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Wait-and-See Estate Planning

Foreword to Counsel and Specimen Documents

Tax considerations

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Wait-and-See Estate Planning

What is Wait-and-See Estate Planning?

The Wait-and-See strategy uses a combination of life insurance and trusts in a way that offers clients the flexibility to support the changing circumstances throughout their lives. It is a strategy for married couples who desire to maintain control and access of life insurance policies that can eventually be used to fund estate tax liquidity along with other legacy needs.

The benefits of utilizing this strategy are:

Full access to cash values accumulated within the life insurance policy until the first few years of retirement or the first death,

The ability to change the estate plan up to the moment of the first death (it is revocable, not irrevocable);

Does not require any current gifts and eliminates the need to use the gift tax annual exclusion to pay premiums,

Provides an estate tax-free death benefit by transferring the life insurance policy into an Irrevocable Life Insurance Trust (ILIT) or a credit shelter trust in the future.

What are the two approaches for Wait-and-See Estate Planning?

There are two approaches that may be used for Wait-and-See Estate Planning: two-policy and one-policy. The two-policy approach uses two single-life policies cross-owned by the spouses. The one policy approach uses a second-to-die policy owned by the mortality inferior spouse - the individual who is likely to die first.

How to use this Foreword to Counsel

This publication was written to support attorneys who work with estate planning clients. At Securian Financial, we understand that practicing attorneys have limited time to review and research a new technique. We also understand that practicing attorneys typically prefer to work with “tried and true” concepts when drafting for a client. To that end, we have pulled together a foundation of analysis, research and specimen language to assist the attorney’s review. This Foreword to Counsel addresses the two separate approaches separately to keep the review focused and thorough for each approach. Therefore, there is repetition since both plans may need a review of similar issues.

It is a strategy for married couples

who desire to maintain control and access of life insurance policies that can eventually be used to fund estate tax liquidity along with other legacy needs.

Two-policy approach

Set-up

With the two-policy approach, each spouse is owner and primary beneficiary of a life insurance policy on the other spouse's life.

Husband's estate
Insured: Wife

Owner: Husband

Beneficiary:
1. Owner/spouse
2. Credit shelter trust

Wife's estate
Insured: Husband

Owner: Wife

Beneficiary:
1. Owner/spouse
2. Credit shelter trust

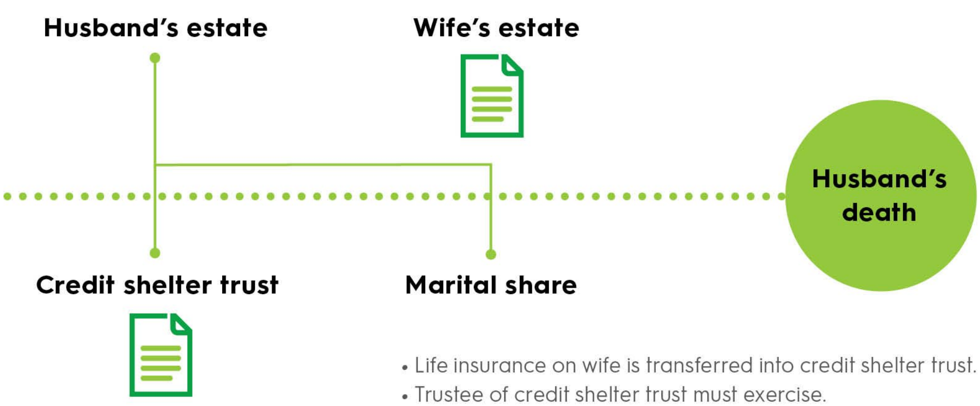
After the first death

After the first death, the surviving spouse receives a death benefit from the policy insuring the deceased spouse free of income and estate taxes.[1] The cash value of the other policy insuring the surviving spouse is included in the deceased spouse's gross estate.[2]

A special personal representative or trustee passes the policy to the decedent's credit shelter trust utilizing a portion of the decedent's applicable exclusion. Due to Internal Revenue Code (IRC) §2035 concerns, the surviving spouse can't be the special representative. The special personal representative or trustee can remove some policy cash value if necessary before transferring the policy to the credit shelter trust. Other assets in the trust or gifts from the surviving spouse to the trust may be used to pay further premiums on the policy in the trust.

With the Wait-and-See Estate Planning approach, the surviving spouse receives the death benefit from the life insurance policy on the deceased spouse. That death benefit could provide necessary income to the surviving spouse to replace the credit shelter trust income and/or to use as a source of cash to gift to the credit shelter trust.

Husband's death



Two-policy approach continued

Common questions with the two-policy approach

What are the methods of continuing paying premiums on the policy in the credit shelter trust?

After the policy insuring the survivor is transferred to the credit shelter trust, the trustee of the trust may need to pay further premiums due on the policy. Here are five methods to pay further premiums:

1. Trustee can use other assets in credit shelter trust. If the cash value of the life insurance policy transferred to the credit shelter trust is less than the applicable exclusion amount, the trust can contain other assets so the total of all assets initially funding the trust is equal to the applicable exclusion amount. The trustee could use liquid assets or sell those other assets and use the proceeds to meet the premium payments as long as the trust allows it.

2. Spouse can purchase assets from credit shelter trust. The death benefit of the policy on the deceased spouse is paid to the surviving spouse. The surviving spouse could use those funds to buy assets from the credit shelter trust.[3] The spouse would use the cash from the policy proceeds to pay the credit shelter trust for certain property in the trust, which would then be transferred to the spouse. The credit shelter trust would receive the cash necessary to pay the premiums, and the spouse would obtain the assets from the trust.

3. Spouse can gift premiums to credit shelter trust. The surviving spouse could also make gifts to the credit shelter trust to help pay the future premiums. This method, although it seems simple, could cause unexpected results if not planned for carefully. Please refer to the next section on gifting for an in-depth analysis.

4. Spouse can disclaim the income interest from credit shelter trust. Another option for the surviving spouse who will make gifts to the credit shelter trust is to disclaim the income interest from the credit shelter trust. If the spouse disclaims a life estate in the credit shelter trust, the value of the life estate is considered a gift from the spouse to the remainder person.[4]

5. The spouse could make loans to provide cash to the credit shelter trust.[5] The death benefit the spouse receives from the policy on the deceased spouse could provide the spouse the cash necessary to lend to the credit shelter trust. Loans to the credit shelter trust could trigger the interest-free loan rules if the loan interest rate is below market.[6] However, if the spouse forgave the loan payments, the forgiveness of the debt would be considered a gift to the trust by the spouse.

What are the gift tax consequences of the surviving spouse continuing to make gifts to the credit shelter trust?

If the spouse makes gifts to the trust, the gifts will not qualify for the annual exclusion unless the trust contains Crummey withdrawal rights.[7] The attorney who drafts the credit shelter trust might want to consider including Crummey rights within the credit shelter trust. See Exhibit IV under the two-policy approach. If Crummey rights are not included, the gifts to the credit shelter trust will be considered future interest gifts not qualifying for the annual exclusion.[8] The surviving spouse would have to file a federal gift tax return, although no gift tax is due until the total of all adjusted taxable gifts exceeds the applicable exclusion amount.

Two-policy approach continued

Can the surviving spouse access principal in the credit shelter trust?

Care must be taken to prevent the surviving spouse from possessing any “incidents of ownership” over the life insurance policy under IRC §2042 or retained powers under IRC §§2036–2038, which could cause the death benefit to be included in his or her estate.[9]

A credit shelter trust typically gives the surviving spouse rights to trust principal. In general, the credit shelter trust should be drafted without spousal rights to principal when using the Wait-and-See approach. With this approach, a life insurance policy insuring the surviving spouse will become part of the credit shelter trust principal after the first spouse dies. If the surviving spouse has the right to withdraw policy cash values, this right would be considered an “incident of ownership” and trigger inclusion of the death benefit in the surviving spouse’s estate.[9]

There may be alternatives for the surviving spouse who wishes to be named a lifetime beneficiary of the credit shelter trust under the Wait-and-See approach. The following guidelines should be reviewed when considering this possibility:

- **Surviving spouse as trust beneficiary**

  The spouse’s right to receive trust income, as well as the ability to receive distributions of trust principal to provide for health, education, maintenance and support or discretionary principal distributions doesn’t appear to cause an incident of ownership.[10] Although the Internal Revenue Service (IRS) has not attributed an incident of ownership where the surviving spouse is entitled to trust distributions, there have been rulings that have alluded to a potential gift tax trap. This trap is where the trustee diverts trust income or principal to pay life insurance premiums. Specifically, where trust income is used to purchase non-income producing assets such as life insurance, the beneficiary spouse may be deemed to have made a gift to the other trust beneficiaries.[11] The drafting attorney using trust provisions that provide for discretionary distributions of income and principal appears to avoid this potential gift tax concern.

- **Surviving spouse should not be trustee**

  Revenue Ruling 84-179 provides that when an insured holds a policy on his/her own life in a fiduciary capacity, he/she is deemed to hold “incidents of ownership of the policy” if these powers are used for his/her own benefit. Since the surviving spouse is generally an income (and possibly a principal) beneficiary, this benefit rule acts as a “circular” inclusion tax trap because the surviving spouse is the beneficiary of his/her own actions.

  If the credit shelter trust is being drafted, the surviving spouse should not be trustee. If the credit shelter trust is already drafted, then the surviving spouse should resign as trustee of the credit shelter trust before the life insurance policy is placed into the trust.[12] If the surviving spouse doesn’t want to relinquish his/her position as trustee, the trust can be carefully drafted to limit the authority the insured/trustee holds over the policy in the trust.[13]

Two-policy approach continued

- **Surviving spouse should not contribute premium to the trust**

  In addition to avoiding estate inclusion by eliminating all incidents of ownership, care must be exercised to avoid estate inclusion under one of the transfer with retained power rules of IRC §§2036–2038. The IRS seems to adopt the view that payment of premium by a trust beneficiary, either directly or indirectly, is a transfer with a retained interest that can cause inclusion.[14] In addition, diverting mandatory distributions of income or principal from the spouse to pay premiums may cause estate inclusion under the retained power rules.

- **Surviving spouse should not have a limited power of appointment**

  An "incident of ownership" exists where an insurance policy is held in trust if the insured has the power to change the beneficial ownership in the policy or its proceeds.[15] A common provision found in many credit shelter trusts passes the trust assets to the children, unless the surviving spouse directs otherwise in his or her estate planning documents. This result can be avoided if the power of appointment is drafted to specifically negate the power if the trust acquires an insurance policy on the life of the power holder (or insured).[16]

- **Surviving spouse should not be given a five-and-five power**

  A five-and-five power arises when a donee fails to exercise a Crummey withdrawal power, and in effect makes a gift to the other trust beneficiaries of that amount in excess of $5,000 or 5 percent of the contributed trust property.

Can the surviving spouse be trustee of the credit shelter trust?

In some cases, the surviving spouse wants to be a trustee of the credit shelter trust. When the credit shelter trust holds a life insurance policy on that spouse as it will with Wait-and-See Estate Planning, the surviving spouse should never be the sole trustee. The risk is too great that the incidents of ownership held by the insured spouse in a fiduciary capacity would cause inclusion of the proceeds in the spouse's estate.[17]

If the trust is drafted properly, it is possible to name the spouse as a co-trustee of the credit shelter trust when using Wait-and-See Estate Planning. The credit shelter trust could be drafted to exclude the surviving spouse from trustee decisions on distributing income or principal to that spouse. The trust could also prohibit the spouse from exercising the trustees' incidents of ownership in the policy, either alone or in conjunction with the other trustees.[18] The impact of IRC §2036(a) should also be considered if the spouse serves as co-trustee.

