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Family Law and Estate Planning Issues Before, During and After Divorce

Evaluating the Impact of Pre- and Post-Nuptial Agreements, Trusts, Gifting, and Revisions to Estate Plans

THURSDAY, MAY 3, 2012

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Today's faculty features:

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Family Law And Estate Planning Issues
Before, During and After the Divorce

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Stages of Planning During the Life of a Marriage

This program will divide the planning process in to four stages of a marriage:

1. Issues prior to the marriage;
2. Issues to focus on when the marriage is "going south," but before the filing of a divorce complaint;
3. Issues which arise during a divorce proceeding; and
4. Matters to consider following the divorce.

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Planning Prior to the Marriage

- Prenuptial Agreements -- recognized in all fifty states and the District of Columbia

- Five elements required for a valid/enforceable agreement:
  1. Agreement must be in writing
  2. Must be executed voluntarily
  3. Must be full and/or fair disclosure of all finances at the time of execution
  4. The agreement must not be unconscionable
  5. Sufficient opportunity to consider the provisions of the the agreement and obtain separate legal advice before execution

Commonly Overlooked Issues to Include in a Prenuptial Agreement

- Life Insurance – often used as wealth replacement for surviving (otherwise disinherited) spouse
- Rights of widow/widower to use and occupy separately owned residence at death of owner spouse
- Waiver of spousal rights in marital residence
- Acknowledgement that agreement applies regardless of disability or change in health or financial status
- Use of Federal gift tax exemption
- Use of QTIP trusts to support surviving spouse
- Obligation to preserve Deceased Spousal Unused Exclusion Amount (DSUEA)

Common Events for "Happy" Couples that Require Caution

- "Asset-Splitting" – Wealthy spouse is often encouraged to transfer assets to less-wealthy spouse if that spouse wouldn't have enough assets to use full federal estate tax exclusion (currently $5.12 million) in event he/she dies first.
  - "Portability" may solve this issue, but advice is still common.
- Transforming separate property into marital property.
  - Classic example: spouse uses separate property to purchase residence and titles it in joint name with other spouse.
- Planning with irrevocable trusts. Referring to non-donor spouse by name in an irrevocable trust document may give him/her ongoing rights to trust control or trust benefits in accordance with document *despite a divorce*. Consider drafting trust to refer only to "Spouse" and defining term carefully to exclude divorced/separated spouse.
- Outright gifts and inheritances from parents/grandparents. Anybody leaving assets to a married descendant should be encouraged to consider leaving gifts/bequests IN TRUST for descendant to provide further protection in event of divorce.

Use of Domestic Asset Protection Trusts (DAPT)

- Can be used as a substitute for a prenuptial agreement or in conjunction with a prenup
- Established in one of several states that provide creditor protection to the Grantor/Settlor (e.g. Alaska. South Dakota, Delaware, Nevada)
- Self-settled trusts established in states that do not provide protection from the Grantor's creditors will not be a valid substitute for a prenup
- Assets contributed to a DAPT with a situs in one of a handful of states, prior to the marriage should protect those assets from future marital claims (e.g. equitable distribution, alimony, forced inheritance)

Example of DAPT Planning

- **Facts**: Thomas is a successful developer and manager of several commercial properties valued at approximately $50,000,000. Thomas is divorced with three children, and he is considering marrying Barbara. He is concerned about protecting his premarital assets and the income generated therefrom. He intends to continue to live off of a portion of the revenues from the real estate which he will continue to manage during the marriage. Barbara is a romantic and the idea of entering into a prenuptial agreement is completely offensive to her.

Example of DAPT Planning

- **Solution**: Thomas establishes an asset protection trust in Nevada. He contributes his real estate interests to the trust making an incomplete gift for gift tax purposes to the extent that he has insufficient exemption available. The trustee has discretion to make distributions back to Thomas for any purpose that the trustee deems advisable. The trust incorporates various spendthrift trust provisions to protect the trust assets from creditors. The Nevada trust should protect Thomas' contributed assets from division in the event of a divorce, and the income from the trust should, likewise, not be deemed available for Barbara's support.

Planning During the Marriage (When the Honeymoon is Looking Like it's Over)

- Postnuptial Agreements
  - Prepared, negotiated and executed after the marriage has already commenced.
  - Can provide for an agreement as to property distribution in the event of divorce or death and set reasonable limits on alimony or spousal support.
  - Like a prenup, cannot fix child support or determine child custody.
  - Not always limited to situations in which a marriage is already rocky.
  - Postnups are widely used in community property states where assets acquired by either spouse during a marriage are considered owned by both spouses.
  - May be appropriate if financial circumstances in a marriage change, such as when one spouse suddenly obtains vast wealth.

What is the problem with postnups?

