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by Lee Slosberg

Although there are many approaches to estate planning including the individual's desire to exercise prudent financial management during his lifetime, or to provide for the proper administration of his estate after his death for the maximum benefit of his legatees, one of the primary purposes of good planning is the minimization or elimination of death taxes, especially the federal estate tax, in order to conserve as much of the estate as possible.

The federal estate tax is imposed on a decedent's estate for the right to transmit the property to his heirs or other donees, as distinguished from the state inheritance tax, imposed on the donee for the right to receive part of an estate. Before the federal estate tax came into being in 1916, distribution of a decedent's estate was fairly simple. However, the federal estate tax has become a significant and burdensome factor in prudent estate planning.

When an individual thinks about passing on property at death he generally thinks of a will. Many assume that the entire estate passes by will, and are unaware that certain assets, such as life insurance proceeds, which are payable to a named beneficiary under the terms of the policy, do not.

When a husband purchases life insurance, life insurance agents often recommend that he make the wife the owner and the premium payer of his policies, in addition to making her the beneficiary, in an attempt to keep those death proceeds out of his estate, thereby lowering his federal estate tax liability. In many situations this would serve to delay the estate tax liability until the subsequent death of his wife. This works only so long as the decedent or the decedent's estate has no more than a 5 percent reversionary interest in the proceeds of the policy. The decedent may exercise none of the so-called incidents of ownership at the time of his death, either alone or in conjunction with any other person.[1]

Another means by which a married individual can lower his gross estate is through the "federal marital deduction". A portion of the estate is bequeathed to the surviving spouse, and under certain conditions, sheltersld from the estate tax. Prior to 1977, the maximum deduction allowed was 50% of the decedent's adjusted gross estate. The new rules permit a $250,000 marital deduction by estates of $500,000 or less, regardless of the customary 50 percent limit,[2] as long as the estate tax marital deduction does not exceed the amount actually passing to the surviving spouse.[3] Because substantial tax savings can be realized, the marital deduction is currently one of the most helpful estate planning tools.

Life insurance proceeds paid outright to the spouse as beneficiary qualify for the marital deduction for estate tax purposes.[4] Proceeds payable under a policy's optional modes of settlement must meet certain requirements. The insurance company must hold the proceeds, to be paid out by agreement under one of the company's optional modes of settlement. These optional modes include payment of interest only or life income with a period certain or fixed amount. The payment of installments or interest must begin no later than thirteen months after the decedent's death and must be at least annual payments. The surviving spouse must have the exclusive power of appointment over the proceeds, exercisable either by will, or during spouse's lifetime, or both.[5] Although proceeds from an insurance policy are excluded from gross income to the surviving spouse, the interest earned on those proceeds is not. If the surviving spouse receives the proceeds under an installment option, she may exclude up to $1,000 of interest annually.[6] Bear in mind that when the surviving spouse dies, the assets of the first spouse's estate are again subject to taxation. If the estate passes to a non-spouse, it does so without the benefit of a marital deduction.

A life insurance trust is another valuable estate planning device to be considered, as a means to minimize tax exposure of the estate, including tax exposure on the death of the spouse, with a provision for a residuary trust. Simply stated, a trust exists where one party, the grantor, transfers legal title to a second party, the trustee, for the benefit of a third party, the trust beneficiary (for example: husband to trustee for benefit of wife). The legal rights of control and ownership are with the trustee, subject to his legal duty to perform as directed by the grantor, while the enjoyment of the beneficial or equitable rights to the property are with the trust beneficiary.[7]

One of the most important uses of the trust is in family settlement, as a trust can provide essential flexibility. The trust instrument offers an ideal method for the grantor to distribute his estate directly to the members of his family as he desires and to impose duties directly on the trustee. The trust also provides protection for those beneficiaries lacking the ability to manage, by placing the management and administration of the property in the hands of a capable manager trustee. A trust, then, can provide for prudent management and protection of trust assets, protection of beneficiaries, and tax savings.

A trust can be a living trust, created and effective during the grantor's lifetime, or a testamentary trust, created by the grantor's will and effective only after his death. The living trust can be either revocable, with the grantor reserving the right to terminate the trust, or irrevocable.