Two-policy approach continued

Can the surviving spouse be the personal representative of the deceased spouse's estate?

Often the surviving spouse is named personal representative or executor for the estate of the deceased spouse. With Wait-and-See Estate Planning, the documents will direct the personal representative or trustee to transfer the policy insuring the surviving spouse to the credit shelter trust. If the surviving spouse acting as personal representative transfers that policy to the credit shelter trust, the IRS may argue that IRC §2035 applies to include the death benefit in the insured's estate. IRC §2035, **"the three-year rule,"** applies when the insured transfers the policy and dies within three years. The question here is whether the rule applies when the insured, who is acting in a fiduciary capacity, transfers the policy.

There are some cases and a ruling holding that under certain circumstances, incidents of ownership held by an insured in a fiduciary capacity may cause the proceeds to be included in the estate under IRC §2042.[19] The logic of those cases could be extended to apply to the situations where the insured in a fiduciary capacity transfers the policy and dies within three years to cause this inclusion under IRC §2035. Thus, to avoid a potential three-year problem, the effect of IRC §2035 should be considered before naming the spouse as the personal representative of the estate. Instead, a special personal representative should be appointed for purposes of transferring the policy.

Withdrawal from cash surrender value

The personal representative of the first-to-die spouse's estate is usually given the discretion to withdraw excess cash value from the policy on the survivor before transferring it into the insurance portion of trust using the applicable exclusion amount. However, the personal representative of the estate of the first-to-die spouse is often the surviving spouse who is also the insured on the policy. This creates a potential problem because the right to withdraw cash from a life insurance policy is generally considered an incident of ownership in the policy. This means that, as personal representative of the estate, the surviving spouse would have an incident of ownership in the policy until transferring it into trust using the applicable exclusion amount.

If he or she died thereafter, but within three years of the transfer to the credit shelter trust, then the proceeds could be brought back into the estate of the second-to-die under the three-year rule. This problem can be avoided, without giving up access to the cash value, by appointing someone other than the spouse to serve as a special personal representative to control all life insurance policies insuring the surviving spouse.

What if the surviving spouse will never make gifts to the credit shelter trust?

If it is certain the surviving spouse would never make gifts to the credit shelter trust and if the surviving spouse wishes to receive income only from the credit shelter trust, language similar to that shown as Exhibit V (under the two-policy approach) which specifically limits spousal rights to principal could be incorporated in the credit shelter trust to avoid an incident of ownership.

Two-policy approach continued

Is the reciprocal trust doctrine applicable in Wait-and-See Estate Planning?

The reciprocal trust doctrine can trigger inclusion of trust assets in the taxable estate under IRC §2036(a). The doctrine applies when individual A transfers property during life to a trust and provides B with a life income interest, and B likewise transfers property to a trust providing A with a life income. Under a literal interpretation of IRC §2036(a), the trust created by B would not be included in A's estate even though A had a retained interest in B's trust. Similarly, the trust created by A would not be included in B's estate.

The courts apply the reciprocal trust doctrine to "uncross" the arrangement with the two trusts described in the hypothetical above. The courts deem A to be treated as a grantor of the trust B established, and B is treated as a grantor of the trust A established. A is then a grantor of the trust in which A had a retained life interest, and B is a grantor of the trust in which B had a retained interest. Upon A's death, the trust B established is included in A's taxable estate, and upon B's death, the trust A established is included in B's taxable estate.[20]

New policies. The reciprocal trust doctrine does not apply to Wait-and-See Estate Planning. The doctrine includes transfers of property in the taxable estate under IRC §2036(a) when there are mutual lifetime transfers of an entire interest and receipt of partial (life income) interests only. With the Wait-and-See Estate Planning, in most cases there are no lifetime transfers to a trust or otherwise. Rather, the spouses simply purchase life insurance policies on each other. The credit shelter trusts that each spouse establishes are unfunded testamentary trusts, which are inoperable until the death of the testator (or grantor for a revocable living trust). Thus, there is no lifetime transfer (actual or deemed) that could bring the Wait-and-See Estate Planning within the parameters of the reciprocal trust doctrine.

Existing policies. If the spouses' existing policies are transferred to each other, mutual lifetime transfers occur. However, the reciprocal trust doctrine involves a situation where mutual transfers of entire interests have occurred with receipt of life income interests only — an attempt to avoid estate taxation on the property transferred and received.[21] Unlike the transfers invoking the reciprocal trust doctrine, the Wait-and-See Estate Planning involves the transfer and receipt of the entire interests in the policies. The entire cash value of the policy is included in the estate of the recipient spouse who dies first. Thus, the proper amount has been subject to estate taxation and the reciprocal trust doctrine does not apply to the Wait-and-See Estate Planning.

Does the three-year rule apply to policy design?

If the insured on a life insurance policy transfers the policy and dies within three years of the transfer, the death benefit is included in the insured's taxable estate.[22] As explained below, the three-year rule does not apply to the Wait-and-See Estate Planning at the first or second death when new policies are purchased with the two-policy approach. Arguably, the three-year rule is inapplicable when existing policies are also transferred.

Two-policy approach continued

New policies. In most cases, with the Wait-and-See Estate Planning, each spouse will purchase a new insurance policy on the other's life. Consequently, there is no transfer by the insured to trigger a three-year rule problem at the first death. After the first death, the policy insuring the surviving spouse previously owned by the deceased spouse passes to the credit shelter trust. Since the transferor is the estate of the non-insured spouse and not the insured, the three-year rule is again inapplicable.

Existing policies. If instead of purchasing new policies, the insured makes a gift of an existing policy to the non-insured spouse, the three-year rule may apply if death occurs within three years of the transfer.[23] However, an exception to the three-year rule is made for "any bona fide sale for an adequate and full consideration."[24] This exception could apply when existing policies are transferred to establish Wait-and-See Estate Planning, which could avoid problems with the three-year rule. Each spouse could transfer "adequate consideration" to the other spouse for the policy received in the transfer. The question is, what is adequate consideration? The Code and Regulations do not define adequate consideration for this specific purpose.

For gift and income tax purposes, the regulations define the value of a life insurance contract as established through the sale of the particular contract or comparable contracts by the company.[25] Generally, the value is the fair market value often expressed as the "interpolated terminal reserve less unearned premium," or approximately the cash surrender value, unless the policy is a single premium policy.[26] If the policy is a single premium policy, then the value is the single premium the company would charge for a comparable contract at the time of the transfer. In most cases, the life insurance policies funding the Wait-and-See Estate Planning are annual premium contracts.

When existing policies are transferred and cash values in the policies are equivalent, the exchange is arguably for adequate consideration. If cash values are not equivalent, the spouse initially owning the policy with the lesser cash value could add cash to the transaction so the total amounts transferred are equal and are therefore adequate consideration. This exchange should invoke the exception and avoid the consequences of the three-year rule.

Although the cash surrender value is traditionally considered the appropriate value of a life insurance contract, in Technical Advice Memorandum (TAM) 8806004, the IRS took the position that the cash value was inadequate consideration to avoid the consequences of the three-year rule. According to the TAM, the consideration must be equal to the value at which such property would be included in the gross estate had it been retained by the decedent.[27] The conclusions in TAM 8806004 are troublesome. Valuation of life insurance policies are established both in the income and gift tax areas. The question of adequate consideration for the transfer of a life insurance policy is confused in this TAM with the valuation of a policy in the insured's estate if no transfer had occurred.

Assume that the cash value is the only consideration furnished and the IRS finds it inadequate. If the death of one spouse occurs within three years of the initial transfer, the policy proceeds from the transferred policy would be included in the deceased spouse's estate. Because the non-insured spouse is the beneficiary of the policy, the unlimited marital deduction would avoid estate taxes on the proceeds at the first death.[28]

Two-policy approach continued

The survivor's policy transfers to the trust using the applicable exclusion amount available after the first death. If the surviving spouse was the original owner of the policy and initially transferred the policy to the deceased spouse with inadequate consideration, the three-year rule would continue to run after the first death when the survivor's policy is subsequently transferred to the trust using the applicable exclusion amount.[29] Therefore, if the second spouse dies within three years of the initial transfer, the death benefit will be included in the estate of the second-to-die. Since that death benefit is paid to the trust using the applicable exclusion amount, the proceeds do not qualify for the marital deduction and instead would utilize some of the applicable exclusion amount of the second-to-die.

Estate inclusion at the second death results only if both spouses die within three years of establishing Wait-and-See Estate Planning and if existing policies were transferred to the non-insured spouse initially. The IRS may challenge the adequacy of the consideration that is paid for the policy. If the cash values and additional monies transferred are equivalent, there is an argument that the adequate consideration exception applies to avoid the impact of the three-year rule. If not, it will be deemed a transfer of the policy, rather than a sale for full and adequate consideration.

What is the "transfer for value" rule and are there transfer-for-value issues?

The transfer for value rule states that "If a life insurance policy is transferred for valuable consideration, the death benefit in excess of post-transfer premiums paid is income taxable to the beneficiary, unless an exception applies."[30] Exceptions to this transfer-for-value rule apply if the transfer is to the insured, to a corporation of which the insured is an officer or shareholder, to a partnership of which the insured is a partner, or to a partner of the insured.[31] Another exception to the rule is for those transfers where the transferee takes "with reference to the transferor's cost basis."[32]

With the Wait-and-See Estate Planning, in most cases, each spouse purchases a new policy insuring the other spouse. When new policies are purchased, there is no "transfer" from one spouse to the other and therefore, no transfer-for-value problem. In other cases, each spouse may already own a policy insuring that respective spouse. To establish Wait-and-See Estate Planning in those cases, each spouse changes ownership on the policy to the other spouse. This change of ownership is a "transfer" and the mutual exchanges arguably could constitute "valuable consideration" to fall within the rule. Although this transaction between spouses is a transfer-for-value, IRC §1041 controls and the carry over basis exception applies. Under this section, no gain or loss is recognized on a transfer of property between spouses. The transferee spouse takes a carryover basis in the property received from the transferor.[33] Therefore, the consequences of the transfer-for-value rule are avoided when existing policies are transferred between spouses because of the carryover basis exception.

Two-policy approach continued

How to avoid inclusion of death proceeds from first-to-die in estate of the surviving spouse?

With the two-policy approach, after one spouse dies, the surviving spouse receives the death benefit from the policy insuring the deceased. To the extent those proceeds are not consumed before the second death, the balance of the proceeds are owned by and included in the taxable estate of the second spouse to die.[34]

1. Use for income replacement. After the first death, the surviving spouse may use part or all of any proceeds received to replace income lost after the first death. In addition, the surviving spouse could also transfer part (or all) of the proceeds to the credit shelter trust to fund the other life insurance policy, or make annual exclusion gifts directly to children or others to reduce the impact of this inclusion.

2. Use of a Charitable Remainder Trust (CRT). Another option for the surviving spouse is to transfer the proceeds to a CRT. The spouse would receive a current income tax deduction for the value of the remainder interest while retaining an income interest in the trust for a term of years or life. A properly established CRT would likely avoid estate tax in the spouse's estate.

