# Essential Estate Planning: Tools and Methodologies For the Military Practitioner

*Major Joseph E. Cole*
*Chief Circuit Trial Counsel*
*United States Air Force Judiciary Eastern Circuit*
*Bolling Air Force Base, District of Columbia*

## Introduction

The issue of personal estate planning is critical for United States military members. Due to the nature of the profession and the mobility requirements that are the trademark of duty in the modern military, service in the military is dangerous. Although no one looks forward to the prospect of considering their own demise, without a prepared, well thought out, and executed estate plan one is unable to take advantage of the legal mechanisms that allow the estate owner the greatest flexibility to manage his assets. The purpose of this article is to present a broad overview of those mechanisms and other issues involved in estate planning.[1]

One way to think of an estate plan is as a process whereby an individual takes measures and makes decisions compatible with the use, preservation, and distribution of his wealth. This planning process also involves many different factors that are not associated with the financial nature of the estate plan; for instance, the personal desires of the estate owner may be entirely inconsistent with the best method for preserving or distributing wealth. This article will raise awareness of estate planning matters for members of the military through a conscious effort to address the practical considerations of anyone concerned with the best use of assets during life and a managed disposition of those assets on death.

The first step for military members in developing the financial aspect of an estate plan is to understand the items that are already part of the estate of the individual as a result of the benefits due by virtue of that individual's citizenship and service in the armed forces. After that, the focus of estate planning shifts to that portion of an estate that makes up the majority of an estate for most service members–life insurance. The key to accumulating assets within an estate also hinges on an individual's ability to invest and build an estate. Once an individual has accumulated some measure of wealth, the issues then most critical to estate planning are the decisions regarding how to manage and then distribute the accumulated assets of the estate. All of these topics will be addressed in this article, with particular emphasis being placed on the unique issues confronting military members in estate planning.

## Government Survivor Benefits

There are certain survivor benefits that an individual enjoys solely as a result of their service on active duty. Despite the general requirement of service on active duty as a trigger for the establishment of the benefits, there are differing criteria for entitlement for survivors under different programs. The basic government survivor benefits include Dependency and Indemnity Compensation (DIC), Survivors' and Dependents' Educational Assistance, Survivor Benefit Plan (SBP), and Social Security Administration survivor benefits. When determining government benefits, there are two questions that must be answered: who is eligible to receive the benefits, and what are the specific benefits to which the recipient is entitled?

The first government program to be addressed is the coverage provided under DIC.[2] Administered by the Veterans Administration (VA), DIC is unequivocally a beneficial program for the survivors of a deceased military member. While there are some limitations on the benefits, there is the potential for the surviving spouse of a military member to receive no-cost, tax-free, life-long financial benefits under DIC.

The threshold requirement in a DIC eligibility inquiry focuses on whether the death of the service member occurred while on active duty, and concurrently, and even more importantly, whether or not the death occurred in the line of duty. The first step in determining eligibility is to ascertain if the service member was on "active military, naval, or air service" at the time of death.[3] As this definition includes active duty, an understanding of how the statute defines active duty is also important. For purposes of DIC coverage, active duty is defined as, "full-time duty in the armed forces."[4] Because the definition is generally applicable to all members on active duty, those members are covered by DIC benefits.

1. The focus of this article is to generally address some of the more common issues that arise when advising service members in the area of estate planning. It is not intended to be a comprehensive review of the tools available for estate planning, or a "how to" on estate building or planning. Hopefully, this article will provide the reader with a baseline on the primary issues affecting military members in this area of the law while providing a reference source to the statutory foundations for some of the specific legal and tax topics surrounding government benefits and estate planning devices.

2. 38 U.S.C.A. § 1310 (West 1999).

The next hurdle is a determination by the VA that the death occurred in *line of duty.* The phrase, "line of duty," has meaning to most service members and certainly all judge advocates and Department of Defense (DOD) civilian attorneys. However, the issues that most persons are familiar with in a line of duty investigation[5] are different from the issues the VA considers in making a line of duty determination for DIC. An injury or disease is considered to have occurred in the line of duty when the member "was, at the time the injury was suffered or disease contracted, in active military, naval, or air service, whether on active duty or authorized leave, unless such injury was the result of the person's own willful misconduct or abuse of alcohol or drugs."[6] This liberal view of the definition seems to support the notion that willful misconduct generally means conduct that is criminal.[7]

Also, DIC provides another way for a survivor to be entitled to benefits under the program even after the service member is no longer serving on active duty; that is, when the death of the member is considered "service-connected."[8] For the VA to consider a death service-connected, there must be a nexus between the death of the service member and that member's service on active duty.[9] An example of the service connection is when a military member is injured or contracts a disease while on active duty then subsequently is discharged or retires from active duty and then dies as a result of the injury or disease. In other words, DIC coverage is only available when the cause of death is closely connected to a medical condition that arose or became aggravated during the veteran's service on active duty.

Once an individual qualifies for DIC benefits, it's simple to determine the amount of benefits that will be received. As of 1 December 1998, surviving spouses of military members of all ranks receive $861 per month from DIC.[10] If the surviving spouse has children, the spouse will receive additional benefits equaling $218 per month for each child under the age of eighteen.[11] That monthly amount is reduced to $185 for any children between the ages of eighteen to twenty-two attending a VA-approved educational institution.[12]

Children are entitled to benefits when there is no surviving spouse.[13] Children's benefits terminate when the child reaches the age of eighteen, or twenty-three if in an authorized educational institution. Any benefits paid to a child who is or becomes disabled before either of the above applicable age cutoffs will continue to receive the benefits.[14] Even parents of the deceased may be entitled to benefits if their annual income is low enough.[15]

There are many benefits to the actual compensation dependents under DIC receive. The most important is that DIC benefits come at no cost to the military member or the dependents. This is not like an insurance policy or an annuity; there are no premiums to pay and no beneficiaries to name. A military member's dependents are entitled to the benefits strictly

---

3. 38 U.S.C.A. § 101(24) provides:

> The term "active military, naval, or air service" includes active duty, any period of active duty for training during which the individual concerned was disabled or died from a disease or injury incurred or aggravated in line of duty, and any period of inactive duty training during which the individual concerned was disabled or died from an injury incurred or aggravated in line of duty.

4. *Id*. § 101(21)(A). This article mainly concentrates on the benefits and considerations for active duty members and does not address specific status or applicability for members of the guard or reserve.

5. *See* U.S. Dep't of Air Force, Secretary of the Air Force Instr. 36-2910, Line of Duty (Misconduct) Determination (15 Aug. 1994); U.S. Dep't of Army, Reg. 600-8-1, Personnel-General, Army Casualty and Memorial Affairs and Line of Duty Investigations (17 Oct. 1986); U.S. Dep't of Navy, Reg. 1124, Misconduct and Line of Duty Findings (14 Sept. 1990).

6. 38 U.S.C.A. § 105(a).

7. *See id*. § 105(b).

8. *Id.* § 1310(a).

9. The term "service-connected" is defined as meaning "that the death resulted from a disability incurred or aggravated, in line of duty. . . ." *Id.* § 101 (16).

10. *See id.* § 1311.

11. *Id.* § 1311(b).

12. While all educational institutions are subject to approval by the Secretary of the Veterans Administration, some examples listed at 38 U.S.C.A. § 104 include: schools, universities, colleges, seminaries, academies, and technical institutes.

13. *See id.* § 1313.

14. *See id.* § 1314(a)-(c).

15. "In no case may dependency and indemnity compensation be paid . . . to any parent if the annual income of such parent exceeds $4038 . . . ." *See id.* § 1315(b)(3).

because of the military service of their sponsor. The DIC compensation is also tax free to the beneficiaries; the benefits are not taxed as income to the recipients.[16] In addition, the benefits also have a cost of living factor added in that allows for increases in the amounts received. These benefits are also not reduced by Social Security or any other government survivors benefit program; if dependents are eligible to receive DIC, they receive the entire amount to which they are entitled without any set-offs.[17] Finally, DIC benefits received by a surviving spouse can be received for the duration of the life of the spouse. The benefits to the surviving spouse are terminated by the death of the spouse and can be terminated upon the remarriage of the spouse.[18]

As previously mentioned, the benefits proceeding from DIC are substantial and in most cases, free from restrictions. The program more than adequately succeeds in it's general purpose of ensuring that the surviving dependents are not left destitute by the death of the service member. While the survivors are not set for life, there will be some income to assist them in regaining the standard of living previously enjoyed. This article will next analyze some of the educational benefits available to the survivors of a deceased service member.

