

SAMPLE CASE STUDIES

FAMILY WEALTH COUNSELING CASE STUDY

DANIEL AND CATHY CARLSON

Daniel and Cathy Carlson are in every sense philanthropic. Daniel, in his late 60s when we met, was a successful attorney. Cathy, in her mid-60s, was a devoted mother and homemaker. Daniel was slowing down in his profession and spending more time developing his philanthropic endeavors. Cathy was already involved with volunteer work and overseeing several philanthropic programs.

Over the years, Daniel had endowed a chair for approximately \$1 million at his alma mater. He and Cathy, together, were contributing approximately \$250,000 a year to various charitable causes. They lived modestly and were very private individuals.

Daniel was doing a last-minute review of the family estate plan before he and Cathy were to leave on an extended vacation. Daniel was told the entire estate could be subject to a 60% transfer tax should they both die.

The Carlsons were referred to us, and we showed them how our Family Wealth Counseling process would enable them to use their Social Capital (tax dollars) to perpetuate their family legacy by redirecting their taxes from the government to the causes they already supported.

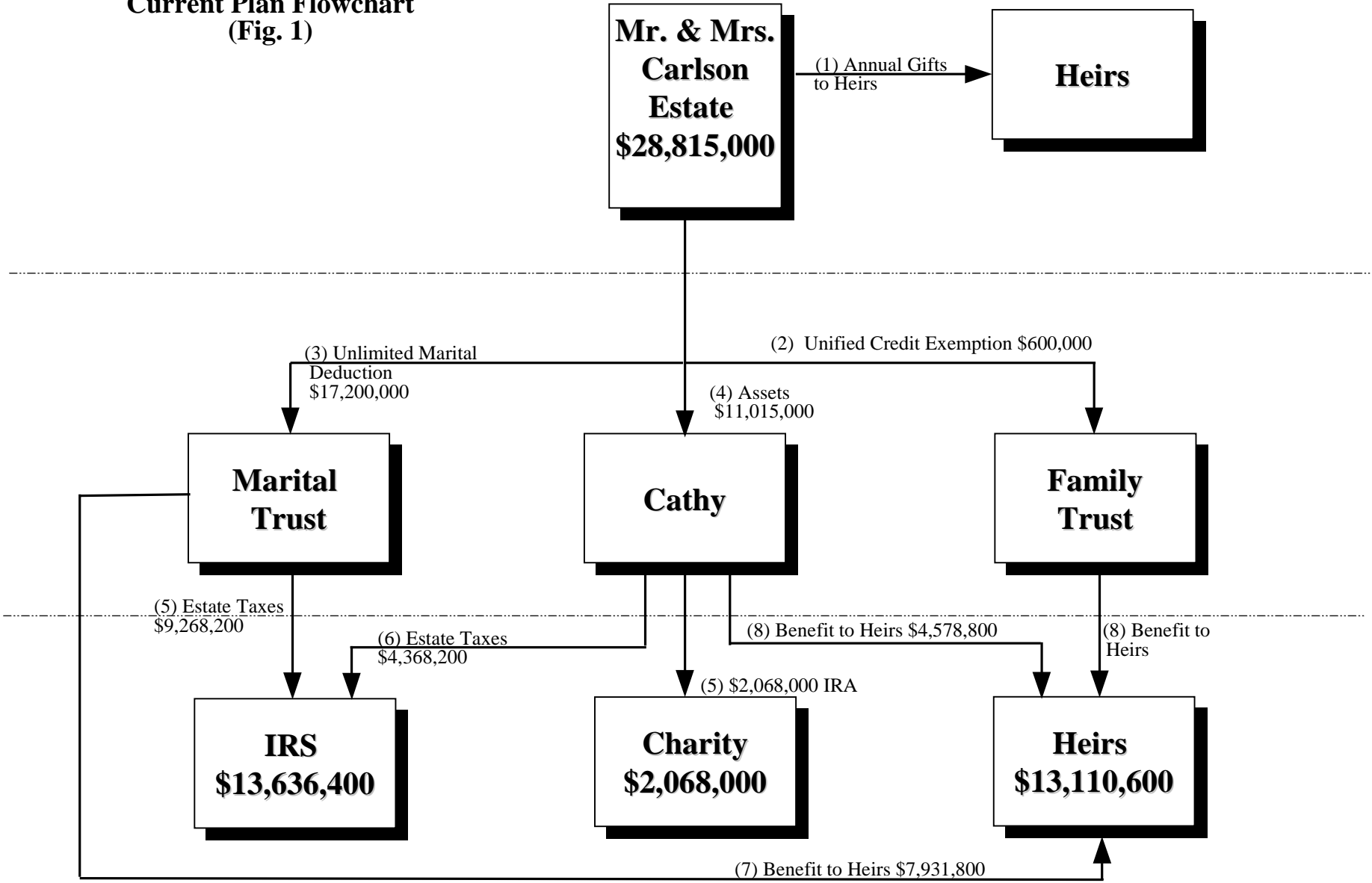
One tax savings transaction they could make immediately was to change the beneficiary on Daniel's \$2 million IRA account to a named charity. This account would suffer as much as an 85% tax bite if left in the estate.

While the Carlsons were completing the Life on Purpose Questionnaire, we analyzed their asset position and legal documents. We showed them exactly where they currently were in relation to where they said they wanted to be as outlined in their Family Wealth Letter of Intent. In the current plan, there was no mention of charity. As a result, their estate would be divided between their two children and the IRS.

The Carlsons were not yet using the Unified Credit. At that time, the credit allowed individuals to pass \$600,000 in assets free of estate tax. One of the Carlsons' goals was to maximize the annual gifts they could give to their children, yet they were limiting themselves to only the \$10,000 per person. We explained that each of the Carlsons could also pass \$1 million to their grandchildren with no transfer tax, avoiding the 50% tax at the children's level. The Carlsons concluded that they wanted their children to have \$5 million each and \$2 million for the grandchildren.

Their current plan provided for the distribution to their children and grandchildren. However, the IRS would get as much as their children, and charity would lose. (See Fig. 1 and following explanation)

**Current Plan Flowchart
(Fig. 1)**



Explanation of Current Estate Plan Flowchart (Fig. 1)

(Assumptions: All tax rates remain the same, both Carlsons live to their life expectancies, the growth of the estate keeps pace with inflation, no further amounts of either spouse's lifetime exclusion will be used up during the remainder of their lives. This plan was created before the increase of the Unified Credit. Therefore, we have assumed a \$600,000 per person lifetime exclusion amount.)

What Happens While Both Are Alive

(1) During the remainder of their lives, they will continue to maximize the annual gifts to the children. These gifts are reinvested for the children. The interest, dividends and capital gains are taxable annually to the children. At the children's deaths, those assets would also be subject to 55% federal estate tax, assuming their estates are each worth more than \$3-4 million.

What Will Happen at Daniel's Death in 17 Years

(2) At Daniel's death, the remaining lifetime exclusion of \$600,000 will be transferred to the Family Trust. This will be a tax-free transfer into that trust.

(3) The balance of Daniel's estate, \$17.2 million, will pass tax free to the marital trust under the unlimited marital deduction.

(4) At Daniel's death, Cathy will receive the IRA and other assets via a beneficiary designation.

What Will Happen at Cathy's Death in 17 Years

(5) At Cathy's death, this plan has the balance of Daniel's IRA transferred outright to charity. This transfer saves approximately \$1.5 million in estate, income and excise taxes. The estate receives a 100% estate tax deduction for this gift.

(6) The IRS would receive approximately \$13.5 million that is due and payable within nine months after Cathy's death. Over 50% of the portfolio would be lost forever.

(7) The children receive the balance of the assets in the Marital Trust with 50% of the principal distributed at age 25 and the balance at age 30.

(8) The balance of the Family Trust would pass tax free to the children.

Summary

As a result of the current estate plan, the Carlsons' heirs would receive approximately \$13 million, the IRS would receive approximately \$13.5 million and charity would receive the balance of the IRA, currently \$2 million. The Carlsons are currently in a 55% estate tax bracket. As their net worth grows, the estate tax problem will get worse. As they continue to liquidate and reposition appreciated assets, additional capital gains tax will erode their principal.

Analysis of their mutual fund portfolio reflects high expenses associated with the management of the Class B shares. This in turn takes away from the overall performance. For example, our analysis reflects approximately \$58,000 per year in extra costs simply because they held Class B shares over Class A shares for the same funds. That amount over a 5-to-6-year period equates to \$300,000-\$350,000 of excess expenses. Since the portfolio mirrors the S&P 500 and no special management was taking place, there seemed to be no reason for such high charges.

