

## **4F. The Irrevocable Life Insurance Trust**



# **ESTATE PLANNING WITH LIFE INSURANCE**

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## I. INTRODUCTION

Life insurance frequently comprises a substantial portion of the typical estate and deserves the planner's careful attention. In tax planning, the primary utility of life insurance is that it allows one to transfer future benefits at a reduced present cost. With the compression of income-tax rates and the opportunities and utility of income shifting lost under the Tax Reform Act of 1986,<sup>1</sup> saving transfer taxes and planning with insurance have become more important. This chapter reviews the fundamentals of the income, estate, gift and generation-skipping transfer tax considerations involved in estate planning with life insurance and the drafting of the irrevocable unfunded life insurance trust.<sup>2</sup>

## II. ESTATE TAX CONSIDERATIONS

The proceeds of an insurance policy on a decedent's life are includable in the gross estate if such proceeds are receivable by or for the benefit of the estate or are "receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person."<sup>3</sup>

### (A) Proceeds Receivable by or for Benefit of Estate

Insurance proceeds receivable by the executor or payable to the decedent's estate will be included in the decedent's gross estate, regardless of whether the policy specifically names the estate as a beneficiary.<sup>4</sup> Thus, even if insurance proceeds are

receivable by another beneficiary but are subject to an obligation, legally binding upon the other beneficiary, to pay taxes, debts, or other charges enforceable against the estate, then the amount of such proceeds required for the payment in full (to the extent of the beneficiary's obligation) of such taxes, debts, or other charges is includable in the gross estate.<sup>5</sup>

This is a trap for the unwary when drafting insurance trust indentures where the donor wants the proceeds to be available for the payment of estate taxes or debts. Estate planning with an irrevocable life insurance trust will prevent insurance proceeds from being included in the insured's gross estate.

### (B) Proceeds Receivable by Others

As noted, the insured's estate includes proceeds payable to others where the insured retained, or possessed, any incidents of ownership in the policy.<sup>6</sup>

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<sup>1</sup> Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of U.S.C. tit. 26).

<sup>2</sup> The appendix to this chapter includes a sample irrevocable unfunded life insurance trust. As with any form, this one is a starting point and must be modified to meet the needs of individual clients.

<sup>3</sup> I.R.C. § 2042.

<sup>4</sup> Treas. Reg. § 20.2042-1(b)(1).

<sup>5</sup> *Id.*

<sup>6</sup> I.R.C. § 2042(2).

## 1. *Incidents of Ownership Defined*

*Incidents of ownership* is not defined here in a technical legal sense, but rather generally refers to the right of the decedent or his or her estate to the economic benefits of the policy. *Thus, incidents of ownership* includes the power to

- change the beneficiary or contingent beneficiaries,<sup>7</sup>
- borrow under the policy,
- surrender or cancel the policy,
- assign the policy or revoke an assignment,<sup>8</sup>
- change the time and manner of receipt of proceeds,<sup>9</sup> and
- veto, or require consent to, an action with respect to the policy.<sup>10</sup>

It does not include the power an employee retains to convert a group term policy to a separate policy upon termination of employment.<sup>11</sup>

A policy owned by a corporation but controlled by the insured, where the proceeds are not payable to the company or its debtors, is includable in the insured's estate.<sup>12</sup> In some circumstances involving corporate-owned policies, however, the insured does not retain any incidents of ownership.<sup>13</sup>

## 2. *Incidents of Ownership by Fiduciaries*

Where a fiduciary (i.e., trustee, executor, custodian) has the power to change (1) the beneficial ownership in the policy, (2) the distribution of its proceeds or (3) the time and manner of their enjoyment, the proceeds will be included in the fiduciary's estate, even if the fiduciary has no beneficial interest.<sup>14</sup>

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<sup>7</sup> *Nance v. United States*, 430 F.2d 662 (9th Cir. 1970); *Broderick v. Keefe*, 112 F.2d 293 (1st Cir. 1940).

<sup>8</sup> Treas. Reg. § 20.2042-1(c)(2).

<sup>9</sup> *Estate of Lumpkin v. Comm'r*, 474 F.2d 1092 (5th Cir. 1973). But see *Estate of Connelly v. United States*, 551 F.2d 545 (3d Cir. 1977).

<sup>10</sup> *Comm'r v. Estate of Karagheusian*, 233 F.2d 197 (2d Cir. 1956).

<sup>11</sup> Rev. Rul. 84-130, 1984-2 C.B. 194.

<sup>12</sup> Treas. Reg. § 20.2042-1(c)(6).

<sup>13</sup> See I.R.S. Priv. Ltr. Rul. 94-21-037 (Feb. 28, 1994) (power of a sole shareholder to fire an employee/policy beneficiary and thereby cause proceeds to be paid to shareholder's family trust was not an incident of ownership, given the employee's rights under an employment contract); see also I.R.S. Priv. Ltr. Rul. 2000-17-051 (Jan. 24, 2000) (partner of a limited partnership, holding a policy on the life of the partner, does not possess an incident of ownership where the partnership agreement forbids any partner/insured from exercising any powers over such policy).

<sup>14</sup> Treas. Reg. § 20.2042-1(c)(4).

### (1) Trustee

A trustee who holds the powers enumerated above has an incident of ownership sufficient to mandate inclusion.<sup>15</sup> If, however, the trustee cannot exercise his or her powers for personal benefit and did not furnish any consideration to maintain the policy, and the insured did not retain the above powers as donor of the trust, the trustee will not be considered to possess incidents of ownership.<sup>16</sup>

The donor may retain the power to remove a trustee and appoint an individual or corporate successor if the successor is not related or subordinate to the donor<sup>17</sup> and may retain the power to appoint a successor for a trustee who resigns, dies or is removed by a court order.<sup>18</sup> The donor's retention of such powers is not considered a reservation of the trustee's discretionary powers of distribution.

### (2) Custodian

When, under state law, a custodian may use funds to satisfy his or her obligations of support, such proceeds should be included in the custodian's estate, even when the custodian is not the donor of the policy.<sup>19</sup>

### (C) Transfers within Three Years of Death

Because policies transferred by the *insured*, either outright or to a trust, do not fit within the general exclusion under I.R.C. § 2035(d),<sup>20</sup> the proceeds of such policies are thus included in the insured's estate. Proceeds of policies transferred by a *noninsured* generally are not included in the insured's estate because the insured possessed no incidents of ownership. Transferred proceeds are includable in certain circumstances, however, such as the following:

- A transfer by the insured's controlled corporation within three years of the insured's death was considered a transfer by the insured.<sup>21</sup>
- Where a decedent applied for insurance to be owned by another and paid the premiums, the proceeds were includable.<sup>22</sup>

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<sup>15</sup> *Rose v. United States*, 511 F.2d 259 (5th Cir. 1975); *but see Estate of Skifter v. Comm'r*, 468 F.2d 699 (2d Cir. 1972).

<sup>16</sup> Rev. Rul. 84-179, 1984-2 C.B. 195; I.R.S. Priv. Ltr. Rul. 2004-04-013 (Jan. 23, 2004).

<sup>17</sup> *Estate of Wall v. Comm'r*, 101 T.C. 300 (1993); Rev. Rul. 95-58, 1995-2 C.B. 191; I.R.S. Priv. Ltr. Rul. 97-35-023 (Aug. 29, 1997).

<sup>18</sup> Rev. Rul. 77-182, 1977-1 C.B. 273, *modified*, Rev. Rul. 95-58, 1995-2 C.B. 191.

<sup>19</sup> Rev. Rul. 84-179, 1984-2 C.B. 195.

<sup>20</sup> This section excludes from the gross estate "any bona fide sale for an adequate and full consideration in money or money's worth."

<sup>21</sup> Rev. Rul. 82-141, 1982-2 C.B. 209; Rev. Rul. 90-21, 1990-1 C.B. 172.

<sup>22</sup> *Bel v. United States*, 452 F.2d 683 (5th Cir. 1971).

