

# Enduring Wealth



THE LAW OFFICES OF JOHN C. MARTIN

Volume 1, Issue 2

April 2009

## Advanced Health Care Directives: Food for Thought



Popular news stores make clear the necessity of advanced health care directives. Many of us have heard the horror stories of Nancy Cruzan and Terry Schiavo— young women who suffered debilitating accidents in the prime of their lives and never emerged from coma. Painful and drawn out legal battles ensued over whether the to “pull the plug.” Religious, political, and familial considerations all played a role in determining how Terry’s and Nancy’s health care decisions should be made. What about their own

beliefs? If Terry Schiavo and Nancy Cruzan had advanced health care directives in place, the uncertainty, endless litigation, and pain could have been avoided.

Here’s a list of things to consider about advanced health care directives: (1) are spiritual values and personal priorities important to you when making medical decisions? (2) Can you think of any situations in which you would *not* want medical treatments to keep you alive? (3) Do you hold beliefs that would dictate the way in which your remains were treated after your death? For instance, would you like to make clear to family and friends your wishes about burial, autopsy, and organ donations? (4) Think about the pros and cons of certain health treatments if you became seriously ill. If the treatments had very severe side effects, would that deter you from seeking those treat-

ments? (5) When choosing someone who will make health care decisions for you during a medical crisis, what criteria would you base your decision upon? The state of California has certain legal criteria for agents that act on your behalf in medical situations. Consult with an attorney to determine whether this criteria would be satisfied. Moreover, would that person be able to speak for you in the event of a crisis? Would they be able to keep their own wishes and your desires separate? Would it be practicable for them to stay by your side in the case of a medical crisis? Think carefully about this one. (6) Finally, remember that communication with relatives and close friends about medical treatment decisions is crucial. Explain to them your wishes for medical treatment so that others will fully understand. It can be difficult to have this discussion, but it can alleviate doubts, pain, and the anxiety that results from a lack of planning.

## Five Ways that an ILIT can Turbo-Charge your Estate Plan

What is an irrevocable life insurance trust (“ILIT”) and why would it be useful to me? This article explores the upsides and downsides of the “ILIT.” The author concludes that an ILIT is both a cost-effective and powerful tool for providing liquidity, paying estate tax, avoiding Generation Skipping Transfer Tax (GSTT), protecting beneficiaries from creditors, and for business owners, keeping a

business in the family.

An ILIT is an irrevocable trust that holds life insurance. Its primary purpose is to keep life insurance proceeds out of the estate of the settlor. But it can also have a number of other purposes. Below are five reasons why one might consider an ILIT:

First, an ILIT is an attractive alternative to other estate planning

strategies that involve transferring substantial amounts of assets out of one’s estate. Grantor Retained Annuity Trusts (GRATs), Charitable Lead Trusts (CLTs), and other trust arrangements may involve the transfer of valuable income producing *Continued on Page 2....*

### What’s Making News at Law Offices of John C. Martin

- NEW TO THE WEBSITE: SIGN UP FOR OUR WEEKLY NEWSLETTER!
- CHECK OUT OUR ARTICLES AND INFORMATION PAGE

### Inside this issue:

FIVE WAYS AN ILIT CAN TURBO-CHARGE YOUR ESTATE PLAN **2**

NOW IS THE TIME TO GIFT: THE CLAT EXAMINED **3**



## Enduring Wealth

### Five Ways that an ILIT can Turbo-Charge your Estate Plan

“IN AN ESTATE LADEN WITH ILLIQUID REAL ESTATE ASSETS, AN ILIT CAN BE ESSENTIAL IN ORDER TO PAY A LARGE ESTATE TAX BILL ....”

Continued from page 1 ...or business assets that most if not all would be hesitant to transfer out of their control (not to mention that the ILIT usually costs less). Yet, transferring a life insurance policy comes more easily: While premiums must be paid, the proceeds are only payable to beneficiaries upon death. Thus, there is not a great fear that transferring the policy would deprive the owner of its benefit.

Second, and most importantly, an ILIT that is structured properly provides liquidity. In an estate laden with illiquid real estate assets, an ILIT can be essential in order to pay a large estate tax bill without selling off assets. Consider the example of Robert and Sally Colmery. Over their lifetimes, Robert and Sally accumulated a small real estate empire throughout California, including a Palo Alto home (\$3,000,000), a vacation home in Tahoe (\$1,000,000) and three rentals in San Mateo (together worth \$2,500,000). Robert's liquid assets were mostly spent by the end of his life, amounting to \$150,000. At the end of his and Sally's life, \$3,150,000 of the estate will be subject to the federal estate tax at a rate of 45%, and Robert's and Sally's children, Peter and Ruth, will not have sufficient cash to cover the bill unless they sell off some of the properties.

Now let's assume that Robert establishes a qualifying ILIT with a second-to-die insurance policy naming his children, Peter and Ruth, as remainder beneficiaries, and pays the premiums by using his

\$13,000 annual gift tax exclusion. Robert structures the payment of premiums with the help of an attorney so that they do not trigger any gift tax by using something called a "Crummey" power. At the time of the second spouse's death, the proceeds of the life insurance policy will pass estate tax-free. As a result, Peter and Ruth are not forced to sell off the real estate when they inherit.

Third, an ILIT can be used to leverage the insured's GSTT exemption. Whenever we would like to give to our grandchildren or to individuals removed by 2 or more generations, the IRS imposes a second layer of tax called the GST tax. However, a \$1 million exemption exists to which transfers to a trust can be allocated at the time of such transfer. If the amounts transferred to a trust appreciate, the ratio of assets exempt from GSTT to non-exempt assets will remain constant. As a result, if the entire transfer to the ILIT is allocated to the GSTT exemption (an inclusion ratio of zero), all GST tax can be eliminated at the final distribution, even if the trust enjoys considerable income over the years.

