

2023 Estate Tax Planning

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1

Introduction

Estate Tax Planning explores estate tax liability. It begins with the origins of estate taxation in English common law and an overview of estate administration. The course covers essential topics: a) estate and its administration, b) federal gift and estate taxes, c) common estate planning trusts, d) calculating federal estate taxes, e) state inheritance and estate taxation, and f) estate tax payment. We introduce estate settlement, including probate estate and the federal gross estate.

2

Introduction (cont.)

We'll break down federal estate tax calculation, delving into terms like federal gross estate, tentative taxable estate, taxable estate, and tentative tax. We'll simplify estate tax credits, deductions, and their role. Discover trust strategies, including credit shelter trusts, QTIP trusts, and irrevocable life insurance trusts, for tax reduction. Compare state death taxes and their payment dynamics. We investigate traditional estate tax payment sources, providing essential insights for effective estate tax planning.

3

Course Learning Objectives

- Explain the differences between an estate for tax purposes and a probate estate;
- Identify the assets that comprise the federal gross estate;
- Compare state inheritance taxes and estate taxes and the typical beneficiary classifications for state inheritance tax purposes;
- Explain how gifts are taxed under the federal gift tax system;

4

Chapter 1 - The Estate and Its Administration

Federal estate taxation has a fascinating history, complicating wealth transfer across generations. Despite changes over time, it remains a concern for many families, potentially shrinking their estate's value. Taxes aren't just about government funding; they're tools for achieving goals, like leveling the wealth playing field through estate taxes.

This system's origins lie in English common law, shaping U.S. legal systems. Feudal land grants by monarchs created wealth disparities, compounded by primogeniture favoring eldest sons. To break land concentration, Britain introduced inheritance taxes, compelling land-rich but cash-poor families to sell their ancestral holdings. This tradition continues in the U.S., forming the basis of estate taxes.

5

Course Learning Objectives (cont.)

- List the deductions and credits allowed under the federal system of estate taxation;
- Describe the common trusts employed in estate tax planning;
- Perform an estate tax calculation; and
- Identify the methods of estate tax payment and their cost consequences.

6

Chapter Learning Objectives

- Explain the differences between the probate estate and the federal gross estate;
- Identify the components of a decedent's probate estate;
- Describe the assets that comprise a decedent's federal gross estate; and
- Explain the duties of an executor or administrator of a decedent's estate.

7

- **Probate estate:** The decedent's property that is distributed by will or intestacy laws. Probate estate assets are part of the federal gross estate, but assets included in the federal gross estate may or may not be part of the probate estate.
- **Purpose of probate:** To settle debts or to establish the title to assets.

8

- **Property avoiding probate, i.e. not passed by will or intestacy laws**
 - Life insurance death benefit proceeds that are payable to a named beneficiary.
 - Property that is owned as joint tenants with right of survivorship.
 - Property that is owned as tenants by the entirety.

9

- **Federal gross estate:** Decedent's property that is subject to federal estate taxation; it may or may not be part of the decedent's probate estate.
- **Property constituting the federal gross estate:**
 - Property that is owned by the decedent at death.
 - Property in which the decedent had any incidents of ownership.
 - Death benefit proceeds payable under decedent-owned policies.
 - Certain gifts.

10

- **Real property:** Land and anything permanently attached to it.
- **Personal property:** All property that is not real property.
- **Jointly owned property included in the federal gross estate:** The value of the portion of jointly-owned property owned by the decedent will be included in the federal gross estate.

11

- **Incident of ownership:** A right in and to property; the term refers to a right that is less than complete ownership. In the case of life insurance, an incident of ownership includes the right to

| | |
|--|---|
| <ul style="list-style-type: none"> ○ Change the beneficiary; ○ Revoke a policy assignment; ○ Surrender the policy; ○ Pledge the policy for a loan; ○ Assign the policy; ○ Obtain a policy loan; or | <ul style="list-style-type: none"> ○ Receive dividends. ○ A donor's retention of an incident of ownership in gifted property will cause the property to be included in the donor's federal gross estate at death. |
|--|---|

12

- **Life insurance "bring-back" rule:** The bring-back rule applies to gifts of existing life insurance policies. To avoid including the death benefit proceeds of a gifted policy in a decedent's federal gross estate under the bring-back rule, the insured donor must live at least three years after the gift was made. If an insured's death occurs less than three years following a life insurance gift, the death benefits will be included in the insured's federal gross estate.

