



SUMMARY OF THE
JANE SMITH FAMILY LAND PRESERVATION TRUST (“FLPT”)
AND FAMILY FORTRESS TRUSTS

I. Purposes

A. Non-Tax Objectives.

1. *To protect and preserve the Martha’s Vineyard Homestead (the “Homestead”) and the endowment established for its short and long term maintenance and improvement, from creditors, hostile spouses, and other predators of family wealth and assets.*

2. *To create a vehicle for the centralized management, ownership control, conservation and maintenance of the Homestead for present and future generations of the Smith family, as a means of reconciling conflict and accommodating the interests of both those family members desiring to continue to use and enjoy the property, and those who are not.*

B. Tax Objectives: Achieve the non-tax objectives in a manner that minimizes the current and future federal gift, estate and generation-skipping transfer tax consequences of the transfer now and as the benefit of the use and enjoyment of the Homestead passes between the generations. Also, to the extent that the trust property does not consist of the Homestead or the endowment, provide for creditor safe generation-skipping subtrusts (“family fortress trusts”) to be managed by each subbranch of the Smith family as generations pass and the family proliferates.

II. How The Trust Does It.

A. Non-Tax Objectives: Multi-Generational Creditor Protection, Maintenance and Centralized Ownership and Management of the Homestead.

1. The Role and Purposes of The Administrative Trustee. John and Jeff will initially serve together as “administrative Trustee.” In this capacity they will manage the Homestead and endowment in accordance with the terms of the trust. The trust gives them the following powers and duties:

a. Receive the Homestead and endowment, and any other property contributed by Mrs. Smith.

b. On their books of account only, carve that property into two (2) separate shares, one established for each branch of the Smith family headed by a Smith son. These separate shares will each constitute a separate “family trust” established in the name of the son in whose name the share was set apart. There will thus initially be two separate “family land trusts”, and two separate “family fortress trusts”. One of each of these trusts will be established in each son’s name. As discussed below, each family land trust will hold an undivided one-half (1/2) interest in both the Homestead and the endowment. The family fortress trusts will hold any other property (i.e., other than the Homestead and the endowment). These family fortress trusts will not initially be funded; indeed, they may never be funded. This is described in more detail below.

c. Establish operating and capital improvements budgets and assess the separate family land trusts for any operating deficit or proposed capital improvements.

i. Operating Budgets and Assessments. Expenses and income will generally be allocated proportionately among the family land trusts. If the family land trusts’

net income (from any timbering operations, rental paid by Mrs. Smith or third party lessees, investment income from the endowment or other sources), and the principal of the endowment exceed the expenses, the arrangement will be self-sustaining and there will be no need to raise capital. However, if expenses exceed income, the administrative Trustee will assess each family land trust for its proportionate share of the deficit. The “interested Trustee” (see below) of the assessed family land trust is responsible for collecting the assessment from the beneficiaries of that trust and remitting the funds collected to the administrative Trustee within 90 days of the interested Trustee’s receipt of the notice of assessment. The beneficiaries of that trust must contribute their trust’s share of the deficit. If any one of the family land trusts establishes an operating capital reserve for the trust’s share of any deficit, the administrative Trustee will tap it first for that trust’s assessment. Otherwise, if a family land trust defaults in the payment of an assessment, the administrative Trustee can assess interest, and, if the default continues uncured, can ultimately force the beneficiaries to liquidate their interests in the trust if a majority of the interested Trustees of all family land trust do not vote to extend a grace period or waive the default.

ii. *Capital Improvements, Budgets and Assessments.* The family may wish to make capital improvements to the Homestead, including improving existing structures and other improvements and building new ones. The administrative Trustee will present the proposed improvements to the interested Trustees of all family land trusts who must unanimously approve the proposal. To finance the costs of the proposal, the administrative Trustee must first look to the net income or liquid principal available in the endowment. If there is no endowment, or if the endowment is insufficient to finance the proposed improvements, the disinterested Trustees of each family fortress trust may distribute its property (if any) to the assessed family land trust. If this source of funding is not available, the administrative Trustee must resort to

some form of financing through third party lenders or even family member beneficiaries. Any loans to finance capital improvements may be secured by mortgages on the Homestead. The administrative Trustee may only make capital improvements assessments against the separate family trusts as a last resort after satisfying him or herself that the payment of the proposed assessments will not create federal transfer tax complications to the contributing assesseees or distribute the generation-skipping benefits of the family land and fortress trusts arrangements. If the administrative Trustee cannot so satisfy him or herself he or she is discouraged from pursuing the proposed assessment.

