

USING THE HANGING POWER OF APPOINTMENT TO QUALIFY A GST GIFT FOR THE ANNUAL EXCLUSION

PERTINENT INFORMATION

- ❑ Mr. Kugler (age 55) is a widower with two children and two grandchildren.
- ❑ He is in the process of establishing a multiple skip “dynasty” life insurance trust and would like the Trust to be totally exempt for Generation Skipping Transfer Tax purposes.

ESTATE PLANNING CONCERNS

- ❑ So that annual gifts will qualify for the gift tax Annual Exclusion, each of the four trust beneficiaries will have a \$10,000 “Crummey” withdrawal right.
- ❑ When beneficiaries allow their respective withdrawal right to lapse, it may be a taxable gift.
- ❑ If so, each beneficiary then becomes a transferor for any lapse amount in excess of \$5,000, or 5% of Trust principal. In other words, the beneficiary is considered to withdraw the excess over the five and five amount and contribute it back to the Trust (IRC Section 2514(e)).
- ❑ The lapse of the “excess” withdrawal right creates an estate tax problem for the beneficiary, because the “excess” gift is back to the Trust in which the beneficiary has an income interest (IRC Section 2036(a)).
- ❑ The lapse of the *children's* “excess” withdrawal right may also create a future generation-skipping transfer because the ultimate trust beneficiaries will be Mr. K's great grandchildren (the children's grandchildren).

PROPOSED ARRANGEMENT

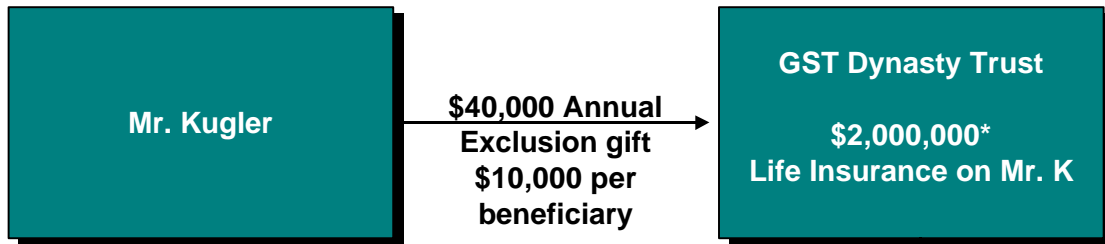
- ❑ Structure the \$10,000 Crummey withdrawal right as a “hanging” power, which provides that the gift in excess of the “five and five” withdrawal amount will not lapse. The excess hanging power amounts are carried forward by each Crummey beneficiary and allowed to lapse in subsequent years, when the \$5,000 or 5% amounts may not be needed for current gifts.
- ❑ The hanging amounts may begin to lapse when the policy cash value exceeds \$200,000 and the 5% lapse amount is greater than the \$10,000 gift, or when gifts are no longer required because premiums may be paid from policy dividends and cash value (not guaranteed).

RESULTS AND BENEFITS

- ❑ Assume the \$40,000 gift should fund the purchase of a \$2,000,000 life insurance policy and also qualify for the Gift Tax Annual Exclusion (not the GST Annual Exclusion).*
- ❑ There is no change of transferor because the lapse in each year never exceeds the allowable \$5,000 or 5% amount for each beneficiary under IRC section 2514(c); the excess amounts do not lapse.
- ❑ As a result, you never have a lapse in any year in excess of the allowable “five-and-five” amount. Thus the transferor never changes, and problems associated with the changing transferor may be eliminated.
- ❑ The Trust is now structured as a multiple skip “Dynasty” trust, and there is no estate tax inclusion or GST tax (exempt trust-- zero Inclusion Ratio) for the entire trust period, so long as total annual gifts to the Trust by Mr. K do not exceed \$1,000,000 (\$40,000 for 25 years).

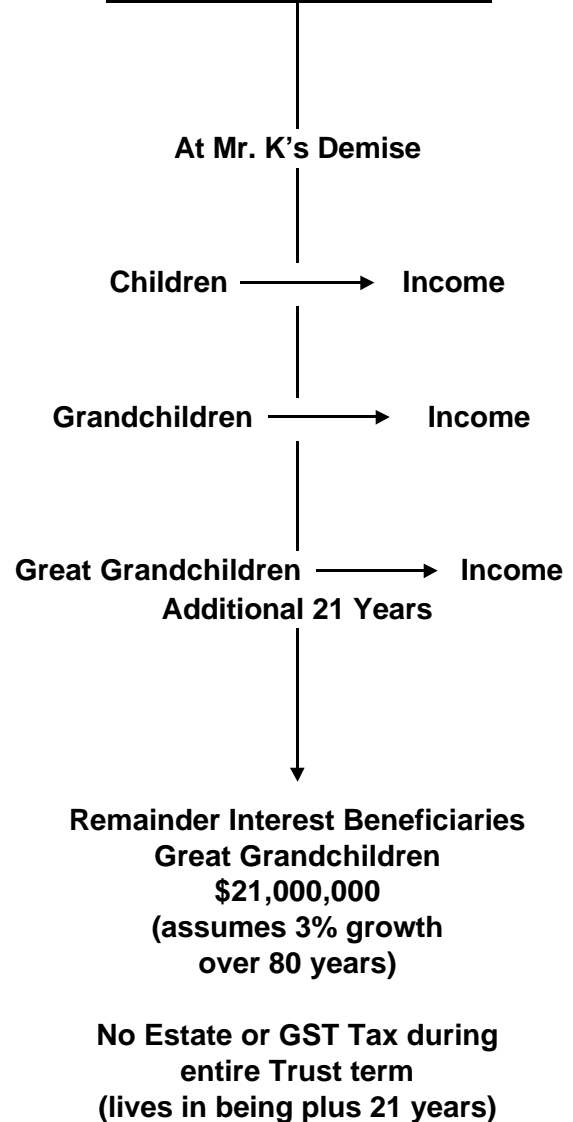
* See important information for clients on disclosure page

PROPOSED ARRANGEMENT



TAX CONSIDERATIONS		
Gift Tax		GST Tax
\$40,000	Annual Gift	\$40,000
40,000	Annual Exclusion	0
625,000	Exemption	1,000,000
0	Exemption Utilized	\$40,000 per year

The above \$40,000 gift will *not* qualify for the GST Annual Exclusion. To qualify, it must be a direct skip gift for the sole benefit of each grandchild. Thus the annual \$40,000 gift for 25 years will be applied against the \$1,000,000 exemption. An annual gift tax return must be filed for the sole purpose of allocating GST Exemption to the gift to maintain a zero GST inclusion ratio.



Note: In the year the insured grantor dies, the \$2,000,000 life insurance proceeds should allow each Crummey beneficiary to lapse up to \$100,000 (5% of \$2,000,000) without gift tax consequences. This may cover any cumulative hanging amounts that may still be outstanding (any excess hanging amount may be withdrawn).

Note: If the Crummey beneficiary dies before the insured grantor, any cumulative hanging amount would be included in the beneficiary's gross estate. The beneficiary's GST Exemption should be applied to this gift because his grandchildren are the ultimate Trust beneficiaries.

Note: The above assumes gift in a year when the Applicable Exclusion Amount is \$625,000.

* See important information for clients on disclosure page