13

- **Personal Representative (Executor(trix)):** The person named in a decedent's will who is charged with administering the decedent's estate.
- **Administrator(trix):** The person appointed by the court to administer the decedent's estate when a decedent dies without a will or when no executor is named in a decedent's will.
- **Functions of personal representative or administrator**
 - Safeguarding and collecting the decedent's assets.
 - Paying the decedent's debts and taxes.
 - Distributing any remaining assets to the heirs specified in the will or pursuant to state intestacy laws.

14

- **IRS Form 706:** A form entitled "United States Estate (and Generation-Skipping Transfer) Tax Return." The form must be filed by the executor or administrator no later than nine months following the date of the decedent's death if the total value of the estate exceeds the amount that may be transferred tax free under the estate tax unified credit.

15

- **Estate tax unified credit:** The tax credit applied against any federal estate tax payable that is available to the estate of every decedent. In 2023, the estate tax unified credit is \$12.92 million.
- **Unified credit exemption equivalent:** The amount of assets that may be transferred estate tax free at death because of the estate tax unified credit. The exemption equivalent of the estate tax unified credit applicable to deaths occurring in 2023 is \$12.92 million.

16

Chapter 2 - Federal Gift and Estate Taxes

To grasp the current gift and estate tax system, we need to look at its evolution. U.S. law draws deeply from English common law, where estates went to the eldest son, called primogeniture, concentrating land in a few hands. To address this and generate more tax revenue, estate taxation was introduced. In 1976, a pivotal year, the Tax Reform Act unified gift and estate taxes, eliminating the old exemptions. The unified tax credit gradually grew, reaching \$192,800, equivalent to the tax-free transfer of \$600,000 before further adjustments up to \$1 million in 2006 under the Taxpayer Relief Act of 1997.

17

Learning Objectives

- Identify the principal estate tax provisions of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Act) and the American Taxpayer Relief Act of 2012 (2012 Tax Act);
- Describe how the current annual gift tax exclusion permits the tax-free transfer of property ownership;
- List the deductions allowed in calculating the federal estate tax liability;
- Define the estate tax unified credit and its exemption equivalent; and
- Explain how the portability provision operates to reduce federal estate tax liability.

18

- **Economic Growth and Tax Relief Reconciliation Act:** In 2001 the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) made substantial changes to both estate and gift tax law. The principal estate tax changes made by EGTRRA include the following:
 - A gradual reduction of the estate tax rate applicable to the largest estates from 55 percent in 2001 to 45 percent in 2007;
 - Repeal of the federal estate tax for deaths occurring in 2010; and
 - A gradual increase in the unified credit exemption equivalent for estate taxes from \$675,000 in 2001 to \$3.5 million in 2009

- **2010 Tax Act:** In December 2010 the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Act) was signed into law. The 2010 Tax Act:
 - Reinstated the federal estate tax for deaths occurring in 2010, 2011 and 2012;
 - Provided an estate tax exemption of \$5,000,000;
 - Contains a portability provision allowing a surviving un-remarried spouse to use the unused portion of the estate tax exemption of the last deceased spouse;
 - Imposed a maximum estate tax rate of 35 percent; and
 - Provided for a full step-up in basis with respect to assets acquired from the decedent.

- **2012 Tax Act:** Had additional legislation not been enacted, the estate tax exemption would have reverted to \$1 million and the maximum federal estate tax rate would have increased to 55 percent for deaths occurring in years after 2012. However, early in January 2013, the American Taxpayer Relief Act of 2012 (2012 Tax Act) was signed into law. The 2012 act, in addition to extending the basic estate tax provisions of the 2010 Tax Act:
 - Continues the estate tax exemption applicable for 2012, inflation-adjusted to \$5.49 million for 2017 deaths; and
 - Increases the maximum estate tax rate to 40%.

- **2017 Tax Act:** The Tax Cuts and Jobs Act of 2017 (2017 Tax Act) became generally effective on January 1, 2018. It changes the estate tax exemption for the estates of decedents dying after December 31, 2017 and before January 1, 2026 by doubling the basic estate tax exemption amount in IRC §2010(c)(3) from \$5 million to \$10 million.
- Because the exemption is indexed for inflation occurring after 2011, the 2017 Tax Act effectively doubles the exemption that would have applied for deaths occurring in 2018 from \$5.6 million to \$11.18 million. In the absence of additional legislation, the basic estate tax exemption amount will revert to \$5 million (indexed for inflation after 2011) for deaths occurring in 2026 and later.

