Chapter 11: Estate and Trust

Corrections were made to this workbook through January of 2007. No subsequent modifications were made.

Note. This chapter reviews and builds upon Chapter 8, "Estate and Trust Basics," from the *2005 University of Illinois Federal Tax Workbook*. The following topics were covered in that chapter and will not be reviewed this year: Trust and Estate Creation, Final Form 1040, IRD property, completing Form 1041, and tax year of entity.

This chapter differentiates probate from nonprobate assets, outlines the duties of the personal representative, and illustrates different types of trusts.

DEFINITIONS

There are many terms associated with trusts and estates which may not be familiar to tax professionals. Some of these definitions differ depending on whether they are used in regard to an estate or a trust. The following terms are used in this chapter:[1]

Administrator. If a person died intestate, or if a testator did not name an executor in his will, the personal representative is called an administrator and is appointed by the court. State statutes provide a list of individuals, in order of priority, who are entitled to serve as administrators. The usual order is the intestate's surviving spouse, adult children, parents, siblings, and lastly, creditors and other reputable people in the community.[2]

Beneficiary. A person named in a will, trust, or other document to receive specified property. A person for whose benefit property is held in trust. A beneficiary of a trust includes a person who has a present or future interest, vested (absolute) or contingent (conditioned upon the occurrence of some future event which is itself uncertain). It also includes any person entitled to enforce the trust. A beneficiary holds equitable title to the trust property. A beneficiary is also referred to as a "grantee" or "cestui que trust."

Bequest. A gift of personal property by last will and testament.

Decedent. A deceased person.

Devise. A gift of real property by last will and testament.

Donee. The recipient of a gift.

Donor. One who makes a gift or one who creates a trust.

1. All of the definitions, unless otherwise indicated, came from *Black's Law Dictionary* (6th ed. 1990).
2. Gerry W. Beyer, *Wills, Trusts, And Estates: Examples And Explanations*, p. 233 (2d ed. 2002)

Equitable Title/Ownership. Ownership rights which are protected in equity. Equity is justice administered according to fairness.

Executor. A person appointed by a testator to carry out the directions and requests in his will.

Fee Simple. An estate limited absolutely to a person and his heirs and assigns forever without limitation or condition.

Fiduciary. A person having duties involving good faith, trust, special confidence, and candor towards another. Includes such relationships as executor, administrator, trustee, and guardian.

Grantor. One who creates a trust.

Heir. A person who would, by statute, succeed to an intestate estate.

Intestate. One who dies without a will or to die without a will.

Income in Respect to a Decedent. Income a decedent had a right to receive before death that has not been taxed.

Joint Tenancy with Right of Survivorship. Ownership of property by two or more people in equal shares in which the survivors automatically gain ownership of a decedent's interest.

Legal Title. Ownership and possession that is enforceable in a court of law, but which carries no beneficial interest.

Life Estate. The right to use, occupy, or receive income from property. This is typically real property for one's life.

Nonprobate Property. Property that does not pass by last will and testament or intestacy under state law. Examples of nonprobate property include joint tenancy with right of survivorship property and contracts that provide for the payment of benefits upon death to a designated person, such as life insurance policies, retirement plans, annuities, and pay-on-death (POD) bank accounts. A personal representative does not have control over nonprobate assets.[3]

Personal Representative. Includes an administrator or executor. Administers (manages or takes charge) of the probate assets and the liabilities of the decedent.

Probate. Generally used to refer to the legal process wherein the estate of a decedent is administered. Generally, the probate process involves the personal representative collecting the decedent's assets, liquidating liabilities, paying taxes, and distributing property to beneficiaries or heirs.

Probate Estate. The property of a decedent that is subject to administration by the personal representative of an estate. This includes any property which does not pass upon death by another method. Examples include property owned solely by one person or by more than one person as tenants in common.

Settlor. One who creates a trust.

Statutes. Legislatively created laws as opposed to court decided laws.

Tenancy in Common. Title to property held by two or more persons, in which each has an "undivided interest" in the property and all have an equal right to use the property, even if the percentage of interests are not equal.

Testate, Testator. One who dies leaving a will or to die with a will.

Trix. Words ending in "trix," such as administratrix, executrix, or testatrix, designate the person as a female.

Trust. A legal entity created by a grantor for the benefit of designated beneficiaries. A trust can be created for any purpose that is not illegal and is not against public policy.

Trust Principal. Property that is transferred to a trust. The property transferred to a trust is also referred to as trust "corpus," "estate," or "res."[4]

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3. Beyer, pp. 240, 247

4. Beyer, p. 299

Trustee. One who holds legal title to property "in trust" for the benefit of the beneficiary and who must carry out specific duties with regard to the property. The trustee owes a fiduciary duty to the beneficiary.

Will, Last Will and Testament. An instrument by which a person makes a disposition of his real and personal property to take effect upon his death.

PROBATE ESTATE

Probate procedures and law are determined by state statutes and case law in each state. Having different laws in each state makes it difficult to generalize about these topics. The following is designed to provide general information by relying on the content of the Uniform Probate Code and to illustrate concepts by utilizing some state-specific law. The Uniform Probate Code has been adopted in its entirety by 13 states, including Alaska, Arizona, Colorado, Florida, Hawaii, Idaho, Maine, Michigan, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Carolina, South Dakota, and Utah. In addition, other states have adopted at least part of the Code, and some states have modified the terms of the Code.[5]

> **Note.** Some **nonprobate** assets under state law are treated differently for federal estate and federal income tax law.

PERSONAL REPRESENTATIVE

The court appoints a personal representative to manage the decedent's probate assets, pay creditors, and distribute any remaining property to the heirs or beneficiaries.[6] The personal representative usually needs to take an oath swearing that the representative will faithfully carry out his duties.[7] The personal representative may be required to post bond conditioned on the faithful performance of the representative's duties.[8] State statutes dictate whether bond is required. For instance, unless a bond is ordered by the court or required by the will, some states, such as, Pennsylvania,[9] Illinois,[10] and those states who have adopted the Uniform Probate Code without modification,[11] do not require bond when an individual personal representative is named in a will and is a resident of the applicable state.

After taking the oath and posting bond, if necessary, the court issues letters testamentary (if there is a will) or letters of administration (if the decedent died intestate). "Letters" are typically a one page document indicating that the personal representative was appointed by the court. The personal representative shows this as evidence of the representative's authority when handling estate affairs or collecting estate property.[12] State law indicates who is entitled to letters testamentary or letters of administration. In some states, letters testamentary are granted to the executor named in the will. Letters of administration are granted to those entitled to the residuary of the estate, the surviving spouse, those entitled under the intestate law, or the principal creditors of the decedent in that order of preference.[13]

5. *Law by Source: Uniform Laws,* at www.law.cornell.edu/uniform/probate.html, March 2003
6. Beyer, p. 233
7. Beyer, p. 238. Pennsylvania law provides that "[b]efore letters shall be granted to a personal representative by the register, the personal representative shall swear that he will well and truly administer the estate according to law. The oath of a corporate personal representative may be taken by any of its officers." 20 Pa. Cons. Stat. §3161 (2005); *Uniform Probate Code, Article III — Probate of Wills and Administration* at www.law.cornell.edu/uniform/probate.html
8. Beyer, pp. 238–39
9. 20 Pa. Cons. Stat. §3174 (2005); Chicago Bar Association, Young Lawyers Division, *Your Guide to the Law,* (2004), at www.chicagobar.org/publi/brochure.asp; Uniform Probate Code, *Article III — Probate of Wills and Administration* at www.law.cornell.edu/uniform/probate.html
10. Thompson, Donald, *Chicago Probate,* Bond (2006) at www.chicagoprobate.com/bond.htm
11. Uniform Probate Code, *Article III — Probate of Wills and Administration,* at www.law.cornell.edu/uniform.probate.html
12. Beyer, p. 239
13. 20 Pa. Cons. Stat. §3155 (2005)

The personal representative must collect and preserve all of the decedent's probate assets for the benefit of the creditors and the heirs or beneficiaries. The personal representative does not have control over nonprobate assets. The personal representative must manage the decedent's probate assets. For example, the representative may need to sell, lease, or invest estate property. The personal representative typically has to prepare an inventory of all of the decedent's probate assets and indicate the fair market value (FMV) of each as of the date of decedent's death.[14]

State statutes require the personal representative to set aside a minimum amount of the decedent's property as free from the claims of certain creditors. Certain property may be protected for a surviving spouse, minor children, and, in a few states, unmarried adult children who still live at home.[15] Many states protect the decedent's homestead (the residence used by the decedent and the decedent's family). The homestead may be protected from creditors or close family members may have a superior right to occupy the homestead. In Illinois, the surviving spouse is allowed $10,000 of the estate proceeds plus an additional $5,000 for each minor or disabled child who lives with the surviving spouse at the time of death.[16]

The personal representative must notify the decedent's creditors of the decedent's death and the appointment of a personal representative. State statutes dictate whether this notice is by publication, mail, or in person and when notice must be given. In some states, and pursuant to Article I of the Uniform Probate Code, the personal representative must give notice in a newspaper.[17] Many states limit the ability of a creditor to collect once the creditor receives a notice and fails to submit a claim.[18]

The personal representative must pay the decedent's creditors. State statutes supply a priority order for paying the claims of creditors if the estate is insufficient to satisfy all creditors.[19] Statutes often favor funeral homes, medical care providers, the property set aside for the surviving spouse[20] and minor children, and administration expenses.[21] Many states require the personal representative to report all of his actions involving estate property, such as all expenditures and income. If estate property is left after the claims are paid, the personal representative distributes the balance to the heirs or beneficiaries. If the estate property is insufficient to satisfy all of a testator's devises and bequests, the representative follows the order of abatement as designated by state statute.[22]

Observation. The personal representative is entitled to charge a fee for his services. This fee is taxable to the personal representative, and must be included on the personal representative's individual income tax return as other income, generally not subject to self-employment tax.

14. Beyer, p. 240. 20 Pa. Cons. Stat. §3301 (2005)
15. Beyer, p. 241
16. 755 ILCS 5/18-3
17. 20 Pa. Cons. Stat. §3162 (2005)
18. Beyer, p. 241
19. 20 Pa. Cons. Stat. §3162 (2005)
20. Beyer, p. 241
21. Beyer, p. 244. 20 Pa. Cons. Stat. §3392 (2005); 2005 Pa. SB 509
22. Beyer, pp. 244–245

TAXATION ISSUES OF ESTATES

The personal representative of a decedent's estate must determine what income should be included on the decedent's final income tax return, on the estate income tax return, and on the income tax returns of the beneficiaries. The decedent's income before death and the beneficiaries' income are reported on Form 1040, *U.S. Individual Income Tax Return*. The estate's income tax is reported on Form 1041, *U.S. Income Tax Return for Estates and Trusts*. The personal representative also has to determine whether any of the income is also subject to state and/or federal estate tax.[23] Federal estate tax is reported on Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*.

FORM 1040

If a taxpayer dies before filing an income tax return, the taxpayer's spouse or personal representative may have to file and sign the return for the deceased taxpayer. If the deceased taxpayer was not required to file a return, but had tax withheld, a tax return should be filed to claim a refund.

A surviving spouse can file a joint return with the decedent for the year of death unless the surviving spouse remarries. If the surviving spouse remarries, the decedent must use a filing status other than married filing jointly. The joint return should indicate the deceased taxpayer's income before death for the year he died and the surviving spouse's income for the entire year. The surviving spouse should write or type "Filing as surviving spouse" in the area where the surviving spouse signs the return. If a joint tax return is filed, both the spouse and the personal representative, if the representative is someone other than the surviving spouse, must sign the return. The person who files the return, must write or type the word "Deceased," the deceased taxpayer's name, and the date of death across the top of the return.