d. Possibility of Disproportionate Assessments. The administrative Trustee is empowered to make disproportionate assessments for operating deficits to reflect one set of beneficiaries' disproportionate use and enjoyment of the Homestead during any year. Thus, if one branch of the Smith family uses the property exclusively during any given year, the administrative Trustee can assess that branch in an amount greater than that assessed against the other branch. The administrative Trustee may also disproportionately assess a separate family land trust for capital improvements if such improvements will exclusively or disproportionately benefit the beneficiaries of the subject family land trust. Any such disproportionate assessments are subject to approval by the unanimous vote of the interested Trustees of both family land trusts.

e. Manage and coordinate the family's use and enjoyment of the Homestead. The administrative Trustee will adopt policies for advance reservations of the use of the homestead by various branches of the family for designated time periods. The Trustee will resolve any conflicting requests, perhaps on a first come - first served basis.

2. The Roles and Powers of the Other Smith Family Members. In general, the administrative Trustee's role and purpose is to perform for the family land trusts

accounting and management, centralize the ownership of the Homestead in one person rather than several people, and administer and “police” burden sharing and use and enjoyment for Smith family members who might otherwise find these responsibilities cumbersome or distasteful, especially as generations pass and the number of beneficiaries increase. To achieve fairness and to avoid autocratic rule and hard feelings, the interested Trustees as representatives of each branch of the family headed by a Smith son can vote to remove the administrative Trustee or take other actions to control important trust decisions by their unanimous vote, and are given a substantial voice in the management of their trust, as follows:

a. Each son, and later, one of the son's descendants (if any), will serve as the interested Trustee of the family trust established in his name. Each son will serve as co-Trustee with the administrative Trustee and any “disinterested” Trustee of a family trust who may be appointed (see below). This will give John and Jeff - and later another representative of their respective families - a controlling voice in all issues other than (i) powers relating to the distribution of trust income and principal which might jeopardize the gift and estate tax benefits of the arrangement (exercised solely by the disinterested Trustee), (ii) compliance with the “crummey” withdrawal rights given to the trust beneficiary to preserve Mrs. Smith’s gift tax annual exclusions for contributions to the trust (see below), (iii) for the family land trusts: (a) the budgeting and assessment procedures described above except for any proposed capital improvements and disproportionate assessments which are subject to the interested Trustees’ approval, and (b) the procedures relating to the exercise of the “Put” options described below. The last three of the powers listed will be exercisable primarily by the administrative Trustee. Importantly, the interested Trustees also have the power by their unanimous vote to remove the administrative Trustee if the trusts are not being administered to their satisfaction. A more “friendly” or suitable

Trustee can be found to replace the removed administrative Trustee. You may liken the powers and rule of the interested Trustees as establishing a representative democracy on important issues which do not fall squarely in the category of administrative matters as defined in the trust document. Each of the two branches will have one vote through a chosen representative they designate by their majority vote. Accountability is assured because any interested Trustee other than a son may be removed and replaced by the vote of a majority of the beneficiaries of the subject family land trust.

b. A majority of the beneficiaries of each family land trust also have a right to "Put" their trust's interest in the trust property. A Put is essentially a right to compel the other family land trust to purchase the electing trust's interest in the Homestead. This could be exercised, for example, by the beneficiaries of a family land trust who no longer wish to use and enjoy the Homestead. This allow a non-participating branch or sub-branch of the family to liquidate their family land trust's interest in the Homestead. There are substantial restrictions on this power. The restrictions are designed to (i) disable a branch of the family which may temporarily be "strapped" for cash from frivolously exercising its Put rights; (ii) prevent the imposition of unmanageable burdens on the trusts for those family branches continuing their participation; (iii) avoid a need to sell the Homestead in a distress sale fashion to produce cash sufficient to satisfy exercised Put rights; and (iv) avoid federal gift and estate tax problems which would exist for the beneficiaries of a family land trust if they had the unrestricted right to liquidate their trust's interest in the Homestead, terminate their trust, and have the liquidation proceeds distributed to them. These restrictions include limiting the put purchase price to 75% of the electing trust's pro rata share of the property's fair market value, allowing payment of the purchase price over a 30-year period, and holding the promissory note or cash received as proceeds of the Put transaction in the electing branch's generation-skipping family fortress trust or trusts - further

