Estate and Distribution Plans

Bakija, J. M., Gale, W. G., & Slemrod, J. (2003). Charitable bequests and taxes on inheritances and estates: Aggregate evidence from across states and time. *The American Economic Review, 93*(2), 366-370.

This paper contains early results from a research program designed to estimate the impact of taxes on charitable bequests using an econometric framework that addresses several problems that plague prior research. The paper exploits the fact that federal and state tax rates on estates and inheritances have changed over time in different ways across states and real wealth levels. The effect of federal and state inheritance and estate taxes on charitable bequests is estimated using pooled cross-sectional data spanning several decades, based on aggregated information from federal estate-tax returns. Under several different specifications, evidence is found of a strong incentive effect of estate and inheritance taxes on charitable bequests.

Bernheim, B. D. & Severinov, S. (2003). Bequests as signals: An explanation for the equal division puzzle. *The Journal of Political Economy, 111*(4), 733-784.

In the US, more than two-thirds of decedents with multi-child families divide their estates exactly equally among their children. In contrast, gifts given before death are usually unequal. These findings challenge the validity of existing theories regarding the determination of intergenerational transfers. In this paper, the authors develop a theory that accounts for this puzzle based on the notion that the division of bequests provides a signal about a parent's altruistic preferences. The theory can also explain the norm of unigeniture, which prevails in other societies.

Blumkin, T. & Sadka, E. (2004). Estate taxation with intended and accidental bequests. *Journal of Public Economics, 88*(1), 1-21.

In this paper we examine the properties of the optimal *estate* tax in the presence of a complete set of tax instruments available to the social planner. We allow for both types of bequest motives, namely altruistic and accidental. We examine the case for *estate* taxation which seems to be the strongest (but not impeccable) with accidental bequests. In general, the *estate* tax is highly sensitive to the relative importance of the two bequest motives.

Brandi, J. T. (2002). Estate tax valuation and comparative discounting for the limited liability company investment fund. *Journal of Legal Economics, 12*(2), 27-46.

Limited liability companies have become popular vehicles for use in tax planning and estate planning in particular. For those family limited liability companies that effectively function as investment portfolio holding companies, it is then often necessary to obtain a valuation for estate tax purposes. This paper provides a methodology for determining the value of LLC holdings when the valuation or "as of" date is not also a trading date. It also provides an argument for the use of a comparative discount to be applied in investment portfolio family limited liability company valuations.

Cardia, E., & Michel, P. (2004). Altruism, intergenerational transfers of time and bequests. *Journal of Economic Dynamics & Control, 28*(8), 1681-1702.

This paper uses a standard two-period overlapping generation model to examine the behavior of an economy where both intergenerational transfers of time and bequests are available. While bequests have been examined extensively, time transfers have received little or no attention in the literature. Assuming a log-linear utility function and a Cobb-Douglas production function, we derive an explicit solution for the dynamics and show that altruistic intergenerational time transfers can take place in presence of a binding non-negativity constraint on bequests. We also show that with either type of transfers capital is an increasing function of the intergenerational degree of altruism. However while with time transfers the labor supply of the young increases with the degree of altruism, with bequests it may decrease.

Dynan, K. E., Skinner, J., & Zeldes, S. P. (2004). Do the rich save more? *The Journal of Political Economy, 112*(2), 397-445.

The question of whether higher-lifetime income households save a larger fraction of their income was the subject of much debate in the 1950s and 1960s, and while not resolved, it remains central to the evaluation of tax and macroeconomic policies. We resolve this long-standing question using new empirical methods applied to the Panel Study of Income Dynamics, the Survey of Consumer Finances, and the Consumer Expenditure Survey. We find a strong positive relationship between saving rates and lifetime income and a weaker but still positive relationship between the marginal propensity to save and lifetime income. There is little support for theories that seek to explain these positive correlations by relying solely on time preference rates, nonhomothetic preferences, or variations in Social Security benefits. There is more support for models emphasizing uncertainty with respect to income and health expenses, bequest motives, and asset-based means testing or behavioral factors causing minimal saving rates among low-income households.

Dynan, K. E., Skinner, J., & Zeldes, S. P. (2002). The importance of bequests and life-cycle saving in capital accumulation: A new answer. *The American Economic Review, 92*(2), 274-279.

