706 (estate tax return) is required to be filed by the taxpayer's executor if the deceased taxpayer's gross estate exceeds the then available (or remaining) exemption equivalent amount.

So, again, a dollar-for-dollar credit can be taken against the dollar value of the estate tax obligation.

In going back to our previous ($10 million) illustration, we see that a transfer tax credit of $4 million can be taken against a $10 million gift/estate tax obligation to ZERO out the estate tax bill. In other words, applying the $4 million *transfer tax credit is equivalent to exempting* $10 million of the transfer tax that would have otherwise been owed to the federal government.

The Annual Exclusion

The US Tax Code allows a certain amount, which is currently set at $17,000 as of the time of this writing, to be “excluded” when calculating the total value of lifetime transfers made in a given year. (The annual gift tax exclusion is also sometimes incorrectly referred to as an “exemption”.) The annual exclusion is separate from the transfer tax credit and may be applied solely without using any of that credit value. Also, the annual exclusion value applies per “giftee” to whom the giftor/transferor may give to during a calendar year. For example, a single parent with three children could gift a value of $17,000 to EACH child – a total of $51,000 – for the current tax year. As an extended example, if he had six children, he could gift $102,000 in equal portions to all six children in one calendar year without using any of his transfer tax credit.

If the giftor is legally married, a split-gift arrangement is allowed among the spouses, regardless if the entire gift were made from only one spouse’s account, enabling the $17,000 annual exclusion to be worth double the amount ($34,000 for the current year) for each donee. In this example, then, the married couple could currently gift a total of $102,000 equally to their 3 children without causing any reduction in the value that could eventually be transferred at their decease without a transfer tax obligation. In addition, the allowable annual exclusion value is renewed each and every calendar year.

Excluded Transfers to an Insurance Trust

It should be mentioned at this juncture that annual exclusion gifts are very often used when a parent or grandparent is establishing an irrevocable life insurance trust (ILIT) for the benefit of their posterity. The primary reason for establishing an ILIT is to have the insurance policy OWNED by the ILIT and not by the insured. (Otherwise, any properly drafted RLT can easily accomplish the very same outcomes that an ILIT can achieve.) The ILIT arrangement enables the death-benefit proceeds of the life insurance policy to be outside of (not included in) the insured’s estate for transfer tax purposes. The reason that works is because the *incidents of ownership* with respect to the insurance policy is attributed to the ILIT, and not to the insured.

To fund the ILIT without incurring taxable transfers or "using up" the transferor's transfer tax credit, the transferor/insured can make annual exclusion gifts to the named beneficiaries of the ILIT through the trustee of the ILIT. In order for an annual exclusion gift to "qualify" as being excluded from the transferor's taxable estate, the transfer must be a "present interest". In other words, the beneficiary/giftee(s) must have the right to use the transferred gift *immediately*. It must be a gift of a present interest. To make that happen, the trustee must first receive the transfer on behalf of the beneficiaries and then notify each beneficiary of their right to "take" the transfer outright. The trustee notifications to the beneficiaries are also known as "Crummey Letters" (named after a 1968 federal court case that recognized such an arrangement gave the ILIT beneficiaries the right to obtain the transfer therefore making it a gift of present interest). Usually the "right to take" the gift expires after a period of 30 days. Afterwards, the trustee uses the annual exclusion gifts that were "not taken" and purchases the insurance premium to pay for the life insurance policy taken out on the life of the transferor.

The Unlimited Charitable (Gift & Estate) Deduction

In addition to the transfer tax credit / exemption equivalent amount applications that we have just discussed, which is relevant to making transfers to natural persons (non charities), taxpayers can also benefit from dollar-for-dollar deductions when making lifetime gifts and/or transfers at death to qualified charities. In both cases of lifetime gifts and transfers at death, the gift and estate tax deductions available for making transfers to qualified charities are unlimited. In other words, whatever value a taxpayer transfers to a qualified charity during his lifetime and/or upon his death will be entirely deducted, dollar-for-dollar, from that taypayer's taxable transferable estate. That means for every taxpayer / asset owner, there is an *unlimited gift-tax charitable deduction* and an *unlimited estate-tax charitable deduction*.