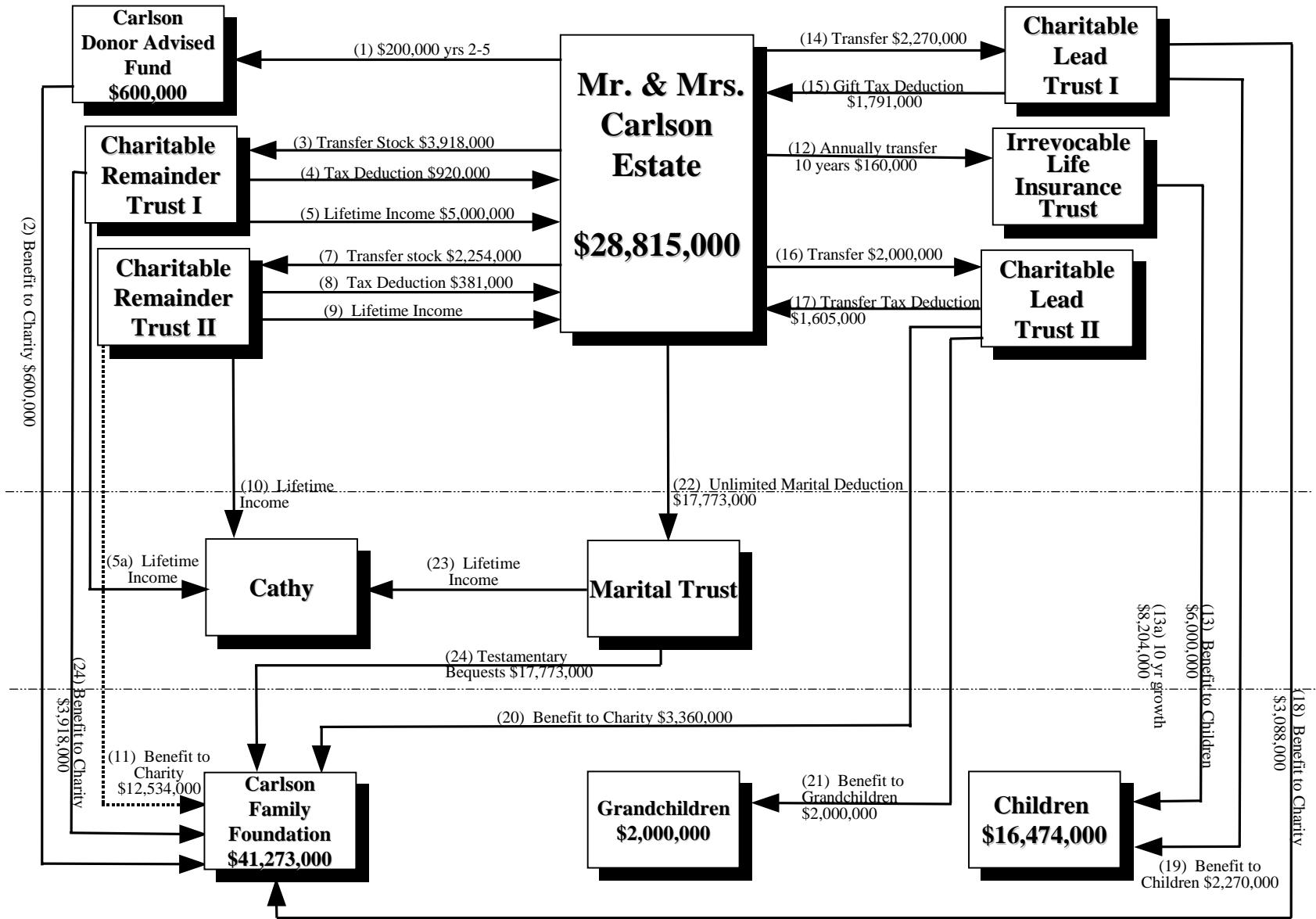
We Helped the Carlsons Determine Their Goals and Objectives:

- Eliminate all estate taxes on the transfer of our estate.
- Minimize capital gains taxes on asset sales.
- Reduce current income taxes through tax planning techniques.
- Secure a comfortable lifestyle with annual after-tax income of \$250,000, all of which should come from investments after Daniel minimizes his wage income.

- ❑ Provide a safety net of asset reserves available for funding any long-term care needs not covered by the annual income provisions.
- ❑ Provide \$5 million minimum to each of the children.
- ❑ Provide \$1 million for each grandchild after the death of the grandparents. These funds should be controlled by each grandchild's parents until they determine when it is appropriate to pass a portion or all outright to the grandchild.
- ❑ Divert funds to charity that might otherwise have been used to pay unnecessary estate, capital gains, income, and excise taxes. Maintain annual charitable giving of \$250,000 to \$300,000.
- ❑ Create an investment environment that will allow for the tax-free growth of investments.
- ❑ Perpetuate intergenerational commitment to the causes of philanthropy supported by the Carlsons.

The Carlsons' current plan did not fulfill their needs. In contrast, our proposed plan (Fig. 2) accomplished all of the Carlsons' planning goals and objectives.

Proposed Plan Flowchart (Fig. 2)



Explanation of Proposed Family Wealth Plan Flowchart (Fig. 2)

(Assumptions: We must maintain after-tax income of at least \$250,000 to \$300,000 per year. We assume that both will live to their life expectancies of 17 years. We also assume that the Federal Estate Tax Rates remain unchanged. At the time of death, all parties take advantage of lifetime exclusions and other provisions of the 1997 Tax Law.)

What Happens While Both Are Still Alive

- (1) Donate \$200,000 per year for three years starting next year to the Carlson Donor Advised Fund (DAF). The existence of a DAF facilitates giving while we establish and wait for IRS approval of alternative philanthropic instruments, such as a public family foundation.
- (2) The Carlsons can direct the DAF assets to a variety of philanthropic projects, or ultimately to the Family Foundation.
- (3) Because their list of goals includes reduction of estate, capital gains, and income taxes, this Family Wealth Plan first proposes tools that will achieve all of these objectives. In particular, by transferring assets to two Charitable Remainder Trusts (CRTs), they can eliminate capital gains taxes, avoid transfer taxes, and generate retirement income streams that could be taxed at capital gains rather than ordinary income tax rates. To take advantage of these benefits, we recommended they move \$3,918,000 of highly appreciated equities into a CRT, specifically a Standard Charitable Remainder Unitrust (SCRUT).
- (4) Contributing assets to the SCRUT produces a tax deduction of \$920,000 in the year of the transfer. We recommended they establish this charitable instrument at the end of this year. This allowed them to use the full amount of available charitable deductions limited to 30% of their Adjusted Gross Income. The portion of the tax deduction not used this year will be able to be carried forward for up to five additional years, if necessary.

Technical Memorandum: The IRS limits charitable deductions for gifts of appreciated securities to public charities to 30% of AGI. These limits apply when stocks are transferred to a CRT that passes

all or part of the gift to a public family foundation when the Carlsons die. We recommend funding the SCRUT at the end of the year to avoid producing an unneeded income distribution this year. Because of the nature of the SCRUT accounting, the IRS will require a small income distribution this year. Because this may be for just one day, we have only shown a token amount in the cash flow projections for the current year.

(5) The SCRUT will generate income during their lifetimes at an 8% rate for a cumulative total of about \$5 million.

Technical Memorandum: This Family Wealth Plan assumes that Daniel will predecease Cathy. Regardless, the survivor will continue to receive income distributions from the SCRUT for life.

(6) Upon the death of the Carlsons, the remaining balance of this Trust will pass to the Foundation.

(7) To receive greater tax benefits than those produced by the SCRUT, we recommended the Carlsons move \$2,254,000 into a second CRT. The second CRT should be a Net Income Make-Up Charitable Remainder Unitrust (NIMCRUT). Unlike the first CRT, which produces income, the second CRT, properly invested, accumulates money in a make-up account. This account can be accessed throughout retirement years, fulfilling the goal of creating a safety net of substantial asset reserves.

(8) Contributing assets to a NIMCRUT with a 10% payout potential produces a tax deduction of \$381,000 in the year of the transfer. We recommended that they establish this charitable instrument at the beginning of next year.

(9) The NIMCRUT is projected to grow throughout the lives of the Carlsons at a 10% rate. If this return is earned but not withdrawn, the earnings will accumulate in a make-up account. Based on this assumption, the NIMCRUT may accumulate more than \$12.5 million of assets, a large portion of which can be accessed if necessary.