3. Transfer both policies to an ILIT. If inclusion of a deceased spouse's assets into the estate of the surviving spouse is projected to become a potential problem, both spouses could transfer the policies to an ILIT before the first death.

Watch out for the Goodman Rule

Changing the primary beneficiary on the policy to a child or someone other than the owner/spouse is generally not a good solution to the estate inclusion problem because it triggers the Goodman Rule. Under the Goodman Rule (or the Goodman Triangle) when an individual other than the insured owns a life insurance policy payable to a third-party beneficiary, the owner of the policy makes a taxable gift to the beneficiary of the death benefit when the insured dies. When one spouse owns a policy insuring the other spouse and the beneficiary is the children, the owner-spouse makes a taxable gift of the death benefit to the children when the insured spouse dies.[35] Most clients would prefer to avoid this result. With the Wait-and-See Estate Planning, the non-insured spouse is named both the owner and beneficiary of the policy that insures the other spouse.

What if both spouses die simultaneously?

With the cross-ownership arrangement, if both spouses die simultaneously, a question arises as to what is included in each spouse's taxable estate — the cash surrender value or the death benefit. A ruling on this issue states that under those circumstances, only the cash value of the policy owned by the decedent is included in the deceased spouse's estate.[36] The ruling relies upon the presumptions under the respective state's Uniform Simultaneous Death Act (USDA), which assumes that the insured survives the death of the owner/beneficiary.[37] Most states have adopted the USDA. Practitioners should check local law to determine if the presumption applies.

Handling community property issues

Clients in community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin) can effectively establish Wait-and-See Estate Planning as long as the community property issues are handled properly. The general community property rule applicable to life insurance acquired during marriage with community funds is that the policy is presumed to be community property even if only one of the spouses is designated policy owner.[38]

When a life insurance policy is community property, it is recognized for federal tax purposes as belonging one-half to each spouse. If the community property life insurance policy insures one of the community spouses and the insured spouse dies, one-half of the policy death benefit is included in the deceased spouse's estate.[39] If the policy is community property and the non-insured spouse dies, one-half of the cash surrender value of the community property is included in the non-insured spouse's estate.[40]

With the two-policy approach for Wait-and-See Estate Planning, the life insurance policies are purchased on a cross-ownership basis. Even though the policy owner's spouse is indicated as owner of each policy, when community funds are used to purchase the policy, the policy is considered community property. If the policies are considered community property and are not effectively changed to separate property, when one spouse dies, one-half of the death benefit on the policy owned by the survivor would be included in the surviving spouse's estate.[41] Because the death benefit is paid to the spouse, no federal estate tax would be due because of the unlimited marital deduction.[42]

To avoid any estate inclusion or gift tax ramifications as a rule, the policies should be separate property. Each spouse should sever his or her respective community interest in the policy insuring that spouse. The proper way to sever that relationship is based on the respective state's community property laws. Generally, that involves documentation signed by both spouses that the policy is to be considered the separate property of one spouse. It may also involve payment of future premiums from a separate checking account.

The other policy owned by the deceased is transferred to the deceased spouse's credit shelter trust after the first death. If the policy was not effectively changed from community property to separate property, only one-half of its cash value is included in the deceased spouse's estate.[43] Under community property rules, the surviving spouse owns the other one-half interest in that policy. Thus, when the policy is transferred to the credit shelter trust, the surviving spouse is deemed to have made a gift of the other one-half of the cash value to the credit shelter trust. Unless there are Crummey provisions in the trust, the entire gift would utilize some or all of the surviving spouse's applicable exclusion amount. In addition, if the surviving spouse is also a beneficiary of the credit shelter trust, the transfer of the community policy to the credit shelter trust coupled with the spouse's rights as a beneficiary could trigger inclusion of the death benefit in the taxable estate of the second-to-die.[44]

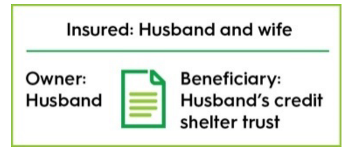
To avoid any estate inclusion or gift tax ramifications

As a rule, the policies should be separate property. Each spouse should sever his or her respective community interest in the policy insuring that spouse.

One-policy approach

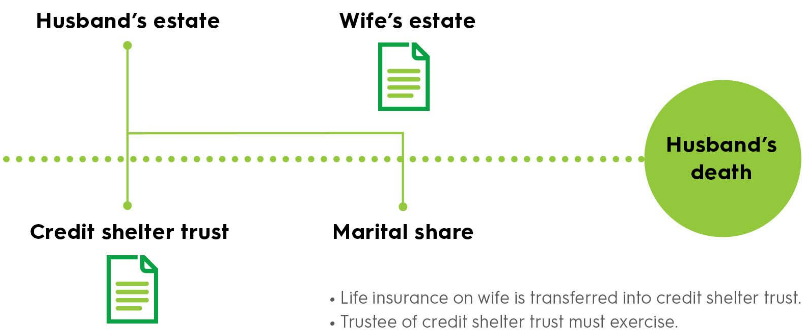
Set-up

With this approach, the mortality inferior spouse (typically, the husband) applies for and personally owns a second-to-die life insurance policy. The policy owner's credit shelter trust should be named as primary beneficiary of the policy.

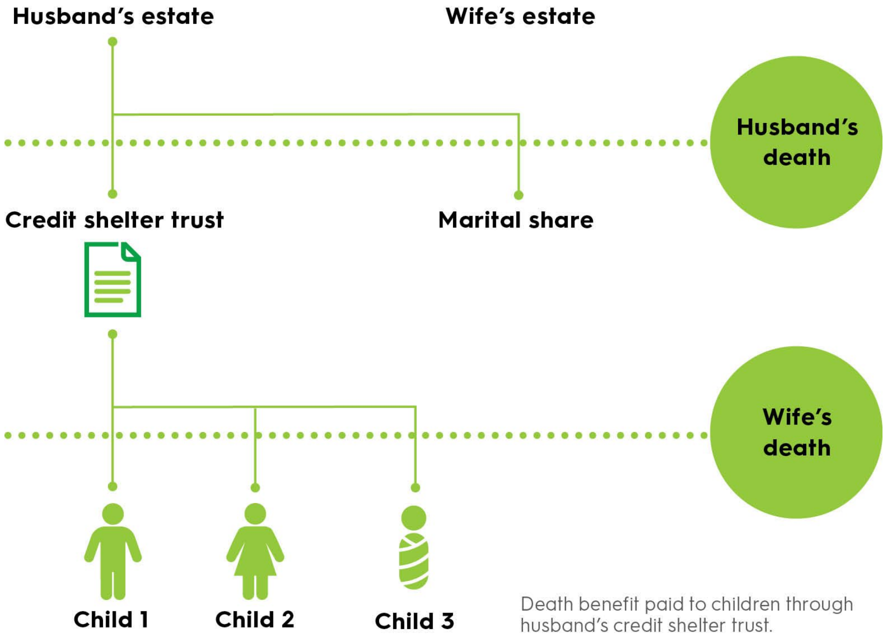


If the policy owner dies first

If the policy owner dies first, the second-to-die life insurance policy passes through the deceased spouse's estate to a special personal representative who then transfers it to the credit shelter trust. Please note that, if the couple is using wills, the surviving spouse will need to get Letters Testamentary in order to show authorization to complete a change of ownership to the credit shelter trust. If, however, the couple's estate is managed by Revocable Trust(s), then this is handled within the trust's administrative powers and the Letters Testamentary are unnecessary. Estate taxes may be payable to the extent the cash value of the policy passing to the trust exceeds the applicable exclusion amount then available. The special personal representative, however, may remove some cash surrender value before transferring it to the credit shelter trust to avoid incurring estate taxes.[45] At the subsequent death of the surviving spouse, the death benefit is received by the trust entirely free from both estate and income taxes.



One-policy approach continued



Death benefit paid to children through husband's credit shelter trust.

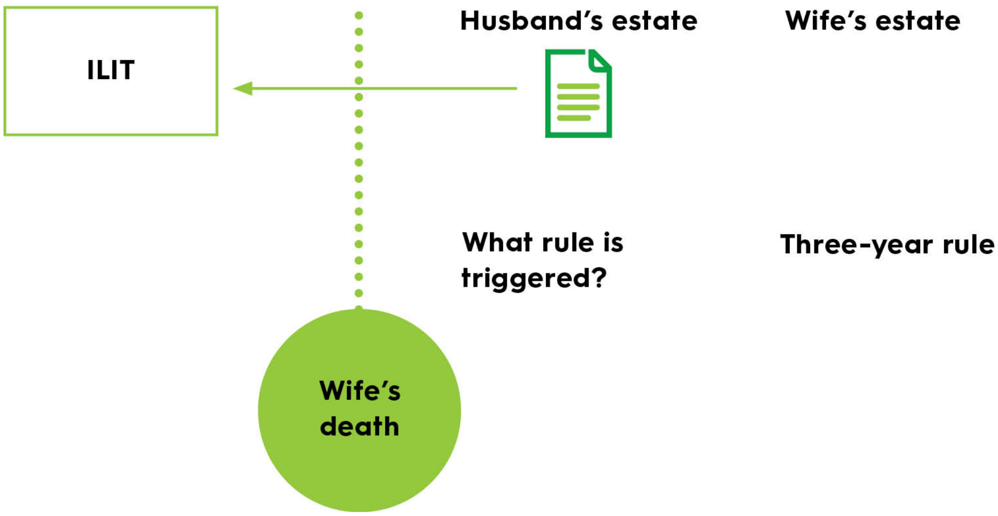
If the cash value of the policy passing to the credit shelter trust exceeds the applicable exclusion amount, federal estate taxes will be due at the first death. One way to avoid this problem is to monitor the values so that the total cash value in a policy never exceeds the applicable exclusion amount. With the one-policy approach, your clients may take withdrawals from the policy if its cash value exceeds the applicable exclusion amount. Another option is to initially purchase an amount of insurance so that the projected cash value of the policy would never exceed the applicable exclusion amount. When the special personal representative receives the policy after the first death, the special personal representative could take a cash withdrawal from the policy to reduce the cash surrender value before transferring it to the credit shelter trust.

If the non-policy owner dies first

If the policy owner's spouse dies first, the policy owner may need to transfer the second-to-die policy to an ILIT in order to avoid estate taxation. This transfer could cause gift taxation if the policy cash value exceeds the applicable exclusion amount plus any available annual exclusions. If the policy owner dies within three years of the transfer and gifts the policy to the ILIT, the death proceeds would be included in his estate under the three-year rule. However, the trustee can eliminate this concern by purchasing an optional policy rider that will provide the option to purchase four years of term coverage without proving insurability. This amount can be used to offset the additional estate taxes generated by the inclusion of the death benefit due to the application of the three-year rule. The option to buy the term insurance is activated by the death of the policy owner's spouse.

One-policy approach continued

One-policy approach – non-owner (wife) dies first



Both spouses are alive and they both desire to transfer the policy

If both spouses survive until the early post-retirement years (e.g., ages 65-70), prudent estate planning suggests that the policy should be transferred to an ILIT so death proceeds are estate tax free. This transfer could generate some gift tax depending on the policy values at the time of the transfer. Again, provided there is a timely transfer to the trust, the death of the policy owner's spouse can result in term coverage, which can offset any additional estate taxes generated due to the application of the three-year rule.[46]

Common questions with the one-policy approach

What are the methods of continuing paying premiums on the policy in the credit shelter trust?