> Charitable Income-Tax Deduction: As an informative side note, it should be stated here that under current law, there is also a *charitable income-tax deduction* available for taxpayers during their lifetimes. The deduction value for income tax purposes for "immediate charitable gifts" is currently capped, however, to a sixty percent (60%) value of the taxpayer's adjusted gross income (AGI). The definition of "immediate gift" here means that the donee/charity is able to receive and use the transferor's gift right away rather than having to wait until a type of split-interest charitable transfer – such as that which applies with charitable remainder

trusts – eventually endows the charity with the present use of the asset transferred to the charity.

With such deferred gift arrangements, the present value of the future-interest gift* that's deemed to be eventually received by the charity is that same value the taxpayer may use to calculate his income tax deduction. Notwithstanding, the income tax deduction cap with deferred gifts is currently set at thirty percent (30%) of AGI or twenty percent (20%) of AGI for transfers to a private foundation or other certain IRC §501 types of charities. However, even though a deferred, split-interest gifting arrangement in conjunction with a 501(c)(3) entity is limited as to the value that can be deducted for federal income tax purposes (up to 60% under current law), that is not the case as to the estate tax deduction since any remainderman interest of any value can be distributed to a qualified charity without any limitation.

**The methods of determining the values of split-interest gifts, such as is commonly associated with charitable remainder trusts, normally involve not only the value of the transfer but also the (i) application of the Federal Mid-Term Rate, (ii) spilt-interest ratios between donor and charity, (iii) type of charitable remainder trust format and (iv) either the exact time or the actuarially-estimated time the charity would eventually receive the charitable transfer.*

The Unlimited Marital (Gift & Estate) Deduction

Just as there are unlimited deductions available for transfers to qualified charities made either during lifetime or upon decease, there is also an unlimited deduction available to the asset-owner transferor when making transfers to his/her legal spouse (if the spouse is a US citizen) at either lifetime or upon decease. Just prior to the passage of the Economic Recover Tax Act (ERTA) of 1981, the marital deduction was limited to only $250,000 or one-half of the decedent spouse/transferor's gross estate, whichever was greater. ERTA changed all of that with the enactment of the unlimited marital deduction (UMD), which has stayed in place ever since. That change also opened additional areas of opportunity for planning among spouses and ultimately for the benefit of their families.

For estate planning purposes, the UMD can be utilized within a few strategic applications dependent upon the circumstances surrounding the family estate. In addition to outright transfers from a decedent/spouse's estate, the UMD can be employed without transferor spouse losing outright control of his estate upon his death. The control factor can be accomplished through the use of either a sole grantor trust or co-grantor marital. We are talking in particular here about the use of a revocable living trust (RLT). RLTs are crucial for achieving proper estate tax planning between spouses and their ultimate family estate especially, of course, among wealthy families.

With the use of RLTs, a marital deduction trust can be created at the death of the first spouse to die where the decent spouse can retain control of the marital deduction property and yet benefit the surviving spouse for her lifetime. Such a trust is normally referred to as a "Qualified Terminable Interest Property" (QTIP) Trust. As a general rule, the QTIP is funded with the decedent spouse's estate value, if any, that *exceeds* the exemption equivalent amount and can be used to qualify for the marital deduction without be allocated outright to the surviving spouse and thus cause the decedent spouse to lose control of that part of his estate. That's because at the surviving spouse's decease, the QTIP Trust distributions are administered according to the terms of the trust established by the decedent spouse before his decease.

Applying Transfer Tax Planning for a Married Couple

When constructing marital co-grantor trusts, other than the obvious of identifying beneficiaries and what/when they are to receive benefits from the trust, there are two important factors to consider. One is how the application of transfer tax planning is to be integrated into the trust draft and the other is structuring the trust in light of a body of law referred to as "powers of appointment". Without going into great detail, it should be understood that there are essentially two primary powers of appointment to consider when planning for the reduction or elimination of estate taxes. One is the (IRC §2041) "general power of appointment" and the other is the (IRC §2038) "limited power of appointment."