- There is little caselaw on the enforceability of these agreements.
- Some states are more restrictive in the enforceability of post-nuptial agreements than they are for prenuptial agreements.

Gifts and Establishment of Trusts During the Marriage

- Can one spouse make gifts of marital assets without the participation of the other spouse?
- Unilateral dissipation
- Are all occurrences of unilateral gifting considered a unilateral dissipation?

Gifts and Establishment of Trusts During the Marriage

- ***QUERY:*** Assume the husband in a marriage is an alcoholic who refuses to receive treatment, refuses to work, and has a tendency to incur debt for unreasonable purposes. He drives an automobile while intoxicated, exposing himself to unimaginable liabilities. The wife works hard, has built a business of her own, and has amassed individually titled assets, which would be subject to equitable distribution. The marriage has disintegrated, but the spouses are still living together for the sake of their minor children. The wife is concerned about preserving the wealth that she or they have amassed. They have children to support and educate, and it is clear to her that she will continue to have that financial responsibility. She establishes an irrevocable trust for the benefit of their two children and begins to make sizable contributions to the trust, without the consent or knowledge of her husband. These contributions go on for a period of three years and total $1,000,000 (but not filing split gift tax returns). The wife, after feeling confident that her hard earned money is "protected" as a result of the funding of this trust, files a complaint for divorce.

Gifts and Establishment of Trusts During the Marriage

- Can the husband claim that these assets were unilaterally dissipated and should, therefore, be charged against the wife's share of equitable distribution?
- See Kothari v. Kothari, 255 N.J. Super. 500 (App. Div. 1992), where the Court cited the following factors in making a determination that the husband unilaterally dissipated marital assets: (i) the proximity of the expenditure to the parties' separation; (ii) whether the expenditure was typical of expenditures made by the parties prior to the breakdown of the marriage; (iii) whether the expenditure benefitted the joint marital enterprise or was for the benefit of one spouse to the exclusion of the other; and (iv) the need for, and amount of, the expenditure.
- How are those factors applied in the hypothetical?

Funding 529 Plans

- If a spouse is considering a divorce, and is quite confident that he or she will be "on-the-hook" for higher education expenses, should he or she consider establishing 529 plans for each child?
- Should the accounts be "front-loaded" -- §529(c)(2)(B) of the Internal Revenue Code provides that contributions to a 529 Plan in excess of the gift tax annual exclusion amount (currently $13,000) can be treated as having been made ratably over the 5-year period beginning in the year of the contribution. This means that a couple can make gifts of $130,000 to a 529 plan for each child without any gift tax consequence.
- The funding of a college expense being in furtherance of the marital enterprise, this should not be considered a unilateral dissipation.

Powers of Attorney

- Often, during the course of a marriage, spouses will execute powers of attorney in favor of each other.
- Powers are often "general powers of attorney", which means that the agent has all of the powers of the principal.
- Anyone acting upon authority of a power of attorney is indemnified for any such actions, unless he/she has actual knowledge that the power of attorney has been revoked.
- How to revoke a power of attorney:
  - Written notice to all custodians of financial accounts will prevent the agent from accessing such accounts
  - Physical destruction of each and every original power of attorney as well as every copy if the original power authorized acceptance of a copy.

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Use of Federal Gift Tax Exemption

- In 2012, each U.S. citizen or resident is entitled to pass $5,120,000 of wealth to any other person or persons during their lifetime, or upon their death (in the aggregate), without the imposition of federal estate or gift taxes. It is unclear what will happen in 2013.
  - Thus, a husband and wife together can transfer $10,240,000 without the imposition of a tax.
  - §2513 of the Internal Revenue Code further provides that a gift from one spouse can be treated as made one-half (1/2) from each spouse if an appropriate election is made and the spouses are married to each other at the time of the gift and the non-contributing spouse does not remarry during the year of the gift.
- <u>Query</u>. Should you counsel your client to stay in the marriage long enough to utilize the credit of the other spouse which otherwise might be wasted?

