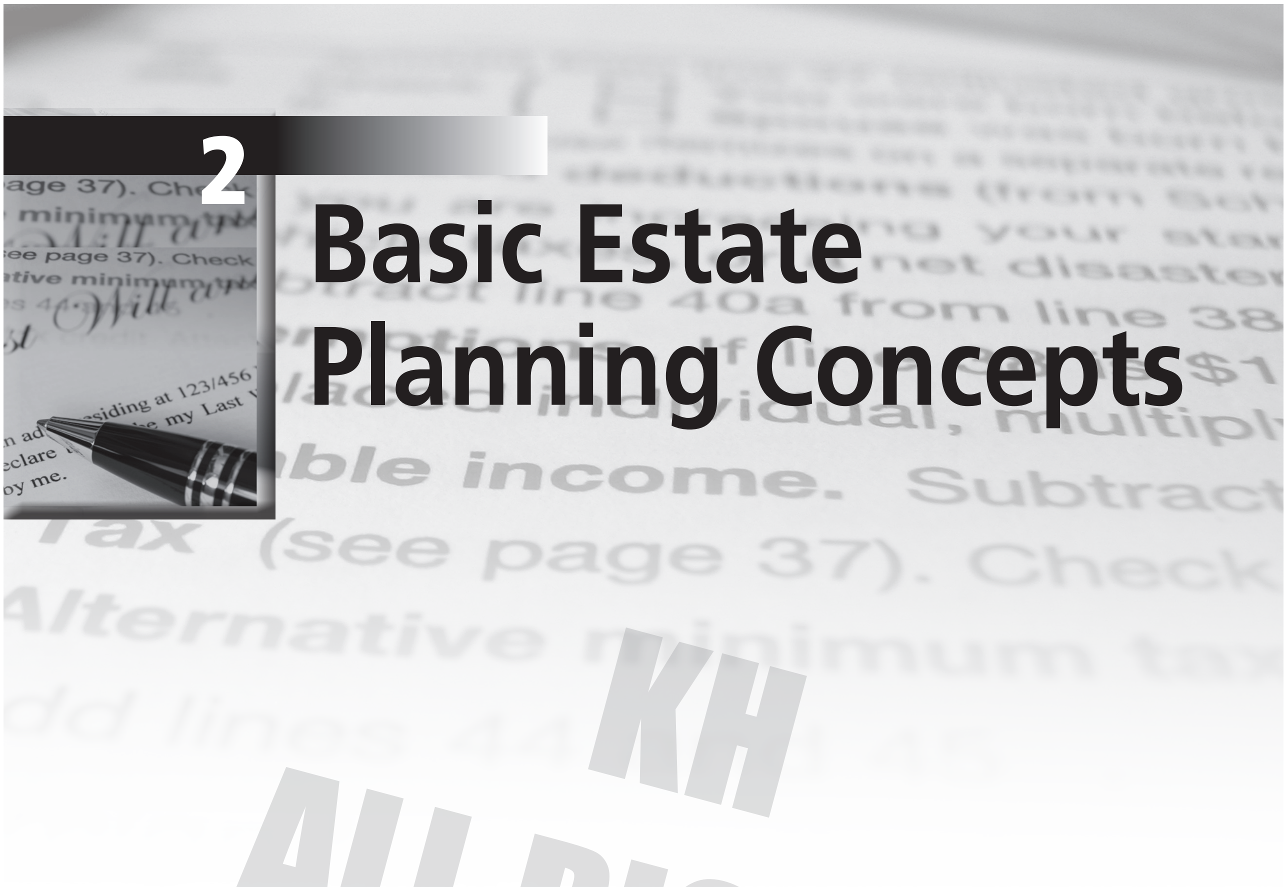

2 Basic Estate Planning Concepts

OVERVIEW

This chapter introduces the basic concepts regularly employed in estate planning. They will be referred to throughout the text. Some of these concepts are so straightforward that mere use of them in a sentence will make their meaning clear. More involved concepts and terms are defined and illustrated. The terms, along with others introduced in later chapters, are included in the Glossary at the end of this book.

CONCEPTS DEALING WITH ESTATES

An *estate* is a quantity of wealth or property. *Property* represents something over which the owner may lawfully exercise the right to use, control, or dispose. More simply, property is anything that can be owned.

Ordinarily, for a person or a family, an estate represents the total amount of property owned. However, the word *estate* is used in several other contexts in estate planning to mean some other amount. In certain situations, estate means the net value of property owned, calculated by subtracting the amount of the estate owner's liabilities from the value of all property owned. Estate might refer to the *probate estate*, which constitutes all property that passes to others by means of the probate process after the death of the owner. Estate may mean the *gross estate* or the *taxable estate*, two concepts used only in connection with taxation at death. As we will see later, the probate estate and the tax-related estate may be very different in size and composition. The net estate and the probate estate are generally less than all property owned; the net estate is less because liabilities are subtracted, and the probate estate is less because many things owned, e.g., held in joint tenancy and life insurance, pass outside the probate process. The gross estate will equal or exceed the value of all property owned because it includes all things owned and may also include things that are not owned, such as gift taxes paid on gifts made within three years of the donor's death. In Chapter 6 we will cover the concepts of the gross estate and the taxable estate in detail.

CONCEPTS DEALING WITH TRANSFERS OF PROPERTY

One of the primary areas of emphasis in estate planning is the transfer of property. This section will cover the terminology used in this area.

Transfers of Legal and Beneficial Interests

A *transfer* or *assignment* of property refers to any type of passing of property in which the *transferor* gives up an *interest* to the *transferee*. The interest transferred can be purely legal, purely beneficial, or both legal and beneficial. *Legal interest* refers to a situation where title passes. For example, an independent trustee of a trust takes title to all trust assets in order to manage the trust property, but cannot use it in a manner inconsistent with the trust agreement. A mother who takes title as custodian of a bank account established for her child's benefit under the Uniform Transfers to Minors Act[1] has legal title, but the beneficial interest is owned by the child.

On the other hand, a purely *beneficial interest* occurs when a transferee receives something that carries an economic benefit, but not title. Examples of beneficial interest in property include the temporary or permanent right to possess, consume, pledge, or otherwise benefit from property. If a friend lends you her car while your car is in the shop, you have a beneficial interest in the car without having title. As we will see, a trust beneficiary's rights may be purely beneficial.

Finally, an interest given up by the transferor can be both legal and beneficial, such as where the transferee receives both title and the beneficial interest. An *outright transfer* occurs when one receives both legal and beneficial interests, without restrictions or conditions, as typically happens when one person gives another a birthday present.

COMPLETE VERSUS INCOMPLETE TRANSFERS. A transfer of property is said to be *complete* and *irrevocable* when it is no longer rescindable or amendable, i.e., when the transferor has totally relinquished all dominion and control over that property. For example, after you purchase a magazine at the store, you have made a completed transfer of money and the store has made a complete transfer of title to the magazine. On the other hand, a transfer is said to be *incomplete* and *revocable* while it is still rescindable or amendable. In some states, if you purchase a time-share property, you have three days after signing the purchase agreement to change your mind and receive a total refund of your deposit. The transaction is incomplete until the three days pass without the buyer's rescission of the contract. When a trust is established, the settlor might or might not retain the right to revoke or amend it. If it is a revokable trust, the settlor has the right to take back the trust property. Even if it is irrevocable, the transfer is deemed incomplete if the settlor has retained control over who gets to benefit from the trust even if the benefits cannot possibly favor the settlor.

EXAMPLE 2–1 *Last year, using property worth over $500,000, Samantha establishes an irrevocable trust for the benefit of her two nieces, Anna and Virginia, 15 and 18 years old, respectively. A private fiduciary serves as the trustee. The terms of the trust allow Samantha to decide each year how to allocate the income between the two nieces, and requires that when Anna turns 25, the trust must terminate with the trust property divided evenly between Anna and Virginia. Because of the retained right to determine who receives the income, the gift is incomplete. It will not become complete until Anna turns 25. The gift will be based upon the value of the assets at that time. Of course, because the gift is incomplete, the income is taxed to Samantha and each distribution of income is considered a completed gift from Samantha to the niece receiving it.*

▶ **PROPERTY AS A BUNDLE OF RIGHTS.** To fully distinguish between complete and incomplete transfers, one must grasp that ownership of property is really a bundle of rights that can sometimes be separated. So if one sells something, such as 100 shares of ABC stock, we would understand that to mean the entire asset, including all rights and interests that go with ownership. However, the bundle of rights *inherent in property* ownership are sometimes divided, hence when one speaks of an interest in property the reference is to one or more of these individual rights. In estate planning, more than one interest in a piece of property may be transferred in a way that highlights the divisibility of the interests associated with property ownership.

EXAMPLE 2–2 *Tom transfers 100 shares of stock in trust to Terry as trustee. The trust terms give Alan the right to all income for five years, followed by Barbara having the right to receive income for ten years, and finally, after 15 years, the trust is to terminate with the trust assets distributed to Carl. Each person has received an "interest" in the stock. Terry's interest is a legal one (title), Alan and Barbara each have a beneficial one (really in the trust, and only indirectly in the stock), and Carl's interest is both beneficial and legal in the sense that he will benefit from the trust and will take title to assets when the trust terminates. We'll take a more detailed look at trusts in the next couple of chapters.*

▶ **GIVING UP CONTROL MAKES A TRANSFER COMPLETE.** A transfer of each specific interest in property is either complete or incomplete. To be complete, the transferor must part with control over the property.

EXAMPLE 2–3 *Continuing with the same facts as above, if Tom retained the right to revoke or amend the entire trust, his transfers of property into trust would be incomplete. On the other hand, if Tom retained the right to revoke or amend only Alan's interest, the transfer of Alan's interest would be incomplete, and the transfer of Barbara and Carl's interests would be complete. Finally, if Tom retained no right whatsoever over the trust, the transfers to Alan, Barbara, and Carl would all be complete.*

When we study gift taxes, it will become clear that this issue of whether a transfer is complete or incomplete is important because gift tax law generally treats completed transfers, even of just a partial interest, as gifts subject to gift taxation and attempts to retain control, even if the right retained has no economic benefit for the transferor, makes the gift incomplete.

▶ **FAIR MARKET VALUE CONCEPT.** The value of a transfer is measured by its fair market value at the time of the transfer. Determining fair market value (abbreviated as FMV) is the subject of several sections in the text. A generally accepted definition of *fair market value* is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts." The IRS uses this definition in the regulations for valuing gifts and estates.[2] For gifts the value is determined as of the date of the gift. For estates it is the date of death value that generally matters, although in some instances the executor can elect to use the value as of six months after the date of death but we will save a discussion of the *alternate valuation election*[3] until Chapter 6.