For at least 40 years, economists have debated the relative importance of bequests and lifecycle saving in thinking about why households accumulate wealth. This paper has argued for a model where saving simultaneously serves 2 purposes. The first purpose (a precautionary function in a lifecycle model) is to guard against future contingencies such as low earnings, living a long time or incurring very high health expenditures later in life. The second purpose (to bequeath wealth to future generations or other causes) becomes operative in the likely event that future developments are not as bad as they could be.

Fox, C. D. IV & Huft, M. J. (2002). Asset protection and dynasty trusts. *Real Property, Probate and Trust Journal, 37*(2), 287-362.

In today's increasing litigious environment, asset protection planning is becoming increasingly significant as a separate area of focus within the field of estate planning. Creditor and liability problems can arise from a variety of sources: contract creditors, tort creditors, regulatory liability, divorce, and disabled beneficiaries. An examination of the domestic protection trusts is presented. Of particular concern is whether a settler who is not a resident of a state that allows either perpetual trusts or self-settled asset protections trusts can choose to have a trust governed by the laws of that state, and whether a court in a state the laws of which have not been chosen to govern the trust would apply the laws of the chosen state to issues governing trust validity, the validity of transfer of property to the trust, the availability of trust assets to satisfy the settler's creditors, and to issues relating to perpetuities. Choice-of-law provisions and conflict-of laws principles as they relate to these provisions of trusts are examined.

Fox, S. & Abendroth, T. (2001). Estate planning in an era of uncertainty. *Journal of Financial Planning, 14*(9), 102-104.

Describes the financial planning ambiguity created by the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 and advises financial planners on how to help their clients in light of this ambiguity. Reports that the Act contains a sunset provision by which all of the provisions of the Act, including the income tax changes and the repeal of the estate tax, cease to apply after December 31, 2010. Suggests that the Act has made careful estate and financial planning more important than ever. Recommends that the best way to focus clients on the impact of changes in the estate tax is to prepare examples of how their assets will be distributed under the estate plan now and in later years. Offers specific guidance for asset allocation for married individuals, estates under the applicable exclusion amount, or under an optimum marital deduction plan. Discusses marital planning for repeal of the estate tax and describes the general power of appointment trusts versus qualified terminable interest trusts. Reviews the usefulness of factors traditionally applied to decide what formula to use to define marital and nonmarital asset shares.

Goetting, M. A. & Martin, P. (2001). Characteristics of older adults with written wills. *Journal of Family and Economic Issues, 22*(3), 243-264.

Using data from the Study of Aging and Health Dynamics of the Oldest Old (AHEAD), an empirical model was tested to examine and explain the presence of a will among older adults. This study investigated the influence of the following multiple factors on the presence of a written will: demographic characteristics, socioeconomic status, physical health problems, negative psychological functioning, sense of control, and financial assessments. Two-thirds of the sample (N = 521) indicated they had a written will. Logistic regression analysis of the empirical model revealed there were four significant predictors of an older adult having a will: race, education, net worth, and the respondent's assessment regarding the chances of leaving a financial bequest.

Gokhale, J. & Kotlikoff, L. J. (2002). Simulating the transmission of wealth inequality. *The American Economic Review*. *92*(2), 265-270.

The role of bequests in propagating wealth inequality has long interested economists, policymakers and social commentators. It is found that many, if not most, bequests in the U.S. appear to arise because the resources of the elderly are not fully annuitized. Consequently, who receives inheritances is, in large part, a random process, which can, according to the model, equalize the distribution of wealth. While bequests are important, the main determinant of wealth inequality, according to the model, is earnings inequality. As to bequests, assortative mating, the annuitization of retirement savings via Social Security, the inheritance of skills and interest rate heterogeneity play more limited roles in generating wealth inequality.

Heer, B. (2001). Wealth distribution and optimal inheritance taxation in life-cycle economies with intergenerational transfers. *Scandinavian Journal of Economics, 103*(3), 445-465.