Use of Federal Gift Tax Exemption

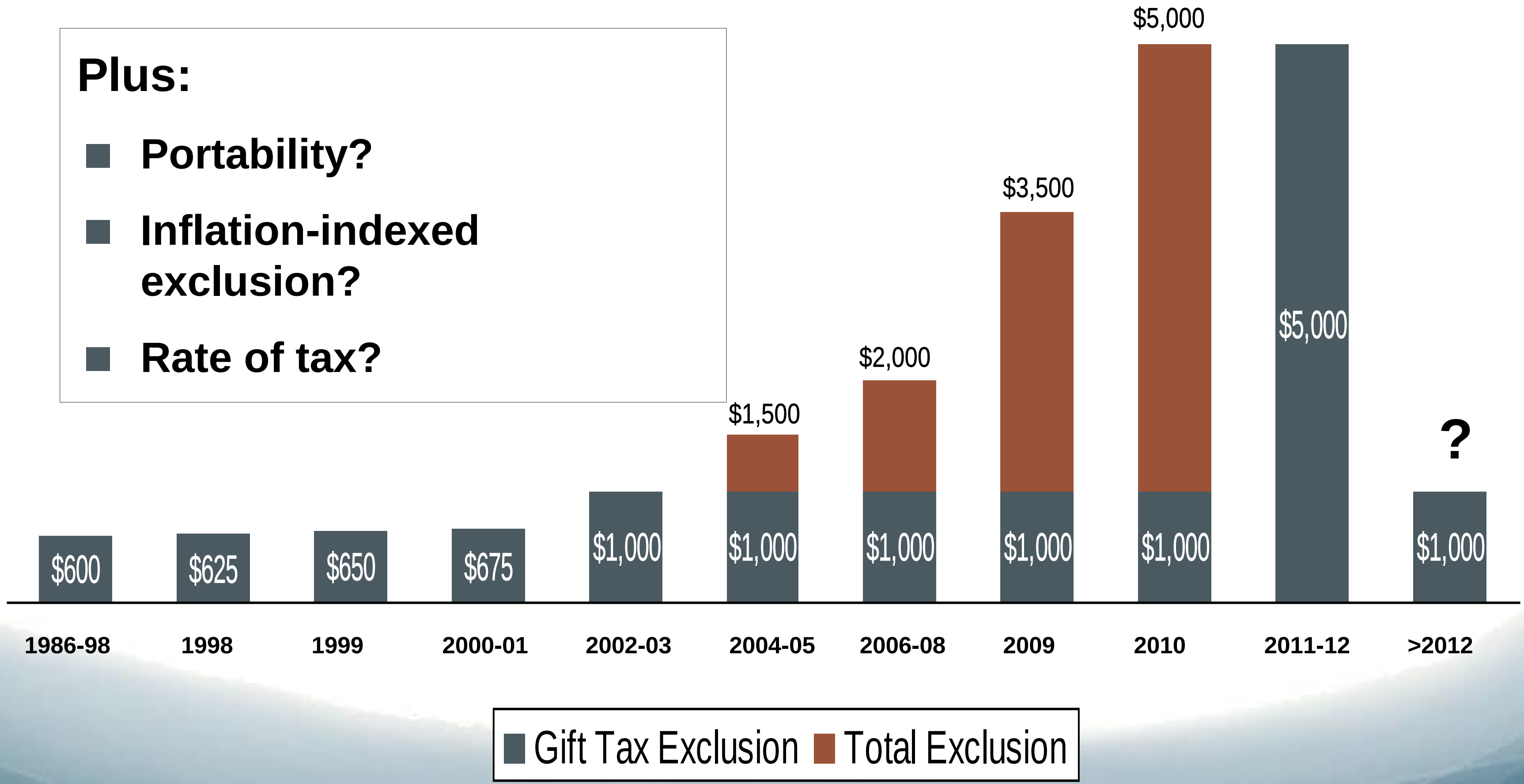
- The ability to utilize the $5,120,000 credit belonging to the soon-to-be-ex-spouse, and his or her annual exclusion gift rights, can have significant value.
- Thus, a spouse anticipating a divorce may wish to consider delaying the filing of a complaint to utilize this opportunity.
- Likewise, for the spouse whose credits will be utilized not for his or her benefit. This may provide a significant bargaining chip in a divorce action, as this credit may have significantly more value to the other spouse, which he or she may be willing to pay for with a larger share of equitable distribution.

Primer on Federal Transfer Tax Exclusion

History of the Applicable Exclusion Amount
$ Thousands

Plus:

- **Portability?**
- **Inflation-indexed exclusion?**
- **Rate of tax?**



Sources: Internal Revenue Code of 1986, as amended ("Code"), Section 2010(c); Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), Section 521(a); Taxpayer Relief Act of 1997 (P.L. 105-34), Section 501(a)(1)(B); Economic Recovery Tax Act of 1981 (P.L. 97-34), Section 401(a)(2)(A).

Basic Estate Planning: Should Client Make a $5 Million Gift?