After the policy insuring the survivor is transferred to the credit shelter trust, the trustee of the trust may need to pay further premiums due on the policy.

Making premium payments with the one-policy approach is similar to doing so with the two-policy method as discussed above, except there is no survivorship agreement and there is no first death benefit unless a first-to-die or single-life term rider is purchased.

1. Trustee can use other assets in credit shelter trust. If the cash value of the life insurance policy transferred to the credit shelter trust is less than the applicable exclusion amount, the trust can contain other assets so the total of all assets initially funding the trust is equal to the applicable exclusion amount. The trustee could sell those other assets and use the proceeds to meet the premium payments as long as the trust allows it.

One-policy approach continued

2. Spouse can purchase assets from credit shelter trust. The surviving spouse could use those funds to buy assets from the credit shelter trust.[47] The spouse would use the cash from his or her estate to pay the credit shelter trust for certain property in the trust which would then be transferred to the spouse. The credit shelter trust would receive the cash necessary to pay the premiums, and the spouse would obtain the assets.

3. Spouse can gift premiums to credit shelter trust. The surviving spouse could also make gifts to the credit shelter trust to help pay the future premiums. The surviving spouse may be considered a grantor of the trust when such gifts are made. If the surviving spouse is also an income or principal beneficiary of the credit shelter trust, any of those retained rights together with the grantor status could trigger inclusion of the entire credit shelter trust (including the life insurance death benefit) in the taxable estate of the second spouse to die under IRC §2036(a). One of the purposes of Wait-and-See Estate Planning is to avoid federal estate tax on the proceeds paid at the second death.

To avoid estate inclusion when the spouse is the donor of premium dollars, the credit shelter trust should be designed without any income or other rights for the surviving spouse.

4. Spouse can disclaim the income interest from credit shelter trust. Spouse can disclaim the income interest from the credit shelter trust. Another option for the surviving spouse who will make gifts to the credit shelter trust is to disclaim the income interest from the credit shelter trust, although that disclaimer may or may not effectively preclude the finding of a retained interest. If the spouse disclaims a life estate in the credit shelter trust, the value of the life estate is considered a gift from the spouse to the remainder person.[48]

5. The spouse could make loans to provide cash to the credit shelter trust.[5] The death benefit the spouse receives from the policy on the deceased spouse could provide the spouse the cash necessary to lend to the credit shelter trust. Loans to the credit shelter trust could trigger the interest-free loan rules if the loan interest rate is below market.[6] However, if the spouse forgave the loan payments, the forgiveness of the debt would be considered a gift to the trust by the spouse.

Is the reciprocal trust doctrine applicable in Wait-and-See Estate Planning?

The reciprocal trust doctrine can trigger inclusion of trust assets in the taxable estate under IRC 2036(a). The doctrine applies when individual A transfers property during life to a trust and provides B with a life income interest, and B likewise transfers property to a trust, providing A with a life income interest. Under a literal interpretation of 2036(a), the trust created by B would not be included in A's estate even though A had a retained interest in B's trust. Similarly, the trust created by A would not be included in B's estate.

The courts apply the reciprocal trust doctrine to "uncross" the arrangement with the two trusts described in the hypothetical above. The courts deem A to be treated as a grantor of the trust B established, and B is treated as a grantor of the trust A established. A is then a grantor of the trust in which A had a retained life interest, and B is a grantor of the trust in which B had a retained life interest. Upon A's death, the trust B established is included in A's taxable estate, and upon B's death, the trust A established is included in B's taxable estate.[49]

One-policy approach continued

The reciprocal trust doctrine does not apply to Wait-and-See Estate Planning when a second-to-die policy is being used because there is only one policy; there are no mutual lifetime transfers.

Does the three-year rule apply?

If the insured on a life insurance policy transfers the policy and dies within three years of the transfer, the death benefit is included in the insured's taxable estate.[50] Thus, the three-year rule can become an issue when using the one-policy approach.

Three-year rule inapplicable if policy owner dies first. If a second-to-die policy is used to fund a credit shelter trust, the spouse most likely to die first is named the sole owner of the policy on the husband and wife. Presuming that the husband does die first, then the policy that he owned will be transferred by the special personal representative into his trust using the applicable exclusion amount, and thereafter it would be excluded from the surviving spouse's estate. It is excluded from the wife's estate because, although she is the sole remaining insured, she never had incidents of ownership in the policy. The husband was the sole owner prior to his death. That means there is no three-year rule upon the transfer. If she were to die a day later, the entire survivorship proceeds would be excluded from her estate.

Three-year rule may be applicable when policy owner's spouse dies first. A problem can arise if the policy owner's spouse dies first. If that occurs, then the surviving spouse is also the policy owner. This means that the surviving spouse will have to make a gift of the policy to an inter vivos ILIT. This triggers a three-year rule problem. To be certain that the ILIT funded with a policy does not suffer the consequences of estate inclusion under the three-year rule, the trustee may exercise a rider attached to the policy that would provide the option to purchase four years of term coverage. It is important to determine at the point of purchasing the life insurance policy that will fund the ILIT whether the policy offers such an agreement.

This agreement provides that in the event the policy owner's spouse dies first, then four years of term insurance can be purchased on the surviving spouse in the amount sufficient to cover the additional estate taxes caused by the three-year rule. This amount will cover an estate tax rate as high as fifty-five percent (55%) if both the original face amount and the term insurance are brought back into the taxable estate under the three-year rule.

Is there a transfer-for-value issue?

If a life insurance policy is transferred for valuable consideration, the death benefit in excess of post-transfer premiums paid is income taxable to the beneficiary unless an exception applies.[51] Exceptions to this transfer-for-value rule apply if the transfer is to the insured, to a corporation of which the insured is an officer or shareholder, to a partnership of which the insured is a partner, or to a partner of the insured.[52] Another exception to the rule is for those transfers where the transferee takes with reference to the transferors' basis.[53]

One-policy approach continued

When using the one-policy approach, you are usually purchasing a new policy insuring both spouses' lives. Because there is no "transfer" involved, there is no transfer-for-value problem. If an existing policy is being used, a change of ownership on the policy may be needed to allow the spouse who is most likely to die first to be the owner. However, in this situation, there is no "mutual exchange" and consequently no "valuable consideration" to have it fall within the rule. Even if valuable consideration was found to exist, no gain or loss would be recognized on the transfer between spouses and we would again fall within the carryover basis exception under the transfer-for-value rule.

What if both spouses die simultaneously?

What will be included in each spouse's taxable estate if they should die simultaneously? If both spouses die simultaneously or "under circumstances that make it impossible to determine the order of their deaths," additional term insurance provided under a policy rider to address the IRS's three-year look-back policy will not be paid. This additional coverage, however, is not necessary because most of the death benefit will not be included in the estate under these circumstances with proper planning. To avoid estate inclusion when there is a simultaneous death, a provision in the owner spouse's estate planning documents should indicate that if there is a simultaneous death, the owner spouse is presumed to have died first. Through the use of such a provision, only the policy's cash value will be included in the owner spouse's estate and the second-to-die death benefit will not be taxed.

How to avoid inclusion of death proceeds from first-to-die in estate of the surviving spouse?

With the one "second-to-die" policy, the proceeds are not paid out until the second death. In most cases, inclusion of the death proceeds from the first-to-die in the estate of the second-to-die is not an issue because there is no first-to-die death benefit with this funding approach.

In some cases, however, there may be a single-life term rider insuring a spouse (or two riders – one on each spouse) on the life insurance policy. When a spouse insured by a single-life term rider dies, proceeds are paid to the beneficiary. The beneficiary should be the surviving spouse so that no federal estate tax will be due because of the unlimited marital deduction.

If one spouse dies and then the insured on the single-life term rider dies, the secondary (contingent) beneficiary of the rider should be either the credit shelter trust in the will of the spouse who died first or an irrevocable trust if the policy already was transferred to an irrevocable trust. If the policy was already transferred to an irrevocable trust, the death benefit would not be included in the estate unless death occurs within three years. In order to avoid inclusion of the death benefit from the first-to-die in the estate of the second-to-die, when using a second to die policy, the issues and options discussed above should be considered.

One-policy approach continued

Special personal representative

With Wait-and-See Estate Planning, the personal representative of the first to die spouse's estate is usually given the discretion to withdraw excess cash value from the policy on the survivor before transferring it into the insurance portion of the trust using the applicable exclusion amount. However, the personal representative of the estate of the first-to-die spouse is often the surviving spouse, who is also the insured on the policy. This creates a potential problem because the right to withdraw cash from a life insurance policy is generally considered an incident of ownership in the policy. This means, as personal representative of the estate, the surviving spouse would have an incident of ownership in the policy until transferring it into trust using the applicable exclusion amount. If he or she died thereafter, but within three years of the transfer to the credit shelter trust, then the proceeds could be brought back into the estate of the second-to-die under the three-year rule. This problem can be avoided, without giving up access to the cash value, by appointing someone other than the spouse to serve as a special personal representative to control all life insurance policies insuring the surviving spouse.

Handling community property issues

Clients in community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin) can effectively establish Wait-and-See Estate Planning as long as the community property issues are handled properly. The general community property rule applicable to life insurance acquired during marriage with community funds is that the policy is presumed to be community property even if only one of the spouses is designated policy owner.[54] When a life insurance policy is community property, it is recognized for federal tax purposes as belonging one-half to the husband and one-half to the wife. If the community property life insurance policy insures one of the community spouses and the insured spouse dies, one-half of the policy is included in the deceased spouse's estate.[55] If the policy is community property and the non-insured spouse dies, one-half of the cash surrender value of the community property is included in the non-insured spouse's estate.[56]

Under the one-policy approach, the life insurance policy is owned by one spouse but both spouses are insured. Therefore, an insured spouse is owner of the policy. When community funds are used to purchase the policy, the policy is considered community property. If the policy is considered community property and is not effectively changed to separate property, one-half of the death benefit of the policy would be included in the last surviving spouse's estate if the policy owner spouse dies first and the other spouse dies within three years, or if they both die simultaneously.

To avoid any estate inclusion or gift tax ramifications, as a rule, the second-to-die policy should be separate property. The policy owner's spouse should sever his or her respective community interest in the policy. The proper way to sever that relationship is based on the respective state's community property laws. Generally that involves a writing signed by the policy owner's spouse that the policy is to be considered the separate property of the owner spouse. It may also involve payment of future premiums from a separate checking account.

One-policy approach continued

Whether the policy owner or the policy owner's spouse dies first, the policy will be transferred to the deceased policy owner's credit shelter trust or an irrevocable trust, respectively. If the policy was not effectively changed from community property to separate property, one-half of its cash value is included in the deceased spouse's estate. Under community property rules, the surviving spouse owns the other one-half interest in that policy. Thus, when the policy is transferred to the credit shelter trust or irrevocable trust, the surviving spouse is deemed to have made a gift of the other one-half of the cash value to that trust. Unless there are Crummey provisions in the trust, the entire gift would utilize some or all of the surviving spouse's applicable exclusion amount. In addition, if the surviving spouse is also a beneficiary of the credit shelter trust, the transfer of the community property to the trust coupled with the spouse's rights as a beneficiary could trigger inclusion of the death benefit in the taxable estate of the second-to-die.