The value of gifts and inheritances is generally not taxable to the donee or beneficiary. However, the **income** from a gift or inheritance, or a gift or inheritance of income is included in a donee or beneficiary's gross income.[24] The further a gift is removed from the family context, the more likely the IRS or the courts are to question whether the transfer was really a gift.[25] For example, a gift to a current employee is usually considered compensation for services and therefore taxable.

FORM 1041

The personal representative must file Form 1041 for an estate that has gross income of $600 or more. A trust or a decedent's estate calculates its gross income in a similar manner to which an individual calculates his gross income. Most deductions and credits permitted to individuals are also permitted to estates. However, the one major difference is that an estate is allowed an income distribution deduction for distributions to beneficiaries. To calculate this deduction, the personal representative must complete Form 1041, Schedule B, *Income Distribution Deduction*. The income distribution deduction determines the amount of any distributions taxed to the beneficiaries.

A decedent's estate is sometimes referred to as a "pass-through" entity because the beneficiary, not the estate, pays the income tax on her distributive share of income. The personal representative uses Form 1041, Schedule K-1, to notify beneficiaries of the amounts to include on their individual income tax returns.

The income distribution deduction results from amounts paid, credited, or required to be distributed to beneficiaries. The income distribution deduction is limited to distributable net income (DNI). The DNI is calculated on Form 1041, Schedule B, line 7, and is used to determine what portion of an amount paid, credited, or required to be distributed to a beneficiary to include in the beneficiary's gross income. DNI is the income of an estate or trust that is available for distribution.[26]

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23. Roger A. McEowen, *Income Taxation of Trusts and Estates*, p. 10. unpublished

24. IRC §102

25. J. Martin Burke & Michael K. Friel, *Understanding Federal Income Taxation*, p. 47 (2001)

26. McEowen, p. 13

The personal representative must sign Form 1041. If there are joint representatives, only one is required to sign the form.

Note. Form 1041 may be filed on a fiscal or calendar year basis.

FORM 706

For 2006, the personal representative must file Form 706 for an estate whose gross estate exceeds $2 million as of decedent's date of death. This also includes adjusted taxable gifts made by the decedent after December 31, 1976, plus the total specific exemption allowed under IRC §2521 for gifts made by the decedent after September 8, 1976. The purpose of Form 706 is to determine the amount of estate tax due. Estate tax is assessed on the entire taxable estate, not just on the share received by a particular beneficiary.

Under current law, the estate tax exemption amount continues to increase through 2009. In 2010 there is no estate tax and beginning in 2011, the exemption amount drops to $1 million.

Gift and Estate Tax Exemptions

Year	Gift Tax Exemption	Estate Tax Exemption
2005	$1,000,000	$1,500,000
2006, 2007, 2008	1,000,000	2,000,000
2009	1,000,000	3,500,000
2010	1,000,000	Unlimited
2011	1,000,000	1,000,000

Estate tax is tax on an individual's privilege of transferring property. In contrast, state inheritance tax is a tax on an heir's or beneficiary's privilege of receiving a gratuitous transfer of property.[27]

DEDUCTIONS

The personal representative must determine on which tax return to deduct expenses, because certain expenditures are deductible for one tax, but not for another. For instance, funeral expenses paid by the estate are a deduction for estate tax purposes (Form 706), but not for estate income tax purposes (Form 1041). Additionally, administration expenses, such as attorney's fees, are a deduction for either estate income tax (Form 1041) or estate tax (Form 706) purposes, but not both.

Medical expenses incurred during the decedent's final illness that are unpaid at the time of the decedent's death are deductible for estate tax (Form 706) or the decedent's income tax (Form 1040) purposes, but only if it is agreed that the estate deduction will not be claimed.[28]

Table of Deduction Alternatives

Description	Deductible on Form
Estate administrative expenses IRC §642 (g)	706 or 1041 or split
Medical expense of decedent paid within the year IRC §213 (d)	706 or final 1040
Funeral expenses IRC §2053 (a)	706
Real estate taxes	706 or 1041 or split

27. Beyer, p. 457

28. McEowen, p. 11

STATE INHERITANCE TAX

Avoiding probate is not the same as avoiding state inheritance tax. Whether property is probate property has no bearing on whether the property is subject to state inheritance tax.

An individual can have a clause in his will that directs inheritance taxes, even on nonprobate or intestate property, to be paid out of his estate. For example, property owned by joint tenants with right of survivorship property is nonprobate property that is subject to inheritance tax in some states.

> **Note.** State filing requirements vary. Consult the appropriate state agency.

NONPROBATE PROPERTY

Nonprobate property is property that does not pass by last will and testament or intestacy. The personal representative does not have control over nonprobate assets.[29] Two examples of real property that pass outside of probate are:

- A joint tenancy with right of survivorship, and
- A life estate.

Real property owned by more than one person as **joint tenants with right of survivorship** passes by operation of law upon the death of one of the owners to the surviving joint owners. Many states provide that real property does not pass to the surviving joint owner and avoid probate unless "right of survivorship" is expressly stated in the instrument.[30] If survivorship is not clearly expressed, the property is considered a tenancy in common.[31]

With a **life estate,** the donor retains the right to use real property during his lifetime, but transfers the future interest/remainder to the donee. The donee has no immediate possessory rights and no obligations for the property, but the donee receives an outright fee simple interest upon the donor's death without the need for probate. If the donee predeceases the donor, the remainder interest passes to the donee's heirs or beneficiaries.[32]

Contracts may direct the payment of money or delivery of other property upon an individual's death. This property does not pass through a decedent's probate estate, unless the payee is the decedent's estate. **Life insurance** is an example of nonprobate property. A life insurance policy is a contract between the owner of the policy and an insurer. In exchange for the owner's payment of premiums, the insurer agrees to pay a stated amount of money to the beneficiary when the insured dies. The owner and the insured are often the same individual.[33]

Employee benefit and **retirement plans** are another example of property that passes outside of probate. If an individual dies before expending the property accumulated in an employee benefit plan or other retirement plan, the benefit contract provides that the remaining property or some other type of death benefit be paid to a designated beneficiary. The death benefit passes outside of a decedent's probate estate as long as the beneficiary is not the decedent's estate.[34]

An **annuity** is another example of nonprobate property. An annuity is a contract between the purchaser of the contract and the annuity provider. In exchange for a lump-sum payment, the annuity provider agrees to make periodic

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29. Beyer, pp. 240, 247
30. Beyer, p. 273
31. John G. Sprankling, *Understanding Property Law*, p. 119 (2000)
32. Beyer, pp. 264–265
33. Beyer, pp. 287–288
34. Beyer, p. 294

payments for the life of the annuitant or some other specified period of time. Annuities may provide for payments to continue after the annuitant's death, which operates as a nonprobate transfer.

With a **refund annuity**, the provider makes payments for the annuitant's life. But if the annuitant dies before receiving at least the amount paid for the annuity, the provider pays the difference between the purchase price and the amount already distributed to a designated beneficiary. For a **life annuity** with a term certain, the provider makes payments for the annuitant's life. However, if the annuitant dies before the term expires, the provider continues to make annuity payments to a designated beneficiary until the end of the specified term.[35]

Multiple-party bank accounts are not part of a decedent's probate estate. Multiple-party bank accounts or certificates of deposit are contractual arrangements for the deposit of money with financial institutions.[36] A provision in a will expressly gifting a bank account would not alter the terms of the account contract that provides for survivorship rights or for payment to a "payable on death" (POD) payee or trust account beneficiary. The proceeds of a joint account with survivorship rights, POD account, or trust account do not pass through a decedent's probate estate.[37]

The nature of a joint account depends upon the intent of the parties, not the terms of the agreement with the bank. Absent clear and convincing evidence of a contrary intent, most states presume each account holder owns a fractional share of the account in proportion to her contribution to the account (tenancy in common during life). Absent clear and convincing evidence of a contrary intent, most states also presume the amount remaining on deposit at the death of one of the account holders belongs to the surviving account holders (joint tenancy with right of survivorship upon death).[38]

Uniform Gifts to Minors Accounts — UGMA accounts are revocable gifts to minors that transfer ownership on death of the donor. Essentially UGMA accounts are incomplete gifts revocable by the grantor. At the grantor's death title transfers to the minor, and the successor custodian becomes the trustee for the benefit of the minor. Generally UGMA accounts are not probate assets subject to administration.

Note. Agency or convenience accounts that do not intend the other party to receive the balance of funds when the despoiting party dies are **probate** assets. For example, an investment account managed by a bank trust department is an agency account subject to probate.

A **payable on death (POD) account** is nonprobate property. A POD account becomes payable to designated persons, the POD payees, after the death of all of the original depositors. Each original depositor owns a fractional share of the account in proportion to her contribution to the account. The POD payees' consent or approval of withdrawals is not required.[39]

A **trust bank account** may be titled, "depositor in trust for beneficiary," or "depositor, trustee for beneficiary." Trust accounts are generally treated like POD accounts. Upon the death of all of the trustees, the balance remaining in the account is divided among the surviving beneficiaries.[40] In some states, a trust account belongs beneficially to the trustee during her lifetime unless the account is irrevocable. An irrevocable trust account belongs beneficially to the beneficiary.[41]

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35. Beyer, p. 293
36. Beyer, p. 277, 20 Pa. Cons. Stat. §§6301, 6303, 6304
37. Beyer, p. 284
38. Sprankling, pp. 120–121
39. Beyer, p. 281
40. Beyer, p. 283
41. 20 Pa. Cons. Stat. §6303

TAXATION ISSUES FOR NONPROBATE PROPERTY

JOINT ACCOUNTS

Each joint tenant is entitled to an equal share of the income from the jointly owned property. The beneficiary of life insurance proceeds is not required to pay income tax on the receipt of proceeds.[42]

Example 1. Dad owned a joint bank account with his two sons, Lou and Charlie. Dad had contributed 100% of the funds to the account during his lifetime. The entire account balance on Dad's date of death is included in Dad's estate. The joint account escapes probate. Even if Dad's last will and testament leaves "everything" to charity, Lou and Charlie split the bank account.

Dad also owned a $100,000 life insurance policy that named Lou and Charlie as beneficiaries. Dad was both the owner of the policy and the insured. The life insurance policy escapes probate because Dad had a named beneficiary that was not his estate. Lou and Charlie split the insurance proceeds which are not income taxable to them.

The transaction is taxed as follows:

1. Lou and Charlie pay income tax only on the interest earned on the joint bank account and life insurance proceeds after Dad's death on their individual income tax returns.
2. The interest earned on the joint bank account and the life insurance proceeds after Dad's death will not be included in the estate income tax return.
3. Depending on how the last will and testament is written and the applicable state statute, any state inheritance tax or federal estate tax must be paid either by the estate or by Lou and Charlie.

EMPLOYEE BENEFIT OR RETIREMENT ACCOUNTS

The initial contributions to and subsequent income from employee benefit and retirement plans are not subject to income tax until the employee makes withdrawals. This typically results in income tax savings, because most employees are in a lower income tax bracket after they retire than they are when the contributions are made and the income accrued. Additionally, employers can usually deduct the contributions on their income tax returns. An employee benefit plan that receives this favorable income tax treatment is called a "qualified plan" and is governed by the Employee Retirement Income Security Act of 1974 (ERISA) and various provisions of the Internal Revenue Code.[43]

With a traditional individual retirement arrangement (IRA), the contributor does not pay income tax on qualifying contributions or on the earnings as they accrue, but must pay tax when the contributor makes withdrawals upon retirement. With a Roth IRA, the contributor has paid income tax on contributions; upon retirement, all qualified withdrawals of both original contributions and earnings are income tax free.[44]

Note. See Chapter 6, "Retirement," for more information on the tax treatment of distributions to beneficiaries.

42. Beyer, pp. 288–289
43. Beyer, p. 294
44. Beyer, p. 295

ANNUITIES

Federal income tax on annuities will be paid by the beneficiaries. The tax is based on the difference between the original contribution and the amount distributed, and is taxed as ordinary income.