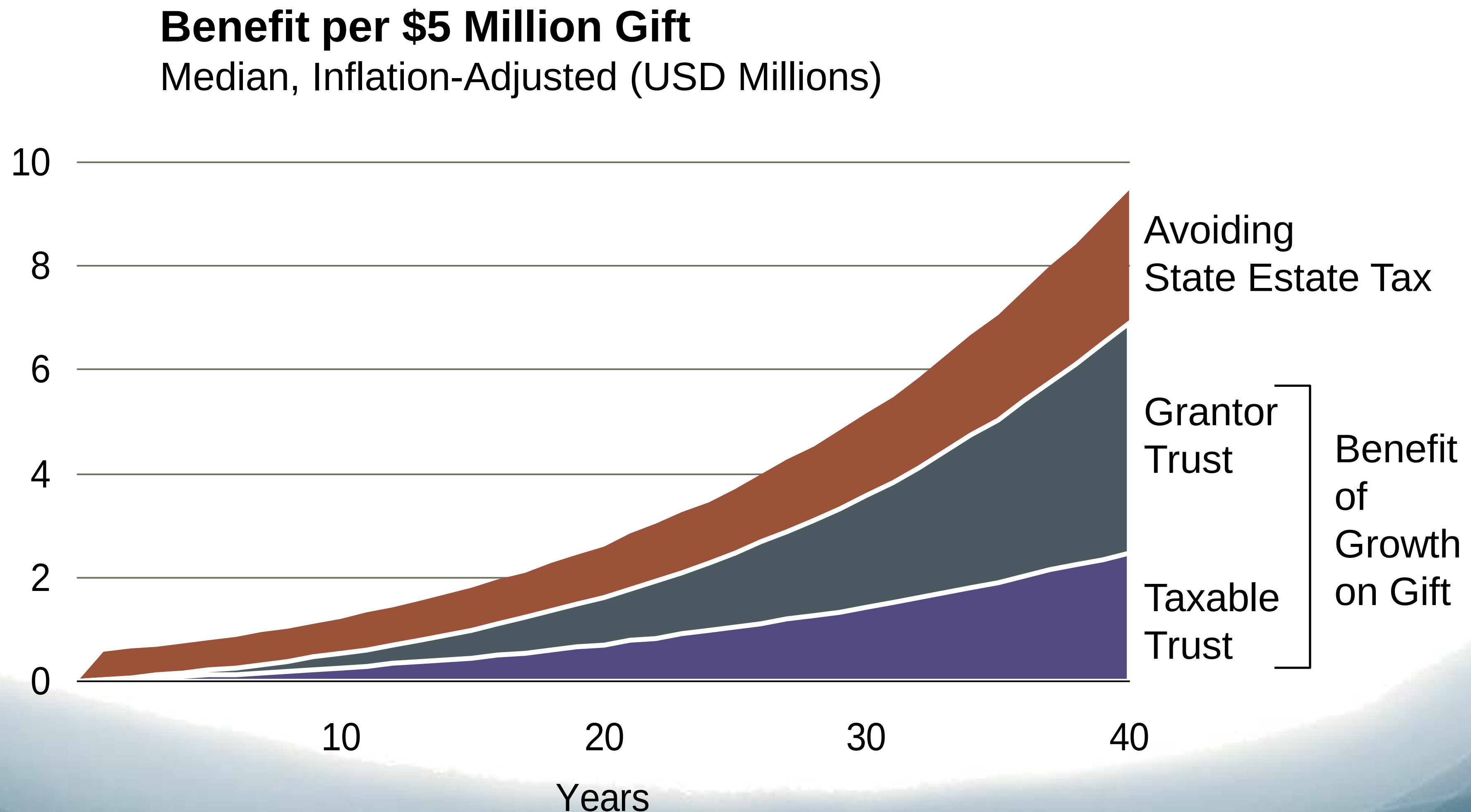
Why No?

- Client can't afford it
- Gifted asset might lose value
- Lose step-up at death
- Clawback?

Why Yes?

- GST exemption can be applied
- Growth out of the estate
- Grantor trust
- Avoid state death/inheritance tax

Leveraging the Benefit of a $5 Million Gift



Assets are assumed to be invested in 60% globally diversified equities and 40% municipal fixed income. Assumes marginal state and federal estate-tax rates of 16% and 35%, respectively.

Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on Wealth Forecasting System for details.

Source: AllianceBernstein

THE BIG QUESTION

Should an unhappy spouse file a complaint for divorce, or wait and see if the other spouse dies first?

- Is the spouse better off divorced or as a surviving spouse?
- **The Elective Share** -- The "elective share" is the share of a deceased spouse's estate which a surviving spouse may claim in place of what they were left in the decedent's will. In other words, it is the minimum that a surviving spouse must inherit. May also be referred to as widow's share, statutory share, election against the will, or forced share.
- In most states, the elective share is between ⅓ and ½ of all the property in the estate, although many states require the marriage to have lasted a certain number of years for the elective share to be claimed, or adjust the share based on the length of the marriage, and the presence of minor children.
  - Some states also reduce the elective share if the surviving spouse is independently wealthy.
  - Some states eliminate the elective share based upon circumstances in the marriage at the time of death.

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Community Property States

- There are nine community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin.
- In these states, most property that a couple obtains during a marriage is classified as "community property." Exceptions include inheritances, premarital property, third party gifts.
- When one spouse dies, the other is automatically entitled to their half of all community property. There is nothing a spouse can do in a will to prevent or limit a spouse's claim to this property.
- Each community property state has its own inheritance laws.

