

APPENDIX I. GUIDE FOR COMPUTATION OF THE COMPROMISE TAX

Introduction

When the tax on a transfer of property cannot be definitely determined until the occurrence of contingencies, the tax liability may be immediately adjusted by the payment of a compromise tax. The compromise tax is the amount of tax that the Branch will accept in satisfaction of a tax liability which, if not settled in this manner, will be held in abeyance for an indefinite period. The compromise tax is determined after a consideration of the tax that may become due upon the occurrence of various contingencies, the present value of the tax, and the probability of the various contingencies occurring.

The settlement of tax on the contingent portion of an estate (that portion subject to the occurrence of contingencies before the tax may be definitely determined) prior to the occurrence of the contingencies is advantageous to both the Branch and the estate representatives.

The Branch prefers an immediate, fair and equitable settlement of the tax. In most cases it eliminates the need to maintain active files for an indefinite period, it eliminates the necessity of making multiple assessments of tax in the same estate, and it provides for the immediate receipt of tax revenue. The representatives of estates usually prefer the immediate settlement of the transfer inheritance tax liability because it results in a more expeditious completion of the inheritance tax proceeding and because it eliminates the requirement that a bond be filed in twice the highest amount of tax that may become due until the contingencies have occurred and the resulting tax liability has been satisfied.

A compromise tax on the contingent portion of an estate may be computed by the estate representative and reported on the inheritance tax return. When a compromise tax is reported on the return, a rider should be attached setting forth the computation and basis for the amount of compromise tax reported. If, upon review of the computations by the Branch, it is determined that the compromise tax is acceptable, and, if none of the contingencies have occurred prior to the completion of the assessment of tax by the Branch, the assessment will be completed on the basis of the amount of compromise tax reported on the return.

If the compromise tax reported on the inheritance tax return is not acceptable, or, if the representative of an estate does not wish to compute a compromise tax for the Branch's review, the Branch will propose a compromise tax on the contingent portion of the estate. If the compromise tax proposed by the Branch is both accepted by the executor, administrator, trustee, or other proper representative of the estate and paid prior to the occurrence of the contingencies, payment of the compromise tax will result in a final adjustment of the tax on the contingent portion of the estate. In most cases the tax on the contingent portion of an estate is settled by the payment of a compromise tax.

Procedure for Computing the Compromise Tax

The following steps are necessary in the computation of a compromise tax:

- 1) Determine the value, for inheritance tax purposes, of the contingent portion of the estate. The contingent portion is that portion of the estate upon which the tax cannot be definitely determined until the occurrence of contin-

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gencies. The contingent portion of the estate is reported on line 8 of the recital page of the inheritance tax return.

2) Determine the amount of contingent tax (tax on the contingent portion of an estate) that will become due upon the occurrence of the various contingencies. In some cases the tax will not vary and there will be only one possible contingent tax; however, in most cases there will be several possible contingent taxes that may result from the occurrence of various contingencies. When several contingent tax possibilities exist, the computation of the compromise tax should be based upon a minimum of three possible contingent taxes. The three possible contingent taxes which should be considered are the contingent tax that will become due upon the occurrence of the most probable contingencies, the highest possible contingent tax, and the lowest possible contingent tax (may be zero if the occurrence of the contingencies could result in no contingent tax liability). If, however, a large amount of contingent tax is involved, a sufficient number of contingent tax possibilities should be considered in order to provide a basis for the proper determination of the compromise tax.

3) Determine the present value of each of the possible contingent taxes calculated in step 2. It is necessary to determine the value, in present dollars, of the contingent tax that will become due upon the occurrence of the various contingencies. Therefore, for each possible contingent tax, it must be estimated when the contingencies will occur. The period of time that will pass between the immediate settlement of the potential tax liability by the payment of a compromise tax and the payment of a contingent tax upon the occurrence of contingencies is used for the purpose of determining the present values of the contingent taxes. The present value of the contingent tax is then determined by multiplying the contingent tax by the factor for this period of time from a table for the present value of \$1.00 at an interest rate of 6% compounded annually.

4) Determine the probability of the various contingencies and resulting contingent taxes occurring. This step involves the assignment of a relative probability of occurrence to each of the contingent taxes computed in step 2.

5) Determine the compromise tax. After a review of the relative probabilities of the various contingent taxes, the next step is to determine the compromise tax. Since this step is based on judgment, there is no set procedure or specific formula used exclusively in the computation of the compromise tax. Three possible methods of completing the computation of the compromise tax are set forth below:

a) start with the present value of the most probable contingent tax and then adjust this value upward or downward on the basis of the present values of the other contingent tax possibilities. For example, if the most probable contingent tax is much lower than most of the other less probable contingent taxes, the present value of the contingent tax with the highest probability of occurrence would be adjusted upward to allow for the possibility of the higher contingent taxes;

b) a second method is the assignment of weights to the contingent tax possibilities on the basis of their relative probability of occurrence. For example, if three contingent taxes were computed in step 2, the most probable might be assigned a weight of 3, the highest possible contingent tax, which is the second most probable contingent tax, might be assigned

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a weight of 2 and the lowest possible contingent tax, also the tax with the lowest probability of occurrence, might be assigned a weight of 1. Then the present value of the most probable contingent tax would be multiplied by 3, the present value of the highest possible contingent tax would be multiplied by 2 and the present value of the lowest contingent tax would be multiplied by 1. The compromise tax is then determined by adding the products and dividing the result by 6;

c) a third method is to assign a percentage of probability to each contingent tax determined in step 2 and, also to the probability, if one exists, that the occurrence of contingencies may result in no contingent tax liability. The total of the percentages assigned would equal 100%. The assigned percentages would then be multiplied by the present value of each contingent tax determined in step 3. The compromise tax is then determined by adding the products.

Examples of the Computation of a Compromise Tax

The computations are based upon the rates of tax and exemptions for use in estates of decedent's dying on or after July 1, 1988.