Intergenerational transfers are introduced into a general equilibrium life-cycle model in order to explain observed levels of wealth heterogeneity. In our overlapping generation’s model, heterogeneous agents face uncertain lifetime and leave both accidental and voluntary bequests to their children. Furthermore, agents face stochastic employment opportunities. The model is calibrated with regard to the characteristics of the US economy. Our results indicate that bequests only account for a small proportion of observed wealth heterogeneity. The introduction of an inheritance tax increases both welfare, as measured by the average lifetime utility of a newborn, and equality of the wealth distribution.

Joulfaian, D. (2004). Gift taxes and lifetime transfers: Time series evidence. *Journal of Public Economics, 88*(9), 1917-1929.

The tax treatment of lifetime transfers was altered on a number of occasions since the enactment of gift tax six decades ago. Trends in gifts by the wealthy show a dramatic response to these changes. In this paper, I examine this trend and gauge its response to taxes, transitory and permanent, over a period of 65 years. Results suggest that gifts are highly elastic with respect to taxes, particularly in the short run. Tax minimization seems to be an important consideration in the timing of intergenerational transfers.

Jurinski, J. J. & Zwick, G. A. (2002). Estate planning for the very elderly. *Journal of Financial Planning, 15*(5), 94-96.

Reviews the estate planning needs of very old adults, focusing on financial and legal aspects of tax reduction and using a 90-year-old widowed client as an example. The annual gift tax exclusion (currently $11,000 per individual recipient) offers an easy way to distribute accumulated assets and avoid estate taxes. Older adults can get even more out of lifetime giving if they are able to take advantage of discounted property gifts through a family limited partnership. If an older adult owns a residence or residential property that is used by a family member who does not pay fair market rent, a qualified personal residence trust is a good way to make gifts that are discounted in value (thereby increasing the amount that can be given). Significant amounts of life insurance can be excluded (at least partly) from an estate through a variety of means, from selling the policy to obtaining a viatical settlement. Other techniques for reducing the estate tax liability of older adults are reviewed.

Kemp, S. & Hunt, F. (2001). Exploring the psychology of inheritances. *Zeitschrift fuer Sozialpsychologie, 32*(3), 171-179.

Investigated the psychology of inheritances across 3 studies. The first, a content analysis of 248 consecutive wills probated in Christchurch, indicated that people predominantly distribute their estates within their families, often to their spouse or equally among their children. Study 2 investigated the significance 89 beneficiaries (aged 30-80+ yrs) attached to bequests they had received. Bequests of money or real estate were invested with less personal significance than bequests of specific objects. Study 3 questioned 38 informants about inheritance conflicts, which turned out to be long-lasting, usually confined within families, and common, especially where wills did not distribute resources equally.

Kopczuk, W. (2003). The trick is to live: Is the estate tax social security for the rich? *The Journal of Political Economy, 111*(6); 1318-1360.

Because estate tax liability usually depends on how long one lives, it implicitly provides annuity income. In the absence of annuity markets, lump-sum estate taxation may be used to achieve the first-best solution for individuals with a sufficiently strong bequest motive. Calculations of the annuity embedded in the U.S. estate tax show that people with $10 million of assets may be effectively receiving more than $100,000 a year financed at actuarially fair rates by their tax payments. According to my calibrations, the insurance effect reduces the marginal cost of funds (MCF) for the estate tax by as much as 30 percent, and the resulting MCF is within the range of estimates for the MCF for the income tax.

Kurlander, G. (2004). Enhancing the protection and independence of fiduciaries. *Estate Planning, 31*(9), 448-454.

A planner who is counseling the testator can help ensure that the client's estate plan will function as intended, and that the fiduciaries will be able to implement the plan effectively. More often than not, the fiduciary will be the critical linchpin in determining whether the wealth plan of the senior generation succeeds or fails. For clients confronting these problems, protecting the fiduciary will be a priority: a fiduciary that lives under the constant threat of litigation or, even worse, who is embroiled in it, almost inevitably will be impaired in exercising fiduciary responsibilities and functions. In these instances, the wealth planner must ensure that the fiduciary-typically the trustee-is invested with the requisite independence and protection to withstand assaults by litigation or other coercive means. To fulfill this mission, the wealth planner can draw on a number of devices, some fairly basic and some that may seem extreme or even onerous in ordinary circumstances, in order to preserve and protect the plan.