Another benefit program administered by VA is Survivors and Dependents Educational Assistance.[19] Under this program, the spouse and surviving children of a service member are entitled to receive benefits toward expenses while pursuing a post-secondary education.[20] Benefit amounts differ based on the full- or part-time status of the student and the type of training or education.[21] This assistance is generally available after the child reaches the age of eighteen or completes secondary schooling, and the benefits can last until the child reaches age twenty-six.[22] For the surviving spouse, the benefits remain available for up to ten years after the service member's eligibility or death, whichever is later.[23] As previously mentioned, to remain eligible for veterans' benefits, the surviving spouse cannot be remarried.[24] One of the main benefits of this program is its duration; "each eligible person shall be entitled to educational assistance . . . not in excess of forty-five months."[25]

Although this review of benefit programs has so far focused on the benefits available only to survivors of military members, there are additional survivor benefits available to all qualified United States' citizens through the Social Security Administration. Eligibility for Social Security survivor benefits is determined by the "insured status" of the deceased.[26] The survivors of a military member are eligible for Social Security due to the military status of the deceased. What this means is that even if a military member has not been employed for a long enough period of time to be either currently or fully insured under Social Security, the member will still be treated as if fully insured.[27] The surviving spouse of a veteran is not entitled to monthly survivor benefits until the spouse has reached the age of sixty.[28] However, the surviving spouse will receive benefits as a custodial parent for any child of the fully or currently insured individual who is under the age of sixteen.[29] The children of the deceased are entitled to benefits until age eighteen or nineteen if still in high school.[30]

16. *Id.* § 5301.

17. While other benefit programs do not reduce DIC, some of those same programs are reduced when the recipient is also receiving DIC. For example, Survivor Benefit Plan benefits are reduced to the extent that the surviving spouse is also receiving DIC benefits. *See* 10 U.S.C.A. § 1450(c)(1) (West 1999).

18. *See* 38 U.S.C.A. § 101(3) (defining "surviving spouse"); 38 U.S.C.A. § 1311 (regarding remarriage of surviving spouse).

19. 38 U.S.C.A. § 3500.

20. *See id*. § 3531.

21. *See id.* § 3532 for differing benefit amounts based on the full-time, three-quarter-time, or halftime status of the eligible person.

22. *See id*. § 3512(a).

23. *Id*. § 3512 (b)(1)(A-C).

24. *Id*. § 104.

25. *Id*. § 3511(a).

26. A "fully insured individual" is one who has generally paid into Social Security for at least forty quarters during their life. A "currently insured individual" is someone who has paid in at least six of the last thirteen quarters before death. *See* 42 U.S.C.A. § 414 (West 1999). "A *quarter* or *calendar quarter* means a period of three calendar months ending March 31, June 30, September 30, or December 31 of any year." 20 C.F.R. § 404.102 (1999).

27. If at the time of his death a veteran is neither fully or currently insured, and the death occurs while on active duty or is service-connected, VA will pay benefits to the survivors equal to what the veteran would have received from Social Security Administration if fully or currently insured. *See* 38 U.S.C.A. §1312.

28. *See* 42 U.S.C.A. § 402(e)(1)(B).

29. *Id.* § 402(g).

Survivor benefits under Social Security are based on the individual employment history of the deceased. The benefits are determined by the primary insurance amount (PIA) attributed to the employee because of his contributions to the system.[31] Without delving too deeply into the mathematics, the PIA is derived from a computation that considers the average monthly wages of the deceased individual.[32] Once the PIA is determined, the amount of benefits due to the survivors is calculated by multiplying the PIA by a factor (these multipliers differ and depend upon the number and type of survivors; for example, surviving spouse and one child; surviving child only; surviving spouse and two or more children). The figure arrived at from this calculation is the amount of monthly benefits available to survivors.[33]

Although the survivor benefits from Social Security are also substantial, there are several limitations on receipt of benefits. First, to receive survivor benefits, the survivors must apply to the Social Security Administration; the benefits do not arise automatically. In addition, benefits will not be paid retroactively; the benefits will begin upon approval of an application, regardless of when the application is made in relation to the death of the service member.[34] Next, survivor benefits are capped at the maximum family benefit (MFB), the amount which Social Security survivor benefits will not exceed.[35] For example, assuming the same PIA, a surviving spouse with two children receives the same benefits as one with six children because the MFB has reached its limit. Finally, similar to DIC, the benefits to the surviving spouse are generally unavailable to the surviving spouse who decides to remarry.[36]

The previous benefits discussions have centered on the benefits available simply because of the service of the military member. The final topic for discussion, the Survivor Benefit Plan (SBP),[37] is also based on the service of the member. The SBP, however, is fundamentally different from the other programs because eligibility for SBP is usually dependent upon voluntary monetary contributions from the service member. With one notable exception, SBP is an annuity program in which the service member determines the annuity to be received by his survivors by electing the level of monetary contribution to the plan. Through this election, the member determines what benefits will be paid to survivors upon his death. As most military members understand, the SBP decision is one of the most critical ones that must be made by retiring military members. Unfortunately, even though aware of the importance, there is often little research done to be adequately informed as to what the benefits are and how those benefits can best fit into the retiree's financial future.

The SBP is a DOD program that provides for the continuing payment of a benefit to specified survivors upon the death of the participating service member. This optional plan is funded by monthly premiums contributed from the retired pay of the military member and partially subsidized by the government.[38] The member determines the amount of that benefit and to whom it is paid.[39] The member can make a number of elections regarding the benefit recipients (for example: spouse only, spouse and qualifying children, qualifying child only) and the amount of benefits to be received. Nonetheless, the service member cannot act alone in making the SBP decision; if there is a spouse, the spouse must also concur with certain decisions of the member regarding participation in SBP.[40] Aside from a one-time opportunity to discontinue participation in the plan,[41] and exceptions for when there are changes to eligible beneficiaries, the decision to participate or not, is irrevocable.[42]

30. *Id.* § 402(d).

31. *Id.* § 415.

32. *Id*. § 415(b).

33. The Personal Earnings and Benefit Estimate Statement (PEBES) is the document the Social Security Administration uses to estimate future benefits as well as determine how individuals qualify for benefits. The PEBES can be requested online at <http://www.ssa.gov> or by calling 1-800-772-1213.

34. Any inquiry by an active duty or retired service member regarding these or other government survivor benefits should begin with a casualty assistance office of the respective service.

35. *See* 42 U.S.C.A. § 403(a).

36. Widow and widower benefits are dependent upon the surviving spouse being unmarried. *See id.* § 402(e)(1)(a). If the surviving spouse remarries after reaching the age of sixty, the marriage will be deemed to have not occurred. *See id.* § 402(e)(3).

37. 10 U.S.C.A. § 1447 (West 1999).

38. For a general idea of the premium costs for SBP, the premium is equal to 6.5% of the base amount selected by the participant. *See* U.S. Dep't of Air Force, Secretary of the Air Force Instr. 36-3006, Survivor Benefit Plan (SBP) and Supplemental Survivor Benefit Plan (SSBP) (1 July 1996).

39. The monthly benefit is determined by the "base amount" selected by the participant. This base amount can be any amount between $300 and the full amount of the monthly retired pay. *See* 10 U.S.C.A. § 1447(6). The monthly SBP benefit is 55% of the selected base amount until the surviving spouse reaches the age of 62; thereafter, the monthly benefit is equal to 35% of the base amount. *See id*. § 1451.

40. 10 U.S.C.A. § 1448(a)(3).

Eligibility for SBP is determined by the term of the member's service to the armed forces. In most cases, a member elects to participate in SBP when retirement eligible and immediately prior to retirement as part of personnel out-processing from active duty.[43] However, in addition to this voluntary participation in SBP, eligibility also arises once the member becomes retirement eligible.[44] For example, if a military member dies while on active duty after the completion of twenty years of active duty service, the surviving spouse (and children if no surviving spouse or if surviving spouse subsequently dies) receives the full benefits from SBP without paying any costs or making any contributions to the plan. In that scenario, the survivor would receive fifty-five percent of the member's monthly base pay each month for as long as otherwise eligible to receive the benefits from SBP.[45]

Before determining whether SBP is an appropriate part of one's estate plan, a service member must consider a number of factors. First, SBP is similar to a bet or gamble (analogous to the considerations in purchasing life insurance)–the participant is betting that he will die and that his spouse will outlive the participant; thus making SBP pay out over the life of the participant's survivor. Its easy enough to consult actuarial tables to determine the mortality of the participant and the spouse. If the participant is decidedly older than his spouse, SBP may have more value to that participant.