- Where the insured transferred funds to a trust under which the trustee was directed to purchase insurance, the trustee was merely an agent of the donor and the proceeds were includable in the donor's estate.<sup>23</sup>
- Where the decedent merely contributed cash to a trust under which the trustee had broad investment authority, the proceeds were includable only if it was determined as a matter of fact that the donor directed the transaction and the trustee was merely the donor's agent.<sup>24</sup>

The IRS follows the holdings<sup>25</sup> in *Estate of Headrick v. Commissioner*,<sup>26</sup> *Estate of Leder v. Commissioner*<sup>27</sup> and *Estate of Perry v. Commissioner*,<sup>28</sup> which all involved transfers of cash to a trustee who used the discretion granted by the trust instrument to invest in life insurance on the life of the donor. Each court held that the proceeds of the policy would be includable in the insured's gross estate if the insured died within three years of the transfer, but only if the donor possessed an incident of ownership under I.R.C. § 2042.

#### **PRACTICE TIP** \_\_\_\_\_

- Despite the position of the IRS, the planner should take care to limit the insured's participation in acquiring a policy to (1) getting a physical examination and (2) helping to prepare the application, *after* the creation of the trust.<sup>29</sup>

The payment of premiums within three years of death on a policy transferred before the period will not cause inclusion of the proceeds.<sup>30</sup> Likewise, changes in the insurer within the three-year period will not cause the proceeds to be included.<sup>31</sup> Notwithstanding the IRS ruling regarding this latter provision, care is still required, as illustrated by *American National Bank & Trust Co. v. United States*.<sup>32</sup> In that case, the husband's company had changed carriers and required a new assignment from the husband as employee, which the husband apparently failed to execute. The new policy appeared similar in all respects to the superseded policy, except the death benefit was increased. The court held the proceeds includable in the husband's estate and rejected an argument that the wife's surrender of the old policy constituted consideration for the new policy.

<sup>23</sup> *Detroit Bank & Trust Co. v. United States*, 467 F.2d 964 (6th Cir. 1972); *Estate of Kurihara v. Comm'r*, 82 T.C. 51 (1984).

<sup>24</sup> *Hope v. United States*, 691 F.2d 786 (5th Cir. 1982); *Harwood v. United States*, 89-2 U.S. Tax Cas. (CCH) ¶ 13,825 (S.D. Fla. 1989).

<sup>25</sup> *Action on Decision*, 1991-012 (July 3, 1991).

<sup>26</sup> 93 T.C. 171 (1989), *aff'd*, 918 F.2d 1263 (6th Cir. 1990).

<sup>27</sup> 89 T.C. 235 (1987), *aff'd*, 893 F.2d 237 (10th Cir. 1989).

<sup>28</sup> 59 T.C.M. (CCH) 65 (1990), *aff'd*, 927 F.2d 209 (5th Cir. 1991).

<sup>29</sup> See I.R.S. Tech. Adv. Mem. 91-41-007 (Oct. 11, 1991).

<sup>30</sup> *First Nat'l Bank v. United States*, 423 F.2d 1286 (5th Cir. 1970).

<sup>31</sup> Rev. Rul. 80-289, 1980-2 C.B. 270.

<sup>32</sup> 87-1 U.S. Tax Cas. (CCH) ¶ 13,709 (N.D. Ill.), *aff'd*, 832 F.2d 1032 (7th Cir. 1987).



#### (D) Estate Taxation of *Crummey* Power upon Death of Holder

A *Crummey* power is a right in a trust beneficiary to withdraw property from the trust immediately after it is contributed. The trust must have assets that may be withdrawn by the beneficiary.<sup>33</sup> The right is typically limited to an amount fixed at the lesser of the annual exclusion or the value of the property contributed to the trust. Usually, the power is noncumulative and lapses within a period set forth in the governing instrument.

Cash can be held in the life insurance trust, either in the form of excess funds or by delaying the payment of premiums until after the power lapses. Alternatively, the beneficiary can be given the right to withdraw an interest in the policy.<sup>34</sup>

The *Crummey* demand right may generate adverse estate tax consequences for the power holder. The holder's estate includes the value of the property presently subject to the power under I.R.C. § 2041 because such power is considered a general power of appointment.

The lapse of a power of withdrawal of assets valued in excess of the greater of \$5,000 or 5 percent of the value of a trust (the "5 & 5" amount) may eventually cause all or a portion of the trust to be includable. Inclusion is triggered where I.R.C. §§ 2035 through 2038 would call for inclusion had the property subject to the power been owned by the holder and contributed to the trust.<sup>35</sup> Thus, inclusion under I.R.C. § 2036 is mandated where the holder has an enforceable right to income or principal of the trust or a limited testamentary power of appointment. Where the holder is only a discretionary income or principal beneficiary, the lapse will not cause inclusion under section 2036.

Where the holder's power of withdrawal is noncumulative, each year's lapse may cause adverse estate tax consequences where the value of the interest subject to the power exceeds the greater of \$5,000 or 5 percent of the trust.

Thus, the holder's gross estate will include a portion of the trust determined by a fraction, the numerator of which is the value of the property released, and the denominator of which is the value of the trust at the time of the release. The fractional interests determined each year are aggregated through the date of death, and the final fraction is used to determine the includable portion of the trust.

### III. GIFT TAX CONSIDERATIONS

#### (E) Gifts

A gift is made when an insured purchases a life insurance policy or pays a premium on an existing policy, the proceeds of which are payable to a beneficiary other than the donor's estate, and does not retain any interest that would make the gift incomplete.<sup>36</sup> Premium payments while the policy is held in the trust are also gifts to the trust's beneficiaries.<sup>37</sup>

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<sup>33</sup> I.R.S. Priv. Ltr. Rul. 81-34-135 (May 29, 1981); I.R.S. Priv. Ltr. Rul. 80-06-109 (Nov. 20, 1979).

<sup>34</sup> See Sample Life Insurance Trust, Article FIRST, in the appendix following this chapter; see also I.R.S. Priv. Ltr. Rul. 81-34-135 (May 28, 1981); I.R.S. Priv. Ltr. Rul. 80-06-109 (Nov. 20, 1979).

<sup>35</sup> I.R.C. § 2041(a)(2).

<sup>36</sup> Treas. Reg. § 25.2511-1(h)(8).

<sup>37</sup> Treas. Reg. § 25.2503-3(c), ex. 6.

## 1. Valuation

Gifts of life insurance are valued as follows:<sup>38</sup>

- The value of a paid-up whole life policy is the cost of a new replacement policy.
- The value of a whole life, not fully paid, policy is the interpolated terminal reserve value and the value of prepaid premiums less loans.<sup>39</sup>
- The value of a term policy is the amount of the unexpired portion of the last premium payment.
- The value of a group term policy is either the Table I cost<sup>40</sup> or the policy's actual cost (whichever valuation method the donor chooses) unless the group plan is discriminatory, in which event actual cost is its value.<sup>41</sup>

## 2. Annual Exclusion

The first \$13,000 of a present interest in property transferred to a donee during 2011 is excluded from gift tax.<sup>42</sup> The annual exclusion is available for outright transfers of insurance policies, but the availability of the exclusion for transfers to a trust is a function of the interests of the beneficiaries under the trust agreement. Generally, the beneficiary must have a present interest in the trust. A bare income interest in an unfunded life insurance trust is insufficient because (1) benefits will not begin until the insured dies and thus constitute a future interest, and (2) life insurance is non-income-producing.<sup>43</sup>

Additional interests in the beneficiary or the nature of the policy may entitle the donor to the exclusion. Such interests include

- transfer to a trust for the benefit of a minor, which trust meets the requirements of I.R.C. § 2503(c);
- transfer of a paid-up policy, the dividends of which are distributable to the income beneficiary, or transfer of a policy with a cash value that the beneficiary may borrow against; and
- possession by the beneficiary of a power of withdrawal.<sup>44</sup>

### (F) Crummey Powers

The *Crummey* demand right may generate adverse gift tax consequences for the power holder.

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<sup>38</sup> Treas. Reg. § 25.2512-6.

<sup>39</sup> *But see United States v. Ryerson*, 312 U.S. 260 (1941) (face amount of policy may be the more appropriate value where the insured is in poor health or is uninsurable).

<sup>40</sup> Treas. Reg. § 1.79-3(d)(2).

<sup>41</sup> Rev. Rul. 84-147, 1984-2 C.B. 201.

<sup>42</sup> I.R.C. § 2503(b); Rev. Proc. 2005-70, 2005-47 I.R.B. 984 (setting forth 2006 adjustments).