- **Gift tax:** The federal tax on an individual's right to give property to another person during his or her lifetime. Applies only to a noncharitable gift.
- **Gift tax exclusion amount:** The dollar amount of a noncharitable gift that may be made by a donor to a donee tax free each year. The annual gift tax exclusion amount in 2023 is \$17,000.

- **Split gift:** A noncharitable gift made by a donor and his or her spouse. Split gifts effectively double the amount of tax-free gifts that may be made to a donee each year.
- **Gift tax unified credit:** The tax credit that may be used to pay federal gift taxes due on taxable gifts, i.e., gifts in excess of the annual gift tax exclusion. The gift tax unified credit in 2023 is \$5,113,800. Use of the gift tax unified credit will reduce the individual's estate tax unified credit dollar-for-dollar. The gift tax unified credit in any year is equal to the gift tax that would be due on taxable gifts of assets equal to the gift tax exemption equivalent.

- **Tentative taxable estate:** The tentative taxable estate is equal to a decedent's federal gross estate less:
 - Funeral expenses
 - Net losses during administration
 - Costs of estate administration
 - The decedent's debts and income and property taxes
 - Marital deduction
 - Charitable and public bequests

25

- **Estate administration costs:** The costs incurred in administering a decedent's estate may include:
 - Executor fees
 - Appraiser fees
 - Attorney fees
 - Commissions
 - Accountant fees
 - Probate court costs

26

- **Marital deduction:** An unlimited deduction for transfers of property from a person to his or her eligible spouse during lifetime and at death.
- **Estate tax unified credit:** The tax credit applied against any federal estate tax payable that is available to the estate of every decedent. In 2023, the estate tax unified credit is \$5,113,800.
- **Exemption equivalent of the estate tax unified credit:** The amount of assets that may be transferred tax free at death because of the estate tax unified credit. The exemption equivalent of the estate tax unified credit applicable to deaths occurring in 2023 is \$12.92 million.

27

• Estate Tax Credits

| Exemption Equivalent | | |
|----------------------|---------------------------|----------------------|
| Year Of Death | Estate Tax Unified Credit | Exemption Equivalent |
| 2002 – 2003 | \$345,800 | \$1,000,000 |
| 2004 – 2005 | \$555,800 | \$1,500,000 |
| 2006 – 2008 | \$760,800 | \$2,000,000 |
| 2009 | \$1,455,800 | \$3,500,000 |
| 2010 | \$1,730,800* | \$5,000,000 |
| 2011 | \$1,730,800 | \$5,000,000 |
| 2012 | \$1,772,800 | \$5,120,000 |
| 2013 | \$2,045,800 | \$5,250,000 |
| 2014 | \$2,081,800 | \$5,340,000 |
| 2015 | \$2,117,800 | \$5,430,000 |
| 2016 | \$2,125,800 | \$5,450,000 |
| 2017 | \$2,141,800 | \$5,490,000 |
| 2018 | \$4,417,800 | \$11,180,000 |
| 2019 | \$4,505,800 | \$11,400,000 |
| 2020 | \$4,577,800 | \$11,580,000 |
| 2021 | \$4,625,800 | \$11,700,000 |
| 2022 | \$4,769,800 | \$12,900,000 |
| 2023 | \$5,113,800 | \$12,920,000 |

*The estate tax unified credit and its exemption equivalent applicable to estates of decedents dying in 2010 are those applicable to the estates of decedents dying in 2011. However, estates of decedents dying in 2010 could elect not to be subject to any federal estate tax but to be subject to a modified tax cost basis regime instead.

• Federal Estate Tax Rates – 2023

| Federal Estate Tax Rates – 2023 | | | | | |
|---------------------------------|--------------|-----------|------|-----|-------------|
| Value of Estate | | Tax | | | |
| Over | But Not Over | \$ | Plus | % | Over |
| | \$10,000 | | | 18% | \$0 |
| \$10,000 | \$20,000 | \$1,800 | | 20% | \$10,000 |
| \$20,000 | \$40,000 | \$3,800 | | 22% | \$20,000 |
| \$40,000 | \$60,000 | \$8,200 | | 24% | \$40,000 |
| \$60,000 | \$80,000 | \$13,000 | | 26% | \$60,000 |
| \$80,000 | \$100,000 | \$18,200 | | 28% | \$80,000 |
| \$100,000 | \$150,000 | \$23,800 | | 30% | \$100,000 |
| \$150,000 | \$250,000 | \$38,800 | | 32% | \$150,000 |
| \$250,000 | \$500,000 | \$70,800 | | 34% | \$250,000 |
| \$500,000 | \$750,000 | \$155,800 | | 37% | \$500,000 |
| \$750,000 | \$1,000,000 | \$248,300 | | 39% | \$750,000 |
| \$1,000,000 | | \$345,800 | | 40% | \$1,000,000 |