Another consideration is whether the member has young or disabled children. In general, a child is a dependent child eligible to receive benefits if unmarried, under eighteen years of age, under twenty but pursuing a full-time course of study or training, and incapable of self support because of mental or physical incapacity. If a disabled child is named as a beneficiary under SBP, there is the potential that SBP could pay benefits to the disabled child as long as the disability continues or until the child marries.[46] For those with young children who are considering participation, one must again consider a mortality analysis. What is the likelihood that the service member will die while the child is still entitled to benefits from SBP? In this case, SBP may become more attractive to the participant.

Yet another concern is the insurability of the member. As covered next in this article, commercial insurance policies can also provide protection for survivors. If a member might otherwise be ineligible for commercial insurance because of a medical condition, they could still participate in SBP because eligibility is not determined on a medical basis. Again, using a comparison to insurance, the factors critical to determining whether SBP is right for an individual is based on a risk assessment dependent upon the personal needs, family needs, and the decision of what amount of risk is appropriate for that particular participant.

The worst case scenario for SBP purposes involves a participant contributing to SBP for many years[47] who dies, followed shortly thereafter by the death of the surviving spouse. At the death of the surviving spouse, the benefits from SBP terminate; they are not passed to successor beneficiaries. In this example, there would be a tremendous amount of payments into SBP without any significant benefits being passed along to the spouse, and for that matter any other heirs after the spouse's death. An alternative method for ensuring that survivors receive benefits upon the death of the retiree is through the purchase of life insurance.

Before making the election under SBP (and the Supplemental Survivor Benefit Plan (SSBP) as discussed later), a retiree should compare the costs of SBP to a life insurance policy that could provide comparable benefits.

Instead of paying premiums to SBP, the member could purchase life insurance that would pay a lump sum to the spouse or other beneficiaries upon his death. If the goal of the military member is to provide assets available to his estate, as opposed to a lifetime benefit to a spouse, that result can be achieved through the purchase of life insurance. In addition to potentially lower premiums than SBP, the retiree could invest the difference between the cost of insurance and the cost of coverage from SBP; thus, providing the ability for even greater assets to be passed to the heirs. A thorough comparison of the costs of SBP and the price of a commercial life insurance that provides comparable benefits is paramount to the overall SBP decision.

---

41. A participant may elect to discontinue participation in the plan within a one-year window after the two-year anniversary of the first payment received. *See id*. § 1448a.

42. *Id*. § 1448(a)(4)(A). An exception to the general irrevocability of elections, a recent one-year open enrollment period (beginning 1 March 1999) has been made available to eligible retired or former members of the uniformed services who are not participants in SBP. *See* Pub. L. 105-261, Div. A, Title VI § 642, 112 Stat. 2045 (1998).

43. This article addresses SBP for active duty members. While the Reserve Component SBP is very similar, there are special rules for eligibility and participation. *See* 10 U.S.C.A. § 1448(a)(1)(B).

44. *Id.* § 1448(d)(1).

45. *Id*. § 1451(c)(1)(A).

46. *See id*. § 1447(11)(a).

47. The Strom Thurmond National Defense Authorization Act for Fiscal Year 1999, Pub. L. No. 105-261, 112 Stat. 1920 (1998). The Act provides that effective 1 October 1998, SBP payments are terminated following 30 years of payment and attainment of the age of 70.

Although this article discussed some of the advantages and disadvantages of SBP, the service member should consider some further limiting factors regarding the plan. For instance, in addition to termination of benefits upon the death of the named beneficiary, SBP benefits also terminate upon the remarriage of the survivor, with some exceptions.[48] If the surviving spouse is also entitled to DIC, the annuity is decreased by the amount of DIC.[49] Unlike the benefits received from DIC, SBP benefits are taxable; and treated as ordinary income. While the benefits are considered income, the SBP premium is withdrawn from the retired pay out of pre-tax dollars.

However, one of the biggest limitations of SBP is the two-tier nature of the system. As mentioned above, once a survivor reaches the age of sixty-two, SBP benefits drop substantially in recognition that the survivor is now eligible to claim retirement benefits under Social Security.[50] To make up this deficit in benefits, participants in SBP are offered participation in SSBP.[51] This optional plan allows participating members to pay an additional premium to avoid decreased SBP benefits to survivors at age sixty-two.

Retirees can choose the level of benefits by paying increasingly graduated premiums that give the participant the ability to maintain the benefit between thirty-five to fifty-five percent of the base amount.[52] A retiree can continue to provide the same monthly benefit (fifty-five percent of the selected base amount) to his survivor even after the survivor reaches the age of sixty-two. The SSBP is essentially a commercial insurance plan; the cost of the benefits is not subsidized by the government like the costs of the SBP. To maintain the same level of benefits as provided under SBP, a participant would pay greatly increased costs with SSBP. Before making the SSBP election under SBP, a retiree should compare the costs of SBP and SSBP to a life insurance policy that could provide comparable benefits.

While these government programs provide fairly generous benefits to a military member, they are usually not enough to enable one's survivors to maintain the standard of living to which they have become accustomed. As mentioned above, the main purpose behind these programs is to provide the day-to-day living expenses. However, when planning an estate, one of the primary goals is to accumulate an estate that can be passed on to heirs. One estate planning tool that most people look to as a source for providing those assets is life insurance. Purchasing life insurance is a critical decision that must be addressed, and continually re-addressed, throughout the life of anyone who is serious about planning to leave an estate for his heirs. The next section will address the uses of life insurance as a means to create an estate, to provide liquidity, and to insure against estate taxes.

### Estate Accumulation

For military members, life insurance can help bridge the gap between the benefits that will be paid to survivors and the amount that the deceased would like to have available for lifetime use by his survivors. Notwithstanding the role that life insurance plays in most estates, an individual must first determine whether there is an actual need for life insurance. The purchase of any type of insurance is a matter of risk assessment. The purchaser must compare how likely the item insured is to be damaged or lost compared to the financial interest the purchaser has in the item. If the likelihood of loss is great and the value of the item is also great, then the purchase of insurance is probably a good risk. Since the financial interest in a person's life is of great value to their survivors, and because death is inevitable, life insurance of some sort is almost required for most individuals.

Whether you need insurance, or how much, is based on individual needs. A simple way of looking at the question is to estimate the total financial resources needed; determine all the financial resources available, including life insurance and other benefits (such as the previously discussed government benefits) already in place; and subtract the amount available from the amount needed to arrive at the amount of additional life insurance needed. This highly individual determination depends on the economic needs of each family. Factors that are important to the assessment of the economic needs of a family include: replacement of family income, debt liquidation, education needs, liquidity, and any additional expenses such as child care, cooking, and cleaning. An in-depth consideration of all these factors is critical to adequately assess one's need for life insurance.

The insurance industry has created many different vehicles to meet the insurance and investment needs of participants. A discussion of these tools is outside the scope of this article, however, an understanding of some of the basic principles is warranted for proper decision-making within an estate plan. The first point of illustration when purchasing life insurance is whether the product is pure life insurance (term insurance), or

---

48. Survivor Benefit Plan coverage is terminated if the surviving spouse remarries before reaching age 55. The annuity shall resume if that marriage is later terminated. *See* 10 U.S.C.A. § 1050(b)(2)(3).

49. *Id*. § 1450(c)(1).

50. *Id*. § 1451(a)(1)(B). The presumption is that because the deceased military member was either fully insured or treated as such, the surviving spouse will make up the difference because of the entitlement to receive Social Security retirement benefits.

51. *Id*. § 1466.

52. *Id*. § 1457(b).

some other type of life insurance that is also imbued with an ability to accumulate a cash value through an investment or savings function (whole life insurance).[53] Generally, the insured will pay quite a bit more for the same amount of death benefits when choosing a policy that will also accumulate a cash value. Most important to one's decision as to what type of policy to purchase is the optimum use of one's current income and wealth as a means to accumulate future assets. The purchaser has to decide whether the cash value policy will do better as an investment or whether the purchaser would be better served to purchase cheaper term insurance and invest the difference in cost from a whole life policy into another investment vehicle. Once this decision is made, the purchaser can control his current income to properly balance insurance payments with investments.