Although there are a number of advantages to the revocable trust, there is the distinct disadvantage that income from the trust could be taxed to the grantor and the property of the trust would be subject to the federal estate tax. While an irrevocable trust requires the grantor to relinquish control over the assets, by so doing the grantor gains certain income and estate tax savings. The life insurance trust is a special kind of living trust which acts as a repository for the proceeds of life insurance policies and can be either revocable or irrevocable. The revocable life insurance trust, like other revocable trusts, does not have the income and estate tax advantages of the irrevocable trust, but is an ideal instrument for making certain that the objectives of the grantor are carried out at his death. It allows the grantor broad flexibility to effect certain discretionary powers that insurance companies are often unable or unwilling to provide; for example, provision for the management expertise of a trustee, or termination or alteration of the trust as the grantor deems desirable. There is the further advantage that insurance proceeds in a living trust are not subject to probate, thus eliminating certain administrative expenses and allowing immediate liquidity. In addition, insurance proceeds paid to a life insurance trust are generally not subject to the claims of creditors.

Revocable life insurance trusts are often used as the ultimate repositories for part or all of the probate property after death. If the legal requirements of state law are met, an individual can provide in his will that after his estate is settled, his probate property be "poured over" into the life insurance trust where it can be managed under the same provisions as the insurance proceeds. If a husband's estate consists principally of life insurance, it might be a good idea to create an insurance trust as a means of administering the entire estate.

One of the most effective ways of reducing an individual's gross taxable estate is by the absolute transfer of the ownership of existing insurance policies to an irrevocable trust. If the gift is made more than three years before death, none of the proceeds, except for the value of premiums paid within three years of death, will be included in the gross estate.[8] The primary advantage of transferring life insurance is that it usually has a relatively low current value for transfer purposes compared to the larger face value that can be removed from the taxable estate. The entire value of the transfer above the $3,000 annual "per donee" exclusion is added into the gross estate for those transfers after 1976.

One major drawback of an irrevocable life insurance trust is the very fact that it is irrevocable and the grantor must relinquish control over the assets and cannot recover them. Notwithstanding the possible estate tax savings, there may be compelling reasons for retaining control over the assets and careful client counseling is imperative.

If the grantor is concerned about flexibility, he can grant a trust beneficiary the power to redirect the disposition of the property through a special power of appointment, without adverse consequences, e.g., a husband could provide for his wife to appoint the property to their children, or a grandparent could provide that a son appoint the property to his children. Note, however, that transfer by appointment of a son to grandchildren makes the transfer subject to generation skipping tax. As long as the estate of the holder of the power and its creditors are excluded as appointees, the special power qualifies for estate and gift tax purposes.[9]

An irrevocable life insurance trust must also contend with the requirements of the gift tax, if the trust is created in the grantor's lifetime. The Internal Revenue Code allows an annual $3,000 tax exclusion for gifts of a present interest, i.e., where the donee has an immediate and unrestricted right to the property. Where the benefits are restricted, or are to be enjoyed sometime in the future, the donee can be said to have a gift of a "future interest", which would not qualify for the annual exclusion. The Internal Revenue Code makes it quite clear that the gift exclusion is only available for gifts of other than future interest in property.[10] This becomes particularly significant when gifts are made in trust. For example, if the trust is funded with life insurance in order to provide benefits in the future, the gift could be considered a gift of future interest and would, therefore, not qualify for the gift tax annual exclusion.

There is a well known device that could be used to solve the "future interest" problem by giving the trust beneficiary the immediate and unrestricted right to withdraw trust assets. These gifts, often referred to as *Crummy* powers, provide the beneficiary with a property interest equivalent to that of absolute ownership, thereby amounting to a "present interest".[11] By utilizing such a device in the irrevocable life insurance trust, and by providing notice to the beneficiary that the power exists, most and perhaps all the contributions to the trust should qualify for the annual exclusion as "present interest" gifts. The Internal Revenue Service appears to regard notification to the trust beneficiaries of their rights of withdrawl of the funds a very necessary ingredient for enabling the *Crummy* powers to qualify as a gift of present interest.[12]

Estate planning is a vast and complicated area due to the fact that individual needs are so varied. Life insurance is a necessary element in proper estate planning and one of the best devices available for the transfer of dollars with minimum tax consequences. While the estate tax liability cannot always be eliminated, its reduction through planning can go a long way to assure that an individual's objectives for the financial stability of his family are carried out after his death.