Sale versus Gift

Most commonly, completed transfers of property interests are undertaken by sale, by gift, and more rarely by a combination of both sale and gift. A *sale* is a transfer of property under which each transferor exchanges *consideration* regarded as equivalent in value. By contrast, a gift is a transfer of property for which the transferor takes back little or nothing of economic value in exchange. The most common methods of making gift transfers are *outright* and *in trust*.

▶ **ARM'S-LENGTH TRANSACTIONS.** Where two parties to a transaction are not related and are each negotiating to secure the best advantage for his or her ownself, it is said to be an "arm's-length" transaction. The fact that one of the parties greatly underestimates the FMV of what he is selling does not make it a bargain sale, indeed, it might just be a bad bargain, e.g., there would be no gift involved if a person sells an old painting for $100 at a garage sale and the painting turns out to be a Cezanne worth hundreds of thousands of dollars.

▶ **A BARGAIN SALE.** A bargain sale occurs when a person (the transferor) transfers property in exchange for other property that the transferor knows has an economic value less than the property he or she is giving up. A bargain sale involves a transfer that is a part sale and part gift. The notion of the bargain sale requires us to define a gift somewhat more broadly than in the last paragraph. Usually a gift means the donor takes nothing in return; however, a bargain sale is obviously a gift even though property is received by the donor. A *bargain sale* occurs when there is an exchange of considerations significantly unequal in value, and the parties know and intend them to be unequal. In tax law, the amount of the gift is the difference between the values of the exchanged property.

Transfers Now or Then

A transfer of property can be inter vivos, meaning that it is made while the transferor is alive, or it can be made at death. Inter vivos is Latin for “among the living.” Transfers at death are guided by legally binding documents prepared by the owner before death (e.g., will, trust, title by joint tenancy, or beneficiary designation), or pursuant to state law (intestate succession) in the event that there is no document to guide or control the transfer. A will or trust document is sometimes referred to as an *instrument*.

BENEFICIARIES. A *beneficiary* or *donee* is a person who receives a gift of a beneficial interest in property from a transferor. The transferor is called a *donor*. Although, in the most general sense, donee and beneficiary are synonymous, in certain contexts one or the other term is more commonly used. For example, the recipient of an outright *inter vivos* gift from the donor is usually called a donee, whereas, the recipient of a bequest by a will or an interest in a trust is usually called a beneficiary. Occasionally, the term *donee* is used to describe one who has received something without also receiving any beneficial interest, such as where one is given a limited power of appointment, an estate planning tool discussed later in this chapter and again, in the context of the estate tax, in Chapter 6.

WILLS, TRUSTS, AND PROBATE

There is a fair amount of misconception about the relationship between wills and probate, between wills and trusts, and between trusts and probate. Having a will neither causes nor avoids probate. Having a trust does not do away with the need to have a will. Having a trust drafted may or may not avoid probate depending upon the type of trust and whether it is funded or not.

Estate Matters

In estate planning, a *decedent* refers to a deceased person. When a person dies, property owned by the decedent must be transferred. Each state takes special interest in ensuring that all property owned by the decedent is transferred to the proper parties. State law recognizes certain documents prepared by the decedent (wills, trusts, joint tenancy arrangements, life insurance policies, etc.) as legally binding guides for the proper disposition of the decedent’s property. A *will* is a written document that expresses a person’s desired distribution of his or her property at death. The person making a will is called the *testator*. The will is said to make *testamentary* transfers, and the actual process by which transfer is accomplished is the probate process. At the death of a person, his or her will controls the transfer of property only if there is no guide to the transfer that is recognized as superior. Thus, the will controls property in the decedent's name alone or held with another as a tenant in common, but not property held in trust or in joint tenancy. Property held in trust will be transferred according to the terms of the trust, not according to the terms of the settlor's will. An attempt to direct the transfer of joint tenancy property by the will of a decedent co-owner is doomed to fail since by law the right of survivorship inherent in joint tenancy title prevails over provisions in a will.

A trust is a fiduciary relationship in which one person (the *trustee*) is the holder of the title to property (the *trust estate* or the *trust corpus*), subject to an equitable obligation to keep or use the property for the benefit of another (the *beneficiary*). The *trust instrument* is the written agreement between the *settlor* (the person creating and funding the trust) and the *trustee* that sets forth the beneficiary or beneficiaries of the trust, how the trust estate is to be managed, its duration, and to whom the corpus must be given when the trust terminates. Another term for settlor is *trustor*. Trusts are described in greater detail later in the chapter.

WILL OR NO WILL. If a valid will is found, the decedent is said to have died *testate*. If the will does not dispose of all the decedent's property, the decedent is said to have died *partially intestate*. If no valid will is found, the decedent is said to have died *intestate*. However, if all property is disposed of by alternative means (e.g., trusts, joint tenancy, beneficiary designation), a will may not be necessary as there would be some mechanism of transfer for the entire estate.

In some cases, the moment that death occurs has significance because it determines the rights of beneficiaries, and, quite obviously, it is extremely important if the dying person has authorized organ donations. The Uniform Determination of Death Act addresses this issue by defining death as follows:

> § 1. [Determination of Death]. An individual who has sustained either (1) irreversible cessation of circulatory and respiratory functions, or (2) irreversible cessation of all functions of the entire brain, including the brain stem, is dead. A determination of death must be made in accordance with accepted medical standards.[4]

PROBATE. *Probate* is the legal process of administering the estate of a decedent with some degree of court supervision. The probate estate consists of all property belonging to the decedent for which there is no other mechanism of transfer. Thus, the probate estate is that property whose disposition is guided by either the decedent's will or the state laws of intestate succession. Generally, *probate assets* fall into one of three groups: property owned by the decedent as an individual, interests of the decedent held with others as tenants-in-common, and, in some community property states, the decedent's one-half interest in community property. Some community property states, such as California, no longer require a probate for property going to the surviving spouse whether that property is the decedent's half of the community property or is the decedent's separate property. *Non-probate assets* include property held in trust, property with title in joint tenancy, property passing by beneficiary designation, the proceeds of insurance policies on the life of the decedent (unless payable to the decedent's estate), and most retirement plan assets. More on this later in the chapter.

▶ **THE ESTATE'S PERSONAL REPRESENTATIVE.** In probate administration, the judge of the probate court determines the validity of the will, if any, and (after a period of administration) authorizes distribution of the probate estate to creditors and beneficiaries. The court appoints a *personal representative* to act as fiduciary to represent and manage the probate estate. If the court appoints the person nominated in the will to be personal representative that person is called the *executor*. An *administrator* is a person appointed by the court to represent the estate of a person who died intestate. In some states, a female personal representative is called an executrix or administratrix, however the trend is to use the title of executor or administrator regardless of gender. At times courts appoint someone other than the person(s) nominated in the will. The person nominated may have predeceased the testator, may be incapacitated, or perhaps is unfit (e.g., is serving time in prison for bank robbery). If the decedent died with a valid will, but the court appoints someone other than the person nominated in it, the personal representative is called an *administrator with will annexed*.

The word "fiduciary" is derived from the Latin word for "trust." A *fiduciary* is a person in a position of trust, loyalty, and confidence, who has the legal duty to act for the benefit of another, putting that person's interests above his or her own. Besides personal representatives, fiduciaries include trustees, guardians, and agents.

▶ **RECIPIENTS OF PROBATE PROPERTY.** Beneficiaries of a decedent's probate property are called heirs, devisees, or legatees. An *heir* is a person who inherits property from a decedent whether by will, intestate succession, or any other mechanism of transfer such as through a trust or by joint tenancy. *Heir at law* refers to the person (or persons) who would have a right to inherit if the person died intestate. Degrees of blood relationship, which are important in determining heirs at law, is a topic covered in Chapter 4. A *devisee* is a beneficiary, under a will, of a gift of real property. A devisee is said to receive a *devise*. A *legatee* is a beneficiary, under a will, of any property other than real property. Non-real estate is called *personalty* or personal property. Personal property does not mean personal use property, it just means that it is not real estate. For instance, a cash register used in a store is clearly business use property but in a technical sense it is considered personal property. A legatee is said to receive a *legacy* or a *bequest*. The trend in modern usage is to use the term bequest for any testamentary gift, whether of real or personal property. The Uniform Probate Code (UPC), discussed extensively in the next two chapters, uses the term "devise" both as a noun and a verb, to mean a bequest or the act of making a bequest (whether of real or personal property) in connection with transfers by will.

Issue refers to a person's offspring or progeny, including children, grandchildren, great-grandchildren, and the like. A *descendant* is one who is descended from a specific ancestor. Thus, the terms issue and descendants are used interchangeably. Be careful not to mix up the term decedent (the one who died) with descendant (a child, grandchild, etc.).

TYPES OF BEQUESTS. Bequests are categorized as specific, pecuniary, general, residuary, and/or class gifts. A *specific bequest* is a gift of a particular item of property capable of being identified and distinguished from all other property in the testator's estate, e.g., "I leave all my household furnishings to Sally Ann," and "I leave my high school ring to my brother Bill." If the property subject to a specific bequest is sold, given away, or lost before the testator's death, under the common law doctrine of *ademption* (from the Latin *ademptio*, a taking away) the bequest fails, meaning the person does not receive anything to replace the missing property. Although most states follow the common law doctrine, some states' statutes have exceptions that do not result in ademption in certain circumstances, e.g., an asset was acquired by the decedent in a manner that made it clear it was intended to replace specific devised real or tangible property.[5] A *general bequest* is a gift that can be satisfied out of the general assets of the estate, e.g., the bequest "I leave 10 percent of my estate to my brother Henry."

At common law the term legacy meant a testamentary gift of money or personal property; however, it has come to mean any bequest. *Pecuniary bequest* is the term used to describe a bequest expressed as a specific dollar amount. The term comes from the Latin *pecunia*, meaning money. It is a pecuniary bequest even though the executor has the option of satisfying it with cash or with assets worth the specified dollar amount. Since the bequest could be paid from any account, or be satisfied by the transfer of any asset not specifically bequeathed, a pecuniary bequest is a type of general bequest.

What remains of the estate after all the foregoing bequests are taken into account is called the *residue* of the estate. A *residuary bequest* is a gift of that part of the testator's estate not otherwise disposed of by the will, e.g., "I leave the rest of my estate to Robert Moon." Generally, debts are paid out of the residue and not charged against the specific bequests.

A *class gift* is a gift to a group of individuals that may not be completely defined at the time the gift is made (e.g., "I leave the residue of my estate to my grandchildren living at the time of my death.")

A person might die leaving insufficient assets to satisfy all bequests and pay all creditors. Under a procedure called *abatement*, bequests are eliminated or reduced so that all debts (and administration expenses) are paid in full, or else the estate is exhausted. In those states that follow the UPC, shares of the beneficiaries abate in the following order: (1) probate property not disposed of in the will, if there are no residuary bequests, (2) residuary bequests, (3) general bequests, and (4) specific bequests. Some state statutes abate gifts to a spouse, or to issue, only after the abatement of gifts to persons not so closely related to the decedent.