Technical Memorandum: Because the Carlsons will have substantial assets in CRT II, they can benefit greatly from maintaining an investment policy that maximizes returns. Their current investment approach exposes them to the risks similar to owning growth stocks in a relatively undiversified portfolio. An expert in strategic asset allocation should analyze the portfolio and recommend how repositioning to different asset classes could help

maintain current returns while reducing volatility and other risks. Moreover, through asset allocation, the Carlsons could increase the current cash flow from the portfolio without compromising total return. Furthermore, by using index funds or annuities, the Carlsons could avoid unnecessary taxes that result from turnover in the current portfolio. In short, a prudent asset allocation philosophy could maximize the after-tax, after-inflation, risk-adjusted return.

(10) Regardless of which spouse dies first, the survivor can continue to receive income distributions from both CRTs for life.

(11) Only after there is no longer a need for any money from the NIMCRUT, the remaining balance will pass to the family foundation. Because the Carlsons have so many cash flow sources in addition to the NIMCRUT make-up account, it is unlikely that they will need funds from this source during their lifetime. As a result, it is possible that the entire accumulated value will pass to charity. Assuming a 10% growth rate, we calculate the future value at \$12,534,000.

(12) We recommended the Carlsons fund an Irrevocable Life Insurance Trust (ILIT). Proceeds from this trust will replace assets transferred to the CRTs and also give the children sufficient funds to purchase antiques or other sentimental assets transferred to the Family Foundation at death. Making annual gifts of \$160,000 per year will fund the trust. As shown in the cash flow calculations, there should be excess income to pay for the annual gifts without compromising the Carlsons' lifestyle. Moreover, through prudent application of estate and transfer tax exemptions, the trust can be entirely funded without tax consequences. In particular, we recommended transferring \$80,000 per year to the ILIT by utilizing the per donor per annum (PDDPA) exclusions for each of the members in the immediate family. In addition to taking advantage of the PDDPA amounts, \$80,000 of the Unified Credit each year can be used.

(13) The ILIT will pay \$6 million to the children after both Carlsons die.

Technical Memorandum: The results illustrated can be achieved by funding the ILIT with gifts of securities, assuming the Carlsons live to normal life expectancy. If the Carlsons wish to guarantee

attainment of similar results regardless of year of death, then consideration should be given to using the stream of gifts to purchase a second-to-die life insurance policy on the lives of Mr. and Mrs. Carlson.

(13a) The Death Benefit is projected to increase to \$14,204,182 over a 10-year period, based on an assumed return of 9%.

(14) We recommended they establish a Charitable Lead Annuity Trust (CLAT) with a transfer of \$2,270,000. This CLAT provides significantly greater tax benefits than leaving assets in the Marital Trust. Consequently, a smaller portion of the assets in the trust ultimately go to the Treasury Department, and a much larger share of the assets will transfer to the children.

(15) Funding the CLAT produces a transfer tax deduction that offsets most of the gift tax. Nonetheless, the IRS tables show that a \$2,270,375 CLAT with an 8% payout with a lifetime term (17 years) will still have a remainder interest of \$479,830, which will be subject to gift taxes. Such taxes can be avoided by applying a portion of the Unified Credit against the taxable amount.

(16) In order to benefit the grandchildren by taking advantage of the Generation Skipping Tax Exemption (GSTE), we recommended they establish a Charitable Lead Unitrust (CLUT). By creating a CLUT, rather than a CLAT, we can determine in advance what the tax benefits will be. Therefore, even if the value of the assets grow, we need not worry that the taxable amount could exceed the \$2 million of GSTE available.

Technical Memorandum: The Generation Skipping Trust (GST) can provide that income, and principal will initially flow to the children. As each child dies, the balance of his or her GST will pass to the grandchildren. If a grandchild has not yet reached an age of maturity, the assets will initially pass to the grandchild in trust. The Carlsons or their children can have greater control over the terms of the GST to ensure that the grandchildren will not have too much discretion over the use of funds in the GST.

(17) Creating the CLUT with assets of \$2 million produces a transfer tax deduction of approximately \$1,605,000. Consequently, the remainder interest subject to gift tax is

approximately \$395,000. Applying a portion of the Unified Credit as well as the GSTE can offset this gift tax.

Technical Memorandum: Most of the Carlsons' GST credit will be allocated to this trust to offset any taxes due on the eventual transfer to grandchildren. To avoid both estate taxes and generation skipping taxes, both Unified Credit and GST credits must be allocated to the trust.

What Happens at Daniel's Death in 17 Years

(18) Assuming that the CLAT is funded at the start of the plan or early in the next year, the trust will make annual distributions of \$181,630 to the Family Foundation for 17 years beginning next year. Over their lifetimes, total transfers to the Foundation should total \$3,088,000.

(19) At the end of the term of the CLAT, assets in the trust will pass to the children. This transfer produces \$2,270,000 of their expected inheritance.

(20) Assuming that the CLUT is funded at the start of the plan or early in the next year, the trust will make annual distributions of approximately \$160,000 to the Family Foundation for 21 years. Over the Carlsons' lifetimes, transfers from this trust to the Family Foundation should total \$3,360,000.

(21) At the end of the term of CLUT, assets in the trust will pass to the grandchildren. This transfer produces \$2 million of their expected inheritance.

(22) Assets in the estate not sheltered from transfer taxes by the various trusts and insurance will be sheltered from estate taxes at the first death by the Unlimited Marital Deduction. All assets will flow to a Marital Trust that will last throughout the life of Cathy.

(23) The Marital Trust will generate income for Cathy during her lifetime.

What Happens at Cathy's Death in 17 Years

(24) The balance of the assets in Cathy's estate passes to the Carlson Family Foundation at Cathy's death. This value is currently estimated to be approximately \$18 million.

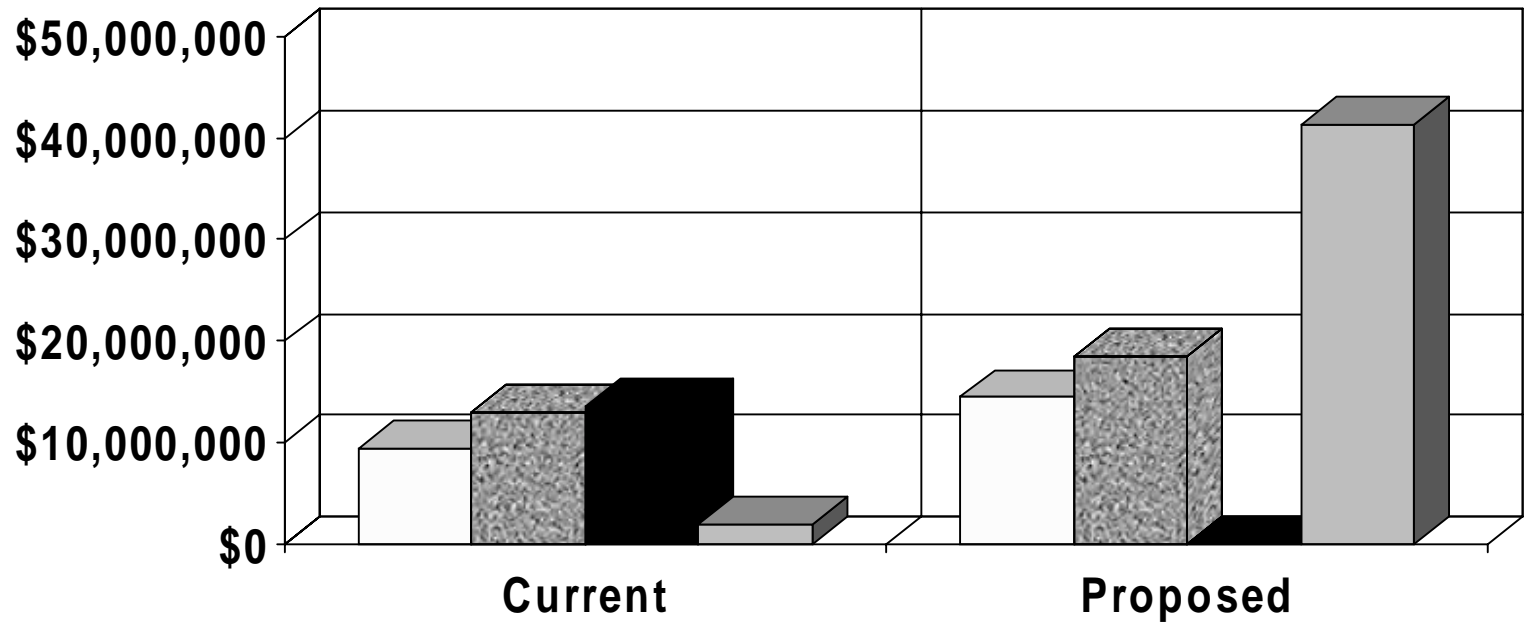
Technical Memorandum: We recommended they structure their foundation as a 509(a)(3) Supporting Organization.