Loftsgard, G. A. (2003). Retirement plan distributions to trusts. *Journal of Financial Planning, 16*(7), 64-66.

Explains how individuals can combine retirement planning and estate planning goals through the use of retirement plan distributions to trusts. Under new regulations imposed by the Comprehensive Retirement Security and Pension Reform Act of 2001, retirement plan owners may use remarkable estate planning strategies with trusts through a combination of the new recalculation rules and the Internal Revenue Service's recent acquiescence in allowing a trustee to receive minimum distributions on behalf of a plan beneficiary. By blending the minimum distribution requirements into resourceful estate planning modes, plan owners will be able to employ certain postmortem restrictions on withdrawal rights over certain retirement plan distributions that were not obtainable under prior law. Two case examples are used to illustrate how the new rules can address common estate planning issues.

Sanborn, V. E. (2004). U.S. tax classification of trusts: When is a trust not a trust? *Estate Planning, 31*(9), 440-448.

When advisors are confronted with a foreign 'trust' that has characteristics of a business trust or an investment trust, a thorough review of the relevant factors is warranted to determine if adverse tax consequences may result. As clients demand cross-border tax and estate planning advice, U.S. tax professionals encounter-with increasing frequency-arrangements that are considered "trusts" for foreign (non-U.S.) purposes, but which may not constitute trusts under U.S. federal tax law. Specifically, even though local law treats a particular arrangement as a trust, if the arrangement is classified as a "business trust" or an "investment trust" under the Internal Revenue Code, it will be treated as an association taxable as a corporation or partnership for U.S. federal income tax purposes. Thus, an arrangement that a U.S. advisor considers to be a foreign trust may instead be a foreign corporation or partnership. The article discusses three varieties of 'trusts'. These trusts are (1) ordinary trusts, (2) business trusts, and (3) investment trusts. This is the type

of entity that one normally thinks of when the word "trust" is used, particularly with respect to fiduciary and estate planning.

Scroggin, J. J. (2003). Influencing the behavior of heirs. *Journal of Financial Planning, 16*(11), 56-58.

Reviews issues related to attempts by clients of financial planners to influence the behavior of heirs. Clients are increasingly struggling with the issue of how to leave money to their children or grandchildren and how sizable (or even modest) bequests might influence their behavior for better or worse. While critics argue that any attempt to influence the behavior of heirs is a not-so-subtle attempt to rule from the grave, others contend that fair and flexible trusts can be set up to encourage children to complete college, protect grandchildren in an unstable marriage, or safeguard the family business. A proper estate plan and trust can help to recognize and protect heirs from the inherent risks of receiving unrestrained wealth. Sidebars contain citations for related books and Internet sites.

Skinner, D. A. & Kohler, J. K. (2002). Parental rights in diverse family contexts: Current legal developments. *Family Relations, 51*(4), 293-300.

Here, we review case law as it applies to parental rights. Specifically, we examine two issues: (a) who has been awarded the right to parent? and (b) What rights have been bestowed to parents? The review demonstrates how family law in the United States reflects and perpetuates society's ambivalence about family structure and, subsequently, parental rights and responsibilities. On the basis of this analysis, we recommend a broadened legal perspective that not only communicates society's expectation of responsible parenting but, in addition, gives legal recognition to diverse family forms in which members carry out these responsibilities.

Slemrod, J. (2003). Thanatology and economics: The behavioral economics of death. *The American Economic Review, 93*(2), 371-375.

Becker argues that people attempt to gain symbolic immortality through their children and through wealth accumulated and passed on to the next generation. A model with immortality in the utility function and with wealth and children as substitutable means for producing immortality could imply that, ceteris paribus, estates would be higher for childless people. This sheds light on the controversy surrounding the claim in Hurd (1987) that the small differences between the wealth of those elderly with and without children cast doubt on the importance of an altruistic bequest motive.

Solomon, R. J. (2004) When are unequal bequests to children equitable? *Estate Planning, 31*(3), 139-144.

