Setting Servicemembers Up for More Success: Building and Transferring Wealth in a Challenging Economic Environment—A Tax and Estate Planning Analysis

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> *[People] make a lot of pocketbook decisions every day that have an impact on the health of the economy, such as whether to take on a particular mortgage, how much to save and invest, whether to lease or buy a car, and how to manage credit cards. . . . The choices we make as individuals . . . are linked to the broader economy in ways that we don't always appreciate. However, one thing is certain—we make better decisions if we are better informed, and the whole economy benefits.*[1]

> *Failures don't plan to fail, they fail to plan—Plan and succeed.*[2]

I. Introduction

In times of increasing financial uncertainty, servicemembers must consider the extent of their financial planning. Current economic conditions have transformed the way people plan for themselves and their families. While, prior to the financial crisis that began in 2007 the average American considered financial planning in terms of building wealth, modern times have forced Americans to focus on providing for their own subsistence and maintaining enough resources to outlast the next financial crisis.[3] This article is the second installment of a 2006 military financial planning resource.[4] While the first article addressed planning considerations for the average military member considering the purchase of a home, this article considers the unique issues facing servicemembers who have substantial assets, who want to provide for non-citizen dependents, and who desire to make unusual conveyances in their wills. These issues are addressed in a manner that is sensitive to the unique challenges of the contemporary financial operating environment.

To avoid financial ruin in times of increased financial risk, all servicemembers should have a process in place for evaluating their current and future needs, including the period after their death. At the simplest level, prudent financial planning is encapsulated in a four-step process. First, servicemembers should understand that estate planning is appropriate for almost everyone. Therefore, they should pursue legal measures, such as preparing a will and power of attorney. Second, servicemembers should become familiar with the tax system so that they can make informed tax decisions and minimize the negative consequences of uninformed legal and financial choices. Third, servicemembers should build and hold assets in a calculated manner to build wealth while accounting for risk. Fourth, servicemembers should make appropriate arrangements during life and at death to ensure that their designated beneficiaries reap the maximum rewards of their lifetime efforts. While most servicemembers will not have to complete the full four-step analysis,[5] servicemembers should become familiar with broader tax concepts so that they can accomplish their lifelong objectives and minimize negative tax and estate planning consequences.

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[1] Frederic S. Mishkin, Governor, Fed. Reserve Sys., The Importance of Economic Education and Financial Literacy, Speech at the Third National Summit on Economic and Financial Literacy (Feb. 27, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/mishkin20080227a.htm (last visited Jan. 28, 2010).

[2] John Alquist, Failures *Don't Plan to Fail, They Fail to Plan—Plan and Succeed*, EZINE ARTICLES, Sept. 13, 2007, http://ezinearticles.com/?Failures-Dont-Plan-to-Fail,-They-Fail-To-Plan---Plan-And-Succeed&id=730076.

[3] *See, e.g.*, Daniel K. Tarullo, Governor, Fed. Reserve Sys., In the Wake of the Crisis, Speech at the Phoenix Metropolitan Area Community Leader's Luncheon (Oct. 8, 2009), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20091008a.htm (last visited Feb. 1, 2010) (pointing out that the economy has been losing about a quarter of a million jobs every month and that uncertainty has made financial planning much more difficult).

[4] Major Samuel W. Kan, *Setting Servicemembers Up for Success: Buying a Home, a Legal and Financial Analysis*, ARMY LAW., Nov. 2006, at 1.

[5] *See generally* JOINT COMM. ON TAXATION, HISTORY, PRESENT LAW, AND ANALYSIS OF THE FEDERAL WEALTH TRANSFER TAX SYSTEM, JCX-108-07, at 1, 29 (2007), *available at* www.jct.gov/x-108-07.pdf (last visited Apr. 21, 2009) [hereinafter JOINT COMMITTEE] (explaining that in 2004, only 19,294 estate tax returns in the United States reported some tax liability; forecasting that only 3.42% of deaths will result in a taxable estate in 2016).

II. Step One: The Need for Servicemembers to use the Estate Planning Process

At present, it is not uncommon to encounter military members who have deployed five times since 11 September 2001.[6] Many servicemembers have been exposed to combat and the dangers of combat environments during recent conflicts.[7] This increased exposure to danger necessitates both financial and estate planning in the military more than civilian occupations. Getting one's affairs in order may involve no more than executing a will and creating a power of attorney. To this end, even if sevicemembers have few assets and no dependents, preparing these basic documents can minimize costs on their survivors and make it easier to attain personal objectives. Effective planning, may, however, require far more in other circumstances, which the following sections explore in detail.

A. Powers of Attorney and Advanced Medical Directives (i.e., Living Wills)

Research has shown that the Iraq and Afghanistan campaigns are different from prior conflicts. Medical and technological advances have improved the quality of healthcare, increasing the chances that American servicemembers will survive even the most horrendous types of injuries.[8] With improvised explosive devices—the "signature" weapon of modern campaigns—accounting for a majority of injuries sustained, servicemembers face complicated medical situations, such as vegetative states and severe neurological impairments. Dependents often must assume the roles of daytime care providers in the most basic activities, struggling with the financial consequences of these injuries.[9] These situations, where round-the-clock care is often required, emphasize the need for serious planning considerations, not only for supplemental income but also for end-of-life decision-making.[10]

Servicemembers may create different types of powers of attorney for different purposes, such as handling financial affairs and making health care decisions. General powers of attorney enable individuals to empower agents to handle all of their legal and financial affairs. Although servicemembers should try to ensure that their powers of attorney comply with state law, federal law protects military powers of attorney even if they might otherwise fail under state law.[11] Unfortunately, many third parties may be unfamiliar with federal law and may initially refuse to honor military powers of attorney that do not comply with state law. Additionally, agents, particularly those acting under the broad authority of general powers of attorney, may abuse their powers or mismanage servicemembers' affairs. Because of these uncertainties, third parties, such as banks, may be reluctant to honor general powers of attorney and may insist on the use of their own forms, which often limit agents' authority to specific types of transactions. Since third parties are not forced to honor powers of attorney, refusals by third parties may create complications for servicemembers.

Special powers of attorney, which give agents specified, limited powers, such as the power to pay taxes, sell property, make gifts, sign leases, or access health records, can protect servicemembers from the risk of refusal. Like general powers of attorney, special powers of attorney offer servicemembers the convenience of allowing someone else to carry on their personal and legal affairs if they are unavailable due to temporary duty or deployments. Additionally, special powers of attorney are more likely to be honored by third parties because of their specificity. Nevertheless, some third parties, such as hospital records rooms, may still prefer the use of their own forms to ensure their own compliance with applicable laws.[12] To ensure third parties honor servicemembers' instructions, servicemembers should coordinate with potential third parties in advance to determine whether their powers of attorney will be honored. In some cases, the use of specific, third-party forms, such as bank or hospital forms, up front will facilitate certain transactions and forgo the need to go to a legal office to have a special power of attorney drafted.

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[6] Laura Savitsky et al., *Civilian Social Work: Serving the Military and Veteran Populations*, 54 SOCIAL WORK 327, 327 (2009).

[7] Charles W. Hoge et al., *Combat Duty in Iraq and Afghanistan, Mental Health Problems, and Barriers to Care*, 351 NEW. ENG. J. MED. 13, 18 tbl. 2 (2004).

[8] J.C. Van Lierop III, Note, *Post-9/11 Army Disability Decisions: Reinforcing Administrative Law Principles in Fitness and Disability Rating Determinations*, 61 FLA. L. REV. 639, 640 (2009) (observing that "a much higher percentage of troops survive battlefield injuries today compared to only a few decades ago").

[9] *E.g.*, Clayton Taylor, *Wounded Vets Need Help*, COURIER-J. (Louisville, Ky.), Nov. 11, 2009, at 11A.

[10] *E.g.*, *id.* (describing how "[t]ypically, with such catastrophic injuries, a parent or spouse is forced to leave the workforce to care for their loved one").

[11] *See generally* 10 U.S.C. § 1044b (2006) (giving legal effect to notarized military powers of attorney without regard to compliance with state law requirements as to form, substance, formality, or recording).

[12] *See, e.g.*, Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), 42 U.S.C. § 1320d (2006) (regulating the disclosure of health information and records); Standards for Privacy of Individually Identifiable Health Information, 65 Fed. Reg. 82, 462 (Westlaw 2010) (codified at 45 C.F.R. § 160–164 (same).

Despite these complications, powers of attorney can be extremely useful, especially if tailored appropriately. For example, depending on state law and the servicemember's intent, powers of attorney can be durable or springing.[13] Durable powers of attorney remain in effect even if a servicemember becomes disabled and loses the capacity to make decisions. To draft a durable power of attorney, attorneys should include language such as, that the powers granted continue to be effective even if the servicemember becomes disabled or incompetent.[14] In this example, disabilities should be stated broadly enough to encompass both physical limitations as well as neurological or psychological conditions. By contrast, springing powers of attorney become effective upon the occurrence of a specified event, such as a servicemember becoming incapacitated. To draft a springing power of attorney, attorneys should include language such as, that the powers may only be used after certification that the servicemember has become disabled, incapacitated, or incompetent.[15] Springing powers of attorney may be more complicated and time consuming for agents to operate under because the specified event (e.g., the occurrence of the servicemember's incapacity) may require proof in the form of a physician's written certification or other tangible evidence.

In addition to general and special powers of attorney for legal and financial affairs, a health care power of attorney allows a servicemember to designate an agent to make health care decisions in the event of the servicemember's incapacitation. For example, if a servicemember becomes disabled and cannot explain his current desires, a previously designated agent, acting under a health care power of attorney, can ensure the servicemember's wishes with regard to health care (e.g., to be admitted to a hospital, to employ a health care provider, or to consent to certain types of surgery) are carried out. Attorneys in the U.S. Army currently use a software program, DL Wills, to draft state specific health care powers of attorney, wills, and advanced medical directives.[16]

To ensure proper planning for "end-of-life medical treatment,"[17] servicemembers should consider completing an advanced medical directive or "living will."[18] In the absence of contrary guidance, the default medical option is to prolong the lives of those who are incapacitated. Servicemembers who do not wish to be kept on life support when they have no reasonable expectation of recovery can specify their wish to be disconnected from life support in an advanced medical directive. Military directives have special value because Federal law protects military advanced medical directives that might otherwise fail under state law.[19]

In any of the above examples, the few hours required to research and develop special healthcare plans can have lifelong benefits. The costs of ignorance in this area are simply far too great.

B. Wills

Similar to an advanced medical directive, a last will and testament can be used to make a servicemember's intent clear on a range of issues, from the disposition of property and the payment of taxes to the identification of the servicemember's state of domicile[20] and the appointment of guardians.[21] By expressing their desires in a will, servicemembers can avoid the default intestacy laws of states, which may direct the disposal of property contrary to a servicemember's wishes. To facilitate the recognition of servicemembers' wills, federal law requires that courts give military testamentary instruments legal effect,

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[13] *See generally* ADMINISTRATIVE & CIVIL DEP'T, THE JUDGE ADVOCATE GEN.'S SCH., 54TH GRADUATE COURSE DESKBOOK, ESTATE PLANNING ELECTIVE P-50 to P55 (2006) (listing each state code with commentary indicating whether a given state recognizes durable and springing/contingent powers of attorney) [hereinafter DESKBOOK 2006].

[14] *See, e.g.*, Drafting Libraries [Will Software], *available at* http://www.draftinglib.com (last visited Jan. 28, 2010) (providing appropriate language).

[15] *See e.g., id.*

[16] *See id.* (providing information on how to acquire DL Wills software and the latest supplement updates to the software).

[17] Captain Thaddeus A. Hoffmeister, *The Growing Importance of Advanced Medical Directives*, 177 MIL. L. REV. 110, 111 (2003) (providing a detailed discussion of advanced medical directives and their interaction with powers of attorney for health care, which together may form a single legal instrument).

[18] *See generally id.* at 110–132 (explaining the need of AMDs in light of Terri Schiavo).

[19] *See generally* 10 U.S.C. § 1044c (2006) (giving legal effect to military advanced medical directives without regard to compliance with state law requirements as to form, substance, formality, or recording).

[20] Because the state law where servicemembers are domiciled can control the disposition of a will, servicemembers can "select" the applicable state law by establishing domicile in a state and declaring their domicile in a will. *See infra* notes 45–49 and accompanying text (discussing the concept of domicile and how to establish domicile).

[21] *See generally* TAX MANAGEMENT INC., TAX MANAGEMENT; ESTATES, GIFTS, AND TRUSTS PORTFOLIOS; ESTATE PLANNING, at A-28 TO A35 (2006) [hereinafter T.M. ESTATE PLANNING] (discussing the purpose, basic structure, and components of a will).

regardless of state law requirements, as long as they are executed by a competent testator eligible for military legal assistance in the presence of a military legal assistance counsel and at least two disinterested witnesses.[22]

III. Step Two: Understanding the Tax System and The Wisdom of Tax Planning

Executing powers of attorney, advanced medical directives, and wills represent an important first step in the estate planning process. However, in order to meet current and future financial needs, servicemembers should also engage in basic tax planning. Understanding the multilayered and multidimensional tax system is crucial to building wealth. Forgoing basic tax planning can result in unintended and significant depletions of a taxpayer's income and, ultimately, a decedent's estate.

The law treats servicemembers like every other individual taxpayer, except that servicemembers receive extra tax benefits and considerations. For example, unlike other taxpayers, servicemembers can receive a tax-free housing allowance that they can use to generate mortgage interest tax deductions on their homes.[23] Despite these benefits, servicemembers, like all other taxpayers, face income, gift, estate, and generation skipping transfer taxes at both state and federal levels. Similarly, servicemembers must pay property, sales, use, and other types of taxes at the state and local government levels.[24]

A. Income Tax Considerations

1. Federal Income Tax

To reduce their federal income taxes, servicemembers must first understand the six steps required to calculate the Federal Income Tax.[25] First, the taxpayer must calculate gross income, which includes numerous items such as compensation for services (e.g., military and non-military pay), interest, rents, and pensions.[26] Second, the taxpayer must calculate adjusted gross income by deducting adjustments (i.e., "above the line deductions"), such as expenses of producing rents and certain individual retirement account (IRA) contributions. Third, the taxpayer must calculate taxable income by deducting personal exemptions and the greater of the standard deduction or itemized deductions. Fourth, the taxpayer must look up the tax due based on taxable income.[27] Fifth, from this amount, the taxpayer must calculate the net tax due (i.e., "total tax") by deducting applicable credits, such as the credit for child and dependent care, educational credits, the child tax credit, and, if applicable, by adding in other taxes such as the self-employment tax.[28] Sixth, the taxpayer must calculate "total payments," which include federal income taxes withheld and credits, such as the earned income credit[29] and the additional child tax credit. If the taxpayer's "total payments" exceed the "total tax," the taxpayer can file for a tax refund. In contrast, if the "total tax" exceeds the "total payments," the taxpayer will owe taxes.

Taxpayers should be familiar with how important characteristics of the federal income tax system may affect their own tax liability. First, a taxpayer's filing status can provide significant benefits. For example, in general, married taxpayers filing joint returns pay less taxes and can qualify for the earned income credit, while married taxpayers filing separate returns

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[22] *See* 10 U.S.C. § 1044d (giving legal effect to military testamentary instruments without regard to state law requirements on form, formality, or recording).

[23] *See, e.g.*, Treas. Reg. 1.61-2(b) (establishing that military housing allowances received by servicemembers are excludable from gross income). *See also,* I.R.C. § 265(a)(6) (allowing a servicemember to deduct mortgage interest on a home even though the servicemember receives a military housing allowance that is excludable from gross income). *See infra* note 32 and accompanying text.

[24] *See generally* Retirement Living Information Ctr., Inc., Taxes by State, *available at* http://www.retirementliving.com/RLtaxes.html (last visited Feb. 16, 2009) [hereinafter Retirement Living] (explaining the numerous types of taxes and the rates applied by each state including property, sales, fuel, cigarette, and other types of taxes, and providing links to official state tax websites); CCH, 2010 U.S. STATE TAX HANDBOOK (2009) (providing a quick-reference guide for state tax issues); OFFICE OF THE JUDGE ADVOCATE GENERAL, CODE 16, STATE TAX GUIDE (Jan. 31, 2010), *available at* http://www.jag.navy.mil/organization/documents/tax/2009StateTaxGuide.pdf (last visited Feb. 18, 2010) (providing a very useful quick reference guide for state income tax issues).

[25] *See, e.g.*, INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, FORM 1040 INSTRUCTIONS (2009) [hereinafter FORM 1040 INSTRUCTIONS]; G. VICTOR HALLMAN & JERRY S. ROSENBLOOM, PERSONAL FINANCIAL PLANNING 257-259 (7th ed. 2003) (describing, in general, how to calculate the federal income tax).

[26] *See* I.R.C. § 61(a) (2009) (defining the numerous components of gross income).

[27] *See* Internal Revenue Serv., U.S. Dep't of the Treasury, Form 1040: U.S. Individual Income Tax Return (2009) [hereinafter FORM 1040].

[28] *See id*. (describing how to calculate the "total tax" or net tax due). *See infra* note 37.

[29] *See* I.R.C. § 32(a) (defining the earned income credit and establishing its limitations).

pay more taxes and cannot qualify for the earned income credit.[30] Second, as individuals earn more taxable income, the Government taxes that income at gradually increasing rates.[31] Third, the Government taxes different types of income at different rates, while excluding certain types of income from taxation, such as military housing allowances[32] and combat pay.[33] Fourth, while the Government allows deductions, exemptions, and adjustments to reduce taxable income, these benefits have limits.[34] For example, if a taxpayer had an adjusted gross income (AGI) of $100,000 in 2009, the taxpayer's first $7,500 of unreimbursed medical and dental expenses incurred would not be deductible due to a 7.5% AGI threshold limitation.[35] Fifth, while the Government allows credits to offset taxes due, all credits are not created equal.[36] For example, if the credit is "nonrefundable" like the child and dependent care credit[37] and the credit is larger than the tax owed, tax refunds will be limited to the amount of the tax owed.[38] In contrast, if the credit is "refundable," like the earned income credit, taxpayers will receive a full refund for the credit even though the credit exceeds the tax due.[39]

Ultimately, servicemembers should understand that, despite the existence of programs designed to reduce taxes, the Federal Government created the Alternative Minimum Tax (AMT) to ensure taxpayers pay a minimum amount of tax, regardless of deductions, exemptions, and credits.[40] To this end, the more income a taxpayer makes, the greater the possibility that the taxpayer will be covered by the AMT.[41]

2. State Income Tax

As states increasingly face "devastating" deficits,[42] the state taxing authorities have increasingly become concerned with residents who have neither filed nor paid state income tax.[43] On one hand, military members who are ordered to move to a

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[30] *See* INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. 4012, VOLUNTEER RESOURCE GUIDE, at H-2 (2009) [hereinafter PUB. 4012] (providing a very useful quick resource guide to identify the Earned Income Credit's qualification requirements).

[31] *See e.g.*, FORM 1040 INSTRUCTIONS, *supra* note 25 (Establishing six individual tax brackets for 2009: 10%, 15%, 25%, 28%, 33%, and 35%). For example, in 2009, married taxpayers filing jointly would have a 15% marginal tax rate if they had taxable income between $16,700 and $67,900, but would have a 28% marginal tax rate if they had taxable income between $137,050 and $208,850. *Id.*

[32] *See, e.g.,* Treas. Reg. 1.61-2(b) (establishing that military housing allowances received by servicemembers are excludable from gross income). *See also,* I.R.C. § 265(a)(6) (allowing a servicemember to deduct mortgage interest on a home even though the servicemember receives a military housing allowance that is excludable from gross income). *See also,* Rev. Rul. 61-5 (establishing that military housing and cost-of-living allowances received by servicemembers while stationed outside the United States are excludable from gross income). *See generally* Kan, *supra* note 4, at 2 (discussing military housing allowances, their non-taxability, and the broader consequences of receiving such allowances).

[33] *See, e.g.,* I.R.C. § 112 (excluding certain combat zone compensation from gross income). *See also,* Treas. Reg. § 1.112-1(f) (2010) (providing examples excluding certain combat zone compensation from gross income). *See also* U.S. DEP'T OF DEFENSE FINANCIAL MANAGEMENT REG. 7000.14-R, DOD, vol. 7A, ch. 44, at 15–16 (July 2009) [hereinafter DOD FMR] (discussing combat zone tax relief areas for personnel in direct support of a combat zone). *But see* I.R.C. §§ 32(c)(2)(B)(vi) & 219(f)(7) (allowing combat pay to be included in earned income for purposes of the earned income tax credit and for purposes of making deductible IRA contributions).

[34] *See generally* INTERNAL REVENUE SERV., PUB. 17, YOUR FEDERAL INCOME TAX: FOR INDIVIDUALS 26–38, 121–140, 141–208 (2009) [hereinafter PUB. 17] (explaining personal and dependent exemptions, available adjustments to income; and available deductions).

[35] *See* I.R.C. § 213(a).

[36] *See generally* PUB. 17, *supra* note 34, at 209–263 (explaining available credits).

[37] *See* I.R.C. § 21 (establishing a credit for taxpayers who incur dependent care service expenses to allow them to have gainful employment).

[38] *See* INTERNAL REVENUE SERV., PUB. 4491, VITA/TCE-2008 STUDENT TRAINING GUIDE 8-3 (2008) [hereinafter PUB. 4491 (2008)].

[39] *See id. See supra* note 29.

[40] *See* The President's Advisory Panel on Federal Tax Reform, *America Needs a Better Tax System: Statement by the Members of the President's Advisory Panel on Federal Tax Reform* (Apr. 13, 2005), *available at* http://www.taxreformpanel.gov/04132005.pdf (last visited Jan. 28, 2010). By 2015, the AMT is estimated to apply to approximately fifty-two million taxpayers. *Id. But see* THE PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, REPORT OF THE PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 5 (2005), *available at* http://www.taxreformpanel.gov/final-report/TaxReform_Intro.pdf (recommending the elimination of the AMT).