Factors used in the computations were taken from the Transfer Inheritance Tax Tables for Use in Estates of Decedent's Dying on or after August 5, 2008 as follows:

Annuities, Life Estates and Remainder Interests - Life Estate Table, Single Life, Female, 6% and Life Estate Table, Single Life, Male, 6%

Life Expectancies - Expectancy of Life Table, Life Table for Females: United States 1999-2001 and Expectancy of Life Table, Life Table for Males: United States 1999-2001

Temporary Annuities and Estates for a Term of Years - Table for Computing Temporary Annuities and Estates for a Term of Years, Female Lives, 6% and Table for Computing Temporary Annuities and Estates for a Term of Years, Male Lives, 6%

Present Values - Discount Table, Present value of \$1.00 at 6% compound interest for anytime from 1 to 100 years

Note - In estates of decedent's dying on or after July 1, 1988, Class "C" beneficiaries (brothers, sisters, wife or widow of a son/surviving civil union partner (after 02/19/2007), husband or widower of a daughter/surviving civil union partner (after 02/19/2007) have a \$25,000 exemption. Some of the Class "C" beneficiaries in the examples, however, were not given the \$25,000 exemption in the computation of the possible contingent taxes that would result from the occurrence of contingencies. These Class "C" beneficiaries have received life estates or other interests in the estate and the \$25,000 exemption would have been used in the computation of the direct tax (tax due and payable immediately on that portion of the estate which was not subject to the occurrence of contingencies).

1) Life estate in residue and the remainder is contingent

The decedent's wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) has a life estate in the residue of his estate and the remainder passes to the decedent's brother, if he survives the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), or, if he does not survive, to two nephews of the decedent, per stirpes.

Value of the residue for inheritance tax purposes - \$100,000

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The wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), brother and nephews all survived the decedent

Age of wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) on decedent's date of death - 60 years

Age of brother on decedent's date of death - 62 years

Ages of nephews - 32 years and 35 years

Life estate factor for a female, aged 60 - .69179

Wife's/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) life expectancy as of the decedent's date of death - 23.09 years

Brother's life expectancy as of the decedent's date of death - 18.23 years

Value of residue	\$100,000
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x Life estate factor	x .69179
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female, 60 years of age

Value of wife's/female	<u>\$69,179</u>
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domestic partner (after

07/10/2004)/female civil

union partner (after

02/19/2007) life estate

(subject to tax immediately
upon the decedent's death)

Value of residue	\$100,000
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Less: Wife's/female	- 69,179
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domestic partner (after

07/10/2004)/female civil

union partner (after

02/19/2007)

Contingent remainder (amount to be	<u>\$30,821</u>
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reported on line 8 of the inheritance

tax return)

Possible contingent taxes:

All to brother $\$5,821 (\$30,821 - \$25,000) \times 11\% = \640.31

All to two nephews or their issue (each Class "D" beneficiary will receive at least \$500 and less than \$700,000) $\$30,821 \times 15\% = \$4,623.15$

In this estate the only two possible contingent taxes would be \$640.31 and \$4,623.15. The contingent taxes are present valued by multiplying the tax by the factor from the table for the present value of \$1.00 at 6% compound interest. The wife's/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) life expectancy is 23 years and upon her death the contingent tax will become payable, therefore, the factor for 23 years (.261797) is used in the computation.

Present value of the contingent tax if the contingent remainder passes to the decedent's brother - $\$640.31 \times .261797 = \167.63

Present value of the contingent tax if the contingent remainder passes to the decedent's nephews or their issue - $\$4,623.15 \times .261797 = \$1,210.33$

The wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) has a longer life expectancy than the brother and, therefore, the contingent tax payable in the event that the contingent portion of the estate passes to nephews, or their issue, has the highest probability of

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occurrence. It is determined that the probability of the contingent tax payable in the event that the decedent's brother survives the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) is 20% and the probability of the contingent tax payable in the event that the brother does not survive the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), and the contingent portion of the estate passes to nephews, or their issue, is 80%. The proposed compromise tax would be \$1,001.79 determined as follows:

$$\begin{array}{rcl}
 \$167.63 \text{ (P.V. of contingent tax, all to brother)} & \times 20\% = & \$33.53 \\
 \$1,210.33 \text{ (P.V. of contingent tax, all to} & & \\
 \text{nephews or their issue)} & \times 80\% = & \underline{968.26} \\
 & & \underline{\$1,001.79}
 \end{array}$$

2) Life estate in trust, the life tenant has a right to limited withdrawals of principal, additional principal distributions may be made to the life tenant by the trustee and the life tenant has a general power of appointment

The decedent's brother has a life estate in a trust and he has the power to invade the principal; however, annual distributions of principal shall not exceed \$5,000.00 or 5% of the value of the trust principal on the last day of the year, whichever is larger. The power to invade principal is not cumulative and will lapse on the last day of each year the power is held. The trustee has a right to distribute, in addition to the amounts that may be requested by the decedent's brother, such amounts of principal as he may deem necessary for the brother's health, maintenance and welfare. The decedent's brother has a general power of appointment with respect to the principal of the trust which he may exercise at his death by will. If he does not exercise his power of appointment, the principal balance of the trust will pass upon the brother's death to the decedent's sister, if living, or, if she does not survive the brother, to two nephews of the decedent, per stirpes.

Value of trust for inheritance tax purposes - \$300,000

Age of brother - 73 years

Living relatives of the brother - a sister, age 67, and two nephews, ages 40 and 45

Life estate factor for a male, age 73 - .43441

Life expectancy of a male, age 73 - 11 years

Life expectancy of a female, age 67 - 17.60 years

Annual income of the brother - \$20,000

Health of brother - good

The contingent portion of the trust is determined by subtracting the brother's life estate from the value of the trust.

Value of trust	\$300,000
x Life estate factor, male, age 73	x .43441
Value of life estate	<u>\$130,323</u>

Value of trust	\$300,000
Less: Value of life estate	- 130,323
Value of the contingent portion of the trust (amount to be reported on line 8 of the inheritance tax return)	<u>\$169,677</u>

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There are numerous contingent tax possibilities in this estate. The most probable and highest and lowest possible contingent taxes will be determined.

