

Estate Planning\*

A trustee's guide to the irrevocable life insurance trust

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## Introduction

The irrevocable life insurance trust is one of the best estate-planning tools available. It is a complex animal that requires proper care and nourishment. It has interrelated (and sometimes contrary) estate tax, gift tax, generation-skipping transfer tax, and income tax requirements. In negotiating the minefield of tax traps, the trustee of the irrevocable life insurance trust is assisted by a variety of advisors (the life insurance salesperson, the attorney, an accountant, sometimes a financial planner, and sometimes a professional or bank trustee). Each advisor has his or her own opinion about which action (or lack of action) is most important. Sometimes the dangers are imagined; sometimes the dangers are real.

The Internal Revenue Service often attacks the irrevocable life insurance trust and will assert unfavorable gift tax, estate tax, generation-skipping transfer tax, or income tax results if the formalities of the trust (and all of its trappings) are not followed. The primary reason, of course, is that the life insurance trust is a key vehicle for letting large portions of an estate escape estate, gift, and generation-skipping transfer tax permanently.

The purpose of this material is to provide the trustee (professional or otherwise) with some practical guidance on the real and imagined dangers associated with the irrevocable life insurance trust, as well as with some helpful hints on dealing with insurance companies and the IRS.

## Terminology

The person who creates the trust is typically the insured. The creator of a trust is often called the grantor, donor, or settlor of the trust.

The people who benefit from the trust are called beneficiaries. The creator of the trust should never be a beneficiary.

The person who is in charge of running the trust is the trustee. The trustee should never be the grantor but may be the grantor's spouse (only if the trust formalities are respected). The written instructions for running the trust are contained in the trust document. The trustee's position requires some effort, and the first thing the trustee should do is obtain a copy of the trust document for his or her files. The second task is to create a filing system for the tasks to be described during the course of this material.

## Trust tax identification number

### >> Do I need a Taxpayer Identification Number (TIN) for the trust?

No, but the insurance companies may make you get one anyway (even though the trust is not technically required to obtain a TIN).

As a practical matter, many insurance companies insist on a Taxpayer Identification Number (TIN) for the trust in order to process change-of-ownership and beneficiary-designation forms. Since it is important that these forms be processed promptly by the insurance company, acceding to the request might be the prudent course of action.

Therefore, where a TIN is “needed,” the trustee can get it from the Internal Revenue Service (IRS) online([www.irs.gov/businesses](http://www.irs.gov/businesses) and click on EINs), by telephone, by fax, or by mail. The form to complete is Form SS-4. There is a 24-hour fax service whereby the completed (and signed) Form SS-4 can be faxed to the IRS and a number is received by return fax. A completed copy of Form SS-4 is attached (see Appendix C). Note that it is possible for the trustee to have a copy of Form SS-4 sent to another party by completing the third-party designation section at the bottom of Form SS-4. Absent the third party designation, the IRS will not provide the TIN to anyone but the trustee or a person acting pursuant to a current IRS power of attorney (Form 2848), a copy of which must be attached to the application for the TIN.

## Naming the trust

The most important feature of the application process is the name chosen to identify the trust. In many respects, this is as important as naming a child. The trust name will appear on various tax filings, insurance company filings, and bank accounts. Sometimes the name of the trust is specified in the document, and you will want to use that name to avoid confusion and to identify the trust correctly. If the trust does not specify the name, you will want to choose carefully what to put on the Form SS-4. The name must be short enough to fit standard forms, yet be specific enough to be identified readily by the trustee and family members. This is especially difficult for a family with a variety of trusts to suit a variety of purposes.

*Suggestion:* Use the family name, the words “life insurance,” and the year of signing, e.g., the “John Doe 2005 Life Insurance Trust.”

Remember that the trust will be alphabetized and referenced by the first letters or words in the name.

## IRS expected tax filings

Once the trust has a TIN, the IRS may expect annual fiduciary income tax-return filings. Since the irrevocable life insurance trust is seldom required to file annual fiduciary income tax returns, the trustee should be prepared to respond to the IRS inquiries, if only to state that the trust has no reportable income.

*Sample response:* “The trust is not required to file fiduciary income tax returns because it has no income of any kind (taxable or not). The trust is not expected to have income for many years.” Or alternatively, “The trust is a grantor trust for income tax purposes, and all items of income, deduction, and credit are reported on the grantor’s individual income tax return.”

The use of the trust TIN on bank accounts or other income-producing assets may require some filings (see section on Income Tax Return Filings).

## Planning advice

Eventually, the trust will probably need a TIN, and the trustee might as well obtain one now. Just don’t use it on any interest-bearing accounts (see Income Tax Return Filings section).

## Trust bank account

>> Do I need a bank account for the trust? Must I use the bank account to pay premiums on the life insurance policies?

This is not an absolute requirement, but it is probably a good idea.

The key formality in the irrevocable life insurance trust is the annual withdrawal right or Crummey power. The more conservative point of view is that the withdrawal right means nothing if there are no assets (read: cash or securities) that could be withdrawn. Thus, in order to provide assets subject to the withdrawal right, some professional advisors will often suggest the use of a bank account funded with enough money to exercise the withdrawal right (This funding is a gift to the trust. See the Gift Tax section). If the professional advisor is also a trustee, the use of a bank account provides a simple and relatively painless (for the client) way of paying trustee fees. The use of an interest-bearing account will create the need to file income tax returns only if the trust TIN is used on account registration forms (Form W-9).

The bank account will be in the name of the trustee (e.g., Jane Smith, as trustee of the John Doe 2005 Life Insurance Trust). If the trust has more than one trustee, only a single-signature account should be created (if permitted by state law). A multiple-signature account can create problems in obtaining the required signatures on a timely basis.

A rounded amount sufficient to pay premiums (and related fees) should be deposited far enough in advance of the premium due date so that the beneficiary can exercise his or her withdrawal right (often one to three months prior to the actual premium payment date). It may be possible for the insurance company to withdraw premiums directly from the trust bank

account; otherwise, the trustee will pay premiums from the trust bank account. If the trust does not pay premiums on life insurance policies (such as group term or insurance purchased with payroll deductions), the bank account should contain an amount approximately equal to the premium payment, so that there are sufficient funds for a beneficiary to exercise withdrawal powers.

In a *community property jurisdiction* (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington state, Wisconsin, and Alaska, if elected) the source of funds is critical. Funds must originate from a separate property account of the insured (who created the irrevocable trust). Failure to use separate property funds may jeopardize the estate tax results (the whole point of the irrevocable trust).

In a community property jurisdiction, separate property funds can be created in a variety of ways (which vary by state). The estate-planning attorney should be consulted for the most appropriate way to create separate property accounts. Typically, separate property is created by dividing an amount of community property (or exchanging equal amounts of community property), then creating separate property accounts using a bank's separate property designation and with a separate property title, e.g., "John Doe separate property account." Furthermore, the process should be formalized in writing. Note that it is also important to create separate property out of the policy itself if the policy is transferred to (rather than purchased by) the irrevocable trust.