[41] *See generally* PUB. 17, *supra* note 34, at 210 (explaining the 2009 income tax limits which may result in the need to pay the AMT). *See generally* GEORGE G. JONES, TOP FEDERAL TAX ISSUES FOR 2009 CPE COURSE 1.20–1.24 (2008) (discussing the history of the AMT, and the current AMT patch created by the Emergency Economic Stabilization Act of 2008). To determine whether the AMT applies, taxpayers should fill out the AMT Worksheet. *See generally* FORM 1040 INSTRUCTIONS, *supra* note 25, at 41. If applicable, taxpayers should fill out IRS form 6251 according to its instructions. *See generally* INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, FORM 6251 INSTRUCTIONS: ALTERNATIVE MINIMUM TAX—INDIVIDUALS (2009).

[42] *See, e.g.,* Ryan Kost, Oregon State Deficit Could Grow by $1 Billion, *available at* http://www.katu.com/news/local/37747104.html (last visited Jan. 28, 2010).

[43] *See e.g.,* Carr v. Dep't of Revenue, 2005 WL 3047252 (Or. Tax Nov. 4, 2005) (holding a servicemember liable for state income taxes in Oregon, even though the servicemember claimed to be from Nevada, a state without a state income tax).

new state may establish sufficient connections to the new state to justify the imposition of that state's income tax. On the other hand, military members who had a prior connection with a state before entering active duty service may appear to have neglected the payment of state tax, when, in fact, these servicemembers legally changed their state of domicile. In short, military members must be vigilant in understanding the meaning of domicile[44] and documenting the factors that prove their domicile. This section explores the fundamental distinctions.

a. Military Pay

In addition to paying federal income tax, many servicemembers must consider state income taxes, depending on their state of domicile.[45] A servicemember can establish a state as their domicile based on their physical presence in the state and their intent to make the state their permanent home.[46] Servicemembers may reap significant tax benefits based on the tax laws of their state of domicile because some states, like Texas, Nevada, and Florida, have no state income tax. In addition, other states exclude some or all military pay from income tax (see Appendix E).[47]

To establish and maintain domicile, servicemembers must take specific steps to demonstrate their intent to make a state their permanent home rather than engaging in subterfuge to avoid paying state income tax.[48] First, after establishing physical presence in the state, servicemembers should visit their local finance office and fill out appropriate paperwork, such as the DD Form 2058, *State of Legal Residence Certificate*.[49] Second, servicemembers should establish as many ties as possible to the state, such as registering to vote, purchasing real property, and obtaining professional and driver's licenses within the state. Third, servicemembers should express their desire to make the state their permanent home by telling others, such as friends and family, about their intent.

Servicemembers must exercise caution due to the variations in state law[50] and level of aggressive enforcement by state revenue collection authorities. For example, in *Carr v. Dep't of Revenue*, the court held that a servicemember had no connection to Nevada, his claimed state of domicile, but had sufficient nexus[51] to the State of Oregon even though he was not registered to vote in Oregon, had no Oregon driver's license, and had no intent to remain in Oregon once his military obligation was completed.[52] As a result of his connections to Oregon, including the purchase of a home and registering vehicles in Oregon, and, more importantly, his lack of current connections to Nevada, the court held that the servicemember was liable for paying Oregon's state income tax on his military income.[53]

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[44] Domicile is defined as "[t]he place at which a person is physically present and that the person regards as home; a person's true, fixed, principal, and permanent home, to which that person intends to return and remain even though currently residing elsewhere." BLACKS LAW DICTIONARY 501 (7th ed. 1999).

[45] *See generally* Retirement Living, *supra* note 24 (providing various resources relating to individual state requirements).

[46] *See generally* Major Wendy P. Daknis, *Home Sweet Home: A Practical Approach to Domicile*, 177 MIL. L. REV. 49, 52 (2003) (explaining the requirements of establishing domicile).

[47] *See id.* at 102–09 (describing the extent to which each state includes or excludes military pay and military retirement pay). *See also* Major Richard W. Rousseau, *Update: Tax Benefits for Military Personnel in a Combat Zone or Qualified Hazardous Duty Area*, ARMY LAW., Dec. 1999, at 1, 15–29 (describing the extent to which each state taxes combat pay).

[48] *See, e.g.*, Texas v. Florida, 306 U.S. 398 (1939) (discussing subterfuge situations).

[49] U.S. Dept. of Defense, DD Form 2058, State of Legal Residence Certificate (Feb. 1977), *available at* http://www.dtic.mil/whs/directives/infomgt/forms/eforms/dd2058.pdf (last visited on Jan. 28, 2010).

[50] *See e.g.*, *In re* Gatchell (N.Y. Tax Comm. 1984), *available at* http://www.nysdta.org/STC/Personal/1984/a_l0170.pdf (last visited Jan. 27, 2010) (establishing that a servicemember who lives in a military barracks does not have a permanent place of abode and thus is not exempt from New York state income tax).

[51] Nexus is defined as "[a] connection or link . . . ." BLACKS LAW DICTIONARY, *supra* note 44, at 1066.

[52] *See, e.g.*, Carr v. Dep't of Revenue, 2005 WL 3047252 (Or. Tax Nov. 4, 2005) (holding a servicemember liable for state income taxes in Oregon, even though the servicemember claimed to be from Nevada, a state without a state income tax).

[53] *See e.g.*, *id.* The court noted that if the taxpayers had "owned property in Nevada, had Nevada driver's licenses, voted in Nevada, registered their vehicles in Nevada, or spoke convincingly of an intention to return to Nevada, their case would be stronger." *Id.*

b. Non-Military (i.e., Civilian) Income

Although military income may not be subject to state income tax in certain states, non-military income of servicemembers and their spouses may be subject to state income tax based on the location where the income is earned. For example, if a servicemember owns rental property in a state that imposes state income tax, the servicemember may be obligated to file a non-resident income tax return for the state in which the rental income was earned. Similarly, if the servicemember receives compensation from a non-military job, the servicemember may need to file a state income tax return.

In a very important statutory development, civilian spouses who meet the domicile test of physical presence and the intent to make a state their permanent home can now receive protections similar to servicemembers due to the Military Spouses Residency Relief Act (MSRRA).[54] As a result of this Act, as of 2009, if military members and their spouses each separately establish and maintain domicile in the same state, they can keep this domicile even though they later move together upon the receipt of military orders to a new state.

For example, a servicemember and a civilian spouse may establish Texas as their domicile if both are physically present in Texas, express the intent to make Texas their domicile, and establish their own contacts to Texas, such as purchasing real property, voting, and becoming licensed in Texas. If the servicemember receives orders to move to Virginia and the spouse moves with the servicemember solely to be together, both can maintain Texas as their domicile. If the servicemember's spouse gets a civilian job in Virginia, the spouse can assert the MSRRA claiming Texas as the state where the spouse established and maintains domicile. By asserting and providing appropriate substantiation to this claim, the spouse's civilian pay would not be subject to taxation by Virginia. This result may seem unfair because the civilian pay of a servicemember who obtains civilian employment in Virginia would be subject to Virginia's income tax.

Servicemembers and their spouses should exercise caution because the Act may be interpreted differently by each state as the states react to the new federal legislation. Servicemembers and their spouses should be prepared to provide to their employers, as well as to the state taxing authorities, substantial evidence that they properly established and currently maintain a specific state as their domicile. If the claimed state of domicile has a state income tax, servicemembers and their spouses should ensure that their employers properly withhold the appropriate state's income tax.

B. The "Unified" Federal Transfer Tax System and "The Unified Credit"

In addition to taxing income, the Government designed a "unified" federal transfer tax system which incorporates the gift tax, the estate tax, and the generation skipping transfer tax to tax the transfer of wealth from one generation to the next.[55] The unified system targets individuals who fall into higher tax brackets and who possess more substantial assets. The gift tax covers lifetime transfers by gift; the estate tax applies to transfers at death; and the generation skipping transfer tax addresses "transfers designed to skip generations."[56] Career military members who have invested over time, built successful businesses during their service, or who have, themselves, inherited sizeable estates may be found throughout the active military.[57] They face unique concerns that are not normally capable of being addressed during the course of a brief meeting with an attorney, such as what occurs at a Soldier Readiness Processing (SRP) station preparing servicemembers to deploy to combat zones.

Although the Government designed a "unified credit" to allow for the tax-free transfer of a limited amount of wealth, the amount of the unified credit has diverged over time due to changes in tax law (see Appendix A). For example, in 2002, the

[54] 50 App. U.S.C. § 571. The Act, which amended the Servicemembers Civil Relief Act, states:

> A spouse of a servicemembers shall neither lose nor acquire a residence or domicile for purposes of taxation with respect to the person, personal property, or income of the spouse by reason of being absent or present in any tax jurisdiction of the United States solely to be with the servicemember in compliance with the servicemember's military orders if the residence or domicile, as the case may be, is the same for the servicemember and the spouse. . . . Income for services performed by the spouse of a servicemember shall not be deemed to be income for services performed or from sources within a tax jurisdiction of the United States if the spouse is not a resident or domiciliary of the jurisdiction in which the income is earned because the spouses is in the jurisdiction solely to be with the servicemember serving in compliance with military orders.

Id.

[55] *See* HALLMAN & ROSENBLOOM, *supra* note 25, at 462.

[56] *Id.*

[57] *E.g.*, Editorial, *Augusta Soldier Wins $1 Million in* Lottery, FLA. TIMES-UNION (Jacksonville), June 1, 2005, at B-4 (describing the lottery winnings of a Fort Gordon sergeant first class who chose to remain in the Army).

unified credit allowed a transferor to transfer up to $1 million tax free through lifetime taxable gifts, bequests at death, or a combination thereof. Specifically, if a transferor previously gave $400,000 of taxable lifetime gifts, he would only be able to transfer an additional $600,000 tax free through bequests at his death in 2002. While the transfers would be "taxable," the unified credit would prevent any tax from being payable. While the gift tax exclusion amount has remained and will continue to remain at $1 million, the applicable exclusion amount for the federal estate and generation skipping transfer tax has increased gradually up to $3.5 million in 2009. As a result, a transferor could have given $1 million of lifetime taxable gifts tax free and still transferred an additional $2.5 million tax free through bequests at his death in 2009.

However, in 2010, the federal estate and generation skipping transfer taxes have been temporarily repealed, with a reinstatement date of 2011.[58] In 2011, the top marginal tax rate for transfers will be 55% and the "unified credit" will shelter $1 million in transfers. Although numerous bills[59] are pending in Congress to change the status quo, no bill has been successful as of the date of this article.[60]

C. The Gift Tax

1. The Federal Gift Tax

In the terminology of tax law, a "gift" is merely a voluntary lifetime transfer of property by one person to another, where the value of the property transferred exceeds any consideration received.[61] Unlike the estate and generation skipping transfer taxes that may disappear for one year in 2010, the gift tax will remain in place for certain lifetime transfers to others.[62] Fortunately, the Government excludes some transfers from taxation under the gift tax, such as medical payments made directly to medical service providers and tuition payments paid directly to an educational organization.[63] Other transfers meeting the criteria of "non-taxable gifts" are excluded from taxation,[64] as are small monetary gifts meeting the threshold for annual de minimis gift amounts.[65] Some gifts exceeding the de minimis threshold may still be transferred as tax-free lifetime gifts as a result of the unified credit.[66] Finally, the Government allows for an unlimited marital deduction for lifetime gifts between U.S. citizen spouses.[67] Servicemembers should study the factors that distinguish between taxable and non-taxable gifts under the Federal gift tax as a hallmark of effective financial planning.

To calculate the gift tax due during a particular year, a servicemember must account for the total amount of lifetime gifts made in previous years. First, the servicemember must add the taxable gifts made in the current year with the gifts made in all previous years; then, the servicemember must calculate the tax on the sum of the lifetime gifts. Next, the servicemember must subtract the gift tax paid in prior years from the previously calculated tax on the total of the lifetime gifts; the remainder

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[58] *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat 38 (codified as amended in 26 U.S.C.). The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 sunsets on 31 Dec. 2010, restoring the tax status quo as of 2001.

[59] For the text of specific acts, visit The Library of Congress: Thomas, *available at* http://www.thomas.gov (last visited Jan. 29, 2010) (search for S. 722, H.R. 2023, H.R. 436, H.R. 498, and H.R. 4154 in the textbox marked "Search Bill Summary & Status").

[60] *See* CCH, CCH Tax Briefing: Federal Estate Tax (H.R. 4154), Estate Tax Extension Passes House, Fails in Senate; Carryover Basis Effective January 1, 2010, *available at* http://tax.cchgroup.com/legislation/HouseEstateTax.pdf (last visited Jan. 29, 2010) (providing an information paper on the current status of the bill). "On December 3 [2009], the House approved the Permanent Estate Tax Relief for Families, Farmers and Small Businesses Bill of 2009 (H.R. 4154), which would permanently extend the top federal estate tax rate of 45 percent with a $3.5 million exclusion. . . . [However,] the bill failed to win support in the Senate, as did a temporary stop-gap measure to extend the 2009 estate tax regime through March 2010." *Id. See generally* CCH, *available at* http://tax.cchgroup.com/news/legislation/default.asp (last visited Jan. 29, 2010) (providing the latest legislative tax updates).

[61] *See generally* CCH, 2010 U.S. MASTER ESTATE AND GIFT TAX GUIDE 353 (2009). An inter vivos gift is defined as, "A gift made during the donor's lifetime and delivered with the intention of irrevocably surrendering control over the property." BLACKS LAW DICTIONARY, *supra* note 44, at 697.

[62] *See generally* I.R.C. §§ 2501 to 2524 (covering all applicable code sections of the federal gift tax). *See generally* RICHARD B. STEPHENS ET AL., FEDERAL ESTATE & GIFT TAXATION 9–5 (8th ed. 2002) (discussing the imposition of the gift tax).

[63] *See* I.R.C. § 2503(e) (excluding qualified transfers for tuition and medical expenses paid on behalf of an individual directly to an educational organization or medical service provider).

[64] *See, e.g.*, *id.* § 2501(a)(4) (excluding transfers to political organizations for gift tax purposes). *See generally* STEPHENS, *supra* note 62, at 9-7, 9-43 to 9-44 (discussing transfers to political organizations; explaining transfers for medical and tuition expenses).

[65] *See* I.R.C. § 2503(b). *See generally* STEPHENS, *supra* note 62, at 9-14 (discussing inflation adjustments). In 2010, the annual exclusion equals $13,000. *See* Rev. Proc. 2009-50 § 2523 (see cost of living adjustments for 2010, Section 3.30(2)).

[66] *See* I.R.C. § 2505(a). In 2010, due to the federal gift tax ("unified") credit, $1 million of lifetime taxable gifts could be made before incurring gift tax.

[67] *See id.* § 2523. However, the unlimited marital deduction does not apply to gifts to foreign spouses. In 2010, taxpayers could transfer up to $134,000 tax free to a noncitizen spouse. *See* Rev. Proc. 2009-50 § 2523 (see cost of living adjustments for 2010, Section 3.30(2)).

will be the amount of gift tax due in the current year. Finally, the servicemember must subtract the unified gift tax credit from the gift tax due to calculate any gift tax owed. For example, independently wealthy Colonel Brad Smith gave his niece a $688,000 home in 2009 (see Appendix B) and later gives his nephew a $500,000 vacation condominium in 2010. Since the annual exclusion covering *deminimis* gifts was $13,000 in 2009 and 2010, the taxable value of the gifts in 2009 and 2010 were $675,000 and $487,000, respectively. When applying the gift tax law to this scenario, Colonel Smith should add $487,000 to $675,000 for a total of $1,162,000. Assuming he gave no other taxable gifts previously, he would then calculate the gift tax due on the $1,162,000. The unified credit would exclude $1 million of the transfer and expose the remaining $162,000 to gift tax. At a gift tax rate of 35%, Colonel Smith would be liable for $56,700 (i.e., .35 x $162,000) in gift tax.

Although taxpayers making taxable gifts must pay the gift taxes owed, they may still enjoy certain tangible benefits. By making taxable gifts, donors can remove the gifted property from their gross estates at a relatively low cost compared to incurring estate taxes, because the gift tax is tax exclusive while the estate tax is tax inclusive (i.e., unlike the gift tax, the estate tax taxes the amount of money used to pay the tax). For example, assume a taxpayer in the 45% gift tax bracket who had already used the unified credit and annual exclusion, made a gift of $1,000,000 of Microsoft stock to his son in 2009. He would incur a $450,000 gift tax for a total transfer cost of $1,450,000.[68] In addition, because the taxpayer made a completed transfer for gift tax purposes, neither the taxpayer nor his estate would be subsequently liable for any future taxes on the property and the property's post-transfer appreciation. If, after the transfer, the stock's value increased by $100,000 and the son sold the stock, the son (i.e., not the father) would be liable for paying tax on that gain.

As a result, for those planning to transfer property and deplete their estates, taxpayers should consider giving others items they expect will appreciate over time. Meanwhile, recipients of these gifts should understand that they will take the donor's basis in the assets and potentially pay greater taxes upon sale of the assets.[69] In addition, special provisions account for taxpayers who die within three years of paying gift taxes. For such taxpayers, the Government includes gift taxes paid in the taxpayer's gross estate.[70] As the next section explains, these taxes may only be the beginning. Specifically, once a servicemember has considered the federal gift tax, the financial analysis may continue forward to the state gift tax.

2. The State Gift Tax

Depending on a servicemember's domicile, state governments may also apply a state gift tax. For example, while most states do not impose a gift tax, states like Connecticut and Tennessee tax gift transfers.[71] The extent to which state gift statutes resemble the federal gift tax vary greatly and hinge on issues such as lifetime exemption amounts and annual exclusions (see Appendix F).[72] For instance, Connecticut imposes a gift tax on the aggregated amount of gifts over $3.5 million made after 1 January 2010, at graduated tax rates as high as 12%.[73] In comparison, Tennessee applies gift rates and exemption amounts depending on the status of donees.[74] Due to the variance in state gift tax statutes, servicemembers must pay close attention to their state's specific gift tax laws in addition to Federal ones. Furthermore, lifetime gift taxes at either level should not be confused with estate taxes, which concern themselves with taxing the transfer of wealth at death.

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[68] *See* I.R.C. § 2001(c) (establishing the maximum gift and estate tax brackets in 2009 as 45%). In contrast, a bequest of only $797,500 would be possible with estate assets worth $1,450,000 under the same circumstances as this gift example. *See infra* note 76 and its accompanying text.

[69] *See* I.R.C. § 1015(a) (establishing that the gift's basis in the hands of the recipient is equal to the donor's basis). Taxpayers should contrast the treatment of gifts with the treatment of bequests regarding basis. Taxpayers acquiring property from a decedent dying before 31 December 2009 received a basis equal to the fair market value at the time of death (i.e., a "stepped up basis"). *See id.* § 1014(a)(1). *But see id.* §§ 1014(f) and 1022 (limiting the step up in basis for property acquired from a decedent dying after 31 December 2009, to an aggregate amount of $1.3 million, with an additional $3 million dollars if the qualified spousal property is acquired by a surviving spouse).

[70] *See id.* § 2035. Gross estate is defined as "The total value of a decedent's property without any deductions." BLACKS LAW DICTIONARY, *supra* note 44, at 568. *See supra* notes 77, 84–92, and accompanying text.

[71] *See generally* 4 RESEARCH INSTITUTE OF AMERICA, INC., ESTATE PLANNING & TAXATION COORDINATOR: FEDERAL ESTATE & GIFT TAXATION 53,001–53,004 (2008) [hereinafter TAXATION COORDINATOR] (discussing the implications of state gift taxation; pointing out that only one-third of the states have enacted gift tax statutes; elaborating that many of these states such as North and South Carolina no longer tax current gift transfers).

[72] *See id*. at 53,003.

[73] *See id.* at 56,014–56,015.

[74] *See id.* at 56,112.

D. The Estate Tax

1. The Federal Estate Tax

Even though most servicemembers do not have the luxury of being able to make large gifts of property during their lifetime, most servicemembers should engage in some degree of estate-planning to maximize the property they can pass at their death. Even with no prior planning, estate taxes may be at issue if property is ultimately inherited by one other than the Government. In short, in addition to facing the income and gift taxes, servicemembers may also be subject to the federal estate tax upon their death, unless they die in 2010.[75] While the gift tax applies to property transfers during one's life, estate tax applies to transfers of property at one's death. When compared to the federal gift tax, the federal estate tax can be costlier. Specifically, the estate tax is tax inclusive like the income tax, because the amounts used to pay the tax are themselves subject to tax. Assuming the unified credit and annual exclusion did not apply, if a servicemember in the 45% estate tax bracket died in 2009 attempting to leave $1,450,0000 to his son, he would incur an estate tax of $652,500 (i.e., 0.45 x $1,450,000), leaving only $797,500 (i.e., $1,450,000 – $625,500) of the original amount to his son.[76] Had the servicemember transferred these funds to his son as a gift during his lifetime, the gift tax would have been $450,000, ultimately providing his son with $1,000,000. Simply by making a lifetime gift, the servicemember would have been able to make his son $202,500 richer, demonstrating the value of proper advance planning.

To further minimize federal estate taxes, servicemembers should understand how to calculate the estate tax due in a comprehensive manner consisting of five steps (see Appendix C). By using fair market value principles, the taxpayer first identifies and determines the value of all the property in the decedent's gross estate, including the value of all the property owned or controlled by the decedent at death.[77] Second, the taxpayer determines the decedent's taxable estate by subtracting applicable deductions—such as reasonable funeral expenses,[78] state death taxes paid,[79] charitable deductions,[80] and the marital deduction—from the decedent's gross estate.[81] Third, the taxpayer determines the tentative estate tax base by adding adjusted taxable gifts made during the decedent's lifetime to the decedent's taxable estate. Fourth, the taxpayer calculates the tentative estate tax by multiplying the tentative estate tax base by the applicable estate tax rate.[82] Fifth, the taxpayer calculates the federal estate tax by subtracting from the tentative tax applicable credits, such as the unified credit, and gift taxes paid on taxable gifts.[83]

Even with these five steps in mind, determining the estate tax is not as simple as it may appear; the property included in a decedent's gross estate is far from intuitive. As just one example, the gross estate includes any illegal property in which the decedent had an interest.[84] As another example, the gross estate also includes property that is not physically owned by the decedent but still under his "dominion and control"[85] such as an irrevocable transfer to a trust in which the decedent retained the power to alter the time when the trust's beneficiary will receive the interest. This property would, no doubt, remain in the decedent's gross estate for tax purposes.[86] Even an irrevocable transfer to a trust with the power to add or change the beneficiaries would fall under the decedent's gross estate based on the same principle.[87]

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[75] *See* I.R.C. §§ 2001–2210 (2009) (covering all applications code sections of the federal estate tax). *See generally* STEPHENS, *supra* note 62, at 2-2 (discussing the federal estate tax and the method of computation). There is currently no federal estate tax in 2010. However, legislation in Congress is currently pending, and if the legislation passes, a federal estate tax may apply to 2010 retroactively. *See supra* notes 59 and 60 and accompanying text.