In most cases, insurance benefits make up the largest asset of a service member's estate.[54] Other than providing family income as discussed above, these assets also contribute flexibility to an estate. First, insurance benefits provide liquidity. One of the biggest items of property included in most estates is real property. This property is generally not as liquid as other assets in the estate; for example, even though there may be accumulated equity in a personal residence, the surviving spouse may be at a loss to benefit from the equity without selling the property or taking out a mortgage on the home. In this example, life insurance benefits can provide an easily transferable asset to an estate that is otherwise encumbered by real property, which the surviving spouse might wish to keep intact. Another very important use of life insurance is as a means of protection against estate taxes. In the simplest form, the benefits can provide assets to the estate for use in paying estate taxes; on a more sophisticated level, life insurance can also serve as the principal of a trust for the same purpose.

All military members have the opportunity to enroll in Serviceman's Group Life Insurance (SGLI).[55] This group term insurance policy generally provides $200,000 to the beneficiaries of the military member.[56] As an example of how to use this type and amount of benefits, SGLI benefits would aid in fulfilling the family income needs of the survivors or even to have available income to pay estate taxes if required. The topic of estate taxes and some of the means for planning to best minimize the effect of taxation will be discussed later in this article.

To this point, this article has addressed the estate planning issues specifically related to benefits incurred as a military member and the estate building aspects insurance can supply to a typical military member. However, to provide the greatest amount of assets for one's survivors, estate planning must also be concerned with the accumulation of wealth. While insurance can provide significant assets toward the creation of an estate, an effective estate plan must address other methods of estate building. Despite the government benefits and insurance proceeds available to members, most will find that those benefits do not provide the assets needed to maintain an accustomed standard of living for the survivors. This additional deficit can be overcome with an individual financial plan that accounts for the needs and desires of the member as a baseline to structure a specific savings and investment strategy.

While this article does not attempt to provide investment advice, it must be mentioned that any estate plan would be remiss without a concentrated plan for how to accumulate wealth to build an estate to provide as desired for survivors. When people begin to save and invest, they usually do it for reasons other than creating an estate. Such reasons usually include: children's education, financial security, and retirement. Even if most would agree that the ultimate goal is to accumulate enough wealth to be self-insured and to take care of all the lifetime needs of one's family, it is difficult to accomplish this deal without an investment plan. Central to this strategy are effective management of credit and debt, consideration of investment methods and strategies (to include tax advantaged investments), participation in an investment plan, and awareness of how federal taxes impact investments.

An example of the effect of taxes on military members and estate building can be seen in the changes to the capital gains tax applied to the sale of rental property. While almost all homeowners benefit from the change to the capital gain exclusion[57] on the sale of a principal residence, the same cannot be said of those homeowners who leased their principal residence and later sold that property. Due to the necessity of transfers inherent in the military, for many military members the purchase of a residence is often accompanied by a period of leasing out that same residence once the member is transferred from that duty station.

53. In a term policy, the insurance company agrees to pay a stated amount of death benefits if the insured dies. Although there are many variations, the insured generally agrees to pay a level premium over the length of the term of the policy. As the name implies, whole life is designed to offer insurance for the whole life of the individual. In addition to death benefits, whole life also has a savings feature that allows the policy to develop a cash value which accrues from the investment earnings on the premiums. In addition to whole life, the insurance industry has developed other insurance/investment vehicles such as universal life and variable life to meet the needs of its customers. *See generally* HAROLD WEINSTOCK, PLANNING AN ESTATE (3d ed. 1988 and Supp. 1993).

54. *See* ASSOCIATES IN THE SOCIAL SCIENCES, THE UNITED STATES MILITARY ACADEMY AT WEST POINT, PRINCIPLES OF INSURANCE AND RELATED GOVERNMENT BENEFITS (10th ed. 1965).

55. 38 U.S.C.A. § 1967 (West 1999).

56. *See id.* § 1967(a) (discussing the options under SGLI).

57. "The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000." I.R.C. § 121(b)(1) (West 1999). The amount of gain that can be excluded by a husband and wife filing a joint return on the sale of a principal residence is $500,000. *Id*.

Prior to The Taxpayer Relief Act of 1997,[58] this was still a relatively safe risk for military members; the service member could hope to possibly return to that home and reestablish residence in it for a period of time to enable them to take advantage of the "rollover" procedure.[59] If the homeowner had a "dominant motive" to sell the principal residence, had the intent to return and reoccupy the residence, and actually reoccupied the residence, the homeowner was able to rollover the capital gain on the sale of that home provided the principal residence was replaced within the specified time period.[60] However, under the new rule, the homeowner is now subject to tax as a result of any gains due to depreciation of the property even if the investment property is later "owned and used" as the principal residence and is sold.[61] To be considered "owned and used," the home must have been the principal residence of the taxpayer for a total of two years during the five-year period prior to the sale of the home.[62] This is a far cry from the previous standard of just showing an intent to reoccupy the home.

Another fundamental change of The Taxpayer Relief Act was the introduction of a new Individual Retirement Account (IRA) option, the Roth IRA.[63] In a traditional IRA, contributions are deductible, as allowed, as long as eligibility requirements are met; then, when the taxpayer withdraws the funds from the account, the income becomes taxable. However, contributions to a Roth IRA are not deductible during the year in which contributed; nonetheless, the earnings on the contributions grow tax free as they accrue. Distributions from the Roth IRA, if made after age fifty-nine and one-half and at least five years after the account is established, are then tax-free.[64]

Because of this opportunity to dramatically change the taxable format of one's IRA, taxpayers have been given a grace period in which to convert their traditional or nondeductible IRAs into a Roth IRA without paying an early withdrawal penalty.[65] However, that conversion comes at a cost; any taxable amounts that are rolled over from a current IRA must be included in the income of the taxpayer. If the rollover was completed prior to 1 January 1999, the income could be apportioned over the next four years.[66] This look at some of the changes from The Taxpayer Relief Act depicts the effect federal taxes can have on the structure and strategy of an investment plan. The focus of the article will next shift to the most important issue in estate planning: the implementation of the wishes of the estate owner to manage the estate according to his personal desires for preservation and distribution of assets.

### Estate Management and Control

To establish an effective estate plan, tools must be used that are consistent with the objectives of the individual. Although tax planning is important to an overall estate plan, of foremost importance is that the plan represents the desires of the individual. Herein lies the dilemma of estate planning; if too much emphasis is placed on avoidance of estate taxes, it may require that the planner give up some control of the estate. Similarly, if the focus is on control of the estate, the individual will likely be subjecting the estate to increased estate taxes. Before using any of the tools available to estate planners, it's vital that those involved in the estate contemplate the goals they wish to accomplish through their estate plan. When all is considered, what is of utmost importance to the owner of the estate is whether or not he feels comfortable with the answer to the question, "Will my estate be administered and distributed in a manner that is consistent with my desires?"

To illustrate the effect that management decisions can have on estate planning, consider the effect that choosing joint ownership as the means for property ownership can have on an estate. For many married military members, like most Americans, joint ownership is generally a preferred method of owning property. The main reason is that if the property is owned jointly with a right of survivorship, ownership of the property will automatically pass to the survivor upon the death of the other joint owner as a matter of law.[67] In this way, joint tenancy with a right of survivorship ensures continuity of ownership for the couple. Another reason that many married couples prefer to own property as joint tenants may be that it projects a relationship where the spouses are equal partners.

58. Pub. L. 105-78, Title V, § 519, 111 Stat. 1519 (1997).

59. Under former I.R.C. § 1034, taxpayers were generally allowed to roll over any gain from the sale of their old residence into a new residence when the cost of the new residence was greater than the old one. (*Repealed by* Pub. L. 105-34, Title III, § 312(b), 111 Stat. 839. (1997)).

60. Pub. L. 105-34, Title III, § 312(b), 111 Stat. 839. (1997).

61. *See* I.R.C. § 121(a).

62. *Id.*

63. *Id*. § 408A. The Roth IRA is named for Senator William Roth, Jr. of Delaware, an ardent supporter of IRA tax benefits.

64. *See id*. § 408A(d).

65. *Id.* § 408A(d)(3)

66. *See id*. § 408A(d)(3)(A)(iii).

Practically, joint ownership also gives each owner the right individually to make all decisions regarding any disposition of the property because each has an undivided ownership interest in the property.[68] The final advantage to joint ownership of property, since it is not considered a testamentary asset, is that title to the property passes to the surviving joint owner without going through probate procedures upon the death of the first joint tenant. Despite these considerations, joint ownership of property can have adverse effects on the taxability of the property both for estate and income tax purposes.