<sup>43</sup> Treas. Reg. § 25.2503-3(c), ex. 2; Rev. Rul. 69-344, 1969-1 C.B. 225.

<sup>44</sup> *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968).

The beneficiary must be given notice of his or her power,<sup>45</sup> the amount of the withdrawal right and a reasonable time within which to exercise it.<sup>46</sup> According to the IRS, a reasonable time is 30 days;<sup>47</sup> according to the U.S. Tax Court, it is 15 days.<sup>48</sup> A beneficiary's waiver of future notices may endanger future gift tax exclusions.<sup>49</sup>

The holder of the power must have more of an interest in the trust than a bare power to withdraw. In one case, the parents created a trust for each of their sons, who were the income beneficiaries and had powers to withdraw.<sup>50</sup> Powers were also granted to the sons' family members in order to increase the number of annual exclusions. The IRS ruled that the bare power to withdraw was insufficient to create a present interest in the trust.<sup>51</sup>

The Tax Court, however, rejected the IRS's argument that an annual exclusion is available only for *Crummey* power holders who also have a vested present or remainder interest in the trust. In *Estate of Cristofani v. Commissioner*,<sup>52</sup> the court held that the annual exclusion was available for grandchildren who were contingent remaindermen of the trust. The IRS still maintains that the *Crummey* power will be insufficient where the beneficiary has no contingent or other interest in the trust.<sup>53</sup> Even so, taxpayers continue to enjoy success. In *Estate of Kohlsaat v. Commissioner*,<sup>54</sup> a *Crummey* power in contingent beneficiaries was approved.

If an agreement or understanding among the beneficiary, trustees and donor of the trust limits the ability, in a legal sense, of the beneficiary to withdraw property from the trust, the beneficiary may not have received a gift of a present interest in the trust.<sup>55</sup> In *Estate of Trotter v. Commissioner*,<sup>56</sup> for example, the decedent transferred her condominium, in which she lived, into an irrevocable trust which named her grandchildren as beneficiaries with a right of withdrawal. The court held that, in light of the relationship between the decedent and the trust beneficiaries, an implied understanding existed that the withdrawal rights would not be exercised and that the annual exclusion was thus unavailable.<sup>57</sup>

Usually, a *Crummey* power is noncumulative and lapses within a period set forth in the governing instrument. The lapse of a *Crummey* power is considered a release of a general power of appointment.<sup>58</sup>

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<sup>45</sup> I.R.S. Priv. Ltr. Rul. 95-32-001 (Apr. 12, 1995); Rev. Rul. 81-7, 1981-1 C.B. 474.

<sup>46</sup> Rev. Rul. 81-7, 1981-1 C.B. 474.

<sup>47</sup> I.R.S. Priv. Ltr. Rul. 92-32-013 (May 4, 1992).

<sup>48</sup> *Estate of Cristofani v. Comm'r*, 97 T.C. 74 (1991), *acq. in result*, 1992-2 C.B. 1 & 1996-2 C.B. 1.

<sup>49</sup> See I.R.S. Tech. Adv. Mem. 95-32-001 (Aug. 12, 1995).

<sup>50</sup> I.R.S. Priv. Ltr. Rul. 87-27-003 (Mar. 16, 1987).

<sup>51</sup> See also I.R.S. Priv. Ltr. Rul. 90-45-002 (July 27, 1990).

<sup>52</sup> 97 T.C. 74.

<sup>53</sup> I.R.S. Tech. Adv. Mem. 96-28-004 (July 12, 1996); I.R.S. Tech. Adv. Mem. 97-31-004 (Aug. 1, 1997).

<sup>54</sup> 73 T.C.M. (CCH) 2732 (1997).

<sup>55</sup> *Estate of Holland v. Comm'r*, 73 T.C.M. (CCH) 3236 (1997); I.R.S. Tech. Adv. Mem. 2003-41-002 (Oct. 10, 2003).

<sup>56</sup> 82 T.C.M. (CCH) 633 (2001).

<sup>57</sup> *Id.*

<sup>58</sup> I.R.C. § 2514(e).

Where the value of the property subject to the lapse exceeds the greater of \$5,000 or 5 percent of the trust corpus (as noted, the “5 & 5 amount”), the holder of the power will have made a gift to other trust beneficiaries of the value in excess of the 5 & 5 amount.

Potential gift tax consequences can be avoided by limiting the right of withdrawal to the lesser of the annual exclusion or the greater of \$5,000 or 5 percent of the trust principal. Granting the holder a limited power of appointment also solves the problem, because any potential gift will be incomplete.<sup>59</sup>

#### (G) Hanging Powers

Where the value of the property subject in any year to the lapsed power likely will exceed \$5,000 or 5 percent of the principal of the trust, the instrument can provide that the power over the excess amount will not lapse but will continue in existence until it is exercised, or until it lapses if not exercised.

By allowing the excess amount to “hang” until a later year, the *Crummey* holder will have prevented a power in excess of the 5 & 5 rule from lapsing and thus will have avoided making a taxable transfer to the other trust beneficiaries. The operation of *Crummey* clauses with and without a hanging power is illustrated in the following examples.

### ***EXAMPLES***

#### ***Crummey Power—Nonhanging***

Assume a married donor splitting gifts, with two children, a term policy and withdrawal power formula limited to the least of the following:

- a pro rata share of the gift
- the annual exclusion
- the 5 & 5 ceiling amount

The maximum total premium contributable is \$10,000, which is derived from the following formula:

- pro rata share—\$5,000
- maximum annual exclusion—\$26,000
- 5 & 5 limitation—\$5,000 (\$5,000 or 5 percent of \$10,000 (\$500))

Each power holder (in this case, two) may withdraw up to \$5,000; thus, the maximum contributable amount on a term policy in a trust holding no other assets is \$5,000 per donee.

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<sup>59</sup> Treas. Reg. § 25.2511-2(c).

### ***Crummey Power—Hanging***

Assume a married donor splitting gifts, with three children, a whole life policy with a cash value of 50 percent of premiums paid, five years of annual premiums of \$66,000, withdrawal power limited to the lesser of the pro rata amount or the annual exclusion subject to hanging power. The maximum contributable amount will be the annual exclusion for the donor and his or her spouse. The chart below, Calculation of Hanging amount for Crummey Trust illustrates this calculation.

Until this hanging power has fully lapsed, the holder's estate will include the amount subject to the hanging power but will not include any other portion of the trust. The IRS, relying on *Commissioner v. Proctor*,<sup>60</sup> concluded that an improperly worded hanging power that creates an impermissible condition subsequent will be ignored for gift tax purposes.<sup>61</sup> The power holder in *Proctor* was deemed to have made a future gift to the other beneficiaries of the trust. However, a properly worded hanging power, which does not void the gift, should survive a challenge.

Where the holder possesses multiple powers under trusts created by the same grantor or where lapses occur successively in one year in a single trust for a single beneficiary, the lapses are aggregated to determine the gift to the trust's remaindermen. The value of the gift is the excess (over the 5 & 5 limitation) of the aggregated value of the property subject to the power, reduced by the actuarial value of the holder's income interests.<sup>62</sup>

#### **Calculation of Hanging Amount for *Crummey* Trust**

<b>Year</b>	<b>Annual Premium</b>	<b>Pro Rata Share</b>	<b>Trust Principal</b>	<b>Bene's Withdrawal Amount</b>	<b>Bene's Annual Lapse Amount</b>	<b>Hanging Amount</b>
1	\$66,000	\$22,000	\$33,000	\$22,000	\$5,000	\$17,000
2	66,000	22,000	66,000	39,000	5,000	34,000
3	66,000	22,000	99,000	56,000	5,000	51,000
4	66,000	22,000	132,000	73,000	6,600	66,400
5	66,000	22,000	165,000	88,400	8,250	80,150
6	-0-	-0-	165,000	80,150	8,250	71,900
7	-0-	-0-	165,000	71,900	8,250	63,650
8	-0-	-0-	165,000	63,650	8,250	55,400
9	-0-	-0-	165,000	55,400	8,250	47,150
10	-0-	-0-	165,000	47,150	8,250	38,900

<sup>60</sup> 142 F.2d 824 (4th Cir. 1944).

<sup>61</sup> I.R.S. Tech. Adv. Mem. 89-01-004 (Jan. 6, 1989).