[76] *See* I.R.C. §§ 2001-2210. Taxpayers should compare the consequences of the gift tax. *See supra* note 68 and its accompanying text.

[77] *See id.* §§ 2001, 2031, and 2033.

[78] *See id.* § 2053.

[79] *See id.* § 2038.

[80] *See id.* § 2055.

[81] *See id.* § 2056.

[82] *See id.* § 2001.

[83] *See id.* § 2010.

[84] *See id.* §§ 2033. For example, illegal drugs would be includable in the gross estate even though no deduction would be allowed for its confiscation.

[85] *See id.* §§ 2035–2038.

[86] *See id.* § 2038.

[87] *See id.*

The gross estate also includes specific types of property the decedent may have irrevocably transfered with no remaining powers exercised if the property was transferred within three years of the decedent's death,[88] such as a servicemember's transfer of a life insurance policy to another less than three years prior to his death.[89] Similarly, if the servicemember makes a taxable gift, pays the gift tax, and then dies within three years, the gift tax paid (but not the value of the gift itself) reverts back into the gross estate for estate tax purposes.[90] Yet another consideration revealing the complexity of these issues involves accounts created by the servicemember under the provisions of the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA).[91] The death of a servicemember serving as a trustee for such accounts before the minor beneficiary reaches the age of majority also results in reversion of the funds into the decedent's gross estate.[92]

Even when estate taxes rise due to the inclusion of property in the gross estate, beneficiaries can still realize positive consequences relating to tax basis, such as a stepped up basis in the property received.[93] This higher basis can reduce income taxes due when the beneficiary later sells the property.

2. State Death Taxation

In addition to the federal estate tax, the District of Columbia and many states, such as New York, impose a state estate tax. Like state gift taxes, state law varies greatly with regard to state estate taxes. For example, New York imposes a state estate tax equal to the maximum 1998 federal estate tax credit[94] while the District of Columbia has a credit of $385,800 for individuals who died on or after 1 January 2003, allowing for the tax-free transfer of estate assets worth $1 million.[95] Complicating the analysis, the Internal Revenue Code temporarily replaced the previous federal estate tax credit for state death taxes with a deduction[96] "for death taxes actually paid to any state . . . with respect to property included in the decedent's gross estate."[97]

Some states also impose inheritance taxes, which are not necessarily the same as estate taxes.[98] In general, while an estate tax covers the "transfer of property by a decedent," an inheritance tax usually applies to "the taking of property by a beneficiary."[99] As an example of the great variances in state tax law, states such as Texas and Maryland impose different types of inheritance taxes (see Appendix G). Texas imposes an inheritance tax based entirely upon the federal estate tax and thus is closer to an estate tax than an inheritance tax.[100] In addition, Texas treats residents, non-residents, and aliens

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[88] *See id.* § 203.

[89] *See id.* §§ 2035 & 2042.

[90] *See id.* § 2035. The gift tax paid includes all gift taxes paid even if the gift was a split gift where the decedent paid the gift taxes.

[91] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-94 (explaining that UTMA and UGMA accounts are custodial accounts that can be used for the support, maintenance, education, and benefit of the minor; explains that the minor takes legal ownership of the property once the minor reaches the age of legal capacity). *See also* ADMINISTRATIVE & CIVIL DEP'T, THE JUDGE ADVOCATE GEN.'S SCH., 57TH GRADUATE COURSE DESKBOOK, ESTATE PLANNING ELECTIVE L-51 (2009) (discussing UTMA and UGMA accounts) [hereinafter DESKBOOK 2009].

[92] *See* I.R.C. § 2035.

[93] *See id.* § 1014(a)(1) (establishing that taxpayers acquiring property from a decedent dying before 31 December 2009, received a basis equal to the fair market value at the time of death (i.e., a "stepped up basis"). *But see id.* §§ 1014(f) & 1022 (limiting the step up in basis for property acquired from a decendent dying after 31 December 2009, to an aggregate amount of $1.3 million, with an additional $3 million dollars if the qualified spousal property is acquired by a surviving spouse).

[94] *See* N.Y. TAX LAW § 952(a) (McKinney 2009). *See generally* TAXATION COORDINATOR, *supra* note 74, at 56,088 (explaining the New York estate tax). Basically, New York's state estate tax is a "fixed" "soak up" tax meant to reap the maximum revenue benefits from the federal law, as of 1998. While some states peg their statutes to a fixed time (i.e., "fixed" systems), other states have "floating" systems which automatically adopt federal law as federal law changes over time. While having a floating system may be easier for states to administer, states take the risk of making federal law state law without the advance opportunity to make adjustments. *See id. See also* MARTIN NISSENBAUM ET AL., ERNST & YOUNG'S PERSONAL FINANCIAL PLANNING GUIDE 339 (5th ed. 2004) (distinguishing states that have "soak-up" type taxes from states that have "decoupled" from the federal estate tax system).

[95] *See* D.C. CODE ANN. §§ 47-3701(4)(C)(ii) & 47-3702 (LexisNexis 2009). *See generally* TAXATION COORDINATOR, *supra* note 71, at 56,019.

[96] *See* I.R.C. § 2058 (providing a deduction for estates of decedents dying before 31 December 2010). *See* JOINT COMMITTEE, *supra* note 5, at 17 (explaining that the state death tax credit will be reinstated for decedents dying after 31 December 2010).

[97] STEPHENS, *supra* note 62, at 5-261.

[98] *See* TAXATION COORDINATOR, *supra* note 71, at 52,001 (discussing typical patterns of state death taxation). *See generally* Retirement Living, *supra* note 24 (providing numerous links and resources).

[99] TAXATION COORDINATOR, *supra* note 71, at 52,001.

[100] *See, e.g.*, *id.* at 56,123; TEX. TAX CODE ANN. §§ 211.051–211.053 (Vernon 2009) (discussing the tax treatment of residents, nonresidents, and aliens).

differently for tax purposes.[101] In contrast, Maryland "imposes an inheritance tax on the privilege of receiving property that passes from a decedent that has a taxable situs in Maryland" and the person who distributes the property is liable for the tax.[102]

All of these differences, especially the different federal and state exclusion amounts, may force some taxpayers to either forgo their full federal exclusion amount or to pay state estate taxes. Due to the complexities of local law, servicemembers should seek out legal counsel familiar with the peculiarities of their state's specific laws.[103] For servicemembers, this necessary task may be extremely difficult, if not impossible, due to the obstacles of assignments, deployments, or temporary duty to remote areas where meetings with legal assistance attorneys are an uncommon luxury.

E. The Daunting Nature of the Generation Skipping Transfer Tax

1. The Federal Generation Skipping Transfer Tax

The Internal Revenue Code anticipates that tax savvy earners will inevitably search for loopholes that allow them to convey property in a tax evading manner. To address the efforts of the wealthy to avoid the imposition of successive estate taxes or reward grandchildren with expensive new cars as college graduation gifts, the Code instituted the generation skipping transfer (GST) tax, with the objective of assessing transfer taxes at each generation of donee.[104] Four common scenarios may trigger the GST tax: (1) the giving of direct gifts to grandchildren or great grandchildren (i.e., inter vivos direct skips);[105] (2) the existence of bequests to grandchildren made in a will (i.e., testamentary direct skips); (3) the creation of testamentary trusts for children and grandchildren in which the trustee retains the power to make distributions to grandchildren (i.e., taxable distributions); [106] and (4) the existence of testamentary trusts for children and grandchildren when the children subsequently die leaving only "skip person"[107] grandchildren as beneficiaries (i.e., taxable terminations).[108] In each of these situations, donors may inadvertently trigger the heavy-handed GST tax, which is limited only by the federal GST exemption,[109] annual exclusions, and gift-splitting measures. Unaffected by the GST tax, however, are transfers directly to educational and medical service providers for tuition and health care, which donors may use freely much like they do with the gift tax.[110] Donors have great incentive to give gifts crossing numerous generations in 2010, as the Internal Revenue Code exempts this year from GST tax coverage.

Where taxes must be paid and the GST exemption and annual exclusions do not apply, the federal transfer tax implications can be quite severe. The first common scenario that may trigger the GST tax is called the "the inter vivos direct skip" scenario, in which a servicemember in the 50% gift, estate, and GST tax brackets plans to transfer $100,000 to his grandchild.[111] As a result of the GST tax, the donor would actually have to expend $225,000 to effectuate the $100,000 transfer, at the loss of a whopping $125,000. Three steps will determine the funds needed to transfer $100,000 under the

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[101] *See, e.g.*, TAXATION COORDINATOR, *supra* note 71, at 56,123; TEX. TAX CODE ANN. §§ 211.051–211.053 (Vernon 2009) (discussing the tax treatment of residents, nonresidents, and aliens).

[102] *E.g.*, TAXATION COORDINATOR, *supra* note 71, at 56,051. *See also* M.D. CODE ANN., TAX-GEN. § 7-202 (LexisNexis 2009).

[103] For example, a servicemember stationed in Iraq and interested in drafting a Louisiana will may be able to visit his local legal assistance office, which may be able to work with licensed Louisiana attorneys at Fort Polk, to draft the will, giving appropriate consideration to the appropriate state law issues rooted in French civil law.

[104] *See* I.R.C. §§ 2601-2664. *See also* Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended beginning at 26 U.S.C. § 1) (enacting the current form of the generation skipping transfer tax). *See generally* ELLEN K. HARISON, GENERATION-SKIPPING TRANSFER TAX PLANNING 9-1 to 9-71 (2009) (discussing an overview of the generation-skipping transfer tax).

[105] *See* I.R.C. § 2612(c).

[106] *See id.* § 2612(b).

[107] *See id.* § 2613(a) (defining "skip persons" as persons assigned to a generation which is two or more generations below the transferor's generation, or a trust where either all interests are held by skip persons or no person holds an interest in the trust and no distribution may be made to a non-skip person).

[108] *See id.* § 2612(a).

[109] *See id.* § 2631(c) (2009).

[110] *See id.* § 2611(b).

[111] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-146 (showing similar examples). The author chose the year 2002 in the example as the year of transfer, because the 50% gift, estate, and GST tax brackets existing at that time simplify calculations and make the analysis easier to follow.

current GST regime. In the first step, the transferor[112] should use the amount "received" as the basis for the tax assessment, which is $100,000 (see Appendix D).[113] Second, the transferor should consider the gift tax amount on $100,000, which is $50,000 (i.e., 0.5 x $100,000). Third, because the transferor must pay the GST tax, the $50,000 GST tax paid constitutes a taxable gift to the grandchild, which is subject to an additional $25,000 gift tax (i.e., 0.5 x $50,000).[114] Although, by definition, direct skip gift transfers are tax exclusive because the GST tax base for a direct skip transfer "does not include the amount of any federal estate or gift tax payable with respect to the generation-skipping transfer,"[115] direct skip transfers are "not entirely tax exclusive"[116] because federal gift tax is imposed on the federal GST tax paid. Even with multiple layers of taxation, the direct skip transfer is still more advantageous tax-wise than a direct skip bequest (the second common scenario), which would require $300,000 (i.e., including $150,000 in estate taxes and $50,000 in GST taxes) in order to complete the transfer of $100,000 to a grandchild. Notably, in a direct skip gift transfer scenario, if the transferor dies within three years of paying the gift taxes, the gift taxes paid are included in the transferor's gross estate for estate tax purposes.[117]

While the direct skip transfer and bequest scenarios may seem heavy-handed and prohibitive to the transferor/testator, scenarios involving the creation of testamentary trusts are more severe because they are more tax inclusive. In situations involving taxable distributions and taxable terminations, a servicemember would have to leave $400,000 in a testamentary trust in 2002 in order to transfer $100,000 to a grandchild later that year. Under the operation of the GST regime, the $400,000 bequest to the trust would first be subject to a $200,000 Federal estate tax. Next, in the taxable distribution scenario, the $200,000 would be distributed to the grandchild who would have to use $100,000 of it to pay[118] the GST tax.[119] Similarly, in the taxable termination scenario, the trustee[120] would have to use $100,000 to pay the GST tax on the $100,000 transfer to the grandchild.[121] In either case, the grandchild would only receive $100,000, while $300,000 would go directly to Federal transfer taxes.

These examples show how proper planning and structuring of generation skipping transfers ensure the minimization of taxes and the accomplishment of servicemembers' goals.[122] If servicemembers cannot avoid transfers subject to GST tax, they should strive to make the best use of their GST exemptions and annual exclusions. Exemptions should be aimed at transfers to grandchildren and other skip person beneficiaries. Here, servicemembers should allocate their GST exemption in order to produce a "dynasty trust"[123] with an "inclusion ratio"[124] of zero and thus an effective tax rate of zero, for the exclusive benefit of skip persons (e.g., grandchildren and subsequent generations). Simultaneously, servicemembers should ensure that no GST exemption is allocated to trusts (i.e., producing an inclusion ratio of one and exposing the entire transfer

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[112] I.R.C. § 2603(a)(3). In contrast to direct skip transfers, taxable distributions impose the tax on the transferee while taxable terminations impose the tax on the trustee. *See id.* § 2603(a).

[113] *Id.* § 2623.

[114] *See id.* § 2515 (2009).

[115] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-146.

[116] E-mail from Ellen Harrison, Adjunct Professor, Georgetown University Law Center, to author (Mar. 29, 2009, 10:22) (on file with author). "I would argue that it is correct to say that the GST tax is computed on a tax exclusive basis because the GST tax is not in the tax base. However, it is true that because there is gift tax on GST tax, the tax on direct skips is not entirely tax exclusive." *Id.*

[117] *See* I.R.C. § 2035(b) (including gift taxes on gifts made during three years before the decedent's death in the decedent's gross estate). One benefit of gross estate inclusion is that the transferee will receive a stepped-up basis in the property (except if the transferor dies in 2010).

[118] *See id.* § 2603(a)(1) (imposing the liability to pay the GST tax on the transferee).

[119] *See id.* § 2621(a) (subjecting the amount received by the transferee minus expenses incurred to the GST tax). For example, because $200,000 was received by the grandchild, 50% of $200,000 = $100,000 GST tax owed.

[120] *See id.* § 2603(a)(2) (2009) (imposing the liability to pay the GST tax on the trustee).

[121] *See id.* § 2622 (subjecting the value of *all property* with respect to which the taxable termination has occurred minus certain deductions to the GST tax). For example, since $200,000 was the value of the property to which the termination occurred, 50% of $200,000 = $100,000 GST tax owed.

[122] *See generally* HARISON, *supra* note 104, at 9-2 to 9-14 (discussing the differences between tax exclusive I.R.C. § 2623 direct skips, and tax inclusive I.R.C. § 2621 taxable distributions and I.R.C. § 2622 taxable terminations; explaining the importance of structuring transactions to ensure either an inclusion ratio of 1 or 0, and thus avoiding a mixed inclusion ratio).

[123] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-38 (discussing the "dynasty trust" concept, a trust that can exist for an extended period of time that is potentially able to pass property free of GST tax liability).

[124] *See* I.R.C. § 2642(a) (defining the inclusion ratio as one minus the applicable fraction; defining the applicable fraction as a fraction with the numerator equal to the GST exemption allocated to the trust or property transferred, and the denominator equal to the value of the property transferred reduced by the sum of certain taxes and charitable deductions allowed with respect to such property). *See also* T.M. ESTATE PLANNING, *supra* note 21, at A-148 (discussing the GST planning concept of layering trusts)

to GST tax) for the exclusive benefit of non-skip persons[125] (e.g., children). Additional considerations arise in the form of automatic allocations that may occur "under certain statutorily prescribed circumstances,"[126] such as lifetime direct skip transfers (e.g., giving a grandchild a car as a college graduation gift). By purposefully allocating their GST exemption and avoiding mixed inclusion ratios (i.e., ratios between zero and one), servicemembers can ensure that their GST exemption will not be squandered on transfers to children, but rather preserved for transfers to grandchildren that might otherwise be subject to GST tax.

2. The State Generation Skipping Transfer Tax

In addition to the federal GST tax, about half the states, including New York and Texas, have a state GST tax.[127] As with the state gift, estate, and inheritance taxes, the state GST tax statutes vary greatly. On the one hand, New York imposes a GST tax equal to the 1998 federal GST maximum tax credit (i.e., a "fixed" system), multiplied by the amount of New York property transferred, divided by the all the property transferred.[128] On the other hand, Texas imposes a GST tax equal to the federal GST exemption (i.e., a "floating" system), multiplied by the value of Texas property transferred, divided by all the property transferred.[129] As a result of such variance, servicemembers should seek guidance from local counsel familiar with the laws of their particular state.

IV. Step Three: Building an Estate and Holding Assets

Despite the existence of a more challenging economy, there are several avenues for servicemembers to invest and establish assets. Some may even argue that the economic downturn has created additional opportunities to profit.[130] With the constraints of the tax system in mind, servicemembers should develop estate plans that minimize taxes, facilitate liquidity in the allocation of resources, and prevent the unnecessary depletion of the estate for the benefit of future beneficiaries. These objectives are attainable when servicemembers account for the property they own, properly assess risk, and accumulate assets that will best preserve their wealth.

A. Holding Assets

Servicemembers hold property in different ways depending on the nature and location of the property, as well as the nature of their marital status. For example, a married servicemember who purchases a home in a community property state may be determined to have made a gift to his spouse worth the value of one-half of the home. This may become an issue if there is a divorce or death later in the marriage. Because several standards may apply to different types of property simultaneously, servicemembers should adopt a standard evaluative approach.

Servicemembers should begin by determining the type of legal system that governs the property: Is it a community property law system, a common law system, or a combination of both? In many common law states, the nature of the title to property often dictates ownership of the property. In contrast, in many community property states, courts often presume that

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[125] *See* I.R.C. § 2613(b) (defining non-skip persons as persons who are not skip persons).

[126] T.M. ESTATE PLANNING, *supra* note 21, at A-147. Servicemembers may elect out of automatic allocations by filing IRS Form 709 and paying applicable GSTs on direct skip transfers. *See* I.R.C. § 2632 (discussing deemed allocation and how to elect out).

[127] *See* TAXATION COORDINATOR, *supra* note 71, at 52501 (discussing the implications of state generation skipping taxation by approximately one-half of all the states).

[128] *See* N.Y. TAX LAW § 1022 (McKinney 2009). *See generally* TAXATION COORDINATOR, *supra* note 71, at 56,090 (explaining the NY GST).

[129] TEX. TAX CODE ANN. § 211.054 (Vernon 2009). *See generally* TAXATION COORDINATOR, *supra* note 71, at 56,131 (explaining the Texas GST).

[130] *See, e.g.*, Warren E. Buffet, *Buy American. I Am*, N.Y. TIMES, Oct. 16, 2008, *available at* http://www.nytimes.com/2008/10/17/opinion/17buffett.html (last visited Feb. 1, 2010).

> A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. . . . But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.

Id.

property is community property,[131] unless the owner can rebut the presumption by demonstrating that the property is separate property.[132]

After determining what system applies, servicemembers should next determine the property that will pass under the servicemember's will, versus property that will bypass the probate process. Servicemembers can best clarify their intentions for the transfer of property by executing a will that clearly disposes of their probate assets and explicitly designates their domicile (i.e., which may determine which state's law applies). Aside from the will, servicemembers should simultaneously designate beneficiaries on appropriate beneficiary designation forms for their non-probate assets, such as life insurance and pay-on-death bank accounts. The sections below provide more detailed guidance for the conscientious financial planner.

1. Who Owns the Property? Community Property Versus Common Law Property

For single servicemembers, the difference between community property and common law systems may be irrelevant because joint ownership of accumulated property is not normally at issue. However, for servicemembers who marry and amass property while stationed in different states during their careers, the nature of the property ownership system can ultimately determine who owns certain property in the event of the servicemember's divorce or death. While most states have adopted a common law system for the disposition of property, "Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin" operate under community property regimes.[133] Because major military bases are located in both common law and community property states, servicemembers may pass through both legal systems during the course of their military service. Conscientious servicemembers must therefore keep tabs on the legal regime that applies to property transfers made at all times during their life and also those which are likely to occur at the time of their death.

Transfers of property during one's life differ significantly between community property and common law regimes because these systems operate under completely different rationales. In general, community property law treats marriage as an equal partnership and thus presumes equal ownership over property acquired during the course of the marriage.[134] Consequently, even where property is titled in one spouse's name, the law nevertheless presumes it to be jointly owned community property.[135] Under such a presumption, servicemembers who give third parties gifts like cars, which were acquired during the marriage, may find such gifts classified as split gifts (i.e., a gift of equal amounts given by each spouse).[136] Similarly, if a portion of the servicemember's salary (presumed community property if earned during marriage) is used to acquire and pay premiums on one's own life insurance policy, at the time of the servicemember's death, half of any insurance proceeds paid to the children may be included in the servicemember's gross estate with the other half determined to be a deemed gift from the surviving spouse.[137]

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[131] Community property is defined as, "Property owned in common by husband and wife as a result of its having been acquired during the marriage by means other than an inheritance or gift to one spouse, each spouse holding a one-half interest in the property. . . . [States with community property systems include] Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin." BLACKS LAW DICTIONARY, *supra* note 44, at 412.

[132] Separate Property is defined as,

> [Property in a community-property state] that a spouse owned before marriage or acquired during marriage by inheritance or by gift from a third party, or property acquired during marriage but after the spouses have entered into a separation agreement and have begun living apart . . . [and property in some common-law states that is] titled to one spouse or acquired by one spouse individually during marriage.

Id. at 1369.

[133] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-155 (explaining that, while some states like California and Texas have established community property law systems, other states, like Alaska, have an elective community property system, while states like Wisconsin implement community property law principles).

[134] *See id.*

[135] *See id.* at A-155 to A-156 (explaining that property acquired through gift, devise, or descent is treated as separate property; explaining that property acquired through the use of separate property should be considered separate property, applying the inception of title doctrine). Servicemembers can use prenuptial agreements to clarify whether property will be considered separate or community property.

[136] *See id.* at A-158. If the gift is over the annual exclusion (e.g., $13,000 for 2010), the taxpayers must file split gift tax returns.