Summary

As a result of the proposed Family Wealth Plan, the heirs (or trusts for their benefit) will inherit substantial assets. The plan also provides for substantial improvements in transfers to charity. Their current portfolio produced income that was subject to unnecessary taxes. Our alternative provided only the after-tax income needed and allowed investment earnings to accumulate tax deferred in the make-up account of a CRT. By adding the after-tax value of the make-up account amounts to their income, the present and potential income available during each year of their retirement exceeds what they had previously expected to have during their retirement years.

In short, the proposed plan outperforms the current plan by eliminating unnecessary transfer taxes, enhancing the inheritance for the heirs, augmenting funds available for charity, and improving access to a substantial after-tax income stream during the Carlsons' retirement years.

Comparison Summary: Current Plan vs Proposed Plan



□ Income

▒ Heirs

■ Involuntary Philanthropy

▒ Voluntary Philanthropy

Family Wealth Counseling

CASE STUDY

DAVID AND MARGARET NOBLE

We were referred to the Nobles by a major law firm. Mr. Noble was 80, a self-made multimillionaire, an entrepreneur who started with a few thousand dollars. He had grown up during the depression of the 1930s. He now had a corporation worth millions of dollars, employing over a thousand people.

We spent four hours just getting acquainted and going through the principles used in Family Wealth Counseling. He had experienced the Economic/Financial Aspects of planning and had an excellent lawyer representing him and his corporation. Further, he had a charitable interest but did not realize how he could leverage his Social Capital for greater good.

The following day, we scheduled the Nobles and their daughter Annie for a Client Retreat. We spent several hours gaining insight into their feelings about their wealth and Social Capital. With our new insight, we commenced work on the Family Wealth Counseling process.

After many hours of analysis, we combined the economic/financial data with the social aspects to create a “before” and “after” blueprint. The uniqueness of linking the emotional/spiritual philosophies of David and Margaret to the economic issues and social issues made the planning process come alive.

Our responsibility was to complete the project in conjunction with the professional advisors (attorneys, tax advisors and trustees). The Nobles’ estate prior to our involvement was valued at approximately \$31 million. Based on the planning that had been done, the heirs would have received roughly \$14.5 million and the government \$16.5 million. Our challenge was to move the Social Capital to the causes the Nobles chose to support.

In the implementation stage, we used three very vital components to the planning process:

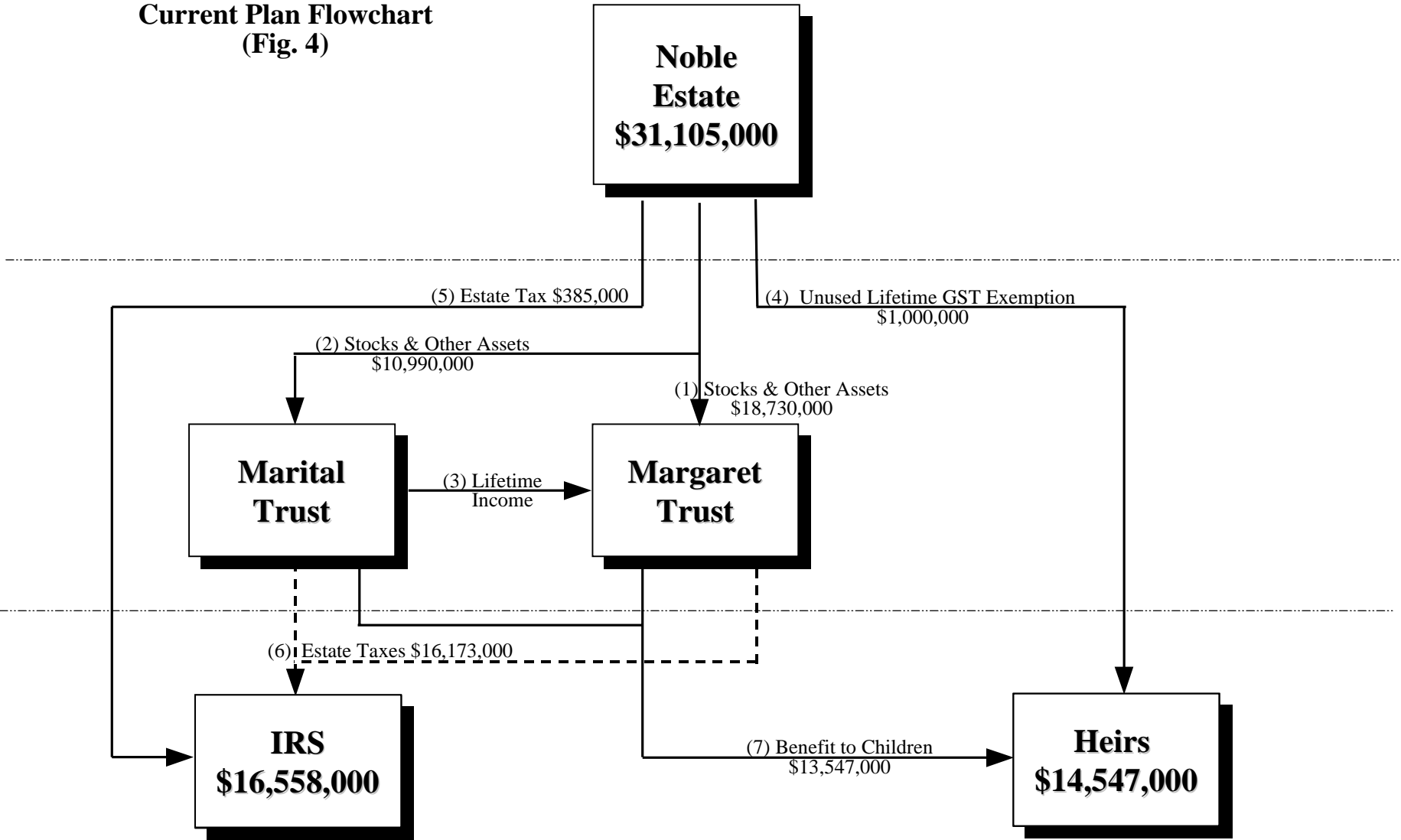
- Valuation adjustments to estate assets

- Charitable giving tools
- Financially leveraged insurance

We doubled the heirs' inheritance, reduced the government from \$16.5 million to \$2 million and gave the family \$32 million for causes they wanted to support.

Our planning process actually increases their cash flow while they are alive, due primarily to additional tax deductions and higher payout rates on their charitable trusts.

**Current Plan Flowchart
(Fig. 4)**



Explanation of the Current Estate Plan Flowchart (Fig. 4)

(Assumptions: The current estate plan flowchart assumes that tax rates and the maximum lifetime exemptions remain unchanged.)

What Happens While Both Are Alive

As long as both are living, all of the income produced by the existing assets will be for the Noble's personal benefit, and they may dispose of any of the assets they wish. However, since many of the assets are made up of highly appreciated stock, a significant capital gains tax will result upon the disposition of the assets.

What Will Happen at David's Death

- (1) David's revocable trust gives Margaret his share of the residences and other collectively held property outright.
- (2) The balance of David's revocable trust assets (less \$1 million for the GST share) is distributed to the Marital Trust.
- (3) The income from the Marital Trust is paid to Margaret quarterly and will pay principal to her as needed for her health and support. In addition, she may remove these assets from the trust at any time for any reason.
- (4) The trust also establishes a Generation-skipping Exemption Share that is funded with the maximum amount of generation-skipping credit available to David's estate. This amount is currently \$1 million. This share is immediately distributed to the Heirs' Trust that is used to benefit the children and grandchildren.
- (5) All of David's property passes to Margaret except for the \$1 million. This will be the only amount that is subject to estate tax at David's death. The tax due is approximately \$385,000.

What Will Happen at Margaret's Death

- (6) At Margaret's death, the majority of the estate taxes will be paid. The total taxes paid will be approximately \$16,173,000.
- (7) The balance of Margaret's trust and the Marital Trust will pass to the heirs. This will be done both outright and through transfers in trust.