Considerations in Filing for Divorce

- When you are trying to determine whether it is in your client's financial best interests to seek a divorce or stay married, you must carefully analyze the anticipated results in both scenarios.

- Clients who thinks that they will benefit financially upon the spouse's death must understand that, at best, all they will be entitled to is a combination of (i) the elective share (if any), (ii) jointly owned assets with rights of survivorship (net of attendant liabilities), and (iii) certain other assets which they have a legally protected right to receive (i.e. ERISA qualified benefits, as discussed above).

- In some cases, these death benefits may exceed what the spouse might be entitled to in a divorce action. However, in some cases, they might be better off divorcing the spouse and quantifying each parties' respective rights.

Issues to Address During the Divorce Proceeding

- Preparing and executing a new Last Will and Testament

- If a Spouse dies during the divorce proceeding
  - If there is no will, then there is an intestacy – What rights does a surviving spouse have in an intestate estate? Look to state's intestacy laws.
  - What if there is a will that bequeaths to the divorcing spouse and one spouse dies during the divorce but before a judgment of divorce has been issued?
  - Generally, until a final judgment of divorce, a divorcing spouse is still entitled to inherit under the deceased spouse's will.

Reviewing and Preparing a New Will

- To avoid any confusion, and to put a client's estate in the best position, a client's existing will should be reviewed as soon as possible in the divorce action – even before the filing of a complaint.
- A new will should be prepared which should consider a disinheritance of the soon-to-be ex-spouse.
- New will should address the manner in which assets are going to be held for any minor children. Who should be the trustee of any funds going to minor or immature adult children?
- New will should address the client's desires for the guardianship of the children of the marriage in the event that both spouses are deceased.

Should New Will Not Disinherit Future Ex-Spouse

- If a surviving spouse would be entitled to an elective share, is a trust for the benefit of the surviving spouse a better way to go?
- A QTIP trust is a special type of trust that provides the surviving spouse with a distribution of all of the income of the trust, and may provide the surviving spouse with limited access to principal. Also provides transfer tax deferral benefits.
- The testator can specify the remaindermen and the manner in which the remaindermen will take at the surviving spouse's death.

Health Care Proxies and Powers of Attorney

- Typically, when the marriage is irretrievably broken such that a divorce proceeding commences, it is usually prudent to name someone other than the spouse as the health care agent.

- A new health care proxy should make it clear that the soon-to-be ex-spouse is not only no longer authorized to make medical decisions, but also that the newly appointed health care agent shall have authority to determine who visits with the infirmed spouse.

- After revoking any prior power of attorney appointing the soon-to-be ex-spouse as the principal's agent, the principal should sign a new power of attorney authorizing someone else to act as agent.

- The new agent should be someone who will be able to participate in any ongoing divorce proceeding (e.g. a child from the marriage may not be the best choice).

- The new power of attorney should also specifically authorize the new agent to continue the divorce proceeding and to resolve any and all marital claims belonging to the principal.

Changing Beneficiary Designations

- Certain assets do not pass pursuant to the terms of a last will and testament (e.g. life insurance, retirement plans, IRAs).
- It is imperative that a divorcing spouse revise all beneficiary designations.
- Certain ERISA governed plans require spousal consent for someone other than the spouse to be named as the beneficiary.
- IRA beneficiary designations can be changed without spousal consent unless prohibited by state law or a Court Order.

Good Financial Planning Leads to Good Estate Planning

- Advisors should aim when possible to secure divorcing clients with "core" wealth – liquid assets and expected income that will endow lifestyle (i.e., spending) at reasonable levels of confidence in face of major unknowns (client longevity, inflation, market environments, etc.)

- If core wealth can be quantified, additional wealth protected or received in divorce settlement can be classified as "excess" wealth not needed for client, and potentially available for estate planning for children, grandchildren, charity, etc.

- "Excess" wealth, in absence of a plan, likely to become larger over time, and thus may be subject to unnecessary estate taxation at death.