[137] *See id.* at A-156 to A-157 (explaining the differences between state laws and the importance of the facts and circumstances of the case, such as whether the spouse had previously agreed to the beneficiary designation).

As a significant benefit, community property law states allow decedents to include only half the value of community property in their gross estates, even though the estates benefit from a step-up in basis to the full market value of the property.[138] For example, if a servicemember purchased a home for $100,000 during marriage and the home appreciates to a value of $300,000 at the servicemember's death, only $150,000 would be included in the servicemember's gross estate (i.e., 0.5 x $300,000), while the recipient of the home would benefit from a $200,000 stepped-up basis in the property (i.e., $300,000 – $100,000). Due to the stepped-up basis, if the beneficiary of the home later sold the property for $550,000, the beneficiary would only recognize $250,000 of gain (i.e., $550,000 – $300,000), which itself may be nontaxable.[139] Spouses in common law states that do not recognize community property principles face far fewer complications in the determination of property ownership. However, to minimize potential issues, servicemembers considering marriage may want to consider prenuptial agreements that clarify property ownership.

2. Probate Property Versus Non-Probate Property

After determining whether common law or community property law governs transferred or transferable property, servicemembers should decide whether to hold the property in a probate or non-probate status. While probate property, such as a home or car held in the testator's name "is subject to the will provisions and to the probate jurisdiction of the local court," non-probate property will bypass local probate administration unaffected "by the existence (or nonexistence) of a valid last will" and testament.[140] Examples of non-probate property include life insurance policies, pay-on-death bank accounts, transfer-on-death securities, property held in trust, and jointly-held property passing under the right of survivorship.[141] Despite the distinction between probate and non-probate property, both categories will ultimately be included in their gross estate at death, even though only their probate property (i.e., their probate estate) will be subject to probate.

The holding of probate versus non-probate property should not be guided by the desire to save taxes on property transfers. It should, instead, depend on the desire to avoid publicity and the supervision of a probate court and other more nuanced benefits. Holding non-probate assets in a trust is particularly useful in maximizing privacy, minimizing the potential for challenges to the servicemember's capacity, and facilitating the administration of property when a servicemember owns real estate in different states. To gain these advantages, the servicmember must be willing to invest the time and money to transfer assets into a trust. Furthermore, trustees must ensure that they administer the trust properly. With non-probate property, such as life insurance and pay-on-death accounts, servicemembers must regularly monitor their assets and ensure beneficiary designation forms are kept current to avoid unintended transfers, such as the transfer of wealth to a former spouse at death.

3. Intestacy

Servicemembers who die without a will or an invalid will become subject to the mercies of state intestacy statutes.[142] Servicemembers may intentionally elect this route in an effort to avoid probate or as the result of a common belief that dying without a last will and testament somehow facilitates a fair distribution of their estate upon their death. Commonly, a servicemember decides not to execute a will after consultation with legal counsel because he is insolvent and his only family members are his happily-married parents who do not require additional income. Contrary to these beliefs, reliance on state intestate succession statutes or holding only non-probate property can markedly frustrate the administration of an estate.[143] Furthermore, servicemembers face situations that change rapidly, such as winning the lottery, having a child out of wedlock, or becoming incapacitated. To meet the ever-changing demands of life with a degree of certainty and the minimization of

[138] *See* I.R.C. § 1014(b)(6). However, the stepped-up basis advantage may be limited and the estate tax itself may not be applicable for deaths in 2010.

[139] *See e.g.*, *id.* § 121 (establishing that if the recipient lived in the property for two out the previous five years, the $250,000 of gain would not be taxable).

[140] T.M. ESTATE PLANNING, *supra* note 21, at A-27.

[141] *See generally id.* at A-28 and A-151 (explaining that if property is held as a joint tenancy with right of survivorship (JTWROS), the joint owners hold concurrent ownership, but the survivor of the joint tenants succeed to the entire property interest pursuant to the contractual arrangement; contrasting JTWROS with property held as a tenancy in common where owners possess a proportionate interest in the property that may be alienated, devised, or inherited under local law).

[142] *See generally* National Conference of Commissioners on Uniform State Laws, Uniform Probate Code § 2-101 (rev. 2006 rev.), *available at* http://www.law.upenn.edu/bll/archives/ulc/upc/final2005.htm (last visited Jan. 26, 2010) (discussing a model intestate succession statute, which many states have adopted in full or in part).

[143] *See id.* § 2-101 to 2-114 (discussing a model intestate succession statute, which many states have adopted in full or in part).

costs, servicemembers should specify in advance who they wish to appoint as executors and guardians and to whom property should be left at their death.

B. Building an Estate

The development of a well-balanced portfolio will assist servicemembers in withstanding the booms and busts of the modern economy. It may ultimately provide for their needs and the needs of their beneficiaries. This process begins with an investment in one's education, the acquisition of marketable skills, and the disciplined practice of cutting unnecessary expenses. It also includes the creation of a realistic budget and the establishment of a liquid financial reserve fund for genuine emergencies. Beyond these fundamentals, servicemembers should focus on building a well-balanced portfolio, which include life insurance, real estate, retirement and survivor benefits, and other prudent financial investments, all of which are described below.

1. Life Insurance

Servicemembers have many reasons to acquire life insurance.[144] For example, ownership of life insurance within one's taxable estate can provide for surviving family members or other beneficiaries in the event of the servicemember's death. It also provides liquidity to pay taxes and other expenses at the time of their death.[145] In addition, ownership of life insurance outside one's taxable estate provides a means to transfer substantial assets to younger generations with minimal tax consequences. These benefits make life insurance an indispensable option in addition to other types of insurance such as liability insurance, property insurance, and disability insurance. Considering the possibility of natural disasters and tort litigation, flood and umbrella policy insurance may also be of great benefit. Because life insurance has many different forms, some of which may produce income during the course of the owner's life, the following section describes the most common issues.

a. Forms of Life Insurance

Life insurance policies available through dependable insurers commonly include term or permanent/cash value policies.[146] While term insurance generally protects an insured individual for a specific period of time, has no cash value, and charges increasingly higher premiums as the policyholder ages, permanent/cash value life insurance generally accumulates up cash value over time,[147] offers investment-type options, and costs more.[148] Types of permanent policies include traditional fixed premium policies, such as whole life insurance, flexible-premium policies, such as universal life insurance, and variable policies, such as variable life insurance.[149] In contrast to whole and universal life insurance, variable life insurance imposes more risk on the insured because the policyholder generally has the ability to allocate premiums among investment sub-accounts that are "distinct from the insurer's general investment portfolio."[150] These term and cash value life insurance policies may be individual or joint policies, where a death benefit is paid on the death of the survivor.[151] Joint/survivorship policies may be especially useful where one of the insured might not otherwise be insurable or where individual policies may be too expensive.

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[144] *See* I.R.C. § 7702 (defining life insurance contracts). *See also* Helvering v. LeGierse, 312 U.S. 531 (1941) (defining life insurance's historic and essential characteristic of risk shifting and risk distribution).

[145] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-162.

[146] *See* HALLMAN & ROSENBLOOM, *supra* note 25, at 30–33, & 43 (describing the financial ratings and other considerations involved in selecting an insurer; distinguishing the general types of insurance available for consumers).

[147] *See id.* at 43-45.

[148] *See id.* For example, available options may include a guaranteed minimum return, the ability to change premium payments, and/or the ability to borrow or even withdraw from the policy.

[149] *See id.* at 43. *See also* T.M. ESTATE PLANNING, *supra* note 21, at A-163 (describing the different types of insurance policies available).

[150] HALLMAN & ROSENBLOOM, *supra* note 25, at 50.

[151] *Id.* at 53.

For most servicemembers, Servicemember's Group Life Insurance (SGLI)[152] and Family Servicemember's Group Life Insurance (FSGLI)[153] automatically cover servicemembers and their insurable dependents, unless a servicemember elects in writing not to be covered. As a type of group term life insurance policy, SGLI provides life insurance protection at a relatively low cost because it is a group policy partially subsidized by Congress.[154] One undesirable aspect of SGLI coverage is its termination after the completion of the policyholder's military service. At such time, former servicemembers may convert their SGLI policies into Veterans Group Life Insurance policies, while spouses may convert their FSGLI policies into commercial policies provided by participating life insurance companies.[155] Fortunately, these follow-on policies do not require proof of good health, provided the insured meets certain procedural requirements.[156]

b. Proceeds of Insurance and Ensuring a Smooth Process

To ensure an efficient transfer of wealth at the time of their passing, servicemembers should properly designate beneficiaries and account for tax consequences ahead of time. Specifically, servicemembers should coordinate their will and trust instruments with their life insurance beneficiary designation forms to minimize any potential inconsistencies or conflicts between the legal documents, especially when servicemembers want to designate ex-spouses, stepchildren, illegitimate children, non-Family members, or minor biological children as their beneficiaries.[157] Failure to coordinate and plan accordingly can result in unintended consequences. For example, if a servicemember fails to designate SGLI beneficiaries or the designation of SGLI beneficiaries otherwise fails, the SGLI proceeds will be distributed according to federal law, which may exclude intended beneficiaries or result in the distribution of funds to beneficiaries who are not mature enough to handle the responsibility of a sudden financial windfall.

Servicemembers can provide for minors using SGLI proceeds while ensuring beneficiaries do not receive funds too early by establishing a testamentary trust in their will for the benefit of their minor children and by making appropriate designations on their SGLI beneficiary form.[158] Those who believe the oversight provided by a trust is not necessary or is not worth the administration costs may instead designate a custodian of an UGMA or UTMA account for the benefit of their minor children.[159] Another important planning precaution is to account for the tax consequences of life insurance policies. To this end, owners of life insurance policies should understand that life insurance proceeds are generally not subject to income tax[160] but are included in the gross estate.[161] To ensure that life insurance proceeds are not included in the gross estate, an individual must neither own the policy nor retain incidents of ownership in the policy. This can be accomplished by establishing an irrevocable life insurance trust (ILIT) that could purchase and own the policy for the benefit of the insured's beneficiaries. Servicemembers who already own a commercial life insurance policy can transfer their policy to an ILIT, but, if they die within three years of the transfer, the value of the proceeds would be included in their gross estate.[162]

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[152] 38 U.S.C. § 1967. Servicemember's Group Life Insurance also automatically covers servicemembers who suffer traumatic injuries (i.e., Traumatic SGLI). *See id.* § 1980A (2006). *See generally* Captain Wojciech Z. Kornacki, *What Every Soldier and Legal Assistance Attorney Should Know about Servicemembers Group Life Insurance*, ARMY LAW., Nov. 2006, at 42, 42–52 (explaining the history of SGLI, the designation of beneficiaries, and the distribution of SGLI proceeds).

[153] *See generally* U.S. Dep't of Veterans Affairs, Servicemembers' & Veterans' Group Life Insurance, *available at* http://www.insurance.va.gov/sgliSITE/FSGLI/sglifam.htm (last visited Jan. 21, 2010) [hereinafter Veterans SGLI] (discussing the policies and procedures of how insurable dependants are insured by FSGLI; including web links to premium rates).

[154] *See* S. REP. NO. 91-398, at 2 (1969). "The low cost to individuals is made possible by insuring all members of the uniformed services under a single group insurance master contract, and by the government bearing the cost of the extra hazard attributable to military service." *Id.*

[155] *See, e.g.*, 38 U.S.C. § 1968(b)(1)(B); *id.* § 1977(e).

[156] *See* 38 U.S.C.A. § 1977(e) (LexisNexis 2010).

[157] *See* Ridgway v. Ridgway, 454 U.S. 46, 52 (1981) (holding that a servicemember has the right to freely designate his SGLI beneficiaries and to alter that choice at any time; holding that the designated beneficiary will take the life insurance proceeds despite contrary state law due to the supremacy clause).

[158] *See* DESKBOOK 2009, *supra* note 91, at L-51 (on file with author) (suggesting appropriate language and procedures to follow in filling out SGLI beneficiary designation forms). For example, on the SGLV Form 8236, servicemembers can designate their beneficiaries as follows: To my "trustee to fund a trust established for the benefit of my children under my will." *Id*.

[159] *See id.* at L-51 (on file with author). For example, on the SGLV Form 8236, servicemembers can designate their beneficiaries as follows: To "(Name of custodian), as custodian for each of my children, pursuant to the UGMA/UTMA of the state of (name of state), with distribution to each minor when that minor reaches age (desired age)." *Id*. *See also supra* note 91 and accompanying text (discussing UTMA and UGMA).

[160] *See* I.R.C. § 101(a)(1).

[161] *See id.* § 2042 (establishing the inclusion of life insurance proceeds in the gross estate). *See also id.* § 2035(a) (establishing the inclusion of life insurance proceeds in the gross estate if the decedent transferred the policy within three years of his death).

[162] *See id.* § 2035.

2. Real Estate

For many servicemembers, the greatest asset they own, other than life insurance, is real estate purchased as a principal residence and, potentially, used later as a rental property. By holding properties for longer periods of time, servicemembers can build wealth by paying down mortgages, experiencing tax savings, and benefitting from appreciation. Because they move frequently, servicemembers often find it difficult to keep their homes, unless they rent out the properties after moving to new duty stations. As a result, prior to buying a home, servicemembers should anticipate the rental cash flows that a property may generate to ensure that the income will sufficiently cover the mortgage, taxes, and other property expenses, such as management fees and repairs.[163]

Servicemembers who choose to be landlords must understand that their ability to deduct possible losses on their income tax returns may be limited by certain legal rules.[164] This is especially important during challenging economic times when properties may remain vacant for months or even years, resulting in significant rental losses. Fortunately, rental real estate qualifies for an exception to the rules that would otherwise limit a taxpayer's ability to deduct rental losses.[165] As long as individuals "actively participate" in the real estate activity, they can reduce their non-passive income (e.g., a salary) by up to $25,000 of rental real estate losses.[166] Assume that a taxpayer has salary income of $70,000, passive activity income of $10,000, active participation rental property income of $22,000, and active participation rental property losses of $60,000.[167] The taxpayer can offset $32,000 of the $60,000 losses against the $10,000 passive activity and $22,000 active participation rental property income. On these facts, the $25,000 "ceiling" limitation will limit the taxpayer's offset to only $25,000 of the remaining $28,000 (i.e., $60,000 – $32,000) worth of losses against his non-passive salary income. The remaining $3,000 of losses must be carried over to later years.[168] Although these provisions can be advantageous, servicemembers need to understand the difficulty of establishing that they qualify for active participation under a given set of circumstances.

As a related consideration, servicemembers who experience significant rental losses over time may struggle to make mortgage payments and ultimately may be unable to sell the property. As a result, they may encounter mortgage workouts, foreclosure, or even bankruptcy. Under prior law, if lenders forgave mortgage debt, the taxpayer could experience taxable income. However, due to recent tax code changes, individuals will face less threat of such cancellation of indebtedness income. The law provides that the discharge of indebtedness from a qualified principal residence will be excluded from the definition of gross income.[169] Furthermore, servicemembers who eventually rent their principal residence and later sell the property for a gain may be able to exclude some of that gain,[170] while those who rent property and sell at a loss may be able to offset that loss against other income.[171]

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[163] *See generally* Kan, *supra* note 4, at 8 (explaining the legal and financial analysis servicemembers should conduct prior to buying a home).

[164] *See* I.R.C. § 465 (limiting deductions of losses to the amount an individual has at risk in an activity). *See generally* BORIS BITTKER ET AL., FEDERAL INCOME TAXATION OF INDIVIDUALS, at 19-20 to 19-30 (3d ed. 2002) (discussing how to identify and compute the at-risk amount). *See* I.R.C. § 469 (limiting passive activity losses and credits; defining "passive activity" as any activity which involves the conduct of a trade or business and in which the taxpayer does not materially participate). *See generally* BITTKER, *supra*, at 19-30 to 19-58 (discussing degrees of participation, types of activities, and the interaction between active and passive income and losses).

[165] *See* I.R.C. § 469(h) (defining "material participation" as an activity where the taxpayer is involved in the operations of the activity on a basis which is regular, continuous, and substantial). *See generally* BITTKER, *supra* note 164, at 19-50 to 19-53 (discussing I.R.C. §469(i)'s relaxation of the passive activity rules to rental real estate).

[166] *See* BITTKER, *supra* note 164, at 19-50 to 19-52 (describing "active participation" as a less stringent standard than "material participation" that can be met if the taxpayer has a significant and bona fide role in management; explaining that the participation of a spouse is taken into consideration by attribution so that the nonparticipating spouse is deemed to "actively participate" if her spouse "actively participates"). *See* I.R.C. § 469(i). But there are phase-out limitations that apply for those taxpayers with adjusted gross income over $100,000. *See id.* § 469(i)(3).

[167] *See* BITTKER, *supra* note 164, at 19-51 (showing the same example).

[168] *See* I.R.C. § 469(b).

[169] *See id.* § 108(a)(1)(E). Gross income also does not include the discharge of indebtedness due to the taxpayer's insolvency. *See id.* § 108(a)(1)(B). *See also* Mortgage Forgiveness Debt Relief Act of 2007, Pub. L. No. 110-142, 121 Stat. 1803. *See generally* Note, *Update for 2007 Federal Income Tax Returns*, ARMY LAW., Dec. 2007, at 60, 71 (explaining the implications of amending I.R.C. § 108(a)). *See generally* JONES, *supra* note 41, at 2.5 (discussing the principal residence exclusion provision's extension until December 31, 2012 due to the Emergency Economic Stabilization Act of 2008).

[170] *See* I.R.C. § 121 (2010) (establishing the exclusion of gain from the sale of a principal residence and the significance of nonqualified use of the residence). *See generally* Major Patricia K. Hinshaw, *Tax Primer for Servicemembers with Residential Rental Property*, ARMY LAW., Nov. 2009, at 1, 10–11 (explaining the exclusion of gain under I.R.C. § 121 and the limitations concerning qualified and non-qualified use of the property after 1 January 2009). *See generally* Kan, *supra* note 4, at 23–25 (contrasting the ability to sell rental properties and take losses, with the ability to sell personal residences and exclude income even though the servicemember rented the property out and did not live in the property due to periods of qualified extended duty).

[171] *See* I.R.C. § 165(c) (discussing losses). However, if their homes are not rented out and treated as rental properties, taxpayers cannot deduct the loss upon sale of their homes. *See* INTERNAL REVENUE SERV., PUB. 523, SELLING YOUR HOME 4 (2008); *see also* 26 C.F.R. §§ 1.165-9 (2010) (discussing losses). In

Fortunately, the Homeowner Assistance Program (HAP), administered by the U.S. Corps of Engineers, may cushion the financial blow for servicemembers, certain civilian employees, and surviving spouses who sold their homes at a loss or were unable to sell their homes due to the recent mortgage crisis or a base closure.[172] Those who qualify for the program[173] may get reimbursed for allowable closing costs of the sale of their home plus the difference between the sales price and an applicable percentage of their original purchase price.[174] If qualifying members cannot sell their homes, the Government can acquire the home for an applicable percentage of the prior fair market value.[175] In addition, the benefits accorded by HAP are excludable from federal income tax.[176]

3. Retirement and Survivorship Planning

a. Individual Retirement Accounts

In addition to real estate investments, servicemembers should strongly consider contributing to traditional[177] and Roth[178] individual retirement accounts (IRA) as part of a diversified portfolio.[179] While traditional IRAs allow servicemembers to make deductible contributions, which grow on a tax deferred basis, lower income phase-out amounts,[180] age, and other limitations may significantly restrict potential benefits from traditional IRAs.[181] In contrast, Roth IRAs do not allow servicemembers to make deductible contributions,[182] but allow qualified distributions to be made tax free.[183] Roth IRAs are not limited by the numerous restrictions imposed by traditional IRAs. For example, unlike traditional IRAs, the phase-out

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addition, if their homes are not rented for profit, taxpayers can deduct rental expenses only up to the amount of the rental income. *See* INTERNAL REVENUE SERV., PUB. 527, RESIDENTIAL RENTAL PROPERTY 5 (2008).

[172] *See* Demonstration Cities and Metropolitan Development Act of 1966, Pub. L. No. 89-754, §§ 101–114, 80 Stat. 1255 (codified as amended at 42 U.S.C. § 3301–3313 (1968) (establishing HAP). *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, § 1001 (expanding HAP). *See* 32 C.F.R. § 239 (authorizing HAP).

[173] *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, § 1001 [hereinafter ARRA]. In general, to qualify for the program, individuals must fall into one of three categories: (1) A servicemember or DOD or non-appropriated funds (NAF) civilian employee who purchased a primary residence before 1 July 2006, at or near a military installation that has been ordered to be closed, who sold the property between 1 July 2006 and 30 September 2012, and who did not previously benefit from HAP; (2) A servicemember or DoD/U.S. Guard civilian employee who was wounded or became ill in the line of duty during a deployment (for civilian employees the deployment must have been on or after 11 September 2001), or their surviving spouse if the member died in the line of duty or as a result of a wound, injury, or illness incurred in the line of duty during a deployment on or after 11 September 2001, and the spouse relocates within two years of the member's death; (3) A servicemember who purchased a primary residence before 1 July 2006, who was reassigned between 1 February 2006 and 30 September2012, to an installation more than fifty miles from his previous installation, and who did not previously benefit from HAP. *See id.* *See* 32 C.F.R. § 239.6.

[174] *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, § 1001. *See* 32 C.F.R. § 239.5(a)(2). Under current implementing policy, the applicable percentage is 95% if the applicant is a Wounded Warrior or civilian, or a Surviving Spouse, and 90% for other applicants. *See* 32 C.F.R. § 239.5(a)(4). *See generally* U.S. Dep't of Defense—Homeowners Assistance Program, Benefits, *available at* http://hap.usace.army.mil/Benefits.html (last visited Jan. 21, 2010) [hereinafter Assistance Program].

[175] *See* ARRA of 2009, *supra* note 173, § 1001. The Government may purchase the primary residence for the greater of the applicable percentage of the prior fair market value (i.e., usually the purchase price) of the residence or the total amount of the eligible mortgage that remains outstanding. *See* 32 C.F.R. § 239.5(a). Under current implementing policy, the applicable percent is 95% if the applicant is a Wounded Warrior or civilian, or a Surviving Spouse, and 75% for other applicants (in addition, other applicants do not receive closing costs). *See id.* § 239.5(a)(4).

[176] *See* I.R.C. § 132(n) (2010). *See also* INTERNAL REVENUE SERV., PUB.4491-X, SUPP., NEW TAX LEGISLATION & OTHER UPDATES TO VITA/TCE TRAINING PRODUCTS 5 (2009) [hereinafter PUB. 4491-X].