Summary

At David's death, the estate will pay approximately \$385,000 in estate taxes. At Margaret's death, the estate will pay taxes of approximately \$16,173,000. This does not include any settlement expenses. In addition to those taxes, if any appreciated assets are liquidated while they are living (i.e. stocks), capital gains taxes will be paid.

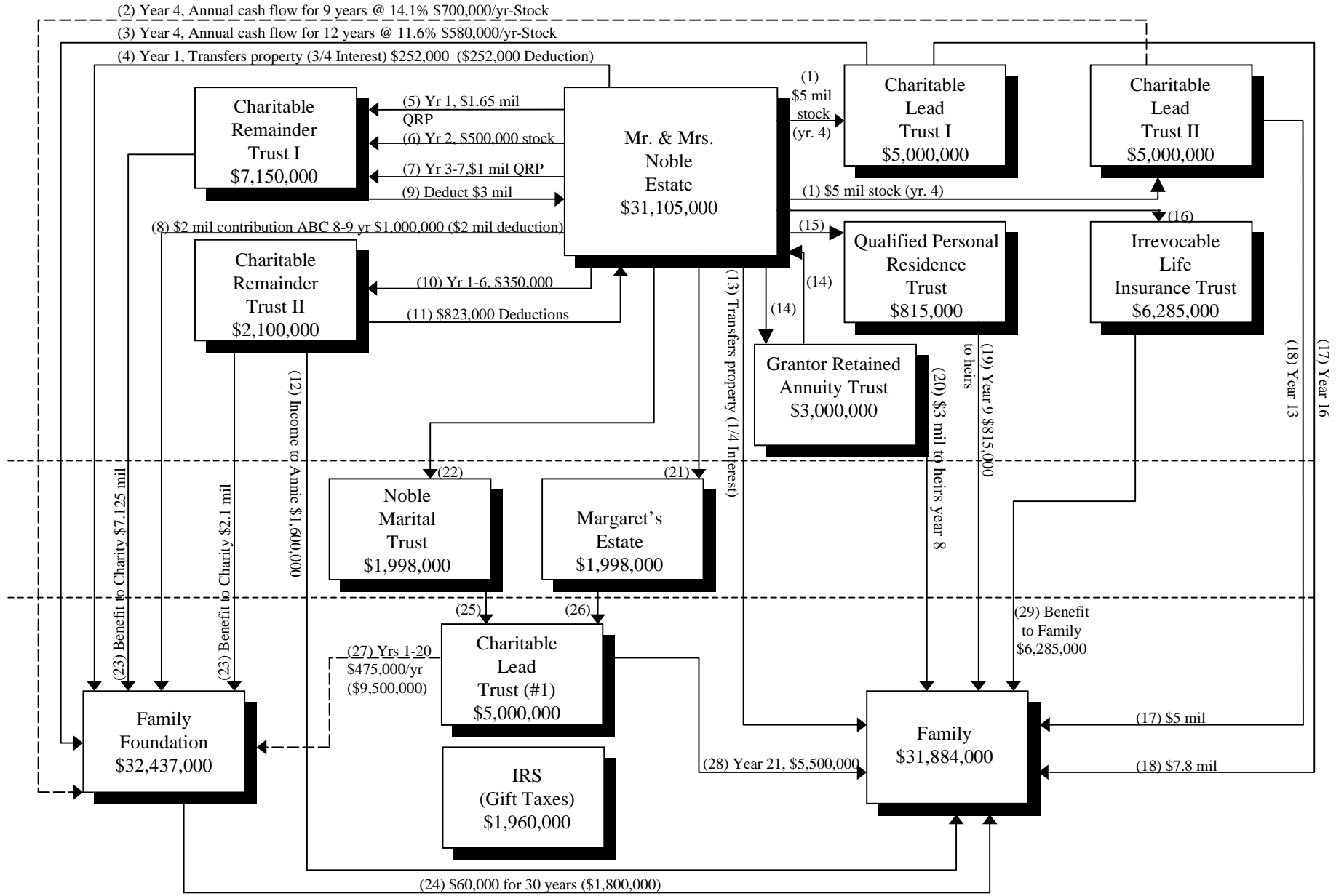
Finally, we would like to note that there are no provisions in the current estate plan for charitable gifts.

We Helped the Nobles Determine Their Goals and Objectives:

- Pass the full value of their estate to daughter Annie and her children.
- Continue current gifting to the grandchildren.
- Provide Annie with a current income equivalent to \$80,000 per year.
- Keep all real estate currently owned in the family.
- Move the home to Annie as soon as possible.
- Eliminate estate taxes.
- Reduce current taxes if possible.
- Provide a legacy through the generations.
- Provide a lump sum to Annie and the grandchildren over time.

The Nobles' current plan did not fulfill their estate planning needs. In contrast, our proposed plan (Fig. 5) accomplished all of the Nobles' planning goals and objectives.

Proposed Plan Flowchart (Fig. 5)



Explanation of the Proposed Estate Plan Flowchart (Fig. 5)

(Assumptions: The proposed estate plan flowchart assumes that David predeceases Margaret. This proposed plan assumes that tax rates and the maximum lifetime exemption remain unchanged. Asset growth is assumed to keep pace with inflation unless otherwise noted.)

What Will Happen While Both Are Alive

- (1) The estate is currently valued at approximately \$31.1 million. The first step to providing distributions to Annie in lump sums and in latter years will be to establish two Charitable Lead Trusts (CLTs). The two CLTs will each be funded with \$5 million of Qualified Replacement Property from the sale of the ABC Corporation Stock. The current plan is to sell this stock in the fourth year. The trusts will be funded when the stock is sold. The trusts will have terms allowing payouts in different years to Annie.
- (2) CLT(II) will pay out to the Family Foundation approximately 14% of the initial funded balance for nine years (\$700,000/year). Distributions may be in-kind (giving stock to the Foundation), particularly after the second year.
- (3) CLT(I) will pay out to the Family Foundation approximately 11.6% (\$580,000/year) for 12 years.
- (4) The Nobles will transfer real estate that the family no longer uses to the Family Foundation and receive a tax deduction for the gift.
- (5) In the first year, they contribute \$1.65 million of Qualified Replacement Property to the Charitable Remainder Trust I [CRT(I)]. This trust will pay income to the Nobles for their lives.
- (6) In the second year, they contribute \$500,000 of existing stock portfolio to CRT(I).
- (7) In years 3-7, they contribute \$1 million of stock. The contribution will probably be Qualified Replacement Property. All contributions to CRT(I) will allow them to sell

stock without upfront capital gains tax, and the trust will pay income annually for both lives. The income will likely be capital gains income, taxed at 20%, depending on the investments selected after the original stock is sold.

(8) In years 8-9, \$2 million of ABC Corporation stock (\$1 million each year) can be directly contributed to the Family Foundation. This will provide an immediate income tax deduction that carries forward for the next five years. This will provide benefits to the Foundation and will help the estate to continue achieving significant tax deductions to offset costs throughout life expectancy. Caution should be used to relate tax deductions to adjusted gross income.

(9) The Nobles will receive a current tax deduction for contributions to CRT(I) equal to the contribution less the present value of the projected income that will be received by the Nobles from the trust in the future. This will total approximately \$3 million of deductions, spread over the years of contribution.

(10) To meet the goal of getting Annie an immediate benefit, we recommend a second CRT [CRT(II)], funded by contributing \$350,000 of Qualified Replacement Property per year for 6 years. A gift tax will be paid on each contribution. This trust will provide an annual income to Annie for a term of 14 years. By then, her salary from the Family Foundation will have increased, and she will have cash from her current options as well as assets from the CLT and GRAT.

(11) The Nobles will receive a tax deduction for each gift with total deductions of approximately \$823,000.

(12) Annie will receive approximately \$1.6 million in income over the term of the trust.

(13) The Nobles may gift the remaining $\frac{1}{4}$ interest in their property to Annie at their discretion. There will be a minimal gift tax to pay with this transaction.

(14) The ABC stock they still hold is projected to grow at 16% or greater. Using this assumption, the Nobles can create a GRAT paying 16% annually of the initial funded balance

for eight years. Payments may be in cash or in-kind. The Nobles will be responsible to pay taxes on any income earned by the trust. This will keep the family in control of ABC stock.

(15) This step will move the homes in Greenville and Oldport to a Qualified Personal Residence Trust. The trust will provide for the Nobles to live in the properties for eight years. The properties would then pass to the designated beneficiary. The gift value of this is approximately \$389,400. The Nobles may wait until the Unified Credit limit has been raised to offset this tax. (Note: Margaret must outlive the trust term to avoid the property being taxed in the total estate).