EXAMPLE 2–4 *Lawrence died in a UPC state. Lawrence's will leaves his car to his son, Sam, $20,000 cash to his sister, Vira, and the residue of his estate to his wife, Mary Ellen. Assume that at his death Lawrence owned only the car and $25,000 in cash, and he owed $6,000 in debts. Most states (perhaps all) would require the $6,000 debt be paid, leaving just $19,000 in cash. The UPC abatement would result in Vira getting the $19,000 balance, the car would go to Sam, and Mary Ellen would receive nothing. As discussed later, many states allow a widow or widower to claim a statutorily determined share of the deceased spouse's estate instead of taking what is left by will. Claiming an elective share would probably give Mary Ellen the entire $19,000, leaving sister Vira with nothing.*[6]

Disclaimers

Most people would welcome a large bequest, especially if it came from a distant relative. After all, such gifts may make for financial security. Yet there are times when it makes sense for a beneficiary to refuse a gift or bequest. A *disclaimer* is an unqualified refusal to accept a gift or bequest. Disclaiming may be preferable when it avoids, reduces, or delays transfer taxes. The person refusing the gift is called the disclaimant. If the disclaimer is done "right" it will not be treated as a gift by the disclaimant. This is referred to as being a *tax effective* disclaimer, meaning that the act of disclaiming does not generate a transfer tax. Usually, a person will disclaim property only if it will then pass to a person the disclaimant wants to have it.

To be tax-effective, the disclaimer must meet the requirements of both state property law and federal tax law. Under property law, a disclaimant is treated as having *predeceased* the decedent-donor.[7] Consequently, the disclaimed property will pass under one of two possible sets of legal guidelines. Either it will pass to the "alternate taker" in accordance with the terms of the decedent's transfer document (which is usually a will or trust) or, if no such document exists or if the document does not name an alternate taker, the property will pass under laws of intestacy.

EXAMPLE 2–5 *Bachelor Barry died recently, and his will left an estate valued at $500,000 to his brother Mike, if living, otherwise to Mike's issue. Mike, age 87, wealthy and in poor health, has three living children. If he immediately disclaims the inheritance, it will pass under the will to his children. The transfer will not be treated as a gift from Mike, but rather as though it passed to them directly from Barry.*

EXAMPLE 2–6 *Changing the facts in the previous example a bit, assume Barry's will stated that if Mike predeceased Barry, then the bequest would go to Barry's long time friend Charlie. If Mike disclaims, Barry's estate will pass to Charlie rather than to Mike's children. Of course, Mike could assign his interest in the estate to his children, but that would be a gift from him to them.*

When we take up estate and gift taxes, we will cover in detail the requirements for a tax-effective disclaimer, and we will illustrate ways in which disclaimers are used to improve estate plans.

LIFE INSURANCE

A *life insurance* policy is a contract in which the insurance company, in exchange for the payment of premiums, agrees to pay a cash lump-sum amount (called the *face value* or *policy proceeds*) to a person designated in the policy to receive it (the *beneficiary*) on the death of the subject of the insurance (the *insured*). Usually, the policy names alternate beneficiaries who will receive the proceeds if the named beneficiary dies. One other important party in the life insurance contract is the *owner*, who has title to the policy, and who generally possesses both legal and beneficial interests in the policy. As beneficial owner, the policy owner has the right to benefit from the policy. Beneficial rights usually include the right to receive policy dividends, the right to designate and to change the beneficiary, and the right to surrender the policy. These rights can have economic value, even before the death of the insured. Whether a life insurance policy has economic value prior to the insured's death depends on the type of policy. If the owner holds title to the policy as the trustee of an irrevocable life insurance trust, then the owner will have legal title but will most likely not have a beneficial interest. Irrevocable life insurance trusts are used to keep life insurance proceeds out of the estate of the insured. Such trusts are discussed in detail later.

Most *term life insurance* policies have minimal cash value prior to the death of the insured because the premium charged, which increases over time along with the increasing risk of death, simply buys pure protection. If the insured dies during the policy term, the company will pay the face value; otherwise, it will pay nothing. Some multi-year term policies (called *level term*) have a constant premium for a stated period (e.g., five or ten years). This requires a cash build-up during the term's early years that is used to pay the higher mortality risk in the later years.

In contrast to a term policy, a *cash value* policy accumulates economic value because the insurer charges a constant premium that is considerably higher than mortality costs require during the earlier years. Part of this overpayment accumulates as a *cash surrender value*, which, prior to the death of the insured, can be used by the owner in one of two ways: (1) at any time the owner can surrender the policy and receive this value in cash, or (2) the owner can request a policy loan and borrow up to the amount of this value.

Life insurance makes a significant contribution to estate planning because a policy can have value prior to the insured's death, can pay cash to the beneficiaries on the insured's death, and can be structured to avoid estate tax. It is said to be the only asset that can create an *instant* estate of substantial magnitude for a person of otherwise modest wealth. For a family that includes dependent children, this may be an important means of assuring the financial well-being of the surviving family members if a parent dies. For the wealthy family, life insurance may provide needed cash to pay the death taxes. A discussion of the types of life insurance and irrevocable life insurance trusts is found in Chapter 13. To use life insurance properly, the planner must be aware of the impact of taxes, a subject explained in detail in Chapters 5 through 8.

TAXATION

In estate planning, the two principal types of taxing authorities are the individual states and the federal government. The four major types of taxes are gift tax, death tax, generation-skipping transfer tax, and income tax.

A *gift tax* is a tax on a lifetime gift; that is, a lifetime transfer of property for less than full consideration.

A *death tax* is essentially a tax levied on certain property owned or transferred by the decedent at death. There are two basic types of death tax statutes, which, depending on the format, are referred to as either an estate tax or an inheritance tax. An *estate tax* is a tax on the decedent's right to transfer property, while an *inheritance tax* is a tax on the right of a beneficiary to receive property from a decedent. Either way, the tax is usually paid by the executor out of the decedent's estate before the property is transferred to the heirs. If most of the property is held in trust, then the trustee will make sure the tax is paid before distributing the trust property. With an inheritance tax, the amount of death tax paid on any given size inheritance is likely to be greater for remote relatives as compared to close relatives, and greatest for non-relatives. For example, amounts going to a surviving spouse might not be taxed at all, and bequests to a child might have a high exemption amount and/or a lower tax rate than property going to a non-relative. The federal death tax is referred to as the federal estate tax. The characteristic of an estate tax is that, for any given net estate (i.e., after debts and expenses), the tax will be the same regardless of who receives it. For example in the year 2015, the federal tax on a $10,000,000 bequest would be $1,828,000 whether the estate went to the decedent's children or went entirely to non-relatives.

However, the federal estate tax is not a pure estate tax because it has two deductions based on the status of the beneficiary. A complete marital deduction is allowed for all property going to a surviving spouse (for a non-USA citizen spouse a special trust might be required, but we'll save that discussion until later), and a complete charitable deduction is allowed for property going to qualified charities. Since these are complete (100%) deductions, subtracted from the gross estate before arriving at the taxable estate, and they are the only two deductions based on the character of the beneficiary, little is lost in our thinking of the federal death tax as an estate tax.

A *generation-skipping transfer tax* is a tax on certain property transferred to someone who is more than one generation younger than the donor—a "skip person." Thus, the surviving spouse and the children of a decedent are not skip persons, but grandchildren and great-grandchildren are. Without this tax, wealth could skip several generations and escape one or more levels of transfer tax. For example, without the GST tax, a gift or estate transfer of a $10 million parcel of land to a grandchild would be subject once to a gift tax or death tax, but it would not be taxed twice. It would be taxed twice if it went through the natural succession, i.e., once when the property passes from the client to the child, and again when it passes from the child to the grandchild. Chapter 5 introduces this topic and Chapter 17 covers it in more detail. It is enough to say here that the generation-skipping transfer tax has a per transferor exemption that makes careful planning in this area necessary only for clients with fairly substantial estates.

An *income tax* is essentially a tax levied on income earned by a taxpayer during a given year. Income tax laws usually distinguish five different taxpayers or entities that must report income by filing income tax returns: individuals, partnerships, corporations, estates, and trusts. Principles of taxation can differ substantially for each. For instance, partnerships generally do not pay income taxes because the partnership is treated as a *passthrough* entity, income and deductions are passed through to be reported by the individual partners. Trusts and estates are partially passthrough entities and tax-paying entities, depending mainly on whether income is retained or distributed. Each taxpayer, including partnerships, must submit an annual income tax return that reports certain items including income, deductions, credits, and the tax due (calculated by using tax tables applicable to that entity). Married individuals may file a joint income tax return in which they report their combined income, deductions, and other information on one return. This textbook will not try to cover income taxes in detail as it is beyond the scope of this course; however, a good introduction to the income taxation of trusts and estates is found in Chapter 8.

PROPERTY INTERESTS

Estate planning seeks to preserve and efficiently transfer an individual's wealth. Wealth is generally thought of as the property a person owns. This section will describe some of the ways in which property can be owned. Essentially, ownership can be classified in the following six ways:

- The physical characteristics of property (e.g., real versus personal)
- The extent of ownership interest in property (e.g., fee simple or a life estate)
- The type of co-ownership (e.g., joint tenancy versus tenants in common)
- A legal versus a beneficial interest (e.g., property held in the name of the trustee versus a trust beneficial interest)
- A present versus a future interest (e.g., an income interest in a trust versus a remainder interest)
- A vested versus a contingent interest (e.g., outright ownership of land versus a contingent remainder interest, where the remainderman must outlive the income beneficiary or the trust property reverts back to the trustor's estate)

Classification of Property by Physical Characteristics

Property is classified as real or personal. *Real property* includes ownership interests in land and any improvements, such as buildings, fences, trees, and the like, that are attached to the land. Curiously, an interest for years (a leasehold) in real estate is considered personal property. Accordingly, a good functional definition of *personal property* is all property except interests in land and its improvements.

Property is further divided into tangible and intangible property. Something is tangible if it can be perceived by the senses as having a physical existence. *Tangible personal property* is personal property whose utility comes primarily from its physical characteristics rather than the legal rights conferred on the owner or possessor of the property. Conversely, *intangible personal property* derives its value from the legal rights it represents. Thus a newspaper is tangible personal property because its value is based on the news printed therein. Initially, one might pay 35 cents to read it. A few days later, the value may drop to almost nothing, being useful only to wrap dead fish or as recycled newspaper. Yet, a very old paper with an article of historical significance on the front page may be worth a lot to collectors of old newspapers. On the other hand, a stock certificate is valuable to the owner of the certificate if the company is a going business, not because of the physical characteristics of the paper it is printed on, but because of the rights it represents, such as the right to vote for the board of directors, the right to dividends when they are declared, and certain liquidation rights. If the company has gone out of business, then the stock certificate has become tangible personal property. The certificate may be worth only the value of the paper it is printed on, or, if it is old or unusual for some reason, it may be of some value as a collector's item.