Most probable contingent tax

If \$10,000 per annum in principal from the trust is distributed to the decedent's brother, and, if upon his death, the principal in the trust passes to the decedent's sister, the contingent tax will be \$15,914.47.

Brother - \$10,000	(annual use of trust principal)
x 11.00	(life expectancy)
\$110,000	Total value of principal distributions
Total value of principal distributions	\$110,000
*Less: Value of a life estate to the decedent's brother in the amount of the principal distributions - \$110,000	
x Life estate factor, male age 73	
	x .43441 47,785.10
Contingent portion of the estate to the decedent's brother	\$62,214.90

*Note: If a life tenant receives principal distributions from a trust which are contingent in character, the principal distributions are reduced by the amount of the life tenant's vested life estate value.

Value of the contingent portion of the estate	\$169,677.00
Less: Value of contingent portion to brother	- 62,214.90
Value of the contingent portion to sister	\$107,462.10
Contingent tax on property to brother	
\$62,214.90 x 11%	= \$6,843.64
Contingent tax on property to sister -	
\$82,462.10 (\$107,462.10-25,000) x 11%	+ 9070.83
Most probable contingent tax	\$15,914.47

Highest possible contingent tax

If no principal of the trust is distributed to the decedent's brother during his lifetime, and, if the brother exercises his power of appointment and devises the principal to his nephews upon his death, the contingent tax will be \$25,451.55

[\$169,677 (contingent portion of the estate) x 15% = \$25,451.55]

Lowest possible contingent tax

If no principal of the trust is distributed to the decedent's brother during his lifetime, and, if the brother exercises his power of appointment in favor of a charity, there will be no contingent tax payable on the contingent portion of the estate.

In the determination of the present value of the contingent taxes, it should be noted that the contingent tax payable on that portion of the principal of the trust distributed to the decedent's brother during his lifetime is present valued by using one-half of the brother's life expectancy. It is assumed that annual distributions of principal from the trust will be made to the brother during his lifetime, and, since a contingent tax will become payable on each principal distribution, the average present value of the contingent tax payable on these distributions will approximate one-half the brother's life expectancy.

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Present value - most probable contingent tax

\$6,843.64 (contingent tax on property to brother) x
.704961 (factor for the P.V. of \$1.00 at 6%
compound interest for 6 years - 1/2 life
expectancy of brother, rounded to nearest year) = \$4,824.50
\$9,070.83 (contingent tax on property to
sister) x .526788 (factor for P.V. of \$1.00 at 6%
compound interest for life expectancy of brother,
rounded to 11 years) = + 4,778.40
\$9,602.90

Present value - highest possible contingent tax

\$25,451.55 x .526788 (factor for
P.V. of \$1.00 at 6% compound interest
for life expectancy of brother \$13,407.57

Present value - lowest possible contingent tax -0-

In this case it is determined that the present value of the most probable contingent tax should be adjusted upward in calculating the compromise tax. There is a greater probability that the brother will exercise his power of appointment in favor of nephews than in favor of a charitable organization. Another reason for the upward adjustment of the present value of the most probable contingent tax is that if the brother does not exercise his power of appointment, and, if he is not survived by his sister, the principal balance of the trust will pass to nephews upon his death. The proposed compromise tax would be around \$11,100.

3) Life estate in Trust A, principal distributions may be made to the life tenant at the discretion of the trustee and the life tenant has a general power of appointment; income and principal distributions from Trust B at discretion of trustee, balance of Trust B to charity upon death of income and principal beneficiary

The decedent's last will and testament provides for the creation of two trusts. Trust A is funded with the least amount of principal needed to reduce the federal estate tax to the lowest possible amount and Trust B is funded with the residue of the estate.

The decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) is to receive all income from Trust A during his lifetime, payable annually, principal distributions may be made from the trust for his health, support, and maintenance at the discretion of the trustee, and he has a general power of appointment over the principal of the trust which he may exercise by will at his death. If he does not exercise his power of appointment, the principal balance of Trust A will, upon his death, pass to Trust B.

The trustee of Trust B shall distribute to the decedent's brother as much of the income and principal of the trust as, in his discretion, he believes desirable for the brother's health, support and maintenance. Upon the brother's death, the remaining principal and undistributed income will pass to charity.

Value of Trust A for inheritance tax purposes - \$500,000

Value of Trust B for inheritance tax purposes - \$600,000

Age of husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) - 80 years

Age of brother - 67 years

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Relatives of husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) - a sister, age 90 and a nephew age 65

Life estate factor for a male, age 80 - .32436

Life expectancy of husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007), age 80 - 7.44 years

Life expectancy of brother, age 67 - 14.74 years

Life expectancy of husband's/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) sister, age 90 - 4.71 years

The decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) has annual income of over \$200,000 and is in good health

The decedent's brother has an annual income of \$10,000 and is handicapped, requiring constant medical care; his handicap, however, is not expected to shorten his normal life expectancy

The decedent's husband/male domestic partner (after 07/10/2004)/male civil union (after 02/19/2007) currently has a last will and testament providing for the exercise of his power of appointment, upon his death, in favor of his nephew

Note - In this estate it was necessary to hold the assessment of tax in abeyance pending final determinations in the federal estate tax proceeding. For this reason, the compromise tax is being computed two years after the decedent's date of death. In determining the present values of the possible contingent taxes, the life expectancy factors will be adjusted to reflect the current ages of beneficiaries. Also, \$50,000 in income and principal of Trust B has been distributed to the decedent's brother. This distribution occurred prior to the offer, acceptance and payment of a compromise tax and, therefore, will be subject to a contingent tax assessment.