To avoid these results, the policy should be properly changed to separate property. Check with local law in the respective community property state to determine how to sever the community ownership.

Under the one-policy approach,

the life insurance policy is owned by one spouse but both spouses are insured. Therefore, an insured spouse is owner of the policy.

Conclusion

Wait-and-See Estate Planning is an attractive alternative for clients who have objections to Irrevocable Life Insurance Trusts. It is simple to establish and avoids the complexities associated with irrevocable trusts. The benefits of cash value access, increased flexibility and control, decreased costs and simplicity could potentially outweigh risks as addressed in this Foreword to Counsel. Wait-and-See Estate Planning should be evaluated as an option whenever an Irrevocable Life Insurance Trust is considered.

For more information on this approach, see the specimen on the “Steps to establish a Wait-and-See Estate Plan,” an “Explanation of the selected specimen credit shelter trust provisions,” and “Selected specimen credit shelter trust provisions” for the one- and two-policy approaches.

Wait-and-See Estate Planning is an attractive alternative for clients who have objections to Irrevocable Life Insurance Trusts. It is simple to establish and avoids the complexities associated with irrevocable trusts.

Two-policy approach

Steps to establish two-policy Wait-and-See Estate Planning

Step 1:

Determine the estimated estate tax obligation at the second death. Determine the amount of cash needed at the first death, if any. The financial professional should then generate the appropriate life insurance product illustrations.

Step 2:

Each spouse is named owner and primary beneficiary of the life insurance policy insuring the other spouse. Husband is named owner and beneficiary of the life insurance policy insuring the wife. Wife is named owner and beneficiary of the life insurance policy insuring the husband.

Step 3:

Attorney drafts mirror-image estate planning documents (wills or revocable trusts) for husband and wife. The estate planning documents will maximize use of the applicable exclusion amount and marital deduction by creating a trust using the applicable exclusion amount (credit shelter trust) and marital deduction provisions after the first death. The documents also include a provision designating a special personal representative to transfer the life insurance policy after one spouse dies.

Selected specimen credit shelter trust provisions

Exhibit I – Special Personal Representative

Explanation of language

With the Wait-and-See Estate Planning, husband owns a single-life policy insuring the wife, and wife owns a single-life policy insuring the husband. After one spouse dies, the policy insuring the survivor owned by the deceased spouse passes into the credit shelter trust in the decedent's estate planning documents. The terms should designate that this policy would pass to the credit shelter trust.

Sample Provision

I appoint ______________________________ (someone other than spouse) as my Special Personal Representative. My Special Personal Representative shall have the right to exercise all rights in any life insurance policies insuring my surviving spouse, including the right to withdraw cash value from any policy on the life of my spouse.

I direct that the Special Personal Representative allocate any life insurance policy issued by Minnesota Life/Securian Life, specifically policy number ______________ , insuring my [spouse], which I own on my death to the Family Trust [or other name of credit shelter trust] and transfer it to said trust upon my death. I direct that the Special Personal Representative transfer any monies received from said policy to my Family Trust [or other name for credit shelter trust].

Exhibit II - Authorizing trustee to invest in life insurance and to exercise policy rights

Explanation of language

The trust language should allow for investments of life insurance and should give the trustee the right to exercise any ownership rights under the insurance contract. These rights are generally included as standard language in the trust document section designating trustee rights.

The special personal representative of the will transfers the policy insuring the survivor to the credit shelter trust. Before the transfer, the special personal representative may withdraw cash from the policy if necessary.

Sample provision

The Trustee is authorized but not required to purchase or invest in life insurance policies on the life of, my spouse [or possibly add: "and my children"]. The Trustee has all rights of ownership in any policies purchased, including the right to increase the face amount pursuant to any agreement on any policy transferred to this trust.

Selected specimen credit shelter trust provisions continued

Exhibit III - Allowing trustee to sell assets in “powers of trustee”

Explanation of language

The trustee may want to make a cash deposit into the policy to reduce the future costs or completely eliminate them. The language of the credit shelter trust should allow the trustee to sell other assets in the trust to convert them to cash for these payments.

Sample provision

“To sell, exchange or otherwise dispose of realty and personal property, publicly or privately, wholly or partly on credit or for any consideration, including stocks, bonds or other corporate obligations, and grant options for the purchase, exchange or other disposition of any such property.”

Exhibit IV - If surviving spouse will make gifts to credit shelter

Explanation of language

When further premiums are due on the survivor’s larger policy, the surviving spouse may wish to make gifts to the credit shelter trust to pay those premiums. If it is planned that the surviving spouse will make gifts to the credit shelter trust, to avoid an IRC § 2036(a) problem, do not give the spouse any rights to the credit shelter trust. Also, if the spouse would make gifts to the credit shelter trust, include a Crummey provision in the credit shelter trust if the goal is to qualify these gifts for the annual exclusion. Specimen credit shelter trust language if the spouse will make gifts to the credit shelter trust is included as:

Sample provisions

Typically located at the beginning of the “Family Trust” (credit shelter trust) section, which appears after the allocation to the “Marital Trust”:

“The balance of my estate, including any life insurance policy issued by Minnesota Life/Securian Life, specifically policy number ___ , shall be set aside as a separate trust. The Special Personal Representative may remove cash from the policy to reduce the cash surrender value before transferring the policy into the trust. The trust shall be designated the “Family Trust” [or other name of credit shelter trust] and shall be held and disposed of as follows:

A. I direct that the Family Trust make no distributions to my surviving spouse if [he or she] survives me. I have otherwise provided for my spouse by outright dispositions and by provisions in the Marital Trust.

B. While my spouse is alive, funds from this trust may not be used to meet any legal obligation of my spouse [or: her or him] to support a child of [hers or his].

C. Continue with standard credit shelter trust provisions applicable to distributions to children after the surviving spouse dies.

Selected specimen credit shelter trust provisions continued

In credit shelter trust subsection describing “Trust Additions”:

“Any person may transfer any real or personal property to this trust after my death by transferring such property to the Trustee by gift, deed, assignment, bequest, or devise.”

In credit shelter trust subsection, “Beneficiaries’ Rights of Withdrawal,” include these Crummey provisions:

“During each calendar year, when a lifetime gift is made to this Trust by anyone who survives me, each living child of mine shall have the right, following any contribution by the survivor to the Trust, to make withdrawals from the Trust in accordance with the following provisions:

A. Any then-living child may withdraw an amount determined by dividing the amount of the contribution by the number of my then-living children, provided, however, that the aggregate amount of such withdrawals by any child of mine during any calendar year shall be limited to the annual exclusion from gift tax pursuant to IRC Section 2503 as in effect for that year.

OR

Any then-living child of mine may withdraw an amount determined by dividing the amount of the contribution by the number of my then-living children, provided, however, that the aggregate amount of such withdrawals by any child of mine during any calendar year shall be limited to the lesser of (1) the largest amount which constitutes the lapse of a nontaxable power of appointment under IRC Sections 2041 and 2514 as in effect for that year or (2) the annual exclusion from gift tax pursuant to IRC Section 2503 as in effect for that year.

One of these two alternative paragraphs may be chosen to create the children’s withdrawal rights which qualify the contribution as a present interest gift qualifying for the gift tax annual exclusion as adjusted for inflation as specified in IRC Section 2503(b)(2). The first alternative allows each child to withdraw his percentage of the net contribution up to the [$19,000] limit currently provided by the gift tax annual exclusion. This alternative runs the risk that if the beneficiary does not exercise the power, a taxable gift will be made to the other trust beneficiaries to the extent of any withdrawal rights in excess of $5,000 or 5 percent of the trust.

The second alternative eliminates this problem. It limits the withdrawal power to the lesser of $10,000 or the “five-and-five power.” However, this creates another problem. To the extent a beneficiary’s portion of the net trust contribution exceeds the lesser of the annual exclusion of the five and five power, the grantor has made a taxable gift to the beneficiary. The size of the policy premium may determine which alternative is used. The first alternative will be used when it is anticipated that each beneficiary’s percentage of the premium exceeds the five and five power. The second provision will be used when it does not.

B. The Trustee shall give written notice within seven (7) days to the beneficiaries authorized to make withdrawals under this article of any contributions made by anyone who survives me to the Trust and the value of such contributions. Such written notice may be delivered personally by the Trustee or it may be sent in the United States mail, postage prepaid, addressed to such beneficiary at his or her last known address, according to the records of the Trustee.

Selected specimen credit shelter trust provisions continued

C. Any beneficiary who wishes to exercise his or her withdrawal right shall deliver a written request therefore to the Trustee. The right of withdrawal is not cumulative and shall lapse in full if not exercised upon the expiration of thirty (30) days after the beneficiary is notified that any addition has been made to the Trust.

D. The Trustee may satisfy the exercise of any right of withdrawal by distributing to the beneficiary making the withdrawal, cash or other assets. As of the date a request for withdrawal is made pursuant to the provisions of this Article, the beneficiary's right to receive the amount requested shall be vested and shall not be terminated by the subsequent death or disability of the beneficiary or any administrative delay resulting from actions taken by the Trustee to effect distribution of principal pursuant to this Article."

Exhibit V - Credit shelter trust language if no gifts from surviving spouse to credit shelter trust

Explanation of language

If the surviving spouse will never make gifts to the credit shelter trust, the spouse could have income and principal for ascertainable standards rights in the credit shelter trust. The spouse should not have rights to principal, however, since those rights may be considered an "incident of ownership" in the life insurance policy under IRC Section 2042 resulting in estate inclusion.

Sample provision

Typically located at the beginning of the "Family Trust" (credit shelter trust) section, which appears after the allocation to the "Marital Trust":

"The balance of my estate, including any life insurance policy issued by Minnesota Life/Securian Life, specifically policy number, shall be set aside as a separate trust. The special personal representative may remove cash from the policy to reduce the cash surrender value before transferring the policy into the trust. The Trust shall be designated the "Family Trust" and shall be held and disposed of as follows:

A. If my spouse survives me, then commencing with my death, the Trustee shall pay the income, if any, from the Family Trust in convenient installments, at least quarterly to [her or him] during [her or his] lifetime.

B. If my spouse survives me, the Trustee shall make distributions of principal as the trustee deems appropriate for the surviving spouse's health, education, maintenance and support.

C. If my spouse does not survive me or after the death of my spouse if my child(ren) survive(s) me ... [continue with typical provisions for surviving children and issue]."

Selected specimen credit shelter trust provisions continued

Exhibit VI - Language allowing trustee to buy assets or make loans to the estate

Explanation of language

The primary purpose of the credit shelter trust when used with Wait-and-See Estate Planning is to provide liquidity to the estate of the spouse who is the second-to-die. The usual way to accomplish that is to authorize but not require the trustee to buy assets or make loans to the estate.

Sample provision

"The Trustee is hereby authorized in the Trustee's absolute discretion, without regard to whether the Trustee may also be serving as a personal representative of my spouse's estate, to purchase on behalf of the Trust Estate any property or undivided interest in property, whether real, personal or mixed, tangible or intangible, and wherever situated, belonging to my spouse's estate, or to make loans, secured or unsecured, to the personal representative of the estate of my spouse, provided that such purchases or loans do not cause the proceeds of any life insurance policies on the life of my spouse owned by the Trustee to be included in my spouse's estate under any provision of the Code, or any Treasury Regulation, including, without limitation, Treasury Regulation 20.2042-1(b) or any successor provision thereto. Any such purchases or loans shall be made upon such terms and conditions as the Trustee in the Trustee's discretion deems appropriate."