Intangible personal property includes a *chose in action*, which is a claim for money or property that could be recovered from another in a lawsuit, if such is necessary. A chose in action represents the right to money or property that is owed to the holder of the chose. That right can be transferred, sold, or assigned to another, who can then act on it in his or her own name. Note that the claim does not have to be certain as to the dollar amount, hence if a car strikes a pedestrian, the pedestrian could assign any claim based on the driver's negligence to a third party who could then make a claim in his or her own right and, if necessary, could file a law suit against the driver in an attempt to obtain a judgment for money. The person holding the chose as a result of a transfer is entitled to keep any recovery.

EXAMPLE 2–7 *Betty borrows $9,000 from Lenny, agreeing to pay it back by December 31 of this year. Lenny signs a piece of paper assigning to his daughter, Christine, his right to collect the debt. Since the debt could be collected by a lawsuit if necessary, it is considered to be a chose in action, and the assignment to Christine gives her the right to collect it.*

Basic Interests in Property

The three basic interests in property are fee simple, life estate, and estate for years.

FEE SIMPLE. A *fee simple* interest, often called a *fee* or a *fee simple absolute*, represents the greatest interest that a person can have over *real* property and corresponds to our usual notion of full ownership. Common rights include the right to possess, use, pledge, or transfer the property. If you own a house, even if it is subject to a mortgage, you probably own it in fee.

▶ **LIFE ESTATE.** A *life estate* interest in property, like a fee simple, is a powerful form of ownership, but is different in that the interest ceases on someone's death. Ordinarily, the *measuring life* is that of the owner of the interest. However, it could be any other person.

EXAMPLE 2–8 *Doctor Bud assigns his interest in a house to Gladis, his widowed mother, for her to use and enjoy until her death. Gladis has received a life estate in the house. Her own life is the measuring life.*

A life estate for the life of someone other than the owner of the interest is called an estate *for the life of another*. These are rarely used.

EXAMPLE 2–9 *Facts are similar to the previous example, except that Gladis's interest will cease on the death of Bud. Gladis still has a life estate in the house but now Bud's life, rather than her life, is the measuring life. She has an estate for the life of another.*

Ordinarily, the owner of a life estate enjoys, for the length of a measuring life, complete ownership, nearly equivalent to a fee, except that it will end on the life tenant's death. However, life estates are sometimes created so that the recipient enjoys only a partial present interest in the property.

EXAMPLE 2–10 *Aunt Jane, owner of dividend-paying common stock, gives to her niece Barbie the right to receive the dividends for as long as Barbie lives. Barbie has received a life estate in the income of the stock. Under the customary arrangements, Barbie does not have many rights in the stock itself. For example, she does not have the right to possess or sell the stock, or to use it as collateral against a loan. The stock will be held by someone else, either the original owner, or more commonly, a trustee under a trust arrangement.*

Trusts are used extensively in estate planning and will be discussed in every chapter of this book. An introduction to trusts follows this discussion of property.

▶ **INTEREST FOR YEARS.** Often, a person transfers possession and/or enjoyment of property to another for a fixed period. This is called an *estate for years* or interest for a term—even if the fixed period is something other than a certain number of years.

EXAMPLE 2–11 *Professor Jackson rents his cottage to Dr. Johnson, a visiting professor, for the spring semester. Dr. Johnson has an estate "for years" even though the semester is only four months long.*

EXAMPLE 2–12 *Mary is presently enjoying a life estate, for her life, in the income from certain common stock. Today Mary transfers to Mark her interest for the next ten years. If Mary does not survive the full ten years, Mark's interest will be cut off on Mary's death. Mary cannot transfer any greater interest than she actually owns, and Mark's interest is limited to that which Mary can legally give; thus, Mark has an income interest in the stock, ending at the earlier of ten years or Mary's death.*

A common example of an interest for years is a *leasehold*, which entitles the lessee to possess and use the property (e.g., a house or computer) for a specified time, usually in exchange for a fixed series of payments. Leasehold interests can amount to a valuable part of a lessee's wealth if the fixed payments are below current market rates, and if the lessee is permitted to "sublet" the property.

EXAMPLE 2–13 *Five years ago, Freda acquired a 15-year leasehold interest in a commercial building and is obligated to pay $15,000 per year for the entire period. If the rent for comparable buildings is $25,000 per year for the next ten years, and assuming a discount rate of 8%, the value of Freda's leasehold is the present value of $10,000 for ten years, discounted at 8%, or $67,101 [see Table B, annuity factor of 6.7101]. Freda could possibly sell her interest for that amount.*

ANNUITIES. Generally, an annuity is a series of payments for a period of time. The source could be a pension or it could be an investment annuity. The person receiving the annuity is called the annuitant and the entity (often an insurance company) or the person making the payments is called the obligor. With an investment annuity, the investor may pay in a lump sum and start receiving payments almost immediately or may delay the payments for a period of time, e.g., timing them to start when the annuitant retires. The payments may be for the annuitant's lifetime or may be for a period of years. On the other hand, the investor-annuitant might pay money into the annuity account for a period of years, called the accumulation phase, and then start drawing out the annuity. Finally, when working with an annuity provider such as an insurance company, the annuitant may have the option of having set payments (the dollar amount will not fluctuate) or might have the payments vary based upon the performance of selected mutual funds or some other indicator.

Concurrent Ownership

Property may be owned individually, in which case one person owns and uses it, or it may be owned concurrently by two or more persons. Where there is *concurrent ownership*, title may be taken as joint tenancy, tenants by the entirety, tenants in common, or as community property.

A common characteristic of all types of concurrent ownership is the *undivided* right to use the entire property, not just a physically identifiable portion. In addition, the co-owners usually each have the right, in the event of a dispute, to have the property physically divided (partitioned), at which time concurrent ownership ends. If the nature of the property is such that it cannot be partitioned, a court may order it sold and the proceeds divided among the owners according to their respective shares.

JOINT TENANCY INTERESTS. The defining characteristic of property held in joint tenancy is that, on the death of one co-owner, the decedent's interest automatically passes to the surviving owner(s). The owners are said to hold title in *joint tenancy*, or it may be said that they are *joint tenants*. Property law, developed as part of our common law, requires that the interests all be equal, and the owners' respective shares should not be stated as part of the title, thus, "Jim, John, and Jose, as joint tenants," not "Jim, John, and Jose, as joint tenants each owning a one-third share." Because tenants in common can own unequal shares, the share of each is usually expressed in the title; therefore the second statement, with the shares defined as "one-third," might result in a claim by the heirs of a deceased co-owner that tenants in common was actually intended and that the one-third interest belongs to them and not to the surviving co-owners.

Under joint tenancy, ownership passes to the surviving cotenant automatically at a cotenant's death by *operation of law*, meaning that the law recognizes the transfer as immediate on the cotenant's death without any action required by the survivors. However some authorities, such as banks, will require document revision in order to transact further business. A title company will want proof of the death of a joint tenant before it will issue title insurance should the survivors try to transfer title to someone else.

EXAMPLE 2–14 *John and Mary own a house as joint tenants. At John's death, Mary automatically becomes the sole owner of the house. However, as a practical matter, she might have to record an affidavit establishing the death of a joint tenant, with a certified death certificate attached, in order to clear the title.*

The automatic right of survivorship inherent in joint tenancy prevails over other means of transfers at death, including the will and the trust instrument.

EXAMPLE 2–15 *Continuing the prior example, if, John had executed a will that left his one-half interest in the house to his son; Mary would still receive it by right of survivorship. The joint tenancy designation supersedes the will.*

However, in certain jurisdictions, agreements can be executed between joint owners to nullify a joint tenancy designation.

EXAMPLE 2–16 *Continuing prior examples, if John and Mary were to execute a written **agreement** stating that their house is in fact held by them as community property or as tenants in common (see descriptions below) even though title is recorded as joint tenancy, many jurisdictions will honor such agreements, and the house would not pass to Mary by automatic right of survivorship.*

Joint tenancy interests in real estate are created by a written document called a deed. In most states, one cotenant can unilaterally "sever" the joint tenancy without the knowledge or consent of the other tenant(s).

EXAMPLE 2–17 *Oscar, Ray, Sam, and Clark own Green Acre Ranch as joint tenants. Without telling the other three, Sam deeds his interest to his friend Ed. Sam has broken the joint tenancy insofar as his interest is concerned. Ed owns a one-fourth interest as a tenant in common with the other three holding title to three-fourths as joint tenants. If Ray then dies, Oscar and Clark will own the three-fourths as joint tenants, and Ed will continue to own one-fourth. If Ed dies, his share will go to his heirs, not to the other co-owners.*

Joint tenancies are commonly created among family members, as they are most likely to appreciate the simplicity of this means of transfer and are least likely to be concerned that the ultimate owner of the property may be determined by whom among them lives the longest.

▶ **TENANTS BY THE ENTIRETY.** Holding title as *tenants by the entirety* is similar to joint tenancy in that it carries that key characteristic of joint tenancy, the right of survivorship; however, an interest by the entirety can be created only between husband and wife. Unlike joint tenancy, neither spouse may transfer or encumber the property without the consent of the other. Tenants by the entirety is a common law concept, generally not recognized in the community property states. In addition, a few of the common law states no longer recognize this form of ownership and will treat an attempt to create it as merely joint tenancy. Since tenants by the entirety is available only to married couples, a divorce causes said title to automatically transmute, from a legal standpoint, into tenants in common.

▶ **TENANTS IN COMMON.** As with joint tenancy, *tenants in common* interests are held by two or more persons, each having an undivided right to possess property. Unlike joint tenancy interests, however, interests in common may be owned in unequal percentages, and when one owner dies the remaining owners do not automatically succeed in ownership. Instead, the decedent's interest passes through his or her estate, by will or by the laws of intestate succession. The interest can also be transferred to the trustee of a trust and pass according to the provisions of the trust.

EXAMPLE 2–18 *Jack owns a 16 percent real estate interest in common with two other individuals who, combined, own the other 84 percent. Jack's will leaves his entire estate to his wife, Deanna. On Jack's death, his will determines who will get his interest. Therefore, the 16 percent interest will pass by the probate process to his wife, Deanna, not to the other cotenants.*

Interests in common are the title of choice for non-related parties since this form of title, in contrast to joint tenancy interests, creates a means of enjoying common ownership without any of the co-owners losing the right of disposition at death. An additional benefit exists in that tenants in common assets are not at risk to the creditors of co-tenants. Only the co-tenant's portion owned is available to creditors where the whole asset is at risk in joint tenancy ownerships.