Contingent portion of the estate

Value of Trust A	\$500,000	
x Life estate factor		
male, age 80	<u>x .32436</u>	
Value of life estate to	\$ <u>162,180</u>	
husband/male domestic		
partner (after		
07/10/2004)/male civil		
union partner (after		
02/19/2007)		
Value of Trust A	\$500,000	
Less: Life estate	<u>- 162,180</u>	
Contingent portion of		\$ <u>337,820</u>
Trust A		
Value of Trust B	\$600,000	
Less: Prior distributions	<u>- 50,000</u>	
to decedent's brother		
Contingent portion of		<u>550,000</u>
Trust B		
Contingent portion of estate		\$ <u>887,820</u>
(amount to be reported on line 8		
of the inheritance tax return)		

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Possible contingent taxes

There are numerous contingent tax possibilities in this estate. The contingent tax on the distribution of principal from Trust A will range from zero, if all principal is distributed to the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007), to \$50,673 if all principal passes to one Class D beneficiary. The contingent tax on the distribution of income and principal from Trust B will range from zero, if all income and principal passes to charity to \$60,500 if all income and principal is distributed to the decedent's brother.

In view of the large amount of possible contingent tax in this estate, several possible contingent taxes will be calculated.

The decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) has an annual income of over \$200,000 and, in addition, a life estate in a \$500,000 trust; therefore, it will be assumed that the trustee of Trust A will distribute very little, if any, of the principal of this trust for his benefit.

If it is assumed that no principal will be distributed to the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) from Trust A, some of the possible contingent taxes resulting from the distribution of principal from this trust are:

	<u>Contingent tax</u>
All principal to charity	-0-
\$100,000 devise to a Class D beneficiary; remainder to charity	\$15,000
One-half to decedent's brother; one-half to charity	\$18,580.10
All to decedent's sister-in-law	\$50,673
All to nephew of husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007)	\$50,673

*May result from decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) exercising his power of appointment or the passage of principal from Trust A to Trust B upon the husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007)'s death.

In a determination of possible contingent taxes that may become payable upon the distribution of the contingent portion of Trust B, consideration should be given to the brother's low annual income, his medical status, and the fact that he has received an average of \$25,000 per annum in income and/or principal from the trust during the two year period subsequent to the decedent's death. Any interest and principal of this trust which is not distributed to the decedent's brother will pass to charity and be exempt from tax. Some possible contingent taxes that may result from the distribution of income and principal from this trust are:

	<u>Contingent tax</u>
Distribution of \$25,000 per annum from the trust to the decedent's brother	
Annual distribution	\$25,000

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x Current life expectancy (based upon the brother's current age of 69)	x 13.43	
	<u>\$316,000 x 11%</u>	
Distribution of trust income (assume 6% annual income) to brother during his lifetime		\$36,932.50
Contingent portion of trust	\$550,000	
	<u>x .06</u>	
Annual income	\$ 33,000	
Current life expectancy	x 13.43	
	<u>\$443,190 x 11%</u>	
		\$48,750.90
Distribution of an average of \$50,000 per annum from the trust to the decedent's brother (on an assumption that cost of living and medical care will increase and the current annual distribution of \$25,000 will be increased by approximately \$5,000 per year)		
Annual distribution	\$ 50,000	
Current life expectancy	x 13.43	
	<u>\$671,500 x 11%</u>	
	<u>\$73,865.00</u>	

Present values of possible contingent taxes

Trust A

	Contingent tax	P.V. Contingent tax
All principal to charity	- 0 -	- 0 -
\$100,000 devise to Class D beneficiary; remainder to charity.	\$15,000	\$9,975.86
Present value based upon current life expectancy of husband/male domestic partner (after 07/10/2004)/ male civil union partner (after 02/19/2007) (current age 82) - 6.6 years - round to 7 years - factor 7 years - .665057		
One-half to decedent's brother; one-half to charity	\$18,580.10	\$12,356.83
Present value factor - .665057		
All to decedent's sister-in-law	\$50,673	\$33,700.43
Present value factor - .665057		
All to nephew of decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007)	\$50,673	\$33,700.43
Present value factor - .665057		

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Trust B

	Contingent tax	P.V. contingent tax
Distribution of \$25,000 per annum from the trust	\$36,932.50	\$24,562.22
Present value based upon 1/2 current life expectancy of brother since equal annual payments are assumed and since the contingent tax will become payable as payments are made -		
Current life expectancy (current age 69) - 13.43 years -		
1/2 rounded to 7 years - .665057		
Distribution of trust income (assumed @ 6% per annum) to brother for lifetime;	\$48,750.90	32,422.13
Present value factor - .665057		
Distribution of an average of \$50,000 per annum to brother;	\$73,865	\$41,245.85
Present value based upon the fact that the brother will be receiving larger annual distributions each year (see comments in contingent tax computation) and since a larger amount of contingent tax will become payable in each succeeding year, the P.V. in this situation will be based upon 3/4 of the brother's current life expectancy 10.07 (13.43 x .75) - rounded to 10 years - .558395		

Probability of the various contingent taxes and computation of the compromise tax

In the proposal of a compromise tax in this estate, particular attention must be given to the following factors:

1) the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) has substantial annual income; therefore the probability that principal from Trust A will be distributed to him is very low;

2) the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) has a last will and testament in which he exercises his power of appointment over the principal of Trust A in favor of his nephew; therefore, the probability that the principal of Trust A will be distributed to the husband's/male domestic partner (after 07/10/2004)/male civil union (after 02/19/2007) nephew is very high;

3) the decedent's brother has a low annual income, medical expenses which will continue during his lifetime, and a history of receiving income and principal from the trust (\$50,000 in two years); therefore, there is a high probability that he will receive a substantial portion, if not all, of the income and principal from Trust B.

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The most probable contingent tax will result from a distribution of the principal of Trust A to a nephew of the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) (P.V. of contingent tax is \$33,700.43) and a distribution of the contingent portion of Trust B to the decedent's brother equal to the average of the distribution of trust income (assuming 6% annual income) (P.V. of contingent tax is \$32,422.13) and the distribution of an average of \$50,000 per annum (P.V. of contingent tax is \$41,245.85).