• Unified Credit

| Unified Credit | | |
|----------------|---------------------------|----------------------|
| Year Of Death | Estate Tax Unified Credit | Exemption Equivalent |
| 2002 – 2003 | \$345,800 | \$1,000,000 |
| 2004 – 2005 | \$555,800 | \$1,500,000 |
| 2006 – 2008 | \$760,800 | \$2,000,000 |
| 2009 | \$1,455,800 | \$3,500,000 |
| 2010 | \$1,730,800* | \$5,000,000 |
| 2011 | \$1,730,800 | \$5,000,000 |
| 2012 | \$1,772,800 | \$5,120,000 |
| 2013 | \$2,045,800 | \$5,250,000 |
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*The estate tax unified credit and its exemption equivalent applicable to estates of decedents dying in 2010 are those applicable to the estates of decedents dying in 2011. However, estates of decedents dying in 2010 could elect not to be subject to any federal estate tax but to be subject to a modified tax cost basis regime instead.

Chapter 3 - Common Estate Planning Trusts

In the previous chapter, we touched on a common situation where assets are entirely bequeathed to a surviving spouse, escaping federal estate tax via the unlimited marital deduction. However, doing so could lead to higher combined federal estate taxes when both estates are considered, especially if the surviving spouse can't utilize the first deceased spouse's unused tax exemption under estate tax portability. This will is often called an 'I love you' will.

31

Chapter 3 (cont.)

In this chapter, we will briefly consider certain trusts often employed in estate planning to meet a decedent's objectives. Although many other trusts may be profitably used, these three trusts are particularly common:

- Credit shelter trusts
- Qualified terminable interest trusts
- Irrevocable life insurance trusts

32

Learning Objectives

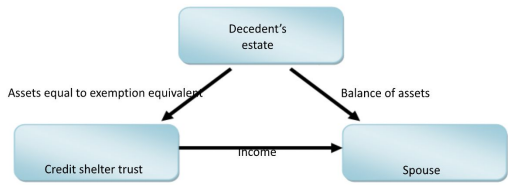
- Describe how a credit shelter trust works to reduce federal estate tax liability in suitable estates;
- List the client estate planning objectives met through a qualified terminable interest (QTIP) trust; and
- Explain how an irrevocable life insurance trust (ILIT) facilitates the use of life insurance to pay estate tax and settlement costs without increasing the federal gross estate.

33

- **Credit shelter trust:** A trust established to be funded by a decedent's assets up to the exemption equivalent of the estate tax unified credit. The exemption equivalent of the estate tax unified credit in 2023 is \$12.92 million.

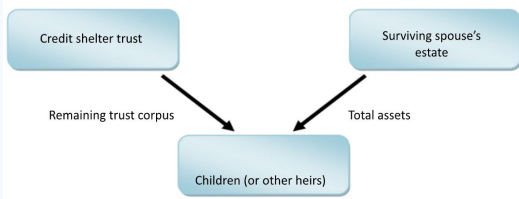
34

Upon Death of First Spouse to Die



35

Upon Death of Surviving Spouse



36

- **Testamentary trust:** A trust established by a decedent's last will and testament.

37

- **Inter vivos trust:** A trust established during the lifetime of the trust creator.

38

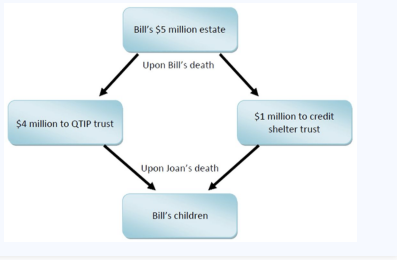
- **Qualified terminable interest property (QTIP) trust:** A trust designed to enable a decedent to:
 - Determine the ultimate beneficiary of his or her assets but who wants to provide a lifetime income to the surviving spouse;
 - Protect the inheritance of children from a previous marriage; or
 - Ensure that his or her estate does not pass to a subsequent marriage partner.