In a community property jurisdiction, future premiums should be paid out of the trust's bank account or the separate property account of the insured. If premiums are to be paid electronically, it is the separate property account that should be designated on the insurance company forms.

In a common law jurisdiction (most of the United States), no special procedures are needed concerning the source of funds.

*Group term life insurance* poses a particular concern to advisors for two reasons. First, the insurance may be provided to the employee at no cost (other than an income tax cost). Second, the cost of the insurance may be deducted automatically from the employee's paycheck. In either case, a trust bank account obviously is useless for premium payments, but is very useful for satisfying withdrawal formalities. The document should also provide that withdrawal rights may be satisfied by a transfer of the policy itself. In a community property state, it is critical to arrange either that separate property funds be used for these premiums, or that an amount equal to the premium payments be transferred into the separate property account of the other spouse. The exchange of community property for separate property must be formalized in writing, as well.

#### Planning advice

Open a trust bank account. If the trustee (e.g., attorney or bank trust company) is required to get an interest-bearing account by a regulatory body, use the creator's (grantor's) Social Security number on the account. If it is a non-interest-bearing account, use either the grantor's SSN or the trust TIN. In a community property state, consult the estate-planning attorney as to the creation of separate property accounts, and make sure to respect the formalities associated with that process.

## Life insurance forms

Life insurance forms are a major part of the life insurance trust. There are two ways that life insurance gets into a life insurance trust:

1. by transferring an existing policy (or policies); or
2. by having the trust purchase a new policy.

The forms for the transfer of an existing policy should be requested in advance of the trust signing “ceremony,” so that the forms can be completed at the same time that the trust is signed. If the life insurance trust is to be the original applicant and owner, the trust must be in effect before the insurance applications are completed.

Sometimes not all the forms are signed and dated in all of the correct places (or to the insurance company’s satisfaction). In such cases, the forms should be corrected or re-signed as soon as possible.

### **If trustee is not original applicant and owner**

#### **Transfer of ownership**

Do not confuse the ownership transfer forms with the beneficiary designation forms. It is not sufficient simply to name the trust as beneficiary; the trust must be the owner of the life insurance as well, or the life insurance will be included in the taxable estate.

#### **>> Must I use the insurance company’s ownership transfer forms?**

**No, but the insurance company might not process the policy transfer unless it is done on the insurance company’s own forms. Letter transfers (sometimes prepared by the attorney) might not be accepted by the insurance company.**

Once the trust is created, the insured should transfer ownership of the policies to the irrevocable trust. If the insured is not the owner, the estate-planning attorney should be consulted to determine how best to transfer the policy to the trust.

The new owner is designated as “Jane Smith, as trustee of the John Doe 2005 Life Insurance Trust.”

Copies of the signed forms should be retained by the trustee, to prove that the transfer took place.

In a community property jurisdiction, it is critical that the life insurance policy, itself, be separate property prior to the transfer into the irrevocable life insurance trust. The estate-planning attorney should be consulted about the most appropriate method for creating separate property. Generally, separate property is created by dividing community property equally between the spouses. The insured would take the life insurance policy, and the spouse would receive other assets of similar value (which would be placed in a “separate” property-labeled account). The division would be formalized in writing. Be especially careful of bank forms when creating separate property accounts.

The transfer of life insurance policy ownership is a gift tax event. The trustee should request Form 712 from the insurance carrier. The transferor will need the Form 712 when completing Form 709, the U.S. Gift Tax Return.

If the insured dies within three years of the transfer of the policy to the trust, the insurance proceeds will be includable in the insured’s estate. To avoid potential estate taxation, it is very desirable for the insurance trust to be the

original applicant and owner of the policy (or policies), as described below. In such a situation, ownership transfer forms need not be completed. Instead, the trustee must complete the application forms.

### **Beneficiary designation**

Once ownership is transferred, the new owner (trustee of the irrevocable trust) must designate himself or herself as beneficiary. Many insurance companies will have special trust beneficiary forms (sometimes combined with ownership transfer forms), which they insist you use. The insurance company may also insist that a trust TIN be provided as well.

The beneficiary is: “Jane Smith, as trustee of the John Doe 2005 Life Insurance Trust.”

Again, copies of the signed forms should be retained by the trustee, to prove who the designated beneficiary is.

### **Verification of insurance company records**

Sometimes an insurance trust will come to ruin over an insurance company’s loss of ownership and beneficiary change forms. Once the transfer or purchase takes place, the prudent trustee will check the insurance company records for current owner and beneficiary designation (as well as retaining copies of all materials sent to the insurance companies).

You should allow the insurance company a reasonable amount of time (one to three months) to process the ownership change or purchase prior to requesting verification. You may experience some frustration during the verification process.

### If trustee is original owner and applicant

It is very desirable for estate tax purposes for the trustee to be the original applicant and owner of the life insurance policy. Thus, in the insurance purchase process, the trustee should be completing and signing the insurance company application for insurance, original ownership, acceptance, and beneficiary-designation forms on behalf of the trust. All of these steps should take place after the trust has been established. In a community property state, the premiums should be paid with separate property funds.

Suggested signature format: Jane Smith, as trustee of the John Doe 2005 Life Insurance Trust.

### Planning advice

Wherever possible (e.g., new policy application), the trustee should be the original applicant, owner, and beneficiary. If this is not possible for all policies, make sure to obtain ownership transfer forms from each carrier, and complete them as required. If the insured is not the current owner, the estate-planning attorney should be consulted. In a community property jurisdiction, make sure to have the policy made into separate property prior to transfer.

## Payment of life insurance premiums

Contributions to the trust or direct payment of life insurance premiums are gift tax events. The trustee should determine the contributions to the trust or the amount of premiums paid (or imputed as income, where paid by the employer), and consider the need for the grantor to file gift tax returns. Furthermore, the amount of premiums paid or amounts deposited into the trust account are important in notifying beneficiaries of their withdrawal rights.

### >> Must I pay all life insurance premiums out of the trust bank account?

This is the preferred approach, especially in a community property state. The reality is that the trustee will be able to pay premiums only on personal policies, and not group term life or split-dollar policies.

### Group term life insurance

Non-contributory group term insurance is term insurance provided at no cost to the employee. However, the employee is required to recognize income (so-called imputed income) if the amount of insurance is in excess of \$50,000. Although there are no premiums paid by the employee, there is still a value passing to the trust equal to the amount of imputed income. The trustee and the grantor need to know the amount of imputed income included in the employee's Form W-2 each year. This amount plus the value of the first \$50,000 of coverage are treated as a gift to the trust, and therefore are subject to the withdrawal rights of the beneficiary, as well as to gift tax-filing requirements.

Contributory group term insurance is term insurance for which the employee pays an annual premium (most often deducted from the employee's paycheck). Again, this value is important for gift tax purposes. The trustee and grantor need to know the amount paid for the coverage and include it in determining withdrawal rights of the beneficiaries (as well as gift tax filing requirements).

