

## Chapter XII

### Planning Estates that Involve Forest Land Assets

#### A. Overview and Purpose

In this chapter more planning strategies and ideas are discussed in the context of their application to a particular situation. The purpose of this approach is to give you more exposure to a wide variety of situations, the problems they create, and the potential solutions that can be fashioned to address them. This discussion will give you the chance to explore a variety of solutions. Unlike earlier chapters that included a set of problems at the end of the chapter, this chapter consists of problems themselves for you to read, review, and then carefully consider. Some of these examples were adapted from *Pennsylvania Forests*, *Forest Farmer*, *National Woodlands*, and the *Practical Accountant* magazines.

Refer to the earlier chapters for valuable information that can help you evaluate the situations and understand the strategies being discussed.

#### B. Lesson Objectives

Following completion of this chapter, you will be able to accomplish the following tasks:

1. You will be able to identify and evaluate the estate goals and objectives that are presented in a wide variety of situations.
2. Based on your evaluation of these goals you will be able to suggest various estate planning strategies that can be employed in the situation to accomplish some or all of the goals you have identified.
3. You will be able to evaluate the impacts of various strategies on accomplishing the potential goals and objectives that you identified.
4. Based on your evaluation of the impacts on potential goals, you will be able to fashion a list of considerations that will aid in deciding which goals should be given priority and which strategies will have the greatest likelihood of accomplishing them.

#### C. Problems

**Preliminary Note:** Because many of the tax issues that are discussed in these problems will vary over time, unless the fact situation otherwise directs you to consider the situation in a different time period, consider 2002 to be the time when the planning decisions are made in these cases.

##### Example 1: Annual Exclusion Gifts

Mr. and Mrs. Jones have four adult married children. Mr. Jones owns 500 acres of woodland in his own name, which has an average value of \$2,000 per acre (FMV = \$1 million). Mr. Jones (the donor) can give each child (donee) \$11,000 in value each year tax-free. That is, he can give each child either 5 acres outright (not including potential subdivision, engineering, survey costs)

or a fractional undivided interest in the property worth \$11,000, for an annual total of \$44,000. A real estate appraisal by a competent professional should be ordered as a means of certifying the value of the property. He can also give each child's spouse a similar 5 acres or a \$11,000 undivided interest annually.

### **Example 2: Split Gifts**

Assume the same facts as in the previous example. After obtaining the real estate appraisal and verifying the value of the land, Mrs. Jones agrees to make a split gift of Mr. Jones' woodland property to the children. Each child will now receive a gift of either \$22,000 in undivided value or 10 acres. This can be increased to \$44,000 or 20 acres by making split gifts to each child and to his (her) spouse.

### **Example 3: Planning with an Irrevocable Life Insurance Trust**

A basic question is, "Why choose to use an irrevocable life insurance trust?" The primary reasons for selecting an irrevocable life insurance trust are to: (1) structure ways that result in the trust being the owner of the policy, and (2) provide that the distribution and use of the proceeds will be subject to controls put in place by the person creating the trust.

Bill has a \$1 million life insurance policy insuring his life. At present Bill controls the economic benefit of the policy because he retains the right to name the beneficiary of the policy and the right to cancel it if he wishes. If he were to die under this set of circumstances, the insurance policy will be included in Bill's gross estate. In planning Bill's estate, he decided to keep assets such as this one out of the calculation of his gross estate. Bill could accomplish that goal by transferring ownership of the policy to someone else or to another entity, such as a trust. If he does that Bill will face a three-year period within which the policy proceeds could still be brought in to the calculation of his "gross estate." In contrast, if Bill decided to create an irrevocable life insurance trust for the express purpose of making the trust the owner of the policy, then whatever policies the trust purchases after the trust is created are not subject to the three-year period during which the policy proceeds could be brought back into the calculation.