“discretionary” trusts which will be administered for the benefit of the electing trust beneficiaries. A discretionary trust is an arrangement in which the timing and amount of any distribution of trust income and principal to the beneficiaries are wholly within the discretion of the “disinterested” Trustee (see below).

c. *Individual beneficiaries may also elect to “Put” their beneficial interests.* Individual beneficiaries of family land trusts and sub-branches of the family below the Smith sons’ generation may also “vote with their feet” by exercising beneficiary put rights they hold for themselves and their minor children. These are done entirely within the family land trust in which the electing beneficiary has an interest. The rights are subject to similar restrictions to those described above applicable to the put rights exercisable at the trust level.

For example, assume that in 70 years from now, one sub-branch of the Smith family headed by a great-grandson of Mrs. Smith may decide that his family lives on the west coast and will never use the Homestead. They face the potential of assuming some of the burdens and obligations of being a beneficiary without the possibility of enjoying any of the benefits. They would prefer having their beneficial interest liquidated and paid to (or initially fund) the generation-skipping family fortress trust from which distributions of any available cash can be made to the great-grandson and his descendants.

The great-grandson may notify the administrative Trustee of his election to put the beneficial interest held by the beneficiary, his spouse, and each of his minor children. Assume there are five people in this class. Assume also that there are 30 other beneficiaries of the separate family land trust in which the beneficiary participates. Finally, assume that the appraised value of the Homestead is then \$2 million. 75% the subject family land trust’s 50% interest in the Homestead is approximately \$750,000 (75% of \$1 million).

The “put price” payable with respect to the electing beneficiary’s family is determined as follows: 5 electing beneficiaries divided by 30 total beneficiaries of the subject family land trust equals .1666 multiplied by \$750,000 equals \$125,000. The interested Trustee of the subject family land trust may assess all continuing beneficiaries of the family land trust to pay a proportionate share of this amount payable in either a lump sum or over several years via installment payments under a promissory note. Any such promissory note or cash proceeds will be distributed to (or initially fund) the family fortress trust established or being maintained with respect to the electing beneficiary and his or her family.

d. The interested Trustees of the family land trusts may vote to sell the Homestead or approve their distribution by the disinterested Trustees.

Because there are only two family land trusts the vote must be unanimous. If there is only one family land trust, the sole interested Trustee can act unilaterally to direct a sale. Any sale proceeds will be divided in a *per stirpes* fashion among any continuing family fortress trusts which will continue as “discretionary” trusts in the same manner described in subparagraph c. above.

e. The family land trusts are also designed to allow the Homestead to be “bailed out” in kind if future circumstances warrant it. To avoid tax problems, the decision to distribute the Homestead must be exercisable by the disinterested Trustee of each family land trust. No such disinterested Trustee need be appointed unless and until both of the interested Trustees decide they want the flexibility to distribute the Homestead. Once a disinterested Trustee is appointed, such Trustee must serve with respect to all family land trusts then in existence. Any decision the disinterested Trustee makes to distribute each family land trust’s proportionate interest in the Homestead is subject to the approval of both of the interested Trustees. This gives them (or the sole interested Trustee if only one family land trust is then in

existence) a “veto” power to avoid the distribution of all or a portion of the Homestead if both of the representatives of the family branches do not support that action. The distribution can be made to one or more of the beneficiaries of the subject family trust (including one of the sons), or a new irrevocable trust which Mrs. Smith might create should the existing FLPT be obsolete for any reason, such as changes in family circumstances or federal tax laws.