If at all possible, the trustee should arrange with the employer to make all payments required of the employee out of trust assets (i.e., the trust bank account). If a bank account is not used, then in a community property jurisdiction, an amount of community property equal to the premiums must be transferred to the non-insured spouse's separate property account in order to create separate property.

In reality, the payment of group term premiums with trust assets is seldom practical.

#### [Split-dollar life insurance](#)

There are myriad split-dollar life insurance arrangements. Some require the employee to pay premiums. Others require no employee payment. Still others have the employee pay the premium, but the employer pays a "bonus" to the employee in an amount equal to the employee's premium. The new IRS regulations concerning split-dollar arrangements have added to the confusion.

The trustee should learn what type of premium payment arrangement is being used. The trustee should then determine the amount of premiums paid (if premiums are paid), or the amount of income the employee is required to recognize (so-called Table 2001 rates, actual term rates if less,

or foregone interest if the loan regime applies), and include these items in determining amounts subject to beneficiary withdrawal rights and gift tax-filing requirements. Note that the actual amount of premiums paid by the employer (if any) may not be relevant. Instead, it is the amount actually paid by the employee (or imputed as income to the employee) that is treated as a gift to the trust (and may be subject to a withdrawal right). These amounts will depend on whether the split-dollar arrangement is under the economic benefit regime or the loan regime (the two tax treatments). Be especially careful of term loans under the loan regime treatment of split-dollar.

If at all possible, the trustee should arrange with the employer to make all payments required of the employee out of trust assets (i.e., the trust bank account). If a bank account is not used, then in a community property jurisdiction, an amount of community property equal to the payment, or deemed payment, must be transferred to the non-insured spouse's separate property account.

#### [Personal life insurance](#)

This is probably the easiest type of life insurance for a trustee, since the insurance companies will deal directly with the trustee as owner of the policy. The trustee should determine the amount of premium due, and make arrangements to pay that premium by using funds in the trust bank account, by borrowing from the policy, or through some combination of the two. Alternatively, the trustee can arrange for the insurance company to withdraw funds electronically from the trust bank account for policy premiums. If the funds in the trust bank account are not sufficient, the trustee should contact the insured (the creator of the trust).

In a community property jurisdiction, the trustee must first obtain “separate property” funds, and then make the premium payment (or payments) with the separate property funds deposited into the trust bank account. It is critical that separate property funds be used for premium payments.

In any case, the trustee will be aware of the amount of money deposited into the trust bank account by the creator of the trust, and will be in a position to notify beneficiaries of withdrawal rights as well as to evaluate the need for gift tax-return filings by the trust creator.

#### Planning advice

In most states, the trustee should pay as many policy premiums as is practical. Often, group and split-dollar policies are beyond the trustee’s control. In a community property state, the trustee must arrange payment of policy premiums out of separate property funds, or arrange to transfer an amount equal to the premium payment to the other spouse’s separate property account, to preserve the desired estate tax consequences.

## Dealing with beneficiaries

The trustee has a set of written instructions on how to deal with beneficiaries—the trust document, itself. Unfortunately, there is no substitute for actually reading the document to determine the responsibilities of the trustee. Sometimes, a professional advisor will have summarized the important features of the trust, but the trustee must use caution when relying on a summary.

### >> Must I tell the beneficiaries of their withdrawal rights each year?

Yes.

There has been a significant shift of opinion on how best to comply with the estate and gift tax rules in this area. Some advisors suggest oral notice, followed by sworn statements from the beneficiaries that they were aware of their rights if the IRS requires proof. Some advisors suggest that a single written notice be provided at the creation of the trust, and that the notice refer to the annual right to withdraw. Neither of these procedures is recommended.

The preferred procedure is to provide written notice each time either a deposit is made into the trust bank account or a premium is paid in another way (e.g., imputed as income by an employer). In fact, life insurance trusts drafted in recent years often permit the creator of the trust (the donor or settlor) to designate each year whether a withdrawal right will be permitted,

and to whom it will be granted. In such cases, the trustee must first determine whether a withdrawal right is effective, and then provide notice. In the case of group term life insurance or split-dollar insurance (where premium payments take place each month), the custom is to provide a blanket notice at the beginning of the year.

The trustee's notice should include:

- the amount subject to the withdrawal right;
- the expiration date for the withdrawal right; and
- the manner for exercise of the withdrawal right.

The notice should contain an acknowledgment that will be signed and dated by the beneficiary, and returned to the trustee. The notice should not contain a "waiver" of the withdrawal right (or similar statement). These notices should go into the trustee's permanent files (along with ownership transfer and beneficiary designation forms). If the beneficiary is a minor (under age 18 in most states), the notice should be given to whomever the trust agreement directs, such as to the guardian of the minor (e.g., a parent). The guardian would then sign the acknowledgment and return it to the trustee (if the trustee is the guardian, then notice is presumed). Note that the creator of the trust should not sign acknowledgments; another guardian is preferred.

### Distributions to beneficiaries

Again, the trust document must be consulted to determine when and to what extent distributions are either required or permitted. A trust summary can sometimes be helpful, but should not be relied on. Furthermore, many life insurance trusts have dispositive provisions that change at the death of the insured.

An important consideration is whether the life insurance owned by the trust was also purchased for investment accumulation (i.e., retirement) purposes. This planning technique is sometimes called a private pension, and involves a planned withdrawal of cash values during retirement. The death benefit is not the primary motivation for the insurance purchase. Arguably, this type of policy should not be transferred to a life insurance trust because it takes an asset with significant value during the insured's life out of the insured's hands. However, if it is in a life insurance trust, distributions prior to the death of the insured (normally to the spouse of the insured) will have been planned, and the trustee must be prepared to deal with the planned withdrawal of cash values.

## Planning advice

The trustee will have to read the document to determine withdrawal rights and the need to make distributions.

If the trust has an index or headings in each section, look for “provisions during insured’s life,” “withdrawal rights,” or some combination of these. The other major dispositive provisions typically make up the first five to ten pages of the document, and are indexed or headed in a variety of ways.

Attorneys, banks, and trust companies are well equipped to send out and receive annual withdrawal notices (and they charge for the service). The individual trustee should obtain a sample withdrawal right notice (see Appendix A or B) from the attorney drafting the trust. There also are commercial organizations that will provide these services to an individual trustee for a fee.

Withdrawal right notices (and corresponding acknowledgment) should be done each year (perhaps at a family gathering), and the trustee should retain copies for his or her files.

Be careful of trusts containing lifetime or testamentary powers of appointment. In such a case, it is the power holder’s document that may control how the trust property is distributed. The trustee must obtain information concerning the exercise or non-exercise of the power of appointment in order to distribute trust property properly.