How can Bill fund payment of the policy premiums? Bill can make annual exclusion eligible gifts to the trust, provided that the beneficiaries of the trust have a present interest in the trust. Bill can accomplish this by structuring the trust with Crummy withdrawal powers (see chapters IX and X). Giving the beneficiaries "Crummey withdrawal powers" allows the exclusion to apply to gifts made to the trust. If beneficiaries do not exercise their withdrawal or demand rights, then the trustee can use the funds to pay the policy premiums.

### **Example 4: Split Purchases and Sales**

This technique involves two variations: (a) assets purchases by multiple purchasers, and (b) assets sales of remainder interests to children. Asset purchases by multiple purchasers involve transactions in which one purchaser purchases a life interest in an item of property and the other purchaser acquires a remainder interest. The determination of the purchase price to be paid by

each party is made using actuarial-based life expectancy tables. The objectives of this method are to avoid creating a taxable gift when the property is acquired and to eliminate estate tax liability when the life estate ends and the remainder interest vests. Sale of a remainder interest in property involves an owner of property who sells a remainder interest in property while retaining a life estate in it. When the owner's life estate ends, the value of the seller's interest has been fully realized and nothing remains to be transferred to the seller's estate after death.

Upon their retirement in April 1992, a couple in the 50% marginal estate-tax bracket and their daughter agreed to make a split purchase of a personal residence. The purchase price was \$500,000. The parents, ages 64 and 62, purchased a life estate that expires at the death of the survivor of the two. According to the Section 7520 valuation tables, the life estate factor is .81254 and the remainder factor is .18746. Assuming a rate of appreciation of 7% annually over the parent's 21.2-year joint and survivor life expectancy, the residence would be worth \$2,099,500 on the death of the surviving parent.

### **Example 5: Appreciating Property**

Take the case of the John and Mary Smith, a hypothetical 45-year-old couple who, in looking at current tax laws, think their \$300,000 in net worth leaves no estate taxation to worry about. After all, should John die his holdings can be passed along tax-free to Mary under the unlimited marital deduction rule. And when she dies, the assets currently are well within the maximum \$1,000,000 allowed to pass tax-free to the next generation.

But what about increasing values? If either John or Mary lives to age 80, the estate will have zoomed to almost \$900,000 based on 3% inflation. At 6% inflation the now modest \$300,000 would become almost \$2.4 million in 35 years! Also bear in mind these projections do not take into consideration other assets the Smiths will probably accumulate during their lifetime. There is also no guarantee that property value will always rise.

### **Example 6: Charitable Remainder Trusts (CRT)**

Bob Sykes is 65 years old and is about to retire. With nearly \$2 million in total assets (\$500,000 in timber), Bob and his wife, Jane, are considering a number of planning strategies. Beyond providing a comfortable retirement income for themselves, they have two main objectives: provide for their two daughters and make a generous contribution to their local church, of which they have been members for nearly 40 years.

After consultation with their financial advisors and forestry consultant, the Sykes decide to harvest a portion of their mature, high-quality hardwood with a current market value for the trees of \$230,000. For simplicity, we'll look at the transaction net of the forester's fee and other costs associated with the sale. The net current market value is \$200,000. Let's assume that Bob and Jane purchased their woodlot in 1965 and that the value of the timber, at that time, was negligible. Again for simplicity, let us assume that their basis is zero. Therefore, if Bob and Jane sell the timber outright, they'll lose 20% (\$40,000) to capital gains taxes, realizing only \$160,000 from the sale. If the \$160,000 is invested at 6% interest per year, they will receive

\$9,600 in interest income on which they will pay income tax. Instead, they decide to place the timber in a charitable remainder trust, naming their church as beneficiary. The value of the charity's remainder interest is considered a charitable gift for income tax purposes. The creation of the charitable remainder trust with the timber in it constitutes a "constructive severance" for purposes of title to the trees. Later, the trustee sells the timber for its full market value of \$200,000 with no capital gains tax due.

The Sykes can structure the trust into which the proceeds of the timber sale will be placed in one of two ways:

1. Annuity Trust: The trust will pay out a fixed dollar amount each year.
2. Unitrust: The trust will pay out a fixed percentage of at least 5% of the net fair market value of the assets in the trust valued each year.