Anyone having retained or who has been granted a *general power of appointment* over a group of assets will be deemed to be the owner of such assets (and the value thereof) for transfer tax purposes upon his decease EVEN THOUGH he may not have ever exercised any such power over those assets during his lifetime. A classic example is where a surviving spouse/trustee of a living trust will generally retain a general power of appointment over assets deemed to be her sole and separate property and her one-half undivided interest in trust property jointly owned with her spouse (often referred to as Trust "A" assets); alternately that same surviving spouse/trustee is generally given a *limited power of appointment* over assets held in the credit shelter trust (often referred to as Trust "B"), which is funded with the trust property that was deemed owned by the decedent spouse. A limited power of appointment over Trust "B" – such as having to right to receive distributions under a *health, education, maintenance & support (HEMS)* standard in addition to receiving all income – allows the surviving spouse/trustee to receive benefits of the credit shelter trust under the HEMS standard without having the value of such credit shelter trust to be deemed a part of her taxable estate upon her decease.

Under the previous transfer tax rules, those terms could have great significance because if the surviving spouse was deemed (for transfer tax law purposes) to be the owner of the Trust "B" estate then that would become a part of her total taxable estate, included with Trust "A" assets, at her decease. That total value, then, of Trust "A" over which the surviving spouse/trustee has a general power of appointment, could therefore exceed the exemption equivalent amount, allowable per each transferor, and thus cause an otherwise avoidable transfer tax obligation.

However, as of 2011, a decedent spouse's "unused" exemption amount (sometimes called exclusion amount) can be ported to the surviving spouse's estate at the time of her decease. This is called the Deceased Spousal Unused Exclusion (DSUE) or portability election. The DSUE can be elected on the Form 706 (estate tax return) if done within 9 months of the surviving spouse's death. That allowance, when used, can potentially save a significant amount on estate taxes for a wealthy family.

The Practical End-Result Applications

Questions abound when the time has come to settle a trust estate and how to get the trust assets transferred or administered properly on behalf of the beneficiaries. But, what about the responsibilities imposed upon a surviving spouse/trustee of a co-grantor marital living trust at the passing of the first spouse to die? This following will help answer those questions.

– The Whiteacre Family Marital Trust –

<u>A common marital trust scenario</u>. A married couple – the Whiteacres – created a co-grantor eStatePlan and utilized the MLCP Funding Kit where their assets were "assigned-by-ledger" to their trust – and not retitled to their trust. Mr. Whiteacre has since died. What happens now?

- The Whiteacres have three children *from the same marriage* (not a "blended" family), living in relative harmony. Mr. & Mrs. Whiteacre both trusted each other, and each believed that all would be well when the time came that (either) one would become the surviving parent and sole grantor/trustee of their trust.

- The survivor (now Mrs. Whiteacre) would be serving as the sole trustee who would then have **full and unhindered access w/functionality** to their eStatePlan through their Client Console; that would allow unlimited changes to be made by the survivor, which has become the case resulting from Mr. Whiteacre's decease. That understood arrangement was expressly accepted by both spouses.

<u>JTWROS ownership</u>. Other than their IRAs (and an inherited property), everything the Whiteacres owned was commonly held as *joint-tenants-with-right-of-survivorship* (JTWROS) including their resident property, other property(s), bank accounts, brokerage accounts etc.

- As with any JTWROS account, by operation of law the surviving tenant always becomes sole owner of the property upon the decease of the other tenant(s) to die. That applies, with few exceptions, regardless if a joint tenant has previously assigned his/her undivided interest in the JTWROS property to anyone else, including to a trust; that's because the contractual terms of the JTWROS account or deed arrangement prevails over the assignment made in the Funding Kit or any other assignment.

- As a result of their JTWROS arrangement, Mrs. Whiteacre is now the outright owner of what was jointly held property between the spouses. She does <u>not</u> have to change the Funding Kit entry since her personal interest in the jointly held property(s), *which is now a 100% interest,* had <u>already</u> been assigned to the trust when the Funding Kit was initially implemented. However, she will eventually need to present her husband's Death Certificate to any vendor who recorded the ownership of their property as JTWROS when it becomes necessary to validate that she is the surviving tenant.