## Gift and generation-skipping transfer (GST) tax returns

Gift tax consequences associated with an irrevocable life insurance trust take place at a variety of times. The transfer of policies into the trust and the transfer of “seed” money into the trust are gift tax events. Furthermore, continued payment of premiums is also a gift tax event. The trustee and other professional advisors should determine whether gift tax returns are required or appropriate, and then should advise the creator of the trust (the donor or settlor), since he or she is the one responsible for gift tax filings.

### >> **Must the donor file annual gift tax returns reporting gifts to an irrevocable life insurance trust?**

In many cases, gift tax returns may not be required but may be desirable for a variety of reasons.

#### **The technical requirement**

A gift tax return is required if gifts of a “present” interest exceed the annual exclusion amount (\$11,000 in 2005, expected to be \$12,000 in 2006) to any one individual. Gift tax returns are not required for gifts to a spouse unless the spouse is not a U.S. citizen. Gifts of a future interest in any amount require a gift tax filing.

A present interest includes (but is not limited to) direct gifts, gifts to trusts where the recipient has the right to remove the funds, i.e., withdrawal rights (a.k.a. Crummey powers), gifts to trusts where the beneficiary has a current right to income, or gifts to certain types of trusts for minor children. A withdrawal right creates a present interest only if the beneficiary has actual

knowledge of the right. Furthermore, the IRS insists that the withdrawal right have some substance—that is, that there be trust assets that actually can be withdrawn. The use of “seed” money in a trust bank account often is the solution when the life insurance policy itself has very little value (group term or split-dollar life insurance).

A future interest includes (but is not limited to) gifts not taking place for a period of time, and most gifts in trust.

Gift tax returns are required to elect “gift splitting,” i.e., where a married couple elects to divide all gifts equally between them for gift tax purposes. However, “gift splitting” can be elected on a late-filed return (even one filed after death but before the estate tax return is filed), as long as neither spouse has previously filed. Note that gift splitting will be necessary even in a community property jurisdiction (since the property transferred is separate property).

#### The practical approach

Life insurance trusts generally are engineered so premium payments qualify as “present” interests. Often, the amount of planned premiums is calculated to be less than the maximum combined annual exclusions (counting one exclusion per beneficiary per spouse). Therefore, for a great number of life insurance trusts, no gift tax return is required for gift tax purposes.

The trustee and advisors should map out future gift implications of planned premiums and use of annual exclusions. Furthermore, the premium payments should be coordinated with other gift planning.

Couples sometimes do not file a gift tax return if “gift splitting” will result in no gift tax liability. Technically, this is not correct, and may result in problems later if the spouse is no longer willing to split gifts. Often, this occurs when the request to split gifts is made after a divorce.

#### The amount of the gift

Two different gift events take place with respect to life insurance trusts. The first event is the transfer of the policy to the trust (or to any new owner). If the trust is the initial owner and beneficiary, then there is no transfer and no gift event at policy purchase. The second event is the payment of premiums or deposit of funds into the trust bank account to pay premiums, which often takes place each year.

*Gift at transfer.* The amount of the gift at transfer from one owner to another is the value of the policy at that time—the policy’s interpolated terminal reserve. For a policy with cash value, this loosely is equal to the cash surrender value, plus unearned premium and earned dividends, less policy loans. These values are all obtained from the insurance company by requesting Form 712. The trustee should especially be careful with split-dollar arrangements, since the Form 712 is likely to show gross policy figures, rather than the employee’s share of the gross.

*Annual premium payments.* The amount of cash deposited into the trust bank account, or paid directly for premiums, is a gift to the trust. Likewise, amounts paid by the insured directly for life insurance owned by the trust, e.g., payroll deductions, also are treated as a gift to the trust. Finally, amounts imputed as income to the insured, e.g., “free” group term life insurance or “free” split-dollar coverage, are also treated as a gift to the trust (an indirect gift).

#### Generation-skipping transfer (GST) tax considerations

One of the goals of the life insurance trust is to avoid estate tax both in the insured’s and insured’s spouse’s estates. Additional estate tax savings are possible at the children’s death if the assets of the trust are also excluded from the children’s estates. However, a special transfer tax applies to

transfers from grandparents to grandchildren (the generation-skipping transfer tax). An annual generation-skipping exclusion per grandchild is available, equal in amount to the gift tax annual exclusion (\$11,000 in 2005, expected to be \$12,000 in 2006). There also is a lifetime GST exemption per grandparent (\$1,500,000 in 2005, \$2,000,000 in 2006).

Unfortunately, gifts to a traditional life insurance trust will not qualify for the annual generation-skipping transfer tax exclusion (unless each grandchild has his or her own special trust). Furthermore, the lifetime exemption usually will not apply to the trust unless affirmative action (i.e., filing a gift tax return) is taken. Finally, significant changes to automatic GST exemption allocation were made in 2001.

Before 2001 (and after 2010), trustees and professional advisors had to evaluate every transfer to a trust for a potential generation skip. If a generation skip was planned or was likely, a gift tax return should have been filed in order to allocate part of the GST exemption and to protect the trust assets from the generation-skipping transfer tax. If the exemption was not allocated to amounts given to the trust, a generation-skipping transfer tax (at the maximum estate tax rate) will apply if and when grandchildren receive distributions (unless special pre-2010 late allocations are permitted). When the generation-skipping exemption was allocated, the exemption used equaled the total amount of gifts received by the trust (deposits to bank accounts and premium payments made directly) each year. In years before 2001, trustees and advisors were making calculated guesses as to when GST exemption should or should not be applied. This same rule will apply after 2010.

After 2001 (and before 2010), GST exemption would be applied automatically to certain types of trusts. Now, trustees and professional advisors have to evaluate whether GST exemption may or may not be applied automatically (these rules are not very clear). Gift tax returns may be filed to elect out of automatic allocation (where appropriate) or to confirm the application of GST exemption to the transfer (where appropriate). The automatic GST allocation will no longer apply after 2010.

With respect to generation-skipping, the trustee should seek out the professional advisors for their recommendations about gift tax filings. The trustee should make a written record of the decision.

#### Planning advice

File gift tax returns each year if:

- a generation skip is planned or likely (and allocate a generation-skipping exemption);
- a generation skip is not planned and electing out of automatic allocation is appropriate;
- a late allocation of GST exemption to an existing trust might be a good idea;
- a gift split is needed to avoid use of lifetime exemption (the ability to file “late” returns to split gifts might go away in the case of a divorce);
- a record of the transaction is needed or desired.

## Income tax return filings

A life insurance trust often has no assets other than life insurance policies and possibly a checking account.

### >> Must the trust file annual federal fiduciary income tax returns (Form 1041)?

In almost all cases, no.

#### The technical requirement

A federal fiduciary income tax return is required if the trust earned any taxable income, had gross income of \$600 or more (regardless of whether the income was taxable, e.g., municipal bonds), or had a beneficiary who is a nonresident alien. If the trust is a grantor trust (for income tax purposes), no filing will be required as long as all items of income, deduction, and credit are reported on a U.S. grantor's individual income tax return, and the grantor's Social Security number is used on the trust's accounts.