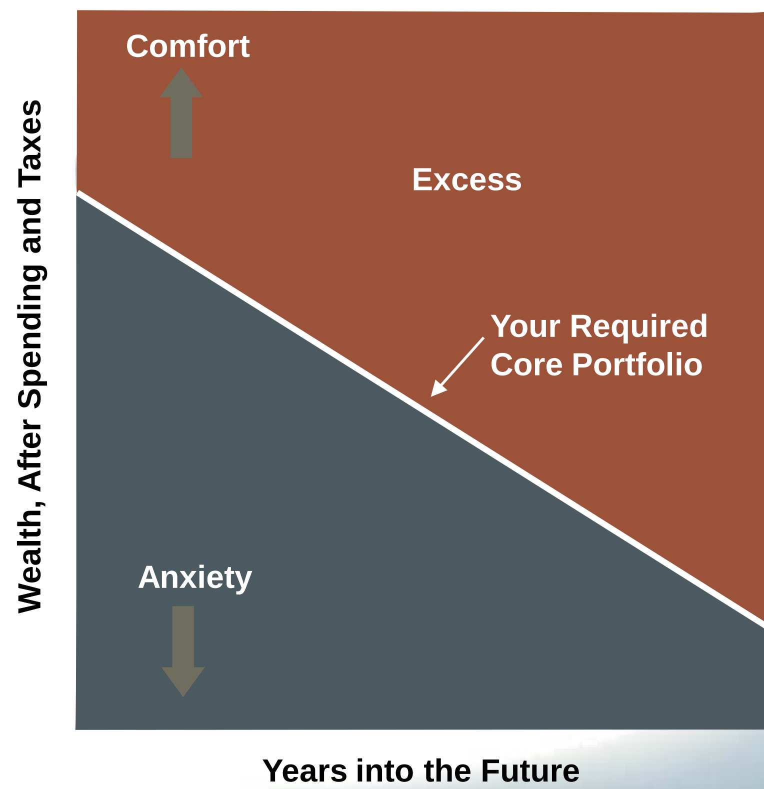
- Divorce proceeding may present favorable opportunities to address planning for "excess" wealth in efficient ways.

Wealth Planning: The Bernstein Framework

Hierarchy of Objectives

- Lifestyle Spending
  - **Core Portfolio*** Assure long-term well-being
- Children
- Grandchildren
- Great-Grandchildren
- Charity
  - **Excess Capacity** Provide for other goals

The Critical Goal: You Have Enough, When You Need It



*After-tax spending level adjusted for inflation with a 95% probability of not running out of money

Age and Spending Determine Core Capital

Sustainable After-Tax Spending Rate in Hostile Markets*
(Mortality-Adjusted)

60% Stocks/40% Bonds

	Age	55	60	65	70	75	80	85
	Spending Rate*	2.9%	3.1%	3.4%	3.8%	4.3%	5.3%	6.3%
				Core Needs				
Spending Needs	$100,000	$3.5 Mil.	$3.2 Mil.	$2.9 Mil.	$2.6 Mil.	$2.3 Mil.	$1.9 Mil.	$1.6 Mil.
	$200,000	7.0	6.4	5.8	5.2	4.6	3.8	3.2
	$300,000	10.5	9.6	8.7	7.8	6.9	5.7	4.8
	$400,000	14.0	12.8	11.6	10.4	9.2	7.6	6.4
	$500,000	17.5	16.0	14.5	13.0	11.5	9.5	8.0
	$750,000	26.3	24.0	21.8	19.5	17.3	14.3	12.0
	$1.0 Mil.	35.0	32.0	29.0	26.0	23.0	19.0	16.0

Data do not represent past performance and are not a promise of actual future results.
*These spending rates are for a couple and assume an allocation of 60% globally diversified stocks (35% US value, 35% US growth, 25% developed foreign markets and 5% emerging markets) and 40% diversified intermediate-term municipal bonds. Spending is percentage of initial value of portfolio grown with inflation; sustainable spending rates assume maintaining spending with a 90% level of confidence. Based on Bernstein estimates of the range of returns for the applicable capital markets over the periods analyzed. See Notes on Wealth Forecasting System at the end of this presentation for further details.
All information on longevity and mortality-adjusted investment analyses in this study are based on mortality tables compiled in 2000. In our mortality-adjusted analyses, the life span of an individual varies in each of our 10,000 trials in accordance with mortality tables.
Source: Society of Actuaries RP-2000 mortality tables and AllianceBernstein

Estate Planning Issues After the Divorce

- Prepare and execute a new will
  - Address fiduciary issues including who should be the trustee of any funds for minor children, and who should be the guardian for minor children.
  - Make sure that any obligations set forth in any property settlement agreement are properly covered in the estate plan.
- Prepare a new living will and health care proxy
- Revise all beneficiary designations, especially those governed by ERISA/REA which could not be changed without spousal consent before the marriage
- QDROs (Qualified Domestic Relation Orders)

Life Insurance Obligations

- In many divorces, there is a continuing insurance obligation to either secure alimony or child support.
- The property settlement agreement should provide for a reduction in coverage over time as the child support obligation reduces and should also be reduced over time if alimony reduces as well.
- In selecting the proper coverage, the obligor should consult with an experienced insurance agent to ensure that the coverage is affordable and covers the entire obligation.
  - For example, if a 45 year old is required to maintain coverage until an infant child is emancipated, purchasing a 15 year term policy is probably imprudent.
- If the policy will continue beyond the obligation period, with another beneficiary being entitled to the remaining death benefit, the insured spouse may wish to consider utilizing an Irrevocable Life Insurance Trust to avoid any potential Federal and/or State Estate Taxation at death.