B. Tax Objectives.

1. Minimizing Gift Tax Consequences Upon Mrs. Smith's Contribution of the Homestead and Endowment.

a. “Crummey Powers”. The gift tax law gives Mrs. Smith the ability to transfer up to \$10,000 per year to anyone without any federal gift tax consequences. This is called the gift tax “annual exclusion”. It allows Mrs. Smith to grant up to \$10,000 per year to each of her sons and grandchildren. The exclusion is available only for transfers of “present interests” in property. Although all the beneficiaries of the family land trusts have the current right in common with each other to use and enjoy the Homestead this is not enough to qualify their interests as “present” under the gift tax law.

The law allows us to cure this problem by giving each beneficiary the power to withdraw up to the greater of five (5%) percent of the value of the property contributed and subject to withdrawal, or \$5,000 up to a maximum of up to \$10,000. These withdrawal rights are triggered by Mrs. Smith's contribution of property to the FLPT. Each beneficiary's withdrawal right lapses if he or she does not exercise it within one (1) month after the contribution.

How will all of this work in the Mrs. Smith's case? We anticipate that the original contribution will have a value in the neighborhood of \$255,000 -- one-half (1/2) of the discounted value of the Homestead. Five percent of \$255,000 is \$12,750. Therefore, each beneficiary can

withdraw the maximum \$10,000 portion of this contribution. These withdrawal rights are not expected to be exercised (but it is important that each beneficiary not be discouraged from exercising his or her withdrawal rights). However, their mere existence will be sufficient to create the necessary present interest in each beneficiary. The rights are given to each of the two (2) Smith children, two (2) spouses and three (3) grandchildren. This makes seven (7) withdrawal powerholders. The amount of any annual contribution which can be sheltered by the annual exclusions is therefore \$70,000 (7 donees times \$10,000). The remaining \$185,000 will be sheltered from current gift taxation by the same amount of Mrs. Smith's \$600,000 lifetime gift and estate tax exemption amount. This will leave \$415,000 in exemption to shelter further lifetime or deathtime gifts from estate taxation. Those future gifts will include Mrs. Smith's transfer of her remaining one-half interest in the Homestead to the FLPT in 1997, consuming another \$185,000 in her exemption amount, and leaving \$230,000 to shelter the value she transferred to her QPRT in 1995 [Note: The "mathematics" and theory behind the fractional interest discounts and \$10,000 annual exclusions are explained in more detail later in subparagraph b. of this Summary]. In addition to the advantage of using the \$10,000 annual exclusion amounts, transferring the Homestead now at its low federal estate and gift tax cost will "freeze" its transfer tax value such that all appreciation will accrue to the trust and not to Mrs. Smith's estate. Assuming a potential marginal federal estate tax rate a minimum of 37%, the gift and estate tax savings in Mrs. Smith's generation may be significant - particularly if Congress reduces the \$600,000 gift estate tax exemption to some lower amount, such as \$200,000, which was recently proposed.

There is a potential capital gains tax issue if Mrs. Smith decides to make the completed gift of the Homestead now. To the extent that the Homestead is appreciated, the trust will succeed to Mrs. Smith's low federal income tax cost basis in the properties. The trust will have to pay a

maximum 28% capital gains tax on any gain realized upon a sale of any of the properties. Perhaps it will never be a problem with respect to the Homestead because there is no intention to sell it; indeed, the intention is to do just the opposite -- hold the Homestead in trust for a long time. The capital gains tax may therefore never be a problem. It may even provide a useful disincentive to a frivolous, hastily made decision to sell the property or exercise a Put option.

b. Other strategies for reducing federal gift tax consequences of funding the FLPT.

i. "Serial" funding with undivided interests. Again, Mrs. Smith will transfer equal one-half (1/2) interests in the Homestead in each of the next two (2) years, resulting in \$300,000 in underlying values transferred in each year. This will provide two (2) notable benefits: (i) shelter more of the Homestead's value from gift taxation by using two years worth of federal gift tax annual exclusions at \$75,000 per year, rather than one year at only \$70,000; and (ii) allow a "fractional interest" discounting of each one-half (1/2) interest in the Homestead gifted to the trust. In this scenario, the discounts and expanded crummey withdrawal powers would significantly reduce the consumption of Mrs. Smith's \$600,000 gift and estate tax exemption. Here's how.