- If Mrs. Whiteacre wants now to sell their home residence, she will need only to record Mr. Whiteacre's Death Certificate – along with the deed conveying the property – at the County Registrar. If she does not sell/transfer the property then at her decease the successor trustee will follow the procedures to get the property titled to the (successor) trustee of the Whiteacre Family Trust for final distribution to the beneficiaries.

<u>Sole & separate property ownership</u>. Spouses frequently may have assets that have been either (i) procured/earned before marriage, or (ii) received as a gift, or (iii) inherited. Such are deemed as sole & separate property and do not have to be commingled as jointly owned property with the other spouse. Moreover, the spouse/owner can maintain continual lifetime control of the separate property including

who he or she may wish to benefit from it as a lifetime gift, or as an inheritance from the owner's will (probate), or as a beneficiary of the owner's trust.

- In this illustration, Mr. Whiteacre inherited lake property from his parents' estate years ago. He maintained the lake property as his sole & separate asset, which (as mentioned) any married person in any state receiving inherited property is allowed to do.

- Since Mr. Whiteacre used the MLCP Funding Kit to previously assign his sole & separately-held lake property to their Whiteacre Family Trust, it will avoid probate when being ultimately transferred to the trust beneficiaries.

- It should be mentioned here that Mrs. Whiteacre will need to record Mr. Whiteacre's Death Certificate and the Assignment of Realty Transfers (and the Affidavit of Identity) in the County Recorder office where the lake property is located so that she, as the current trustee of the Whiteacre Family Trust, may take over control of the property, so as to pay its property taxes & maintenance costs, and to "occupy" the property.

<u>Trust "B" Funding</u>. Marital A/B (co-grantor) Trust formats are commonly used with married couples' estate plans. Upon the first spouse's decease, Trust "A" becomes the surviving grantor's trust, and the Credit Shelter Trust "B" is to be funded with *the trust estate of the decedent grantor (first spouse to die).*

- However, the Whiteacres' family estate value, including their IRAs, totaled just $2 million, which is well below the (current) federal transfer tax threshold. That means basic estate tax planning – that is, funding the Credit Shelter Trust "B" at Mr. Whiteacre's decease – was not necessary, at least not for transfer tax purposes.

- Funding Trust "B" may well be considered otherwise for asset protection purposes. Since Trust "B" was not funded, all of Mr. Whiteacre's asset base comes under the full control of his surviving-grantor spouse (Mrs. Whiteacre) by default; it could therefore be subjected to any of her potential creditors in the future.

<u>Unlimited Marital Deduction Application</u>. The transfer of the decedent spouse's estate to the surviving spouse will not be taxed since the unlimited (federal & state) marital deduction will always apply. That means any value of assets can be transferred – either by lifetime gifting or at death – to a surviving spouse without gift or estate taxation.

- Also, in this scenario, assuming the surviving spouse (Mrs. Whiteacre, in this case) is the primary beneficiary of Mr. Whiteacre's IRA, she may receive it as a qualified "roll-over" to her IRA or as a beneficiary to an inherited IRA. Either method is deemed a transfer from the decedent spouse's estate. But again, the transfer value of the IRA roll-over is sheltered under the unlimited marital deduction as is all other transfers from any decedent to his/her surviving spouse.

- Mrs. Whiteacre's estate is now worth $2 million and that will be the value (not counting appreciation) deemed transferred at her decease, which is well below the federal transfer-tax exemption equivalent amount (currently over $11 million). So, there are no transfer tax concerns in this case even at Mrs. Whiteacre's decease.

<u>Mrs. Whiteacre has full control</u>. Since Trust "B" was not created (by default), all of the Whiteacre trust estate assets come under the *full, general-power-of-appointment control of the surviving spouse by "default"*, which means as earlier illustrated that entire value of the trust estate will be in Mrs. Whiteacre's estate for transfer tax purposes upon her decease.

<u>Previous assignments still apply</u>. Because the joint assets were held as JTWROS, the fact that one tenant is now deceased means that the surviving tenant (Mrs. Whiteacre) is now a 100% owner of those assets. And the eStatePlan Funding Kit still shows the record of assignment to their trust. So, even though Mrs. Whiteacre now owns ALL of the asset value, instead of 50% as before, the fact that her personal assets have been previously assigned by her (using the Funding Kit) still holds as legally applicable though the values have changed (doubled).