Planning Note. Designating a trust as the beneficiary can be costly due to the higher tax rates of trusts.

FEDERAL ESTATE TAX

Generally, the full value of jointly-owned property is included in the decedent's estate for federal estate tax purposes. If any part of jointly-owned property was acquired with consideration originally belonging to the surviving joint owner(s), an amount proportionate to the consideration provided by the surviving owner(s) is excluded from the decedent's estate.

IRC §§2033 AND 2040 AND JOINT TENANCY

IRC §2033 provides "The value of the gross estate shall include the value of all property **to the extent of the interest therein of the decedent** at the time of his death."

IRC §2040 reinforces this concept. It states, in part:

The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants . . . except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration.

The phrase "to the extent of the interest therein" limits the inclusion in the gross estate. Consequently, the basis step-up is limited to the portion owned by the decedent, unless the other joint tenant was the original owner.

IRC §2040 states:

Provided, that where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person.

In this subparagraph, "excepted" means that the interest is excluded from the gross estate. Therefore, the interest of a joint tenant who does not pay full consideration for that interest is included in the decedent's gross estate, conferring a step-up is limited in basis. This applies equally to personal and real property and not only to joint tenancies, but also to life estates, and even the mere use of property can confer a step-up in basis.

IRC §2036 AND BENEFICIAL USE

IRC §2036 provides that "the gross estate shall include the value of all property" in which the decedent retained for life or "for any period which does not in fact end before his death . . . the possession or enjoyment of, or the right to the income from, the property," or "the right . . . to designate the persons who shall possess or enjoy the property." Therefore, property in which the donor retained a life estate may be included in the donor's estate for federal estate tax purposes.[45]

However, there is a possible problem with a life estate after 2009. After the termination of the estate tax, the basis of assets acquired from a decedent after 2009 may be increased by $1.3 million plus an additional $3 million for a spouse. But, the termination of a life estate by the death of the life tenant is not considered "acquired" from a decedent under new IRC §1022. Thus, there may be no basis step-up. Similarly, property in which the decedent retained a general power of appointment is not considered acquired from a decedent and may not receive the basis step-up under the new law.

45. Beyer, p. 265

Owning property as joint tenants or reserving a life estate avoids probate while providing the basis step-up, but there are other considerations an individual should note before changing ownership of her property. The most important is the donor's loss of control over the property. Depending upon the nature of the property and how it is titled, the donor may lose the ability to dispose of the property without the permission of other owners. With bank accounts, the opposite problem arises; the other joint tenants have full access to the funds and may remove them at will.

Life insurance on the decedent's life is included in the decedent's estate for federal estate tax purposes. This is true even if the beneficiary is not the decedent's estate, if at death, the decedent possessed any of the incidents of ownership.

FEDERAL GIFT TAX

To compute the amount of federal gift tax due, determine all gifts made by the donor during the donor's entire lifetime. Value each gift. Generally, the value of a gift is its FMV on the date the donor made the gift. Subtract excluded gifts, such as those that qualify for the annual exclusion and the educational and medical expense exclusion. Subtract deductions, such as gifts to a spouse that qualify for the marital deduction and gifts for the public benefit that qualify for the charitable deduction. If the donor made gifts after September 8, 1976, but before January 1, 1977, subtract the amount computed under IRC §2505(b).[46]

Compute the gift tax by calculating the tentative tax on all taxable gifts the donor made over his entire life, subtracting the tentative tax on all taxable gifts made in prior years, and subtracting any unused portion of the applicable credit amount.[47]

When the contributions of joint tenants are not equal, the gift portion of the transfer may trigger tax consequences. For instance, if a parent makes a gift of an undivided one-half interest of a real property to a child, the transfer may be subject to federal gift tax to the extent the value of one-half of the property exceeds the annual exclusion.[48]

Note. The gift tax exemption is $12,000 beginning January 1, 2006.

Example 2. On May 15, 2005, Martha Jones goes to Elder Law Firm and tells Elder Law Attorney she wants to gift her home to her daughter, Jane Jones. Martha wants to add Jane as a joint tenant with the right of survivorship. Martha has one other child.

Martha's spouse died in 1979. Martha bought her home in 1980 for $250,000. Martha made a cash gift of $75,000 to her son after her husband died in 1979, on which $14,300 gift tax was paid.

Elder Law Firm prepares the deed to Martha's home, and Martha executes the deed on June 1, 2005. Martha and Jane now own Martha's home as joint tenants with the right of survivorship.

On July 1, 2005, Martha goes to State Bank and adds Jane as a joint owner on Martha's savings account, which has a balance of $100,000.

Martha must file Form 709 no later than April 17, 2006 because she made a 2005 gift of more than $11,000 to a person other than her spouse. The FMV of Martha's home on June 1, 2005, was $400,000. Martha made a gift of $200,000 (half of the FMV of the real estate) to Jane when Martha added Jane's name to Martha's home.

46. Beyer, pp. 458–459

47. Ibid

48. Beyer, p. 273

For Example 2

Form **709** | **United States Gift (and Generation-Skipping Transfer) Tax Return** | OMB No. 1545-0020
(For gifts made during calendar year 2005)
Department of the Treasury Internal Revenue Service
▶ See separate instructions.
2005

Part 1—General Information

1 Donor's first name and middle initial	2 Donor's last name	3 Donor's social security number
Martha	Jones	123 45 6789
4 Address (number, street, and apartment number)		5 Legal residence (domicile) (county and state)
123 Apple Street		Orange County, PA
6 City, state, and ZIP code		7 Citizenship
Orangeville, PA 12201		U.S.

		Yes	No
8	If the donor died during the year, check here ▶ ☐ and enter date of death .... , ...		
9	If you extended the time to file this Form 709, check here ▶ ☐		
10	Enter the total number of donees listed on Schedule A. Count each person only once. ▶ 1		
11a	Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b	✓	
11b	If the answer to line 11a is "Yes," has your address changed since you last filed Form 709 (or 709-A)?	✓	
12	**Gifts by husband or wife to third parties.** Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (See instructions.) (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. **If the answer is "No," skip lines 13–18 and go to Schedule A.**)		✓
13	Name of consenting spouse — 14 SSN		
15	Were you married to one another during the entire calendar year? (see instructions)		
16	If 15 is "No," check whether ☐ married ☐ divorced or ☐ widowed/deceased, and give date (see instructions) ▶		
17	Will a gift tax return for this year be filed by your spouse? (If "Yes," mail both returns in the same envelope.)		
18	**Consent of Spouse.** I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.		

Consenting spouse's signature ▶ **Date** ▶

Part 2—Tax Computation

1	Enter the amount from Schedule A, Part 4, line 11	1	189,000	
2	Enter the amount from Schedule B, line 3	2	65,000	
3	Total taxable gifts. Add lines 1 and 2	3	254,000	
4	Tax computed on amount on line 3 (see *Table for Computing Gift Tax* in separate instructions)	4	72,160	
5	Tax computed on amount on line 2 (see *Table for Computing Gift Tax* in separate instructions)	5	0	
6	Balance. Subtract line 5 from line 4	6	72,160	
7	Maximum unified credit (nonresident aliens, see instructions)	7	345,800	00
8	Enter the unified credit against tax allowable for all prior periods (from Sch. B, line 1, col. C)	8	14,300	
9	Balance. Subtract line 8 from line 7	9	331,500	
10	Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions)	10	0	
11	Balance. Subtract line 10 from line 9	11	331,500	
12	Unified credit. Enter the smaller of line 6 or line 11	12	72,160	
13	Credit for foreign gift taxes (see instructions)	13	0	
14	Total credits. Add lines 12 and 13	14	72,160	
15	Balance. Subtract line 14 from line 6. Do not enter less than zero	15	0	
16	Generation-skipping transfer taxes (from Schedule C, Part 3, col. H, Total)	16		
17	Total tax. Add lines 15 and 16	17	0	
18	Gift and generation-skipping transfer taxes prepaid with extension of time to file	18		
19	If line 18 is less than line 17, enter **balance due** (see instructions)	19		
20	If line 18 is greater than line 17, enter **amount to be refunded**	20		

Attach check or money order here.

Sign Here — Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than donor) is based on all information of which preparer has any knowledge.

▶ Signature of donor — Date

Paid Preparer's Use Only

Preparer's signature ▶ — Date — Check if self-employed ▶ ☐

Firm's name (or yours if self-employed), address, and ZIP code ▶ **Elder Law Firm**
111 Main St., Elder, PA 55555 — Phone no. ▶ (555) 555-5555

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 12 of the separate instructions for this form. Cat. No. 16783M Form **709** (2005)

For Example 2

Form 709 (2005) Page **2**

SCHEDULE A **Computation of Taxable Gifts** (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . . Yes ☑ No ☐

B ☐ ◀ Check here if you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified tuition program as made ratably over a 5-year period beginning this year. See instructions. Attach explanation.

Part 1—Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions. See instructions.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1	**Jane A. Jones** **456 Lemon Street** **Orangeville, PA 12201** **1/2 Interest in real estate**		**125,000**	**6/1/06**	**200,000**		**200,000**
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 1. Add amounts from Part 1, column H . . . . ▶							**200,000**

Part 2—Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1							
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 2. Add amounts from Part 2, column H . . . . ▶							

Part 3—Indirect Skips. Gifts to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1							
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 3. Add amounts from Part 3, column H . . . . ▶							

(If more space is needed, attach additional sheets of same size.) Form **709** (2005)

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For Example 2

Form 709 (2005) Page **3**

Part 4—Taxable Gift Reconciliation

1	Total value of gifts of donor. Add totals from column H of Parts 1, 2, and 3			1	200,000
2	Total annual exclusions for gifts listed on line 1 (see instructions)			2	11,000
3	Total included amount of gifts. Subtract line 2 from line 1			3	189,000
	Deductions (see instructions)				
4	Gifts of interests to spouse for which a marital deduction will be claimed, based on items .... of Schedule A	4			
5	Exclusions attributable to gifts on line 4	5			
6	Marital deduction. Subtract line 5 from line 4	6			
7	Charitable deduction, based on items .... less exclusions	7			
8	Total deductions. Add lines 6 and 7			8	
9	Subtract line 8 from line 3			9	189,000
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule C, Part 3, col. H, Total)			10	
11	Taxable gifts. Add lines 9 and 10. Enter here and on line 1 of the Tax Computation on page 1			11	189,000

12 Terminable Interest (QTIP) Marital Deduction. (See instructions for Schedule A, Part 4, line 4.)

If a trust (or other property) meets the requirements of qualified terminable interest property under section 2523(f), and:

a. The trust (or other property) is listed on Schedule A, and

b. The value of the trust (or other property) is entered in whole or in part as a deduction on Schedule A, Part 4, line 4, then the donor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2523(f).

If less than the entire value of the trust (or other property) that the donor has included in Parts 1 and 3 of Schedule A is entered as a deduction on line 4, the donor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on Schedule A, Part 4, line 6. The denominator is equal to the total value of the trust (or other property) listed in Parts 1 and 3 of Schedule A.

If you make the QTIP election, the terminable interest property involved will be included in your spouse's gross estate upon his or her death (section 2044). See instructions for line 4 of Schedule A. If your spouse disposes (by gift or otherwise) of all or part of the qualifying life income interest, he or she will be considered to have made a transfer of the entire property that is subject to the gift tax. See *Transfer of Certain Life Estates Received From Spouse* on page 4 of the instructions.

13 Election Out of QTIP Treatment of Annuities

☐ ◄ Check here if you elect under section 2523(f)(6) **not** to treat as qualified terminable interest property any joint and survivor annuities that are reported on Schedule A and would otherwise be treated as qualified terminable interest property under section 2523(f). See instructions. Enter the item numbers from Schedule A for the annuities for which you are making this election ►

SCHEDULE B Gifts From Prior Periods

If you answered "Yes" on line 11a of page 1, Part 1, see the instructions for completing Schedule B. If you answered "No," skip to the Tax Computation on page 1 (or Schedule C, if applicable).