Although a discussion of what assets are considered part of the gross estate of the deceased for estate tax purposes is saved for later in this article, presume that the value of the joint property will be included in determining the taxability of a decedent's estate.[69] With regard to an asset owned by a husband and wife as tenants by the entirety or as joint tenants with right of survivorship, one-half of the value of that property will be included in the gross estate of the first to die.[70] Although title to the property will transfer to the surviving joint owner, the estate of the decedent will be increased by half of the value of that property without gaining any control over the disposition of that property. If avoidance of estate taxes is a goal of the estate plan, joint ownership can have the effect of exposing more assets and increasing the probability that the estate will be subject to estate taxes.

The major disadvantage to joint ownership of property for income tax purposes is the effect a joint tenancy has on the taxable basis that the surviving tenant maintains in the property after the death of the first joint tenant. If the asset that is owned in joint tenancy appreciates, it subjects the surviving joint tenant to greater taxability on any gain that arises as a result of the later sale of that property.[71] For example, if a married couple purchased a vacation home as joint tenants with right of survivorship (or as tenants by the entirety) in 1970 for $40,000, and the present value of that home is $100,000 at the death of the first joint tenant, the surviving spouse would have a taxable basis in the property of $70,000. That amount is equal to the half of the original basis in the house ($20,000) plus the stepped-up basis of the deceased spouse's share of the property ($50,000).[72]

The general rule is that if that same property had been owned solely by the first spouse to die and then passed to the surviving spouse through the estate, the surviving spouse would receive a stepped-up basis equal to the federal estate tax value of the asset.[73] Furthermore, when the first spouse dies, one-half of the value of the property will be included in the gross estate of that spouse.[74] Considerations such as these are important to what decisions are made and when regarding the disposition of assets. The article will next begin a discussion of the tools available to manage and distribute an estate.

The primary, and still the singularly most important planning tool for controlling the disposition of one's estate, is the last will and testament. Despite the use of joint tenancy, or other vehicles that will be discussed later, as a means of transferring assets, there will undoubtedly be a need for a will. For example, for those with children, only through a will can the testator identify who will be the guardian of those children upon the death of the testator. A will is also the main method for distributing personal property that cannot be transferred through some other manner.

When considering how best to use the varied estate planning tools to accomplish individual objectives, the will should be thought of as the foundation upon which the estate plan is built. For military members, especially those just getting started in estate planning, the execution of a will is an easy way to make initial progress in taking control of an estate. Some members may have accumulated an estate with assets that are already so great as to raise immediate estate tax concerns.[75] Because it's likely their legal issues will be outside the scope of typical legal assistance, there may be a need for that individual to seek more specialized assistance from an attorney specializing in estate planning.

---

67. State property law governs the manner in which property may be "jointly titled" (title held by more than one individual or entity) and whether a particular form of joint ownership provides the "right of survivorship" (the automatic transfer of a decedent's share of jointly owned property to the surviving joint owner(s)). *See* Danforth, 823 T.M., *Taxation of Jointly Owned Property*, for a good general discussion of jointly owned property and a detailed analysis of relevant estate planning issues.

68. *Id*.

69. Usually all property "to the extent of the interest therein of the decedent at the time of his death" is included in the gross estate of the decedent. I.R.C. § 2033. However, joint property interests receive different tax treatment under I.R.C. § 2040.

70. I.R.C. § 2040(b). To maintain a general approach in this article, the impact of community property will not be addressed. In addition, the discussion of joint property will be limited to that property owned by a husband and wife as joint tenants with a right of survivorship.

71. Danforth, s*upra* note 67.

72. *See* I.R.C. § 1014(a), (b)(9).

73. *Id*. § 1014 (a)(1).

74. *Id*. § 2040(b).

In addition to these functions of a will, there are also trust mechanisms that can be built into a will to further enhance the testator's control over the estate. Because these testamentary trusts do not come into operation until the testator's death, they have the advantage of giving the testator the ability to benefit from the control of a trust without the costs inherent in the creation and maintenance of a trust during his life.[76] As in any trust, a testamentary trust will transfer legal title to property from one party (the testator) to a third party (the trustee) who will then manage the property (the corpus or principal) for the beneficiaries until some stated time when ownership of the property will be transferred to the beneficiaries.[77] This article first discusses the contingent trust for minors.

Of valid concern for married couples is the question of how their estate will be distributed to their minor children if both parents are deceased. It is easy to understand that concern, if for no other reason than the parents would be unable to effect any control over the financial welfare of their surviving children. If the minor children are left the estate through a will, or even if the parents die intestate, most states would create a trust for minor children and then appoint a custodian and/or a conservator (usually a close relative) to manage the assets for the children.[78]

By taking the precaution of creating a contingent trust for minors in the will, the parents can appoint the trustee themselves and ensure the terms of the trust are to their specifications. In a contingent trust for minors, the parent bequeaths the property to his spouse, if survived by that spouse, otherwise to the trustee for the benefit of the children. The trustee then manages the assets for the children until the youngest child reaches the age of majority, or as specified in the trust. At that time, the principal of the trust would be paid to the beneficiaries equally. During the specified period, the trustee may use income from the trust to provide for needs of the children as spelled out by the will and consistent with the powers of a trustee as directed by state law.[79] This method of managing the distribution of assets can be especially comforting to a testator who has concerns about the influence of family or friends who lack the ability to adequately perform as a fiduciary for the benefit of the children.

Another testamentary trust that accomplishes the same goal of protecting the assets for the long-term benefit of the surviving children is the simple family trust. Again, this trust will also come into effect upon the death of the testator and become operative through the will. The purpose of the trust is to provide income to the surviving spouse for life and support for minor children while ensuring that the principal of the trust remains intact for the surviving children.[80] One of the reasons a testator

---

75. "A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." *Id*. § 2001(a). If an individual dies with a taxable estate (generally, the gross estate + adjusted lifetime taxable gifts – administration expenses and other deductions) greater than the "applicable exclusion amount," the estate will be subject to estate taxes on the balance over such "applicable exclusion amount." Stated inversely, anyone whose total assets will clearly remain below the "applicable exclusion amount" (currently $650,000) for the foreseeable future, need not worry about estate taxes. The applicable exclusion amount (and thus the "applicable credit amount" or "unified credit") is I.R.C. § 2010. The Taxpayer Relief Act of 1997 (P.L. 105-34, 111 Stat. 788 (1997)) increased the exclusion amount from the prior $600,000 as follows:

| Year | Applicable Credit Amount | Applicable Exclusion Amount |
|---|---|---|
| 1998 | $202,050 | $625,000 |
| 1999 | $211,300 | $650,000 |
| 2000 & 2001 | $220,550 | $675,000 |
| 2002 & 2003 | $229,800 | $700,000 |
| 2004 | $287,300 | $850,000 |
| 2005 | $326,300 | $950,000 |
| 2006 & after | $345,800 | $1,000,000 |

Eric Brown, Federal Estate and Gift Taxes Explained 9 (1998).

76. *See* Jay D. Waxenberg & Henry J. Leibowitz, *Comparing the Advantages of Estates and Revocable Trusts*, Est. Plan. (Sept./Oct. 1995) at 265.

77. *See* 1A Austin Scott, Scott on Trusts §§ 2-4, 54 (4th ed. 1987 & Supp. 1998).

78. Distributions to minors (or their guardian or conservator) are governed by state law. Commonly, a will directs the named executor to appoint a custodian under the applicable "Uniform Transfers to Minors Act" or similar applicable statute for any transfer to a minor from the estate. Most states have adopted some form of the Uniform Transfers to Minors Act.

79. *See* Stephan R. Leimberg et al., The Tools & Techniques of Estate Planning (1998).

80. *Id.*

may wish to avoid leaving the property outright to the surviving spouse is concern about the capability or desire of the surviving spouse to manage the assets of the estate. Another frequently mentioned reason is the fear that the surviving spouse will remarry and transfer assets to the new spouse and then die leaving the new spouse as the owner of the majority of the assets of the estate.