Appendix

Notes on Wealth Forecasting

1. Purpose and Description of Wealth Forecasting Analysis

Bernstein's Wealth Forecasting Analysis^{SM} is designed to assist investors in making long-term investment decisions regarding their allocation of investments among categories of financial assets. Our new planning tool consists of a four-step process: (1) Client Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: Our proprietary model, which uses our research and historical data to create a vast range of market returns, takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: Based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th percentiles on "box and whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized.

2. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

3. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses that will have capital gains tax implications.

Notes on Wealth Forecasting

4. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled As…	Annual Turnover Rate
Intermediate-Term Diversified Municipal Bonds	AA-rated diversified municipal bonds with seven-year maturity	30%
Intermediate-Term Taxable Bonds	Taxable bonds with seven-year maturity	30%
US Value Stocks	S&P/Barra Value Index	15%
US Growth Stocks	S&P/Barra Growth Index	15%
Developed International Stocks	MSCI EAFE Unhedged	15%
Emerging Markets Stocks	MSCI Emerging Markets Index	20%

5. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital Markets Projections page at the end of these Notes. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.0%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgment that the volatility of fixed income assets is different for different time periods.

6. Technical Assumptions

Bernstein's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of September 30, 2011. Therefore, the first 12-month period of simulated returns represents the period from October 1, 2011 through September 30, 2012, and not necessarily the calendar year of 2012. A description of these technical assumptions is available on request.

Notes on Wealth Forecasting

7. Tax Implications

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

8. Income Tax Rates

Bernstein's Wealth Forecasting Analysis has used various assumptions for the income tax rates of investors in the case studies that constitute this analysis. See the assumptions in each case study (including footnotes) for details. Contact Bernstein for additional information.

The Federal Income Tax Rate is Bernstein's estimate of either the top marginal federal income tax rate or an "average" rate calculated based upon the marginal-rate schedule. The Federal Capital Gains Tax Rate is the lesser of the top marginal federal income tax rate or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The State Tax Rate generally is Bernstein's estimate of the top marginal state income tax rate, if applicable.

The Wealth Forecasting System uses the following top marginal federal tax rates unless otherwise stated. In 2012, the maximum federal ordinary income tax rate is 35% and the maximum federal capital gain tax rate is 15%. For 2013 and beyond, the maximum federal ordinary income tax rate is 43.4% and the maximum federal capital gain tax rate is 23.8%. State income taxes vary in each case study; contact Bernstein for additional information.

9. Lifetime Gifts and Generation Skipping Transfers

The Wealth Forecasting System models the transfer taxes on gifts to descendents, including generation-skipping transfers (i.e., direct skips, taxable terminations and taxable distributions). The system applies the transfer tax regime applicable in the year of the gift under the current law. The system takes into account gifts made prior to the beginning of the analysis by the transferor and the transferor's spouse (if applicable). The system reflects the use of credits, exemptions and exclusions resulting from transfers to portfolios that are not modeled in the system (e.g. a life insurance trust). When modeling gifts from a member of a married couple, it is assumed that the couple "splits" gifts throughout the duration of the analysis. For transfers to children (the second generation) or grandchildren (the third generation), the system assumes that the gifts are made in equal shares to each member of the generation to which the gift is made.

Notes on Wealth Forecasting

10. Taxable (Nongrantor) Trust

The Taxable (Nongrantor) Trust is modeled as an irrevocable tax-planning or estate-planning vehicle with one or more current beneficiaries and one or more remainder beneficiaries. Annual distributions to the current beneficiaries may be structured in a number of different ways, including 1) an amount or a percentage of fiduciary accounting income (FAI) (which may be defined to include some or all realized capital gains); 2) FAI plus some principal, expressed either as a percentage of trust assets or as a dollar amount; 3) An annuity, or fixed dollar amount, which may be increased annually by inflation, or by a fixed percentage; 4) A unitrust, or annual payment of a percentage of trust assets, based on the trust's value at the beginning of the year, or average over multiple years; or 5) any combination of the above four payout methods. The trust will pay income taxes on retained income and will receive an income distribution deduction for income paid to the current beneficiaries. Capital gains may be taxed in one of three ways, as directed: 1) taxed entirely to the trust; 2) taxed to the current beneficiaries to the extent the distributions exceed traditional income; or 3) taxed to the current beneficiaries on a pro rata basis with traditional income.