The Sykes chose the unitrust option that provides for an annual payout of 7%. If the Sykes choose the payout to continue during Bob's lifetime only, the value of the charity's remainder interest is 35% of the gift. This figure is taken from IRS valuation tables. If the Sykes choose a payout that continues until the death of Bob and Jane, the value of the charity's remainder interest drops to 21% of the gift.

The charity earns interest on the amount in the trust and through prudent investment can enjoy an increase in asset value. In the first year of the trust, the payout to the Sykes is approximately \$14,000 plus a portion of the interest income and capital appreciation that the trust enjoys. This amount will also be subject to income tax. In this arrangement, the Sykes are receiving greater income than they would have received had they invested the money themselves. Since a unitrust pays a fluctuating income based on the value of the assets in trust, revalued annually, as the trust assets increase/decrease in value, Bob and Jane receive a higher/lower income.

To provide for their daughters, the Sykes gift a portion of their CRT payout to a "wealth replacement" trust, with their daughters as beneficiaries. Bob's younger brother, Pete, is trustee of this separate and distinct trust. Pete, as the trustee, then uses the gifted cash to purchase life insurance on the lives of Bob and Jane. As beneficiaries of the trust, the two daughters will eventually receive the insurance proceeds. This arrangement keeps the life insurance out of Bob and Jane's estate so that it will not be subject to estate taxes at their death.

What is the net result of using the CRT? The Sykes have a higher income and realize the full value of their hard-earned assets, enabling them to enjoy a more comfortable retirement. They are also able to leave more to their children. Because they made a charitable contribution of only the timber to be harvested, the children also inherit the family woodlands. At the Sykes' death, their church will receive the trust principal that remains as a charitable gift and will set up an endowed scholarship fund in the Sykes' name.

**Example 7: Marital Deduction Planning**

With a little bit of planning, trusts of various types can be used to dramatically increase the amount you and your spouse leave to your children free of estate taxes. Over the next 10 years the exclusion equivalent to the unified credit rises from \$1 million in 2002 to \$3.5 million by 2009, is repealed in 2010, and then is resurrected in 2011 at the \$1 million level.

Suppose you leave your entire \$10 million estate outright to your spouse. After your death, in 2009 your estate incurs no taxes because of the marital deduction. But upon the death of your spouse, also in 2009, only \$3.5 million is sheltered from estate taxes by the exclusion equivalent to the unified credit. Your children will pay federal estate taxes on the remaining amount and any appreciation occurring between deaths. The unfortunate result in many cases is that the family may have to sell assets (the woodlot or liquidate the timber) to pay the taxes. If death occurred before 2010, the federal estate tax rate would about 45% of net taxable estate. Assuming that amount is \$6 million, the tax would be approximately \$2.7 million

But suppose instead that you willed the exclusion equivalent to your unified credit to a credit shelter trust. The balance of your estate would pass to your spouse. From the credit shelter trust your spouse would be entitled only to the income it generates. At your death in 2009 there would be no taxes at your death as the unified credit and the “marital deduction” will eliminate the tax. After the death of your spouse, also in 2009, the assets in the credit shelter trust won’t be part of your spouse’s estate, so they’ll pass estate tax-free to your children. Another \$3.5 million is also untaxed at your spouse’s death due to your spouse’s own \$3.5 million exemption. The result is that \$7 million in value passes free of estate tax. To obtain these savings, your spouse should have the same credit shelter trust in his or her estate plan that you do. Also, each spouse should have \$3.5 million of assets in his or her own separate name to take advantage of the tax savings of such a trust.