A grantor trust is one that is ignored for income tax purposes. All items of income and expense are treated as belonging to the grantor, and the trust itself is not the taxpayer. Because of the nature of a life insurance trust, it is almost impossible for it to be anything but a grantor trust for income tax purposes.

If the trust's Tax Identification Number is used on income-producing accounts, the trustee of an income tax grantor trust has two filing choices to redirect the income to the grantor. First, the trustee could file Form 1041, Fiduciary Income Tax Return, and direct the income to the grantor's personal return. Alternatively, the trustee could file a nominee Form 1099. The nominee Form 1099 must be filed on machine-readable forms.

Most states follow federal rules on when a fiduciary tax return must be filed. If a federal return is not required, most states will not require a state fiduciary tax return.

### The practical approach

A life insurance trust typically has no income unless:

- the trust's bank account is an interest-bearing account;
- dividends on the life insurance policy are accumulating interest; or
- the trust has other income-producing investments.

It is possible to arrange the affairs of the trust to avoid an income tax filing requirement. The trustee simply can arrange to have all income reported using the Social Security number of the grantor (the creator of the trust). If any of

the income attributes above are contemplated, the trustee should arrange for all tax reporting to be done using the grantor's Social Security number, and not the trust's TIN, in order to avoid the need to complete (and pay for) unnecessary income tax filings.

Once income is reported using the trust TIN, the trustee technically is required to file a fiduciary tax return, even if only to state that the income, deductions, and credits are reported on the grantor's individual return. Although the trustee may decide not to file a fiduciary return if the amounts involved are nominal, this is not correct and may result in IRS inquiries.

### Planning advice

If annual income tax filings are to be avoided, the trustee must make sure that the trust EIN is not used on account registration forms (Form W-9). Instead, the grantor's Social Security number should be used on accounts.

### After the death of the insured

Just as the dispositive provisions of the trust may be different after the death of the insured, so, too, the income tax treatment of the trust will change. In such a case, complicated income tax rules, which are beyond the scope of this publication, apply.

## Dealing with life insurance

Historically, the trustee of a life insurance trust simply put the insurance policy (or policies) in a safe place, paid premiums when due, and notified the creator of the trust when the trust bank account required additional funds.

### >> Can I put the policy in a safe place and forget it?

Probably not.

Modern life insurance policy payment strategies now require some interaction between the trustee, the insurance agent, and the issuing insurance company. Furthermore, improvements to life insurance products take place each year, and the trustee can no longer put the policy in a safe place and forget it. Finally, some life policies (variable life and variable universal life) permit the owner to choose among a menu of investment choices (much like a 401(k) plan).

### Policy loans

At one time (before about 1986), it was a wise financial decision to borrow the cash value of a life insurance policy and reinvest the funds elsewhere. However, most insurance companies have taken steps to discourage borrowing from life insurance policies. Often, the discouragement takes the form of increased dividends on policies without policy loans.

The trustee should reexamine any life insurance policies with policy loans and determine whether it makes economic sense to repay the loan or continue the loan. Likewise, the trustee should determine whether to pay interest on policy loans directly, or to borrow the interest from the policy as well.

### Vanishing premiums

Life insurance premiums never stop. However, the need to make premium payments may stop by borrowing from the policy, partially surrendering paid-up additional insurance, using dividends, or through a combination of the three. Furthermore, variations in the investment returns on the life insurance policy may cause premiums to vanish and then reappear (this is the case for many policies).

The trustee should have a clear picture of how premiums are planned to be paid during the entire life of the policy. The trustee also should be aware of the interaction needed with either the agent or issuing insurance company in making future premium payments. Most premiums do not vanish automatically. Instead, two or three forms might need to be completed each year in order to accomplish the “vanishing” premium.

### Use of policy dividends

Life insurance policy dividends can be used in a variety of ways (to reduce premiums, to reduce loans, to accumulate interest, to purchase term insurance, or to purchase paid-up additional insurance). Often, the use of dividends was set during the original policy application process. The trustee should review the use of policy dividends on a periodic basis, especially in conjunction with planned premium arrangements.

Allowing policy dividends to accumulate with interest paid to the trust may create an income tax filing requirement, unless the grantor’s Social Security number is used for account registrations.

### Policy investments

For those policies with investment choices, the trustee should develop an allocation strategy and reexamine it from time to time. The strategy would consider historic returns in a class, historic deviation in those returns, prior performance of the available choices, and the underlying fees and expenses associated with available choices.

The trustee should be mindful that investment performance and fluctuation will have an impact on the premium payment requirements.

### Changing policies

One of the perceived life insurance abuses is the “churning” of life insurance policies. Churning is a practice of exchanging an existing policy for a new policy (or policies) on the rationale that the new policy provides “better” coverage. The abuse is that the new policy generates a substantial commission for the selling agent, and cuts off the renewal commissions on the old policy. In all fairness, life insurance companies frequently improve their product offerings due to more favorable life expectancy statistics and competitive pressures on administrative charges. However, these changes may not be sufficient to justify paying surrender charges (to terminate the old policy) and commissions (on the new policy).

The trustee can no longer put life insurance policies in a safe place and never reevaluate them. Instead, the trustee should review the policy (or policies) periodically, and remain alert to market changes. Before exchanging one life insurance policy for another, the economics involved should be evaluated, since the economics often do not favor the exchange of policies.

Furthermore, the trustee should also monitor the financial health of the life insurance carriers. The trustee may be expected to take action if there is an issue associated with the policies owned by the trust. Such action may include a policy exchange.

#### Policy illustrations

The trustee should obtain a copy of the original policy illustration in order to determine planned premium payment strategies (e.g., vanishing premiums). The trustee should be aware that policy illustrations are illustrations only, and are subject to a high degree of fluctuation.

The trustee may also wish to obtain “in force” illustrations of the policy (or policies) periodically (every three to five years), to determine if the planned premium strategy must be adjusted.

#### Death of the insured

At the death of the insured, the trustee must contact the insurance company (or companies) to obtain the death benefits. The trustee usually will be required to provide a death certificate, which can be obtained from the executor or from the county in which the insured died. The insurance company also will have an array of forms for the trustee to complete. The trustee should obtain Form 712 and provide it to the executor of the insured’s estate.

The trustee also should review the trust document, since the dispositive provisions often change at the death of the insured.

#### Planning advice

Don’t put the policy in a safe place and forget it. Monitor the economics of the policy and the financial health of the insurance carrier.

## Trust assets (other than life insurance)

The irrevocable life insurance trust contains a variety of special provisions dealing with life insurance policies and powers of withdrawal. These provisions create income tax concerns if additional assets are added to the trust.

### >> [Can I use this trust for other gift planning?](#)

**Because of its unique provisions, the life insurance trust may not be suited for general trust transfers.**

Before adding assets (other than life insurance) to a life insurance trust, a careful review of the income tax, gift tax, estate tax, and generation-skipping transfer tax implications is in order.