	P.V. of Contingent Tax
Distribution of principal of Trust A to nephew of the decedent	\$33,700.43
Distribution of Trust B income to brother for life time	\$32,422.13
Distribution of an average of \$50,000 per annum to brother from Trust B	\$41,245.85

P.V. value of total contingent tax on Trust B is $\$32,422.13 + \$41,245.85 = \$73,667.98$. If 1/2 of Trust B was distributed to the brother, P.V. of contingent tax will be $\$36,833.99$. The present value of most probable contingent tax is $\$36,833.99 + \$33,700.43 = \$70,534.42$.

There are many other possible contingent taxes, however, and it should be noted that the present values of several of the other possible contingent taxes are lower than the most probable. Therefore, some downward adjustment in the present value of the most probable contingent tax is necessary in order to determine a proper compromise tax offer.

After reviewing the present values of the probable contingent taxes and considering that the most probable contingent tax would be lower if the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) receives principal from Trust A, if the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) changes his will and exercises his power of appointment over the principal in Trust A in favor of a charity, if the decedent's husband/male domestic partner (after 07/10/2004)/male civil union partner (after 02/19/2007) does not exercise his power of appointment and the principal balance of Trust A at the time of his death passes through Trust B to the decedent's brother and/or a charity, and, if the decedent's brother does not receive a substantial portion of the income and principal from Trust B, the compromise tax proposal would be around \$70,000.

4) Life estate to wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), subsequent life estate to sister and remainder to nephew

The decedent devises the residue of his estate to a trust in which his wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) receives the income during her lifetime, upon her death the income is payable to the decedent's sister for the remainder of her life, and, upon the death of both the decedent's wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) and sister, the principal of the trust passes to the decedent's nephew.

Value of the residuary portion of the estate - \$300,000

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The wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), brother and nephew all survived the decedent

Age of wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) - 68 years

Age of sister - 55 years

Life estate factor for a female, age 68 - .58017

Life estate factor for a female, age 55 - .75050

Life expectancy of wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) - 16.86 years

Life expectancy of sister - 27.31 years

Contingent portion of the estate

The tax on the life estate of the decedent's wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) and the remainder interest of the decedent's nephew is immediately due and payable. The subsequent life estate of the decedent's sister-in-law is contingent, however, because she must survive the decedent's wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) in order to receive income from the trust.

In order to determine the value of the contingent portion of the estate, it is necessary to calculate the values of life estates in the residue based upon the life estate factors for the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) and the sister. The value of the wife's/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) life estate is then subtracted from the value of the sister's life estate and the difference in value between the two life estates represents the contingent portion of the estate. It should be noted that if the subsequent life tenant's life estate is equal to or less than the original life tenant, the subsequent life estate has no value for inheritance tax purposes. The calculations are as follows:

Residue	\$300,000
x Life estate factor for wife/female domestic partner (after 07/10/2004)/ female civil union partner (after 02/19/2007), female age 68	x .58017
Value of life estate to wife/ female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007)	<u>\$174,051</u>

Residue x Life estate factor for sister, female, age 55	\$300,000 x .75050
Value of life estate to sister	<u>\$225,150</u>
Value of sister's subsequent life estate equals -	

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Value of life estate to sister	\$225,150
Less: Value of life estate to wife /female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007)	- <u>174.051</u>
Contingent portion of the estate (amount to be reported on page 8 of the inheritance tax return)	\$ <u>51,099</u>

Possible contingent taxes

In this estate there are only two possible contingent taxes. If the decedent's sister survives his wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), she will obtain her interest in the income from the trust and upon the death of the decedent's wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), a contingent tax will become payable on the value of the sister's subsequent life estate. If the decedent's sister does not survive his wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), however, the contingent portion of the estate will pass to the decedent's nephew. If the decedent's sister survives his wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), the contingent tax will be \$2,870.89 [\$26,099 (\$51,099 - \$25,000) x 11%] and, if the decedent's sister does not survive the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007), the contingent tax will be \$7,664.85 (\$51,099 x 15%).

Present values of possible contingent taxes

	<u>Contingent tax</u>	<u>P.V. contingent tax</u>
Decedent's sister survives his wife/ female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) and receives a subsequent life estate Present value factor - .371364 (17 years) (Based upon the life expectancy of the decedent's wife/ female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007); upon her death the decedent's sister will acquire her subsequent life estate in the trust and a contingent tax would become payable - life expectancy of wife/female domestic partner (after 07/10/2004)/ female civil union partner (after 02/19/2007) - 16.86 year rounded to 17)	\$2,870.89	\$1,066.15
Decedent's wife/female domestic	7,664.85	2,846.45

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partner (after 07/10/2004)/female
civil union partner (after 02/19/2007)
survives the decedent's sister and
the contingent portion of the estate
passes to the decedent's nephew
Present value factor (same as
above) - .371364

Probability of possible contingent taxes and computation of compromise tax

The life expectancy of the decedent's sister is approximately 10 years longer than the decedent's wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) and, for this reason, the most probable contingent tax will result from the decedent's sister surviving his wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) and receiving a subsequent life estate in the residuary trust. After considering the relative probabilities of the two possible contingent taxes, it is determined that the contingent tax resulting from the sister surviving the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) should have a weight of 6 and the contingent tax resulting from the sister predeceasing the wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007) should have a weight of 1.

The compromise tax proposal would be in the amount of \$1,320.48, determined as follows:

(P.V. of contingent tax, sister survives wife/female domestic partner (after 07/10/2004)/female civil union partner (after 02/19/2007))	\$1,066.15 x 6 =	\$6,396.90
(P.V. of contingent tax, wife/female domestic partner (after 07/10/2004)/ female civil union partner (after 02/19/2007) survives sister)	\$2,846.45 x 1 =	<u>+ \$2,846.45</u>
		\$9,243.35

\$9,243.35 = \$1,320.48

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5) Income from trust to two sisters, in equal shares, and to the survivor: upon the death of both sisters, the remainder passes to a charity.

The decedent devises the residue of his estate to a trust in which his two sisters receive the income, in equal shares, during their lifetimes. Upon the death of one life tenant, the income is payable to the survivor. Upon the death of both life tenants, the remainder passes to a charity.