This simple trust will allow the testator to name a trustee who will then manage the assets to provide income to the spouse and also to preserve the corpus of the trust for the benefit of the children. Because the spouse's interest in this property terminates upon his death, this type of trust could raise some estate tax issues. Particularly, the spouse's interest in the property may not qualify for the marital deduction.[81]

Yet another method for using the will to manage, rather than just distribute, the assets of the estate is the pour-over will. In a pour-over will, the testator makes a devise or bequest of the residue of the estate into a revocable living trust. Essentially, the remaining unspecified assets of the estate then pour over into a living trust.[82] This trust, whether funded or unfunded by the testator during his lifetime, must be identified in the testator's will, and the terms must be set forth in a written instrument that is executed before or concurrently with the execution of the testator's will. As a precautionary measure, the pour-over will should also provide that if the trust is invalid or has been revoked, the provisions of the trust should be incorporated by reference into the will and treated as a testamentary trust. This language will be especially helpful in the rare case where both husband and wife are grantors of the trust and one revokes the trust without the other's knowledge or consent.[83]

One of the benefits of the pour-over will is that if the trust is unfunded, the grantor will avoid the ancillary problems of maintaining the trust during his lifetime. If the estate owner's assets are used during his life to fund a revocable living trust, the pour over to the trust as a result of the will does not insulate the trust assets from probate. All assets that had not been transferred before death will be admitted to probate.[84] While this discussion of these testamentary trusts illustrates how a will can provide short- and longer-term solutions for estate management, they are certainly not the only solutions. After a discussion of probate, this article examines the relative advantages and disadvantages of using other trust forms in estate planning.

To properly transfer clear title to property passing from the decedent to the beneficiaries named in the will, or otherwise entitled to the property under the appropriate state intestacy rules, a will must go through probate. Probate is the court-supervised process for collecting, valuing, and retitling the assets of the decedent; it provides the administrative legal process for validating the testamentary distributions made by the decedent.[85] The probate process does not apply to those assets that transfer by some other method, such as through contract, joint ownership with right of survivorship, or by statute. These non-probate assets transfer in accordance with the appropriate legal process governing the subject of the property.

Since many individuals are fearful of probate, and especially the perceived high costs involved, they look for methods to avoid the probate process. An estate-planning tool that is frequently used to avoid the costs and hassles associated with probate is the *inter vivos* or living trust. Such a trust is formed and operates during the testator's life. A living trust can be either revocable, that is the grantor can modify the agreement, or irrevocable, that is they cannot be amended even if personal or family circumstances change. While certainly not a panacea, these living trusts present different opportunities for estate management and different liabilities of estate taxation.

Before reviewing living trusts, its important to understand how gift tax rules generally apply, and how gifts can be used to manage the estate. Since 1977, there has been a unified estate and gift tax imposed on the value of transferred property; due to this unification, the same tax rates apply regardless of whether the property is transferred by gift or though estate distribution.[86] The gift tax is a tax on the gratuitous transfer of property or services made during the lifetime of the transferor or donor "for less than full and adequate consideration in money or money's worth."[87] In general, a gift occurs when a donor has so parted with dominion and control of the property so as to leave the donor powerless to change the disposition of the property.[88]

For estate planning purposes, the most beneficial aspect of the gift tax rules is the $10,000 per donee annual exclusion from

81. If the interest that passes to the surviving spouse will terminate because of a lapse of time or the occurrence of an event or the failure of an event to occur and then pass to some other person, no marital deduction will generally be allowed with respect to such interest. I.R.C. § 2056(b) (1999).

82. *See generally* Annotated, 12 A.L.R. 3d 56, "*Pour-Over*" *Provisions from Will to Inter Vivos Trust*; Berall et al., 468-2d T.M., *Revocable Inter Vivos Trusts*, at A-27 for a discussion of the use of a revocable trust as a receptacle for pour-over from a probate estate. *See also* Scott, *supra* note 77, § 54.3 for a discussion of the issues and potential problems regarding the disposition of property by will in accordance with an inter vivos trust.

83. Planning an Estate, *supra* note 53, at 163.

84. *Id*.

85. *See* Robert A. Stein & Ian G. Fierstein, *The Role of the Attorney in Estate Administration*, 68 Minn. L. Rev. 1107 (1984).

86. *See* I.R.C. § 2001.

87. *Id.* § 2512.

taxes.[89] The exclusion, however, is limited to the gift of a present interest; the donor must transfer an unrestricted right to the immediate use, possession, or enjoyment of the item.[90] Furthermore, if one spouse makes a gift to a third party, the spouse who did not make the gift can elect to treat one-half of the gift as if made by him.[91] The effect of this gift splitting is to allow one spouse to give up to $20,000 per year tax free to a donee, provided the other spouse makes no gifts to that donee. The annual exclusion provides two benefits to the donor. The first benefit is somewhat intangible in that the annual exclusion gives the donor a certain satisfaction in actually seeing a beneficiary use and enjoy the gift during the donor's lifetime. The secondary benefit from the annual exclusion is that by giving away assets of the estate, the donor is actually decreasing the size of the estate and thereby decreasing the estate's liability for estate taxes. Any gifts over the annual exclusion will be subject to gift tax and will have the concurrent effect of decreasing the amount of the unified credit.[92] An analysis of some different types of trusts will show how these trust tools can accomplish management goals of the planner, yet still be in conflict with the gift and estate tax rules.

The revocable living trust allows the estate owner, during his lifetime, to transfer assets to the trust while retaining all of the beneficial rights to the property of the trust, including the right to receive income or even the ability to revoke the trust.[93] Upon the death of the grantor, the trust becomes irrevocable and the corpus of the trust is administered consistent with the desires of the grantor as specified in the trust. Since legal title to the assets of the trust is held by the trustee and not the grantor, these assets are non-probate property and are not subject to probate. In addition to this, the trust will also provide flexibility to the estate through the ability of the trust to control the assets in the event of the incapacity of the grantor. Due to the transfer of legal title to the trust, there is no need for appointment of guardians or conservators to manage the grantor's assets.

Furthermore, if the grantor is looking for professional management or just relief from the headaches inherent in the management of trust property, this trust can also be useful to serve that purpose while still providing income to the grantor during the grantor's lifetime. The grantor can have another manage the assets for his benefit without irrevocably giving up control of the assets since the grantor retains the ultimate power of revocation of the trust. One of the most important benefits that this type of trust has for military members is the use of the trust as a means to transfer title to property located in different states. Since military members often accumulate property in different states due to their military assignments, the retitling of that property through different probate systems may be a cumbersome task. Depending on how the property is titled, it may be easier to transfer those assets into a revocable living trust and then have the provisions in the trust determine how and to whom the property is transferred upon the death of the grantor.[94] While these are generally thought to be some of the main advantages of the revocable living trust, there are equally as many disadvantages to this vehicle.[95]

In addition to being an advantage of the revocable living trust, the power to revoke the trust is also a disadvantage of this device. As will be discussed later, a revocable living trust is considered part of the gross estate of the decedent. The decedent is treated as the owner of the trust because of the dominion enjoyed over that property due to the power to revoke.[96] Thus, the value of the revocable living trust assets is considered in the gross estate of the decedent. Another disadvantage, or at least

88. Treas. Reg. § 25.2511-2 (1999).

89. For each calendar year after 1998, the annual exclusion shall be increased by a cost-of-living adjustment. *See* I.R.C. § 2503(b). (The annual exclusion does not apply to spouses, as the value of a gift to a spouse will be deducted from amount of taxable gifts during a calendar year. *See id*. § 2523(a).)

90. *See id.* § 2503(b) *See also* Treas. Reg. § 25.2503-3(b).

91. I.R.C. § 2513(a).

92. The rationale for this is that:

> Although the gift credit must be used to offset gift taxes on lifetime transfers, regardless of the amount so used, the full credit is allowed against the tentative estate tax. The rationale for such full application is that, under I.R.C. § 2001(b)(2), the estate tax payable is calculated using the cumulative transfers at life and at death as then reduced by the amount of gift tax paid by a decedent. If a portion of the unified credit was used to avoid the payment of gift taxes, the gift tax paid reflects the amount subtracted under I.R.C. § 2001(b)(2). The estate tax payable is necessarily increased by the amount of the gift tax credit used.

*See* BROWN, *supra* note 75, ¶ 15.

93. *See* SCOTT, *supra* note 77, § 54.3. (discussing of the issues and potential problems regarding the disposition of property by will in accordance with an inter vivos trust). *See generally* Berall et al., *supra* note 82 (discussing inter vivos trusts).

94. The method of ownership is an important consideration for determining the need for a revocable living trust. For example, if property is owned as joint tenants with a right of survivorship, there may be no need to use a revocable living trust.