[1] Reg 20-2042-2 (c) (1)
[2] IRC Sec 2056 (c) (1) (A)
[3] IRC Sec 2056 (a)
[4] IRC Sec 2056 (d) (7)
[5] Treas. Reg Sec 20.2056 (b)6(a)
[6] IRC Sec 101 (d)
[7] 89 CJS 741
[8] Rev. Rul. 710497
[9] IRC Sec. 2041
[10] IRC Sec 2503 (b)
[11] Crummy v. Commissioner, 397 F.2d82
[12] TAM 7946007, PLR 7947066

Sex & Law in Recent Decisions

By: Harold D. Norton & Linda Lee Panlilio

A brief review of some selected 1980 decisions from the Courts of Appeal of Maryland and the Regional United States District Courts and Courts of Appeal gives an indication of the current trend in issues concerning sex and the law.

TITLE VII[1]

Sexual harassment is now generally recognized as actionable under federal law.[2]

The United States District Court for the District of Columbia in *Williams v. Civiletti*,[3] added to "the foundation of a growing body of law providing remedies for . . . sexual harassment"[4] by holding that a woman's dismissal from employment for rejecting her supervisor's sexual advances violated Title VII.[5]

In *Mazus v. Department of Transportation*,[6] the plaintiff failed to convince the United States District for the Middle District of Pennsylvania that the state's patronage system constituted a discriminatory practice prescribed by Title VII or that it violated her freedom of political association. The plaintiff claimed that the goal of the patronage system was to hire a work force composed of males.

In *Rogers v. McCall*,[7] where a male plaintiff attempted to establish a *prima facie* case using comparative evidence, the D.C. court noted that promotion of a female parole officer instead of her male counterpart "in no way diminished or increased (his) eligibility for promotion,"[8] and was therefore nondiscriminatory.

Other noteworthy decisions resolved procedural issues, holding, for example, that the three year District of Columbia statute of limitations applies to back pay recoverable under Title VII.[9]

Construing the "relation back" provision of Federal Rule 15, in *Kuhn v. Philadelphia Elec. Co.*,[10] the District Court for Pennsylvania determined that an individual class member's Title VII action commenced on the date of her "consent to become party plaintiff"[11] rather than the date the original class action was filed. This issue was considered by the court to be a case of federal first impression.

Separate but interrelated corporations were treated as a single entity for the jurisdictional requirements of Title VII and the Equal Pay Act[12] by the Pennsylvania Eastern District,[13] in *Ratcliffe v. Ins. Co. of North America.*

The same court spelled out federal pleading requirements for claims brought pursuant to Title VII[14] (failure to allege sex based discrimination constituted failure to allege jurisdiction); the Equal Pay Act[15] (claim must, at least indirectly, allege disparity in wages); the Fourteenth Amendment to the United States Constitution[16] (claim must allege inadequacy of statutory remedies); and Civil Rights Act provisions other than Title VII[17] (claim must plead that the defendant acted under color of state law in section 1983 action).

Proof requirements under Title VII[18] were the subject of many recent federal decisions. In a case where "business necessity" was claimed as a justification for unequal treatment, the female plaintiff was able to refute the defense by establishing that she and other women employees were able to perform all tasks included in the job analysis.[19] In another case, a woman who worked as a foreign language broadcaster for Voice of America, through purchase order contracts rather than employment contracts, was held not to be an "employee within the meaning of Title VII."[20]

In *Kunda v. Muhlenberg College*[21] the United States Court of Appeals found employment discrimination based on sex for failure to promote or grant tenure to a female college professor. The District Court based its decision on evidence that the complainant met all promotion and tenure requirements set forth in the Muhlenberg College Faculty Handbook, and that she "was regarded by her colleagues as an excellent teacher. . ." The Court of Appeals simply noted that the finding was not clearly erroneous under Federal Rule 52(a).[22]

Finally, in *Clark v. Alexander*,[23] where Title VII provided the basis for a cause of action regarding discrimination in the military, Judge Robinson commented: "The evidence establishes beyond doubt that pervasive systematic defects existed and continue to exist in the (Department of Army) Career Program,"[24] leading "inexorably to the inference of discriminatory intent."[25]