Value of residue - \$900,000
Both life tenants survived the decedent
Age of sister A - 70
Age of sister B - 65
Life estate factor, sister A - .54838
Life estate factor, sister B - .62489
Life expectancy of sister A - 15.40 years
Life expectancy of sister B - 19.12 years

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Contingent portion of the estate

The tax on each life tenant's right to 1/2 of the income from the trust during her lifetime is immediately due and payable. The remainder interest in the trust will pass to charity and be exempt from tax.

The subsequent life estate that will be received by the life tenant with the longer life expectancy if she survives the life tenant with the shorter life expectancy is contingent, however, and the value of the possible subsequent life estate is the contingent portion of the estate.

The value of the life estates and possible subsequent life estate equals the value of a life estate in the entire trust to the life tenant with the longest life expectancy. Therefore, by subtracting the life estate of each life tenant in 1/2 of the trust from a life estate in the full value of the trust determined by using the life estate factor for the life tenant (sister B) with the longest life expectancy, the value of the contingent portion of the estate may be determined. The calculations are as follows:

Value of Trust	\$900,000
x Life estate factor, female, age 65	<u>.62489</u>
Value of a life estate in the trust to the life tenant with the longest life expectancy	\$559,071
Less: \$450,000 (1/2 trust)	
x .54838 (L.E. factor, female, age 70) = \$246,771.00	
\$450,000 x .62489 (L.E. factor, female, age 65) = <u>281,200.50</u>	<u>527,971.50</u>
Value of the contingent portion of the estate	\$34,429.50
amount to be reported on line 8 of the inheritance tax return)	

Possible contingent taxes

There is only one possible contingent tax that may become due in this estate. If sister B survives sister A she will receive a subsequent life estate in a 1/2 share of the income from the trust and the contingent tax will be \$3,787.25 (\$34,429.50 x 11%). If, however, sister A survives sister B, the contingent portion of the estate will pass to a charity, as part of the remainder, and be exempt from tax. Sister A would not acquire a subsequent life estate in the trust because she has a shorter life expectancy than sister B.

Present value of contingent tax

The present value of the contingent tax (\$3,787.25) that will become due and payable if sister B survives sister A is determined by multiplying the tax by the factor for the P.V. of \$1.00 at 6% compound interest for 15 years (sister A's life expectancy, 15.40 years rounded to 15). The computation is as follows:

$$\$3,787.25 \times .417265 = \$1,580.29$$

Probability of contingencies occurring

The contingency that has the highest probability of occurrence is that sister B will survive sister A and receive a subsequent life estate in 1/2 of the in-

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come from the trust. Some consideration, however, must also be given to the probability that sister A will survive sister B and that the contingent portion of the estate will be exempt from tax. It should be noted that sister A's life expectancy is approximately 3 1/2 years shorter than sister B's. Therefore, although this contingency is not the most probable, it does have a good chance of occurrence.

Computation of the compromise tax

After giving consideration to the relative probabilities of the two possible contingencies occurring (sister A survives sister B or sister B survives sister A) it was determined that the probability of sister B surviving sister A (P.V. of contingent tax \$1,580.29) has a 70% chance of occurrence and the probability of sister A surviving sister B has a 30% chance of occurrence. The proposed compromise tax would be \$1,106.20 determined as follows:

$$\begin{array}{r} \text{(P.V. of contingent tax if sister B} \\ \text{survives sister A) } \$1,580.29 \times 70\% = \\ \text{(Contingent tax if sister A} \\ \text{survives sister B) } 0 \times 30\% = \end{array} \begin{array}{r} \\ \$1,106.20 \\ \\ - 0 - \\ \hline \underline{\underline{\$1,106.20}} \end{array}$$

6) Estate for a term of years and the remainder is contingent

The decedent devises the residue of this estate to a trust. The trustee is to pay or apply the income from the trust to or for the benefit of the decedent's grandniece until she attains the age of 25 years. The trustee may also distribute to or for the benefit of the grandniece so much of the principal of the trust as he deems necessary for the grandniece's support, maintenance and education. When the grandniece has attained the age of 25 years, the trustee shall pay to the grandniece the remaining principal of the trust. If the grandniece does not survive to age 25, the trustee shall, upon her death, pay the remaining principal of the trust to the decedent's niece.

Value of trust principal - \$300,000
The grandniece and niece both survived the decedent
Age of grandniece - 17 years
Age of niece - 47 years
Life expectancy of grandniece - 63.19 years
Life expectancy of niece - 34.47 years

Contingent portion of the estate

The tax on the grandniece's right to receive income from the trust until age 25 is immediately due and payable. The remainder interest in the estate, however, is contingent. Therefore, the contingent portion of the estate is determined by subtracting the value of the grandniece's estate for a term of years from the value of the principal of the trust.

Valuation of the grandniece's estate for a term of years (based upon data from the Table for Computing Temporary Annuities and Estates for a Term of Years, Female Lives, 6%)

$$\begin{array}{r} 588031.62454 \text{ (Nx - 18 years)} \\ - 360052.63244 \text{ (Nx - 26 years)} \\ \hline 227978.99210 \\ \underline{227978.99210} = 6.20 \\ 36781.50319 \text{ (Dx - 17 years)} \\ \text{Trust principal} \end{array} \begin{array}{r} \\ \\ \\ \\ \\ \$300,000 \\ \times .06 \end{array}$$

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Annual income (at the statutory rate of 6%)	\$18,000
	x 6.20
Value of grandniece's estate for a term of years	<u>\$111,600</u>
Trust principal	\$300,000
Less: Value of estate for a term of years	-111,600
Value of contingent portion of the estate (amount to be reported on line 8 of the inheritance tax return)	<u>\$188,400</u>

The contingent tax in this estate will be \$28,260 (\$188,400 x 15%) except in the unlikely event that the decedent's niece receives a portion of the contingent remainder of the estate and this portion of the estate has a value of less than \$500. Since that unlikely event would lower the contingent tax by less than \$75 (\$500 x 15%), it will be disregarded in the determination of the compromise tax.