One of the biggest challenges for clients who are deciding on an estate plan is how to divide their assets. This article analyzes what happens when clients believe that their assets should be bequeathed to their children in unequal shares. The more that estate planners can be aware of the psychological issues in these situations, the greater chance they have of steering families in a positive direction. Considering individual differences in family members sometimes makes good sense. Postponing the decision to divide an estate unequally or using a limited power of appointment is important strategies that should be reviewed by the estate planner. Another possible strategy would be to give the "advantaged child" the right to disclaim any property received by that child, and provide that any disclaimed property would pass not to that child's children (as is the usual case), but to the sibling or other family member who is needy.

Storms, P. (2001). Real estate issues in estate settlements. *Journal of Financial Planning, 14*(5), 56-57.

Reviews real estate issues that financial planners should consider in estate settlements. Most often, planners are not consulted when the heirs are left to decide what to do with the assets they receive. Tangible assets, especially real estate, must be handled promptly and effectively to prevent major deterioration in value. Conventional wisdom dictates that a licensed appraiser should evaluate the property. Evaluations for estate tax purposes need to take advantage of every opportunity to obtain discounts. One often overlooked opportunity involves private mortgages held by the deceased. In cases where real estate or privately held mortgages are the major asset, generating liquidity may be a priority even if no estate taxes are due. Vacant properties must be maintained; taxes, insurance, and utilities must be paid; and vandalism must be prevented. Advisors can help their clients by making sure that they have an accurate perception of the value and access to a number of sources of liquidity. Financial planners who remain involved during the estate settlement process can locate additional business and perform a valuable service for their clients' heirs.

Wahl, J. B. (2003). From riches to riches: Intergenerational transfers and the evidence from estate tax returns. *Social Science Quarterly, 84*(2), 278-296.

Objective. Intergenerational transfers of wealth and ability can influence the distribution of wealth. This research examines the empirical relationships among intergenerational variables and cross-sectional wealth distribution. **Methods**. Models pioneered by Gary Becker set out the conditions necessary for regression to the mean in wealth across generations. However, empirical testing of such models has been incomplete because large, reliable, intergenerational data sets especially with data from three generations are hard to find. This article unveils a remarkable new source of intergeneration ally linked data: federal estate tax records filed in Wisconsin from 1916 to 1981 and linked across three generations of families. **Results**. Wealth tends to regress to the mean at the top end of the distribution, but slowly. Consequently, wealth inequality in the United States is likely to persist. What is more, recent federal tax changes, particularly the repeal of the estate tax and the reduction in capital gains tax rates, will exacerbate cross-sectional wealth disparities. **Conclusions**. In the long run, intergenerational forces may help overcome inequalities in wealth across U.S. families. Empirical results suggest, however, that regression to

the mean will occur quite slowly, and the long run could be long indeed.

Weber, S. A. (2001). Re-thinking the estate tax: Should farmers bear the burden of a wealth tax? *Elder Law Journal, 9*(1), 109-139.

Explores the history and policy behind the enactment of the estate tax, current developments in the congressional estate tax debate, and the illogical impression the estate tax has left upon the family farmer. Estate taxes were introduced for brief periods in the aftermath of the American revolution, during the Civil War, and during the Spanish-American War before becoming a permanent fixture of the American tax system in 1916. While the very wealthy can often circumvent the effects of the tax to a limited extent, estate taxes hit small business owners--including family farms--the hardest. Not only is the tax liability itself a threat to small family farms and businesses, but the cost of planning for and around the estate tax is a menace as well. Several possible solutions to the current problems caused by the tax include an outright appeal, an increase in the unified credit (the amount of assets excluded from the tax), and more global solutions, such as the introduction of a consumption tax or a flat income tax. Congress is currently considering legislation to increase the unified credit or repeal the estate tax in its entirety. It is concluded that an increase in the unified credit would protect small family farms and businesses while still allowing the estate tax to reach the wealthy targets it seeks.

Wolven, L. (2004). An estate planner's guide to advising couples about divorce. *Estate Planning. 31*(9), 427-436.

This article examines the challenges the estate planning attorney faces when representing a couple contemplating marriage or divorce, including a discussion of separate property and a brief guide to drafting premarital agreements. The article also analyzed how to incorporate divorce into a discussion with clients who are already married and offer post marital agreements. Further, this article summarized procedures involved in advising a couple contemplating divorce and the necessary steps once the divorce is final.