11. Intentionally Defective Grantor Trusts (IDGTs)

The Intentionally Defective Grantor Trust (IDGT) is modeled as an irrevocable trust whose assets are treated as the grantor's for income tax purposes, but not for gift or estate tax purposes. Some income- and transfer-tax consequences associated with transfers to and the operation of an IDGT remain uncertain, and the strategy may be subject to challenge by the IRS. Hence, this technique requires substantial guidance from tax and legal advisors. The grantor may give assets to the trust, which will require using gift tax exemptions or exclusions, or paying gift taxes. The IDGT is modeled with one or more current beneficiaries, and one or more remainder beneficiaries. Distributions to the current beneficiaries are not required, but the system permits the user to structure annual distributions in a number of different ways, including 1) an amount or a percentage of fiduciary accounting income (FAI) (which may be defined to include some or all realized capital gains); 2) FAI plus some principal, expressed either as a percentage of trust assets or as a dollar amount; 3) An annuity, or fixed dollar amount, which may be increased annually by inflation, or by a fixed percentage; 4) A unitrust, or annual payment of a percentage of trust assets, based on the trust's value at the beginning of the year, or average over multiple years; or 5) any combination of the above four payout methods. Because the IDGT is modeled as a grantor trust, the system calculates all taxes on income and realized capital gains that occur in the IDGT portfolio each year, based on the grantor's tax rates and other income, and pays them from the grantor's personal portfolio. The IDGT may continue for the duration of the analysis, or the trust assets may be distributed in cash or in kind at a specific point in time or periodically to (1) a non-modeled recipient, (2) a taxable trust, or (3) a taxable portfolio for someone other than the grantor. If applicable, an installment sale to an IDGT may be modeled as a user-entered initial 'seed' gift followed by a sale of additional assets to the trust. The system will use one of two methods to repay the value of the sale assets plus interest (less any user-specified discount to the grantor): 1) user-defined payback schedule, or 2) annual interest-only payments at the applicable federal rate (AFR) appropriate for the month of sale and the term of the installment note, with a balloon payment of principal plus any unpaid interest at the end of the specified term.

Notes on Wealth Forecasting

12. Estate Transfer and Taxation

The Wealth Forecasting System models the transfer of assets to children, more remote descendants, and charities, taking into account applicable wealth transfer taxes. If the analysis concerns a grantor and his or her spouse, the System assumes that only the first to die owns assets in his or her individual name and that no assets are owned jointly. It is further assumed that the couple's estate plan provides that an amount equal to the largest amount that can pass free of Federal estate tax by reason of the Federal unified credit against estate taxes (or, if desired, the largest amount that can pass without state death tax, if less) passes to a trust for the benefit of the surviving spouse and/or descendants of the first-to-die, or directly to one or more of those descendants. It is further assumed that the balance of the first-to-die's individually owned assets passes outright to the surviving spouse and that such transfer qualifies for the Federal estate tax marital deduction. Any state death taxes payable at the death of the first-to-die after 2010 are assumed to be paid from the assets otherwise passing to the surviving spouse. To the extent that this assumption results in an increase in state death taxes under any state's law, this increase is ignored. In addition, it is assumed that the surviving spouse "rolls over" into an IRA in his or her own name any assets in any retirement accounts (e.g., an IRA) owned by the first to die, and that the surviving spouse withdraws each year at least the minimum required distribution ("MRD"), if any, from that IRA. At the survivor's death, all applicable wealth transfer taxes are paid, taking into account any deductions to which the survivor's estate may be entitled for gifts to charity and/or (after 2010) the payment of state death taxes. The balance of the survivor's individually-owned assets passes to descendants and/or charities and/or trusts for their benefit. The survivor's retirement accounts (if any) pass to descendants and/or charities. To the extent that a retirement account passes to more than one individual beneficiary, it is assumed that separate accounts are established for each beneficiary and that each takes at least the MRD each year from the account. In all cases, it is assumed that all expenses are paid from an individual's taxable accounts rather than his or her retirement accounts to the maximum extent possible.

Notes on Wealth Forecasting System

13. Capital Markets Projections

	Median 10-Year Growth Rate	Mean Annual Return	Mean Annual Income	One-Year Volatility	10-Year Annual Equivalent Volatility
Int.-Term Diversified Municipal Bonds	2.4	2.6	2.7	4.7	2.8
US Value Stocks	8.5	10.2	3.6	23.3	16.0
US Growth Stocks	7.8	10.0	2.4	26.9	17.8
Developed International Stocks	9.1	11.3	4.3	26.4	17.4
Emerging Markets Stocks	7.1	11.6	3.8	39.4	27.9
Inflation	3.2	3.5	N/A	1.9	6.2

Based on 10,000 simulated trials each consisting of 10-year periods. Some case studies in this presentation were modeled for periods in excess of 10 years. Contact Bernstein for additional information.
Reflects Bernstein's estimates and the capital market conditions of September 30, 2011.
Does not represent any past performance and is not a guarantee of any future specific risk levels or returns or any specific range of risk levels or returns.