<sup>62</sup> Rev. Rul. 85-88, 1985-2 C.B. 201.

Year	Annual Premium	Pro Rata Share	Trust Principal	Bene's Withdrawal Amount	Bene's Annual Lapse Amount	Hanging Amount
11	-0-	-0-	165,000	38,900	8,250	30,650
12	-0-	-0-	165,000	30,650	8,250	22,400
13	-0-	-0-	165,000	22,400	8,250	14,150
14	-0-	-0-	165,000	14,150	8,250	5,900
15	-0-	-0-	165,000	5,900	8,250	-0-

#### IV. INCOME TAXATION CONSIDERATIONS

A person other than the grantor shall be treated as the owner of a portion of a trust with respect to which “such person has a power exercisable solely by himself to vest the corpus or income therefrom in himself.”<sup>63</sup> Thus, during the period within which the holder may withdraw a fractional portion or fixed sum, the holder will be the owner and will be taxed a proportional share of all income items, prorated for the portion of the year the power is in existence.

A question arises, however, regarding how to treat for income tax purposes the holder of a lapsed power of withdrawal. A person other than the grantor may be considered the owner of the entire trust, or a portion of it, and thus have all or a portion of the trust’s income attributable to him or her.

A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: . . . such person has previously *partially released* or otherwise modified such a power and after the release or modification *retains* such *control* as would, within the principles of sections 671 to 677, inclusive, subject the grantor of a trust to treatment as the owner thereof.<sup>64</sup>

An analysis of the operative (*i.e.*, emphasized) words indicates that the holder of a noncumulative power could be treated as an owner. Unlike I.R.C. §§ 2041(b)(2) and 2514(e), I.R.C. § 678(a)(2) (and all other grantor trust sections) fails to include lapse of a power in the definition of release. In any event, a lapse of a noncumulative power is a complete release, not a partial release. But, if the section otherwise applies, it appears that the amount lapsing under a hanging power would be only a *partial* lapse. There is no modification of the power because, upon its lapse, it does not change but terminates. In a typical trust, the holder has a mere income interest and thus would not have any control for the purpose of the statute.

An exception to the application of section 678(a)(2) provides that the holder of a power over income will not be treated as an owner if the grantor is otherwise treated as an owner—that is, if the grantor has retained sufficient powers or interests.<sup>65</sup> The IRS appears to ignore the limitation to a power over income and frequently taxes the income to the grantor. Nevertheless, it has held that at the moment of lapse, the holder will be treated as the owner of that portion of the trust attributable to the power.<sup>66</sup> This

<sup>63</sup> I.R.C. § 678(a)(1).

<sup>64</sup> I.R.C. § 678(a)(2) (emphasis added).

<sup>65</sup> I.R.C. § 678(b).

<sup>66</sup> I.R.S. Priv. Ltr. Rul. 81-42-061 (July 21, 1981).

ruling, however, ignores the question of the lapse being a partial release and does not apply any 5 & 5 limitation.<sup>67</sup>

An alternative argument in favor of making the holder an owner looks to the economics of the lapse. A lapse is the economic equivalent of withdrawing the property and then contributing it, making the holder a grantor for purposes of I.R.C. §§ 673 through 677. However, no case or ruling has supported the argument, and section 678 appears to be the exclusive means of determining the issue.

## V. GENERATION-SKIPPING TRANSFER TAX CONSIDERATIONS

A nontaxable gift in trust will be subject to the generation-skipping transfer (GST) tax unless (1) no portion of the principal and income of the gift may be distributed to any other person and (2) the assets will be included in the gross estate of the beneficiary if the beneficiary dies before termination of the trust.<sup>68</sup>

The typical insurance trust does not qualify under these provisions because, during the life of the insured, no individual has a separate share of the trust, and such undivided interest is not taxable if a beneficiary dies before the insured. Application of the rule would subject trust property distributed to grandchildren of the insured to the GST tax.

The rule should not adversely affect those donors who wish only to avoid estate and gift taxation for themselves and their spouses and to pass the proceeds to children. Thus, an insurance trust that terminates on the death of a surviving spouse and is distributed to children or to a trust for their benefit, which in turn terminates during their lives or upon their deaths and is subject to a general power of appointment, will not be subject to the GST tax. Such a trust should be combined with an equalizing legacy in the insured's will to the issue of a deceased child, which will not be subject to the GST tax by reason of the predeceased child rule under I.R.C. § 2612(c)(2).

The rule can be satisfied by the use of a separate trust for each grandchild, which grants each a *Crummey* power and an interest in the trust subject to estate taxation (i.e., a general power of appointment or a remainder interest in the grandchild's estate).

The donor may also allocate a portion of his or her \$5 million GST tax exemption to the trust. In such event, the trust should continue for the maximum period permitted by the rule against perpetuities.

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<sup>67</sup> See also I.R.S. Priv. Ltr. Rul. 85-21-060 (Feb. 26, 1985).

<sup>68</sup> I.R.C. § 2642(c). The Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of U.S.C. tit. 26), provided that the GST tax did not apply to any transfer if the amount transferred was less than the then-annual exclusion of \$10,000. I.R.C. § 2642(c). Thus, insurance planning with *Crummey* powers was attractive; with careful planning, the initial gift tax and subsequent estate tax could be avoided on a trust in existence for multiple generations, and further, no GST tax would ever be payable. However, under the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"), Pub. L. No. 100-647, 102 Stat. 3342 (codified as amended in scattered sections of U.S.C. tit. 26), I.R.C. § 2642(c) was radically changed, which severely limited opportunities to avoid the GST tax.

**APPENDIX**

**Sample Irrevocable Unfunded Life Insurance Trust**

**THE 201\_ LIFE INSURANCE TRUST**

THIS INDENTURE, made the \_\_\_\_\_ day of \_\_\_\_\_, 201\_\_\_\_, between \_\_\_\_\_, of \_\_\_\_\_, (hereinafter referred to as the Donor) and \_\_\_\_\_, of \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_, of \_\_\_\_\_, (hereinafter referred to as the “Trustees”);

**W I T N E S S E T H:**

The Donor hereby transfers and delivers unto the Trustees the property described in Schedule A, attached hereto, the receipt of which is hereby acknowledged by the Trustees. [The Donor has caused or may cause to be assigned to the Trustees the Donor’s entire interest in certain insurance policies on the Donor’s life, and has caused or may cause the Trustees to be named as the beneficiary to receive the proceeds of such policies and of certain pension or other benefit plans in which the Donor participates;]

TO HAVE AND TO HOLD such property unto the Trustees, their successors and assigns, in trust, nevertheless, as follows:

FIRST: During the life of the Donor, the Trustees shall manage, invest and reinvest the trust estate and collect the income thereof and shall distribute so much of the net income and principal as the Trustee or Trustees other than a beneficiary hereunder (hereinafter referred to as the “Disinterested Trustee”) in said Trustee’s absolute discretion from time to time may determine to and among such of the Donor’s spouse and the Donor’s issue living from time to time, in such proportions as said Trustee may determine, and shall accumulate the balance of the net income. In reaching any determination as to the advisability of making any such discretionary distribution of income or principal of the trust, the Disinterested Trustee shall have no duty to inquire into or to consider any other income or resources of any beneficiary (or, if he or she shall be a minor, of his or her parent or parents), and may exclude any



one or more of the beneficiaries from any such distributions and make distributions in equal or unequal proportions.

During the life of the Donor, the Trustees are authorized, in their discretion, at any time to terminate the trust and thereupon to pay over and distribute the principal thereof, and any income then accrued or held, to and among such of the then living income beneficiaries of the trust in such amounts and proportions as the Disinterested Trustee shall determine.

The Trustees are authorized to invest any or all of the trust assets, whether received from the Donor or from others, in life insurance policies upon the life of the Donor and to apply trust income or principal to the payment of premiums on such policies. The Trustees also are authorized to join with others in holding any such policy, or part thereof, under a split dollar agreement, whereby the Trustees own certain portions of the life insurance policy and the other owner or owners, in return for payment of an appropriate premium or share of the total premium, also own a portion of the life insurance policy. Notwithstanding such authorization, the Trustees shall have no obligation to pay any premiums, assessments or other charges necessary to keep any insurance policies in force, shall have no obligation to ascertain whether the same have been paid or to notify the Donor or any beneficiary hereunder of the non-payment of premiums and shall have no responsibility or liability of any kind in case such premiums are not paid. If the Donor's status as a group member shall terminate for any reason other than the Donor's death, the Trustees shall have the right to convert any group insurance policies into individual insurance policies on the life of the Donor, and thereafter to hold any such policies, together with any dividends received on such policies. The Trustees may borrow against any insurance policies held in the trust and apply such borrowed amounts for the education of the Donor's children, or for such other purposes as the Disinterested Trustee in said Trustee's discretion may determine. The Trustees also may invest trust assets in other property.