Exhibit VII - Language creating two nonmarital ("B") trusts and a marital share upon the testator's death

Explanation of language

In some cases, it may be desirable to have two credit shelter trusts: (1) the life insurance credit shelter trust and (2) the traditional credit shelter trust or family trust. If the goals are to provide the surviving spouse with all the traditional income and principal rights of a credit shelter trust and also use Wait-and-See Estate Planning to pass the policy insuring the surviving spouse to a credit shelter trust, the two credit shelter trusts are necessary. The total amount placed in the two credit shelter trusts would not exceed the applicable exclusion amount.

Sample will provisions

Note: If revocable living trusts are used, this language should be modified.

Division of balance of estate if spouse survives

If my spouse survives me, the balance of my estate shall be divided into three (3) shares, a Nonmarital Insurance Trust Share, a Family Share and a Marital Share, as follows:

A. The Nonmarital Insurance Trust Share shall include all policies of life insurance on the life of my spouse [plus the initial cash sum of _________________]. The Nonmarital Insurance Trust Share shall be held in trust and administered according to Article [X] provisions.

Selected specimen credit shelter trust provisions continued

B. The Family Share shall be a fractional share of the remainder of my estate, after setting aside the Nonmarital Insurance Trust. The numerator of this fraction shall be the maximum amount (if any) that can pass free of the federal estate tax in my estate by reason of the applicable exclusion amount (after taking into account all adjusted taxable gifts) and the state death tax credit (provided that the use of this credit does not require an increase in the state death taxes payable to any state) allowable against the federal estate tax imposed in respect of my estate. The numerator of the Family Share will also be diminished by the value of all other property and interests in property passing as the Nonmarital Insurance Trust or passing outside of this trust (if any) that are included in my gross estate for federal estate tax purposes, the dispositions of which do not qualify for the charitable, marital or other federal estate tax deductions, and further diminished by the amount of any charges to the principal of this trust that are not allowed as deductions in computing the federal estate tax imposed in respect of my estate. The denominator of this fraction shall be a figure equal to the value of the remainder of my estate. The Family Share shall be held in trust and administered according to the provisions of Article [Y].

C. The Marital Share will be the remaining fractional share of the balance of my estate. The Marital Share will be held and distributed to my spouse according to the provisions of Article [Z]. It is my intention that the Marital Share qualify for the federal estate tax marital deduction, and all provisions of my will shall be interpreted consistent with this intent.

Article [X]. Nonmarital Insurance Trust

The Trustee will hold the Nonmarital Insurance Trust as follows:

A. Until the death of my spouse, the Trustee will expend so much of the trust income and principal as may be required to pay the premiums on any policies of life insurance on the life of my spouse. The Trustee shall also distribute to or expend as much of the Trust's net income and principal as is required, to meet emergencies relating to the needs of my children, after taking into account all other income and assets available to them (including those available under other trusts created under this instrument). The Trustee shall add to principal any income not paid out. In making these distributions, the Trustee may make payments of income and principal unequally, and may omit paying principal or income or both to one or more beneficiaries, while making payments to others.

B. During the life of my spouse, the following demand powers shall exist with respect to contributions to the Nonmarital Insurance Trust by any person or persons:

1. Immediately following any contribution to this Trust, each of my then-living children shall have the right to withdraw an amount equal to a proportionate share of the contribution. The proportionate share will be the amount of the contribution, divided by the number of my children living at the time of the contribution, except as limited elsewhere in this paragraph.
2. If any child of mine demands and receives a distribution in excess of the amount he or she is authorized to receive under this paragraph, the Trustee shall immediately notify the child in writing, requiring the prompt repayment of the excess amount. This demand power takes precedence over any other power or discretion granted the Trustee or any other person.

Selected specimen credit shelter trust provisions continued

3. Each of my then-living children can exercise this demand power by a written request delivered to the Trustee. If any child is unable to exercise this demand power because of a legal disability, including minority, his or her legally authorized personal representative, including (but not limited to) a guardian, committee or conservator, may make the demand on the beneficiary's behalf. If there be no legally authorized personal representative, the Trustee will designate an appropriate adult individual who may make the demand on the child's behalf. However, in no event can my spouse make the demand for any of my spouse's children, regardless of their relationship.
4. The Trustee must reasonably notify the person who would exercise a child's demand power of its existence and that of any contributions made to the Trust that are subject to the power.
5. The maximum amount that any child of mine may withdraw with respect to all contributions made by the same donor during a single calendar year shall be the lesser of the total amount of the child's share of the contributions and the amount of the federal gift tax annual exclusion in effect on the date of the earliest of the contributions. If a married donor so requests at the time of a contribution, the alternative limitation based on the gift tax annual exclusion shall be two (2) times the amount of the gift tax annual exclusion. I recognize that the gift tax annual exclusion is [nineteen thousand dollars ($19,000)] on the date of this Trust, but that it may be changed from time to time, and this demand power shall reflect the annual exclusion in effect on the date of the individual gift.
6. All demand powers under this paragraph lapse generally on the earlier of the last day of the calendar year in which a contribution is made or sixty (60) calendar days following the date of the contribution. However, a demand power that is not exercised within the said sixty (60) day period shall continue to be exercisable by its holder to the extent that the amount that the holder could have withdrawn under this article exceeds the greater of five thousand dollars ($5,000) or five (5) percent of the aggregate value of the assets out of which the demands could be satisfied. A demand power continuing after the sixty (60) day period shall be and together shall lapse annually only to the extent of the greater of five thousand dollars ($5,000) or five (5) percent of the aggregate value of the assets out of which the demands could be satisfied.
7. The Trustee may satisfy any demand under this article for a distribution by distributing cash, other assets or fractional interest in other assets, as the Trustee deems appropriate. Without limiting the Trustee's power to select assets to satisfy a demand, I prefer that cash or tangible assets be distributed before life insurance policies and other intangible assets, unless the Trustee decides that another selection is warranted.
8. "Contribution" means any cash or other assets transferred to the Trustee to be held as part of the Trust funds and the payment of any premiums on life insurance policies owned (in whole or in part) by the Trust. The amount of any contribution is its federal gift tax value, as determined by the Trustee at the time of the contribution.

Selected specimen credit shelter trust provisions continued

C. Upon the death of my spouse, during the administration of the estate of my spouse under applicable state law, the Trustee shall retain the Nonmarital Insurance Trust funds and may use them, in the Trustee's discretion, to lend money to and buy assets from the estate, on the terms and conditions as the Trustee deems to be in the best interests of the Trust's beneficiaries. The Trustee will not, however, make grants to the estate or otherwise distribute funds except through bona fide loans or purchases, it not being my intention to make any persons who are not specifically so identified in this article the beneficiaries of any trust created hereunder. If no personal representative is appointed with respect to the estate of my spouse under applicable state law, the "administration" of the estate will include the settlement of debts, claims and taxes in respect of the estate of my spouse by the Trustee of any revocable trust or by any other person in actual possession of assets in which my spouse had a legal or equitable interest.

D. Upon the death of my spouse, and after the Trustee has determined that the purposes of paragraph C have been met, the Trustee will divide the Nonmarital Insurance Trust fund into as many separate equal shares as are required to provide one separate equal share for each of my then-living children and one separate equal share for the then-living descendants, collectively, of each of my deceased children having descendants then living. The Trustee will then:

1. Distribute outright and free of trust one separate equal share to each of my then-living children; and
2. Distribute outright and free of trust one separate equal share to the then-living descendants, collectively, of each of my deceased children, the descendants to take per stirpes the share which their ancestor, the deceased child of mine, would have taken if living.

Article [Y]. Family Trust

(Insert here appropriate administrative provisions for a Nonmarital Family Trust.)

Article [Z]. Marital Trust

(Insert here appropriate administrative provisions for the Marital Trust or for distributing outright to spouse in a manner qualifying for the marital deduction.)

One-policy approach

Steps to establish one-policy Wait-and-See Estate Planning

Step 1:

Determine the estimated estate tax obligation at the second death. Determine the amount of cash needed at the first death, if any. The financial professional should then generate the appropriate product illustration.

Step 2:

Husband and wife purchase a second-to-die policy insuring both of their lives. The mortality inferior spouse initially owns the policy. The policy owner's credit shelter trust is named as primary beneficiary of the policy.

Step 3:

Attorney drafts estate planning documents for husband and wife. The documents maximize use of the applicable exclusion amount and marital deduction by creating a trust using the applicable exclusion amount and marital deduction provisions after the first death. The policy owner's documents include a provision designating a special personal representative to transfer the policy if the policy owner dies first.

Selected specimen credit shelter trust provisions

Exhibit I – Special Personal Representative language

Explanation of language

With Wait-and-See Estate Planning, the spouse with the shorter life expectancy initially owns the policy insuring both spouses. A policy rider providing the option to purchase an additional four years of term insurance is added to the policy naming the policy owner's spouse as the designated life. Where the policy owner's spouse is named personal representative of the policy owner's estate, a special personal representative should be named to control all life policies insuring the policy owner spouse. This will enable cash to be removed from the policy without causing the policy to be subject to the three-year rule. Specimen language for the special personal representative provision is included in Exhibit I. If the policy owner dies first, the special personal representative transfers the unmatured policy to the credit shelter trust in the policy owner's will. To ensure that the special personal representative passes the policy to the trust, however, it is a good idea to so designate in the will. Before transferring the policy to the credit shelter trust, the special personal representative may withdraw cash from the policy if necessary.

Sample provision

"I appoint _____ (someone other than spouse), as my Special Personal Representative. My Special Personal Representative shall have the right to exercise all rights in any life insurance policies insuring my surviving spouse, including the right to withdraw cash value from any policy on the life of my spouse at the Special Personal Representative's discretion."

"I direct that the Special Personal Representative allocate any life insurance policy issued by Minnesota Life/Securian Life, specifically policy number __, insuring myself and my [wife or husband] which I own on my death to the Family Trust [or other name of credit shelter trust] and transfer it to said Trust upon my death. I direct that the Special Personal Representative transfer, at their discretion, any monies received from said policy either to the Family Trust [or other name for credit shelter trust] or my surviving spouse."

Exhibit II – Provisions authorizing Trustee to invest in life insurance and to exercise policy rights

Explanation of language

The trust language should allow for investments of life insurance. These rights are generally included as standard language in the trust document section designating trustee rights.

Sample provision

"The Trustee is authorized but not required to purchase or invest in life insurance policies on the life of myself and my spouse [or could add: and my children]. The Trustee has all rights of ownership in any policies purchased."

Selected specimen credit shelter trust provisions continued

Exhibit III - ILIT Trust language authorizing to invest in life insurance and exercise policy rights

Explanation of language

If the policy owner's spouse dies first, the policy owner must immediately transfer the policy to an Irrevocable Life Insurance Trust. The trust language should give the trustee the right to exercise any ownership rights under the insurance contract – specifically the right to exercise any policy rider options to purchase four years of additional term insurance.

Sample provision

"The Trustee is authorized but not required to purchase or invest in life insurance policies on the life of myself and my spouse [or could add: and my children]. The Trustee has all rights of ownership in any policies purchased, including the right to activate the four-year term policy rider."