The undiscounted value of each one-half (1/2) annual transfer of the value of the total property is \$300,000 (\$600,000 divided by two). The federal Tax Court has recognized that the recipient of an undivided one-half (1/2) interest in real property actually receives value of less than one-half of the fractionalized property's total value because if the donee attempted to sell the property, he or she must first petition local court for the partitioning of the property. This can be an expensive, time consuming process. The courts have generally recognized that a discount is appropriate to reflect this marketability problem. Let's assume that an appraiser assigns a

conservative 15% discount in this case.

Fifteen percent (15%) of \$300,000 is \$45,000. The discounted value of a one-half (1/2) interest in the Homestead is \$255,000. Over two years, the discounted value of the Homestead transferred to the *FLPT* is \$510,000. From this we must subtract \$140,000 -- representing two (2) years of annual exclusion gifts at \$70,000 per year. The net amount of gift and estate tax exemption consumed is \$370,000. This is \$160,000

less than if Mrs. Smith were to make the contribution all in one year at an undiscounted value. It is a full \$230,000 less than if Mrs. Smith had waited until her death and transferred the entire \$600,000 in value without any discounts or annual exclusions. If we assume a 45% marginal estate tax rate at which the Homestead would have otherwise been taxed on Mrs. Smith's death, this planning stands to save the family \$103,500 in federal estate taxes.

ii. The "articulated QPRT". Mrs. Smith has also established a QPRT to hold her New Hampshire primary residence. A "QPRT" is an acronym for a "Qualified Personal Residence Trust". A QPRT is a specialized trust sanctioned by the tax code and IRS regulations and available as a planning strategy only for "personal residences". It is not something that can be used in conjunction with the crummey trust described above. It involves a completely different technique for reducing the federal gift tax value of personal residences which will ultimately transferred to children and further descendents. Significant reduction in gift tax value is available because the senior generation family member creating the trust will retain certain rights in the property, including the right to its rent-free occupancy for a defined term of years. The value of the "gift" to future generations is measured only after subtracting from the current value of the property the actuarially determined value of the donor's retained rights, including the right to rent free use. The FLPT can be coupled with the QPRT to continue as a management and generation-

skipping trust after the donor's term of rent-free occupancy expires. A secondary meaning of "articulated" is "a coupling"; hence the name "articulated QPRT".

We will not take the time to describe the QPRT strategy in detail here. Summaries we have previously sent dealing with the NH QPRT adequately describe it and its purposes. The articulated QPRT and the pure FLPT crummey trust are mutually exclusive alternative strategies. While it is perhaps fair to say that in most cases the FLPT crummey trust wins out, the choice is sometimes a difficult one. One drawback of the articulated QPRT is that it offers no guarantees. If the donor dies before the expiration of the chosen rent free term, the trust terminates and the entire value of the property is included in the donor's estate for federal estate tax purposes. The family will lose all of the transfer tax benefits that the QPRT was intended to provide. Using the QPRT requires the family to gamble that the donor will survive the chosen term. Thus, while the QPRT does offer the advantage of a period of rent free occupancy it can come at significant opportunity cost - something we do not feel you should risk in this case. The FLPT, by contrast, offers more certain transfer tax savings. That is one reason why we are recommending it (and not the QPRT) for the Homestead.

2. *The FLPT creates potential for federal estate and generation-skipping transfer tax savings on the passing of future generations.*

a. *The Family Land Trusts.* As beneficiaries of the family land trusts -- again, those initially established to hold a family branch's one-half (1/2) interest in the Homestead and the endowment - Jeff and John will both benefit from the use and enjoyment of the property¹. However, because they are not given any estate taxable powers over it, the portions of