Present value of the contingent tax

The present value of the contingent tax will be determined upon the basis of three possible distributions of the remainder interest in the trust.

A possible distribution will be based upon the grandniece receiving \$5,000 per annum in principal from the trust for each of the 8 years until she attains the age of 25, and, at that time she will receive the remaining principal of the trust. The present value of the contingent tax in this event will be \$18,351.18 (\$2,984.61 + \$15,366.57), determined as follows:

Annual principal distributions	\$ 5,000
Total value of annual distributions	x 8 years
	<u>\$40,000</u>

*Less: Estate for a term of years in this portion of the trust

\$40,000	
x .06	
<u>\$ 2,400</u>	
x 6.20 years	
	<u>\$14,880</u>
Contingent portion of annual distributions	\$25,120
	x 15%
	<u>\$3,768</u>

Contingent tax on annual distributions

Present value - based upon 1/2 the total period during which payments will be made - since a portion of the contingent tax will become due each year - 1/2 the total period equals the average time in which the contingent tax will become payable on the annual distributions factor 4 years

- .792094	x.792094
Present value of contingent tax on annual distributions	<u>\$2,984.61</u>

*Since the beneficiary of the annual principal distributions has received an estate for a term of years in the principal of the trust which was immediately

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vested and subject to direct tax, the distributions must be reduced by the value of the beneficiary's estate for a term of years in that portion of the trust.

Contingent portion of estate	\$188,400.00
Less: Contingent portion of annual principal distributions	- 25,120.00
	<u>163,280.00</u>
	x .15

Contingent tax on principal distributed to the grandniece when she attains 25 years of age	\$24,492.00
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Present value - based upon the 8 year period until the distribution will be made and the contingent tax will become payable - factor 8 years - .627412

	x .627412
Present value of contingent tax on principal distribution to grandniece when she attains 25 years of age	<u>\$15,366.57</u>

If the grandniece does not receive any distributions of principal from the trust prior to attaining 25 years of age, the present value of the contingent tax will be \$17,730.66, determined as follows:

Principal distribution at age 25 - the entire contingent portion of estate	\$188,400
--	-----------

	x .15
Contingent tax	<u>\$28,260</u>

Present value - based upon the 8 year period until the principal is distributed and the contingent tax becomes payable - factor 8 years - .627412

	x .627412
	<u>\$17,730.66</u>

If the grandniece receives \$5,000 per annum for 4 years, is deceased at age 21, and is survived by the decedent's niece, the present value of the contingent tax will be \$22,569.02 (\$1,676.75 + \$20,892.27) determined as follows:

Annual principal distribution	\$ 5,000
	x 4 years
Total value of annual distributions	<u>\$20,000</u>

Less: Estate for a term of years in this portion of the trust \$20,000

	x .06
	\$1,200
	x 6.20 years
	<u>- 7,440</u>

Contingent portion of annual distributions	\$12,560
Contingent portion of annual distributions	\$12,560

	x .15
Contingent tax on annual distributions	<u>\$1,884.00</u>

Present Value - based upon 1/2 the total period during which payments will be made - 2 years - factor 2 years - .889996

	x .889996
Present value of contingent tax on annual distributions	<u>\$1,676.75</u>

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Contingent portion of estate	\$188,400
Less: Contingent portion of annual principal distributions	- 12,560
	<u>\$175,840</u>
	x .15
Contingent tax on distribution to niece in 4 years	<u>\$26,376</u>
Present value - based upon the 4 year period until the distribution will be made - factor 4 years - .792094	x .792094
Present value of contingent tax on distribution to niece in 4 years	<u>\$20,892.27</u>

Determination of compromise tax

If the grandniece dies within a short period of time after the decedent, the contingent tax would become payable and not subject to present value consideration. The amounts to be considered in the computation of the compromise tax range from a high of \$28,260, which represents the total contingent tax with no present value consideration, to a low of \$17,730.66 which would represent the present value of the contingent tax if the entire contingent portion of the estate passes to the decedent's grandniece when she attains 25 years of age.

The most probable present value of the contingent tax will fall between the present value of the contingent tax in the event that the grandniece receives the entire contingent remainder at the age 25 (\$17,730.66) and the present value of the contingent tax if the grandniece uses \$5,000 per annum from the trust in principal distributions and the remainder at the age of 25 (\$18,351.18).

After giving consideration to the various possibilities for the amounts and dates of distribution of the contingent portion of the estate and the present values of the resulting contingent tax, the proposed compromise tax would be around \$18,040.

7) Estates for a term of years and the remainder is contingent

The decedent devises the residue of his estate to a trust. The trustee is to pay or apply the income from the trust to the decedent's daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007). When the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) attains 28 years of age the trustee shall distribute to her 1/4 of the principal of the trust as it shall then exist. When the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) attains 35 years of age, the trustee shall distribute to her 1/3 of the principal of the trust as it shall then exist. When the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) attains 40 years of age, the trustee shall distribute to her the remaining principal of the trust and the trust shall terminate. If the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies before receiving all of the principal distributions, any principal of the trust remaining on the date of her death is to be distributed to a nephew of the decedent.

Value of trust - \$400,000

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Age of daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) - 21 years

Contingent portion of the estate

The decedent's daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) has three estates for a term of years (temporary annuities) in the trust and the tax on these three estates is immediately due and payable. The remainder interest in the trust, however, is contingent.

The value of the three estates for a term of years is determined by calculating the value of an estate for a term of 7 years (female, age 21 to 28) in 1/4 of the trust principal, the value of an estate for a term of 14 years (female, age 21 to 35) in 1/4 of the trust principal (1/3 of the remaining 3/4), and the value of an estate for a term of 19 years (female, age 21 to 40) in 1/2 of the trust principal (the principal remaining after the distribution at age 35). Factors from the Table for computing Temporary Annuities and Estates for a Term of Years, Female Lives, 6% were used in the calculations.