A Calendar year or calendar quarter (see instructions)	B Internal Revenue office where prior return was filed	C Amount of unified credit against gift tax for periods after December 31, 1976	D Amount of specific exemption for prior periods ending before January 1, 1977	E Amount of taxable gifts
1998	Cincinnati, OH	14,300	14,300	65,000
1 Totals for prior periods	1	14,300	14,300	65,000

2	Amount, if any, by which total specific exemption, line 1, column D, is more than $30,000	2	0
3	Total amount of taxable gifts for prior periods. Add amount on line 1, column E and amount, if any, on line 2. Enter here and on line 2 of the Tax Computation on page 1	3	65,000

(If more space is needed, attach additional sheets of same size.) Form **709** (2005)

The donor is responsible for paying any gift tax that is due. In Martha's case, no tax is due.

Martha does not include the savings account on the gift tax return, because Jane has not withdrawn any of the money in the account for Jane's own benefit. Martha has not made a gift to Jane until Jane draws on the account for her own benefit. The amount of the gift is the amount the donee takes without any obligation to repay the donor.

Example 3. Use the same facts as **Example 2.** Martha dies on June 1, 2006, with a gross estate of more than $2 million. Filing of Form 706 is required. The FMV of Martha's home, now $450,000, and the entire value of the savings account are included in Martha's gross estate. Pursuant to IRC §2012(a), a credit is allowed on Form 706, *Federal Estate Tax Return*, for the amount of tax paid for gifts which are included in the gross estate. This avoids double taxation on both gift and estate tax. However, the date of death value is reported on Form 706. Therefore, the increased value of the asset ($450,000) would be includable in the gross estate.

Jane receives a step-up in basis **on the entire value of the real estate,** because the entire value was included in Martha's gross estate. Jane's basis in the real estate is the FMV of the property on Martha's date of death ($450,000).

Example 4. Use the same facts as **Example 3.** On July 1, 2007, Jane sells Martha's home for $500,000. Jane realizes a gain of $50,000 (sale price of $500,000 minus Jane's basis of $450,000). Jane must report the $50,000 on her 2007 individual income tax return.

GIFTING AND TAX BASIS ISSUES

Appreciated assets received by gift generally have a carry-over basis in the hands of the recipient. However, property acquired by reason of the death of another person generally has basis equal to FMV as of the date of death or alternate valuation date. Retention of a joint interest, a life estate, or even a beneficial use causes property to be included in the decedent's gross estate for estate tax purposes. This triggers a basis step-up on the death of the original owner. Property in the decedent's gross estate is property "acquired by reason of death." Thus, counting the property for estate taxes, which is a serious disadvantage for a large estate, has the beneficial side-effect of stepping-up the bases for the beneficiary. This will be adjusted in 2010, unless Congress intervenes.

BASIS FOR SURVIVING SPOUSE IN JOINT INTEREST PROPERTY

To illustrate the surviving spouse rules, consider the following example.

Example 5. Connie and John are married. Connie purchased real property with her own money for $10,000 in 1985, but took title jointly with John. In 2005, when Connie died, the property was worth $100,000. In John's hands, the real property now has a tax basis of $55,000 [$50,000 step-up basis from Connie's death plus $5,000 from John (half of the $10,000 original purchase price)]. The result would be the same if John died, and Connie was the survivor.

FMV at date of death	$100,000
Ownership percentage	× 50%
Value in estate	$ 50,000
John's share of original basis	5,000
John's basis in property	$ 55,000

Note. Assets received from a decedent receive a step up in basis for depreciation purposes. Amounts first reported on Form 1041 may transfer to the beneficiary after the trust files its final return.

There are two important exceptions to this 50% step-up. The first is that both halves of community property have a stepped-up basis on the death of either spouse. There are nine community property states. They are:[49]

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin

The second exception is found in federal case law in the *Gallenstein* case.[50] Mr. Gallenstein purchased property with his own funds in 1955, but took title jointly with his wife. After Mr. Gallenstein's death, his wife claimed that because the property was purchased before the 1977 amendments to IRC §2040, the property should have a full step-up in basis. The IRS only allowed a 50% step-up. The 6th Circuit Court agreed with Mrs. Gallenstein and established a rule for entireties property purchased prior to 1977. On the death of the spouse who provided more than half of the consideration for the purchase, the surviving spouse may claim a basis step-up on the portion of the consideration provided by the deceased spouse.

Typically, for property made joint after 1976, when one spouse dies, only 50% of the entireties property receives a step-up in basis. One tends to reason by extension that the same rule applies to all joint tenancies. Fortunately, for gratuitous joint tenants who are not married, the rule does not apply. Rather, the joint tenant that is not a surviving spouse receives a 100% step-up in basis.

Stepped-up basis is also obtained by an owner of a remainder interest following the decedent's life estate if the decedent owned the entire property before transferring the remainder.

SALE OF PRINCIPAL RESIDENCE

A problem arises if the property is the grantor's principal residence and the grantor decides to sell it after deeding it to others. The seller may exclude up to $250,000 of gain on the sale of a principal residence. However, if the seller does not own the whole property, only a prorated portion of the gain may be excluded. The statue is not explicit on whether the seller must have exclusively owned, as well as lived in the principal residence for the required two years. Consequently, the original owner should be permitted to claim the full exclusion if the joint tenants convey their interests back before the sale. The IRS stated that a joint tenant may exclude gain to the extent of the joint tenant's interest.[51] The IRS's ruling **does not state** that the joint tenant may **only** exclude gain to the extent of the interest. There is very little guidance on this section, and the regulations do not address the issue. The statue does not say that the person must be an "exclusive" owner. It only says "owner."

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49. About.com, *Community Property States*, at taxes.about.com/od/taxglossary/g/CommunityProper.htm (last visited May 31, 2006)

50. *Gallenstein v. U.S.*, 71A, AFTR 2d 93-4963, September 18, 1991

51. Ltr. Rul. 8942008, 1989 WL 596548, October 20, 1989

After sorting out all of the negatives, IRC §121(d)(8)(A) seems to apply to the situation where the owner has conveyed a remainder interest in the property, followed by a sale. If the remainder is sold at the same time as the life interest, the seller may elect to cover both interests under the capital gains exclusion.

Note. It could reasonably be inferred that when the seller is the only resident and the house has been the seller's principal residence for the requisite period, the fact that gratuitous joint tenants give back their interest just before the sale does not prevent the seller from excluding the whole gain. However, some well-respected tax practitioners believe that the seller must have been the sole owner, as well as resident of the property for the entire two years. Considering the lack of a clear answer, some caution and careful counseling are warranted before changing the ownership of a principal residence.

TRUST

Generally, a trust is used when a property owner wants to bestow a benefit upon an individual or charity, but the owner does not want to make an unrestricted outright gift. The owner transfers legal title to a "trustee," and equitable title to a "beneficiary." The trustee manages the trust property according to the original owner's instructions as set forth in the trust instrument. The trustee may make payments to, or for the benefit of the beneficiary according to the trust instrument.[52]

The trustee has a fiduciary duty for the trust property. The trustee must manage the property with reasonable care, avoid self-dealing, and avoid any situation where the trustee's personal interests are in conflict with the beneficiary's interests. If the trustee fails to live up to these standards, he may be held personally responsible in a civil action for damages or criminally responsible.[53] The trustee may receive a fee for serving as trustee. An individual or a bank or trust company can serve as trustee.

The most common reason for creating a trust is to provide for and protect someone. A property owner may want to convey property in trust to a minor, to an individual who lacks the skills necessary to manage property, to an individual who is prone to use property in an excessive or frivolous manner, or to an individual who is susceptible to influence from others.[54]

TYPES OF TRUSTS

There are many different types of trusts. In addition, these trusts may have different variations. These variations include:

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1. Revocable versus Irrevocable

These terms identify whether the trust can be changed by the grantor up to the time of his death.

A revocable trust may be amended or terminated by the settler during his life. A revocable trust may include a provision, such as the following:

The trust created by this agreement shall be revocable. *The donor may revoke or amend this agreement by delivering a written request during the donor's life to any trustee, but no amendment shall increase the trustee's duties or liabilities without the trustee's consent.*

52. Beyer, p. 299

53. Beyer, p. 300

54. Beyer, pp. 301–02

An irrevocable trust may not be amended or terminated after it is created. An irrevocable trust may include a provision, such as the following:

The trust created by this agreement shall be irrevocable. *The donor may not revoke or amend this agreement in any way. The trustee, however, may at any time, or from time to time, amend any administrative provision of this trust by any instrument in writing signed and acknowledged by the trustee. For purposes of the foregoing, the term "administrative provision" refers to any provision of the trust dealing with the management and administration of the trust, and in no event shall any such amendment affect, enlarge, or shift any beneficial interests created hereunder.*

Under the law, an irrevocable trust is treated as a separate entity.

2. Testamentary versus Inter Vivos

These terms describe when the trust comes into existence.

A testamentary trust is created within a last will and testament and does not take effect until the death of the settlor.[55] A testamentary trust does not avoid probate.[56] A testamentary trust requires the will to be probated. Therefore, the trust may then be accountable and have to report to the court, under state law. Because of the "paperwork" involved in formally transferring property into the trust, many people leave the trust unfunded. This only serves to add to the work of the trustee because the "paperwork" must be completed at the time of death.

An inter vivos trust is created by the settlor during his life and becomes operative during the settlor's life.[57] An inter vivos trust avoids probate. When the settlor dies, the property remaining in the trust is distributed according to the terms of the trust. It does not pass through the settlor's will.[58]

3. Self-Settled versus Third-Party

These terms describe the funding source for the trust.

A **self-settled trust**, or a first-party trust, is one funded with the beneficiary's own assets for the beneficiary's own benefit. Typically, this occurs when a person with a disability wins a lawsuit and places the settlement into a supplemental needs or a special needs trust. A self-settled trust can also come about when an inheritance is placed into a trust after it is distributed by the estate to the person with a disability.[59]

A **third-party trust** is created with funds from a third party. A third-party trust is created by an individual other than the disabled person for the benefit of the disabled person with the third party's own assets, such as a parent creating a trust for a child.[60]

4. Funded versus Unfunded

This describes whether assets have been transferred into the trust. A trust may remain "empty" during the grantor's lifetime, however to function at all, it must have assets formally transferred to the trustee. Unless the asset is transferred into the trust, the asset becomes part of the probate estate.

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55. *Black's Law Dictionary* (6th ed. 1990)

56. Beyer, p. 304

57. *Black's Law Dictionary* (6th ed. 1990)

58. Beyer, p. 303

59. Martha A. Churchill & Patricia E. Kefalas Dudek, *Self-Settled Trusts*, The National Fragile X Foundation, at www.fragilex.org/html/self-settled.htm (last visited May 18, 2006)

60. Wikipedia, *Supplemental Needs Trust*, at en.wikipedia.org/wiki/Supplemental_Needs_Trust (last modified May 8, 2006)

5. Grantor versus Nongrantor

The grantor is the person who creates the trust. The trust is disregarded for income tax purposes and the grantor is taxed on the trust income if he retains substantial control of the trust assets. If the grantor only retains partial control, the grantor is treated as the owner of the assets, but the income is taxed to the trust or its beneficiaries. If the grantor does not retain power to revoke the trust or retain sufficient control in some other way, the trust is a nongrantor trust.

INCOME TAXATION OF GRANTOR TRUSTS

A grantor trust may occur when the grantor:

- Retains a reversionary interest in the trust income or principal,
- Retains the power to revoke the trust,
- Derives benefit from the income,
- Retains power over beneficial enjoyment, or
- Is able to exercise certain administrative powers over the trust's operation.