If in any year a contribution is made to the trust estate by any person, the Trustees shall notify promptly such of the Donor's spouse and the Donor's then living descendants as the Donor shall select of such contribution, or, if any descendant of the Donor shall then be a minor, his or her

representative for the receipt of such notice under the provisions of Paragraph (6) of Article TENTH hereof, and each of the Donor's spouse and descendants so selected, or such representative acting on behalf of any such descendant during his or her minority, shall have the right at any time within two months of receipt of such notice to withdraw from the trust estate an amount determined as follows:

(1) The Donor's spouse if so selected shall have the prior right to withdraw an amount not in excess of the lesser of: (i) the amount of such contribution and (ii) the sum of Five thousand Dollars or such larger amount that shall not exceed the maximum annual amount with respect to which a power of appointment may lapse and not be considered a release of such power for United States Federal gift tax purposes under Section 2514 of the Internal Revenue Code of 1986, as amended ("the Code");

(2) Each of the Donor's descendants so selected, or his or her representative, shall have the right to withdraw an amount not in excess of the lesser of (i) the beneficiary's pro rata share of the amount of such contribution after reduction by the amount subject to withdrawal by the Donor's spouse under paragraph (1) and (ii) the annual exclusion available to the contributor (and his or her spouse as if such spouse shall have consented to being deemed to have made one-half of such contribution) for United States Federal gift tax purposes with respect to the beneficiary's pro rata share of such contribution, after reduction by the amount subject to withdrawal by the Donor's spouse under paragraph (1), and after taking into account any other gifts made by the contributor (and his or her spouse, if applicable) to the beneficiary in that year. For this purpose, a beneficiary's pro rata share of a contribution shall be a fraction of which the numerator shall be one and the denominator shall be the number of persons other than the Donor's spouse receiving notice (or on behalf of whom notice is received by a representative under Paragraph (6) of Article TENTH hereof) of the contribution. If a beneficiary's power of withdrawal is limited by clause (ii) above, then the excess of the amount determined under clause (i) over the amount determined under clause (ii) as to such beneficiary shall be treated as an additional transfer to the trust except that such beneficiary shall be excluded as a withdrawal power holder for purposes of applying clauses (i) and (ii) to such additional transfer.

In satisfaction of such right of withdrawal, the Trustees may distribute to a beneficiary any asset held in the trust estate (including any insurance policies or any interests in such policies), valued as of the date of withdrawal. Such right of withdrawal shall not be cumulative with respect to any prior contributions made to the trust and, if such right of withdrawal is not exercised within such two-month period, it shall lapse, provided that the amount with respect to which the right of withdrawal shall lapse for any beneficiary in any year shall not exceed the maximum annual amount with respect to which a power of appointment may lapse and not be considered a release of such power for United States Federal gift tax purposes under Section 2514 of the Code, as in effect for that year taking into account any excess withdrawal rights carried over from previous years (hereinafter referred to as the “maximum lapse amount”). If any beneficiary has a right of withdrawal in any year which shall exceed the maximum lapse amount, the power for that beneficiary for that year shall lapse only to the extent of the maximum lapse amount, and any excess withdrawal right shall continue to be exercisable by the beneficiary, but shall lapse in the next succeeding year or years to the extent of the maximum lapse amount for such year, on the second day of such year. The right of withdrawal hereunder shall be exercised by written notice delivered to the Trustees.

SECOND: Upon the death of the Donor, the Trustees shall collect, as principal of the trust estate, the net proceeds of any insurance policies then included in the trust estate, or of any pension or benefit plans payable to the Trustees as beneficiary, after deduction of all charges against such policies or benefits by way of advances, loans, premiums or otherwise. The Trustees may use any part of the income or principal of the trust estate to meet expenses incurred in collecting any such proceeds or benefits. If, however, the Trustees in their discretion shall determine that the income and principal on hand in the trust estate may not be sufficient to meet any expenses and obligations to which they may be subjected in any litigation to enforce payment of any insurance policy, benefits or proceeds then included in the trust estate, then the Trustees shall not be required to enter into or maintain any litigation to enforce payment of any such policy until they shall have been indemnified to their satisfaction against all such expenses and obligations. The Trustees are authorized to compromise and adjust claims arising out of

any such policies, upon such terms and conditions as they may deem advisable, and the decision of the Trustees in this respect shall be binding and conclusive upon all persons then or thereafter interested in the trust estate.

THIRD: (A) If any assets held in the trust estate shall be included in the Donor's estate for Federal estate tax purposes, and if the Donor's spouse shall survive the Donor, then from and after the Donor's death, subject to the provisions of Article SECOND hereof, the Trustees shall hold, manage, invest and reinvest the assets of the trust estate so included in the Donor's gross estate for Federal estate tax purposes upon a separate trust, shall collect the income thereof and shall pay the net income to the Donor's spouse, annually or at more frequent intervals, for the life of the Donor's spouse. Upon the death of the Donor's spouse, the Trustee shall dispose of the principal of the trust, as then constituted, as provided in Part (B) of this Article.

The Disinterested Trustee is authorized to pay over and distribute to the Donor's spouse (or apply for such spouse's benefit) from time to time all or any part of the principal of the trust held during such spouse's lifetime under this Part (A). Such distributions may be made for any purpose whatsoever, including for the sole purpose of terminating the trust, and the determination of the Disinterested Trustee with respect to any distribution of principal shall be final and binding upon all persons then or thereafter interested in the trust.

The Donor's Executor is hereby authorized to elect to treat all or any part of the transfer made under this Part (A) as a qualified terminable interest under Section 2056(b)(7) of the Code, or similar provision of state law, and to claim a marital deduction with respect thereto for Federal and state estate tax purposes. Such election shall be binding upon the Trustees hereunder. If the Donor's Executor shall make a partial election, the Trustees thereafter shall segregate upon their books the property with respect to which the election was made. The Donor recognizes that in exercising the discretion granted hereby, the Donor's Executor may affect the amount of estate taxes payable by the Donor's estate and the estate of the Donor's surviving spouse, and otherwise materially may affect the interests of the beneficiaries hereunder. The Donor's Executor is nevertheless granted the broadest authority to exercise

the power granted hereby as such Executor shall deem best, and the determination of such Executor shall be final and binding upon all persons at any time interested in the trust estate. If the Donor's Executor has made a partial election and the Trustees are holding trust assets in two segregated accounts, any principal distributions for the benefit of the Donor's spouse shall be made solely from the account with respect to which a Section 2056(b)(7) election has been made, until that account has been exhausted.

(B) From and after the date of the Donor's death, subject to the provisions of Article SECOND hereof, the Trustees shall hold upon a separate trust under the terms of this Part (B) all assets of the trust estate except those held under Part (A) of this Article, together with any amounts received by the Trustees under a Will or other instrument of the Donor or any other person directed to be held under this Part (B). The Trustees shall manage, invest and reinvest the same and collect the income thereof, and, until termination of the trust as hereinafter provided, shall distribute so much of the net income as the Trustees from time to time may determine to and among such of the Donor's spouse and the Donor's issue living from time to time (hereinafter referred to as "the income beneficiaries"), as the Disinterested Trustee from time to time may determine, in such proportions as said Trustee may determine, and shall accumulate and add to the principal of the trust any net income not so distributed within sixty-five days after the end of the trust year in which it was collected.