**Example 8. Planning for an Estate That is Above the Equivalent Exemption Amount**

Sam and Betty are the parents of two children, Bernice and Buddy. They jointly own 400 acres of land that is located in a growing residential area. One hundred fifty acres of that land includes a stand of high value timber that will be ready for market condition in three years. Sam has bought and sold timber for many years while operating a timber management company in this area. The value of Betty and Sam’s prime residential land is \$3,000,000. The value of their timber land is \$2,000,000. The value of their stone farmhouse and outbuildings is \$1,000,000. Miscellaneous vehicles, machinery and equipment involved in the business are valued at \$100,000. Sam maintains a separate account for his timber management company. He and Betty maintain joint checking and savings accounts at the Hometown Bank and Trust Company. At Betty’s death the accounts contained \$6,000 in the savings account and \$1,800 in the checking account. In addition, Sam and Betty jointly owned \$336,000 in a variety of mutual fund accounts and a cash management account with their broker that is valued at \$24,000. The current timber market is at its highest level in the past 10 years and future prospects for timber prices are bright.

While enjoying their present situation, Betty dies suddenly. Sam is very much affected by her death, but he struggles to continue to operate the business with the help of his children, Bernice and Buddy. Both children have expressed interest in continuing their father's timber management business and in managing the timber land. Sam and Betty had discussed the need to plan their estates many times, but they simply did not make it a priority item in order to get it done. They had simple wills prepared by one of Sam's nephew over 25 years ago, but the wills have not been updated since then. Under her will, Betty leaves all of her property to Sam if he survives her by five days. If he does not survive, Betty donates her property in several shares to her local church, a local hospital and the Hometown Land Conservancy where the land will be used to provide open space benefits in the community.

What is the legal impact of Betty's death? Since all of their property is owned jointly as husband and wife, most states would recognize that the surviving spouse becomes the owner of the property after the first spouse dies. Sam has the property appraised to set the value of Betty's one-half interest that passes to him after her death. Although the value of Betty's gross estate is considerable, i.e., approximately \$2.68 million, Sam will be allowed to take a marital deduction for the value of Betty's interest that passes to him after her death. For state inheritance tax purposes, Sam's survival may eliminate inheritance tax as well.

At Betty's death, the unlimited marital deduction has saved Sam a considerable amount of money. Bernice and Buddy are now considering how they can plan for their future in the business and they recognize that without special planning that future will be affected by the estate and inheritance taxes their father's estate will pay after his death. In order to reduce taxes they convince their father to consider several options. First, the current business should be organized into some type of business arrangement that will allow the children to begin to build up an equity interest in the business. This could involve a corporation, a partnership, or a limited liability company. The objective here is to transfer assets to the children during Sam's lifetime through a series of annual gifts and to allow them to receive the largest amount of the business property at discounted tax cost when Sam dies. As Bernice and Buddy are already involved in the business with their father, they envision that they will be able to take advantage of the special use valuation opportunity to specially value the qualified forest land and also the family-owned business deduction. Bernice and Buddy intend to continue to operate the business and they are committed to doing that.

### **Example 9: Planning with Qualified Conservation Contributions**

John and Mary own 264 acres of land. The property is located about 10 miles northwest of a small city of 60,000 people. The property has 3,000 feet of frontage along the Lazy River, a hilly topography and substantial amounts of mature timber in its woodlands. A dwelling, parts of which were built in the mid 19<sup>th</sup> century, and related out buildings are the only structures located on the property. The dwelling was included in a survey of historic properties conducted by the local county government. The woodlands and river banks support several species of wildlife, such as white-tail deer, beaver, turkeys, grouse, fox, migratory birds, Canada geese, and a variety of other birds, 48 species of which have been observed on the property.

Although agricultural activities remain the predominant use of land in the county, significant residential development has occurred because of the county's proximity to major employers and easy access to nearby urban centers. Development has occurred on land between John and Mary's land and the small city. Land that is adjacent to this land is undeveloped and is committed to agricultural, forestry and low density residential uses. Under the county zoning ordinance, John and Mary's land is zoned as part of a rural agricultural district, as agricultural and forestry uses are the predominant uses in the area. State law includes an Agricultural and Forest District Law that has as its purpose the conservation, protection, development, and improvement of the state's agricultural and forest lands for the production of food and other agricultural and forestry products. This law states that it is the state's policy to preserve and protect agricultural and forestry lands as valued natural and ecological resources that provide essential open spaces and clean air sheds, as well as for aesthetic purposes.