(16) Their existing life insurance of \$300,000 will be transferred to the ILIT. This will remove the insurance proceeds from the taxable estate, so they will pass income and estate tax free to the beneficiaries of the trust. The Nobles have chosen to obtain an additional \$6 million of life insurance to provide liquidity in order to meet their goals. We have assumed a joint second-to-die insurance policy for cost effectiveness. The additional liquidity needed will be funded with the assistance of the tax deductions from the CRT. This additional insurance will replace the value of the assets placed in the other trusts while providing liquidity in the event of premature death. The cost of the additional liquidity is approximately \$280,000 and will be covered by income tax deductions.

(17) The remaining balance in CLT(I) passes outright to Annie. Based on current projections, this will occur in year 16.

(18) The remaining balance in CLT(II) passes outright to Annie. Based on current projections, this will occur in year 16.

(19) The properties in the Residence Trust will go outright to Annie in approximately year nine.

(20) The remaining balance in the GRAT will go outright to Annie in approximately year 8. Based on current assumptions, this will be about \$3 million.

What Will Happen at David's Death

(21) At David's death, Margaret's assets will remain in her estate.

(22) David's assets will be transferred to the Noble Marital Trust.

What Will Happen at Margaret's Death

(23) At Margaret's death, the value of CRT(II) will move to the Family Foundation.

(24) The Family Foundation will pay an annual salary of approximately \$60,000 per year for 30 years to Annie.

(25) Assets from the Noble Marital Trust will pass to CLT(I) to benefit the grandchildren.

(26) Assets from Margaret's estate will pass to CLT(I) to benefit the grandchildren. The remainder value of this trust (approx. \$1 million or less) will pass to the grandchildren, and Margaret's estate will incur an estate tax on this amount.

(27) CLT(I) will pay 8% of the original value of the trust for 20 years to the Family Foundation. This provides additional funds to perpetuate the Nobles' legacy and provides additional assets for Annie to manage.

(28) After 20 years, the value of the trust will pass to the grandchildren. They will likely be in their late 40s to mid-50s. This can pass outright to the grandchildren or in a Dynasty trust for their benefit for many years to come.

(29) The value of the ILIT will pass directly to their heirs-- income, gift and estate tax free.

Summary

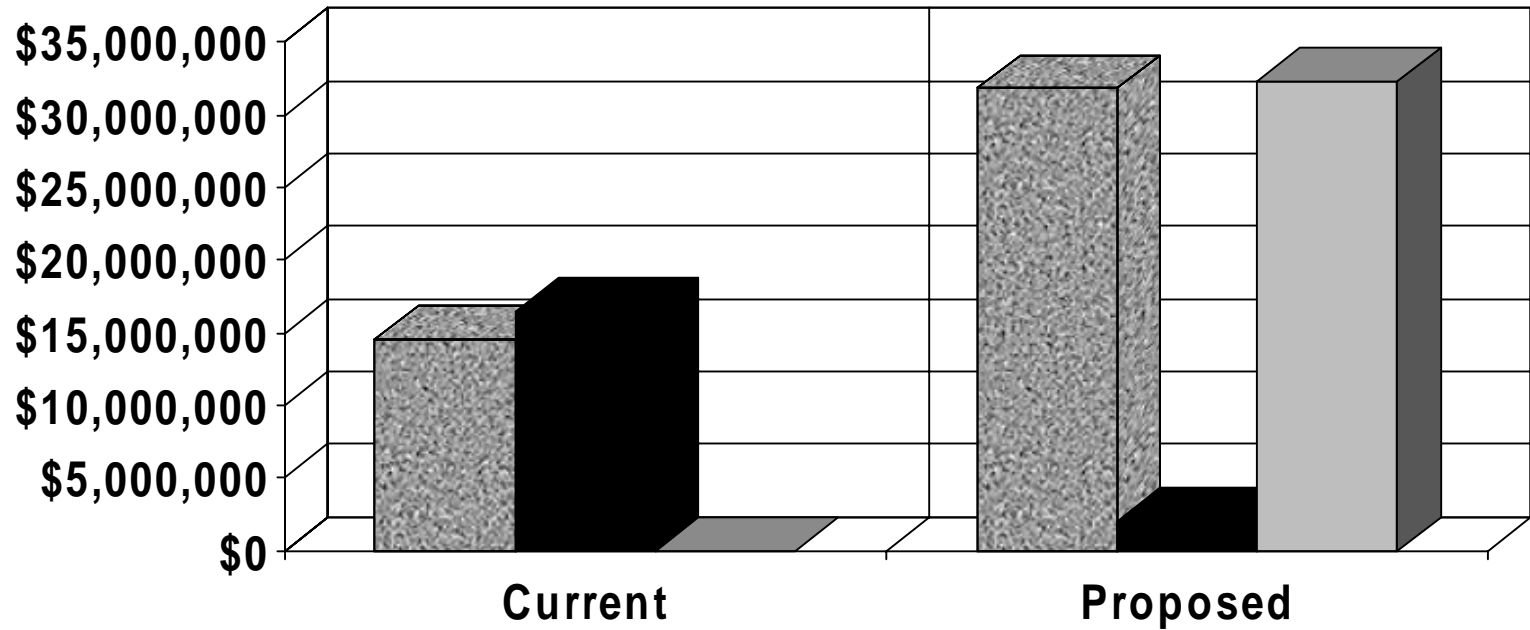
1. Our plan allows the Nobles and their heirs the opportunity to self-direct their Social Capital to the Family Foundation so that it can be used to support charitable and civic organizations close to their hearts.
2. The family will control and direct significantly more Social Capital.
3. The family will receive a larger inheritance.

4. The Nobles will receive more income during their lives.

In summary, the proposed plan took the Nobles' assets, philosophies and values and blended them in such a way as to meet all their goals and objectives.

Comparison Chart
(Fig. 6)