<u>What does Mrs. Whiteacre need to do now</u>? As pointed out earlier, if she wants to sell or transfer the resident property, she will need to first acquire and then file Mr. Whiteacre's Death Certificate at the County Recorder office along with the new deed.

- Mrs. Whiteacre will need notify existing account vendors that she is the surviving joint owner of the accounts originally owned jointly with her husband as the vendors will eventually need to know that information. That would also include contacting Mr. Whiteacre's IRA holder about his decease and that she is the inherited IRA beneficiary thereto, or she may otherwise request a direct spousal roll-over to her IRA.

- Otherwise, unless something unforeseen applies, nothing else should need attention except possibly having to file some type of "notification of tax exempt" form in their state of domicile as to Mr. Whiteacre's decease (that varies from state to state).

- It should also be noted that since the realty property and other assets were simply assigned (not retitled) to the trust using the Funding Kit, Mrs. Whiteacre could sell or transfer any such assigned property as a natural person WITHOUT having to disclose the existence of the trust or that she is serving as the trustee of the trust.

- If the property had been earlier retitled (in other words, deeded) to the trust then the surviving spouse would have to sell it as the trustee of the trust instead of selling it as a natural person / sole-surviving joint tenant.

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– The Blackacre Family Marital Trust –

<u>A blended family scenario</u>. Mr. & Mrs. Blackacre established a co-grantor eStatePlan and similarly utilized the MLCP Funding Kit where their assets were "assigned-by-ledger" to their trust. We'll assume that essentially the same financial and asset-ownership terms apply with them as with the Whiteacre Family > *but with one important difference*. The Blackacres are a "blended" family in that each spouse has children from a previous marriage. That reality may have significant influence with respect to the trustee using all the proper methods of trust administration upon the decease of the first spouse to die.

<u>Mrs. Blackacre died. What happens now</u>? As mentioned earlier, JTWROS held properties are normally vested to the surviving tenant. That can present a very real problem in this blended family (step-children) situation because if the surviving spouse/grantor has full control (Mr. Blackacre in this case), he could effectively "disinherit" his step-children since he has total access to the MLCP Client Console.

That is the reason for the recommended use of sole-grantor eStatePlans for each spouse with children/beneficiaries from a previous marriage(s).

<u>There are solutions WHEN applied</u>. The eStatePlan co-grantor trust contains a provision that effectively "transmutes" JTWROS property to tenants-in-common (or community) property based on the clients' state of domicile (there are currently nine community property states). That provision is located in Article 1 / §1.1 and reads as follows:

> *All such assigned-to-trustee property co-owned by the Settlors – together with the titles, rents, issues and profits therefrom – shall be deemed as tenants-in-common (community) property of the Settlors being contemporaneously assigned with the* ***mutual relinquishment of any joint-tenants-with-right-of-survivorship provision(s)*** *that may apply to such property subject, however, to the terms of this Agreement and applicable state law.*

<u>Transmutation upon assets assignment</u>. So, when co-grantor clients implement the eStatePlan, they are agreeing to essentially allow the contemporaneous transmutation of their JTWROS property into tenants-in-common (TC) property (or community property) by way of the above clause WHEN they assign their JTWROS property to their co-grantor, eStatePlan trust.

<u>Irrevocable Trust "B" must be funded</u>. Since the undivided interest of TC property does NOT (automatically) vest to the surviving tenant by operation of law (as with JTWROS) but rather is controlled by the dispositive terms of the decedent-tenant's trust (or will/probate), that will allow/require the trustee to transfer the decedent-grantor's undivided interest to Trust "B" since **Article Four** of the co-grantor mandates the funding of Trust "B" (and QTIP Trust "C" if necessary) with the decedent spouse's sole & separate property (if any) and his/her undivided interest in the TC property(s) assigned to the trust.