State law also provides that preservation of open land is in the public interest and is to be encouraged. An organization was created to promote identified public interests and to encourage private gifts of money and property for the purpose of preserving natural, scenic, historic, scientific and recreational uses in the state. Statutes authorize the use of easements to maintain the character of open space lands and authorize the organization to accept gifts, such as easements if the gift is consistent with the state's objectives.

John and Mary are concerned about the future use of their land. They want to preserve its rural character and they want to prohibit industrial or commercial activities except those that can be conducted from the existing or permitted buildings. They also want to prohibit exploration for or extraction of subsurface materials as well as the alteration of the property's topography. John and Mary want to retain the right to divide the property into two parcels, the smallest of which is to be no less than 100 acres. One single-family home and associated outbuildings and roads may be constructed on each parcel. The existing home will be one of the homes as long as it remains standing. No structure can be built closer within 1,000 feet of the Lazy River. Management of the timber would be required to be conducted in accordance with sound forestry management practices, subject to the approval of the state. Conservation and management of the property would also include a natural habitat for wildlife. John and Mary are interested in making a qualified conservation contribution on their land. How will the requirements of Section 170 of the IRC apply to this situation? What benefit will Section 2031(c) offer John and Mary if their planned contribution qualifies for it?

Assuming that the organization to which the easement will be transferred meets the requirements of the Internal Revenue Code, the landowners will get an income tax deduction for the value of their contribution as determined by an appraisal by a qualified professional. Restricting the use of their land will also affect the property value of federal estate and state inheritance tax value. In the estate of the decedent, the Section 2031(c) opportunity to reduce the value of the restricted land may also be available. Details on the requirements to gain the income tax and estate tax deductions are further described in Chapter VIII.

**Example 10: Evaluating Alternatives**

Consider the following situation. Woody is 65 years old and his wife, Mary, is 62. They have two children and four grandchildren. Their combined net worth is \$5 million, \$4 million of the net worth consists of timberland owned by Woody and Mary as tenants by the entireties. Of the remaining assets, Woody owns \$600,000 in his name alone and Mary owns \$400,000. Woody and Mary have jointly decided that it is their goal to minimize the impact of federal estate and gift taxes on their estate. Neither of their children is interested in managing the timberland, but several of the grandchildren are interested in it. Two grandchildren are enrolled in forestry degree programs. All grandchildren are under the age of 21 at this point. Woody and Mary are willing to separate their joint ownership interest into two tenant in common interests which they will then transfer in any way that they care to, including to individual living trusts. What are some things that Woody and Mary can do to accomplish their objectives?

**Alt. 1: Using living trusts and coordinating their provisions**

- a) Each living trust provides that at the death of Woody (or Mary), assets that remain after the payment of all debts, expenses, taxes, fees, and costs will be divided among two trusts in amount that is equivalent to the exclusion equivalent to the unified credit and distributed to one of the trusts. Woody and Mary's children are the beneficiaries of the income from this trust. Following the death of both Woody and Mary, this trust is to be divided equally between the children if they survive at that time. However, if one or both of the children die before Woody and Mary pass away, any children or grandchildren of the deceased child who survive Woody and Mary will receive the share that their deceased parent/ grandparent would have received if they had survived Woody and Mary.
- b) The remaining portion of their property will be distributed to a second trust that is structured as a qualified terminal interest property trust (QTIP) for the benefit of Mary (or Woody in the case of Mary's trust). As a qualified terminable interest property trust, all of the income from this trust is to be paid to Mary (or Woody) quarterly for all long as they live. Upon the trustee exercising his discretion to act, the trust principal is available to Mary (or Woody) if it is needed to satisfy reasonable support and comfort during their lives. After the death of Mary (or Woody) the remaining principal in this trust will be divided equally among their children who survive them, or among the children and grandchildren of any of their children who predecease them. Under this plan, both exclusion equivalents have been sheltered, but considerable tax remains to be paid if death occurs before the exclusion equivalents rise because the trusts will only shelter the exclusion amount that is equivalent to the unified credit. As time goes on and the exemption equivalents rise, Mary and Woody can increase their separate property holdings to take advantage of the increases.