Comparison Summary: Current Plan vs Proposed Plan



■ Heirs

■ Involuntary Philanthropy

■ Voluntary Philanthropy

Family Wealth Counseling

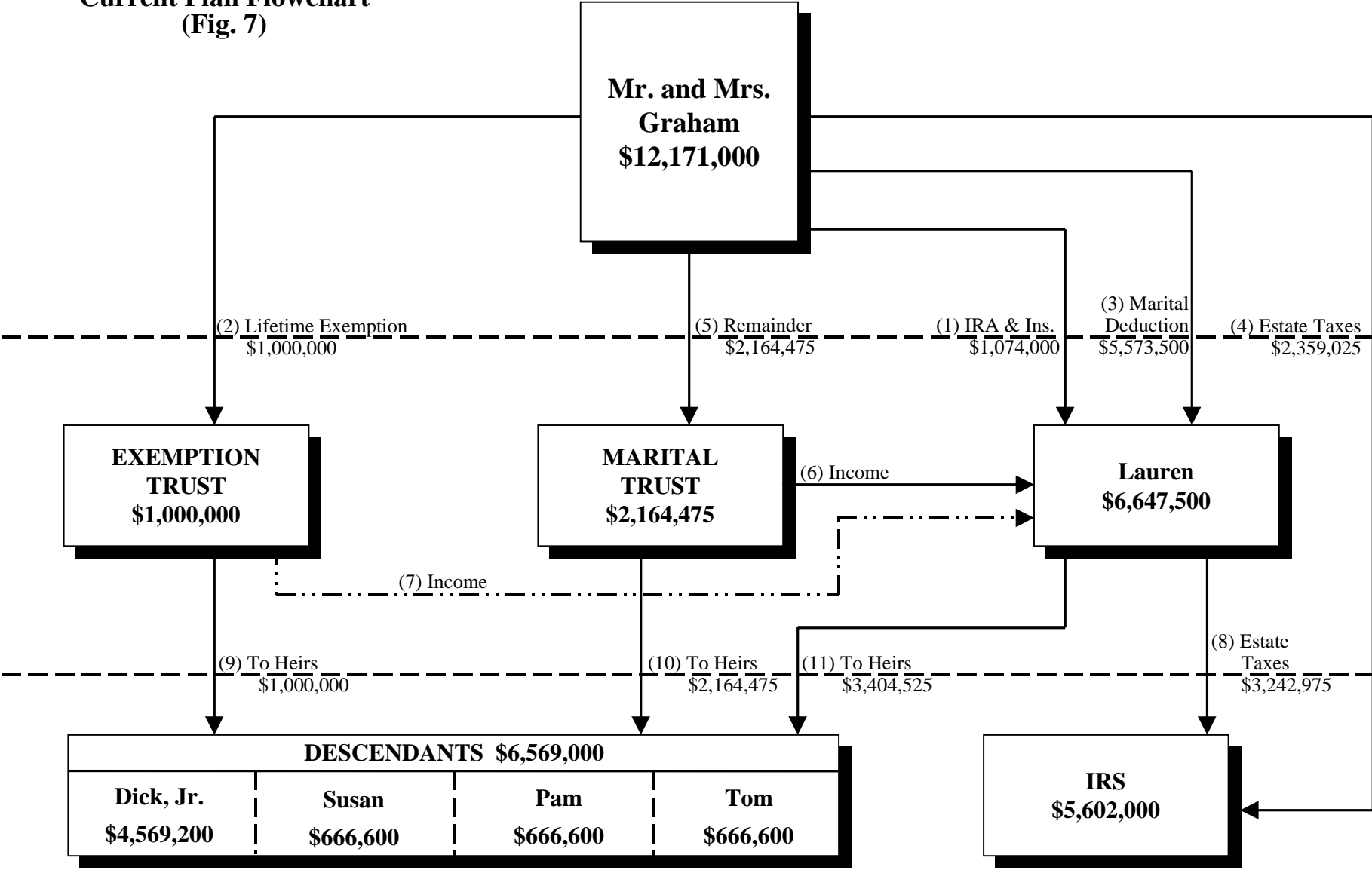
CASE STUDY

Dick and Lauren Graham

The Grahams were in their mid-60s. They had a publishing business as well as a construction business. The businesses produced a very good income, far more than they needed. Without solicitation, they were offered \$10 million cash for their businesses. Four months after the offer, the businesses were sold. Their estate totaled approximately \$12 million. When they met us, they had been holding the sale proceeds for more than a year, unsure how to move.

Through our Family Wealth Counseling process, Dick and Lauren became very clear as to how much and when they wanted to leave their family their wealth. Also, they discovered what they wanted to do for the rest of their lives and how they wanted to include their family in the process.

**Current Plan Flowchart
(Fig. 7)**



Explanation of Current Estate Plan Flowchart (Fig. 7)

(Assumptions: The current estate plan flowchart assumes that Dick predeceases Lauren. It also assumes that both will live to their life expectancies of 14 years and 17 years, respectively. All tax rates will remain unchanged.)

What Happens While They Are Still Alive

The Grahams have traditional estate planning that includes a Revocable Living Trust (RLT). They are also making annual gifts to their children and grandchildren. In addition, they have set aside more than \$91,000 in UGMA accounts for the education of their grandchildren.

What Happens at Dick's Death in 14 Years

(1) By virtue of the beneficiary designations, Lauren will be the recipient of the \$677,000 in the IRAs and \$397,000 of life insurance policies for a total of \$1,074,000.

(2) The Exemption Trust will consist of the maximum amount that can pass free of estate tax. This amount is currently \$650,000, but will be increasing to \$1 million by the year 2006. The higher amount has been used for this illustration. This trust will pay income to Lauren for life, and pay principal to Lauren or Dick, Jr. if needed for their health, maintenance, or support.

(3) Lauren's share of the marital assets is \$5,573,500 and it passes tax free to her by virtue of the unlimited marital deduction.

(4) Dick's share of the remaining property would also be \$5,523,500. However, \$1 million was left to the Exemption Trust, so his portion would normally be \$4,523,500. Unfortunately, due to an error in the wording of the Marital Trust, it will not be eligible for the Marital Deduction at Dick's death and will pay \$2,359,025 in estate taxes and settlement expenses.

Technical Memorandum: The Marital Trust in this case was flawed and did not qualify for the Marital Deduction at the death of

the first-to-die. At the first death, the trust was to split into three shares. The Marital Trust is the balance of the first-to-die's assets less the Unified Credit amount allocated to the Exemption Trust. The obvious intent is to make the QTIP election on the Marital Trust and have it taxed at the survivor's death. Unfortunately, the Marital Trust does not qualify for the QTIP election because it fails one of the basic requirements: no one other than the spouse may have an interest in the trust during the survivor's life. In this case, page 10 of the trust allows principal to be distributed "to or for the benefit of any one of the beneficiaries."

The consequence of this error is much greater than the loss of \$2,359,025. Assuming the lost principal generated 10% per year, the survivor of the couple would lose the potential income of \$235,900 per year, forever. This could amount to millions of dollars if either spouse were to die well before life expectancy.

(5) The Marital Trust will contain Dick's share of the remaining property, \$2,164,475. (\$5,523,500 less the \$1 million Lifetime Exemption and the estate tax of \$2,359,025)

(6) The Marital Trust may pay Lauren income for life.

(7) Lauren will be entitled to all of the income from the Exemption Trust.

What Happens at Lauren's Death in 17 Years

(8) The federal estate tax and settlement expenses due upon Lauren's death will be \$3,242,975.

(9) The Exemption Trust, valued at \$1,000,000, will pass to the descendants free of estate tax.

(10) The Marital Trust, valued at \$2,164,475, will pass directly to the descendants free of additional estate tax.

(11) The balance of Lauren's assets, estimated at \$3,404,525, will pass to the descendants.

The Balance of Lauren's assets, valued at \$3,404,525, plus the Exemption Trust of \$1 million and the Marital Trust of \$2,164,475 will be divided. Dick, Jr. will receive \$4,569,200, and Dick, Jr.'s children will share the remaining \$1,999,800, or \$666,600, per grandchild.

Summary

There are only three places that the Graham estate can go when death occurs: family, IRS and charity. The Grahams are facing maximum exposure to the government's system of Involuntary Philanthropy.

The following illustrates how the estate would be distributed under the current plan.

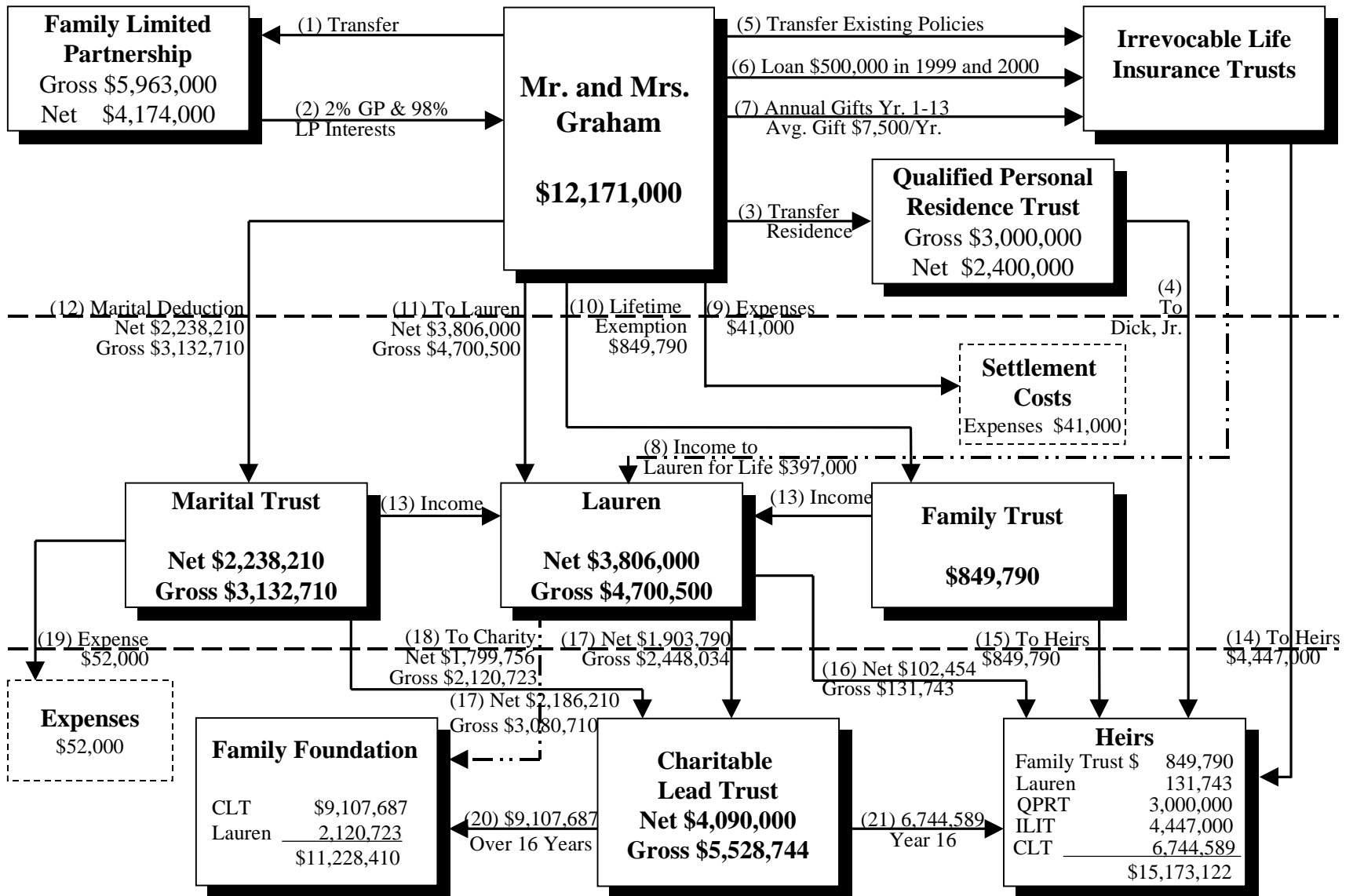
<u>Beneficiary</u>	<u>Amount</u>	<u>% of Estate</u>
Dick, Jr.	\$4,569,200	38%
Grandchildren	\$1,999,800	16%
IRS	\$5,602,000	46%