Except for retaining a reversionary interest in the trust, the grantor is not considered the owner of the trust. Even if he meets the other factors listed above, he is not considered the owner if an adverse party must consent to the grantor's exercise of control.

A person with a substantial beneficial interest in the trust, and who would be adversely affected by the exercise or nonexercise of the grantor's powers is considered an adverse party.[61] Trust beneficiaries are usually considered adverse parties, but only for that portion of the income or principal to which they are entitled. A remainder beneficiary is not considered an adverse party over income, but only to distributions of principal.

The use of grantor trusts is an effective planning tool in the field of elder law. Grantor trusts do not need to be assigned an employer identification number. Rather, these trusts can use the donor's social security number. The most common forms of grantor trusts are revocable trusts. There is a common misconception that irrevocable trusts cannot be grantor trusts. However, many irrevocable trusts are able to be classified as grantor trusts.

The grantor can be treated as the owner of any portion of the trust in which he has a reversionary interest in the income or corpus of the trust.[62] An example of a reversionary interest is one that is created upon the death of someone else. For instance, a son may give an income interest to his mother for her life. Upon her death, the principal of the trust reverts back to him. This is a reversionary interest and that portion of the trust property could be taxed to the grantor.

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The grantor can be treated as the owner if he retains the power to control the beneficial enjoyment of the trust principal or income.[63] Examples of this include the power to apply income for the support of a dependent, and the power to allocate among charitable beneficiaries.

The grantor can be treated as the owner of the portion of the trust in which the grantor can deal with property for less than adequate consideration.[64] An example of this is when the grantor retains the power to gift the property to another person. In addition, if the grantor retains the power to borrow funds without adequate consideration, the grantor would be determined to retain control.

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61. IRC §672
62. IRC §673
63. IRC §674
64. IRC §675

The grantor can be treated as the owner of the portion of the trust in which the grantor has the discretion of allocating the income.[65] Common irrevocable trusts are referred to as income-only trusts. In these trusts, the grantor retains the income for his life.

INCOME TAXATION OF NONGRANTOR TRUSTS

A trustee must file Form 1041 for a trust that has any taxable income for the tax year or gross income of $600 or more regardless of taxable income. A trust calculates its gross income similar to the manner in which an individual calculates her gross income. Most deductions and credits permitted to individuals are also permitted to trusts. However, the one major difference is that a trust is allowed an income distribution deduction for distributions to beneficiaries. To calculate this deduction, the trustee must complete Form 1041, Schedule B. The income distribution deduction determines the amount of any distributions taxed to the beneficiaries. A trust is sometimes referred to as a "pass-through" entity, because the beneficiary, not the trust, pays the income tax on his distributive share of income. The trustee uses Form 1041, Schedule K-1 to notify the beneficiaries of the amounts to include on their individual income tax returns.

The income distribution deduction is for amounts paid, credited, or required to be distributed to beneficiaries. The income distribution deduction is limited to the distributable net income (DNI). The DNI is calculated on Form 1041, Schedule B, line 7. DNI is used to determine what portion of an amount paid, credited, or required to be distributed to a beneficiary is included in the beneficiary's gross income. DNI is the income of an estate or trust that is available for distribution.[66]

A trust whose governing instrument requires all income to be distributed currently is permitted a $300 exemption, even if it distributed amounts other than income during the tax year.

A trust is a "simple" trust if the trust instrument requires that all income must be distributed currently, no amounts are used for charitable purposes, and no distributions are from the corpus of the trust. A "complex" trust is any trust that does not qualify as a simple trust.

The trustee must sign Form 1041. If there are joint trustees, only one is required to sign the return.

> **Caution.** The computation of a trust's taxable income is similar to, but does not follow the same format as, that used by an individual taxpayer. This computation was covered in detail in the *2005 University of Illinois Federal Tax Workbook.*

SPECIALIZED TRUSTS

Special Needs Trust

Parents, and other family members of special needs children contribute to the child's needs in various ways. For instance, they may provide the funds to allow the child to attend a camp for special needs children. Many of the things the parent provides cannot be funded by SSI or Medicaid. Many parents want to continue to provide similar opportunities after the parents' death. However, if the parent leaves the child an inheritance by simply naming the child in the will as a beneficiary, the child may lose his SSI and Medicaid benefits. The benefit loss can be overcome with the use of a supplemental or special needs trust.

The special or supplemental needs trust may be either self-funded, or funded by a third party. The purpose of either type of trust is to provide benefits to and protect the assets of a disabled person, and still allow the person to receive governmental health and disability benefits. The assets in the special needs trust can be used to pay for the beneficiary's special and supplemental needs for which the government does not provide. For instance, the assets in

65. IRC §677

66. McEowen, p. 13

the trust can be used to pay for an aide to accompany a disabled person on a family cruise so the disabled person can join the rest of the family, but not be a burden.[67] Typically, the trustee of a special needs trust is prohibited from making distributions that provide the beneficiary with food or shelter. Language contained in a supplemental needs trust gives the trustee more discretion and may include:

Purpose of the Supplemental Needs Trust. *The purpose of this trust is to supplement, but not to supplant, whatever benefits and services the primary beneficiary may from time to time be eligible to receive by reason of age, disability, or other factors, from federal, state, and local governmental and charitable sources. I have entered into this trust with the recognition that governmental and charitable programs, in themselves, contain many gaps that, if unaddressed, will greatly reduce the possibility of the primary beneficiary maintaining himself as independently as possible and having the capacity to meet his future needs for residential, personal, and other nonmedical services. It is, therefore, my intent and direction that the trustee use the principal and income of the trust to provide the primary beneficiary with those benefits and services, and only those benefits and services, that, in the trustee's judgment, are not otherwise available to the primary beneficiary from other sources as or when needed for his welfare. Without limiting the discretion of the trustee to take whatever actions it may consider necessary for the primary beneficiary's welfare, in accordance with the trust purposes, I desire that the trust be used in ways that will best enable the primary beneficiary to lead as normal, comfortable, and fulfilling a life as possible.*

Payment of Income and Principal of the Supplemental Needs Trust. *The making and the amount of any payment from the trust shall be totally and solely within the discretion of the trustee, provided that the trustee shall not make payments directly to the primary beneficiary in excess of twenty dollars ($20.00) per calendar month. Whenever the trustee has discretion to pay income or principal to the beneficiary, the trustee may make the payments at any time, in any amounts and proportions, and for any purposes as the trustee considers advisable. The trustee may take into account any factors he or she considers appropriate, having regard for the purposes of the trust described above. Neither the primary beneficiary nor any person acting on his behalf as guardian, conservator, guardian ad litem, attorney, or agent, except for the trustee alone, shall have any right, power, or authority to liquidate the trust, in whole or in part, or to require payments from the trust for any purpose. The trustee is directed to conserve and accumulate the trust estate to the extent feasible, due to the unforeseeability of the primary beneficiary's future needs. However, accumulation or use of the trust is to be determined solely on the basis of the needs of the primary beneficiary, without regard to the interests of the remaindermen.*

In order for a **self-settled trust** not to be counted as an asset for governmental benefits purposes, the trust must have a "payback" provision. Upon the death of the beneficiary, the state must be reimbursed for the costs of the medical assistance that was provided. For instance, wording in a self-settled trust may include:

Distribution of Supplemental Needs Trust Upon Death of Primary Beneficiary. *Upon the death of the primary beneficiary, the trustee shall distribute an amount of the remaining trust assets, principal and accumulated income, as required under 42 U.S.C. 13 96p(d)(4)(A), or any regulations promulgated thereunder, or the corresponding provisions of any subsequent federal law, to any state providing medical assistance on the primary beneficiary's behalf, equal to the total previously unreimbursed medical assistance paid on the primary beneficiary's behalf under the state's plan under Title 42 U.S.C. 1396(a) et seq.,and shall forthwith distribute the balance of the trust to the primary beneficiary's surviving siblings.*

Depending on the value of the trust and the amount of funding from SSI and Medicaid, the trust may pay out all the proceeds upon the death of the special needs child. However, the trust has allowed the special needs child to enjoy a better quality of life.

11

67. Keep Media, *Kiplinger's Retirement Report: A Trust That Keeps Blooming for Beneficiaries*, www.keepmedia.com/pubs/KiplingersRetirementReport/2004/03/01/403600/?extID=10047&data=third-party_trust (last visited May 18, 2006)

Living Trust

Living trusts are very common. They are widely discussed in books and advertising. The term "living" comes about because they are created during the grantor's lifetime rather than by will. **It is very important to understand that these trusts do not save taxes.** The trust can save probate costs, but the assets are subject to tax as if no trust existed. The savings of probate costs should be evaluated in each state because probate costs in some states are minimal.

This is a revocable trust which becomes irrevocable at the time of the grantor's death. Because the grantor may have been serving as the trustee, it is important that the trust have a named successor trustee. The living trust does not eliminate the need for a will.

In the case of a married couple, the trust can remain revocable until the death of the surviving spouse. When the survivor dies, the trust assets may remain in the trust for the benefit of all beneficiaries, or they may be transferred into separate trusts, each benefiting only one beneficiary.

Caution. Taxpayers should seek legal counsel before forming a living trust.

In addition to avoiding probate, another advantage of the trust is the time required before assets can be distributed. Probating a will can take up to six months or more. A notice must be published to notify creditors to come forward and make any claims against the decedent. If the credit fails to make a claim within a certain period of time, he forfeits any right to collect the debt. With a trust, the trustee can immediately distribute trust assets according to the terms of the trust. Because the trust is not required to publish a notice, it may be possible for a creditor to come forward after the assets are distributed to collect a debt of the decedent.

MARITAL DEDUCTION AND BYPASS TRUST (A/B TRUST)

This is a common trust used by married taxpayers who are attempting to pass the maximum amount of wealth to their heirs by minimizing federal estate taxes, but yet retaining maximum control over their assets. Married taxpayers whose joint estate does not exceed $2 million do not benefit from this type of trust today; however, unless the estate laws change before 2011, this trust can create substantial tax savings.

A married taxpayer can leave his entire estate to his spouse without any federal estate tax. However, when the surviving spouse dies, she can have a substantial estate tax liability because her estate consists of the assets of both people. Based on this premise, the first person to die leaves the maximum amount of the estate tax exemption in the "B" trust with the income going to his spouse for her lifetime, and the assets going to his other heirs at her death. He leaves the remainder of his estate directly to the spouse in the "A" trust, thereby escaping estate tax on his entire estate. He may also choose to leave a larger amount in the "A" trust to ensure that the spouse has adequate access to assets for life. For instance, if the estate is worth $2.5 million, the remaining spouse may desire to have access to more than just the $500,000. In addition, the exact amount available to fund either trust can depend on the nature of the assets which make up the estate. Special attention must be paid to estates which contain business or farming assets.

Because the surviving spouse does not have control of the assets in the "B" trust, they are not taxed at her death. However she has total control of the "A" trust assets and consequently they become a part of her estate. This trust arrangement has effectively eliminated any federal estate tax on the current $2 million exemption amount.

LIFE INSURANCE TRUST

A life insurance trust is one which is usually irrevocable and is permitted to purchase life insurance. The advantage of the life insurance trust is that the proceeds of the insurance policy are not taxable in the estate of the decedent. In order to preserve the advantage of this type of trust, the taxpayer must follow very strict rules and should follow the advice of a professional estate planner.

CHARITABLE TRUSTS

There are several types of charitable trusts. One purpose of a charitable trust is to allow the taxpayer to claim a current charitable income tax deduction without foregoing the current income benefits of the assets. The **charitable remainder trust (CRT)** is an irrevocable trust which serves this purpose. One type of CRT is the **charitable remainder annuity trust (CRAT).** The grantor transfers assets into the trust which generates annual income. The trust distributes a fixed amount of income to the grantor (beneficiary) each year with the remainder of the trust assets transferring to the charity at the grantor's death.