Could that result be improved? Without someone, other than Mary or Woody, who is interested and able to carry on the forest management business, special use valuation, the family-owned business deduction, and the installment payment arrangement are not available and would not offer an opportunity to lower the size of the taxable estate. Gifts to charities and gifts of

conservation easements would offer an opportunity to lower the size of the taxable estate of either Mary or Woody. Transferring the timber to a charity and retaining a lifetime annuity for Mary and Woody would allow both of them to gain additional income they can use to fund the purchase of insurance for the benefit of their children.

### **Alt. 2: Direct gifts to grandchildren; dealing with the generation skipping transfer tax**

Should Woody and Mary consider distributing property to their grandchildren as some of them are interested in managing the forestland? An important consequence of doing this would be the generation skipping transfer tax (GSTT). But there are planning opportunities available to them there, also. One important feature is the GSTT exemption of \$1,100,000 available to each of them. Another technique is known as a “Reverse Q-TIP.” In this situation the original grantor of the trust transfers property to a trust that provides that all income is to be paid to the grantor’s spouse during the spouse’s lifetime. At the spouse’s death the property is to be transferred to the grantor’s grandchild and great-grandchildren. The grantor can elect to have the transfer qualify for marital deduction treatment as a Q-TIP trust, but also can elect to treat it as a “reverse Q-TIP” that will enable the grantor to consider the property as his own for purposes of the GSTT, particularly the authority to designate the property to which the grantor’s \$1 million GSTT exemption applies. An effective strategy to follow in regard to gifts to grandchildren and beyond is to take full advantage of this exemption and apply it to property that can be expected to appreciate in value.

### **Alt. 3: Charitable giving**

Gifts to charities can also be applied in a situation like that which applies to Woody and Mary. This type of gift allows Mary and Woody to save several different types of tax, including income, estate, and gift taxes. Gifts to charities come in many different forms, i.e., charitable remainder trusts (interest of a designated beneficiary precedes the gift to the charity), or charitable lead trusts (where interest of the charity precedes interest of another designated beneficiary). Charitable remainder trusts can be one of three types: a remainder annuity trust (income from property is paid to designated beneficiary, remainder to the charity), a remainder unitrust (a fixed portion of the trust principal is paid to designated beneficiaries, remainder to charity), or a pooled income fund. A pooled income fund is an arrangement by which the donor contributes an irrevocable remainder interest in property to a public charity, retaining for himself an income interest for life. In such a fund, the property contributed is commingled by the charity with property transferred by other donors.

Gifts to charities can also be considered as charitable gift annuities. In such cases, a property owner transfers the property to a charity that agrees to pay the owner an annuity for life. This arrangement is designed to provide a benefit to the charity in the amount in excess of the value of the lifetime payments reserved for the beneficiary. Another variation is a qualified terminable interest property (Q-TIP) trust with a charitable remainder. This vehicle blends the benefits of the marital deduction with a charitable gift of the property after the surviving spouse passes on.

What is the best type of property to give to a charity? Since a gift to a charity will not be burdened with fears about the income tax consequences of selling “high value and low basis” property, gifting should consider highly appreciated property where part of the benefit is to save the capital gain tax. This helps to motivate owners to make these gifts to charities where avoiding the capital gain tax is significant. Is forest land a good candidate for a gift to a charity? Since a charity will sell the asset to raise cash to pay the retained benefit to the grantor, any attempt to maximize the timberland value could be lost. Would that matter to someone who has spent considerable time and effort managing the value of the forest land to gain its full potential?