[177] I.R.C. § 408 (2009).

[178] *Id.* § 408A.

[179] *See generally* Major Joseph E. Cole, *Essential Estate Planning: Tools and Methodologies for the Military Practitioner*, ARMY LAW., Nov. 1999, at 1, 8 (explaining the difference between traditional and Roth IRAs).

[180] *See* I.R.C. § 219(g). For example, for the 2009 tax year, the IRA deduction for single and head of household taxpayers who are active participants in employer's retirement plans begin to be phased-out when their modified adjusted gross income (MAGI) reaches $55,000, and are completely phased-out when their MAGI reaches $65,000. *See* CCH, 2010 U.S. MASTER TAX GUIDE 687 (2009) [hereinafter 2010 U.S. MASTER TAX GUIDE]. For married filing joint return taxpayers, the phase-out amounts are $89,000 and $109,000 respectively. *See id*. at 688. In contrast, for the 2009 tax year, "the maximum yearly contribution that can be made to a Roth IRA is phased out for a single individual with modified AGI between $105,000 and $120,000, [and] for joint filers with modified AGI between $166,000 and 176,000. . . ." *Id*. at 693.

[181] *See* I.R.C. § 219. *See also* DESKBOOK 2006, *supra* note 13, at S-6 to S-12 (on file with author) (explaining the numerous restrictions of traditional IRAs).

[182] *See* I.R.C. § 408A(c)(1) (2009).

[183] *See id.* § 408A(d)(1). Roth IRA qualified distributions should be contrasted with traditional IRA distributions which are generally includable in gross income. *See id.* § 408(d).

amounts for Roth IRA contributions are higher,[184] individuals may make contributions after reaching age seventy-and-a-half,[185] and Roth IRAs are not subject to the required minimum distribution rules.[186]

The benefits of Roth IRAs may appeal to servicmembers, especially if servicemembers earn income that is above the phase-out levels for traditional IRAs and can only make nondeductible contributions.[187] If servicemembers believe they will occupy a higher income tax bracket when they receive IRA distributions, they may want to consider converting their traditional IRAs to Roth IRAs now that the Internal Revenue Code has eliminated the $100,000 adjusted gross income limit for conversions in tax years after 2009.[188] Not only can taxpayers earning taxable income contribute to their own IRAs, but they can also contribute to spousal IRAs, even if their spouses do not earn income.[189] Furthermore, in situations where contributors have deployed, servicemembers can still participate in IRAs even though they do not earn taxable income, as they may have received only tax-free combat pay due to continual deployment throughout the tax year.[190]

b. The Thrift Savings Plan

Participation in the Thrift Savings Plan (TSP),[191] a defined contribution plan similar to a 401(k)[192] plan, may be advantageous for servicemembers.[193] The primary benefits of contributing to the TSP are the tax deferral of income, ease of making contributions, and extremely low fund maintenance costs.[194] In 2011, the TSP will begin to offer the significant new benefit of a Roth 401(k) feature.[195] For 2009 and 2010, servicemembers can make contributions up to $16,500, and up to $49,000 if they are in a combat zone.[196] The TSP offers several investment funds with varied rates of return,[197] including lifecycle funds, a government securities fund, a fixed income index fund, a common stock index fund, a small capitalization stock index fund, and an international stock index fund.[198] Unfortunately, while civilian employers often match employee

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[184] *See generally* HALLMAN & ROSENBLOOM, *supra* note 25, at 364 (contrasting traditional IRAs with Roth IRAs that are not affected by coverage under employer retirement plans). For example, in 2009, "the maximum yearly contribution that can be made to a Roth IRA is phased out for a single individual with modified AGI between $105,000 and $120,000, [and] for joint filers with modified AGI between $166,000 and 176,000 . . . ." 2010 U.S. MASTER TAX GUIDE, *supra* note 180, at 693. The phase-out amounts for a single and a joint filer who are active participants in employer's retirement plans are $55,000–$65,000, and $89,000-$109,000 respectively. *See id*. at 688.

[185] *See* I.R.C. § 408A(c)(4).

[186] *See id*. § 408A(c)(5).

[187] *See generally* HALLMAN & ROSENBLOOM, *supra* note 25, at 367 (describing that the only real tax advantage of making non deductible IRA contributions is that the investment income and capital gains will accumulate in the IRA without current income taxation).

[188] *See* I.R.C. § 408A(c)(3)(B).

[189] *See generally* HALLMAN & ROSENBLOOM, *supra* note 25, at 370 (describing spousal IRAs).

[190] *See* I.R.C. § 219(f)(7). *See generally* TJAGLCS Practice Note*: Update for 2006 Federal Income Tax Returns*, ARMY LAW., Dec. 2006, at 51, 51 (explaining the implications of the Heroes Earned Retirement Opportunities (HERO) Act which allowed tax-free combat zone pay to be considered for purposes of determining qualification for IRA contributions).

[191] 5 U.S.C. §§ 8431–8840 (2006). *See* Thrift Savings Plan, *available at* http://www.tsp.gov (last visited Apr. 12, 2009) (providing a wealth of information regarding the Thrift Savings Plan including applicable forms and publications as well as historical rates of returns for each type of TSP fund). *See generally* Captain Anita J. Fitch, *Thrift Savings Plan Update*, ARMY LAW., Dec. 2005, at 70, 70–71 (explaining changes to the TSP enrollment procedures and changes through the selection of asset allocations).

[192] I.R.C. § 401(k).

[193] *See generally* MAJOR DAVID TRYBULA & LIEUTENANT COLONEL RICHARD HEWITT, ARMED FORCES GUIDE TO PERSONAL FINANCIAL PLANNING 278–80 (5th ed. 2002) (evaluating the advantages and disadvantages of the TSP, including the Government's failure to provide matching contributions for servicemembers).

[194] *See generally* Thrift Savings Plan, *supra* note 191. For example, servicemembers can have contributions taken directly from their pay without the high minimum initial investments typical of many mutual funds.

[195] *See* 5 U.S.C. § 8432(d). *See* Thrift Savings Plan, Is the TSP Offering a Roth 401(k) Feature?, *available at* http://www.tsp.gov/forms/oc06-5.pdf (last visited Jan. 25, 2010).

[196] *See* I.R.C. § 402(g) (2010) (limiting income exclusions for elective deferrals). *See id.* § 415(c) (allowing contributions of more than the I.R.C. § 402(g) elective deferral limit to servicemembers in combat zones). *See* Thrift Savings Plan, Summary of the Thrift Savings Plan 5, *available at* http://www.tsp.gov/forms/tspbk08.pdf (last visited Jan. 25, 2010).

[197] *See* Thrift Savings Plan, TSP Individual Funds Historical Rates, *available at* http://www.tsp.gov/rates/history-summary.html (last visited Apr. 12, 2009) (showing that ten year compounded rates of return from 1999 to 2008 ranged from a negative 1.4% for the common stock index fund to a positive 5.7% for the fixed income index fund).

[198] *See* Thrift Savings Plan, Thrift Saving Plan Fund Information, March 2008, *available at* http://www.tsp.gov/forms/fundsheets-all.pdf (last visited Apr. 12, 2009).

contributions to 401(k) plans as a significant incentive to encourage contributions, the Government currently does not match the contributions of military TSP participants.[199] This and other TSP limitations, may motivate servicemembers to maximize their own Roth IRA and their spouse's 401(k) to the extent of employer matching contributions before contributing to the TSP.[200]

c. Retirement and Survivor Benefits[201]

Servicemembers who are eligible for retirement may take advantage of one of the few remaining defined benefit retirement plans without the need to financially invest in defined contribution plans like their civilian counterparts. Although most retired servicemembers must wait before eventually receiving social security benefits,[202] they enjoy the luxury of immediately drawing a reliable monthly government paycheck without the necessity of a single financial contribution.[203] Retired servicemembers also qualify for numerous additional benefits, including post-exchange and commissary privileges, reduced medical costs, and free space-available travel.[204]

Retirees may also benefit from the Survivor Benefit Plan (SBP), a program that provides a potential lifetime annuity to beneficiaries at the retiree's death.[205] The SBP automatically covers all active duty servicemembers once they become retirement eligible.[206] However, in general, those who do not want to participate, or want less than spousal SBP coverage based on full retired pay once they retire, must get their spouse's written consent and must submit their election not to fully participate before they retire.[207] Retirees participating in SBP experience a reduction in their retirement pay to cover the costs of premiums, but their survivors will benefit from an annuity paid upon their death.[208] Like regular annuities that allow the decedent to designate beneficiaries, the SBP annuity distributed to survivors is taxable as ordinary income to the beneficiaries, and includable in the retiree's gross estate.[209]

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[199] *See* MARGARET H. BELKNAP & F. MICHAEL MARTY, ARMED FORCES GUIDE TO PERSONAL FINANCIAL PLANNING 210 (6th ed. 2007). Although the statute authorizes matching contributions, the service secretaries are not currently authorizing matching servicemember contributions. *See* Thrift Savings Plan, Summary of the Thrift Savings Plan 4, *available at* http://www.tsp.gov/forms/tspbk08.pdf (last visited Jan. 25, 2010).

[200] *See* BELKNAP & MARTY, *supra* note 199, at 199 (recommending a specific retirement savings priority list with a servicemember's Roth IRA as the highest priority).

[201] *See generally* Cole, *supra* note 179, at 1–8 (explaining the numerous government survivor benefits available to servicemembers).

[202] *See generally* BELKNAP & MARTY, *supra* note 199, at 275–84 (discussing eligibility and the benefits of social security). *See* U.S. Social Security Administration, http://www.ssa.gov (last visited Apr. 12, 2009) (providing a wealth of information on social security).

[203] *See generally* BELKNAP & MARTY, *supra* note 199, at 285 (discussing the three military retirement systems).

[204] *See generally* SPACE-A TRAVEL.COM, WORLDWIDE SPACE-A TRAVEL HANDBOOK & RV CAMPING GUIDE (13th ed. 2002) (offering an indispensable and, by far, the most useful guidebook for servicemembers regarding free space-A travel; providing domestic and international travel policies, major flight routes and schedules, phone and fax numbers to installations worldwide, and useful maps and descriptions of each base to facilitate travel and lodging).

[205] *See* 10 U.S.C. § 1447 (2006) (defining SBP terms). *See generally* TRYBULA & HEWITT, *supra* note 193, at 355–66 (describing SBP and evaluating it financially compared to life insurance; concluding that SBP is an excellent program that guarantees a secure income for a surviving spouse and dependent children that cannot be eroded by inflation due to cost of living allowances). *See generally* BELKNAP & MARTY, *supra* note 199, at 290 (listing the advantages and disadvantages of participating in SBP). *See generally* My Army Benefits, *available at* http://myarmybenefits.us.army.mil/EN/default.aspx (last visited Aug. 24, 2009) [hereinafter My Army Benefits] (calculating available benefits).

[206] *See* 10 U.S.C. § 1448(d).

[207] *See* DOD FMR, *supra* note 33, at vol. 7B, ch. 43, para. 430101 & 430303 (June 2008), *available at* http://comptroller.defense.gov/fmr/07b/07b_43.pdf (last visited Feb 2, 2010). Elections that do not comply with all the requirements, such as having the spouse's consent witnessed by at least one person, will be disregarded and the retiree will be enrolled for the full amount of SBP coverage. *See id.* *See* 10 U.S.C. § 1448(a)(2). *See also* Dept. of Health and Human Services, Form PHS-5150: Survivor Benefit Plan (SBP) Election Certificate, *available at* http://dcp.psc.gov/PDF_docs/phs5150.pdf (last visited Feb 2, 2010) (providing a form to make an SBP election).

[208] *See* MyArmyBenefits, MyArmyBenefits Survivorship Calculator, *available at* https://myarmybenefits.us.army.mil/PreBuilt/customapps/Survivorship/Instructions.aspx (last visited Jan. 25, 2010) [hereinafter Survivorship Calculator] (last visited Jan. 25, 2010). *See* Dept. of Defense Office of the Actuary, SBP Program Premium, *available at* http://actuary.defense.gov/ (last visited Feb. 2, 2010) (providing a calculator to determine the cost of active duty retiree SBP premiums and a probability estimator to compute the probability that a retiree's spouse will outlive the servicemember and benefit from SBP). U.S. Army Human Resources Command, Calculate Survivor Benefit Plan Application, *available at* https://www.hrc.army.mil/site/reserve/soldierservices/retirement/survivorbenefitpaycalc.asp (last visited Feb. 2, 2010) (providing those with AKO access a calculator to calculate the premiums and benefits of SBP for reserve servicemembers).

[209] *See* DOD FMR, *supra* note 33, at vol. 7B, ch. 46, para. 461401 & 461405 (Dec. 2009), *available at* http://comptroller.defense.gov/fmr/07b/07b_46.pdf (explaining that SBP monthly annuity amounts received by beneficiaries are subject to federal income tax; recommending that executors handling the estates of servicemembers should contact the General Actuarial Branch of the IRS to compute the value of the SBP annuity for federal estate tax purposes). *See also* DESKBOOK 2009, *supra* note 91, at L-18 and G-51, app. C (on file with author) (showing a calculation of the estate tax value of the SBP upon the death of a retired military member).

For those servicemembers who die on active duty in the line of duty,[210] their eligible survivor beneficiaries qualify for numerous benefits, including SBP,[211] dependency and indemnity compensation (DIC),[212] dependents educational assistance (DEA),[213] social security, death gratuities,[214] the Marine Gunnery Sergeant John David Fry Scholarship,[215] and other benefits.[216] Many benefits, including DIC and the death gratuity, are neither includable in the decedent's gross estate nor taxable to the recipient.[217] Despite these tax savings, servicemembers must be concerned that their conduct (e.g., a finding that their conduct was not in the line of duty) may cause their families to lose many of these benefits.

In addition, servicmembers and their families should be prepared for their government benefits to decrease in the future, such as when dependent children reach the age of 18 and social security drops to zero (until the surviving spouse reaches age 62).[218] Furthermore, servicemembers and their family members must stay alert as the available federal and state benefits frequently and continually change each year. As a result, servicemembers must plan their financial affairs appropriately so that their beneficiaries are financially supported in the event of their untimely death. A balanced financial portfolio will help accomplish this objective.

4. Financial Investments

A well-balanced financial portfolio includes not only life insurance, real estate, and a retirement plan, but also a calculated asset mixture including investments such as stocks, bonds, precious metals, treasuries, and cash. Servicemembers can build a balanced portfolio by using asset allocation models, which attempt to reduce risk through diversification among several asset classes.[219] Diversifying between equity, fixed income, growth, value, short-, and long-term investments can

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[210] *See* DOD FMR, *supra* note 33, vol. 7B, ch. 46, para. 460204 (Dec. 2009), *available at* http://comptroller.defense.gov/fmr/07b/07b_46.pdf (explaining that a servicemember's death will generally be considered to be in the line of duty unless the death occurred under one of the following conditions: (1) the death occurred while the servicemember was not serving on active duty; (2) the death resulted from the servicemember's own intentional misconduct or willful negligence; or (3) the death occurred during a period of unauthorized absence).

[211] *See* 10 U.S.C. § 1448(d)(1)(B) (establishing automatic SBP benefits for servicemembers who die in the line of duty while on active duty). *See* DOD FMR, *supra* note 33, at vol. 7B, ch. 46, para. 460201 (Dec. 2009), *available at* http://comptroller.defense.gov/fmr/07b/07b_46.pdf (establishing the active duty death requirements to qualify for SBP).

[212] *See* 38 U.S.C. §§ 1301–1322. Surviving spouses who receive both DIC and SBP, have their SBP annuity amount "offset by DIC, unless the eligible surviving spouse remarries after age 57, and thereby, retains entitlement to DIC. A surviving spouse who receives DIC due to remarriage after age 57 becomes entitled to the full SBP annuity unreduced by DIC, as well as the full DIC amount." DOD FMR, *supra* note 33, at vol. 7B, para. 460401. *See also* Sharp v. United States, 580 F.3d 1234 (Fed. Cir. 2009) (holding that surviving spouses who remarried after the age of 57 were entitled to SBP payments unreduced by any offset for DIC payments). Surviving spouses who have their SBP annuity amount offset by DIC may qualify for Special Survivor Indemnity Allowance (SSIA), a monthly amount which increases from $60 in 2010 to $310 in 2017. *See* 10 U.S.C. § 1450(m). Because government benefits change constantly, servicemembers, family members, and financial advisors must stay attuned to current developments. One way to see the most current benefits is to visit the MyArmyBenefits website. *See* My Army Benefits, *supra* note 208. Those who do not stay current and abide by appropriate timelines may experience financial loss. For example, surviving family members who do not file DIC applications within one year of the servicemember's death will only receive DIC payments as of the date the Veterans Administration receives the claim. *See* 38 C.F.R. § 3.400 (Westlaw 2010).

[213] *See* 38 U.S.C. §§ 3500–3566 (2006).

[214] *See* 10 U.S.C. § 1475.

[215] *See* 38 U.S.C. § 3311 (entitling children of servicemembers who die in the line of duty on or after 11 September 2001, to Post 9/11 Educational Assistance). *See generally* Veterans Administration, Post 9/11 GI Bill: Marine Gunnery Sergeant John David Fry Scholarship, *available at* http://www.gibill.va.gov/ documents/Fry_Scholarship.pdf (last visited Jan. 27, 2010) (providing an information paper on who is eligible for the scholarship and how the benefits will be paid).

[216] *See, e.g.*, 10 U.S.C. § 1482 (establishing burial benefits). *See e.g.*, DESKBOOK 2009, *supra* note 91, at L-43 to L-45 (on file with author) (listing benefits such as the shipment of household goods, the temporary allowance to live in military housing or receive basic allowance for housing, commissary and post-exchange privileges, and the right to medical care and legal assistance). Surviving family members who would like free professional assistance attaining all the benefits to which they are entitled, as well as, managing their financial assets should see advisors at FinancialPoint and the Armed Forces Services Corporation. *See generally* U.S. Dept of Veterans Affairs, Free Financial Counseling Service, *available at* http://www.insurance.va.gov/SGLISITE/BFCS. htm (last visited Feb. 2, 2010) (providing information about free financial counseling services provided by FinancialPoint). *See generally* Armed Forces Services Corporation, Member Services, *available at* http://www.afsc-usa.com/services_to_members.html (last visited Feb. 2, 2010) (providing commission free referrals concerning financial decisions).

[217] *See* I.R.C. § 134(b)(3)(C). *See generally* 10 U.S.C §§ 1448(d). *See generally* Major Dana J. Chase, *Survivors Benefit Update*, ARMY LAW., Dec. 2008, at 20, 23 (describing changes to the taxability of survivor benefits due to the Heroes Earnings Assistance and Relief Tax Act of 2008 and The National Defense Authorization Acts for Fiscal Years 2007–2009).

[218] *See e.g.*, Survivorship Calculator, *supra* note 208 (showing that many benefits such as social security, SSIA, and even SBP may decrease to zero depending on the circumstances) (last visited Jan. 25, 2010).

[219] *See* HALLMAN & ROSENBLOOM, *supra* note 25, at 233 (describing asset allocation strategies and models).

achieve liquidity and reduce overall financial risk.[220] Investors can maintain liquidity by "laddering" assets, whereby investors invest amounts that mature in different years over time.[221] By "laddering" fixed income investments, such as certificates of deposits (CDs) insured by the Federal Deposit Insurance Corporation (FDIC), servicemembers can guard against interest rate fluctuations and the loss of capital, provide liquidity as assets become available over time, and benefit from higher interest rates compared to investing only in shorter-term investments.[222] As the CDs mature, servicemembers can use the funds to meet expenses or reinvest. Other beneficial fixed income investments include U.S. savings bonds, which provide tax advantages such as the exclusion of savings bond interest from income taxes when taxpayers use Series EE bonds to pay college tuition and fees.[223]

While fixed income investments provide liquidity and protect assets against interest rate fluctuations—as well as outright loss of one's investment principal—equity investments protect against inflation and often generate significant financial gains during economic booms. Investors can achieve broad diversification in equities through mutual funds and exchange traded funds (ETFs). When investing in equities, servicemembers can invest a fixed dollar amount in mutual funds every month in a strategy commonly known as "dollar cost averaging." This practice can be used in all different types of mutual funds such as those that focus on growth, value, precious metals, or international exposure.[224] Dollar cost averaging forces the investor to invest in both good and bad economic times, which can result in the purchase of a greater number of shares at lower prices and benefit from rising prices, assuming the market improves over time.[225] Those who believe they can identify market bottoms when they can purchase a large number of shares at discount prices, might rather invest in a few ETFs to save on fund maintenance costs.[226] ETFs also tend to generate fewer capital gains in addition to saving costs because most ETFs are index funds that experience a lower turnover of securities.[227]

Digesting all of these investment opportunities within the current challenging economic environment can be overwhelming to a servicemember. As a result, servicemembers should develop a methodical strategy to deal with these issues by properly positioning themselves through regular investing, rebalancing portfolios, diversifying their assets, and applying the investment principles of the time value of money and compound interest. Essentially, to maximize their future financial growth potential, servicemember must pay themselves by saving and investing first, and then by paying bills second. Paying oneself first, by automatically investing funds directly out of one's pay or bank accounts, allows investors to invest early in their careers and thus compound their earnings over time. More important, paying oneself first forces investors to live on less while retaining the flexibility to splurge (e.g., cut back on one's savings) if emergencies arise.

V. Step Four: Transferring Assets Out of the Gross Estate and Related Tax Consequences

As servicemembers acquire wealth, they may become subject to the estate tax or GST tax, especially in light of possible reductions in the unified credit. As a result, these individuals should plan ahead to avoid the unnecessary taxes that would otherwise deplete their assets at a significant cost to their beneficiaries. Those who remain unaffected by the estate tax may also plan accordingly to ensure that any lifetime transfers they might make will be subject to only minimal income and gift tax consequences. Legal and financial guidance from qualified experts is necessary before investors decide how to proceed on these complex issues. The following sections explore the tax consequences of one's active measures to minimize taxation.

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[220] *See id.* at 234–35.

[221] *See id.* at 135.

[222] *See id.* at 202.