For instance, let's say that Robert sets up a generation-skipping ILIT. The ILIT directs the proceeds from the life insurance to be invested in securities. All net income is payable to Peter and Ruth over their lifetime, with a remainder interest to Peter and Ruth's children. Normally, Peter and Ruth's children would be liable for GST tax at the maximum applicable federal rate when they take. However, if the ILIT is set up so

that the inclusion ratio of assets subject to GSTT is zero, Peter and Ruth's grandchildren will pay no GST tax. If ILIT assets grow at a modest rate, the grandchildren would take potentially significant amounts without incurring any additional GST or estate tax liability.

Fourth, Robert can also protect his children and grandchildren from future creditors by including a spendthrift provision in the trust document and granting discretion to the trustee in giving distributions to the beneficiaries. If the ILIT is set up with investments or cash that Robert doesn't need to access, the amounts can be shielded from Peter's and Ruth's creditors.

Fifth, while the ILIT is non-amendable, it can be structured so that beneficiaries are incentivized to engage in positive behavior. The trustee may be given directions to not make distributions until the beneficiaries reach a certain age, or unless they have demonstrated positive behavior. For instance, they can be directed to withhold funds that would pay for a drug addiction, gambling, or otherwise. The trustee can be directed to pay for the education, business planning, or other positive expenditures that the beneficiaries may require.

The settlor should be cautious when establishing an ILIT. Take note of the following caveats: (1) there must not be incidents of ownership by the owner / insured within 3 years of purchase of the policy; (2) The reciprocal trust doctrine may bring the proceeds of the policy back into the estate...

*Continued on the Next Page.*



An ILIT can ease the estate tax burden on one's children, allowing them to keep a family home.



**Compassionate, Straightforward, No Surprises.**

THE LAW OFFICES OF JOHN C. MARTIN

*The Law Offices of John C. Martin was founded in order to help individuals, families, and businesses on the San Francisco Peninsula and beyond with their Estate Planning needs. We are dedicated to compassionate, thoughtful estate planning that leaves clients loving their lawyer. First and foremost, we've tossed out the billable hour and charge only flat fees. Second, we've streamlined the follow-up process so that clients receive guaranteed regular review. Finally, we offer the option of membership in a VIP club to all estate planning clients for a monthly fee. Members receive unparalleled access to follow up meetings, review of assets, family conversations, insurance updates, discounts on future legal work, and more....*

1145 Merrill Street  
Menlo Park, CA 94025

Phone: 650-329-9500  
Fax: 650-289-0984  
E-mail: [jcm@johncmartinlaw.com](mailto:jcm@johncmartinlaw.com)

**We're on the web!**  
<http://JohnCMartinLaw.com>

### **Five Ways that an ILIT can Turbo-Charge your Estate Plan**

*Continued from page 2 ... (i.e., when two spouses who set up life insurance policies on each other at the same time); (3) gift tax consequences may result with funded ILITs. Consider the use of the annual gift tax exemption with an un-*

funded ILIT.

In conclusion, the ILIT is a powerful and cost-effective estate planning strategy. Often more attractive to individuals than strategies that require transfer

of income-producing assets, the ILIT can ensure that estate taxes are paid; that beneficiaries are provided for according to the principal's wishes; and that the GST, estate, or gift tax are reduced or eliminated.

### **Now is the Time to Gift: the CLAT Examined**

Today's low interest rates and depressed asset valuations are creating a tremendous opportunity to plan with Charitable Lead Annuity Trusts ("CLATs"). The CLAT sprang to public attention upon the death of Jacqueline Kennedy Onassis, whose will provided for a testamentary Charitable Lead Annuity Trust (CLAT) to benefit her children. By using a CLAT, Jacqueline Kennedy Onassis' estate was able to claim a charitable deduction of 97% of CLAT assets. What could be better, we might ask: benefiting one's favorite charities and gifting to one's children with minimal tax at the same time. As a result of remarkably low in-

terest rates and depressed asset values, it's not just millionaires who might benefit from a CLAT. Like Jacqueline, individuals with little or lots to give can benefit a charity for a term of years through CLATs, leaving a remainder to their children. The more that the assets grow, the more can pass to one's beneficiaries tax-free. In this article, attorney John Martin explores why individuals might choose to set up a CLT.

The gift that keeps on giving. With proper planning and foresight, a CLAT allows one to give to charity and provide for non-charitable beneficiaries in ways that outright gifts would not allow.

Suppose for instance, that Jack Spear gives \$100,000 to a 2-year CLAT that pays an annuity of \$50,000 per year to the SPCA of San Francisco. Assume that the applicable interest rate is 5% and that CLAT assets grow by 7% compounded annually. This would result in a \$92,970 charitable interest. At the end of the trust term, the amount in the trust would be \$10,991, which is equal to would pass to the beneficiaries without additional gift tax. Thus, Jack has gifted to charity and his children, all while reducing the tax costs of doing so.



The gift that keeps giving

Law Offices of John C. Martin  
1145 Merrill St.  
Menlo Park, CA 94025



This newsletter is not and should not be construed as the provision of legal advice or the formation of an attorney client relationship. Please do not communicate confidential information by email. Thank you.

IRS CIRCULAR 230 NOTICE: To the extent that this newsletter or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law.