▶ **COMMUNITY PROPERTY INTERESTS.** In the eight states recognizing it, *community property* is that property acquired by the efforts of either spouse during their marriage while living in a community property state, and other property which by the agreement of the spouses is converted from separate property into community property. *Separate property* is all other property owned by the spouses (e.g., acquired by only one of the spouses by gift, devise, bequest or inheritance, or by a spouse domiciled in a common law state, or acquired by either spouse prior to their marriage). The traditional community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. In addition, Wisconsin has adopted the Uniform Marital Property

Act (UMPA)[8], which creates a presumption that property owned by the spouses is property of the marriage, and, as such, it does not belong to just one spouse. This presumption holds even if title to property is in one spouse's name alone. The "marriage property" presumption can be overcome by evidence that sufficiently establishes otherwise, e.g., evidence that it was owned prior to the marriage or acquired by inheritance. Alaska allows couples to opt-into community property through a community property agreement.

When it comes to classifying income, most of the community property states follow what is referred to as the California rule, which is that income from community property is community property, as is anything bought with that income, and income from separate property is separate property, as is anything bought with that income. Three community property states, Texas, Idaho, and Louisiana, follow what is called the Texas rule and treat income earned from separate property during the marriage as community property. Likewise, Wisconsin law provides, with some exceptions, that "income earned or accrued by a spouse or attributable to property of a spouse during marriage and after the determination date is marital property."[9] The "determination date" is the later of the couple's marriage, their domicile in Wisconsin, or the enactment of Wisconsin's Marriage Property Act. Even in states following the Texas-rule, proceeds from the sale of separate property remain separate property, and anything bought with those proceeds would be separate property.

Community property is owned equally by both spouses. Generally, both spouses must consent to a gift of community property. Community property states allow couples to convert community property to separate property, and vice versa, although some states require a written agreement wherein the spouse whose interest is reduced acknowledges the fact that something has been lost. Separate property is considered entirely owned by the acquiring spouse. In states without community property provisions, of course, all property is separate property. In those states, it would simply be referred to as "the property owned by" Sam, Wanda, or whomever.

EXAMPLE 2–19 *Pat and Mary live in New Mexico, a community property state. When they married two years ago, Pat owned a sports car that Mary now uses. Last year Mary's father gave her 100 shares of XYZ stock, which pays a quarterly dividend. Mary used the last dividend check to buy a bicycle. Pat bought a rowboat from money saved from his July paycheck. The stock and bicycle are Mary's separate property. The car is Pat's separate property. All the other assets, including both salaries and the rowboat, are community property.*

Community property laws represent the attempt by certain state governments to impose greater fairness in property ownership by married couples. Under old English common law, the husband owned all property that either husband or wife acquired during their marriage. Even after most states recognized the right of married women to own property, during pre-World War II America, the husband typically earned most of the outside income while the wife performed the non income-producing household chores; therefore, husbands usually acquired title to almost all the family wealth. At early common law, a wife was entitled to own none of this property until her husband's death, at which time she received a life estate in one-third of her husband's real property. Called a "dower" interest, it has been modified by most common law states; however, it seldom gives the non-working spouse the advantages inherent in the law of community property, which automatically gives both spouses an immediate equal share in all the property acquired by their efforts during the course of their marriage.

Arizona, California, Idaho, Texas, Washington, and Wisconsin have a concept called *quasi-community property*, which is defined as that property, acquired by a resident while domiciled in a non-community property state, which would have been community property had the resident been domiciled in a community property state at the time of acquisition. For example, if a married couple moves to California owning common stock acquired with salary earned during the marriage while they were residents of New York, the stock is quasi-community property. Essentially, quasi-community property is treated as separate property of the acquiring spouse until divorce or death. If the parties divorce, the property is divided in a manner similar to community property. Treatment at death depends on which spouse dies first. If the acquiring spouse dies first, the surviving spouse is entitled to one-half of the property. On the other hand, if the non-acquiring spouse dies first, his or her interest in the property ceases.

Joint tenancy (JT) and community property (CP) have several major similarities and differences that are summarized in the outline below:

1. **Major Similarities:**
   a. Both involve ownership by more than one person.
   b. The owners have equal ownership rights and equal rights to use the entire property. Their interests are undivided.
   c. Any owner may demand a division of the property into separate, equal shares.
2. **Major Differences:**
   a. CP exists only between spouses. JT can exist between any two or more persons.
   b. CP rights arise automatically, by operation of law under state statute, even if title or possession is taken by just one of the spouses. Hence, CP is created immediately on acquisition of the property. JT rights are usually created by an agreement of the parties (e.g., they ask that stock be issued in their names as joint tenants) and are not governmentally imposed.
   c. JT includes automatic right of succession to ownership (right of survivorship) by surviving joint owners. This right takes priority over any will. In contrast, CP includes no automatic succession to ownership of the decedent's share by the surviving spouse. Therefore, at death, a spouse can transfer his or her share of CP, by will, to someone other than the spouse. However, intestacy will ordinarily result in succession by the surviving spouse under most state laws of intestate succession.
   d. Property held in JT will not be subject to the probate process. In contrast, the decedent's share of CP may be subject to probate. However, as mentioned earlier, some CP states no longer require a probate if the property is left to the surviving spouse or if, because of intestacy, the surviving spouse will receive the property by the laws of intestate succession.

It is important to make two observations regarding item 2c: First, some states, such as New York, recognize an agreement between the spouses declaring that specified property is held in joint tenancy "for convenience only;" and second, Arizona, California, Idaho, Nevada, Texas, and Washington have enacted statutes that allow the designation "community property with right of survivorship." This results in the property being treated like joint tenancy. This means that the decedent spouse's will does not control disposition, and the property transfers to the surviving spouse by operation of law, meaning there is no need for probate.

Introduction to Trusts

Usually, the owner of property has all the rights to possess and enjoy it; however, these interests can be divided so one party has just the "bare legal title" and is responsible for preserving and managing property for the benefit of another, and the other is entitled to enjoy the property in specified ways. The former holds the *legal interest* while the latter holds a *beneficial interest*, also called an *equitable interest*, in the property. Trusts are the most common legal arrangement to employ this division.

▶ **THE PARTIES.** There are three major parties to the trust: settlor, trustee, and beneficiary. The *settlor*, also called *grantor*, *creator*, or *trustor*, is the person who creates the trust, and whose property is used to *fund* the trust. The property held in a trust is called the *principal*, but also the *corpus*, the *res* (Latin for things), or the *trust estate*. The *trustee* is the person, persons, or entity (e.g., bank trust department) who takes legal title to the trust property and manages the trust estate. Usually the trust instrument names an initial trustee and several alternates. The trust *beneficiary* is the person or persons who are named to enjoy beneficial interest in the trust. Placing property in a trust is called *funding* the trust. Funding is accomplished by transferring title of the property into the name of the trustee. Since trusts often last for a long period of time, there are likely to be income beneficiaries, who, as the name implies, receive distributions of trust income. How much of the income will depend on how the trust was written. For instance, some trusts designed to qualify for the estate marital deduction require the surviving spouse receive all of the income from the trust distributed at least annually. Other trusts might give the trustee discretion as to how much income to retain and how much to distribute. Eventually, trusts end and property remaining is distributed, either back to the settlor or the settlor's estate, or to someone else depending on the terms of the trust. If the trust requires the property return to the settlor, this retained interest is referred to as a *reversion*. The property is said to revert to the settlor. If the trust is silent on who receives the property on the termination of the trust, then it will *revert* to the settlor. Often, the trust does not return to the settlor, but rather goes to someone else, in which case the person is called the *remainderman*, or if more than one person, the *remaindermen*, and the interest is call a *remainder* interest. Figure 2-1 illustrates the relationship between the parties to the trust.

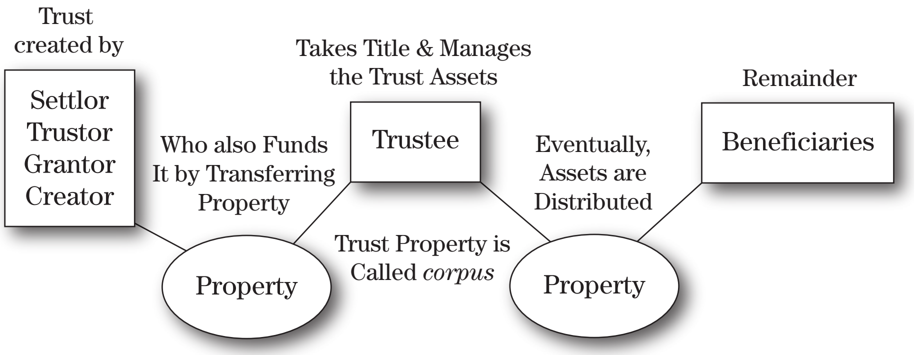

Figure 2–1 *The Parties to a Trust*

A trust can be *living* or *inter vivos*, meaning it is funded during the life of the trustor, or it can be testamentary, to take effect at the trustor's death with the funding mechanism being the probate process. A testamentary trust is one created by the trustor's will. An example of the provisions of a testamentary trust can be found in Chapter 3, Exhibit 3-3.

EXAMPLE 2–20 *On November 23, 2015, trustor Harold Stuart transferred 1,000 shares of ABC stock in trust to Uncle Jay as trustee, with the income payable to Harold's son, Chet, for 11 years after which the corpus of the trust reverts to Harold. Jay receives only legal title which would probably read, "Jay Stuart, as trustee of the Chet Stuart Trust, dated 11/23/2015." Jay is responsible for managing the property during the term of the trust. He can sell the stock and buy other investments in his name, as trustee, but he may not use trust assets for his own benefit, and he is required to distribute all of the net income to Chet, the income beneficiary. Chet has a beneficial interest that is an estate for years in the income of the trust.*

REASONS FOR CREATING TRUSTS. Clients may wish to include trusts in their estate plans for five principal reasons: to provide for multiple beneficiaries, to manage their property if they become incapacitated, to protect beneficiaries from themselves and others, to avoid probate, and to avoid or reduce transfer taxes. Since these factors are discussed in detail in numerous sections of the text, the following commentary will be brief.

First, clients may wish to *leave their property to more than one person*, either at the same time or successively, over a period of time, and may need an arrangement that will fairly protect each beneficiary's individual property rights.

EXAMPLE 2–21 *After his death, Constantine wants to let his second wife enjoy the use of his property for the rest of her life. After her death, Constantine wants the income from his property to be payable to the children of his first marriage until they reach age 30, at which time he wants them to receive the principal outright. By executing a trust, Constantine can appoint a responsible trustee (even his second wife, if both of them are comfortable with the arrangement) to manage the property for what may turn out to be a very long time.*

A transfer into a trust is sometimes called a *split interest* transfer, because it divides rights to the corpus into two or more interests, usually an income interest for a specified period of years or for the beneficiary's lifetime, and a "remainder" interest in the principal. Remainder interests will be described shortly and income versus principal interests will be covered a little later.