[223] *See* I.R.C. § 135 (excluding U.S. savings bonds income from the definition of gross income if the redeemed funds are used for higher education expenses, certain modified adjusted gross income amounts are not exceeded, the bonds were issued after 1989, and the bonds were issued to someone over the age of twenty-four before the date of issuance). *See* HALLMAN & ROSENBLOOM, *supra* note 25, at 198.

[224] *See* HALLMAN & ROSENBLOOM, *supra* note 25, at 215–16 (explaining that growth funds target capital appreciation in companies while precious metal funds are surrogates for holding gold or other precious metals directly).

[225] *See id.* at 158–59 (providing an example of dollar cost averaging in table 9.1). Dollar cost averaging "normally results in a lower average cost per share than the average market price per share during the period in question, because the investor buys more shares with the fixed amount of money when the stock is low in price than when it is high." *Id.*

[226] *See* BELKNAP & MARTY, *supra* note 199, at 168 (discussing that mutual funds are best for more frequent purchases of shares, while ETFs are best for large dollar-amount purchases, because mutual funds avoid brokerage fees for multiple-share purchases while ETFs charge brokerage fees for each transaction). *See generally* HALLMAN & ROSENBLOOM, *supra* note 25, at 230 (discussing the differences between mutual funds and ETFs such as that ETFs are traded on an organized exchange and bought and sold through brokerage firms, and that ETFs can be traded through limit orders, sold short, and purchased on margin).

[227] *See* BELKNAP & MARTY, *supra* note 199, at 167.

A. Minimizing Taxation Before Death: Lifetime Gifts

Although the future of the federal estate and GST taxes remain uncertain, the gift tax will remain in full force. The federal gift tax provides a limited unified credit[228] for lifetime gifts before taxpayers must pay gift tax. To maximize the value of this credit, servicemembers should fully disclose the value of gifts in timely-filed gift tax returns. This precaution fixes the value of the transfers and starts the statute of limitations for gifts whose value may later be challenged by the Internal Revenue Service during an audit.[229] Such disclosure is especially important for transfers of property that have the potential to realize substantial appreciation over time. By transferring such property, taxpayers can remove substantially appreciating assets from their estates while paying gift tax on the transfers to reduce the value of their gross estates.

Considering the Government allows only a limited gift tax credit, servicemembers should take full advantage of strategies that avoid using the credit, such as the annual exclusion, the marital deduction, the charitable deduction, and financial principals that maximize the use of these transfers (e.g., leverage, discounts, and the time value of money). Servicemembers should also use nontaxable gifts, such as direct transfers to educational institutions for tuition and to medical service providers for health services and long term care.[230] The effective use of all these tools during one's lifetime can enable many servicemembers to deplete their estates and totally avoid estate and generation skipping transfer taxes.

1. Annual Exclusions

Using annual exclusions is one of the easiest ways to deplete an estate free of tax consequences. Specifically, the Government allows a donor to make a certain dollar amount of tax-free gifts (other than gifts of future interests) to any person in a given year.[231] Servicemembers may double the amount that they can transfer tax free by making split gifts with their spouses and filing applicable gift tax returns. By making split gifts, each spouse is treated as the donor of half the gift, which uses the annual exclusion of both spouses.[232] Taxpayers can further increase the amount that they can transfer in a single calendar year using annual exclusions by contributing to certain plans (e.g., 529 plans) for the purpose of paying a beneficiary's future qualified higher education expenses.[233] This transfer not only qualifies as a completed gift in the year of transfer (i.e., not as a gift of a future interest), it also allows for the consideration of any amount contributed over the annual exclusion ratably over five years, beginning with the year of the transfer.[234] The operation of this provision permits individuals to frontload up to ten annual exclusions in a single year, if their spouses make split gifts to such plans.

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[228] *See* I.R.C. § 2505(a) (2010). The federal gift tax credit is currently $1 million. As a result, taxpayers can make $1 million of taxable gifts before they must begin paying gift tax.

[229] *See id.* § 6501(a) (providing a three year statute of limitations for the IRS to assess and challenge gift valuations). This is especially important, because the value of these lifetime taxable gifts will be considered when calculating estate taxes, which incorporates the value of adjusted taxable gifts. *See id.* § 2001(f). In general, if the Government unsuccessfully attempts to collect a tax, interest, or penalty, and it cannot establish that its position was substantially justified, taxpayers may be able to be awarded a judgment for reasonable administrative and litigation costs incurred. *See id.* § 7430.

[230] *See id.* § 2503(e) (excluding certain transfers for educational and medical expenses from treatment as transfers of property by gift for purposes of Chapter 12 of the gift tax).

[231] *See id.* § 2503(b) (establishing an annual exclusion of $10,000 and adjusting the amount each year for inflation). In 2009 and 2010, the annual exclusion was $13,000. *See id.*

[232] *See id.* § 2513(a) (considering spousal gifts to third parties as made one-half by each spouse). Individuals making split gifts must file IRS Form 709. Once spouses make the gift splitting election, gift splitting will apply to "all such gifts made during the calendar year by either [spouse] while married to the other." *See id.*

[233] *Id.* § 529. *See generally* Lieutenant Colonel Craig D. Bell & Maureen C. Ackerly, *A Primer: Section 529 Plans, Coverdell Education Savings Accounts (Education IRAs), and Other Tax-Smart Ways to Save for College*, ARMY LAW., Apr. 2004, at 28, 28–44 (discussing the use of 529 plans and other ways to save for college and, as a result, deplete a taxpayer's gross estate). In addition, servicemembers can save for college and reduce the money needed to pay educational expenses by taking advantage of opportunities to pay in-state tuition at public institutions of higher education. For example,

> In the case of a member of the armed forces who is on active duty for a period of more than 30 days and whose domicile or permanent duty station is in a State that receives assistance under this chapter, such State shall not charge such member (or the spouse or dependent child of such member) tuition for attendance at a public institution of higher education in the State at a rate that is greater than the rate charged for residents of the State.

20 U.S.C.A. § 1015d(a) (Westlaw 2010).

[234] I.R.C. § 529(c)(2).

The use of other, more sophisticated, leveraging tools, including Crummey[235] powers, life insurance trusts, and split gifts, can further maximize annual exclusions when used in conjunction. For example, if a transferor contributes the annual exclusion amount every year to an irrevocable trust for the benefit of a beneficiary, the beneficiary can be given the power to withdraw the amount for a period of thirty days after the contribution (i.e., Crummey powers) to ensure the amount qualifies for the annual exclusion as a gift of a present interest. If the beneficiary is provided adequate notice of his right to withdraw and voluntarily chooses not to withdraw the funds, the trust can use the funds to purchase life insurance on the transferor's life[236] and pay the required premiums.[237] Since the trust would own the life insurance policy, the life insurance proceeds would not be included in the servicemember's gross estate at his death. Those interested in even more sophisticated techniques should seek the advice of an experienced estate planner to discuss the numerous possibilities available.[238]

2. Spousal Gifts and Limitations to Foreign Spouses

Servicemembers can also deplete their estates by making lifetime gifts to spouses. In general, lifetime gifts to U.S. citizen spouses qualify for the unlimited marital deduction.[239] However, gifts to non-U.S. citizen spouses do not qualify in the same manner.[240] Instead, gifts that "would have qualified for the marital deduction had the donee spouse been a U.S. citizen" can be given tax-free, as long as the gift's value falls within a maximum amount established by law, indexed for inflation.[241] For example, in 2010, a spousal donor could gift a non-U.S. citizen spouse up to $134,000 tax-free.[242]

3. Charitable Gifts

Contributions to charity allow servicemembers to take advantage of both income tax and gift tax charitable deductions[243] while simultaneously achieving their charitable objectives at a significantly reduced "net real cost."[244] For example, a taxpayer in the 45% gift tax bracket could effectively transfer $14,500 to a public charity at the same cost as transferring $10,000 to a non-charitable beneficiary (assuming annual exclusions did not apply) and paying the resulting $4,500 in gift taxes (i.e., 0.45 x $10,000 = $4,500). In addition to taking gift tax charitable deductions and efficiently removing property

[235] Crummey v. Comm'r, 397 F.2d 82 (9th Cir. 1968). *See generally* STEPHENS, *supra* note 62, at 9-29 to 9-34 (discussing how Crummey powers can be used to qualify for the annual exclusion and avoid the problems created by a transfer of future interests). As an alternative to using Crummey powers, transferors could establish defective grantor trusts for income tax purposes, to buy insurance on the transferor's life.

[236] To buy life insurance, there must be an insurable interest. The general principal behind requiring an insurable interest is to allow only those who will be hurt by the insured's death to purchase a policy on the insured's life.

[237] The trust may take advantage of the "5 & 5 rule" and include "hanging powers," a controversial technique that the IRS does not believe works, to prevent a gift from being made from the beneficiary to the trust. Using these powers, the right to withdraw would lapse every year to the extent of the greater of $5,000 or 5% of the trust's corpus, while the remaining amount would "hang" in the balance and lapse in subsequent years as the corpus of the trust grows.

[238] *See generally* T.M., ESTATE PLANNING, *supra* note 21, at A106 to A107 (providing a useful discussion of the use of defective grantor trusts). *See generally* Rev. Rul. 2004-64 (establishing the ability of owners of defective grantor trusts to pay the income taxes of the trust without being treated as making gifts to the trust beneficiaries). *See generally* Samuel A. Donaldson, Fundamentals of Grantor Trusts 242–44 (June 18–23, 2006), *available at* http://files.ali-aba.org/thumbs/datastorage/skoobesruoc/pdf/CL092_chapter_03_thumb.pdf (last visited Apr. 22, 2009) (discussing the use of Crummey powers in defective grantor trusts; explaining that many practitioners do not give Crummey powers to beneficiaries of defective grantor trusts due to the uncertainties involved). *See generally* HOWARD M. ZARITSKY, *GRANTOR TRUSTS: SECTIONS 671–679* (2d Portfolio 858) (Tax Mgmt. Inc. 2001) (discussing the numerous aspects of grantor trusts).

[239] *See* I.R.C. § 2523(a) (2010). *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-88 (explaining the gift tax marital deduction). *But see* I.R.C. § 2523(b) (denying an unlimited deduction for gifts of terminable interests).

[240] I.R.C. § 2523(i). *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-88 (explaining the tax implications of gifts to non-U.S. citizen spouses).

[241] T.M. ESTATE PLANNING, *supra* note 21, at A-88.

[242] *See* Rev. Proc. 2009-50, sec. 3, para. 30 (2009) (establishing the cost-of-living adjustments for 2010).

[243] *See* I.R.C. § 170 (outlining the income tax charitable deduction). *See id.* § 2522 (outlining the gift tax charitable deduction). *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-175 to A-186 (explaining the tax implications of charitable transfers). STEPHENS, *supra* note 62, at 11-3. In contrast, I.R.C. § 2055(c) reduces the estate tax charitable deduction for estate taxes paid from the charitable bequest, while I.R.C. § 642(g) preclude double deductions under the estate tax for charitable bequests. *See id.* at 5-62 to 5-63. Specifically, under § 642(g), the estate tax charitable deduction is reduced by administrative expense deductions taken under § 2053 and losses taken under § 2054. *See id.* at 5-62 to 5-63. *See* I.R.C. §§ 642(g) and 2055(c). As a result, servicemember may want to make only charitable gifts rather than charitable bequests to maximize the beneficial tax savings effect. For those who want to make charitable bequests, servicemembers may want to consider specifying in their will that taxes will be paid out of other funds rather than out of the charitable bequest pro rata, to ensure that the charitable estate tax deduction is not reduced under I.R.C. § 2055(c).

[244] T.M. ESTATE PLANNING, *supra* note 21, at A-176.

from their gross estates, taxpayers could take income tax deductions for charitable contributions, although the deductions may be limited by factors such as the donor's adjusted gross income and the specific status of the charitable recipients.[245]

To increase the benefits of charitable deductions, instead of contributing cash, servicemembers can donate appreciated tangible personal property, such as a valuable painting to an art museum. Where there is clearly "related use" between the contributed property and the public charity (e.g., the museum will display the donated painting for the public's pleasure rather than selling it to generate income to feed the homeless), the taxpayer will be entitled to a charitable deduction equal to the painting's full fair market value, even though the gain resulting from the painting's appreciation is not included in the taxpayer's gross income.[246]

4. Premiums, Discounts, and other Valuation Issues

To maximize gift transfers while minimizing tax implications, servicemembers can also take advantage of valuation issues. Servicemembers who own a family business can use minority interest, lack of marketability, and fractional interest discounts to transfer property to others at a tax value that is a fraction of its inherent value.[247] Furthermore, due to historically low interest levels, taxpayers may take advantage of more advanced instruments, such as short-term rolling grantor retained annuity trusts (GRATs).[248] "Zeroing out" the GRATs, taxpayers can make tax-free transfers of assets that are expected to appreciate substantially while retaining an income interest for the term of the GRAT equal to the value of the original transfer.[249] Reliance on historically low interest rates (i.e., "the hurdle rate") often prompts GRAT assets to outperform the interest rate, producing a significant remainder for tax-free transfer.[250] At the expiration of the short-term GRAT, servicemembers can create another GRAT (hence the term "short-term rolling GRATs"), creating further opportunities to outperform the "hurdle rate" and make tax-free transfers of remainder interests. Where the servicemember dies during the term of the GRAT, the Internal Revenue Code includes the entire amount, including any appreciation, in the servicemember's gross estate.[251]

B. Minimizing Taxation at Death: Using Available Credits and Deductions

To minimize the overall tax effect on a family and maximize the funds available for transfer to beneficiaries, taxpayers should structure their estate planning documents and transactions to take advantage of both spouses' federal estate and GST tax exemptions and available deductions, such as the marital and charitable deductions. Specifically, servicemembers who want to provide for their spouses by deferring tax should ensure that their estate planning documents include appropriate formula clauses that allow them to fall back on the unlimited marital deduction after using their exemptions.[252] The most

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[245] *See* I.R.C. § 170(b). For example, the income tax deduction for a cash contribution to a public charity is limited to 50% of the taxpayer's adjusted gross income. *See id.* § 170(b)(1)(A). In contrast, the income tax deduction for a cash contribution to certain non operating private foundations (e.g., a foundation that just makes grants) is limited to 30% of the taxpayer's adjusted gross income. *See id.* § 170(b)(1)(D)(i)(II). Fortunately, excess contributions can be carried over for five years. *See id.* § 170(b).

[246] *See id.* § 170(e)(1)(B)(i)(I). *See* T.M. ESTATE PLANNING, *supra* note 21, at A-177.

[247] *See generally* STEPHENS, *supra* note 62, at 10-56 to 10-66 (explaining available premiums and discounts with regard to transfers of interests in property). It important to understand that discounts are layered and not cumulative. For example, if a taxpayer has a 20% lack of marketability discount and a 40% other type of discount, the taxpayer only has a 52% discount (i.e., 20% + (80% x 40%) rather than a 60% discount. *See* Estate of Bailey v. Comm'r, 83 T.C.M. (C.C.H.) 1862 (2002). In addition, servicemembers, especially those interested in shifting effective control in a family business to younger generations, need to ensure they do not inadvertently run afoul of the special valuation rules of Chapter 14 of the Internal Revenue Code. *See* I.R.C. §§ 2701-2704. *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-191 to A-209 (explaining the complicated provisions and almost punitive effects of Chapter 14).

[248] *See* I.R.C. § 2702 (2010). In general, to qualify for a GRAT, there must be a fixed annuity amount paid at least annually without the possibility of commutation or payment via a note. *See generally* Treas. Reg. § 25.2702-3(b) & (d) (2009) (establishing the requirements and limitations of GRATs).

[249] *See* Walton v. Comm'r, 115 T.C. 589 (2000).

[250] *See* I.R.C. § 7520 (establishing the applicable interest rates which change monthly (e.g., March 2009 had a rate of 2.4%)).

[251] *See id.* § 2036(a).

[252] *See id.* § 2056. In general, to qualify for the marital deduction for bequests, etc., to the surviving spouse, the decedent must have been survived by his spouse, the value of the interest deductible must be includible in the decedent's gross estate, the interest must pass from the decedent to the surviving spouse, and the interest must not be a nondeductible terminable interest. *See id*. Some examples of exceptions to these general requirements to qualify for the unlimited marital deduction include marital deduction and QTIP trusts, as well as, transfers to non US citizen spouses. *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-48 to A-77 (explaining the estate tax marital deduction).

effective clauses leave spouses with assets in a marital deduction trust[253] in an amount determined by a formula.[254] Such a clause will ensure that servicemembers use their full exemption, leaving the maximum amount to their beneficiaries in a credit shelter or bypass trust, free of federal estate and GST taxes. Additionally, any estate assets over the full exemption amount would pass to the surviving spouse and be protected by the unlimited marital deduction, ultimately deferring taxes due until the surviving spouse's death.

Servicemembers who want to provide for a surviving spouse and defer taxes while maintaining control of the ultimate disposition of funds should consider establishing a qualified termination of interest property (QTIP) trust.[255] The unlimited marital deduction clause in a QTIP trust must provide all income (except stub income) to the spouse, at least annually, and disallow any other permissible beneficiary during the spouse's lifetime.[256] In addition, the executor must make an irrevocable QTIP election on the decedent's estate tax return. Depending on the circumstances, an executor may make either a full or partial QTIP election [257] to minimize taxes. The flexibility of the election itself and the ability to make the election as late as fifteen months after the decedent's death[258] gives the executor the ability to do significant postmortem estate planning.[259]

For servicemembers with non-U.S. citizen spouses, a qualified domestic trust[260] (QDOT) can accomplish some of the same objectives as a QTIP trust, including the deferment of estate taxes. To ensure the property transferred does not escape U.S. estate taxation, the law requires that at least one trustee be either a U.S. citizen or a U.S. corporation (unless the Department of the Treasury waives the requirement), and that no distributions, other than of income, be made unless the trustee has the power to withhold applicable taxes.[261] In contrast to a QTIP trust, a QDOT can still qualify for the marital

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[253] I.R.C. § 2056(b)(5). In general, to qualify for the unlimited marital deduction under § 2056(b)(5), the trust must pay all income (except stub income) to the surviving spouse at least annually and give the spouse a general power of appointment that is "exercisable by such spouse alone and in all events." *Id. See also* Regs. 20.2056(b)-7(d)(4) (specifying that stub income, income between the last distribution date and the date of the surviving spouse's death, need not be paid to the surviving spouse or to the surviving spouse's estate).

[254] *See, e.g.*, STANLEY JOHANSON, WILLS & ESTATES FALL SEMESTER 1999 SUPPLEMENTAL MATERIALS, pt. VI, at 65 (1999). As an example, a formula clause could include the following language:

> If my wife survives me, I give to [my wife] [the trustee of a marital deduction trust] a cash legacy in an amount which, when added to the value for federal estate tax purposes of all items in my gross estate which qualify for the marital deduction and which pass or have passed to my wife in a form qualifying for the marital deduction otherwise than under this . . . [bequest], produces *the smallest marital deduction* (and thus *the largest taxable estate*) that will result in no federal estate tax being payable by my estate, after allowing for the . . . [estate tax] credit against the federal estate tax and all other factors that affect my estate's federal estate tax liability. In making this computation, values as finally determined for federal estate tax purposes should be used. If no federal estate tax would be payable by my estate even if no gift were made by this paragraph, this gift shall not me made.

Id.

[255] I.R.C. § 2056(b)(7). *See also* Regs. 20.2056(b)-7(d)(4) (specifying that stub income, income between the last distribution date and the date of the surviving spouse's death, need not be paid to the surviving spouse or to the surviving spouse's estate). *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-58 to A-62 (explaining QTIPs and their requirements; warning of the dangers associated with the estate making a QTIP election that was not necessary to reduce estate tax liability and the corresponding possible relief available for a surviving spouse under Rev. Proc. 2001-38).

[256] *See* I.R.C. § 2056(b)(7).

[257] *See, e.g.*, JOHANSON, *supra* note 254, pt. VI, at 103 (on file with author). As an example, a partial QTIP election might include the following formula language:

> I elect qualified terminable interest property treatment for the following fractional share of the residuary trust created by . . . the decedent's will: The numerator of the fraction shall be an amount which, when added to the value for federal estate tax purposes of all items in the decedent's gross estate which qualify for the marital deduction and which pass or have passed to the decedent's spouse in a form qualifying for the marital deduction otherwise than under this trust, produces the smallest marital deduction (and thus the largest taxable estate) that will result in no federal estate tax being payable by the decedent's estate, after allowing for the . . . [estate tax] credit against the federal estate tax and all other factors that affect my estate's federal estate tax liability. The denominator of the fraction shall be the value of the corpus of the residuary trust. In making this computation, values as finally determined for federal estate tax purposes shall be used.

Id. The elected portion would be includable in the spouse's gross estate under §2044 while the unelected portion would bypass the spouse's estate. *Id.* Pt. VI, at 104.

[258] Nine months to file the federal estate tax return plus six months if the estate gets an extension.

[259] *See* I.R.C. § 2056(b)(7) (2010).

[260] *Id.* § 2056A. *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A50 and A-74 to A-75 (explaining the history and requirements of the QDOT; discussing how to conduct marital deduction transfers to non-U.S. citizens surviving spouses).

[261] *See* T.M. ESTATE PLANNING, *supra* note 21, at A-74. The U.S. trustee is personally liable for the taxes if they are not paid.

deduction even though there is no requirement to pay the surviving spouse all the income at least annually.[262] In addition, unlike a QTIP trust, lifetime distributions from a QDOT other than distributions of income will be subject to estate tax when made, and any property remaining will be subject to the estate tax at the surviving spouse's death.[263]

C. Minimizing Taxation After Death: Postmortem Planning

After a servicemember's death, executors and beneficiaries can still conduct postmortem estate planning using various mechanisms, such as using an alternate valuation date[264] if the decedent's gross estate depreciates after the decedent's death,[265] and selecting an estate's accounting year[266] if the estate's income can be spread out more evenly. In addition, servicemembers can use three powerful postmortem planning techniques including QTIP elections, qualified disclaimers, and the choice of where and when to take deductions. For example, by making a QTIP election after the decedent's death, the executor can modify the use of the marital deduction and ensure the full use of the decedent's unified credit.[267]

A beneficiary can accomplish similar results by making a qualified disclaimer.[268] By making an "irrevocable and unqualified refusal"[269] to accept the property transferred, the property will bypass the beneficiary, as if the beneficiary died before the decedent. This technique can be extremely useful in cases where the use of the marital deduction "overfunds" the marital transfer.[270] For instance, if a taxpayer with a $4.5 million gross estate died in 2009 leaving his entire estate to his independently wealthy spouse, the taxpayer would overfund the marital transfer wasting the unified credit. To resolve this error, the surviving spouse could disclaim $3.5 million of assets.[271] As a result, the disclaimed $3.5 million of assets could pass tax-free to their children. Furthermore, if the taxpayer had not previously used his GST exemption and the children to whom the assets would pass were themselves wealthy, the children could make a qualified disclaimer,[272] passing the property to their children (i.e., the taxpayer's grandchildren) free of federal estate and GST taxes. In short, while $1 million would pass to the surviving spouse tax-free under the unlimited marital deduction, $3.5 million could escape both the federal estate and GST taxes.