¹ Both of their spouses will also be eligible "beneficiaries" entitled to use and enjoy the property, subject to the administration and coordination of the administrative Trustee. Jeff's FLPT will continue for his and his wife's benefit until both of their deaths. At that time, if Jeff still has no "issue", his FLPT will terminate and his share of

the property held in these trusts will not be subject to federal estate taxation upon Jeff's and John's deaths. The same is true with respect to John's children and possibly further descendants. And, because Mrs. Smith will be allocating an approximately \$510,000 portion of her \$1 million generation-skipping transfer tax exemption to the \$510,000 discounted value of the Homestead, the ultimate distribution of the trust property to some future generation of the Smith family (perhaps as long as 100 years from now) will not be subject to federal generation-skipping transfer tax. Without the allocation of the generation-skipping transfer tax exemptions, this termination and distribution of the trust property could be subject to tax at a flat rate of 55% [We have previously provided a technical summary of these generation-skipping concepts].

b. Family Fortress Trusts. Note that Section IV of ARTICLE III of the document provides for multiple "family fortress trusts" to hold any trust property other than the Homestead and the endowment. These trusts may hold each son's family branch's one-half share of any remaining endowment and the proceeds of any future sale of the Homestead if the interested Trustees exercise their power to direct a sale. In such event, the family land trusts will terminate, and the family fortress trusts will be enhanced or initially established. One or more (but not all) of the family fortress trusts may be funded or enhanced upon the termination of one or more family land trusts as a result of the exercise of a trust's rights to Put its share of the Homestead, or upon a beneficiary's exercise of a beneficiary Put option. Any such proceeds of a sale or Put, or any other property allotted to the family fortress trusts, is to be divided among the multiple family fortress

the family lands will be added to John's FLPT to be held for the benefit of descendants in John's branch of the family. If Jeff does not like this result, he can Put his interests during his lifetime, or provide for his interest to be kept Put immediately upon his death. This will allow Jeff to "cash in" his family land trust's interest in exchange for a promissory note given by John's family land trust. That note will produce a stream of income for Jeff and his spouse, and will be subject to Jeff's power of appointment under the terms of Jeff's family fortress trust. Importantly, both Jeff and John's spouses' interests in the family land trusts terminate if they become divorced. Neither spouse has the right to serve as interested or administrative Trustee -- an office reserved for Mrs. Smith's issue only.

trusts eventually to be established on a *per stirpital* basis with respect to the branch of the family terminating the Homestead trust was originally established for². For example, if in 70 years there are 10 living adult grandchildren of a child of Mrs. Smith (i.e., Mrs. Smith's great-grandchildren) in whose name a separate family land trust is being maintained, and the interested Trustee of the subject trust in which the grandchildren are beneficially interested elects to Put the trust's interest in the Homestead to the two continuing family land trusts, the proceeds of the Put transaction (including any promissory note) may be divided among 10 separate family fortress trusts, one established in each grandchild's name. As interested Trustee of the trust established in his or her name, each grandchild can negotiate with the "disinterested" Trustee of his or her trust to either continue the trust or terminate it and distribute it all to the grandchild and his or her descendants, depending upon what appears to be in the family's best interest at the time. The disinterested Trustee will probably exercise its discretion to distribute all of the property if each family fortress trust's fractional share of the proceeds has a modest value (probably \$100,000 or less). Having the disinterested Trustee (and not the beneficiary) exercise this discretion is important to preserve the generation-skipping benefits of the trust arrangement.

You may ask "what if one branch of the family puts its family land trust's interests back to the other after the Homestead has appreciated in value a great deal? Might this make it economically impossible for the remaining family land trust to continue to maintain the Homestead and satisfy their obligations to the putting trust's beneficiaries at the same time?" The answer is a resounding "maybe". But the continuing family land trust cannot be held hostage. It's ultimate out

² Translated: If John dies survived by his three children, John's family fortress trust will be subdivided into three family fortress trusts, one each established in the name of his two children. Thus, unlike the family land trusts of which there will never be more than two in number, it is likely that in the future there will be more than only two family fortress trusts as John's family proliferates.

is to vote with its feet. If things get too difficult, its interested Trustee can vote to sell their trust's interest in the Homestead and eliminate their problem. This gives the remaining family land trust the flexibility to "bail out" of the arrangement at any time, as long as its interested Trustee representing the remaining branch of the family determines that is the proper course.