### **Example 11: Forest and Estate Planning Pitfalls**

The following cases illustrate outcomes if (1) you fail to plan, (2) a very simple plan is used, (3) a marital deduction formula is used, and (4) the estate values are balanced between you and your spouse with a marital deduction formula used by each. Initially, assume that one of the spouses holds full ownership to \$4 million of assets and dies in 2002. When the spouse dies, there are three other surviving children. The surviving spouse dies in 2002 without remarrying. There have been no taxable lifetime gift transfers. State law governs the actual distribution of the assets, but applies a generic solution for these examples under which the first \$100,000 and one-half of the remainder is transferred to the surviving spouse and whatever remains is transferred to children. The growth (income) from the assets is exactly consumed in the interim 10-year period, so that at the end of the period, the full principal amount remains intact. Amounts are rounded to the nearest thousand.

**Case One** - If a person dies without a will (unplanned estate in 2002), under the intestate law described above that person’s surviving spouse will inherit \$2,050,000, of the deceased spouse’s estate. The amount inherited by the spouse qualifies for the marital deduction which then leaves a taxable estate of \$1,950,000. The children will inherit the property remaining after the spouse’s share is determined. After the application of the exemption equivalent to the unified credit and state death tax credit, a federal estate tax of approximately \$295,000 would be due when the estate tax return is filed, no later than nine months after death. State inheritance taxes may also be imposed. In 2002, the surviving spouse’s estate is \$2,050,000. If the spouse’s estate remains at that level and the full exclusion equivalent amount under the unified credit is available, the spouse’s estate will be concerned with federal estate tax. Note, that \$1,000,000 of property could be sheltered by the surviving spouse. The remaining portion of the spouse’s estate will generate a net tax due of approximately \$300,000 at the spouse’s death. State inheritance may also be imposed.

**Case Two** - Consider the same situation but instead of an unplanned estate, the property owner executes a simple “I love you” will that gives all of the assets to the spouse. This decision results in no tax at the first death since the entire amount qualifies as a marital deduction. This plan improves on case one by deferring tax at the first death. It gives the spouse full access to the assets with opportunities to consume the funds or to plan for their eventual use and distribution. At the second death, however, there is a tax of approximately \$1.3 million on the \$4 million estate since there is no marital deduction available and the exclusion equivalent was wasted when the first person died. This levy will likely cause liquidity problems on most tree farms that

cannot take advantage of special use or qualified family owned business deductions. In comparison to case 1, this option results in greater financial security for the surviving spouse, but at greater tax cost.

**Case Three** - The third case involves dividing the assets between the spouses and uses a basic marital deduction formula in the will that makes the estate share going to the children at the owner's death equal to the amount shielded by the tax credit that remains available - \$1,000,000 in this case. It also uses the marital deduction to defer estate taxes on property that is directed to pass to the surviving spouse. This plan fully uses the tax credits at both deaths, defers tax at the first death, and offers the surviving spouse additional opportunities to plan. When the second spouse dies, approximately \$1.11 million in federal estate taxes would be due. The differences in the outcomes of cases two and three can be attributed to use of the exclusion equivalent and the lower tax rates being applied.

**Case Four** - Using the same example of a \$4,000,000 estate, the property owner decides to divide the value of the estates between the spouses such that each estate can be equalized with the other. When the first spouse dies in 2002, the net federal estate tax due on the decedent's \$2,000,000 estate after the exemption equivalent to unified credit and state death tax is calculated will be approximately \$295,000. State inheritance tax may also be applied. When the surviving spouse dies, a similar outcome could be expected. Directing that the exclusion equivalent to the unified credit and state death tax credit be placed in trust for the benefit of the surviving spouse but limiting the spouse's authority over the fund so that it does not become included in the spouse's estate will assure that the financial benefit is there if needed. Additional planning opportunities permit the survivor to explore special use valuation, a program of gifting, and other means for reducing the taxable estate below the amount that is sheltered by these provisions.