### [Planning advice](#)

Before using the life insurance trust for other purposes, reread the document and review the history of transfers to the trust, and make sure that the trust produces the desired dispositive and tax results.

## Changing trustees

The choice of trustee (and the trustee powers) for an irrevocable life insurance trust is very important for estate tax purposes and for the practical operation of the trust. Remember that the irrevocable life insurance trust is likely to be around for a long period of time.

>> **I don't like my current trustee. Can I change?**

**Better read the document. Removal and replacement provisions vary wildly, depending on when the document was drafted and how conservative the attorney was.**

Trustee removal and replacement provisions were the subject of some heated debate concerning adverse estate tax treatment. Since 1979, the IRS has attempted to use trustee removal and replacement provisions as a means to attack irrevocable life insurance trusts. The courts have been rejecting the IRS position out of hand, and, since about 1994, the IRS has backed away from the issue to some extent. Depending on when the trust was drafted, there may be limited (or no) trustee removal and replacement provisions.

Your choices for trustee break down into several major groups:

- trusted friends;
- family members and beneficiaries;
- attorneys or accountants; and
- banks and trust companies.

Each group has advantages and disadvantages. Furthermore, the need for a particular type of trustee will vary before and after the death of the insured. Thus, the ability to fire and replace the trustee is an important power (even though it adds to the estate tax complications of the trust as a whole).

By and large, attorneys, accountants, banks, and trust companies rightfully are very serious about their role as trustee, and consider any fiduciary action carefully. Use of such a trustee relieves friends and family members of the headaches associated with trust administration. However, the world of life insurance trust administration is filled with shades of gray, and the use of a careful trustee is not always practical.

Bear in mind that choosing an attorney, accountant, bank, or trust company may also bring into play requirements imposed on the trustee by regulatory or professional organizations. These trustees will charge to send out, receive, and store beneficiary withdrawal notices. They may charge a flat annual fee or

a percentage of trust assets fee for serving as trustee. However, use of such a trustee probably will insure that the formalities will be observed.

On the other hand, trusted friends and family members are more likely to operate in the gray areas, are less likely to charge a fee during the insured's life, but are less well trained in life insurance trust administration (hence this publication).

#### Planning advice

Weigh the trustee choice carefully. The trust document should contain some type of trustee removal and replacement arrangements. Absent a removal and replacement provision, the trustee can resist removal, and often is permitted to use trust assets to defend himself or herself. Even with a trustee willing to stand aside, local law may force you to go to court in order to permit the change.

## Trust termination

The trustee must again seek instruction from the trust document, itself, on when the trust may terminate.

### >> When will this responsibility end?

You need to read the trust document. Trusts last for a long time. If tax laws change (or the trust is too small), some documents (or local laws) allow the trustee to terminate the trust. Some trusts end at the death of the insured or the insured's spouse.

Some trusts permit termination at the trustee's discretion, if certain tax changes take place. Most trusts provide for termination at certain family events—death of a generation, or upon the reaching of certain ages.

### Termination during insured's lifetime

Sometimes a trust can be terminated when certain tax events take place, e.g., the repeal of the estate tax. Thus, the trustee must remain informed about such matters (the debate around repeal of the estate tax constantly receives national attention in the media). Some documents give the trustee unrestricted discretion in determining if the trust should be terminated.

As a practical matter, the trust often will terminate if the policy lapses from insufficient premiums.

If the trustee is uncomfortable about exercising discretion, he or she can request court approval (from the state or county court responsible for trust administration matters) of any actions.

#### Termination after insured's lifetime

Most often, trusts will terminate at the occurrence of certain family events, such as the death of the insured or the death of the insured's spouse. Trusts sometimes end when the beneficiary reaches a certain age.

The trustee must be aware of the important events, and have enough information to determine if the event has occurred. Thus, the trustee must monitor deaths in the family. Furthermore, the trustee should have the names, addresses, Social Security numbers, and birth dates of all beneficiaries. If the class of beneficiaries continues to grow, the trustee also should obtain the data for any new arrivals (birth, marriage, or adoption).

Maintaining this information will allow the trustee to track family events and predict (in some cases) the end of the trust. Likewise, it will help with required withdrawal notices. Not only is the trust termination an important income tax and bookkeeping event, it also is of interest to the beneficiaries.

However, there may be other trust termination events contained within the document (passage of time; trust is too small in size, etc.) that should be monitored as well.

#### Planning advice

In the trustee's permanent files, there should be a listing of important dates, names, Social Security numbers, and birth dates. The trustee may wish to create a "cheat sheet" of triggering events, and monitor events accordingly.

## Conclusion

The trustee of the irrevocable life insurance trust has a variety of tasks. The purpose of this material is to remove the mystery from many of these tasks and to provide practical guidance. In many situations, there is no substitute for professional assistance, and we have attempted to point out these areas as well.

The irrevocable life insurance trust is one of the greatest tools available to the estate planning professional. With proper care and nourishment, it can yield substantial benefits to the creator and his or her spouse, children, grandchildren, and great-grandchildren.

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## Appendix A

Annual Withdrawal Right Notice—monthly arrangement such as group term insurance or insurance paid with payroll deductions.

Jane Smith, Trustee

Date

Re: John Doe 2005 Life Insurance Trust Withdrawal Right

Dear Mrs. Doe [or Doe Children],

John Doe has created an irrevocable trust, of which you are a beneficiary. You should know that this year, we anticipate that additions will be made to the principal of the trust during the first ten (10) days of each month of the year. The amount of the addition will vary monthly, beginning at about \$\_\_ per month. Within \_\_\_\_\_ [time limit specified by trust instrument] after any such addition is made, you may request that I distribute such monthly addition to the trust. Your withdrawal request must be in writing. Your annual right to withdraw such additions is, however, limited to \$ \_\_\_\_.

If other additions (other than the monthly amount above) are made to the principal of the trust, I, as Trustee, have been directed to give you prompt written notice of such additions.

You have every right to request a distribution of any trust additions. Your right to compel distribution will cease within \_\_\_\_\_ days [time limit specified by trust instrument] if it is not exercised.

Yours,

Jane Smith,  
Trustee of John Doe 2005

Life Insurance Trust

Receipt of this letter is  
acknowledged this

\_\_ day of \_\_\_\_, 2005

\_\_\_\_\_  
Mrs. Doe [or Doe Children]

## Appendix B

Annual Withdrawal Right Notice—where trustee pays premiums directly

Jane Smith, as Trustee of the John Doe 2005 Life Insurance Trust

Date

Mrs. Doe [or Doe Children]

[Address]

Re:

Trust Agreement between John Doe

as grantor, and Jane Smith as

trustee, dated January 6, 2005

Dear Mrs. Doe [Doe Children]:

As you may know, John has now contributed to his insurance trust \$ \_\_\_\_ for payment of a premium on an insurance policy on his life.