Executors can engage in further postmortem planning by selecting whether and when to take funeral, administrative, and medical expenses[273] on either the decedent's last income tax return, the estate's income tax return, or the estate's estate tax return.[274] If estate taxes are not due as a result of the unified credit and marital deduction, executors may choose to deduct an

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262 *See* I.R.C. § 2056A(a)(2); T.M. ESTATE PLANNING, *supra* note 21, at A-75 (explaining that the Revenue Reconciliation Act of 1989 deleted the requirement of former § 2056A(a)(2) requiring current income distributions).

263 *See* I.R.C. § 2056A(b)(1).

264 *See id.* § 2032.

265 *See* T.M. ESTATE PLANNING, *supra* note 21, at A-253 (explaining that the alternate valuation date is six months after death, unless the property was distributed, sold, exchanged, or otherwise disposed at an earlier date, in which case that earlier date would be applicable date).

266 *See id.* at A-241 (describing the advantages of having the estate select either a fiscal or calendar year such as the deferral of taxes through staggered fiscal years).

267 *See generally* STEPHENS, *supra* note 62, at 5-174 (discussing the advantages of allowing the executor to make a QTIP election as a method of post mortem planning; describing how to make a QTIP election).

268 *See* I.R.C. § 2046 (referencing the uniform disclaimer rules of § 2518 which also apply for purposes of the estate tax). *See id.* § 2518 (defining qualified disclaimers and explaining the implications of making qualified disclaimers). *See generally* STEPHENS, *supra* note 62, at 10–108 (discussing disclaimers).

269 *See* I.R.C. § 2518(b). To qualify as a qualified disclaimer, (1) the refusal must be in writing and received by the transferor not later than nine months after the interest's creation (i.e., the testator's death) or the beneficiary's 21st birthday, (2) the beneficiary must not accept the property nor any of its benefits, and (3) as a result of the refusal, the property must pass without any direction on the part of the beneficiary to the spouse of the decedent or to a person other than the person making the disclaimer. *Id.* As a result, "[t]o minimize complications, wills or trusts should have an express provisions as to what will happen if a property interest is disclaimed." HALLMAN & ROSENBLOOM, *supra* note 25, at 523. *See generally* STEPHENS, *supra* note 62, at 10-118 (discussing that a resident's use of residential property held in joint tenancy or as community property, is not acceptance of the property).

270 T.M. ESTATE PLANNING, *supra* note 21, at A-75.

271 *See generally* HALLMAN & ROSENBLOOM, *supra* note 25, at 523–24 (showing a similar example from a decedent dying in 2002). The unified credit in 2009 would protect the transfer of $3.5 million.

272 *See generally* STEPHENS, *supra* note 62, at 10-108 (discussing timely disclaimers). It is important to note that a "person who receives an interest in property as a result of a qualified disclaimer of the interest must also disclaim the previously disclaimed interest no later than nine months after the date of the taxable transfer creating the interest." *Id.* In short, if the property is left by will, all parties over the age of twenty-one must disclaim within nine months of the decedent's death. *See id.* at 10–116.

273 *See* I.R.C. § 2053.

274 *See generally* T.M. ESTATE PLANNING, *supra* note 21, at A-239 (discussing post-mortem planning techniques).

administrative expense on the estate's income tax return. In contrast, if both income and estate tax is due, executors may choose to deduct the expenses on the estate tax return as it will generally be "more valuable"[275] as a estate tax deduction. However, if both income and estate taxes are due and the executor takes deductions on the estate's income tax return, rather than the estate's estate tax return, the estate tax will increase to the detriment of the remainder beneficiaries while the income tax will decrease to the benefit of the income beneficiaries.[276] If the remainder and income beneficiaries are not the same people, these issues may create conflicts.

VI. Conclusion

The current unpredictable economic climate has created substantial challenges for servicemembers seeking to build wealth and provide for beneficiaries after death. While proper financial planning requires substantial energy and intense thought, it is essential. Servicemembers should be especially cautious of estate planning ramifications and tax consequences of investments and property transfers. Any effort at tax and estate planning should begin with the guidance of a knowledgeable and trained professional. After servicemembers have executed a will and power of attorney, they should strive to become better informed about the tax system so that they can use the system to their advantage.

Building wealth and providing for future generations requires diversification of assets and commitment of funds in a manner that does not expose assets to excessive risk. The acquisition of life and property insurance serve as a productive starting point, but servicemembers can reap significant benefits from regular investments in financial assets such as a Roth IRA diversified mutual fund that facilitates tax savings, dollar cost averaging, the compounding of funds, and the exploitation of the time value of money. Exposure to both fixed income and equity investments can also benefit servicemembers. While fixed income investments, such as "laddered" CDs and savings bonds, protect against the loss of capital in economic busts, equity investments allow servicemembers to benefit from economic booms. In addition, those wishing to reap potentially huge benefits from owning real property should consider purchasing well-located properties that will sustain themselves with positive rental cash flows when the property no longer serves as a principal residence.

In order to generate funds for investment, maintain liquid financial reserves, and sustain a diversified, balanced portfolio, servicemembers must be prepared to live beneath their means. They may begin by cutting expenses and taking advantage of numerous military benefits, such as free education and space available travel, as well as, reduced on-post housing costs and utility fees. Automatically investing one's annual pay raises and tax refunds can also increase the availability of funds by preventing servicemembers from continually increasing their living standards every time their wealth increases. Servicemembers who elect to work after achieving retirement from the military can invest their military retirement pay check while paying monthly bills with their civilian employment's earnings. However, the best way to reduce expenses is for servicemembers and retirees simply to distinguish their needs from their wants. By focusing on actual needs, such as basic food, clothing, and shelter, servicemembers can steer clear of the dangers of keeping up with their neighbors and can expedite their journey to financial freedom and success.

A final step to attaining financial security and building wealth for oneself and for one's family is the establishment of a comprehensive plan to transfer wealth to beneficiaries in a tax-efficient manner. By taking advantage of annual exclusions, direct tuition payments to schools, direct payments to medical providers, the unified credit, charitable deductions, and the marital deduction, servicemembers can set themselves and their beneficiaries up for success. In short, conscientious legal and financial planning combined with a diversified investment strategy will help servicemembers build and keep the wealth they have earned through a lifetime of work. These measures will also allow servicemembers to pass more of that wealth to future generations with minimal losses to taxes.

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[275] *Id.* at A-239.

[276] *See id.* at A-242.

Appendix A

Exclusions, Exemptions, and Gift / Estate / GST Tax Rates[277]

Year	Annual Gift Exclusion	Estate / GST Exclusion	Gift Tax Exclusion	Highest Estate & Gift Tax Rate
2002	$11,000	$1 Million	$1 Million	50%
2003	$11,000	$1 Million	$1 Million	49%
2004	$11,000	$1.5 Million	$1 Million	48%
2005	$11,000	$1.5 Million	$1 Million	47%
2006	$12,000	$2 Million	$1 Million	46%
2007	$12,000	$2 Million	$1 Million	45%
2008	$12,000	$2 Million	$1 Million	45%
2009	$13,000	$3.5 Million	$1 Million	45%
2010	$13,000	(Taxes Repealed)	$1 Million	35%
2011	To be Determined	$1 Million	$1 Million	55% (EGTRRA Sunsets)

[277] *See* JOINT COMMITTEE, *supra* note 5, at 11 and 14 (showing similar tables). *See* DESKBOOK 2006, *supra* note 13, at G-5 (on file with author) (showing a similar table). *See* JOINT COMMITTEE, *supra* note 5, at 11 and 14 (showing similar tables). *See supra* note 58 and accompanying text (explaining that EGTRRA sunsets on 31 December 2010).

Appendix B

Federal Gift Tax Computation Examples[278]

Hypo A: Colonel Smith, who has previously never made any taxable gifts to anyone, gave his niece a home worth $688,000 in 2009 and gave his nephew a condominium worth $338,000 in 2010.

Hypo B: The same as Hypo A, except Colonel Smith's gift of the condominium to his nephew in 2010 is worth $500,000.

	2009	(Hypo A) 2010	(Hypo B) 2010
Gift	$688,000	$338,000	$500,000
- Annual Exclusion	- 13,000	-$13,000	-$13,000
= Taxable Gift	= $675,000	$325,000	$487,000

Taxable Gift	$675,000	$325,000	$487,000
+ Prior Taxable Gifts	- 0	+675,000	+675,000
= Total Taxable Gifts	= $675,000	=$1,000,000	=1,162,000

Tax of Total Gifts under I.R.C. § 2502(a)	$220,550[279]	$330,800[280]	$387,500[281]
- Tax from Gifts made in Prior Years	- 0	- 0	- 0
= Gift Tax in Current Year	= $220,550	= $330,800	= $387,500

Gift Tax in Current Year	$220,550	$330,800	$387,500
- Federal Gift Tax Credit (Unified Credit)[282]	- 220,550	-330,800[283]	-330,800
= Gift Tax Owed	= $0	= $0	= $56,700

[278] *See* DESKBOOK 2006, *supra* note 13, at G-12 (on file with author) (showing a similar example).

[279] *See* I.R.C. § 2502(a) (2009) (applying gift rates under I.R.C. § 2001(c) for gifts made *prior to* 31 December 2009). For example, tax on taxable gifts of $675,000 = 155,800 + .37 x (675,000 – 500,000) = $220,550.

[280] *See id.* § 2502(a)(2) (applying gift rates for gifts made *after* 31 December 2009). For example, tax on taxable gifts of $1,000,000 = 155,800 + .35 x (1,000,000 – 500,000) = $330,800.

[281] *See id.* § 2502(a)(2) (applying gift rates for gifts made *after* 31 December 2009). For example, tax on taxable gifts of $1,162,000 = 155,800 + .35 x (1,162,000 – 500,000) = $387,500.

[282] *See id.* § 2505(a) (setting the federal gift credit imposed for gift taxes imposed by I.R.C., § 2501).

[283] *See id.* § 2505(a) (setting the federal gift credit imposed for gift taxes imposed by I.R.C., § 2501). For example, the maximum credit for lifetime gifts = $155,880 + .35 x (1,000,000 – 500,000) = $330,800.

Appendix C

Outline for Calculating Federal Estate Tax[284]

IRC Section	Property Covered
§2033	Property Owned at Death
+ §2035	Certain Transfers Within Three Years of Death
+ §2036	Transfers with Retained Life Estate or Retained Control
+ §2037	Transfers Taking Effect at Death
+ §2038	Revocable Transfers
+ §2039	Annuities and Employee Death Benefits
+ §2040	Property Passing by Rights of Survivorship
+ §2041	General Powers of Appointment
+ §2042	Life Insurance Proceeds (Where Decedent Held Incidents of Ownership)
+ §2043	Transfers for Partial Consideration
+ §2044	QTIP Transfers for which Marital Deduction was Previously Allowed
= **Gross Estate (GE)**	

	Type of Deduction
- §2053	Deduction for Administrative and Funeral Expenses, as well as Debts
- §2054	Deduction for Casualty Losses
- §2055	Charitable Deduction
- §2056	Marital Deduction
- §2058	Deduction for State Death Taxes Paid (dying between 1 JAN 05 - 31 DEC 09)
= **Taxable Estate**	

+ Adjusted Taxable Gifts   Taxable Gifts Made After 1976 not Otherwise Includable in GE
= **Tentative Estate Tax Base**

x §2001 Estate Tax Rate Schedule
= **Tentative Estate Tax**

	Type of Credit
- Gift Taxes Paid on Taxable Gifts Made After 1976	
- §2010	Estate Tax Unified Credit
- §2011	Credit for State Death Taxes (decedents dying after 31 DEC 10)
- §2012	Credit for pre-1977 Gift Taxes on Property Included in Gross Estate
- §2013	Credit for Taxes on Prior Transfers *to* Decedent (i.e., prior inclusion in *a* GE)
- §2014	Credit for Foreign Death Taxes
= **Federal Estate Tax**	

[284] *See* JESSE DUKEMINIER ET AL., WILLS, TRUSTS, AND ESTATES 869–70 (7th ed. 2005) (showing a similar outline). *See also* HALLMAN & ROSENBLOOM, *supra* note 25, at 472 (showing a more general outline).

Appendix D

Federal GST Tax Calculation Examples[285]

Task: Ensure that skip person grandchild receives $100,000 in 2002.

Conditions: Servicemember Transferor is in the 50% gift, estate, and GST tax brackets. Neither the unified credit nor annual exclusions are available.

Standard: Incur the least federal transfer taxes by comparing the alternatives.

Alternative 1: Inter Vivos Direct Skip to Grandchild (This is the Best Alternative)

Amount Received by Grandchild	**$100,000**
+ GST Tax on Gift	+ 50,000
+ Federal Gift Tax on Gift	+ 50,000
+ Federal Gift Tax on GST Tax Paid	+ 25,000
= Total Funds Needed for Transfer	**= $225,000**

Alternative 2: Testamentary Direct Skip Transfer to Grandchild (i.e., A Bequest)

Funds Necessary for Bequest	**$300,000**
- Federal Estate Tax on Funds	- 150,000
- GST Tax on Bequest	- 50,000
= Amount Received by Grandchild	**= $100,000**

Alternatives 3 and 4: Transfer to Grandchild from Testamentary Trust (e.g., Taxable Distribution and Taxable Termination)

Funds for Bequest to Testamentary Trust	**$400,000**
- Federal Estate Tax on Funds	- 200,000
- GST Tax Paid by Grandchild or Trustee	- 100,000
= Amount Received by Grandchild	**= $100,000**

[285] *See* T.M., ESTATE PLANNING, *supra* note 21, at A-146 (showing a similar example). The year 2002 was chosen in the example as the year of transfer, because the 50% gift, estate, and GST tax brackets existing at that time simplify calculations.

Appendix E

State Income Tax (A Quick Reference Guide)

STATE	MILITARY PAY EXCLUDED?	MIL. RETIREMENT PAY EXCLUDED?	CITATION
Alabama	No	Yes	ALA. CODE § 40-18-3 (LexisNexis 2009), ALA. CODE § 40-18-20 (LexisNexis 2009)
Alaska	No State Income Tax	No State Income Tax	ALASKA STAT. § 43.20.010 (2009)
Arizona	Yes[286]	Partial[287]	ARIZ. REV. STAT. § 43-1022 (LexisNexis 2008)
Arkansas	Partial[288]	Partial[289]	ARK. CODE ANN. § 26-51-306 (2008), ARK. CODE ANN. 26-51-307 (2008)
California	Yes[290]	No	CAL. REV. & TAX. CODE § 17140.5 (Deering 2009)
Colorado	No[291]	Partial[292]	COLO. REV. STAT. § 39-22-103 (2008), COLO. REV. STAT. § 39-22-112 (2008), COLO. REV. STAT. § 39-22-104 (2008)
Connecticut	Yes[293]	No	CONN. GEN. STAT. § 12-701 (2008)
Delaware	No	Partial[294]	DEL. CODE ANN. tit. 30, § 1121 (2009), DEL. CODE ANN. tit. 30, § 1106 (2009)
Florida	No State Income Tax	No State Income Tax	FLA. STAT. ANN. *§ 220.02 (LexisNexis 2009)*
Georgia	No	Partial[295]	GA. CODE ANN. § 48-7-27 (2009)
Hawaii	No	Yes	HAW. REV. STAT. § 235-2.3 (2009); HAW. REV. STAT. § 235-7 (2009)

[286] ARIZ. REV. STAT. § 43-1022 (Westlaw 2010). Excluded from Arizona state tax is "compensation received for active service as a member of the reserves, the national guard or the armed forces of the United States."

[287] ARIZ. REV. STAT. § 43-1022 (Westlaw 2010). Up to $2500 in military retirement benefits may be excluded for Arizona state tax purposes.

[288] ARK. CODE ANN. § 26-51-306 (Westlaw 2010). Only the first $9000 of active duty pay is exempt.

[289] ARK. CODE ANN. § 26-51-307 (Westlaw 2010). Up to $6000 of pension is excluded.

[290] CAL. REV. & TAX. CODE § 17140.5 (Deering 2009). An individual domiciled in California when entering the military is considered to be a nonresident while stationed outside of California on PCS orders. *See* STATE OF CALIFORNIA FRANCHISE TAX BOARD, FTB PUB. 1032 TAX INFORMATION FOR MILITARY PERSONNEL (2009), *available at* http://www.ftb.ca.gov/forms/2009/09_1032.pdf (last visited Feb. 12, 2010).

[291] COLO. REV. STAT. § 39-22-103 (Westlaw 2010). An individual domiciled in Colorado who Is absent from the state for a period of at least three hundred five days of the tax year and is stationed outside of the United States of America for active military duty may file as a non-resident.

[292] COLO. REV. STAT. § 39-22-104 (Westlaw 2010). Servicemembers age fifty-five to sixty-four may exclude up to $20,000 of their military retirement benefits. Servicemembers age sixty-five and up may exclude up to $24,000.

[293] CONN. GEN. STAT. § 12-701 (Westlaw 2010). A servicemember domiciled in Connecticut may qualify as a non-resident for tax purposes if he meets either of the following requirements: (A) 1. Maintains no permanent place of abode in CT. 2. Maintains a permanent place of abode elsewhere. 3. Spends no more than thirty days of the taxable year in CT. or (B) 1. Within any period of 548 consecutive days, he is not present in the state for more than 90 days and does not maintain a permanent place of abode in CT [with some exceptions].

[294] DEL. CODE ANN. tit. 30, § 1106 (Westlaw 2010). Servicemembers under age sixty may exclude up to $2000 of their pension. Those age sixty and over may exclude up to $12,500.

[295] GA. CODE ANN. § 48-7-27 (Westlaw 2010). For taxable years beginning on or after 1 January 2008, Georgia allows a retirement exclusion of up to $35,000 for individuals age sixty-two or over.

Idaho	Yes[296]	Partial[297]	IDAHO CODE ANN. § 63-3013 (2008), IDAHO CODE ANN. §63-3022A (2008)
Illinois	Yes	Yes	35 ILL. COMP. STAT. ANN. 5/203 (LexisNexis 2009)
Indiana	No	Partial	IND. CODE ANN. § 6-3-2-1 (LexisNexis 2009), IND. CODE ANN. § 6-3-2-3.7 (LexisNexis 2009)
Iowa	No	Partial	IOWA CODE § 422.9 (2008)
Kansas	No	Yes	KAN. STAT. ANN. § 79-32,117 (2008)
Kentucky	Yes[298]	Partial	Joe Biesk, *Income Tax Exemption to Benefit Military Personnel*, DAILY INDEP., July 3, 2009, KY. REV. STAT. ANN. § 141.021 (LexisNexis 2009)
Louisiana	Partial[299]	Yes	LA. REV. STAT. ANN. § 47:293 (2009), LA. REV. STAT. ANN. § 47:44.2 (2009)
Maine	No	Partial[300]	ME. REV. STAT. ANN. tit. 36, § 5122 (2009)
Maryland	No	Partial[301]	MD. CODE ANN., TAX-GEN. § 10-207 (2009)
Massachusetts	No	Yes	MASS. ANN. LAWS ch. 62, § 2 (LexisNexis 2009)
Michigan	Yes	Yes	MICH. COMP. LAWS SERV. § 206.30 (LexisNexis 2009)
Minnesota	Yes[302]	No	MINN. STAT. § 290.01 (2008)
Mississippi	No	Yes	MISS. CODE ANN. § 27-7-15 (2008)
Missouri	Yes[303]	Partial[304]	MO. REV. STAT. § 143.041 (2009), MO. REV. STAT. § 143.123 (2009)
Montana	No	Partial[305]	MONT. ADMIN. R. 42.15.219 (2009)
Nebraska	No	No	NEB. REV. STAT. ANN. § 77-2716 (LexisNexis 2009), NEBRASKA DEPT. OF REVENUE, NEBRASKA INCOME TAX FOR MILITARY SERVICE MEMBERS AND CIVILIANS WORKING WITH U.S. FORCES IN COMBAT ZONES 1 (2009), *available at* http://www.revenue. ne.gov/info/8-364.pdf. (last visited Jul. 20, 2009)
Nevada	No State Income Tax	No State Income Tax	Nevada Dept. of Taxation, *available at* http://tax.state. nv.us (last visited Jul. 20, 2009).

[296] IDAHO CODE ANN. § 63-3013 (Westlaw 2010). Servicemembers who are absent from the state for at least 445 days in a fifteen-month period are not considered residents and do not have to file an Idaho income tax return. This classification does not apply to servicemembers who (1) have a permanent home where their spouses or minor children live for more than sixty days in any calendar year or (2) claim Idaho as their tax home for Federal Income Tax purposes. Servicemembers regain their resident status when they spend more than sixty days in Idaho in any calendar year.

[297] IDAHO CODE ANN. §63-3022A (Westlaw 2010). Retirement pay is excluded once servicemember reaches age of sixty-five, or sixty-two if disabled.

[298] Joe Biesk, *Income Tax Exemption to Benefit Military Personnel*, DAILY INDEP., July 3, 2009, http://www.dailyindependent.com/statenews/local_story_ 184083714.html/resources_printstory. Active duty military pay is exempt for Kentucky state tax purposes starting January 2010.

[299] LA. REV. STAT. ANN. § 293(9)(e) (Westlaw 2010) ("[I]n the case of an individual who is on active duty as a member of the armed forces of the United States, which full-time duty is or will be continuous and uninterrupted for one hundred twenty consecutive days or more, total compensation paid for services performed outside this state by the armed forces of the United States of up to thirty thousand dollars shall be excluded from "tax table income" and is hereby declared exempt from state income taxation.").

[300] ME. REV. STAT. ANN. tit. 36, § 5122 (Westlaw 2010). Servicemembers may deduct up to $6000 of their military pensions.