95. For a good counterpoint to the advocates of revocable living trusts, *see* JOHN P. HUGGARD, LIVING TRUST LIVING HELL, WHY YOU SHOULD AVOID LIVING TRUSTS (1998).

96. I.R.C. § 2038.

refuting a purported advantage, relates to the authority of the trustee (or a successor trustee if the grantor is also the trustee) to make management decisions regarding the trust property if the grantor becomes incapacitated.

Another tool available that can accomplish this same goal is the "springing" durable power of attorney.[97] With this power of attorney, the grantor appoints another person, called an attorney-in-fact, to handle the affairs of the grantor if he becomes legally incapacitated. These powers are typically called springing powers because they only spring to life upon the incapacity of the grantor. Much simpler than a trust, and undoubtedly less expensive, the durable power of attorney can carry out this task equally as well as a revocable living trust.

Next, although usually touted as a probate avoidance device, the revocable living trust will not obviate the need for a will and the concomitant need to probate the will. If a grantor has a living trust that does not contain all of the assets of the estate, then probate becomes much more likely. As the grantor acquires other assets, he must be quick to retitle them into the trust or those assets may have to pass through probate as well. In addition, a will is the predominant instrument to enable parents to name guardians for their children. Finally, the costs associated with creating a living trust and paying the annual management fees may over time be greater than the probate costs associated with an estate. Probate costs are not usually as onerous as feared and are dependent upon the property that is subject to probate.

Service members can use numerous methods to manage assets to ensure that they are not subject to probate, thereby further limiting the costs of probate. While not comprehensive, this discussion of the advantages and disadvantages of the revocable living trust helps supply issues for consideration in determining whether or not this mechanism of estate management is appropriate for a personal estate plan.

Living trusts may also be irrevocable. Obviously, a disadvantage to this type of trust is that the grantor loses the power to control assets as could be done under a revocable living trust. What the grantor gains with this type of trust though is the removal of the trust assets from the gross estate of the decedent for estate tax purposes. Provided the grantor has relinquished his or interest in the property by transferring the assets irrevocably to the trust, the property will not be included in the gross estate of the decedent.[98]

One of the most popular methods for taking advantage of this benefit is the irrevocable life insurance trust. This alternative gives the grantor a trust mechanism that gives him the ability to purchase life insurance and then transfer ownership of the policy to a trustee (unfunded) or to transfer assets into the trust and have the trustee purchase life insurance from the trust assets (funded). Upon the death of the grantor, the trust will pay the proceeds of the policy to the beneficiaries of the trust.[99] The grantor's intent in these trusts is usually to provide liquidity to the beneficiaries or to have available cash assets to pay estate taxes if owed.

Issues that must be considered in creating an irrevocable life insurance trust are whether the trust is a completed gift for tax purposes and whether the trust is includable in the estate of the grantor or donor because it was an incomplete gift. Generally, a transfer of a life insurance policy or the premium of a life insurance policy to a trust would be considered a gift of a future interest. As stated above, such a transfer would not qualify for the gift tax annual exclusion because the gift must be of a present interest–a right to use, possess, or enjoy the property.[100] Clearly then, a transfer of an existing life insurance policy or the payment of premiums of a life insurance policy to an irrevocable life insurance trust is generally a gift for purposes of the gift tax.[101]

By giving the trust beneficiary the present right to demand a distribution of assets from the trust, however, the value of the assets that are subject to that demand power qualify for the annual exclusion as a present interest.[102] This so-called *Crummey* power, is a general power of appointment; as such, it is defined as "a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate."[103] A

97. *See generally* Michael N. Schmitt & Steven A. Hatfield, *The Durable Power Of Attorney: Applications and Limitations*, 132 MIL. L. REV. 203 (1991) (providing general information on powers of attorney).

98. Because the grantor will no longer have an interest in the property that is the principal of the trust, it will not be subject to consideration as part of the gross estate. *See* I.R.C. § 2033.

99. *See* Slade, 210-4th T.M., *Personal Life Insurance Trusts* (for a detailed explanation and analysis of the use of life insurance trusts in estate planning). *See also* SCOTT, *supra* note 77, § 57.3 (discussing the general validity of insurance trusts irrespective of the tax implications of such trusts).

100. *See* I.R.C. § 2503(b).

101. If the same gift was made to a revocable living trust it would not be considered a gift at all for gift tax purposes. The asset and any income generated from it would be treated as belonging to the donor because of the control retained over the asset due to the revocable nature of the trust.

102. *See* Crummey v. Commissioner of Internal Revenue, 397 F.2d 82 (9th Cir. 1968).

103. Because of the control granted to the holder through a general power of appointment, it is considered part of the value of the gross estate of the decedent. However, in the case of a power to invade the principal of a trust, such a general power of appointment is not included in the gross estate if the power is limited by an "ascertainable standard relating to the health, education, support, or maintenance of the decedent." I.R.C. § 2041(b)(1)(A).

power of appointment is the power to determine who will become the owner of the property. Provided the beneficiary's power to demand a distribution is limited to the lesser of $5000 or five percent of the assets subject to the demand power, the transfer will qualify for the annual exclusion.[104] The donor must also give the power holder actual notice of the transfer and the right to withdraw the assets, and a reasonable time to exercise the power to withdraw the assets.

The practical effect of this approach is that the grantor puts the beneficiaries on notice that a transfer is being made to the trust (for example, a life insurance policy or the premiums that will be used by the trustee to purchase life insurance) and then notifies the beneficiary that he has the right to demand, within the amount stated above, the transferred assets. In most cases, this will be prearranged between the grantor and the beneficiary to ensure that the transfer proceeds without any mishaps. After all, the resultant effect is that the beneficiary will be the ultimate beneficiary of the assets regardless of whether the demand power is exercised or the assets are transferred to the trust.

### Estate Distribution

This article has concentrated on the assets that comprise an estate and how an individual can best manage those assets to accomplish the goals set out within an estate plan. Upon the death of the taxpayer, the focus switches to the distribution of these assets in accordance with the objectives of the decedent and the federal tax implications on those transfers. Because probate issues and some estate planning tools have been previously addressed, this section focuses on the potential federal tax consequences inherent with an estate.[105] However, this segment will also discuss additional estate planning instruments available to protect the property of the estate from taxes. Implicit in this approach is that the goals of the decedent encompassed the objectives of providing for the disposition of assets in such a way as to maximize the estate while transferring property in conformity with both the desires of the decedent and the needs of survivors.

The starting point for any analysis of estate distribution is at the source–the federal estate tax system. The estate tax is an excise tax levied on the transfer of property that occurs at the decedent's death.[106] It is not a property tax or an inheritance tax; it is a tax on the transfer of property itself. The first step in understanding how the rules apply to an estate is determining what part of the estate is subject to taxation. Because of the high rates of tax[107] on the transfer of an estate, a majority of the attention on estate planning focuses on tax avoidance. As stated above, tax planning is an extremely important aspect of the estate plan. However, it should remain secondary to the underlying goals and purposes of the estate owner.

The inquiry into estate taxation begins with an understanding of the gross estate. The value of the gross estate is determined by calculating the value of all property "real or personal, tangible or intangible, wherever situated" at the time of the decedent's death.[108] While this provision seems to include almost all property in the gross estate, the definition is then limited somewhat to the "the value of all property to the extent of the interest therein of the decedent at the time of his death."[109] Due to this still aggressive approach, it is beneficial to each estate to have a plan for how to remove assets from the gross estate in order to limit the potential tax.

Reducing the gross estate centers on methods of transferring incidents of ownership over assets of the estate. Some previously mentioned examples include the annual gift exclusion, the irrevocable living trust, and the irrevocable life insurance trust. As life insurance is a major part of most estate plans, it often makes up the bulk of the gross estate of the decedent.[110] A way of removing these assets from the gross estate is to transfer away all incidents of ownership over the policies. The following are some examples of incidents of ownership: power to change beneficiaries, right to economic benefits of the policy, power to cancel or surrender the policy, and power to borrow against the cash value of the policy. The downside to a transfer of ownership in a life insurance policy is the possible gift tax implications depending on the policy and whether the transfer was of a present interest. Another concern is that any transfers of ownership in a life insurance policy within three years of the death of the decedent will be treated constructively as if transferred in contemplation of death, and it will be included in the gross estate of the insured.[111]

---

104. *See id*. § 2041(b)(2).