We Helped the Grahams Determine Their Goals and Objectives:

- Eliminate estate taxes and effectively redirect Social Capital from the government to the Graham Family Foundation.
- Maintain their ideals and principles.
- Maintain ample liquidity and generate excess cash flow.
- Create observable and measurable standards for receiving an inheritance.
- Fund their grandchildren's educational expenses without gift taxes

The Grahams' current plan did not fulfill their estate planning needs. In contrast, our proposed plan (Fig. 8) accomplished all of the Grahams' planning goals and objectives.

**Proposed Plan Flowchart
(Fig. 8)**



Explanation of the Proposed Estate Plan Flowchart (Fig. 8)

(Assumptions: The Grahams both live to their life expectancies. The average income tax bracket is 42% and the capital gains rate is 27%, including state and federal. Estate tax rate remains at current level. Security investments, stocks and bonds, are projected to grow at 9%. The remainder of the estate is not estimated to grow.)

What Happens While They Are Still Alive

(1) We suggested they transfer \$5,963,000 of assets to the FLP consisting of the following:

California Mutual	\$4,179,000
U.S. Savings	25,000
Bank of York (cash)	106,000
Net Proceeds Bus. Sale	500,000
Hill Head	400,000
Condo-Kashmir	150,000
Land – 40 Acres	200,000
Graham Office Bldg.	343,000
County Property	<u>60,000</u>
Gross Value	\$5,963,000
Market Adjusted Value	\$4,174,000

(2) After the contribution of \$5,963,000 to the FLP, they received two 1% General Partner (GP) units (total of 2%) and 98% Limited Partner (LP) units with a total market adjusted value of \$4,174,000. This assumes a 30% market adjustment factor. They will retain the GP units in their estate throughout their life to maximize control over all of their assets in the FLP. They were able to discount the value of the LP units due to the constraints on marketability and liquidity.

(3) The home is owned jointly in the Graham Trust. Each of their community property interests should be transferred to a 10-year Qualified Personal Residence Trust (QPRT). Under the terms of the QPRT, if each of them survives the full 10-year term, 50% interest in the home will pass to Dick, Jr., including all future appreciation, free of gift and estate tax.

Since the home cannot be sold without the agreement of the owners of the separate trusts, an appraiser would assign a discount to the value. A 20% valuation adjustment was used.

The gift tax value of this transaction is \$150,210 for Dick's interest and \$139,661 for Lauren's interest. If either does not survive the term of the QPRT, the individual's share of the home will be included in the deceased's estate but would pass to the surviving spouse tax-free under the terms of the Unlimited Marital Deduction.

Technical memorandum: It is recommended that a certified appraisal on a property be made prior to the inclusion of a residence into a QPRT. Also, a longer term QPRT could have been used if the Grahams wanted to pass the ownership of the home more than 10 years later.

(4) At the end of the 10-year term of the QPRT, ownership of the property will pass to Dick, Jr. The Grahams can continue to live in the home but would be required to pay market rent to Dick, Jr. While at first glance this may seem to be a negative issue, many families view this as an opportunity to transfer additional assets without gift tax through the rent payments.

(5) We recommended they establish an Irrevocable Life Insurance Trust (ILIT). Initially, we recommended they transfer their existing life insurance policies to this trust. By transferring existing policies, they utilized \$60,000 of their \$80,000 annual gift exclusion as the cash value in the policies approximated \$60,000. Additionally, they wanted the trust to acquire an additional \$4 million of second-to-die life insurance for reasons discussed below. (Note: A different ILIT should hold the new insurance.)

(6) Utilizing a Family Split Dollar Agreement in conjunction with a Variable Life policy will fund the new \$4 million policy. In 1999 and 2000, they will loan \$500,000 per year to the trust for a total of \$1,000,000 over the 2-year period. At the end of 10 years, the loans will be repaid to them.

(7) Under the IRS regulations referring to split-dollar life insurance, the insureds are deemed to have made a taxable

gift to the trust, computed using a government table (P.S. 38). Therefore, in years 1-13, taxable gifts will average approximately \$7,500. They have a reportable gift of \$7,500 that they will have to contribute, in cash, to the trust each year.

What Happens at Dick's Death in 14 Years

(8) Upon Dick's death, Lauren will be entitled to receive the income from the \$397,000 life insurance proceeds on Dick's life from his single life policies. At Lauren's option, she can waive the income and allow the interest to accumulate in the ILIT.

(9) Estimated final expenses are \$41,000.

(10) Dick's lifetime exemption is projected to be \$1 million. However, \$150,210 was utilized when the QPRT was created. Therefore, \$849,790 will pass directly to the Family Trust. (The current lifetime exemption is \$650,000 and increases gradually to 2006, when it becomes \$1 million.)

(11) Lauren will receive her half of the community property. Her half of the community property is as follows:

50% of the FLP – Adjusted Value	\$2,087,000
50% of the cash	500,000
50% of marketable securities	187,000
50% of Dakota Road	300,000
50% of personal property	<u>55,000</u>
Total	3,129,000

Lauren will also receive Dick's IRA of \$677,000. The total net value will be \$3,806,000. The gross value of the underlying assets will be approximately \$4,700,500.

(12) The remaining portion of Dick's half of the estate, with an adjusted value at \$2,238,210 and a gross value at \$3,132,710, flows into the Marital Trust.

(13) Lauren will have the right to all of the income from the Marital and the Family Trusts. She will also have the right to

invade the principal to maintain her support, health and maintenance.

What Happens at Lauren's Death in 17 Years

(14) At Lauren's death, \$4,447,000 of life insurance proceeds will pour into the trusts. The trustee can examine the total inheritances received by Dick, Jr. and the grandchildren before deciding what portion of the proceeds should be distributed to the heirs. This enables them to achieve their goal of maximizing their inheritance to their grandchildren.

(15) The Family Trust, valued at \$849,790, will pass directly to the heirs.

(16) The balance of Lauren's lifetime exemption, \$102,454, is left directly to the heirs. This should include any GP interest remaining in the estate. Either the heirs or the ILIT should purchase any GP interest not passed by the remaining lifetime exemption from the estate.

(17) The LP interests of the FLP that are valued at a total adjusted value of \$4,090,000 will pass to a testamentary CLT. From the Marital Trust will come \$2,186,210 and from Lauren's estate will come \$1,903,790. The terms of the trust are designed to provide an estate tax charitable deduction large enough to eliminate any tax attributable to these assets.

(18) The rest of Lauren's assets will pass directly to the Graham Family Foundation.

(19) The estimated settlement expenses are \$52,000.

(20) The testamentary CLT will make distributions to the Family Foundation for a period of 16 years following Lauren's death. The annual payments begin at \$531,700. Due to the design of the trust, annual payments will increase to \$608,283 in year 16. The total payments to the Graham Family Foundation will be \$9,107,687.

(21) At the end of the term of the CLT, the balance of the LP interests with a discounted present value of \$2,143,550 will go directly to the heirs. The underlying asset value will be approximately \$6,744,589.

Summary

The proposed plan has created substantial advantages for the Grahams, their family and our country. The Grahams' heirs inherit substantially more of the estate, and the inheritance to the grandchildren will be spread out in the manner the Grahams' directed.

In addition, the Graham family will be able to direct 100% of their Social Capital. They have gained substantial leverage that will make a difference in this world.

Comparison Chart
(Fig. 9)

Comparison Summary: Current Plan vs Proposed Plan