[301] MD. CODE ANN., TAX-GEN. § 10-207 (Westlaw 2010). The first $5000 of military retired pay may be excluded.

[302] MINN. STAT. § 290.01 (Westlaw 2010). Members of U.S. Armed Forces stationed outside the state are not considered residents for tax purposes.

[303] MO. REV. STAT. § 143.041 (Westlaw 2010). Military pay is not subject to Missouri tax if servicemember is considered a non-resident for tax purposes. He or she must spend less than 30 days in Missouri and not maintain permanent living quarters.

[304] MO. REV. STAT. § 143.123 (Westlaw 2010). Up to $6000 of retirement pay may be excluded.

[305] MONT. ADMIN. R. 42.15.219 (Westlaw 2010). There is a $3600 exclusion, if adjusted gross income is less than $30,000.

New Hampshire	No State Income Tax	No State Income Tax	New Hampshire Dept. of Revenue Administration Taxpayer Assistance, *available at* http://www.nh.gov/ revenue/faq/gti-rev.htm (last visited Jul. 20, 2009).
New Jersey	Yes	Yes	N.J. REV. STAT. § 54A:6-26 (2009)
New Mexico	No	No	N.M. ADMIN. CODE § 3.3.4.1-12 (2009), N.M. ADMIN. CODE § 3.3.11.13 (2009)
New York	Yes[306]	Yes	N.Y. TAX LAW § 605 (Consol. 2009), N.Y. TAX LAW § 612 (Consol. 2009)
North Carolina	No	Partial[307]	N.C. GEN. STAT. §105-134.6 (2009)
North Dakota	Partial[308]	Partial[309]	CORY FONG, TAX COMMISSIONER, INCOME TAX TREATMENT OF MILITARY PERSONNEL 5 (n.d.), *available at* http://www.nd.gov/tax/indincome/ pubs/guide/gl-28243.pdf (last visited Feb. 4, 2010)
Ohio	Yes[310]	Yes[311]	OHIO REV. CODE ANN. § 5747.01(24) (LexisNexis 2009); OHIO REV. CODE ANN. § 5747.01(26) (LexisNexis 2009)
Oklahoma	Yes[312]	Partial	S.B. 881, 52nd Legis. Sess., 1st Sess. (Okla. 2009); OKLA. STAT. tit. 68, § 2358 (2009)
Oregon	Partial	Partial	OR. REV. STAT. § 316.791 (2007), Oregon Department of Revenue, Military Personnel Filing Information 150-101-657 (Rev. Jan. 2010), *available at* http://egov.oregon.gov/DOR/PERTAX/docs/101-657.pdf (last visited Feb. 22, 2010)
Pennsylvania	Partial	Yes	72 PA. CONS. STAT. § 3402-303 (2009), Pennsylvania Department of Revenue, PA-40 Pennsylvania Personal Income Tax Return 2009, *available at* http://www.portal.state.pa.us/portal/server.pt/community/personal_income_tax/14692 (last visited Feb. 22, 2010)
Rhode Island	No	No	R.I. GEN. LAWS § 44-30-2.6 (2009)

[306] N.Y. TAX LAW § 605 (Consol. 2009). Servicemembers are considered non-residents for tax purposes if they fall into either of two groups. Group A: (1) they do not maintain a permanent home in New York, (2) They maintain a permanent home outside New York, and (3) They did not spend more than 30 days in New York during the tax year. Group B: (1) They were in a foreign country for at least 450 out of 548 consecutive days, and (2) spent less than 90 days in a permanent home in New York during that time.

[307] N.C. GEN. STAT. §105-134.6 (Westlaw 2010). Retirees may deduct up to $4,000 depending on their circumstance.

[308] CORY FONG, TAX COMMISSIONER, INCOME TAX TREATMENT OF MILITARY PERSONNEL 5 (n.d.), *available at* http://www.nd.gov/tax/indincome/pubs/ guide/gl-28243.pdf. If resident servicemembers use form ND-2, they may exclude up to $1,000 of military pay. Additionally, they may exclude $300 per month for each month they served overseas.

[309] *Id*. Retirees who are at least fifty years old may exclude up to $5000 of retirement pay.

[310] OHIO REV. CODE ANN. § 5747.01(24) (Westlaw 2010).

> Deduct, to the extent included in federal adjusted gross income and not otherwise allowable as a deduction or exclusion in computing federal or Ohio adjusted gross income for the taxable year, military pay and allowances received by the taxpayer during the taxable year for active duty service in the United States army, air force, navy, marine corps, or coast guard or reserve components thereof or the national guard. The deduction may not be claimed for military pay and allowances received by the taxpayer while the taxpayer is stationed in this state.

[311] *Id.*

> Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, amounts received by the taxpayer as retired military personnel pay for service in the United States Army, Navy, Air Force, Coast Guard, or Marine Corps or reserve components thereof, or the national guard, or received by the surviving spouse or former spouse of such a taxpayer under the survivor benefit plan on account of such a taxpayer's death.

[312] S.B. 881, 52nd Legis. Sess., 1st Sess. (Okla. 2009). Oklahoma State Senate Bill 881 passed in May 2009. Active duty military pay is exempt for state tax purposes beginning 1 July 2010.

South Carolina	No	Partial[313]	S.C. CODE ANN. § 12-6-1170 (2008)
South Dakota	No State Income Tax	No State Income Tax	South Dakota Department of Revenue & Regulation, http://www.state.sd.us/drr2 (last visited Jul. 20, 2009)
Tennessee	No State Income Tax	No State Income Tax	Tennessee Dept. of Revenue Frequently Asked Questions, *available at* http://www.tennessee.gov/ revenue/faqs/indincome.htm#3 (last visited Jul. 20, 2009)
Texas	No State Income Tax	No State Income Tax	Comptroller of Public Accounts Windows on State Government, *available at* http://www.window.state. tx.us/taxes/ (last visited Jul. 20, 2009)
Utah	No	No[314]	UTAH CODE ANN. § 59-10-1019 (2009)
Vermont	Partial	No[315]	VT. STAT. ANN. tit. 32, § 5823 (2009), VT. STAT. ANN. tit. 32, § 5824 (2009)
Virginia	Partial[316]	Partial[317]	VA. CODE ANN. § 58.1-322 (2009)
Washington	No State Income Tax	No State Income Tax	Dept. of Revenue Income Tax, *available at* http://dor.wa.gov/content/FindTaxesAndRates/IncomeTax/ (last visited Jul. 20, 2009)
West Virginia	Yes[318]	Partial[319]	W. VA. CODE § 11-21-7 (2009), W. VA. CODE § 11-21-12 (2009)
Wisconsin	No	Yes	WIS. STAT. § 71.05 (2008)
Wyoming	No State Income Tax	No State Income Tax	Wyoming Dept. of Revenue, *available at* http://revenue.state.wy.us/ (last visited Jul. 20, 2009)

[313] S.C. CODE ANN. § 12-6-1170 (Westlaw 2010). An individual taxpayer who is the original owner of a qualified retirement account is allowed an annual deduction from South Carolina taxable income of not more than three thousand dollars of retirement income received. Beginning in the year in which the taxpayer reaches age sixty-five, the taxpayer may deduct not more than ten thousand dollars of retirement income that is included in South Carolina taxable income.

[314] UTAH CODE ANN. § 59-10-1019 (Westlaw 2010). Starting in 2008, Utah retirees can no longer exclude retirement income. Retirees sixty-five and over may claim tax credit of $450. Retirees under sixty-five may claim a credit the greater of 6% of retirement income or $288.

[315] VT. STAT. ANN. tit. 32, § 5824 (Westlaw 2010). Vermont follows federal tax rules for retirement pay.

[316] VA. CODE ANN. § 58.1-322 (Westlaw 2010) ("$15,000 of military basic pay for military service personnel on extended active duty for periods in excess of 90 days; however, the subtraction amount shall be reduced dollar-for-dollar by the amount which the taxpayer's military basic pay exceeds $ 15,000 and shall be reduced to zero if such military basic pay amount is equal to or exceeds $30,000.").

[317] *Id*. Retirees may deduct up to $12,000, depending upon age and amount of income.

[318] W. VA. CODE § 11-21-7 (Westlaw 2010). A servicemember is considered a non-resident for tax purposes if "he maintains no permanent place of abode in [the] state, maintains a permanent place of abode elsewhere, and spends in the aggregate not more than thirty days of the taxable year in [the] state, or (2) . . . is not domiciled in [the] state but maintains a permanent place of abode in [the] state and spends in the aggregate more than one hundred eighty-three days of the taxable year in [the] state." *Id*.

[319] W. VA. CODE § 11-21-12 (Westlaw 2010). The first $20,000 of military retirement pay may be excluded.

Appendix F

State Gift Tax (A Quick Reference Guide)

STATE	STATE GIFT TAX?	CITATION
Alabama	No.	*See* Alabama Dept. of Revenue, *Alabama Estate and Inheritance Tax*, *available at* http://www.ador.state.al.us/incometax/Estate&Inh.htm (last visited Jul. 20, 2009). *See generally* ALA. CODE tit. 40 (LexisNexis 2009)
Alaska	No.	*See* Alaska Dept. of Revenue, *Tax Division* Programs, *available at* http://www.tax.alaska.gov/programs/index.aspx (last visited Jul. 20, 2009). *See generally* ALASKA STAT. tit. 43 (2009)
Arizona	No.	*See* Arizona Dept. of Revenue, *Estate Tax*, *available at* http://www.azdor.gov/brochure/900.pdf (last visited Jul. 20, 2009). *See generally* ARIZ. REV. STAT. tit. 42 (LexisNexis 2009).
Arkansas	No.	*See* Arkansas Dept. of Finance & Administration, *Taxes Overview*, *available at* http://www.state.ar.us/dfa/dfa_taxes.html (last visited Jul. 20, 2009). *See generally* ARK. CODE ANN. tit. 26 (2009).
California	No.	*See generally* CAL. CODE REGS. tit. 18, § 13301 (2009)
Colorado	No.	*See generally* COLO. REV. STAT. tit. 39 (2008)
Connecticut	Yes.[320]	CONN. GEN. STAT. § 12-640 (2008)
Delaware	No.	*See generally* DEL. CODE ANN. tit. 30 (2009)
Florida	No.	*See generally* FLA. STAT. ANN. tit. 14 (2009)
Georgia	No.	*See* Georgia Dept. of Revenue, *Estate Tax*, *available at* https://etax.dor.ga.gov/inctax/estatetax/index.aspx (last visited Jul. 20, 2009). *See generally* GA. CODE ANN. tit. 48 (2009)
Hawaii	No.	*See generally* HAW. REV. STAT. tit. 14 (LexisNexis 2009)
Idaho	No.	*See generally* IDAHO CODE ANN. tit. 63 (LexisNexis 2009)
Illinois	No.	*See generally* 36 ILL. COMP. STAT. ANN. (LexisNexis 2009)
Indiana	No.	*See generally* IND. CODE ANN. tit. 6 (LexisNexis 2009)
Iowa	No.	*See generally* IOWA CODE tit. 10 (2008)
Kansas	No.	*See generally* KAN. STAT. ANN. ch. 79 (2008)
Kentucky	No.	*See generally* KY. REV. STAT. ANN. tit. 11 (LexisNexis 2009)
Louisiana	No.	*See generally* LA. REV. STAT. ANN. tit. 47 (2009)
Maine	No.	*See generally* ME. REV. STAT. ANN. tit. 36 (2009)
Maryland	No.	*See generally* MD. CODE ANN., TAX-GEN. (LexisNexis 2009)
Massachusetts	No.	*See generally* MASS. ANN. LAWS tit. 9 (LexisNexis 2009)
Michigan	No.	*See generally* MICH. COMP. LAWS SERV. ch. 205 (LexisNexis 2009)
Minnesota	No.	*See* MINN. STAT. ch. 292 (2008)
Mississippi	No.	*See generally* MISS. CODE ANN. tit. 27 (2008)
Missouri	No.	*See generally* MO. REV. STAT. tit. 10 (2009)
Montana	No.	*See generally* MONT. CODE ANN. tit. 15 (2008)
Nebraska	No.	*See generally* NEB. REV. STAT. ANN. ch. 77 (LexisNexis 2009)
Nevada	No.	*See generally* NEV. REV. STAT. ANN. tit. 32 (LexisNexis 2009)
New Hampshire	No.	*See generally* N.H. REV. STAT. ANN. tit. 5 (LexisNexis 2009)
New Jersey	No.	*See generally* N.J. STAT. ANN. tit. 54 (2009)
New Mexico	No.	*See generally* N.M. STAT. ANN. ch. 7 (LexisNexis 2008)
New York	No.	*See generally* N.Y. TAX LAW (Consol. 2009)
North Carolina	No.	N.C. GEN. STAT. § 105-188 (2009)

[320] CONN. GEN. STAT. §12-640 (Westlaw 2010). Connecticut imposes a gift tax on property transfers at a rate according to a chart in § 12-642.

North Dakota	No.	*See generally* N.D. CENT. CODE tit. 57 (2009)
Ohio	No.	*See generally* OHIO REV. CODE ANN. tit. 57 (2009)
Oklahoma	No.	*See generally* OKLA. STAT. tit. 68 (2009)
Oregon	No.	*See generally* OR. REV. STAT. tit. 29 (2009)
Pennsylvania	No.	*See generally* PA. STAT. ANN. tit 72 (2009)
Rhode Island	No.	*See generally* R.I. GEN. LAWS tit. 44 (2009)
South Carolina	No.	*See generally* S.C. CODE ANN. tit. 12 (2008)
South Dakota	No.	*See generally* S.D. CODIFIED LAWS tit. 10 (2009)
Tennessee	Yes.[321]	TENN. CODE ANN. § 67-8-101
Texas	No.	*See generally* TEX. TAX CODE ANN. tit. 2 (2009)
Utah	No.	*See generally* UTAH CODE ANN. tit. 59 (2009)
Vermont	No.	*See generally* VT. STAT. ANN. tit. 32 (2009)

[321] TENN. CODE. ANN. § 67-8-102 & 106(b) (Westlaw 2010).

The following named donees shall be included in:

(1) Class A: Husband, wife, son, daughter, lineal ancestor, lineal descendant, brother, sister, stepchild, son-in-law or daughter-in-law. If a person has no child or grandchild, a niece or nephew of such person and the issue of such niece or nephew shall be a donee within this class. For the purposes of this part, a person who is related to the donor as a result of legal adoption shall be considered to have the same relationship as a natural lineal ancestor, lineal descendant, brother, sister or stepchild; and

(2) Class B: Any other relative, person, association or corporation not specifically designated in Class A

<u>Tax Rates on Gifts made before 1984</u>

CLASS A

1.4 % on amounts from $10,000 to $25,000;

2 % on the next $25,000 or part thereof;

4 % on the next $50,000 or part thereof;

5.5 % on the next $200,000 or part thereof;

6.5 % on the next $200,000 or part thereof;

9.5 % on the excess over $500,000.

CLASS B

6.5 % on amounts from $5000 to $50,000;

9.5 % on the next $50,000 or part thereof;

12 % on the next $50,000 or part thereof;

13.5 % on the next $50,000 or part thereof;

16 % on the next $50,000 or part thereof;

20 % on the excess over $250,000.

<u>Tax Rates on Gifts made after 1983</u>

CLASS A

5.5 % on the amount of net taxable gifts up to $40,000;

6.5 % on the next $200,000 or part thereof;

7.5 % on the next $200,000 or part thereof;

9.5 % on the excess over $440,000.

CLASS B

6.5 % on the amount of net taxable gifts up to $50,000;

9.5 % on the next $50,000 or part thereof;

12 % on the next $50,000 or part thereof;

13.5 % on the next $50,000 or part thereof;

16 % on the excess over $200,000.

Virginia	No.	*See generally* VA. CODE ANN. tit. 58.1 (2009)
Washington	No.	*See generally* WASH. REV. CODE tit. 83 (2009)
West Virginia	No.	*See generally* W. VA. CODE ANN. ch. 11 (LexisNexis 2009)
Wisconsin	No.	*See generally* WIS. STAT. ch. 72 (2009)
Wyoming	No.	*See generally* WYO. STAT. ANN. tit 39 (2009)

Appendix G

State Estate Tax (A Quick Reference Guide)

STATE	ESTATE TAX?	CITATION
Alabama	No.	*See* ALA. CODE § 40-15-2 (LexisNexis 2009); Alabama Dept. of Revenue, *Alabama Estate and Inheritance Tax*, *available at* http://www.ador.state.al.us/incometax/Estate&Inh.htm (last visited Jul. 20, 2009)
Alaska	No.	*See* ALASKA STAT. § 43.31.011 (2009).
Arizona	No.	*See* ARIZ. REV. STAT. §§ 42-4001, 4051 (LexisNexis 2009)
Arkansas	No.	*See* ARK. CODE ANN. §§ 26-59-103, 106, 109 (2009)
California	No.	*See* CAL. REV. & TAX. CODE §§ 13302, 13411 (Deering 2009)
Colorado	No.	*See* COLO. REV. STAT. §§ 39-23.5-102, 103 (2008)
Connecticut	Yes.[322]	CONN. GEN. STAT. § 12-391 (2008)
Delaware	Pick-up only.	*See* DEL. CODE ANN. tit. 30, § 1502 (2009)
Florida	No.	*See* FLA. STAT. ANN. § 198.02 (2009)
Georgia	No.	*See* GA. CODE ANN § 48-12-2 (2009)
Hawaii	No.	*See* HAW. REV. STAT. ANN. § 236D-2, 3 (LexisNexis 2009)
Idaho	No.	*See* IDAHO CODE ANN. §§ 14-403, 63-3004 (LexisNexis 2009)
Illinois	Pick-up only.	*See* 35 ILL. COMP. STAT. ANN. § 405/2-3 (LexisNexis 2009)
Indiana	Inheritance tax.	*See* IND. CODE ANN. §§ 6-4.1-1-4, 6-4.1-11-2 (LexisNexis 2009)
Iowa	Inheritance tax.	*See* IOWA CODE §§ 451.13, 451.2 (2008)
Kansas	Yes.[323]	*See* KAN. STAT. ANN. § 79-15 (2008)
Kentucky	Inheritance tax.	*See* KY. REV. STAT. ANN. § 140.130 (LexisNexis 2009)
Louisiana	No.	*See* LA. REV. STAT. ANN. §§ 47:2431, 2432, 2434 (2009)
Maine	Pick-up only.	*See* ME. REV. STAT. ANN. tit. 36, § 4062 (2009)
Maryland	Yes	*See* MD. CODE ANN., TAX-GEN §§ 7-304, 309 (LexisNexis 2009)
Massachusetts	Pick-up only.	*See* MASS. ANN. LAWS ch. 65C, § 2A (LexisNexis 2009)
Michigan	No.	*See* MICH. COMP. LAWS SERV. §§ 205.232, 205.256 (LexisNexis 2009)
Minnesota	Pick-up only.	*See* MINN. STAT. § 291.005, 291.03 (2008)
Mississippi	No.	*See* MISS. CODE ANN. § 27-9-5 (2008).
Missouri	No.	*See* MO. REV. STAT. §§ 145.011, 145.091 (2009)
Montana	No.	*See* MONT. CODE ANN. §§ 72-16-904, 905 (2008)

[322] CONN. GEN. STAT. § 12-391 (Westlaw 2010). Connecticut has a separate estate tax with a $2 million exemption.

[323] *See* KAN. STAT. ANN. § 79-15 (Westlaw 2010). In addition to a pick-up tax, Kansas has an estate tax effective 1 January 2007 through 31 December 2009.

Nebraska	Inheritance tax.[324]	*See* NEB. REV. STAT. ANN. § 77-2102.01 (LexisNexis 2009)
Nevada	No.	*See* NEV. REV. STAT. ANN. §§375A.025, 375A.100 (LexisNexis 2009)
New Hampshire	No.	*See* N.H. REV. STAT. ANN. § 87:1, 87:7 (LexisNexis 2009)
New Jersey	Pick-up and inheritance tax.	*See* N.J. STAT. ANN. §54:38 (2009)
New Mexico	No.	*See* N.M. STAT. ANN. §§ 7-7-2, 7-7-3 (LexisNexis 2008)
New York	Pick-up only.	*See* N.Y. TAX LAW §§ 951, 952 (Consol. 2009)
North Carolina	Pick-up only.	*See* N.C. GEN. STAT. §§ 105-32.1, 105-32.2, 105-228.90 (2009)
North Dakota	No.	*See* N.D. CENT. CODE § 57-37.1-04 (2009)
Ohio	Separate estate tax.	*See* OHIO REV. CODE ANN. § 5731.02 (2009)
Oklahoma	Separate estate tax.	*See* OKLA. STAT. tit. 68, §§ 804, 809 (2009)
Oregon	Pick-up only.	*See* OR. REV. STAT. § 118.010 (2009)
Pennsylvania	Inheritance.	*See* 72 PA. STAT. ANN. § 9117 (2009)
Rhode Island	Pick-up only.	*See* R.I. GEN. LAWS §44-22-1.1 (2009)
South Carolina	No.	*See* S.C. CODE ANN. §§ 12-6-40, 12-16-20, 12-16-510 (2008)
South Dakota	No.	*See* S.D. CODIFIED LAWS §§ 10-40A-1, 10-40A-3 (2009)
Tennessee	Inheritance.	*See* TENN. CODE ANN. § 67-8-202, 67-8-203 (2009).
Texas	Inheritance.	*See* TEX. TAX CODE ANN. §§ 211.001, 211.003, 211.051 (2009)
Utah	No.	*See* UTAH CODE ANN. § 59-11-102, 59-11-103 (2009)
Vermont	Pick-up only.	*See* VT. STAT. ANN. tit. 32, §§ 7402(8), 7442a, 7475 (2009)
Virginia	Pick-up only.	*See* VA. CODE ANN. §§ 58.1-901, 58.1-902 (2009)
Washington	Separate estate tax.	*See* WASH. REV. CODE §§ 83.100.020, 83.100.040. (2009)
West Virginia	No.	*See* W. VA. CODE ANN. § 11-11-3 (LexisNexis 2009)
Wisconsin	No.	*See* WIS. STAT. §§ 72.01, 72.02 (2009)
Wyoming	No.	*See* WYO. STAT. ANN. §§ 39-19-103, 39-19-104 (2009)

[324] *See* NEB. REV. STAT. ANN. § 77-2102.01 (Westlaw 2010). Nebraska counties have separate inheritance taxes.