105. Although there are possible state inheritance taxes and estate taxes, this article only addresses federal estate tax issues.

106. I.R.C. § 2001(a).

107. After the application of the unified credit, the initial rate for estate tax is thirty-seven percent on the amount of the taxable estate greater than the applicable exclusion amount. There is a graduated tax rate schedule that eventually is capped at 55% on all estates greater than $3,000,000. *See id.* § 2001(c)

108. *Id.* § 2031.

109. *Id.* § 2033.

110. Life insurance benefits are generally not taxable to the recipient. *Id.* § 101(a). However, proceeds of life insurance on the life of the decedent are included in the gross estate of the decedent if death benefits are either receivable by the decedent's estate or receivable by other beneficiaries and decedent had any incidents of ownership in the policy at death. *See id.* § 2042.

The next consideration is to ascertain what part of that gross estate is taxable. The taxable estate is determined by subtracting allowed deductions from the gross estate of the decedent.[112] While there are numerous deductions from the gross estate,[113] the two items that have the most significance for estate tax planning purposes are the marital deduction and the unified credit. For property that passes to a surviving spouse by the decedent's estate, the estate tax rules provide for an unlimited marital deduction for that property if it is included in calculating the gross estate of the decedent.[114] This unlimited deduction is only available for spouses who are United States citizens.[115]

If the unlimited marital deduction applies, essentially all property that is received by the surviving spouse because of the death of the other spouse is free from estate taxes. The marital deduction is not so much a deduction as it is a deferral; the assets transferred to the spouse are exposed to estate taxation when later transferred by the surviving spouse through devise or bequest. While most married couples want the security of having all the assets of the estate available for support of both spouses during their lives, transferring the entire estate to the surviving spouse may be inconsistent with another estate plan purpose like maximizing assets for surviving children. Regardless of the value transferred to the surviving spouse, the amount is deductible from the taxable estate of the decedent.

As previously discussed in the section on gift tax, there is a single unified tax rate whether the property is transferred as a gift or included in the gross estate of the decedent. After concluding the taxable estate of a decedent, this unified rate is applied to the assets of the estate to determine the tax liability of the estate.[116] However, before applying the tax, the recipient of the estate is able to claim a credit against the taxes payable on the transfer of property to the estate.[117] This enables the recipient of the estate to subtract the amount of this unified credit from the amount of estate tax liability owed.[118]

For 1999, the unified credit of $211,300 is equal to the amount of tax due on a transfer of $650,000; by the year 2006, that amount will rise to $1,000,000.[119] This entire credit amount will be available for estate purposes unless the decedent made lifetime taxable gifts. If taxable gifts were made, the amount of the gift tax is subtracted from the amount available as a credit for estate taxes.[120] The benefit of the unified credit is clear; for those taxable estates that are less than $650,000 there is no estate tax owed. With an understanding of what property is taken into account in the taxable estate and how the unified credit applies to that taxable estate, an individual can be in a better position to make the most advantageous use of different estate management tools to achieve estate planning goals.

An example of an excellent way to take advantage of the unified credit and the marital deduction is seen in the bypass or credit shelter trust. While there are many variations on this theme, the simplest method for achieving an estate tax bypass of the surviving spouse's estate is for the husband (assume he dies first) to transfer the exclusion amount ($650,000 in 1999) into a trust, and then transfer his remaining assets[121] to his wife by an outright bequest. The result of this is that at the husband's death, there would be no estate tax owed as the amount transferred to the wife is not subject to estate tax because of the marital deduction and the husband's unified credit could be applied to the amount transferred to the trust. This would allow the couple to shield $1,300,000 from estate taxes.

Although a very simple example, the notable characteristic of this approach is the marital deduction and the unified credit are used in an interrelated fashion to minimize estate taxes. A more sophisticated use of this same principle would be to have

111. *See id.* § 2035.

112. *See id.* § 2051.

113. For example: funeral expenses, estate administration expenses, casualty and theft losses, bequests to qualified charities, and debts and enforceable claims against the estate are all deductions from the gross estate. *See id.* §§ 2051-2056.

114. *See id.* § 2056.

115. While I.R.C. § 2056(d)(1) disallows the marital deduction where the surviving spouse is not a United States citizen, the qualified domestic trust (QDT) option under § 2056(d)(2) allows the marital deduction if the decedent used a QDT as defined in § 2056(A), or one is created prior to the date of the tax return.

116. *See id.* § 2001(a).

117. *See id.* § 2010(a).

118. *Id*.

119. *Id.* § 2010(c).

120. *Id.* § 2001(b).

121. As first seen in the analysis of the estate tax effect on joint property, the method in which property is owned by a married couple becomes more important as the size of their estate gets closer to the exclusion amount provided by the unified credit. It will often become more advantageous to change how some properties are owned to equalize the effect of taxes on each estate.

two trusts where the marital deduction portion of one spouse's estate would go into one trust and the residue of that spouse's estate would go into another trust. The first trust would be designed to qualify for the marital deduction; the purpose of the second trust could be to pay income to the surviving spouse during his lifetime, while keeping the principal of the estate separate from the surviving spouse's estate. Usually, the children of the grantor are then named as the beneficiaries of the principal of the trust.[122] This is possibly the best way to continue to make available nearly all of the assets for the benefit of the surviving spouse during his lifetime while ultimately passing on the bulk of the estate to the children.

A limitation to the marital deduction arises when such lifetime benefits are used in trusts. Because the spouse's interest in this property terminates upon his death, this type of transfer could be seen as disqualifying this asset for the marital deduction due to the creation of a terminable interest.[123] However, if certain requirements are met, the bequest to the trust will be properly considered as a qualified terminable interest property (QTIP).[124] To ensure the property can qualify for the marital deduction, the following conditions must be specified in the trust: the surviving spouse must be entitled to receive all of the income from the trust at least annually, for life; no person can have a power to appoint property to a third person during the surviving spouse's lifetime; and, any income that has accrued at the death of the surviving spouse must be paid over to the estate of that spouse.[125] The decedent's executor then has the ability to make a one-time irrevocable election as to whether the property will be considered as QTIP.[126] It may not always be advantageous to make this election, because, once made, the value of the assets in the QTIP trust will be included in the estate of the surviving spouse.[127] Without these steps to ensure treatment as a QTIP trust, a transfer to the trust would lose the marital deduction for property placed in the trust.[128] Like the simple family testamentary trust, the QTIP trust permits the surviving spouse to use and enjoy the income from the trust, while reducing the risk that the spouse will violate the principal to the detriment of the ultimate beneficiaries.

## Conclusion

While this article is not intended to be an exhaustive treatise on the topic of estate planning, the purpose is to provide an overview to the general issues, rules, and mechanisms important to military members. For example, disability planning was not covered although the use of durable powers of attorney and advanced medical directives has an important function related to an estate plan, especially for military members. The focus was on those areas of the subject that had the most general applicability as well as the broadest base of insight into the tools and processes that are the normative framework of estate planning. After discerning how the topics of government benefits, insurance, and investing provide the baseline for the financial portion of the estate plan, its easier to comprehend how personal objectives determine the best methods to manage the estate with individual strategies for asset protection and distribution.

The most significant feature of any estate plan is recognizing the needs and objectives of the participants in the plan. Once identified, the decisions can more easily be made as to what tools should be used to manage the estate to accomplish the goals of the participants. By acknowledging their needs and addressing the practicalities of planning an estate, the participants will progress steadily toward the ascertainable goals of preparedness and self-sufficiency.

---

122. Grantors should be wary of naming grandchildren as beneficiaries when children of the grantor are still alive. Such a transfer to a generation that is two below the generation of the transferor will likely result in a generation skipping transfer (GST) subject to tax. *See* I.R.C. § 2601. Although this is often not much of an issue since the GST rules allow for a $1,000,000 GST exemption from tax on any property transferred by the individual. *See id.* § 2631.

123. If the interest that passes to the surviving spouse will terminate because of a lapse of time, the occurrence of an event, or the failure of an event to occur and then pass to some other person, no marital deduction will generally be allowed with respect to such interest. *See id.* § 2056(b).

124. *Id.* § 2056(b)(7)(B).

125. *Id.*

126. *Id.* § 2056(b)(7)(B)(v).

127. *Id.* § 2044.

128. The QTIP is but one of the exceptions to the terminable interest rule. Other examples include an estate trust, a power of appointment trust, and life insurance or annuity payments.