Exhibit IV - Credit shelter trust and ILIT language allowing trustee to sell assets in "Powers of Trustee" section

Explanation of language

After the option to purchase four years of additional term insurance is activated, the trustee may have to pay additional premiums for the rider. The trustee may also want to make a cash deposit into the policy to reduce the future costs, completely eliminate them or further increase the death benefit whether the policy is owned by the credit shelter trust or the Irrevocable Life Insurance Trust. The language of the credit shelter trust and the ILIT should allow the trustee to sell other assets in the trust to convert them to cash for these payments.

Sample provision

"To sell, exchange or otherwise dispose of realty and personally, publicly or privately, wholly or partly on credit or for any consideration, including stocks, bonds or other corporate obligations, and grant options for the purchase, exchange or other disposition of any such property."

Exhibit V - Credit shelter trust language if surviving spouse will make gifts to credit shelter trust

Explanation of language

When further premiums are due on the policy, the surviving spouse may wish to make gifts to the credit shelter trust or ILIT to pay those premiums. If it is planned that the surviving spouse will make gifts to the credit shelter trust or ILIT, do not give the spouse any rights to the credit shelter trust or ILIT to avoid an IRC §2036(a) problem. Also, if the spouse will make gifts to the credit shelter trust or ILIT, include a Crummey provision in the credit shelter trust or ILIT to qualify these gifts for the annual exclusion.

Selected specimen credit shelter trust provisions continued

Sample provisions

Typically located at the beginning of the "Family Trust" (credit shelter trust) section, which appears after the allocation to the "Marital Trust":

"The balance of my estate, including any life insurance policy issued by Minnesota Life/Securian Life, specifically policy number ______________ , shall be set aside as a separate trust. The Special Personal Representative may remove cash from the policy and is not required to allocate it at its full amount. The Trust shall be designated the 'Family Trust' and shall be held and disposed of as follows:

A. I direct that the Family Trust make no distributions to my surviving spouse if [he or she] survives me. I have otherwise provided for my spouse by outright dispositions and by provisions in the Marital Trust.

B. While my spouse is alive, funds from this Trust may not be used to meet any legal obligation of my spouse [or: her or him] to support a child of [hers or his].

C. Continue with standard credit shelter trust provisions applicable to distributions to children after the surviving spouse dies."

In credit shelter trust subsection describing "Trust Additions":

"Any person may transfer any real or personal property to this Trust after my death by transferring such property to the Trustee by gift, deed, assignment, bequest or devise."

In credit shelter trust subsection, "Beneficiaries' Rights of Withdrawal," include these Crummey provisions:

"During each calendar year, when a lifetime gift is made to this Trust by anyone who survives me, each living child of mine shall have the right, following any contribution by the survivor to the Trust, to make withdrawals from the trust in accordance with the following provisions":

A. Any then-living child may withdraw an amount determined by dividing the amount of the contribution by the number of my then-living children, provided, however, that the aggregate amount of such withdrawals by any child of mine during any calendar year shall be limited to the annual exclusion from gift tax pursuant to IRC Section 2503 as in effect for that year.

OR

Any then-living child of mine may withdraw an amount determined by dividing the amount of the contribution by the number of my then-living children, provided, however, that the aggregate amount of such withdrawals by any child of mine during any calendar year shall be limited to the lesser of (1) the largest amount, which constitutes the lapse of a nontaxable power of appointment under IRC Sections 2041 and 2514 as in effect for that year or (2) the annual exclusion from gift tax pursuant to IRC Section 2503 as in effect for that year.

Selected specimen credit shelter trust provisions continued

(One of these two alternative paragraphs may be chosen to create the children's withdrawal rights, which qualify the contribution as a present interest gift qualifying for the annua] gift tax annual exclusion currently [$19,000] as adjusted for inflation as specified in IRC Section 2503(b)(2). The first alternative allows each child to withdraw his or her percentage of the net contribution up to the 2025 annual gift tax exclusion limit of [nineteen thousand dollars ($19,000)]. This alternative runs the risk that if the beneficiary does not exercise the power, a taxable gift will be made to the other trust beneficiaries to the extent of any withdrawal rights in excess of five thousand dollars [$5,000] or five [5] percent of the trust.

The second alternative eliminates this problem. It limits the withdrawal power to the lesser of ten thousand dollars [$10,000] or the "five-and-five power." However, this creates another problem. To the extent a beneficiary's portion of the net trust contribution exceeds the lesser of the annual exclusion of the five-and-five power, the grantor has made a taxable gift to the beneficiary. The size of the policy premium may determine which alternative is used. The first alternative will be used when it is anticipated that each beneficiary's percentage of the premium exceeds the five-and-five power. The second provision will be used when it does not.)

B. The Trustee shall give written notice within seven (7) days to the beneficiaries authorized to make withdrawals under this article of any contributions made by anyone who survives me to the Trust and the value of such contributions. Such written notice may be delivered personally by the Trustee or it may be sent in the United States mail, postage prepaid, addressed to such beneficiary at his or her last known address, according to the records of the Trustee.

C. Any beneficiary who wishes to exercise his or her withdrawal right shall deliver a written request therefore to the Trustee. The right of withdrawal is not cumulative and shall lapse in full if not exercised upon the expiration of thirty (30) days after the beneficiary is notified that any addition has been made to the Trust.

D. The Trustee may satisfy the exercise of any right of withdrawal by distributing to the beneficiary making the withdrawal, cash or other assets. As of the date a request for withdrawal is made pursuant to the provisions of this Article, the beneficiary's right to receive the amount requested shall be vested and shall not be terminated by the subsequent death or disability of the beneficiary or any administrative delay resulting from actions taken by the Trustee to effect distribution of principal pursuant to this Article.

Exhibit VI - Credit shelter trust language if no gifts from surviving spouse to credit shelter trust

Explanation of language

If the surviving spouse will never make gifts to the credit shelter trust or ILIT, the spouse could have income rights in the credit shelter trust or ILIT. Specimen credit shelter trust and ILIT language, if the spouse will not make gifts to the credit shelter trust or ILIT, is below.

Selected specimen credit shelter trust provisions continued

Sample provisions

Typically located at the beginning of the "Family Trust" (credit shelter trust) section, which appears after the allocation to the "Marital Trust":

"The balance of my estate, including the Minnesota Life/Securian Life life insurance policy number ______________________________, shall be set aside as a separate trust. The special personal representative may remove cash from the policy before placing it in the Trust. The Trust shall be designated the "Family Trust" [or other name of credit shelter trust] and shall be held and disposed of as follows:

A. If my spouse survives me, then commencing with my death, the Trustee shall pay the income, if any, from the Family Trust in convenient installments, at least quarterly to [her or him] during [her or his] lifetime.

B. If my spouse survives me, the Trustee shall make distributions of principal as the trustee deems appropriate for the surviving spouse's health, education, maintenance and support.

C. If my spouse does not survive me or after the death of my spouse if my child(ren) survive(s) me ... [continue with typical provisions for surviving children and issue.]"

Exhibit VII - Credit shelter trust language allowing Trustee to buy assets or make loans to the estate

Explanation of language

The primary purpose of the credit shelter trust or ILIT when used as a Wait-and-See Trust is to provide liquidity to the estate of the spouse who is the second-to-die. The usual way to accomplish that is to authorize but not require the trustee to buy assets from or make loans to the estate. Specimen credit shelter trust and ILIT language authorizing the trustee to do so is included as Exhibit VII.

Sample provisions

"The Trustee is hereby authorized in the Trustee's absolute discretion, without regard to whether the Trustee may also be serving as a personal representative of my spouse's estate, to purchase on behalf of the Trust Estate any property or undivided interest in property, whether real, personal or mixed, tangible or intangible, and wherever situated, belonging to my spouse's estate, or to make loans, secured or unsecured, to the personal representative of the estate of my spouse, provided that such purchases or loans do not cause the proceeds of any life insurance policies on the life of my spouse owned by the Trustee to be included in my spouse's estate under any provision of the Code, or any Treasury Regulation, including, without limitation, Treasury Regulation 20.2042-1(b) or any successor provision thereto. Any such purchases or loans shall be made upon such terms and conditions as the Trustee in the Trustee's discretion deems appropriate."

Selected specimen credit shelter trust provisions continued

Exhibit VIII - Language creating two nonmarital (“B”) trusts and a Marital Share upon the testator’s death

Explanation of language

In some cases it may be desirable for the owner spouse to have two credit shelter trusts (in the event the owner spouse dies first): (1) the life insurance credit shelter trust or ILIT, and (2) the traditional credit shelter trust (family trust). If the goals are to provide the surviving spouse with all the traditional income and principal rights of a credit shelter trust and also use Wait-and-See Estate Planning to pass the policy insuring the surviving spouse to a credit shelter trust, the two credit shelter trusts are necessary. The total amount placed in the two credit shelter trusts would not exceed the applicable exclusion amount. Specimen language for the double credit shelter trust arrangement is included in Exhibit VIII.

Sample provisions

Note: If revocable living trusts are used, this language should be modified.

Division of balance of estate if spouse survives

If my spouse survives me, the balance of my estate shall be divided into three (3) shares, a Nonmarital Insurance Trust Share, a Family Share and a Marital Share, as follows:

A. The Nonmarital Insurance Trust Share shall include all policies of life insurance on the life of my spouse [plus the initial cash sum of ______]. The Nonmarital Insurance Trust Share shall be held in trust and administered according to the provisions of Article [X].

B. The Family Share shall be a fractional share of the remainder of my estate, after setting aside the Nonmarital Insurance Trust. The numerator of this fraction shall be the maximum amount (if any) that can pass free of the federal estate tax in my estate by reason of the applicable exclusion amount (after taking into account all adjusted taxable gifts) and the state death tax credit (provided that the use of this credit does not require an increase in the state death taxes payable to any state) allowable against the federal estate tax imposed in respect of my estate.

The numerator of the Family Share will also be diminished by the value of all other property and interests in property passing as the Nonmarital Insurance Trust or passing outside of this trust (if any) that are included in my gross estate for federal estate tax purposes, the dispositions of which do not qualify for the charitable, marital or other federal estate tax deductions, and further diminished by the amount of any charges to the principal of this trust that are not allowed as deductions in computing the federal estate tax imposed in respect of my estate. The denominator of this fraction shall be a figure equal to the value of the remainder of my estate. The Family Share shall be held in trust and administered according to the provisions of Article [Y].

C. The Marital Share will be the remaining fractional share of the balance of my estate. The Marital Share will be held and distributed to my spouse according to the provisions of Article [Z]. It is my intention that the Marital Share qualify for the federal estate tax marital deduction, and all provisions of my will shall be interpreted consistent with this intent.

Selected specimen credit shelter trust provisions continued

Article [X]. Nonmarital Insurance Trust

The Trustee will hold the Nonmarital Insurance Trust as follows:

A. Until the death of my spouse, the Trustee will expend so much of the trust income and principal as may be required to pay the premiums on any policies of life insurance on the life of my spouse. The Trustee shall also distribute to or expend as much of the trust's net income and principal as is required, to meet emergencies relating to the needs of my children, after taking into account all other income and assets available to them (including those available under other trusts created under this instrument). The Trustee shall add to principal any income not paid out. In making these distributions, the Trustee may make payments of income and principal unequally, and may omit paying principal or income or both to one or more beneficiaries, while making payments to others.