Accordingly, pursuant to the terms of the trust agreement, you have a right to withdraw, for a period of \_\_\_\_\_ [time limit as specified by trust instrument] following the date of this notice, up to \$ \_\_\_\_ from the principal of the trust in respect of John's contribution.

If you intend to exercise your withdrawal right, please do so in writing. Please sign and return the enclosed copy of this letter, acknowledging its receipt, to me.

Sincerely,

Jane Smith

I have received the original of this letter on \_\_\_\_\_, 2005.

\_\_\_\_\_  
Mrs. Doe [or Doe Children]

Appendix C

Form SS-4

<b>Form SS-4</b> (Rev. December 2001) Department of the Treasury Internal Revenue Service		<b>Application for Employer Identification Number</b> (For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, Indian tribal entities, certain individuals, and others.) See separate instructions for each line. Keep a copy for your records.		EIN _____  OMB No. 1545-0003																
1 Legal name of entity (or individual) for whom the EIN is being requested																				
2 Trade name of business (if different from name on line 1)		3 Executor, trustee, "care of" name																		
4a Mailing address (room, apt., suite no. and street, or P.O. box)		5a Street address (if different) (Do not enter a P.O. box.)																		
4b City, state, and ZIP code		5b City, state, and ZIP code																		
6 County and state where principal business is located																				
7a Name of principal officer, general partner, grantor, owner, or trustor		7b SSN, ITIN, or EIN																		
8a Type of entity (check only one box) <table border="0" style="width:100%"> <tr> <td><input type="checkbox"/> Sole proprietor (SSN) _____</td> <td><input type="checkbox"/> Estate (SSN of decedent) _____</td> </tr> <tr> <td><input type="checkbox"/> Partnership _____</td> <td><input type="checkbox"/> Plan administrator (SSN) _____</td> </tr> <tr> <td><input type="checkbox"/> Corporation (enter form number to be filed) _____</td> <td><input type="checkbox"/> Trust (SSN of grantor) _____</td> </tr> <tr> <td><input type="checkbox"/> Personal service corp. _____</td> <td><input type="checkbox"/> National Guard _____</td> </tr> <tr> <td><input type="checkbox"/> Church or church-controlled organization _____</td> <td><input type="checkbox"/> Farmers' cooperative _____</td> </tr> <tr> <td><input type="checkbox"/> Other nonprofit organization (specify) _____</td> <td><input type="checkbox"/> REMIC _____</td> </tr> <tr> <td><input type="checkbox"/> Other (specify) _____</td> <td><input type="checkbox"/> Indian tribal governments/enterprises _____</td> </tr> <tr> <td></td> <td>Group Exemption Number (GEN) _____</td> </tr> </table>					<input type="checkbox"/> Sole proprietor (SSN) _____	<input type="checkbox"/> Estate (SSN of decedent) _____	<input type="checkbox"/> Partnership _____	<input type="checkbox"/> Plan administrator (SSN) _____	<input type="checkbox"/> Corporation (enter form number to be filed) _____	<input type="checkbox"/> Trust (SSN of grantor) _____	<input type="checkbox"/> Personal service corp. _____	<input type="checkbox"/> National Guard _____	<input type="checkbox"/> Church or church-controlled organization _____	<input type="checkbox"/> Farmers' cooperative _____	<input type="checkbox"/> Other nonprofit organization (specify) _____	<input type="checkbox"/> REMIC _____	<input type="checkbox"/> Other (specify) _____	<input type="checkbox"/> Indian tribal governments/enterprises _____		Group Exemption Number (GEN) _____
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<input type="checkbox"/> Other (specify) _____	<input type="checkbox"/> Indian tribal governments/enterprises _____																			
	Group Exemption Number (GEN) _____																			
8b If a corporation, name the state or foreign country (if applicable) where incorporated		State _____ Foreign country _____																		
9 Reason for applying (check only one box) <table border="0" style="width:100%"> <tr> <td><input type="checkbox"/> Started new business (specify type) _____</td> <td><input type="checkbox"/> Banking purpose (specify purpose) _____</td> </tr> <tr> <td><input type="checkbox"/> Hired employees (Check the box and see line 12.) _____</td> <td><input type="checkbox"/> Changed type of organization (specify new type) _____</td> </tr> <tr> <td><input type="checkbox"/> Compliance with IRS withholding regulations _____</td> <td><input type="checkbox"/> Purchased going business _____</td> </tr> <tr> <td><input type="checkbox"/> Other (specify) _____</td> <td><input type="checkbox"/> Created a trust (specify type) _____</td> </tr> <tr> <td></td> <td><input type="checkbox"/> Created a pension plan (specify type) _____</td> </tr> </table>					<input type="checkbox"/> Started new business (specify type) _____	<input type="checkbox"/> Banking purpose (specify purpose) _____	<input type="checkbox"/> Hired employees (Check the box and see line 12.) _____	<input type="checkbox"/> Changed type of organization (specify new type) _____	<input type="checkbox"/> Compliance with IRS withholding regulations _____	<input type="checkbox"/> Purchased going business _____	<input type="checkbox"/> Other (specify) _____	<input type="checkbox"/> Created a trust (specify type) _____		<input type="checkbox"/> Created a pension plan (specify type) _____						
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	<input type="checkbox"/> Created a pension plan (specify type) _____																			
10 Date business started or acquired (month, day, year)		11 Closing month of accounting year																		
12 First date wages or annuities were paid or will be paid (month, day, year). <b>Note:</b> If applicant is a withholding agent, enter date income will first be paid to nonresident alien. (month, day, year) _____																				
13 Highest number of employees expected in the next 12 months. <b>Note:</b> If the applicant does not expect to have any employees during the period, enter "-0-". Agricultural _____ Household _____ Other _____																				
14 Check one box that best describes the principal activity of your business. <table border="0" style="width:100%"> <tr> <td><input type="checkbox"/> Construction</td> <td><input type="checkbox"/> Rental &amp; leasing</td> <td><input type="checkbox"/> Transportation &amp; warehousing</td> <td><input type="checkbox"/> Accommodation &amp; food service</td> <td><input type="checkbox"/> Wholesale-agent/broker</td> <td><input type="checkbox"/> Wholesale-other</td> <td><input type="checkbox"/> Retail</td> </tr> <tr> <td><input type="checkbox"/> Real estate</td> <td><input type="checkbox"/> Manufacturing</td> <td><input type="checkbox"/> Finance &amp; insurance</td> <td><input type="checkbox"/> Other (specify) _____</td> <td><input type="checkbox"/> Health care &amp; social assistance</td> <td></td> <td></td> </tr> </table>					<input type="checkbox"/> Construction	<input type="checkbox"/> Rental & leasing	<input type="checkbox"/> Transportation & warehousing	<input type="checkbox"/> Accommodation & food service	<input type="checkbox"/> Wholesale-agent/broker	<input type="checkbox"/> Wholesale-other	<input type="checkbox"/> Retail	<input type="checkbox"/> Real estate	<input type="checkbox"/> Manufacturing	<input type="checkbox"/> Finance & insurance	<input type="checkbox"/> Other (specify) _____	<input type="checkbox"/> Health care & social assistance				
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15 Indicate principal line of merchandise sold; specific construction work done; products produced; or services provided.																				
16a Has the applicant ever applied for an employer identification number for this or any other business? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No <b>Note:</b> If "Yes," please complete lines 16b and 16c.																				
16b If you checked "Yes" on line 16a, give applicant's legal name and trade name shown on prior application if different from line 1 or 2 above. Legal name _____ Trade name _____																				
16c Approximate date when, and city and state where, the application was filed. Enter previous employer identification number if known. Approximate date when filed (mo., day, year) _____ City and state where filed _____ Previous EIN _____																				
Complete this section only if you want to authorize the named individual to receive the entity's EIN and answer questions about the completion of this form. <table border="1" style="width:100%"> <tr> <td rowspan="2" style="width:100px">Third Party Designee</td> <td style="width:500px">Designee's name _____</td> <td style="width:150px">Designee's telephone number (include area code) _____</td> </tr> <tr> <td>Address and ZIP code _____</td> <td>Designee's fax number (include area code) _____</td> </tr> </table>					Third Party Designee	Designee's name _____	Designee's telephone number (include area code) _____	Address and ZIP code _____	Designee's fax number (include area code) _____											
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Date _____																				
For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 16055N Form <b>SS-4</b> (Rev. 12-2001)																				