Usufruct Interest

A usufruct interest in property refers to the right to use property—or income from property—that is owned by another.

39

• **Bill & Joan**



- **Revocable trust:** A trust whose terms may be changed by the grantor and that may be revoked entirely; revocable trusts offer no estate tax protection.
- **Irrevocable trust:** A trust that cannot be revoked and whose terms cannot be changed; irrevocable trusts offer estate tax protection.

- **Irrevocable life insurance trust (ILIT):** An irrevocable trust established during the grantor's lifetime that is used to own life insurance usually on the life of the grantor. An ILIT may keep life insurance death benefit proceeds payable on the decedent's death out of his or her federal gross estate.

- **Crummey powers:** Powers that are generally included in an unfunded irrevocable life insurance trust giving trust beneficiaries a limited period—usually 30 days—during which they may withdraw funds transferred to the trust. The limited right of withdrawal, known as Crummey powers, causes the noncharitable gift to be eligible for the gift tax annual exclusion by changing the beneficiaries' future interest in the transferred funds into a present interest.

43

Chapter 4 - Calculating Federal Estate Taxes

We are now going to change that focus somewhat, from a more academic approach to one that is practical and hands-on. You are going to have the opportunity to calculate the estate tax liability for several hypothetical clients.

44

Learning Objectives

- Identify the components of the federal gross estate;
- List the deductions that may be taken from the federal gross estate to arrive at the tentative taxable estate;
- Explain how state estate taxes are accounted for in calculating the federal estate tax liability;

45

Learning Objectives (cont.)

- Calculate the value of adjusted taxable gifts that must be added to a decedent's taxable estate;
- Describe the use of the estate tax unified credit, the credit on prior transfers and the foreign death tax credit in determining federal estate tax liability; and
- Calculate the federal estate tax liability under various estate tax fact patterns.

46

- **Federal gross estate:** The first step in calculating any federal estate tax. Equal to the sum of (a) the total value of the property owned by the decedent, (b) the value of property in which the decedent had an incident of ownership at death, (c) life insurance death benefits under policies owned by the decedent, and (d) certain gifts.

47

- **Tentative taxable estate:** The second step in calculating any federal estate tax. Equal to the federal gross estate minus various deductions.
- **Taxable estate:** The third step in calculating any federal estate tax. Equal to the tentative taxable estate minus any state taxes paid at death.

48

- **Bill & Lori**

| Asset | Value | Ownership Arrangement |
|--------------------------------|--------------|------------------------------|
| Principal residence | \$ 3,330,000 | All assets are owned by Bill |
| Vacation home | \$1,550,000 | |
| Furnishings | \$100,000 | |
| Two vehicles | \$70,000 | |
| Savings | \$25,000 | |
| IRA | \$900,000 | |
| Pension plan | \$4,500,000 | |
| Public company stock portfolio | \$1,000,000 | |
| Bill's life insurance policy | \$2,500,000 | |
| Business value | \$4,000,000 | |

52

- **Adjusted taxable gifts:** The fourth step in calculating any federal estate tax requires adding the value of any adjusted taxable gifts to the taxable estate. "Adjusted taxable gifts" are gifts made by the decedent during life to the extent they exceeded the then-applicable annual gift tax exclusion.

53

- **Estate value for calculation of tax:** The amount calculated by adding the adjusted taxable gifts to the taxable estate. It is the value of the estate for the purpose of applying the tax rate in the Gift and Estate Tax Table.

54

- **Tentative estate tax:** The federal estate tax calculated before subtracting the total gift taxes paid on taxable gifts made after 1976. Subtracting the gift taxes paid eliminates double taxation of taxable gifts because the taxable part of those gifts has already been added to the taxable estate in the fourth step of the estate tax calculation.
- **Gross estate tax:** The federal estate tax payable after subtracting the total gift taxes paid but before subtracting the various estate tax credits (unified credit, foreign death tax credit, and credit on prior transfers).
- **Net estate tax:** The federal estate tax payable after subtracting all allowable tax credits.

Chapter 5 - State Death Taxes

It isn't only the federal government that levies taxes at death. Several states also impose taxes at death. In the last section we noted that estates were formerly given a credit for their payment of state death taxes and that the credit declined for deaths occurring through 2004. That credit has been replaced by a deduction.