During the continuance of the trust, the Trustees are authorized from time to time to pay to any one or more of the income beneficiaries (or to set apart hereunder in a separate trust solely for the benefit of an income beneficiary hereunder upon the terms of Part (C) of this Article) such amounts from the principal of the trust (including the whole thereof) as the Disinterested Trustee in said Trustee's discretion may deem advisable for any reason or purpose whatsoever. In reaching any determination as to the advisability of making any such discretionary distribution of income or principal of the trust, said Trustee shall have no duty to inquire into or to consider any other income or resources of any income beneficiary (or, if he or she shall be a minor, of his or her parent or parents), and said Trustee may exclude any one or more of the income beneficiaries from any such income or principal distribution and make distributions in equal or unequal proportions. The determination of said Trustee as to the

advisability of making or refraining from making any such discretionary distribution of income or principal shall be final and binding upon all persons then or thereafter interested in the trust estate.

The Trustees are authorized, in their discretion, at any time to terminate the trust and thereupon to pay over and distribute the principal thereof, and any income then accrued or held, to and among such of the then living income beneficiaries of the trust, in such amounts and proportions as the Disinterested Trustee in said Trustee's discretion shall determine.

In lieu of making any distribution of income or principal to any income beneficiary as above provided, the Disinterested Trustee may apply the same for such beneficiary's support, maintenance, education or other benefit or, in the case of a minor, may set the same apart for distribution, to be administered as provided in Article FIFTH hereof.

Upon the death of the Donor's spouse, the Trustee shall pay over and distribute the principal of this trust and of the trust under Part (A) of this Article, as then constituted (or, if the Donor's spouse shall not survive the Donor, upon the Donor's death the Trustee shall pay over and distribute the entire principal of the trust estate which the Trustee shall collect), and any income then accrued or held, to the Donor's issue then living, per stirpes.

(C) Whenever the Trustees in their discretion shall determine to hold a share of the trust estate hereunder in a separate trust under this Part (C) or shall receive under a Will or other instrument of the Donor or any other person any property to be held, administered and disposed of in trust for a descendant of the Donor who shall not then have reached the age of [thirty] years, and notwithstanding any provision in this Indenture to the contrary, if any share shall be distributable to a descendant of the Donor who shall not then have reached the age of [thirty] years, such share, amount or property shall be held by the Trustees. The Trustees shall hold such share, amount or property upon a separate trust for such descendant (each descendant being hereinafter referred to as the "beneficiary" of his or her trust). The Trustees shall manage, invest and reinvest the same and collect the income thereof, shall apply so much of the net income as the Disinterested Trustee from time to time may deem necessary or desirable for the support, maintenance, education or other benefit of the beneficiary, and shall accumulate any

balance of said net income and add it to the principal of the trust until such beneficiary shall have reached the age of [twenty-five] years or sooner died. After a beneficiary shall reach the age of [twenty-five years or sooner graduate from college], the Trustees shall distribute to such beneficiary the net income of his or her trust, annually or at more frequent intervals.

The Trustees are authorized to pay to or apply for the benefit of a beneficiary such amounts from the principal of his or her trust (including the whole thereof) as the Disinterested Trustee shall deem advisable for any reason (including solely for the purpose of terminating the trust), irrespective of any other resources of such beneficiary or of his or her parent or parents. The determination of said Trustee with respect to income and principal distributions to a beneficiary shall be final and binding upon all persons then or thereafter interested in the trust. Without in any way limiting the discretion of said Trustee, it is the Donor's wish that principal distributions be made to a beneficiary only for important and well-considered purposes which the beneficiary shall set before the Trustees, such as, for example, the purchase of a first home or investment in a business.

When and if a beneficiary shall reach the age of [thirty] years, the Trustees shall pay over and distribute to such beneficiary, absolutely, the principal of the trust held for him or her, as then constituted.

[Insert the following paragraph when there are multiple principal distributions.]

[If any beneficiary shall have reached an age herein specified as the occasion for distribution or distributions of principal to him or her on the date a share of property shall become distributable to a trust for his or her benefit, such distribution or distributions shall be made forthwith to such descendant by the Trustees.]

If a beneficiary shall die before reaching the age of [thirty] years, the Trustees shall pay over and distribute the principal of such beneficiary's trust, as constituted at his or her death, and any income then accrued or held, to the then living issue of such beneficiary, per stirpes, or, if no such issue shall then be living, to the then living issue of the descendant of the Donor who was the parent of the beneficiary, per stirpes, or, if no such issue shall then be living, to the child of the Donor who was the

parent of the beneficiary or, if such child shall not then be living, to the then living issue of the Donor, per stirpes.

(D) Notwithstanding anything herein to the contrary, in exercising any power of distribution of income or principal hereunder, in lieu of distribution outright to a beneficiary hereof, the Trustees are authorized to distribute such income or principal for the benefit of the person who shall be a beneficiary of such trust assets, on such further or other trusts and with further or other dispositive, discretionary and administrative powers, including discretionary trusts and powers of appointment, advancement and accumulation and other powers of management or administration exercisable by the Trustees or separate or other trustees or other persons, whether such further or other trusts shall be governed by instruments created by the Trustees or otherwise existing, all without Court approval; provided, however, that any distribution made from a trust created under Part (A) of this Article shall only be made on such further or other trusts with the same dispositive or discretionary powers as those conferred under said Part, and provided, further, that every distribution shall be made and all interests so distributed shall vest in interest upon the expiration of the period described in Part (E) of this Article;

(E) Unless sooner terminated under the foregoing provisions of this Article, each trust created hereunder shall terminate upon the expiration of twenty-one years following the death of the last to die of all of the descendants of either of the Donor's parents and of either of the Donor's spouse's parents who shall be living at the date of this Indenture, and thereupon the Trustees shall pay over and distribute the principal of such trust, as then constituted, and any income then accrued or held, to the income beneficiary of such trust.

FOURTH: If any person whose life measures the duration of a trust hereunder and any remainderman of such trust shall die under such circumstances that there is reasonable doubt as to who died first, then such person whose life measures the duration of such trust shall be deemed conclusively to have survived such remainderman for the purposes of all provisions of this Indenture.

Any distribution required to be made per stirpes in this Indenture to the descendants of any person shall require division of such assets into as many equal shares as there are living children of



that person, if any, and deceased children of that person who leave issue then living (even if all of such children are then deceased). Each living child shall be allocated one share, and the share of each deceased child who leaves issue then living shall be divided in the same manner.

FIFTH: If any principal or income of any trust hereunder shall become payable to or be set apart to be distributed to a minor, the Trustees are authorized in their discretion to pay over such principal or income at any time to the guardian of the property of such minor, appointed in any jurisdiction, or to a custodian then acting or appointed by the Trustees for such minor (including one of the Trustees) under the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act of any state or any similar state law, or to retain such principal and income for such minor during minority. In paying over any principal or income to a custodian, the Trustees may direct that the custodianship shall continue until the minor reaches the age of twenty-one, rather than eighteen. In case of such retention, the Trustees may apply such principal or income, and income therefrom, to the support, maintenance, education or other benefit of such minor, irrespective of any other resources of such minor or of his or her parent or parents. Any such application may be made either directly or by payments to such guardian of the property or parent of such minor or to the person with whom such minor may reside, in any case without requiring any bond, and the receipt of any such person shall be a complete discharge to the Trustees, who shall not be bound to see to the further application of any such payment. Any such principal or income so retained, and any income therefrom, which is not applied under the provisions of this Article, shall be paid over to such minor upon reaching the age of majority or, if he or she shall sooner die, to his or her estate. In holding any principal or income for any minor, the Trustees shall have all the powers and discretion hereinafter conferred.

The retention of any funds under this Article shall not preclude the Trustees from receiving any commissions to which they would have been entitled had such funds been distributed. The Trustees also shall be entitled, for services in respect of each fund retained under the provisions of this Article, to the same commissions to which testamentary trustees would be entitled from time to time

under the laws of the State of \_\_\_\_\_, as though each such fund were a separate trust fund, such commissions to be payable without judicial authorization.