A second type of CRT is the **charitable remainder unitrust (CRUT).** One difference with the CRUT is that the grantor/beneficiary receives a fixed percentage of the trust assets each year.

> **Example 6.** On January 15, 2004, Fred Smith goes to Elder Law Firm and tells Elder Law Attorney he wants a revocable trust to avoid probate. Elder Law Attorney explains the advantages and disadvantages of a revocable trust.
>
> **Advantages of a Revocable Trust.** Elder Law Attorney tells Fred that he can modify or terminate a revocable trust during his life. A revocable trust can protect children or other beneficiaries of Fred's estate from their own inexperience, while providing for their care and custody. Additionally, the assets in the trust may be protected from a medical assistance estate recovery program if Fred's trust has named beneficiaries. Furthermore, the assets held in the revocable trust do not need to be probated upon Fred's death. Consequently, the revocable trust avoids probate fees which are normally minimal.
>
> **Disadvantages of a Revocable Trust.** Elder Law Attorney explains to Fred that the assets held in a revocable trust are available to pay for the grantor's nursing home care. Elder Law Attorney advises Fred that a revocable trust does not reduce state inheritance tax and does not ensure privacy. The state inheritance tax return will be on file at the local county courthouse, and the assets and beneficiaries will be listed on the inheritance tax return. Elder Law Attorney tells Fred that a trust is not a substitute for a last will and testament.
>
> **The Fred Smith Revocable Trust.** Fred decides that he wants a revocable trust. Fred is a widower. Fred has two children, Sam Smith, who is 28 years old, and Sally Smith, who is 17 years old. Fred is the trustee of the trust during his life. During Fred's life, the trustee (Fred) may pay to himself and his children as much of the trust principal and income as he desires. He has no obligation to make any distribution.
>
> Upon Fred's death, Sam is the trustee. When Fred dies, Sam must pay half of the principal and income of the trust outright to himself. The other half of the trust principal and income shall remain in trust for the benefit of Sally until she reaches age 21. Upon Fred's death, the revocable trust becomes irrevocable. Sam must distribute all the income from the trust to Sally in annual payments. The trustee may pay as much of the principal at his sole discretion as necessary for Sally's maintenance, support, medical expenses, education, and best welfare.
>
> Elder Law Firm prepares the revocable trust for Fred, and Fred executes The Fred Smith Revocable Trust (trust) on February 1, 2004. Fred also executes a last will and testament (will) on February 1, 2004. In his will, Fred gives his estate in equal shares to Sam and Sally, with Sally's share to be held in The Fred Smith Revocable Trust until Sally reaches age 21. Fred appoints Sam as the executor of his will.
>
> **Funding the Trust.** On February 1, 2004, Fred executes a deed for his home granting his home to his trust. The trust indicates that on Fred's death, the real estate shall be sold and the proceeds distributed as indicated above. On February 5, 2004, Elder Law Firm sends a letter to State Bank asking the bank to change the ownership of Fred's $100,000 certificate of deposit (C.D.) to the trust. State Bank calls Elder Law Attorney and asks for the employer identification number (EIN) for the trust. Elder Law Attorney explains that the trust does not need an EIN, because it is a grantor trust under the Internal Revenue Code. State Bank uses Fred's social security number.

Income Taxes. Fred, as the trustee, does not make any trust distributions in 2004. Fred has to file his income taxes for 2004 no later than April 15, 2005. Fred claims the interest from the CD in the trust on his 2004 individual income tax return. Since the trust is owned by one grantor, Fred may choose an optional method of reporting instead of filing Form 1041. Pursuant to one of the optional methods of reporting, Fred, as the trustee, must give all payers of income (State Bank) the name (Fred), taxpayer identification number of the grantor (Fred's social security number), and the address of the trust (Fred's address).

Fred Dies. Fred dies on June 1, 2005. Sam, as the executor of Fred's will, must file a final Form 1040 for Fred no later than April 17, 2006. The final Form 1040 includes the interest income of the trust from January 1, 2005, until Fred's date of death.

Upon Fred's death, the trust becomes irrevocable. Sam, as the trustee, must apply for an EIN for the trust using Form SS-4.

The trust earned $1,000 of income from June 1, 2005, to December 31, 2005. Sam must file Form 1041 for the trust, because the trust has taxable income for the tax year and/or gross income of $600 or more.

Sam must complete Schedule K-1 (Form 1041), because under the trust, the entire $1,000 of income was distributed to Sally in 2005. A Schedule K-1 must be issued to the beneficiary of a trust and filed with Form 1041 if the beneficiary received a distribution from the trust during the tax year. Sally must include in her gross income the $1,000 distribution she received.

For Example 6

Form **SS-4** (Rev. February 2006)
Department of the Treasury Internal Revenue Service

Application for Employer Identification Number

(For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, Indian tribal entities, certain individuals, and others.)

► See separate instructions for each line. ► Keep a copy for your records.

OMB No. 1545-0003

EIN **20-1234567**

Type or print clearly.

1 Legal name of entity (or individual) for whom the EIN is being requested
The Fred Smith Revocable Trust

2 Trade name of business (if different from name on line 1)

3 Executor, administrator, trustee, "care of" name
Sam Smith, Trustee

4a Mailing address (room, apt., suite no. and street, or P.O. box)
123 Maple Street

5a Street address (if different) (Do not enter a P.O. box.)

4b City, state, and ZIP code
Treeville, PA 12345

5b City, state, and ZIP code

6 County and state where principal business is located
Forest County, PA

7a Name of principal officer, general partner, grantor, owner, or trustor
Fred Smith

7b SSN, ITIN, or EIN
123-45-6789

8a **Type of entity** (check only one box)
- ☐ Sole proprietor (SSN)
- ☐ Partnership
- ☐ Corporation (enter form number to be filed) ►
- ☐ Personal service corporation
- ☐ Church or church-controlled organization
- ☐ Other nonprofit organization (specify) ►
- ☐ Other (specify) ►
- ☐ Estate (SSN of decedent)
- ☐ Plan administrator (SSN)
- ☒ Trust (SSN of grantor) **123 45 6789**
- ☐ National Guard
- ☐ Farmers' cooperative
- ☐ REMIC
- ☐ State/local government
- ☐ Federal government/military
- ☐ Indian tribal governments/enterprises

Group Exemption Number (GEN) ►

8b If a corporation, name the state or foreign country (if applicable) where incorporated | State | Foreign country

9 **Reason for applying** (check only one box)
- ☐ Started new business (specify type) ►
- ☐ Hired employees (Check the box and see line 12.)
- ☐ Compliance with IRS withholding regulations
- ☐ Other (specify) ►
- ☐ Banking purpose (specify purpose) ►
- ☐ Changed type of organization (specify new type) ►
- ☐ Purchased going business
- ☒ Created a trust (specify type) ► **Irrevocable Trust**
- ☐ Created a pension plan (specify type) ►

10 Date business started or acquired (month, day, year). See instructions.
6-1-05

11 Closing month of accounting year
December

12 First date wages or annuities were paid (month, day, year). **Note.** If applicant is a withholding agent, enter date income will first be paid to nonresident alien. (month, day, year) . . . . ► **N/A**

13 Highest number of employees expected in the next 12 months (enter -0- if none).
Do you expect to have $1,000 or less in employment tax liability for the calendar year? ☐ **Yes** ☐ **No.** (If you expect to pay $4,000 or less in wages, you can mark yes.)

Agricultural	Household	Other
0	**0**	**0**

14 Check **one** box that best describes the principal activity of your business.
- ☐ Construction
- ☐ Real estate
- ☐ Rental & leasing
- ☐ Manufacturing
- ☐ Transportation & warehousing
- ☐ Finance & insurance
- ☐ Health care & social assistance
- ☐ Accommodation & food service
- ☒ Other (specify) **Trust Administration**
- ☐ Wholesale–agent/broker
- ☐ Wholesale–other
- ☐ Retail

15 Indicate principal line of merchandise sold, specific construction work done, products produced, or services provided.
Trust

16a Has the applicant ever applied for an employer identification number for this or any other business? . . . . ☐ **Yes** ☒ **No**
Note. If "Yes," please complete lines 16b and 16c.

16b If you checked "Yes" on line 16a, give applicant's legal name and trade name shown on prior application if different from line 1 or 2 above.
Legal name ► Trade name ►

16c Approximate date when, and city and state where, the application was filed. Enter previous employer identification number if known.
Approximate date when filed (mo., day, year) | City and state where filed | Previous EIN

Third Party Designee

Complete this section **only** if you want to authorize the named individual to receive the entity's EIN and answer questions about the completion of this form.

Designee's name | Designee's telephone number (include area code) ( )

Address and ZIP code | Designee's fax number (include area code) ( )

Under penalties of perjury, I declare that I have examined this application, and to the best of my knowledge and belief, it is true, correct, and complete.

Name and title (type or print clearly) ► **Sam Smith, Trustee**

Applicant's telephone number (include area code) (**123**) **456-7890**

Applicant's fax number (include area code) (**123**) **456-7800**

Signature ► Date ►

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 16055N Form **SS-4** (Rev. 2-2006)

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For Example 6

Form **1041** Department of the Treasury—Internal Revenue Service
U.S. Income Tax Return for Estates and Trusts **2005** OMB No. 1545-0092

A Type of entity (see instr.):	For calendar year 2005 or fiscal year beginning , 2005, and ending , 20	
☐ Decedent's estate ☒ Simple trust	Name of estate or trust (If a grantor type trust, see page 12 of the instructions.) **The Fred Smith Revocable Trust**	**C** Employer identification number **11 1234567**
☐ Complex trust ☐ Qualified disability trust	Name and title of fiduciary **Sam Smith**	**D** Date entity created **06/01/2005**
☐ ESBT (S portion only) ☐ Grantor type trust ☐ Bankruptcy estate–Ch. 7	Number, street, and room or suite no. (If a P.O. box, see page 12 of the instructions.) **123 Number Street**	**E** Nonexempt charitable and split-interest trusts, check applicable boxes (see page 13 of the instr.): ☐ Described in section 4947(a)(1)
☐ Bankruptcy estate–Ch. 11 ☐ Pooled income fund	City or town, state, and ZIP code **Treesville, PA 55555**	☐ Not a private foundation ☐ Described in section 4947(a)(2)
B Number of Schedules K-1 attached (see instructions) ▶ **1**	**F** Check applicable boxes: ☐ Initial return ☐ Final return ☐ Amended return ☐ Change in fiduciary ☐ Change in fiduciary's name	☐ Change in trust's name ☐ Change in fiduciary's address

G Pooled mortgage account (see page 14 of the instructions): ☐ Bought ☐ Sold Date:

Income	1	Interest income . . . **See Statement 1**	1	**1,000**
	2a	Total ordinary dividends	2a	
	b	Qualified dividends allocable to: (1) Beneficiaries ______ (2) Estate or trust ______		
	3	Business income or (loss) (attach Schedule C or C-EZ (Form 1040))	3	
	4	Capital gain or (loss) (attach Schedule D (Form 1041))	4	
	5	Rents, royalties, partnerships, other estates and trusts, etc. (attach Schedule E (Form 1040))	5	
	6	Farm income or (loss) (attach Schedule F (Form 1040))	6	
	7	Ordinary gain or (loss) (attach Form 4797)	7	
	8	Other income. List type and amount	8	
	9	**Total income.** Combine lines 1, 2a, and 3 through 8 ▶	9	**1,000**
Deductions	10	Interest. Check if Form 4952 is attached ▶ ☐	10	
	11	Taxes	11	
	12	Fiduciary fees	12	
	13	Charitable deduction (from Schedule A, line 7)	13	
	14	Attorney, accountant, and return preparer fees	14	
	15a	Other deductions **not** subject to the 2% floor (attach schedule)	15a	
	b	Allowable miscellaneous itemized deductions subject to the 2% floor	15b	
	16	Add lines 10 through 15b ▶	16	
	17	Adjusted total income or (loss). Subtract line 16 from line 9 . . 17 **1,000**		
	18	Income distribution deduction (from Schedule B, line 15) (attach Schedules K-1 (Form 1041))	18	**1,000**
	19	Estate tax deduction (including certain generation-skipping taxes) (attach computation)	19	
	20	Exemption	20	**300**
	21	Add lines 18 through 20 ▶	21	**1,300**
Tax and Payments	22	Taxable income. Subtract line 21 from line 17. If a loss, see page 20 of the instructions	22	**(300)**
	23	**Total tax** (from Schedule G, line 7)	23	**0**
	24	**Payments: a** 2005 estimated tax payments and amount applied from 2004 return	24a	
	b	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	24b	
	c	Subtract line 24b from line 24a	24c	
	d	Tax paid with Form 7004 (see page 20 of the instructions)	24d	
	e	Federal income tax withheld. If any is from Form(s) 1099, check ▶ ☐	24e	
		Other payments: **f** Form 2439 ______ ; **g** Form 4136 ______ ; Total ▶	24h	
	25	**Total payments.** Add lines 24c through 24e, and 24h ▶	25	
	26	Estimated tax penalty (see page 20 of the instructions)	26	
	27	**Tax due.** If line 25 is smaller than the total of lines 23 and 26, enter amount owed	27	
	28	**Overpayment.** If line 25 is larger than the total of lines 23 and 26, enter amount overpaid	28	
	29	Amount of line 28 to be: **a Credited to 2006 estimated tax** ▶ ; **b Refunded** ▶	29	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of fiduciary or officer representing fiduciary | Date | ▶ EIN of fiduciary if a financial institution

May the IRS discuss this return with the preparer shown below (see instr.)? ☐ Yes ☐ No

Paid Preparer's Use Only

Preparer's signature **Elder Attorney**	Date	Check if self-employed ☐	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code	**East Central FBFM Association**	EIN	
	900 Washton, Tuscola, IL 61953	Phone no.	(**217**) **123-4567**

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2005)

For Example 6

Form 1041 (2005) The Fred Smith Revocable Trust 11-1234567 Page **2**

Schedule A **Charitable Deduction.** Do not complete for a simple trust or a pooled income fund.

1	Amounts paid or permanently set aside for charitable purposes from gross income (see page 21)	1	
2	Tax-exempt income allocable to charitable contributions (see page 21 of the instructions)	2	
3	Subtract line 2 from line 1	3	
4	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes	4	
5	Add lines 3 and 4	5	
6	Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes (see page 21 of the instructions)	6	
7	**Charitable deduction.** Subtract line 6 from line 5. Enter here and on page 1, line 13	7	

Schedule B **Income Distribution Deduction**

1	Adjusted total income (see page 22 of the instructions)	1	1,000
2	Adjusted tax-exempt interest	2	
3	Total net gain from Schedule D (Form 1041), line 15, column (1) (see page 22 of the instructions)	3	
4	Enter amount from Schedule A, line 4 (reduced by any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1 (see page 22 of the instructions)	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	
7	**Distributable net income (DNI).** Combine lines 1 through 6. If zero or less, enter -0-	7	1,000
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law (8)		
9	Income required to be distributed currently	9	1,000
10	Other amounts paid, credited, or otherwise required to be distributed	10	
11	Total distributions. Add lines 9 and 10. If greater than line 8, see page 22 of the instructions	11	1,000
12	Enter the amount of tax-exempt income included on line 11	12	
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	1,000
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	1,000
15	**Income distribution deduction.** Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	1,000

Schedule G **Tax Computation** (see page 23 of the instructions)

1	**Tax: a** Tax on taxable income (see page 23 of the instructions)	1a			
	b Tax on lump-sum distributions (attach Form 4972)	1b			
	c Alternative minimum tax (from Schedule I, line 56)	1c			
	d Total. Add lines 1a through 1c ▶			1d	0
2a	Foreign tax credit (attach Form 1116)	2a			
b	Other nonbusiness credits (attach schedule)	2b			
c	General business credit. Enter here and check which forms are attached: ☐ Form 3800 ☐ Forms (specify) ▶	2c			
d	Credit for prior year minimum tax (attach Form 8801)	2d			
3	**Total credits.** Add lines 2a through 2d ▶			3	0
4	Subtract line 3 from line 1d. If zero or less, enter -0-			4	
5	Recapture taxes. Check if from: ☐ Form 4255 ☐ Form 8611			5	
6	Household employment taxes. Attach Schedule H (Form 1040)			6	
7	**Total tax.** Add lines 4 through 6. Enter here and on page 1, line 23 ▶			7	0

	Other Information	**Yes**	**No**
1	Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses		X
	Enter the amount of tax-exempt interest income and exempt-interest dividends ▶ $		
2	Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement?		X
3	At any time during calendar year 2005, did the estate or trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country?		X
	See page 25 of the instructions for exceptions and filing requirements for Form TD F 90-22.1. If "Yes," enter the name of the foreign country ▶		
4	During the tax year, did the estate or trust receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the estate or trust may have to file Form 3520. See page 25 of the instructions		X
5	Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see page 25 for required attachment		X
6	If this is an estate or a complex trust making the section 663(b) election, check here (see page 25) ▶ ☐		
7	To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here (see page 25) ▶ ☐		
8	If the decedent's estate has been open for more than 2 years, attach an explanation for the delay in closing the estate, and check here ▶ ☐		
9	Are any present or future trust beneficiaries skip persons? See page 26 of the instructions		X

Form **1041** (2005)

11

For Example 6

Form 1041 (2005) **The Fred Smith Revocable Trust** **11-1234567** Page **3**

Schedule I **Alternative Minimum Tax** (see pages 26 through 32 of the instructions)

Part I—Estate's or Trust's Share of Alternative Minimum Taxable Income

1	Adjusted total income or (loss) (from page 1, line 17)	1	1,000
2	Interest	2	
3	Taxes	3	
4	Miscellaneous itemized deductions (from page 1, line 15b)	4	
5	Refund of taxes	5	( )
6	Depletion (difference between regular tax and AMT)	6	
7	Net operating loss deduction. Enter as a positive amount	7	
8	Interest from specified private activity bonds exempt from the regular tax	8	
9	Qualified small business stock (see page 27 of the instructions)	9	
10	Exercise of incentive stock options (excess of AMT income over regular tax income)	10	
11	Other estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A)	11	
12	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	12	
13	Disposition of property (difference between AMT and regular tax gain or loss)	13	
14	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)	14	
15	Passive activities (difference between AMT and regular tax income or loss)	15	
16	Loss limitations (difference between AMT and regular tax income or loss)	16	
17	Circulation costs (difference between regular tax and AMT)	17	
18	Long-term contracts (difference between AMT and regular tax income)	18	
19	Mining costs (difference between regular tax and AMT)	19	
20	Research and experimental costs (difference between regular tax and AMT)	20	
21	Income from certain installment sales before January 1, 1987	21	( )
22	Intangible drilling costs preference	22	
23	Other adjustments, including income-based related adjustments	23	
24	Alternative tax net operating loss deduction (See the instructions for the limitation that applies.)	24	( )
25	Adjusted alternative minimum taxable income. Combine lines 1 through 24	25	1,000
	Note: *Complete Part II below before going to line 26.*		
26	Income distribution deduction from Part II, line 44 — 26: 1,000		
27	Estate tax deduction (from page 1, line 19) — 27:		
28	Add lines 26 and 27	28	1,000
29	Estate's or trust's share of alternative minimum taxable income. Subtract line 28 from line 25	29	

If line 29 is:

- $22,500 or less, stop here and enter -0- on Schedule G, line 1c. The estate or trust is not liable for the alternative minimum tax.
- Over $22,500, but less than $165,000, go to line 45.
- $165,000 or more, enter the amount from line 29 on line 51 and go to line 52.

Part II—Income Distribution Deduction on a Minimum Tax Basis

30	Adjusted alternative minimum taxable income (see page 30 of the instructions)	30	1,000
31	Adjusted tax-exempt interest (other than amounts included on line 8)	31	
32	Total net gain from Schedule D (Form 1041), line 15, column (1). If a loss, enter -0-	32	0
33	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes (from Schedule A, line 4)	33	
34	Capital gains paid or permanently set aside for charitable purposes from gross income (see page 30 of the instructions)	34	
35	Capital gains computed on a minimum tax basis included on line 25	35	( )
36	Capital losses computed on a minimum tax basis included on line 25. Enter as a positive amount	36	0
37	Distributable net alternative minimum taxable income (DNAMTI). Combine lines 30 through 36. If zero or less, enter -0-	37	1,000
38	Income required to be distributed currently (from Schedule B, line 9)	38	1,000
39	Other amounts paid, credited, or otherwise required to be distributed (from Schedule B, line 10)	39	
40	Total distributions. Add lines 38 and 39	40	1,000
41	Tax-exempt income included on line 40 (other than amounts included on line 8)	41	
42	Tentative income distribution deduction on a minimum tax basis. Subtract line 41 from line 40	42	1,000
43	Tentative income distribution deduction on a minimum tax basis. Subtract line 31 from line 37. If zero or less, enter -0-	43	1,000
44	**Income distribution deduction on a minimum tax basis.** Enter the smaller of line 42 or line 43. Enter here and on line 26	44	1,000

Form **1041** (2005)

For Example 6

661105

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0092

Schedule K-1 (Form 1041) **2005**

Department of the Treasury
Internal Revenue Service

For calendar year 2005, or tax year beginning ________, 2005 and ending ________, 20 ____

Beneficiary's Share of Income, Deductions, Credits, etc. ► See back of form and instructions.

Part I Information About the Estate or Trust

A Estate's or trust's employer identification number

11-1234567

B Estate's or trust's name

The Fred Smith Revocable Trust

C Fiduciary's name, address, city, state, and ZIP code

Sam Smith
123 Number Street
Treesville, PA 55555

D ☐ Check if Form 1041-T was filed and enter the date it was filed ____/____/____

E ☐ Check if this is the final Form 1041 for the estate or trust

F ☐ Tax shelter registration number, if any ________

G ☐ Check if Form 8271 is attached

Part II Information About the Beneficiary

H Beneficiary's identifying number

456-78-9100

I Beneficiary's name, address, city, state, and ZIP code

Sally Smith
456 Alpha Lane
Treesville, PA 55555

J ☒ Domestic beneficiary ☐ Foreign beneficiary

Part III Beneficiary's Share of Current Year Income, Deductions, Credits, and Other Items

1	Interest income	1,000	
2a	Ordinary dividends		
2b	Qualified dividends		
3	Net short-term capital gain		
4a	Net long-term capital gain		
4b	28% rate gain		
4c	Unrecaptured section 1250 gain		
5	Other portfolio and nonbusiness income		
6	Ordinary business income		
7	Net rental real estate income		
8	Other rental income		
9	Directly apportioned deductions		
10	Estate tax deduction		
11	Final year deductions		
12	Alternative minimum tax adjustment		
13	Credits and credit recapture		
14	Other information	E	1,000

*See attached statement for additional information.

Note: A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041. Cat. No. 11380D **Schedule K-1 (Form 1041) 2005**

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LONG-TERM CARE PLANNING EXAMPLE

Note. This example relies on information contained in both this chapter and Chapter 10, "Elder Issues."

The following case illustrates a client who is seeking advice on estate planning and long-term health care planning. If this were an actual situation, the planner would collect additional client information.