Second, clients may create trusts to *manage their property if they become incapacitated*. If, due to injury or old age, a person becomes unable to manage his or her property, who will do so? On petition, a court will appoint someone to manage the estate of a disabled person. Depending on the jurisdiction, the court-appointed caretaker is called a conservator (i.e., one charged with "conserving" the disabled person's assets) and the arrangement a *conservatorship*, or a *guardian* (i.e., one "guarding" the person's interests) and the arrangement a *guardianship*. Some states use the term guardian only for minors and use the term conservator for adults (the person being cared for is called the *conservatee*). Other states use guardian whether the person cared for is a minor or an adult. In either case, the person caring for the estate must make annual reports to the court and, depending on the circumstances, may have to get court approval for certain expenditures or to sell certain assets.

EXAMPLE 2–22 *Several years ago, Linda Smith created a* ***revocable living trust****, changing the title of all her property to read "Linda Smith, trustee of the Linda Smith Revocable Living Trust, dated March 19, 2013." The terms of the trust provide that if Linda becomes incapacitated during her lifetime, her brother Tom will become successor trustee. Linda has taken steps to avoid expensive court procedures to determine who should be appointed guardian or conservator of her property if she becomes incapacitated before death. The trust has the added benefit of allowing Linda's estate to avoid probate when she dies.*

Third, clients may wish to create trusts to *protect beneficiaries from themselves and others*.[10] As we will see in the next chapter, trust documents typically contain provisions restricting use of the property by beneficiaries. For example, trust instruments often provide that the trustee's discretion will determine the amount and timing of distributions to beneficiaries. In addition, they often prohibit any beneficiary from pledging his or her interest in the trust property as collateral for a loan. Many other restrictions can be included.

Fourth, a trust that is funded during the trustor's lifetime allows the property that is placed in the trust to *avoid the probate process*. Trusts funded while the trustor is alive are called *living trusts*. Trusts can also be funded through the probate process, either by means of a *pour-over will* (a will that has a previously established trust as its primary beneficiary) or by means of a testamentary trust also known as a *trust-will* (a trust is a substantial part of the will and, as such, the trust is not funded until after the testator dies). The probate process, and various means of avoiding probate, are discussed in more detail in Chapter 10.

Fifth, clients may wish to use trusts to *avoid or reduce taxes*. On the inside front cover of the textbook is a table that shows the amount that can be passed tax-free (meaning without the payment of gift or estate taxes), e.g., for the year 2015 the applicable exclusion amount is $5,430,000 for gifts and for estates. In general, the applicable exclusion amount has little relevance when property is transferred from one spouse to the other because there is a 100% marital deduction, but it is very important when property passes to other family members, e.g., to the children. A fair amount of estate planning for very wealthy families revolves around using both parents' applicable exclusion amounts while keeping the couple's combined estate intact for as long as either of them is alive. This is usually accomplished by holding in trust, for the benefit of the surviving spouse, the estate of the first spouse to die, with the children named as the remaindermen. By doing this, the trust estate is not merged with the surviving spouse's estate, and both spouses' applicable exclusion amounts are used, with the additional benefit that the trust attributed to the estate of the first spouse to die is generally sheltered from the claims of the surviving spouse's creditors. Chapters 5 through 8 examine the taxation of gifts, estates, trusts, and beneficiaries; Chapters 9 and 10 consider the use of trusts in tax planning.

Power of Appointment

In arranging property transfers into trusts or otherwise, clients can add considerable flexibility to their estate plans by granting a power of appointment. A *power of appointment* is a power to name someone to receive a beneficial interest in property. The grantor or creator of the power is called the *donor*. The person receiving the power is called the *holder* or *donee*. The parties to whom the holder may appoint (i.e., give) property by *exercising* the power are called the *permissible appointees*, and the parties to whom the holder actually appoints are called the *appointees*. In addition, the persons who receive the property if the holder permits the power to *lapse* (i.e., does not exercise the power within the permitted period) are called the *takers by default* and are also know as the *default beneficiaries*. In some cases, the holder of a power of appointment can *release* the power by formally relinquishing the right to exercise the power.

Depending on how it is written, a power of appointment can be exercisable either during the lifetime of the holder or at his or her death, or both during lifetime and at death. If exercisable during lifetime it is exercisable either sometime during the holder's entire lifetime, or only for a stated period. A *testamentary* power is only exercisable at the holder's death, usually by a provision in the holder's will. The broadest powers allow the holder to exercise both during lifetime and at death.

EXAMPLE 2–23 *Assume that Dona grants Harold a power of appointment over her 100 shares of ABC stock, permitting Harold to appoint the stock to Anna, Bobby, or Carol, and designating Terry as the taker in default should Harold fail to appoint the stock within 90 days. Shortly thereafter, Harold appoints Bobby to receive the stock. Dona was the donor, Harold was the holder (of the power), Anna, Bobby, and Carol were the permissible appointees, and Bobby was the actual appointee (of the stock). Terry, the taker in default, didn't get to "take" because the holder did not permit the power to lapse.*

Comparing the relationship between the parties to a power of appointment with the parties to a trust, the donor of the power is usually the trustor. The holder is commonly the trustee but may also be one or more beneficiaries or a trusted friend of the trustor. The permissible appointees are usually the trust's beneficiaries but could be others such as the trustor's favorite charities. Trustee powers of appointment may be over trust income, principal, or both income and principal. Trustees may also be granted the power to *distribute income* among a group of beneficiaries, which is sometimes referred to as "sprinkling the income" of the trust. Where the trustee has this discretion, the trust is referred to as a "*sprinkling trust.*" Almost humorously (we estate planners are always looking for a good laugh), the term "*spray*" is sometimes used to describe a trust clause that gives the trustee discretion to *distribute principal* in different amounts among permissible beneficiaries. Powers of appointment are important estate planning tools and will be discussed frequently in this book.

EXAMPLE 2–24 *Upon his death, Walter's will created a trust for the benefit of his disabled sister Phillis. First Bank was named trustee. One clause gave the trustee the power to distribute so much of the income to Phillis or to expend it on her behalf as the trustee thought would be useful to enrich Phillis's life. Another stated that if the income was insufficient to carry out the purpose of the trustee could liquidate principal (i.e., sell assets to raise cash) and use it for her benefit. The trust was to terminate at the earlier of Phillis no longer being cognizant of her surroundings due to dementia or her death. Whatever remained of the trust assets at termination would be distributed to Walter's nephew Chris. Walter is the donor of the power, First Bank as trustee is the holder, Phillis is the beneficiary both of income and principal, and Chris is the default taker.*

Powers of appointment are often created as part of trust planning. Figure 2-2 illustrates the relationship amongst the parties to a power of appointment.

In the chapter on estate taxes, we will see that death taxes play an important role in the use of powers of appointment—so much so that we commonly classify two types of powers using Internal Revenue Code classifications. Under the Code, a power of appointment is either a *general* power of appointment or a *non-general* power of appointment, also called a *limited* or *special* power of

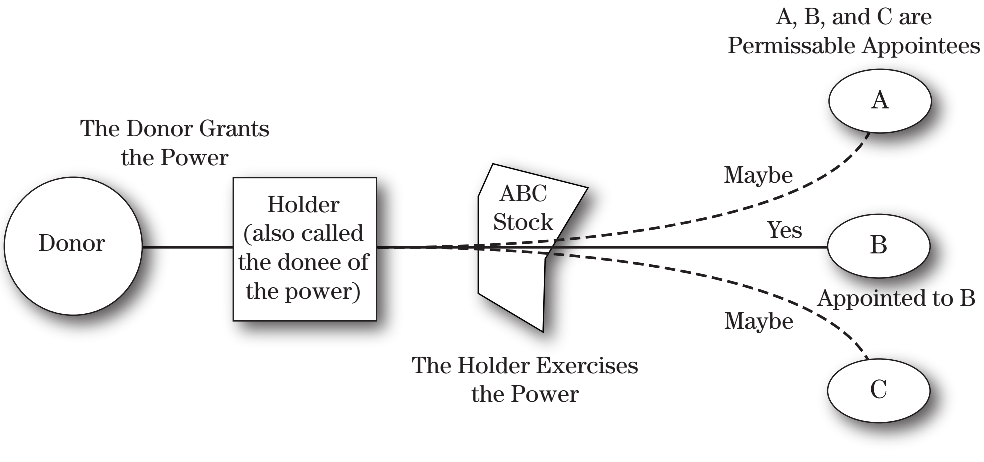

Figure 2–2 *The Parties to a Power of Appointment*

appointment. We'll define these terms in greater detail when we start working on estate taxes, noting how the wording of a power can cause property to be included in the holder's estate, subjecting it to estate taxes. The next example shows a common use of a power of appointment.

EXAMPLE 2–25 *Charles, a single parent, died recently, and his will placed some of his property in trust for the benefit of his children. A bank is named trustee and is given a non-general power of appointment over the corpus. The bank has, among other things, discretion to distribute corpus to the children in accordance with their needs "for their proper support, health, and education." This year, the trustee has distributed $16,000 to one son and $14,000 to a daughter to pay their college tuition.*

Powers of appointment can add great flexibility to a person's estate plan by enabling someone to direct trust dispositions after taking into account changes in circumstances that occur long after the person's death. According to common law, property subject to a power of appointment is not considered legally owned by the holder, rather, the holder is treated as merely a proxy for the donor. However, when it comes to federal estate and gift tax law, some powers cause the holder to be treated as if he or she owned the property, at least to the extent that the holder has control over the property. We will consider powers of appointment as they relate to the estate tax in Chapter 6 and to the gift tax in Chapter 7.

Present versus Future Interests

A beneficial interest in property may be classified as a present interest or a future interest, depending on whether the owner has the immediate right to possess or enjoy the property. The owner of a *present interest* has an immediate right to possess or enjoy the property while an owner of a *future interest* does not, because the latter's right to possess or enjoy the property is delayed, either for a specific period of time or until the happening of a future event. The most common types of future interests are reversions and remainders. A *reversion* is a future interest in property that is retained by the transferor after the transferor transfers to another some interest in the property. The reversion is said to be *vested* if it will become a present interest of the transferor, or the transferor's estate, at the termination of all interests that were transferred, i.e., at some point in time the donor will get the property back. It is said to be contingent if the reversion is conditional, e.g., it will only come back if the transferor is still alive, and if not, it will go elsewhere.