SIXTH: (A) Without limitation of the powers conferred by statute or general rules of law, the Trustees are specifically authorized and empowered with respect to any property held hereunder:

- (1) To retain any property transferred to any trust hereunder for so long and upon such terms as the Trustees in their discretion shall deem it advisable to do so;
- (2) To invest any funds in any stocks, bonds or other securities or property, real or personal, including any insurance policies on the life of the Donor (and including without limitation the power to invest in oil, gas and mineral interests or in any partnership of any kind or description, to write or buy put and call options, whether or not covered, to buy securities on margin, to sell securities short and to enter into futures transactions in any commodities), and to join with others in such form of ownership of such property (including without limitation in the case of a life insurance policy, to enter into split dollar agreements) as they shall determine, notwithstanding that such investments may not be of the character allowed to trustees by statute or general rules of law, and without any duty to diversify investments, the intention hereof being to confer the broadest investment powers and discretion upon the Trustees;
- (3) To sell (at public or private sale, without application to any court) or otherwise dispose of any property, whether real or personal, for cash or on credit, in such manner and on such terms and conditions as they may deem best, and no person dealing with the Trustees shall be bound to see to the application of any moneys paid;
- (4) To manage, operate, repair, improve, mortgage and lease for any period any real estate forming a part of the trust estate (whether expiring before or after the termination of any trust hereunder);
- (5) To lend any funds or property held in the trust estate to, and borrow such amounts from, such persons (including the Trustees or any beneficiary of any trust hereunder) and for such purposes as they may deem advisable, and to pledge any assets of any trust hereunder to secure the repayment of any amounts so borrowed all upon such terms and conditions as they may deem advisable;
- (6) To maintain margin accounts with one or more individuals, partnerships, associations, banks or other corporations (including without limitation [ ] or any affiliate of said firm) on such terms and conditions as they in their discretion shall determine, and to conduct such transactions in such accounts as they shall so determine, and to pledge all or any portion of any trust hereunder as security for the payment of the respective debit balances in such accounts;
- (7) To engage in any arbitrage transactions;
- (8) To determine in their discretion whether any premium on any investment acquired at a premium shall be amortized from income;
- (9) To cause any securities to be registered in the names of their nominees, or to hold any securities in such condition that they will pass by delivery;
- (10) To employ such attorneys, accountants, custodians, investment counsel (including without limitation [ ] or any affiliate of such firm), real estate consultants and other persons as they may deem advisable in the administration of any trust hereunder, and to confer on them such authority and to pay them such compensation as the Trustees may deem proper, notwithstanding that one or more of the Trustees may be a member of, or otherwise connected with, such person or firm, and without any

diminution of, or offset against, the commissions to which the Trustees may be entitled by law;

(11) To use any securities or brokerage firm (including without limitation [ ] or any affiliate of such firm) in the purchase or sale of stocks, bonds or other securities or property for the account of any trust hereunder and to pay such firm such compensation as the Trustees may deem proper, notwithstanding that one or more of the Trustees may be a member of, or otherwise connected with, such firm, and without any diminution of, or offset against, the commissions to which the Trustees may be entitled by law;

(12) To distribute any income or principal of any trust hereunder in cash or in kind and, if in kind, in a fashion other than pro rata, having regard in such event to the characteristics, including tax characteristics, of the property being distributed and to the income, needs and tax status of the recipient;

(13) To delegate investment and management functions as prudent under the circumstances. In delegating such investment functions, the Trustees shall exercise reasonable care, skill and caution in selecting an agent, establishing the scope and terms of the delegation consistent with the purposes of the terms of the trust, and periodically reviewing the agent's overall performance and compliance with the terms of the delegation. In performing a delegated function, an agent has a duty to exercise reasonable care to comply with the terms of the delegation. If the Trustees comply with the requirements of this subparagraph, they shall not be liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated;

(14) To divide any trust hereunder at any time into two or more equal or unequal separate trusts for any reason, including but not limited to assuring that the generation-skipping transfer tax inclusion ratio for each such trust shall be either zero or one; provided, however, that such trust shall be severed on a fractional basis. Such division may be made on a non-pro rata basis, provided funding is based on either the fair market value of the assets on the date of the funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the date of the creation of such trust to the date of division; and

(15) In general, to exercise any and all rights and powers in the management of the trust estate which any individual could exercise in the management of property owned in his or her own right, upon such terms and conditions as the Trustees may deem best, and to execute and deliver all instruments and to do all acts which they may deem necessary or advisable to carry out the purposes of this Indenture.

(B) At any time when there shall be more than one Trustee serving hereunder, the signature of one Trustee shall be sufficient to bind the trust upon all undertakings to third parties in all administrative matters or in any other matter upon which the Trustees agree between themselves.

(C) Notwithstanding any provision in this Indenture to the contrary, no Trustee who is also a beneficiary of any trust hereunder shall participate in any decision regarding distributions of

income or principal of such trust to himself or herself, nor shall such Trustee participate in any decision regarding distributions of income or principal of such trust to any other beneficiary of such trust, other than for such beneficiary's health, education, maintenance or support. No Trustee who shall have a legal obligation to support an income beneficiary of any trust hereunder shall participate as a Trustee in any decision with respect to making income or principal distributions that would satisfy such obligation.

SEVENTH: All sums received by the Trustees and representing interest accrued or dividends declared but unpaid on securities at the time of the delivery thereof to the Trustees shall be considered by the Trustees as income and disposed of accordingly.

All liquidating distributions received by the Trustees shall be disposed of in accordance with the law from time to time in effect. All stock dividends and other distributions payable in shares of the distributing corporation or association, all stock dividends and other distributions by a corporation or association payable in shares of any other corporation or association, provided that the same shall be treated as a non-taxable distribution or as a capital gains distribution to the recipient for United States Federal income tax purposes, and all rights to subscribe to securities either of the issuing corporation or association or of any other corporation or association shall be solely principal. Distributions made by a regulated investment company from ordinary income shall be solely income, and all other distributions made by such a company shall be solely principal. All other distributions shall be treated solely as income.

EIGHTH: Any trust estate held hereunder may be increased from time to time by the addition of such property as may be added to it by the Donor or by any other person with the consent of the Trustees.

NINTH: The Trustee is empowered to pay any taxes which may become payable from time to time with respect to any trust hereunder, or any transfer thereof or transaction affecting the same, under the laws of any jurisdiction which the Trustee is advised validly may tax the same. The Trustee shall not reimburse the Donor from trust income or principal for the amount of any gift taxes which may be payable by the Donor by reason of this transfer or for the amount of any income taxes, of any trust

hereunder which may be payable by the Donor by operation of law upon any income (including capital gains).

The Trustees are authorized in the Trustees' discretion to pay out of the principal of the trust estate all estate, inheritance and similar taxes, including any interest and penalties thereon, which may be imposed upon the death of the Donor's spouse by the United States of America or any state or subdivision thereof (and, in the Trustees' discretion, any such taxes imposed by any foreign jurisdiction) with respect to the Donor's spouse's estate, including not only the trust estate, but also any other property or interest of any character taxable in the Donor's spouse's estate. The determination of the Trustees as to the amount of such taxes shall be final and binding upon all persons then or thereafter interested in the trust estate. The Trustees shall be under no duty to take part in the proceedings to determine any such tax, and may rely upon the certificate of the executor or administrator of the estate of the Donor's spouse as to the amount of any such tax, as returned, tentatively assessed or ultimately determined.

The Trustees are further empowered to pay any other taxes which may become payable from time to time with respect to the trust estate or any transfer thereof or transaction affecting the same under the laws of any jurisdiction which the Trustees are advised may validly tax the same.

TENTH: (1) The Donor during the Donor's lifetime and thereafter any individual Trustee acting as such hereunder from time to time is hereby empowered, by written instrument, duly executed and acknowledged, to designate an individual (other than the Donor) or a bank or trust company to act as a co-Trustee or successor Trustee hereunder, upon such conditions as such instrument shall specify [if there shall be no successor or co-Trustee named herein or appointed as provided herein who shall be willing and able to qualify]. Any such appointment so made may be revoked by the maker thereof, by written instrument, duly executed and acknowledged, at any time prior to the happening of the event upon which it is to become effective, and a new appointment may be made as above provided. Upon the happening of the event upon which such appointment is to take effect and upon qualifying as hereinafter provided, any co-Trustee or successor Trustee so appointed shall become a Trustee hereunder as though originally named herein.

(2) Any Trustee acting hereunder may resign and be discharged from any trust hereunder by giving, personally or by mail, written notice of resignation, duly acknowledged, to the Donor or, if the Donor shall not then be living, to the Donor's spouse or, if such spouse shall not then be living, to the income beneficiary or beneficiaries of such trust (or if any income beneficiary shall be a minor, to the representative serving under the provisions of Paragraph (6) of this Article). Such notice shall specify the date when such resignation shall take effect, which date shall be at least thirty days after the service or mailing thereof.