B. During the life of my spouse, the following demand powers shall exist with respect to contributions to the Nonmarital Insurance Trust by any person or persons:

1. Immediately following any contribution to this Trust, each of my then-living children shall have the right to withdraw an amount equal to a proportionate share of the contribution. The proportionate share will be the amount of the contribution, divided by the number of my children living at the time of the contribution, except as limited elsewhere in this paragraph.
2. If any child of mine demands and receives a distribution in excess of the amount he or she is authorized to receive under this paragraph, the Trustee shall immediately notify the child in writing, requiring the prompt repayment of the excess amount. This demand power takes precedence over any other power or discretion granted the Trustee or any other person.
3. Each of my then-living children can exercise this demand power by a written request delivered to the Trustee. If any child is unable to exercise this demand power because of a legal disability, including minority, his or her legally authorized personal representative, including (but not limited to) a guardian, committee or conservator, may make the demand on the beneficiary's behalf. If there be no legally authorized personal representative, the Trustee will designate an appropriate adult individual who may make the demand on the child's behalf. However, in no event can my spouse make the demand for any of my spouse's children, regardless of their relationship.
4. The Trustee must reasonably notify the person who would exercise a child's demand power of its existence and that of any contributions made to the Trust that are subject to the power.

Selected specimen credit shelter trust provisions continued

5. The maximum amount that any child of mine may withdraw with respect to all contributions made by the same donor during a single calendar year shall be the lesser of the total amount of the child's share of the contributions and the amount of the federal gift tax annual exclusion in effect on the date of the earliest of the contributions. If a married donor so requests at the time of a contribution, the alternative limitation based on the gift tax annual exclusion shall be two (2) times the amount of the gift tax annual exclusion. I recognize that the gift tax annual exclusion is [nineteen thousand dollars ($19,000)] on the date of this trust, but that it may be changed from time to time, and this demand power shall reflect the annual exclusion in effect on the date of the individual gift.
6. All demand powers under this paragraph lapse generally on the earlier of the last day of the calendar year in which a contribution is made, or sixty (60) calendar days following the date of the contribution. However, a demand power that is not exercised within the said sixty (60) day period shall lapse annually and shall continue to be exercisable by its holder to the extent that the amount that the holder could have withdrawn under this article exceeds the greater of five thousand dollars ($5,000) or five percent (5%) of the aggregate value of the assets out of which the demands could be satisfied. A demand power continuing after the sixty (60) day period shall be and together shall lapse annually only to the extent of the greater of five thousand dollars ($5,000) or five percent (5%) percent of the aggregate value of the assets out of which the demands could be satisfied.
7. The Trustee may satisfy any demand under this article for a distribution by distributing cash, other assets or fractional interest in other assets, as the Trustee deems appropriate. Without limiting the Trustee's power to select assets to satisfy a demand, I prefer that cash or tangible assets be distributed before life insurance policies and other intangible assets, unless the Trustee decides that another selection is warranted.
8. "Contribution" means any cash or other assets transferred to the Trustee to be held as part of the trust funds and the payment of any premiums on life insurance policies owned (in whole or in part) by the trust. The amount of any contribution is its federal gift tax value, as determined by the Trustee at the time of the contribution.

C. Upon the death of my spouse, during the administration of the estate of my spouse under applicable state law, the Trustee shall retain the Nonmarital Insurance Trust funds and may use them, in the Trustee's discretion, to lend money to and buy assets from the estate, on the terms and conditions as the Trustee deems to be in the best interests of the trust's beneficiaries. The Trustee will not, however, make grants to the estate or otherwise distribute funds except through bona fide loans or purchases, it not being my intention to make any persons who are not specifically so identified in this article, the beneficiaries of any trust created hereunder. If no personal representative is appointed with respect to the estate of my spouse under applicable state law, the "administration" of the estate will include the settlement of debts, claims and taxes in respect of the estate of my spouse by the Trustee of any revocable trust or by any other person in actual possession of assets in which my spouse had a legal or equitable interest.

Selected specimen credit shelter trust provisions continued

D. Upon the death of my spouse, and after the Trustee has determined that the purposes of paragraph C have been met, the Trustee will divide the Nonmarital Insurance Trust fund into many separate equal shares as are required to provide one separate equal share for each of my then-living children and one separate equal share for the then-living descendants, collectively, of each of my deceased children having descendants then living. The Trustee will then:

1. Distribute outright and free of trust one separate equal share to each of my then-living children; and
2. Distribute outright and free of trust one separate equal share to the then-living descendants, collectively, of each of my deceased children, the descendants to take per stirpes the share which their ancestor, the deceased child of mine, would have taken if living.

Article [Y]. Family Trust

(Insert here appropriate administrative provisions for a Nonmarital Family Trust.)

Article [Z]. Marital Trust

(Insert here appropriate administrative provisions for the Marital Trust or for distributing outright to spouse in a manner qualifying for the marital deduction.)

Endnotes

1. IRC §101(a), 2042.
2. IRC §2033.
3. See Revenue Ruling (Rev. Rul.) 77-157, 1977-1 C.B. 279.
4. Letter Ruling 8034095.
5 IRC §7872.
6 PLR 8034095, IRC §2511 & §2512
7 See Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968); Private Letter Ruling (PLR) 7826050.
8 Id.
9. IRC §2042.
10. See PLRs 9434028, 9451053, and 9748020.
11. See PLRs 9434028 and 9602010.
12. See PLR 9434028 where the surviving spouse resigns as trustee and the successor trustee acquires the insurance policy for the trust.
13. See PLR 9602010 where the trust can provide that, if life insurance is purchased on the surviving spouse's life, the spouse should not have any power over the insurance policy.
14. See PLR 9728020.
15. Treasury Regulation (Treas. Reg.). §20.2042-1(c).
16. See PLRs 9111028 and 9602010.
17. Rev. Rul. 84-179 1984-2 CB 195.
18. See PLR 9111028.
19. Rev. Rul. 84-179, 1984-2 CB 195; Estate of Fruehauf v. Commissioner, 427 F.2d 80 (6th Cir. 1970).
20. See Estate of H.M. Lehman, 201 F.2d 874 (3rd Cir. 1940), Estate of Levy, 46 TCM 910 (1983).
21. Id.
22. IRC §2035(a).
23. Id.
24. IRC §2035(d).
25. Rev. Rul. 59-195, 1959-1 CB 18; Treas. Reg. §25.2512-6.
26. Treas. Reg.§25-2512-6(a) Examples 3 and 4.
27. Tax Advice Memorandum (TAM) 8806004. See Estate of James S. Pritchard v. Commissioner, 4 TC 204 (1944).
28. IRC §2056(a).
29. IRC §2035(a).
30. IRC §101(a)(2).
31. IRC §101(a)(2)(B).
32. IRC §101(a)(2)(A).
33. IRC §1041(b).
34. IRC §2033.
35. Goodman v. Commissioner, 156 F.2d 218 (2nd Cir. 1946).
36. Rev. Rul. 77-181.
37. Uniform Simultaneous Death Act Sec. 5.
38. See Commissioner v. Fleming, 155 F.2d 204 (5th Cir. 1946); Estate of W. Vincent Meyer v. Commissioner, 66 TC (1976); Estate of Madsen v. Commissioner, 659 F.2d 897 (9th Cir. 1981).
39. Treas. Reg. §20.2041-1(b)(2).
40. U.S. v. Stewart, 270 F.2d 894 (9th Cir. 1959); Rev. Rul. 74-284, 1974-1 CB 276; Treas. Regs. §20.2031-8.
41. Treas. Reg. §20.2041-1(b)(2).
42. IRC §2056(a).
43. U.S. v. Stewart, 270 F.2d 894 (9th Cir. 1959); Rev. Rul. 74-284, 1974-1 CB 276; Treas. Regs. §20.2031-8.
44. IRC §2036(a).
45. Loans and withdrawals will reduce both the policy cash value and death benefit.
46. Letter Ruling 200120007. The impact of the three-year rule may be minimized through the use of an irrevocable grantor trust. Under the private letter ruling the insured was allowed to sell the survivorship life policy to an irrevocable trust. The sale eliminated the three-year rule because the three-year rule applies only to gifts, not sales. The strategy discussed in the private letter ruling also assisted in avoiding estate taxation of death benefits under the transfer-for-value rule because a sale to a grantor/defective trust is deemed a sale to the insured-grantor. However, it is important to note that this is only an alternative strategy that must be used in conjunction with the four-year term policy agreement. The PLR only applies to that specific taxpayer and may not be a viable strategy in the future.
47. See Rev. Rul. 77-157, 1977-1 C.B. 279.
48. PLR 8034095, IRC §2511 & §2512.
49. See Estate of H.M. Lehman, 201 F.2d 874 (3rd Cir. 1940), Estate of Levy, 46 TCM 910 (1983).
50. IRC §2035(a).
51. IRC §101(a)(2).
52. IRC §101(a)(2)(B).
53. IRC §101(a)(2)(A).
54. See Commissioner v. Fleming, 155 F.2d 204 (5th Cir. 1946); Estate of W. Vincent Meyer v. Commissioner, 66 TC 41 (1976); Estate of Madsen v. Commissioner, 659 F.2d 897 (9th Cir. 1981).
55. Treas. Reg. §20.2041-1(b)(2).
56. U.S. v. Stewart, 270 F.2d 894 (9th Cir. 1959); Rev. Rul. 74-284, 1974-1 CB 276; Treas. Regs. §20.2031-8.

Product features and availability may vary by state.

Please keep in mind that the primary reason to purchase a life insurance product is the death benefit.

Guarantees are based on the claims-paying ability of the issuing life insurance company.

Life insurance products contain charges, such as Cost of Insurance Charge, Cash Extra Charge, and Additional Agreements Charge (which we refer to as mortality charges), and Premium Charge, Monthly Policy Charge, Policy Issue Charge, Transaction Charge, Index Segment Charge, and Surrender Charge (which we refer to as expense charges). These charges may increase over time, and these policies may contain restrictions, such as surrender periods. Policyholders could lose money in these products.

Additional agreements may be available. Agreements may be subject to additional costs and restrictions. Agreements may not be available in all states or may exist under a different name in various states and may not be available in combination with other agreements.

Policy loans and withdrawals may create an adverse tax result in the event of lapse or policy surrender and will reduce both the surrender value and death benefit. Withdrawals may be subject to taxation within the first fifteen years of the contract. You should consult your tax advisor when considering taking a policy loan or withdrawal.

Administrative and insurance charges are deducted every month regardless of whether premium outlays are made. Depending upon actual policy experience, the owner may need to increase premium payments. Any policy loans and partial surrenders will affect policy values and may require additional premiums to avoid policy termination.

This information is a general discussion of the relevant federal tax laws provided to promote ideas that may benefit a taxpayer. It is not intended for, nor can it be used by any taxpayer for the purpose of avoiding federal tax penalties. Taxpayers should seek the advice of their own advisors regarding any tax and legal issues specific to their situation.

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Insurance products are issued by Minnesota Life Insurance Company in all states except New York. In New York, products are issued by Securian Life Insurance Company, a New York authorized insurer. Minnesota Life is not an authorized New York insurance company and does not do insurance business in the state of New York. Both companies are headquartered in Saint Paul, MN. Product availability and features may vary by state. Each insurer is solely responsible for the financial obligations under the policies or contracts it issues.

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