

Dear Colonel and Mrs. _____

December 28, 2001

Thank you for the opportunity to prepare your wills and living wills. As you know, you should safeguard these important documents against accidental loss or damage. I also recommend you prepare an instructional memorandum identifying the location of important documents and information. It will also be useful in handling routine administrative details not included in your wills.

You will recall that the will I prepared distributed your property as you desired, but did not undertake any significant estate tax planning. Accordingly, I am writing to summarize for you basic estate tax law so you may determine whether you desire any further estate planning.

Year 2001 tax law concerning estate taxes provides an exemption equivalent of \$675,000 per person. Each of you can give away during life or at death a combined total of \$675,000, without any federal gift or estate tax at all. The new law gradually and periodically increases the \$675,000. Starting in year 2006, the exemption stays at \$1,000,000. The exemptions increase as follows:

2002-2003	700,000
2004	850,000
2005	950,000
2006+	1,000,000

If at the death of the first spouse all property goes to the surviving spouse, there is no estate tax because of the unlimited marital deduction. When the surviving spouse dies owning all of the family assets, he or she has his/her \$675,000 exemption. Anything (including life insurance) in that estate over \$675,000 will be taxed at a rate that begins at 37%. If you give everything to your surviving spouse, without good estate tax planning, your \$675,000 exemption equivalent is wasted.

Good estate tax planning involves utilizing as fully as possible each spouse's \$675,000 exemption equivalent, so as to pass up to \$1,350,000 estate tax free to your children, rather than just \$675,000 from the surviving spouse. To accomplish this, when the first spouse dies, rather than giving everything to your surviving spouse outright, you put up to \$675,000 in trust (usually called a "Family" or "credit shelter" trust). The surviving spouse can serve as trustee of this trust and receive all the trust income, and receive principal if necessary for his/her support and medical care. When your surviving spouse dies, however, the trust assets are not part of his/her estate. In this way you can pass \$1,350,000 estate tax free to your children (\$675,000 through the estate of the second spouse to die because of his/her exemption, and the \$675,000, or whatever it has appreciated to, that is in the Family trust created by the first spouse to die.

To ensure maximum utilization of your \$675,000 exemptions, each of you should have property worth \$675,000, or as close to that as possible, in trust, or in your name alone so it can pass into your trust pursuant to your wills at your death. Remember that property held jointly with the right of survivorship passes automatically to the surviving joint tenant and is not controlled by your will.

During your life, you may give \$10,000 (\$20,000 in the case of a married couple) annually to anyone without incurring any gift tax. A significant tax benefit of such a lifetime gift is that appreciation in value following the date of the gift is not subject to transfer taxes. By giving property likely to appreciate in value, you remove from your estate the increases in value, thereby avoiding any transfer tax on the appreciation. If you make taxable gifts during your lifetime (e.g., gifts of more than \$10,000 to any individual in any one year or more than \$20,000 to one individual if your spouse joins in the gift), your \$675,000 exemption may be reduced by the amount of any gift tax. If you have a lower exemption equivalent then the estate tax will apply at a lower level. Beginning in 1998 the maximum gift-tax-free amount will be adjusted for inflation. But because the amount will be adjusted in increments of \$1,000, it could be several years before the exclusion rises to \$11,000.

This short explanation emphasizes the need to consider federal gift and estate tax consequences not presently satisfied by the will I prepared at your request. I trust you will find it useful in deciding whether you should consider further estate tax planning.

Finally, I want to remind you that you should periodically (at least annually) review the estate planning documents I prepared to be sure that they remain consistent with your desires.

Sincerely,

David Riddle
Attorney Advisor
(408) 242-5083/4