(3) If at any time the Donor's spouse shall be acting as sole Trustee without having designated a co-Trustee as hereinabove provided, or if at any time there shall be no Trustee acting hereunder and no successor shall have been designated as hereinabove provided who shall then be willing and able to qualify, such individual other than the Donor or any trust beneficiary (who may be one of its own partners) or bank or trust company as shall be designated by the firm of [ ] of New York, New York (or any firm successor thereto), is hereby appointed as a co-Trustee or as successor Trustee. Upon qualifying as hereinafter provided, the co-Trustee or successor so designated shall become a Trustee hereunder as though originally named herein.

(4) In case any Trustee acting as such hereunder for any reason shall cease to act, the retiring Trustee or his or her personal representative upon the effective date of his or her resignation or upon his or her death shall turn over the trust estate or any portion of it under his or her control to the Trustee who thereafter shall be acting hereunder, and shall execute and deliver all instruments which may be deemed necessary more effectively to vest title in such Trustee.

(5) Any co-Trustee or successor Trustee named herein or designated as above provided and then entitled to act hereunder shall qualify by delivering or mailing written acceptance of such trust, duly acknowledged, to the Donor, any other Trustee then acting hereunder and to the income beneficiary or beneficiaries, or if any shall be a minor, to his or her parent, to the adult with whom he or she shall reside, or to the representative serving under the provisions of Paragraph (6) of this Article.

(6) The Donor's [ ], [ ], shall serve as the representative of the Donor's minor descendants for purposes of receiving notices, and taking (or electing not to take) action on behalf of such descendants during their minority for all purposes of this Indenture. The representative at any time may resign as such representative by delivering written notice of his or her resignation to the Trustees in which case he or she shall be succeeded as representative by [ ]. If at any time there shall be no person acting as a representative for minor descendants hereunder and no successor shall be named herein who is willing and able to qualify, he or she shall be succeeded by such individual as shall be designated by the Trustees. A successor representative shall accept his or her appointment by written acceptance delivered to the Trustees.

(7) Notwithstanding anything herein to the contrary, but subject to Article \_\_\_\_ [*the article that permits the Trustees to change the governing law and forum of administration of the trust to a foreign jurisdiction*], during the period in which any beneficiary of the trust hereunder shall be a U.S. Person (as defined in Section 7701(a)(30) of the Internal Revenue Code of 1986, as amended (the "Code")) and any regulations validly promulgated thereunder, (i) all Substantial Decisions (as defined in Section 7701(a)(30)(E)(ii) of the Code and any regulations validly promulgated thereunder) of the trust shall be made exclusively by the U.S. Persons then acting as Trustee [or Protector, if any shall then be serving,] of the trust hereunder, (ii) no Substantial Decision of the trust shall require the consent, or be subject to the veto, of any person who is not a U.S. Person, and (iii) any power, fiduciary or otherwise, held by a person who is not a U.S. Person shall be effective only to the extent such power is not the power to make a Substantial Decision.

(8) Except as otherwise expressly provided herein, all estates, powers, trusts, duties and discretion herein created or conferred upon the Trustees shall extend to any Trustee who at any time may be acting hereunder, whether or not named herein. No bond or other security shall be required of any Trustee hereunder in any jurisdiction.

ELEVENTH: Any Trustee at any time acting hereunder at any time may render an account of his or her proceedings to the income beneficiary or beneficiaries of any trust during the



accounting period (or, if any such person shall have died during or after the accounting period, to his or her personal representative and to any person or persons to whom any principal of the trust estate is to be paid over and distributed). If any person to whom an account would be so rendered shall be a minor, such account instead may be rendered to either of such minor's parents or the guardian of his or her property appointed in any jurisdiction or the representative for such minor then serving under the provisions of Paragraph (6) of Article TENTH hereof, other than an accounting Trustee. If approved in writing by the parties to whom such account shall have been rendered as above provided, such account shall be final, binding and conclusive upon all persons who then or thereafter may have any interest in the trust estate. The Trustees also at any time may render a judicial account of their proceedings.

In any accounting or other proceeding in which all persons interested in any trust hereunder are required by law to be served with process, if a party to the proceeding who is not under a disability has the same or a similar interest as a person under a disability, it shall not be necessary to serve process upon the person under a disability, it being the Donor's intention to avoid the appointment of a guardian ad litem whenever possible.

No beneficiary hereunder shall be authorized to anticipate, alienate (other than by disclaimer), assign, hypothecate or otherwise dispose of or encumber any part of his or her interest in the income or principal of any trust hereunder, whether or not any such act may be authorized, in whole or in part by any statute or other rule of law whether now or hereafter in force. Any such attempted act on the part of any beneficiary shall be void. No interest of any beneficiary hereunder shall be subject, while in the hands of the Trustees, to legal process on behalf of, or to the claims of the creditors of any such beneficiary.

TWELFTH: During the life of the Donor, the Trustees shall not be entitled to any commissions or other compensation for their services as Trustees, except as may be paid to them under separate written agreement with the Donor. Following the death of the Donor, the Trustees shall be entitled for services hereunder to the same commissions to which testamentary trustees would be entitled

from time to time under the laws of the State of \_\_\_\_\_, to be payable without judicial authorization

THIRTEENTH: The property constituting the principal of the trust estate is situated in the State of \_\_\_\_\_ and has been accepted by the Trustee in the State of \_\_\_\_\_, and all questions pertaining to the construction, validity and effect of the trust shall be determined in accordance with the laws of the State of \_\_\_\_\_.

Any Trustee acting hereunder, if it seems expedient in the administration of the trust, may remove any or all of the property constituting the trust estate from the State of \_\_\_\_\_ to any other jurisdiction.

If at any time the Trustee for the time being hereunder is domiciled in a jurisdiction (other than the State of \_\_\_\_\_) under the laws of which the trust would be valid, then the Trustee may determine that thereafter the construction and effect of this Indenture for any or all purposes shall be subject to the laws of such other jurisdiction. Such determination shall be evidenced by a written instrument duly acknowledged by the Trustee and delivered to the Donor or, if the Donor is not then living, to the person or persons to whom an account would be rendered under Article ELEVENTH hereof.

FOURTEENTH: This Indenture and the trusts created hereunder shall be irrevocable and shall take effect upon acceptance by the Trustees. This Trust shall be known as “The \_\_\_\_\_ 201 Life Insurance Trust”.

FIFTEENTH: This instrument may be executed in counterparts or copies, each of which

so executed shall be deemed an original, but all such counterparts shall be taken together to constitute but one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have duly executed this Indenture under seal as of the day and year first above written.

\_\_\_\_\_  
Donor

\_\_\_\_\_  
Trustee

\_\_\_\_\_  
Trustee

I accept my designation as representative of the Donor's minor descendants for all purposes of this Indenture.

\_\_\_\_\_

SCHEDULE A

\$10.00

STATE OF )  
 : ss.:  
COUNTY OF )

On this            day of            in the year 201\_ before me, the undersigned, personally appeared            , personally known to me or proved to me on the basis of satisfactory evidence to be the individual(s) whose name(s) is(are) subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their capacity(ies); and that by his/her/their signature(s) on the instrument, the individual(s), or the person(s) upon behalf of which the individual(s) acted, executed the instrument.

\_\_\_\_\_  
Notary Public

STATE OF )  
 : ss.:  
COUNTY OF )

On this            day of            in the year 201\_ before me, the undersigned, personally appeared            , personally known to me or proved to me on the basis of satisfactory evidence to be the individual(s) whose name(s) is(are) subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their capacity(ies); and that by his/her/their signature(s) on the instrument, the individual(s), or the person(s) upon behalf of which the individual(s) acted, executed the instrument.

\_\_\_\_\_  
Notary Public

STATE OF NEW YORK            )  
  : ss.:  
COUNTY OF                    )

On this            day of                                    in the year 201\_ before me, the undersigned, personally appeared                                    , personally known to me or proved to me on the basis of satisfactory evidence to be the individual(s) whose name(s) is(are) subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their capacity(ies); and that by his/her/their signature(s) on the instrument, the individual(s), or the person(s) upon behalf of which the individual(s) acted, executed the instrument.

\_\_\_\_\_  
Notary Public