Glossary

**Annual exclusion:** The amount of assets that can be given per person per year without gift tax or generation-skipping tax complications. The annual exclusion is indexed for inflation and changes every few years. The annual exclusion is \$11,000 for 2005 and expected to be \$12,000 for 2006.

**Assets:** The property (stocks, bonds, real estate, etc.) that is owned by someone or something. The assets of a trust are owned by the trustee. Assets are also known as corpus or principal.

**Beneficiary:** A person or entity that is entitled to receive something. The beneficiary of a trust may be entitled to income or principal distributions. The beneficiary of life insurance is entitled to receive the death benefits.

**Community property:** A form of property ownership for married couples in certain states (Alaska (if elected), Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington state, and Wisconsin). Community property generally is all property obtained during the marriage, and is treated as owned one-half by each spouse. Special federal tax consequences are associated with community property. See also Separate Property.

**Corpus:** The technical name for the assets owned by a trust. Also known as the principal of a trust.

**Creator:** The person who creates a trust. Also called grantor, settlor, or trustor. There are technical distinctions between a settlor and a grantor, which are not important for the purposes of this material.

**Crummey power:** The ability of a beneficiary to withdraw funds given to a trust by the donor. The Crummey Power permits use of the annual gift tax exclusion (but not the generation-skipping exclusion). Named for the Crummey family, which was first to test its use in court.

**Death tax:** Tax on the value of assets passing to beneficiaries and heirs at death. The federal death tax is called the estate tax. State death taxes may be called inheritance, succession, estate, or death taxes.

**Donee:** A person who receives a gift. Also known as gift recipient.

**Donor:** A person who makes a gift. The term sometimes is used to describe the person who creates a trust during life (also called trust creator, settlor, or trustor). Generally not used to describe a person who created a trust at death.

**Dynasty trust:** A trust that continues on for many generations of beneficiaries. The purpose of the trust is to permit family members to benefit from assets and income without owning the assets for estate tax purposes.

**Estate:** All of the assets owned and controlled by a person or entity. Also the name for the legal entity that succeeds to the ownership of property that had been owned by a decedent and will be disposed of through a will or intestacy.

**Estate tax:** A tax on the passing of assets at death. Also known as the death tax. The federal tax is known as the estate tax. Similar state taxes are called inheritance, succession, or estate taxes.

**Fiduciary:** A person or entity held to a higher standard of responsibility for dealing with assets on behalf of others (beneficiaries). The word comes from the Latin term meaning trust and confidence. A trustee is a fiduciary.

**Generation-skipping:** This is an exceptionally technical term that refers to the practice of transferring assets to generations after children (such as grandchildren and great-grandchildren). The purpose is to reduce estate taxes imposed on the children and/or subsequent generations. There is a special generation-skipping tax system, which is designed to keep such activities within certain guidelines.

**Grantor:** The person who created a trust during life (creator, trustor). Technically, it does not refer to a person who creates a trust at death. It also can refer to a person who is making a transfer of real estate by deed.

**Guardian:** This is the adult person who is in charge of a minor or incapacitated person. The guardian can be the person who will take care of the day-to-day living needs of the minor or incapacitated person. Note that the guardian may also be in charge of the minor's or incapacitated person's financial affairs, as well, although this can be a different person. An official (court-appointed) guardian in charge of financial affairs is a fiduciary.

**Heir:** A person who inherits property. An heir usually is a blood relative.

**Income:** Refers to the investment earnings produced by trust assets. Trust income and trust principal are important technical terms, and can be the subject of lawsuits between trustees and beneficiaries.

**Intestacy:** The state-required distribution of someone's assets after death, when there is no will. All states have distribution-ordering rules based on marriage and blood relations.

**Insurance Trust:** A specific type of irrevocable trust that is designed to own life insurance and save estate taxes.

**Irrevocable Trust:** A trust that cannot be altered, amended, or changed by the original grantor or creator. Irrevocable trusts can be interpreted by certain state courts, and more modern irrevocable trusts give certain persons the power to change certain terms.

**Minor:** A person under the age of 18 (age 21 in some states).

**Principal:** The assets or corpus of a trust. Does not refer to the investment income produced each year unless that income is used to purchase new assets. Trust income and trust principal are important technical terms and can be the subject of lawsuits between trustees and beneficiaries.

**Separate property:** A form of property ownership by a husband and/or wife in a community property state (see Community Property). Separate property is not community property. Separate property belongs to the separate property owner. Separate property must be created in certain ways, depending on state law. It is critical that life insurance-related activities be conducted with separate property from a separate property account.

**Settlor:** Another term for the creator of a trust (grantor or trustor). Technically, a settlor is the person who creates a trust, either during life or at death, while a grantor creates a trust during life only. This technical distinction is not important for this material.

**Trust:** An arrangement to provide for legal title, management, and disposition of assets by someone (the trustee) on behalf of others (the beneficiaries). The directions for the arrangement almost always are contained in a written trust instrument.

**Trustee:** The person or entity that serves as the legal owner of property on behalf of another. The trustee is responsible for the management and disposition of assets under a trust. The trustee is a fiduciary, and acts on behalf of the beneficiaries. The trustee is obligated legally to the beneficiaries, and the beneficiaries can sue the trustee if the trust is not operated correctly.

**Trustor:** Another term for the creator, grantor, or settlor of a trust.

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