EXAMPLE 2–26 *Jerry transfers property, in trust, to Eve for her life. The trust document was silent as to what should happen to the property after Eve's death. By not designating a remainderman, Jerry has retained a vested reversion, also called a reversionary interest. The trust property will belong to Jerry, if he is still alive when Eve dies, otherwise, it will belong to his estate (the interest will pass according to his estate plan).*

EXAMPLE 2–27 *In the prior example, suppose the trust provided that the property would return to Jerry if he was still alive, otherwise it would go to his brother, Ned. Jerry has retained a contingent reversion. The trust property will belong to Jerry, if he is still alive when Eve dies, otherwise, it will belong to his brother.*

Technically, a *remainder* is the right to use, possess, and enjoy property after all prior owners' interests end, and all interests must have been created at the same time by a single document. As mentioned earlier, it is a future interest held by someone other than the transferor and it will become a present interest when all other interests have ended. In estate planning, remainders usually arise in the context of trusts, where the remainderman is entitled to the remaining trust assets at the termination of the trust. In many, if not most, trust situations, the remaindermen are the settlors' children or grandchildren, who will receive the remainder at the death of both settlors. In some of these estate plans, the trust changes at the death of one spouse into several trusts, including one or more irrevocable trusts. Where multiple trusts are formed at the death of one spouse, the survivor usually has a life estate in all the trusts, even those that are irrevocable, and the children wait as remaindermen until the surviving spouse dies.

EXAMPLE 2–28 *George irrevocably transfers property to Sally for her life, then to John or his estate. John's future interest in the property is a remainder. It is not a reversion because it does not return to George.*

Vested versus Contingent Future Interests

A *vested remainder* is a remainder that is non-forfeitable; it is a remainder whose possession and enjoyment are delayed *only by time*, and is not dependent on the happening (or not happening) of any future event. Note that the property might go to the remainderman's estate if he or she is dead when the preceding interests end, in which case it will be the remainderman's heirs and beneficiaries that get to enjoy use of the property but it is still considered vested.

EXAMPLE 2–29 *With regard to the transfer by George in the previous example, John's remainder is vested. Nothing prevents him or his estate from receiving possession, except the passage of time. Morbidly but accurately speaking, eventually Sally will die. If John dies before Sally, it is John's estate plan that determines who will own the property.*

A *contingent remainder* is a remainder that is not vested; that is, it is a remainder whose possession and enjoyment are dependent on the happening of a future event, not on just the passage of time.

EXAMPLE 2–30 *Catherine transfers property to Flo for her life, then outright in fee simple to Jason, if alive, otherwise to Chris, if alive, and if not, then it reverts to Catherine. Jason and Chris each have a contingent remainder interest in the property and Catherine has a contingent reversionary interest. If Jason outlives Flo, the property is his; Chris is next in line if Jason doesn't make it. Finally, Catherine, or her estate, will get the property back if neither Jason nor Chris outlive Flo.*

A few more examples, presented in the context of common transfer devices, should help to clarify the distinctions discussed above.

EXAMPLE 2–31 *When Gary died, his will created a trust funded with his entire estate. The terms of the trust give income to his wife, Joan, for her life. At Joan's death, the trust terminates and the property passes outright in fee to Gary's son Max, if still alive, otherwise to the Salvation Army. At Gary's death, Joan received a present interest called a life estate in the income, and Max and the Salvation Army each received a future interest, called a contingent remainder. Max and the Salvation Army share something in common; only one of the interests can ever become a present interest since an event will occur which will defeat one or the other interest. Max's interest will cease if he predeceases Joan. The Salvation Army's interest will cease if Max survives Joan. Therefore, both have contingent remainder interests because possession is dependent on the happening of a future event and not on the mere passage of time.*

EXAMPLE 2–32 *Sam left property in trust, giving his wife, June, income for life with the remainder going to Sam's son, Kurt, or Kurt's estate. Kurt has a vested remainder in the property. Although initially a future interest, it is certain that it will become a present interest someday; it cannot be defeated. Only the passage of time keeps Kurt's interest from being a present interest. Of course, Kurt may not be alive to enjoy the property, but then the beneficiaries of his estate will.*

We have seen that the transfer of property in trust results in a division into two interests, with the trustee receiving the legal interest and the beneficiaries receiving the beneficial interests. In addition, transfers into trust typically result in a second type of division of interests when the beneficial interests are split among two or more beneficiaries. Ordinarily, one group of beneficiaries, called the *income beneficiaries*, receives a life estate or estate for years in the trust income, while the other group, called the *remaindermen*, receives the remainder at the termination of the income interests. The many reasons for splitting beneficial interests into a life estate, or into an estate for years and a remainder, will be explained in later chapters. At present, the reader should simply be aware of the interest-splitting nature of the trust. You should recognize that, at the time of the transfer into the trust, the life estate and estate for years are usually, but not always, present vested interests; the remainder is a future interest, either vested or contingent.

Quantifying Present and Future Interest

It is important to understand the quantitative nature of remainders, reversions, life estates, and interests for years. The estate tax is based upon the date of death value of property included in a decedent's estate. What value should be assigned if the property is an interest that only lasts for a period of time or is an interest that comes into possession only in the future? What value is assigned to an annuity that will pay the survivor $50,000 for the next 20 years? How much would one include if the decedent owns a vested remainder in a $1,000,000 trust that does not terminate until the death of the 65-year-old income beneficiary? Sometimes we must value a present or future interest to determine a taxable gift. Indeed, in determining the gift tax we subtract an annual exclusion, a $14,000 deduction in 2015, but only if the gift qualifies as a present interest. If $40,000 is placed in an irrevocable trust that gives one beneficiary income for 5 years after which the trust terminates in favor of someone else, is there a present interest? If so, how is it valued? Generally, we use must use a discount rate to take into account that the property is either being received over a period of time or will be received only after a delay for a period of time.

The value of an annuity, life estate, or remainder interest is determined by using a factor based upon the discount rate applicable for the month when the interest was created. The appropriate discount rate, referred to as the §7520 rate, is published by the Treasury in the monthly Internal Revenue Bulletin.[11] Appendix A includes part of IRS Tables "S," "B," "K," and "2000 CM," four tables commonly used in estate planning. Table S is used when the property being valued either lasts a lifetime or is being postponed for someone's lifetime, e.g., to value the income from a trust that will last as long as the beneficiary lives or to value a remainder interest that will be received after a life income beneficiary dies. Table B is used where the interest being valued lasts for a specific period of time or is postponed for a specific period of time, e.g., an annuity for 10 years or a remainder interest that won't be received until 10 years have passed. Table S and Table B are abridged to list a sampling of present value factors for discount rates of 2, 4, 6, 8, 10, and 12%. Tables S and B assume for annuities and life estate an annual payment, with the first payment at the end of the first year. Table K gives adjustment factors where annuity payments are made other than annually. We will be using the actuarial factors in examples and problems as they are especially helpful in the *planning* stage, when estimates are useful in calculating the values of life estates, remainders, and the like. Table 2000 CM is a one-page mortality table, useful for valuing interests that are contingent on survival, e.g., the value of a remainder interest that will come into possession 10 years from now, but only if you are still alive, is much higher if you are 25 years old than if you are 85 years old. With Table 2000 CM you can figure out the probability of a 25-year-old living 10 years compared to the probability of an 85-year-old doing so.

The following series of examples will illustrate the use of these four tables for the valuation of four basic property interests: remainders, reversions, annuities for life, and annuities for a *term certain.* The choice of table for a particular problem depends on whether the interest valued is predicated on someone receiving either all income or a fixed annuity (1) for a fixed number of years, or (2) for life. All examples will assume payments start at the end of the first year after the interest is created.

▶ **INTEREST BASED ON A TERM OF YEARS.** We use Table B, Appendix A, to determine the value of an income interest that is for a *fixed period of time* (also called an interest for a *term certain*) or the value of a remainder interest that follows another interest that lasts for a fixed period of time.

EXAMPLE 2–33 *When the 7520 rate was 10%, Dana created an irrevocable trust by transferring $200,000 in property to the Fish-Net Bank Trust Department. By the terms of the trust, the trustee must distribute all the income to Harry (or his heirs) for a period of ten* *years, then terminate the trust by distributing the remainder to Stephen (or his heirs). The value of Harry's ten-year annuity is calculated as follows: the income interest (Inc. Int. column) factor for 10 years is 0.614457, thus the current value of Harry's income interest is $122,891 [$200,000 * 0.614457]. What is the value of Stephen's remainder interest? Since the income interest and the remainder represent the entire value of the trust at the outset, the value must be $77,109. In Table B, REM stands for remainder value and we could arrive at $77,109 either by multiplying the factor found there for 10%, 10 years (i.e., .385543) by $200,000 or by subtracting the income interest ($122,891) from the $200,000 initial value of the trust.*

In determining the value of a reversionary interest, one takes the same steps as if it were a remainder interest, i.e., use the REM column.

EXAMPLE 2–34 *For this example, we revise the terms of the trust in the prior example such that on termination the trust corpus comes back to Dana (or her heirs). The initial value of Dana's reversion is $77,109 found by multiplying the REM factor by the initial value of the trust. Of course it is the same as the value of a remainder interest since in both instances the value is based upon a delay of ten years with the value of the trust and the 7520 rate being held constant.*

With an annuity interest, we must use the annuity column (A) whether we are valuing the income interest or a remainder interest. The values in the annuity column are the present value factors for an annuity of $1 for a set period of time.

EXAMPLE 2–35 *At a time when the 7520 rate was 4%, Brett established an irrevocable trust by transferring $200,000 in property to the Fish-Net Bank Trust Department. The trust gives him the right to receive an annual distribution of $16,000 for 15 years, after which the trust would terminate and be distributed to Brett's two children. The value of Brett's 15-year retained interest is calculated by finding the factor in Table B that corresponds to a 15-year payment period discounted at 4%, i.e., 11.1184, and multiplying it by the annual payment. Thus the current value of Brett's annuity interest is $177,894 [$16,000 × 11.1184]. For gift purposes, the important value is not what Brett kept, but what he gave away, which of course is the remainder interest. What is its value? The difference between his retained interest and the initial value of the trust, i.e., $200,000 – $177,894 = $22,106. Brett would report this value on a gift tax return.*

▶ **INTEREST BASED ON A LIFE ESTATE.** We use Table S, Appendix A, to determine the value of an income interest that lasts for a person's lifetime, i.e., a *life estate* (also referred to as *income for life*), or the value of a remainder interest that follows a life estate.

Valuation of a Life Estate. Table S indicates what portion of a property's total value is reflected in the value of a beneficiary's income or annuity interest for life. We cannot use Table S where the person with the measuring life (e.g., the person with a life estate) is terminally ill at the time the interest is being valued. The regulations define terminal illness as "an incurable illness or other deteriorating physical condition . . . if there is at least a 50 percent probability that the individual will die within one year." However, if the person actually lives 18 months or longer, there is a presumption that the person was not terminally ill, unless the contrary is established by clear and convincing evidence.[12] In the examples that follow we will assume the person was not terminally ill.