Client Names	Date of Birth	Years of Age
Cody Allen	7/1/1924	82
Cortney Allen	5/1/1925	81

Address
1417 Happy Valley Ln.
Somewhere, PA 17701
(570) 555-5555

Children	Spouse	# Children
Stephanie 54 Camelot LockOut, PA 17745 (570) 555-5554	Lee Smith	3
McKennan 1155 Suzietown Rd. All About, PA 17721 (570) 555-5553	Julian Jones	2
James 1750 Orangeville Rd. Orangetown, PA 17740 (570) 555-5552	Ann Allen	3

ASSETS

Description	Ownership	Basis	FMV	Countable Assets Cody	Countable Assets Cortney
Personal residence	Joint	$15,000	$ 97,490	$ 0	$ 0
Savings					
Happy Valley Bank	Joint	3,700	3,700	3,700	3,700
Checking					
Friendly Credit Union	Joint	5,000	5,000	5,000	5,000
Certificate of Deposit					
Southeastern Bank	Joint		7,000	7,000	7,000
Retirement Plans					
Retire Young Investment IRA	Cody	0	17,000	17,000	0
Investments					
GIN Brokerage Acct #1	Joint	12,158	30,200	30,200	30,200
GIN Brokerage Acct #2	Cody	24,694	49,500	49,500	49,500
Life Insurance					
Blessed Life Ins. Co.	Cody		5,200	4,200	4,200
Face value: $49,225					
Beneficiary: Cortney					
Contingent beneficiary: children					
Family Protection Life Ins. Co.	Cody		7,700	7,700	7,700
Face value: $7,220					
Beneficiary: Cortney					
Contingent beneficiary: children					
Savings Bond Series EE	Joint	15,000	24,200	24,200	24,200
Stock					
Young People of America					
960 shares @ $66.50	Joint	26,163	63,840	63,840	63,840
Total FMV of Assets			$310,830	$212,340	$195,340
Long-term care insurance					
Premium: $3,060/yr					
Benefit: $100/day					

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LIABILITIES

None

INCOME

Source	Recipient	Monthly	Annual
Pension: J & D Excavating	Cody	$ 825	$ 9,900
Social Security	Cody	1,067	12,804
Cody's income		$1,892	$22,704
Social Security	Cortney	$ 413	$ 4,956

LONG-TERM HEALTH CARE PLAN — CODY AND CORTNEY ALLEN

> **Note.** This plan attempts to make a recommendation for estate and long-term care planning options. Some of the options may vary from state to state. The purpose of this analysis is to discuss the advantages and disadvantages of different options based on legal and tax considerations.

Cody and Cortney's Concern

They want to protect their home and other assets from the cost of nursing home care, if required**.**

Assets

The total FMV of Cody's and Cortney's assets is $310,830. This amount must be adjusted to determine what amount of assets are "countable" or available for nursing home or in-home care costs.

- Total countable assets if **Cody** requires nursing home or in-home care today are approximately **$212,340** ($310,830 – $97,490 FMV of house – $1,000 cash value life insurance threshold).
- Total countable assets if **Cortney** requires nursing home or in-home care today are approximately **$195,340** ($212,340 – $17,000 IRA).
- "Countable" assets generally include all belongings **except:**
  - Personal possessions, such as clothing, furniture, and jewelry (not reported on the previous table);
  - One motor vehicle (not reported on the previous table);
  - An applicant's principal residence (therefore the $97,470 value of the house is not countable as an available asset);
  - Assets that are considered inaccessible for one reason or another, such as a spouse's IRA or other type of retirement plan. (Therefore the $17,000 is not "countable" for Cortney's nursing home care.); and
  - The first $1,000 of cash value of life insurance, if the face value of the life insurance exceeds $1,500. (Therefore, only $11,900 of the life insurance is used as a countable asset in the above calculations.)

Medicaid for Nursing Home Care

For the most part, if a person requires nursing home care or in-home care, he either has to pay this cost out of pocket or qualify for Medicaid.

An applicant for Medicaid may have no more than **$2,400** in countable assets in his name if his income is **$1,809** or more per month. An applicant may have no more than **$8,000** in countable assets if his income is less than **$1,809** per month.

Cody's monthly income is more than **$1,809**, so he is permitted to keep **$2,400** of his countable assets and is still eligible for Medicaid.

Cortney's monthly income is less than **$1,809**, so she is permitted to keep **$8,000** of her countable assets and is still eligible for Medicaid.

The healthy spouse is allowed to keep half of the countable assets up to a maximum of **$99,540** and a minimum of **$19,908**.

If Cody required nursing home care, Cortney, as the healthy spouse, is permitted to keep **$99,540** of the countable assets ($212,340 ÷ 2 = $106,170, but the maximum limit is $99,540).

If Cortney required nursing home care, Cody, as the healthy spouse, is permitted to keep **$97,670** of the countable assets ($195,340 ÷ 2 = $97,670).

The bottom line:

- If **Cody** needs nursing home care today, approximately **$110,400** ($212,340 – $99,540 – $2,400) of his countable assets would be available to pay for his nursing home care.
- If **Cortney** needs nursing home care today, approximately **$89,670** ($97,670 – $8,000) of her countable assets would be available to pay for her nursing home care.
- While Medicaid will pay for one spouse's care as described above, the rules are much less generous if both spouses should require nursing home care.
- The second spouse would have to spend down his savings to **$8,000** (if his income is less than **$1,809** per month) or **$2,400** (if his income is **$1,809** or more per month), and pay all but $40 per month of his income to the nursing home.

Home

An applicant's home is considered a "noncountable" resource. This means that an applicant for Medicaid may continue to own his home if he claims it as his residence, regardless of whether he has no realistic prospect of returning home. However, if his home remains in his estate after the death of the second spouse, federal law, the Omnibus Reconciliation Act of 1993, mandates that states recover correctly-paid medical assistance from estates of certain decedents. Therefore, some states place an automatic lien on the home to the extent of its expenses for the decedent's care. Thus, to the extent his home remains in his probate estate, it is subject to estate recovery by the State.

The Allens' current deed does not indicate that their property is owned as tenants in common, tenants by the entireties or joint tenants with right of survivorship; therefore, their property may be subject to estate recovery after the death of the first spouse.

ESTATE PLANNING DOCUMENTS

Power of Attorney. Cody and Cortney executed powers of attorney on March 9, 1987. They need to update these for several reasons:

- The law regarding powers of attorney changed; therefore, these documents are not adequately drafted.
- They do not contain a notice or acknowledgments.
- They do not contain comprehensive financial or health care powers.
- They do not contain gifting powers, which restricts their agent's ability to engage in long-term care planning on their behalf.
- They do not address the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

Living Will. Cody and Cortney do not have living wills. A living will is included in the health care powers of attorney prepared by Elder Law office.

Last Will and Testament. Cody and Cortney executed last will and testaments on March 9, 1987. Their wills need to be updated because they do not contain a bypass clause.

Cody and Cortney should consider using wills which contain a provision whereby the community spouse's estate bypasses the spouse who is in a nursing home. This prevents the community spouse's assets from passing to the institutionalized spouse, making the institutionalized spouse ineligible for Medicaid until his assets are reduced to no more than **$8,000** (the asset limit for a single person with income less than **$1,809** per month).

However, even with a bypass clause, under state law, some of the community spouse's estate may be available for the institutionalized spouse's nursing home care.

ASSET PROTECTION OPTIONS

Pursuant to the Deficit Reduction Act of 2005, for transfers after February 8, 2006, the ineligibility period may begin on the date when the Medicaid application is filed and the applicant is determined to be eligible for Medicaid if it were not for the transfer(s). However, when applying for Medicaid, an applicant is only penalized for those transfers made during the five years preceding the date of the application.

The table on the following two pages outlines several asset protections available to the Allens.

Option	Advantages	Disadvantages
Transfer of home: reserving a **life estate** and giving a remainder interest to their children.	They would retain current ownership of their property while their children would automatically have ownership after the Allens pass away.	The children may be subject to state inheritance tax on the entire value of the property. The children and their spouses (depending on state law) would have to sign the deed if the Allens were to sell or mortgage the property or change their mind about to whom it should go. If the Allens sold their home, the children would be entitled to a portion of the proceeds from the sale. The property is vulnerable in the event of a child's divorce, lawsuit, or bankruptcy.
Adding one child as a **joint tenant with right of survivorship.**	The child would have an undivided one-third ownership interest in the property during the Allens' life and automatically have ownership after they pass away. **Basis:** The child would receive a step-up in basis on the entire value of the property.	The child and his or her spouse (depending on state law) would have to sign the deed if the Allens were to sell or mortgage the property or change their mind about to whom it should go. If the Allens sold their home, the child would be entitled to a portion of the proceeds from the sale. The property is vulnerable in the event of the child's divorce, lawsuit, or bankruptcy.
Granting the home to an **irrevocable asset protection trust.**	The Allens would retain control over their home. The Allens' property would be protected in the event of a child's divorce, lawsuit, or bankruptcy. The Allens' property would be protected in the event of their children or their children's spouse's decision not to sign the deed if the Allens wished to sell the property during their life. **Basis:** The children would receive a step-up in basis on the entire value of the property if the trust passes at the Allens' death.	
Transfer some of the assets to the children.	Making gifts outright rather than to a trust makes the transfer simple to accomplish. The assets transferred to children would be protected from the cost of the Allens' in-home and nursing home care.	The Allens' assets would be subject to their children's divorce, lawsuit, or bankruptcy. The Allens' assets would not be protected if their children or their children's spouses decided not to retain the assets for the Allens' use. **Basis:** The children would not receive a step-up in basis.

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Option	Advantages	Disadvantages
Transfer nonresidential assets to an irrevocable asset protection trust. The Allens would retain control over their assets.	Their assets would be protected in the event of their children's divorce, lawsuit, or bankruptcy. Their assets would be protected in the event of their children's or their children's spouse's decision not to retain the assets for the Allens' use. The assets transferred to their irrevocable asset protection trust would be protected from the cost of their nursing home care. **Basis:** Their children would receive a step-up in basis.	The Allens' assets would not be protected from the cost of their in-home care.
Transfer to an income-only trust.	The principal of the trust is protected from the cost of the Allens' nursing home care. The income from the trust is available to pay for their nursing home care. The principal of the trust is protected from the cost of their in-home care. **Basis:** The children would receive a step-up in basis.	The grantor would have access only to the income. The Allens would not have access to the principal of the trust. Because of this disadvantage, if the Allens choose to use an income-only trust, they also may want to use an irrevocable asset protection trust. They would have access to the principal and income of the assets in the irrevocable asset protection trust.
Execute a care coordination agreement. If someone eventually coordinates their care, the Allens could enter into an agreement, which would indicate that the caregiver would receive compensation, or a set amount of money for the help provided.	It eliminates the transfer penalty that makes a person ineligible for Medicaid for one month for every $6,757.67 given away.	The compensation must be reported as income.
Purchase long-term care insurance.	The Allens have long-term care insurance. The average cost of nursing home care is approximately $225 per day. The Allens should consider purchasing additional long-term care insurance so that they have $225 per day of nursing home coverage to pay for their nursing home care, if required, during the look-back period (the next five years).	

RECOMMENDATIONS OF ELDER LAW ATTORNEY

- Execute updated financial and health care powers of attorney.
- Execute updated last will and testaments.
- Prepay your funerals or place $7,500 per person into an irrevocable burial account.
- Execute an irrevocable asset protection trust.
- Execute a deed for your home granting your home to your irrevocable asset protection trust.
- If the Allens transfer their home, they should notify their homeowner's insurance company of the conveyance.
- The Allens should consider transferring the investments they have with GIN (account numbers 5551212 and 123456789) and their Young People of America stock to their asset protection trust.
- The Allens' qualified assets should not be put into their asset protection trust at this time. Transferring ownership of these assets to the trust would cause income taxes to be due on the assets. The cost and/or benefit of this should be reviewed in the future.
- The Allens should not transfer all of their assets to their trust at this time, because they may need money outside of the trust to pay for their nursing home care during the ineligibility period outlined above.

Note. The prior example is only an illustration. These recommendations may differ depending on the professional providing the plan, the state law involved, and the goals of the clients.