<u>Trust "B" assets are vested to the beneficiaries</u>. That's important because by the terms of the trust, the surviving grantor, serving as trustee and having full access to the Client Console, does not legally own – or legally have general power of appointment to – the assets of Trust "B". Therefore, any dispositive changes made in the trust by the surviving grantor does NOT legally apply to the assets of Trust "B". In fact, the terms of the trust allow only that income and maintenance/support distributions be made to the surviving spouse/grantor from Trust "B". *The assets of the Credit Shelter Trust "B" have actually become* ***vested to the beneficiaries*** *of the trust or to specific beneficiaries of the trust if so drafted.*

<u>Applying the terms of Trust "B"</u>. Even though the co-grantor eStatePlan trust can be used to affect a positive outcome with blended family scenarios and can actually avoid potentially adverse consequences, the inherent problems lie with the administration of the trust as in "substance over form" since the surviving grantor/spouse normally serves as the sole trustee after the first grantor's decease. However, if a corporate trustee was required to serve, by the terms of the trust, as a co-trustee with the surviving grantor/spouse immediately upon the decease of the first grantor to die, the inherent

problems could addressed and the trust estate of the first grantor to die would be retained and ultimately distributed as initially intended.

Non-apportionment clause. In light of our review in applying trust administration terms of a co-grantor trust upon the decease of the first grantor to die and the fact that the co-grantor trust actually does require the funding of Trust "B" regardless of the value of the trust estate, there is an eStatePlan Specific Trust Directives App that allows for the "non-apportionment" of assets to Trust "B". This is an appropriate/recommended app to use with co-grantor trusts established under a blended family condition but where the grantors are NOT requiring the (otherwise mandated) funding of Trust "B" upon the first grantor decease, that reads as follows:

> Notwithstanding the express apportionment clause in Article Four with respect to the funding of Trust "B" - with the Trust Estate of the first spouse to die - as prescribed in Sections 4.2, 4.2(a), 4.2(b), 4.2(c) & 4.2(d), it is hereby decreed with the application of this Specific Directive - as it pertains to Section 4.3 - that Trustee shall not be required to fund Trust "B" with the Trust Estate of the first spouse to die upon such spouse's decease, and that the entire Trust Estate shall be deemed as constituting a general power of appointment trust under the full control of the surviving settlor/spouse.

In closing. It should be clear that using a co-grantor trust for blended-family conditions has limitations. If both grantor/spouses trust each other – regardless of who is the first spouse to die – to carry out their respective planning goals and objectives then very well. However, in such case, it would be wise to document and record their mutual understanding through the use of the eStatePlan NotePad Center. When there is a controversy over estate planning matters, it seems very often that nobody really wins and the adverse effects of an unfortunate legal contestation can linger, sometimes for a lifetime. In any case, careful and deliberate estate planning with proper assistance will go a long way to prevent unwanted outcomes and even prepare for the unforeseen.

IMPORTANT NOTICE: Although the filing of Form 706 may not be required if the gross estate of the first spouse to die is under the federal exemption equivalent amount, depending on domicile location, there may be a **state-imposed estate tax** due upon the decease of the first spouse to die (as well as the surviving spouse's estate). Page nine of the Estate Settlement Primer provides more detailed information on that matter. Also, the timely filing of a Form 706 may be needed on the estate of the first spouse to die if it is intended to utilize the deceased *spouse's unused exemption amount* for the taxable estate of the surviving spouse, which can be accomplished under the unified credit "portability provisions" defined under IRC §20.2010-2.

State Estate & Inheritance Tax

In addition to federal estate tax, there are currently twelve(12) states that impose a "state estate tax" and six states(6) have an "inheritance tax"; Maryland requires both estate and inheritance taxes. *Currently, thirty-three states require neither estate nor inheritance tax of their citizens):*

Estate Tax (only) States ➢ Connecticut, Hawaii, Illinois, Maine, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont and Washington (and Washington, D.C.) *Estate taxes are imposed on the (trust) estate of the transferor*.

Inheritance Tax (only) States ➢ Iowa, Kentucky, Nebraska, New Jersey, and Pennsylvania. *Inheritance taxes are imposed on the transferee/beneficiary of an estate.* Note: Spouses and certain other heirs (e.g., transferor's children) are generally excluded from inheritance taxes.