Currently, twelve states and the District of Columbia levy an estate tax and provide for varying exclusion levels. Those taxing jurisdictions and their exclusion thresholds are as follows:

| Estate Taxing Jurisdiction | Exclusion Threshold | Estate Taxing Jurisdiction | Exclusion Threshold |
|----------------------------|---------------------|----------------------------|---------------------|
| Connecticut | \$3,600,000 | Minnesota | \$2,700,000 |
| District of Columbia | \$5,600,000 | New York | \$5,000,000 |
| Hawaii | \$5,500,000 | Oregon | \$1,000,000 |
| Illinois | \$4,000,000 | Rhode Island | \$1,561,719 |
| Maine | \$5,600,000 | Vermont | \$2,750,000 |
| Maryland | \$5,000,000 | Washington | \$2,193,000 |
| Massachusetts* | \$2,000,000 | | |

In addition, five states—Iowa, Kentucky, Nebraska, New Jersey and Pennsylvania—impose only an inheritance tax. And one state, Maryland, imposes both an inheritance tax and an estate tax.

* 10/4/23 Governor Healey signed law increasing estate tax exemption effective 1/1/23

Learning Objectives

- Describe the principal differences between state estate taxes and inheritance taxes;
- Identify the factors that affect the amount of state inheritance tax liability; and
- Explain how the familial relationship of a beneficiary to a decedent determines the applicable inheritance tax class.

58

- **Estate taxes & Inheritance taxes:** Taxes levied by states at the death of a decedent may be either an estate tax—one imposed on the decedent's estate—or an inheritance tax under which the beneficiary, rather than the estate, is liable for any tax.

59

- **Inheritance Taxation:** Although state estate taxes are calculated solely on the fair market value of the property passed, inheritance taxes are generally more complicated and are based on both the value of the transferred property and the beneficiary's relationship to the decedent. Inheritance tax classes, from highest to lowest, generally fall into the following categories:

- Decedent's spouse
- Decedent's children and grandchildren
- Decedent's parents and grandparents
- Decedent's brothers and sisters and their children
- Decedent's parents' siblings and their descendants
- Other relatives of the decedent

60

Chapter 6 - Estate Tax Payment

A vital part of estate planning involves reducing estate tax liabilities via trusts and titling changes. However, even with these strategies, larger estates still face estate tax realities. Recent changes, such as tax rate reductions and increased unified credits, haven't eliminated the concerns for wealthier individuals and their families. This chapter delves into options for paying federal estate taxes, state death taxes, and estate administration costs, addressing these ongoing concerns.

61

Learning Objectives

- Describe the four methods generally available for payment of estate settlement costs;
- Identify the factors that need to be considered when evaluating the relative effectiveness of the various methods of paying estate settlement costs;
- Determine the parties that should normally own life insurance when designed to be used solely to pay estate settlement costs; and
- Explain how life insurance death benefit proceeds payable to an irrevocable life insurance trust are used by a decedent's estate to pay estate taxes and settlement costs.

62

- **Paying Estate Taxes and Settlement Costs:** There are four methods generally available for payment of estate settlement costs including federal and state taxes:
 - Use liquid assets held in the estate
 - Sell assets to produce cash
 - Borrow funds to pay costs
 - Use life insurance death benefit proceeds

63

- **Use of Liquid Estate Assets:** When we talk about liquidity, we mean an investment's ability to be converted to cash quickly at little or no loss of value. The kinds of investment vehicles that offer the greatest liquidity are:
 - Passbook savings accounts
 - Money market accounts

64

- **Selling Illiquid Estate Assets**

| Obtaining Cash for Estate Liquidity Comparison of Methods | |
|--|--------------------|
| Source of Funds | Comparative "Cost" |
| Use liquid estate assets | \$1.00 |
| Sell illiquid estate assets | \$1.33 |

65

- **Borrowing to Pay Taxes**

| Obtaining Cash for Estate Liquidity Comparison of Methods | |
|--|--------------------|
| Source of Funds | Comparative "Cost" |
| Use liquid estate assets | \$1.00 |
| Sell illiquid estate assets | \$1.33 |
| Borrow funds | \$1.40 |

66

- Using Life Insurance Death Benefits to Pay Taxes

| Obtaining Cash for Estate Liquidity Comparison of Methods | |
|--|--------------------|
| Source of Funds | Comparative "Cost" |
| Use liquid estate assets | \$1.00 |
| Sell illiquid estate assets | \$1.33 |
| Borrow funds | \$1.40 |
| Use life insurance | \$0.50 |

67

Questions

68