EXAMPLE 2–36 *The 7520 rate was 6% when Martha created an irrevocable trust with assets worth $100,000. The terms give Charles, age 50, a life estate and Samuel (or his heirs) the remainder interest. The 6% "life estate" factor corresponding to age 50 is 0.77758, hence the value of Charles's interest is $77,758 [$100,000 × 0.77758]. Of course we can determine the value of Samuel's remainder interest by using the remainder column (REM) factor of 0.22242 to arrive at $22,242 or simply subtract the value of the life estate from the initial value of the trust.*

Valuation of Reversion After a Life Estate. As with reversions after an income interest or an annuity interest for a term certain, reversions after a life estate are calculated in exactly the same manner as remainders.

Valuation of Annuity for Life and a Remainder that Follows. If the payments are a fixed amount, rather than all the income, we use the annuity column (A) from Table S.

EXAMPLE 2–37 *Muhammad is the beneficiary of a testamentary trust that must pay him $2,000 per month for life, with the remainder designated as going to Ali or Ali's estate. Since Ali died before Muhammad, the remainder value must be included in his estate.[13] At the time, the 7520 rate was 6%, the trust was worth $750,000, and Muhammad was 70 years old. To determine the value of the annuity, turn to Table S, 6%, age 70, to find the factor 8.6645 in column A. Since the payments are made monthly, we will have to adjust the value using Table K. Thus, the value of this life annuity is $213,604 [8.6645 * $2,000 * 12 * 1.0272]. The vested remainder is the difference between the annuity value and the value of the trust, i.e., $750,000 – $213,604 = $536,396. Remember, when a monthly payment is given, you must multiply by 12 to get the annual amount, likewise, 52 for a weekly payment. It may be obvious, but it is a step easily overlooked.*

▶ **FUTURE INTEREST CONTINGENT OF SURVIVAL.** A remainder interest that is contingent on the remainderman's survival for the duration of the trust is calculated by determining the value of the remainder as shown above, then reducing the remainder by the fraction that represents the probability of the person being alive at the end of the trust. IRS Mortality Table, 2000 CM, Appendix A, shows the number of people expected to be living at each age based on statistics for the 2000 census (since this table was made available in May of 2009, the next one, based on the 2010 census, is not expected to arrive much before 2019). According to the table, out of 100,000 live births (age 0 = birth), only 96,419 of them are expected to be alive at age 40. Calculating the probability of a person age X surviving to age Y is determined by dividing the number of people alive at age Y by the number alive at age X. Thus, the probability of a newborn reaching age of 40 is 0.96419 [96,419 ÷ 100,000]. Since one of the goals in estate planning is to transfer property with a minimum of transfer tax, the smaller the value of a gift the better, especially if we are able to transfer a significant amount without using up too much of the donor's AEA (the estate or gift tax free amount).

EXAMPLE 2–38 *At a time when the 7520 rate was 4%, Mavis, age 60, established an irrevocable trust by transferring property worth $1,000,000 to the trust department of Hip-Hop Bank. The trust gives her the right to receive an annual distribution of $5,000 per month for 10 years, after which the trust terminates and is distributed to Mavis's three children. However, the trust states that if Mavis dies before the trust ends, the trust corpus reverts to her estate. What is the value of the gift to the children? First, determine Mavis's interest using Table B, 4%, 10 years, $5,000 per month for 10 years, i.e., 8.1109 * $5,000 * 12 * 1.0182 = $495,511. This is the value of what Mavis kept; the remainder interest is $1,000,000 minus $495,511, i.e., $504,489. What is the probability that the children will receive the remainder instead of seeing it revert to Mavis's estate? According to the 2000 CM table, 74,794 of the 87,595 alive at 60 will make it to 70, hence the value of the remainder after taking the contingency into account is: $504,489 * 74,794/87,595 = $430,764. This would be the value of the gift Mavis must report on a gift tax return.*

These IRS tables will be used to value property interests in several sections of the text, covering such estate planning techniques as annual exclusion gifts (Chapter 7), minor's income trusts (Chapter 11), private annuities and charitable remainder trusts (Chapter 12).

TRANSFER ON DEATH ARRANGEMENTS

Somewhere between sole ownership and joint tenancy are several title arrangements that avoid probate without giving immediate rights to the designated beneficiary. These arrangements include what are called "pay on death accounts," "transfer on death securities," and "Totten trust accounts." These arrangements have in common an initial owner who retains full control of the account or security until his or her death at which time ownership shifts to a designated beneficiary.

PAY ON DEATH ACCOUNTS. Probably all states now accept *pay on death* (POD) *accounts* as valid probate avoidance arrangements. Generally, the account has the account owner's name in the title, followed by "in trust for" and then the name of the person who will take the account if the owner dies before closing the account. Most states allow POD accounts to be used with checking and savings accounts, money market accounts, and certificates of deposit. It can be an account at a bank, credit union, or savings and loan. The depositor maintains control of the account so long as he or she is alive. Upon death, assuming the account is still open, transfer to the designated beneficiary is accomplished without probate. POD accounts are often referred to as Totten Trusts, a name derived from an early New York appellate case that recognized the arrangement as a legitimate way to transfer a cash account to a designated beneficiary at the account owner's death.[14] Other states followed New York's lead and recognized these POD arrangements either by court approval or by legislative action. Once assets are transferred into joint tenancy they can generally be withdrawn by any of the joint tenants and are subject to the liabilities of each joint tenant, whereas, the owner of a POD account maintains control and can revoke the beneficiary's interest by revoking or changing the beneficiary designation, or closing the account. Obviously, the creditors of the designated beneficiary have no way of reaching the account as long as the owner is alive.

▶ **TRANSFER ON DEATH.** Currently, all states have adopted the Uniform TOD Securities Registration Act, bringing to owners of securities the same benefits already recognized for cash accounts, this Act permits issuers of securities (e.g., stocks, bonds, mutual fund shares, security accounts) to offer owners the ability to name death beneficiaries to whom securities transfer when the owner dies. TOD is an acronym for "Transfer on Death." While there is no separate uniform code governing POD accounts, the Uniform TOD Securities Registration Act recognizes it as a type of TOD registration, keeping both terms mainly because the POD is already widely accepted at financial institutions. During his or her life, the owner retains complete control over the securities or the brokerage account, including the power to revoke or change the beneficiary designation without needing to obtain the beneficiary's consent. As with POD accounts, the owner's will has no control over the disposition of the TOD property. Generally, the beneficiary can obtain possession of the property by presenting the death certificate of the deceased owner and identification that establishes that he or she is the person designated in the title as next in line. The Act frees issuers and financial institutions of any liability for making a good faith transfers to a named beneficiary. It also preserves the rights of a deceased owner's creditors where the securities have been used as collateral.[15]

CONCLUSION

We have covered a wide range of topics in this chapter: estates, property interests and transfers, wills, trusts, probate, disclaimers, a little about taxation and about insurance, also POD and TOD arrangements, Totten trusts, and much more. The concepts and terms listed in the table on the next page are ones that we will use often in our study of estate planning. The next chapter explores the major documents used in the property transfer process.

IMPORTANT CONCEPTS AND TERMS COVERED IN THIS CHAPTER

Estate
Property
Probate estate
Gross estate
Taxable estate
Transfer
Assignment
Transferor and Transferee
Legal interest
Beneficial interest
Transfer
Outright gift
Complete (transfer)
Irrevocable (transfer)
Incomplete (transfer)
Revocable (transfer)
Interest in property
Partially complete (transfer)
Sale
Consideration
Gift
Bargain sale
Inter vivos
Instrument
Beneficiary
Donee
Donor
Decedent
Will
Testamentary
Executed
Testator
Trust
Intestate
Testate
Partially intestate
Probate
Personal representative

Fiduciary
Executor
Administrator
Heir
Devisee
Legatee
Legacy
Issue
Descendant
Specific bequest
Ademption
General bequest
Pecuniary bequest
Residuary bequest
Residue
Class gift
Abatement
Disclaimer
Life insurance
Insured
Term life insurance
Level term life insurance
Cash surrender value
Cash value life insurance
Unified transfer tax
Gift tax
Death tax
Inheritance tax
Estate tax
Generation-skipping transfer tax
Fee simple
Life estate
Measuring life
Interest for years
Leasehold
Real property
Personal property

Tangible personal property
Intangible personal property
Chose in action
Concurrent ownership
Joint interest
Joint tenancy
Interest by the entirety
Tenants in common
Community property
Separate property
Trust
Trustor, grantor, creator or settlor
Trust principal or corpus
Trustee
Trust beneficiary
Living trust
Testamentary trust or trust-will
Power of appointment
Donor or creator (of a power)
Holder or donee (of a power)
Permissible appointee
Appointee
Exercise (a power)
Release (a power)
Lapse (of a power)
Taker in default
Present interest
Future interest
Reversion
Remainder
Vested remainder
Contingent remainder
Income beneficiary
Remainderman
Totten trust
Pay on Death Account
Transfer on Death securities

ENDNOTES

1. The Uniform Transfer to Minors Act, completed by the Uniform Law Commissioners in 1983 and amended in 1986, has, as of July 2011,been adopted by all states except Georgia, Massachusetts, Ohio, South Carolina, and Vermont. It has also been adopted in the District of Columbia and the Virgin Islands. See <http://uniformlaws.org>.
2. IRS Reg. 20.2031-1(b).
3. IRC § 2032.
4. The National Conference of Commissioners on Uniform State Laws, Uniform Determination of Death Act, completed in 1980. As of July of 2011 it has been adopted in 36 states and the District of Columbia and the Virgin Islands. See <http://uniformlaws.org>.
5. For the Uniform Probate Code's six exceptions. See UPC § 2-606.
6. See UPC § 2-202. Elective Share
7. The rules for a tax effective disclaimer are found in IRC § 2518.
8. Uniform Marital Property Act (UMPA), completed by the Uniform Law Commissioners in 1983. As of July 2011 only Wisconsin has adopted UMPA. See <http://uniformlaws.org>.
9. Wisconsin Statutes, § 766.31 (4). See http://www.legis.state.wi.us/rsb/ Statutes.html, click on the link to Chapter 766, "*Property rights of married persons; marital property*."
10. Somewhat humorously, Edward Schlesinger has described the trust as capable of protecting assets from "inability, disability, creditors, and predators."
11. For the a table of 7520 rates go to http://www.irs.gov/index.html; put 7520 in the search box and you will find rate tables both current and going back to 1997.
12. IRC § 1.7520(b); Reg. §§ 20.7520-3(b)(3)(i); 25.7520-3(b)(3).
13. Students of finance may notice that traditional financial mathematics can *not* derive this number. It is based not only on the time value of money, but also on life expectancy.
14. *In re Totten*, 179 N. Y. 112, 71 NE 748 (1904).
15. The Uniform TOD Securities Registration Act is available by entering TOD in the search box at The National Conference of Commissioners on Uniform State Laws' website <http://uniformlaws.org/Default.aspx>.