III. Miscellaneous.

A. Mrs. Smith's Continued Use of the Homestead. Mrs. Smith must understand that she cannot continue her rent-free use of the Homestead. She will no longer own the property. Any continued occupancy must be either (i) episodic, informal use as the administrative Trustee's guest³, or (ii) under the terms of a short term lease negotiated at arms-length with the administrative Trustee. If the family chooses the later option, Mrs. Smith must pay fair rental value as determined and updated periodically by appraisal. There can be no guarantee or even implied understanding that a lease arrangement will be structured or entered, or if one is entered that it will be renewed. The administrative Trustee is duty bound to act in the best interests of the trust beneficiaries without any regard for the interest of Mrs. Smith who is not a beneficiary. To do otherwise would create a risk that the IRS will consider that Mrs. Smith remained the owner of the property for estate tax purposes. Paying fair rental values will have the positive effects of:

1. Shrinking Mrs. Smith's gross estate for federal estate tax purposes without the payment of rent being considered a gift which would otherwise consume the \$10,000

³ The administrative Trustee and Mrs. Smith must be careful if they choose the "guest" alternative. It is important that Mrs. Smith change her prior pattern of use of the property for the IRS upon her death to respect her "guest" status. For example, if during all years prior to creating the FLPT Mrs. Smith spent the entire summer at the property, and she continued to do so without paying rent, the IRS will attempt to include the full date of death value of the property in Mrs. Smith's estate on the theory that there was a implied agreement between her and the administrative Trustee that Mrs. Smith would retain a "life estate" in the property. If, however, Mrs. Smith reduced her use of the Homestead from the entire summer to a few weekends, and the sons and their families occupied the properties exclusively for substantial portions of the summer, Mrs. Smith is more likely to be viewed by the IRS as a "guest", not a de facto life tenant.

annual exclusion, Mrs. Smith's \$600,000 estate tax exemption, or, once the exemption is completely consumed, pay a gift tax; and

2. *Helping build (or at least maintain) the endowment*⁴.

B. Appraisals. Assuming Mrs. Smith chooses to make a completed gift of the property for gift taxes purposes, we must establish the Homestead's fair market and fair rental values by professional appraisals. A qualified appraiser should be retained at the earliest possible time.

C. Endowment Building. Mrs. Smith do not now have sufficient liquid assets to "seed" the *FLPT* with an endowment. The purpose of the endowment would be to provide a fund of investable assets, the income of which would be used to defray carrying charges associated with the property. Mrs. Smith's liquid assets currently consist of an investment portfolio which she will need for her future financial security. Mrs. Smith counts on the income and a portion of the principal of this fund to sustain her in her retirement. She cannot comfortably part with all or a portion of it to fund an endowment and still feel financially secure.

There are two ways to address this problem. First, if she feels she can comfortably afford it, her payment of fair rental value for her continued occupancy of the Homestead can make the trust financially self-sustaining for as long as Mrs. Smith lives and continues her rental payments. If the trust becomes strapped for cash, and the interested Trustees do not want to use the assessment procedure to carry the property, they can decide to sell certain of the separate building lots

⁴ Each of the family land trusts is designed as an "intentional grantor trust". This means that Mrs. Smith, and not the separate family land trusts or their beneficiaries, is accountable for the taxable income earned by each by each family trust. It also means that any "rent" Mrs. Smith pays for her use of the trust will not be deemed taxable income; the rationale for this is that Mrs. Smith and the trust are considered to be the same entity -- you could not pay yourself taxable income. It is unlikely, therefore, that the trust will have to file anything other than simple federal income tax returns during Mrs. Smith's lifetime. I can discuss this later in more detail with Mrs. Smith or her accountant.

comprising the Homestead to establish, enhance or re-establishment the endowment. Second, we have asked that Joe Jones amend Mrs. Smith's revocable trust to provide for the funding of the endowment with Mrs. Smith's other liquid assets which may remain upon her death. Each son should also consider irrevocable trust owned life insurance on his life (or perhaps preferably on his and his spouse's life). The trust ownership will remove the insurance proceeds from the son's taxable estate upon his death. The trust will provide that those funds will "pour" into the endowment upon the son's death.