Valuation of an estate for 7 years

(female, age 21 to 28) in \$100,000 (1/4 of trust principal)

460713.72144 (Nx - 22 years)

- 298653.57835 (Nx - 29 years)

162060.14309

162060.14309 ÷ 29083.21898 (Dx - 21 years) = 5.57

Trust principal

\$100,000

x .06

Annual income (at statutory rate of 6%)

6,000

x 5.57

Value of an estate for 7 years (female, age 21 to 28) in trust principal of \$100,000

\$33,420

Valuation of an estate for 14 years (female, age 21 to 35) in \$100,000 (1/4 of trust principal)

460713.72144 (Nx - 22 years)

- 191308.15443 (Nx - 36 years)

269405.56701

269405.56701 ÷ 29083.21898 (Dx - 21 years) = 9.26

Trust principal

\$100,000

x .06

Annual income (at statutory rate of 6%)

6,000

x 9.26

Valuation of an estate for 14 years (female, age 21 to 35) in trust principal of \$100,000

\$55,560

Valuation of an estate for 19 years (female, age 21 to 40) in \$200,000 (1/2 of trust principal)

460713.72144 (Nx - 22 years)

- 137737.31891 (Nx - 41 years)

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322976.40253

322976.40253 ÷ 29083.21898 (Dx - 21 years) = 11.11

Trust principal \$200,000

x .06

Annual income (at statutory rate
of 6%) 12,000

x 11.11

Value of an estate for 19 years
(female age 21 to 40) in trust principal
of \$200,000 \$133,320

Total value of trust principal \$400,000

Less: Estate for 7 years in
\$100,000 33,420

Estate for 14 years in
\$100,000 55,560

Estate for 19 years in
\$200,000 133,320

222,300

Value of the remainder interest in
the trust - the contingent portion
of the estate (amount to be reported on
line 8 of the inheritance tax return) \$177,700

Possible contingent taxes

There are four possible contingent taxes that may become payable in this estate.

If the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies before attaining 28 years of age, the entire contingent portion of the estate will pass to the decedent's nephew and the contingent tax will be \$26,655 (\$177,700 x 15%).

If the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies between the ages of 28 and 35, she will receive a distribution of \$100,000 in trust principal. The remainder interest (portion subject to contingent tax) in this distribution is \$66,580 [\$100,000 - \$33,420 (valuation of the estate for 7 years)] and this amount will be taxable to the decedent's daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007). The remainder of the contingent portion of the estate will pass to the decedent's nephew. The contingent tax in this event will be \$23,991.80, determined as follows:

(portion of contingent remainder to daughter-in-law/female domestic partner of a son (after 07/10/2004)/ female civil union partner of a son (after 02/19/2007)) \$66,580 x 11% =	\$7,323.80
(portion of contingent remainder to nephew) \$111,120 x 15% =	<u>16,688.00</u>
	<u>\$23,991.80</u>

If daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies between the ages of 35 and 40, she will receive two distributions of trust principal, a distribution in the amount of \$100,000 at age 28 and a distribution in the amount of

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\$100,000 at age 35. The remainder interest in the distribution at age 28 is \$66,580 as determined above and the remainder interest in the distribution at age 35 is \$44,440 [\$100,000 - \$55,560 (valuation of the estate for 14 years)]. The contingent tax, in this event, will be \$22,214.20 determined as follows:
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007)

Remainder interest in principal distribution at age 28	\$66,580	
Remainder interest in principal distribution at age 35	44,440	
	\$111,020	x 11% = \$12,212.20

Nephew

Remainder of the contingent portion of the estate (\$177,700 - \$111,020)	\$66,680	x 15% =	10,002.00
			<u>\$22,214.20</u>

If the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) survives to age 40 and receives all three principal distributions from the trust, the contingent tax will be \$19,547 (\$177,700 x 11%).

Present value of possible contingent taxes

	<u>Contingent tax</u>	P.V. of <u>contingent tax</u>
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies before attaining 28 years of age	\$26,655	\$21,113.27
Present value - the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) may die at any time between 21 and 28 years of age - use 1/2 the 7 year period - 3.5 years - rounded to 4 - factor 4 years .792094		
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies between the ages 28 and 35 years	23,991.80	13,651.24
Present value - two present value determinations are necessary - for the contingent tax that will become payable when the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) attains 28 years of age - P.V. factor for 7 years (21 to 28) - factor .665057		
Contingent tax		

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(\$66,580 @ 11%) \$7,323.00
 x .665057
 \$4,870.74

for the contingent tax that will become payable upon the death of the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) between 28 and 35 years of age - based upon mid-point between the ages - 31.5 - rounded to 32 - current age 21 - 32 minus 21 = 11 years - factor 11 years - .526788

Contingent tax \$16,688
(\$111,120 @ 15%) x .526788
 \$8,780.50

Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies between the ages of 35 and 40 \$22,214.20 \$10,747.26

Present value - three present value determinations are necessary - for the contingent tax that will become payable when the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) attains 28 years of age - P.V. for 7 years - as determined above \$4,870.74

for the contingent tax that will become payable when the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) attains 35 years of age - factor 14 years (21 to 35) - .442301

Contingent tax \$4,888.40
(\$44,440 @ 11%) x .442301
 \$2,162.14

for the contingent tax that will become payable upon the date of death of the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) - may occur at

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any time between 35 and 40 years
of age - based upon the mid-point
between the ages - 37.5 -
rounded to 38 - 21 (current age) to 38 -
17 years - factor 17 years .371364
Remainder of the contingent portion
of the estate to decedent's nephew -
Contingent tax \$10,002.00
(\$66,680 @ 15%)

$$\begin{array}{r} \times .371364 \\ \hline \$3,714.38 \end{array}$$

Daughter-in-law/female domestic partner of a son (after 07/10/2004)/
female civil union partner of a son
(after 02/19/2007) survives to age 40
Present value - three present value
determinations are necessary -
for the contingent tax that will become
payable when the daughter-in-law/
female domestic partner of a son
(after 07/10/2004)/female civil union
partner of a son (after 02/19/2007)
attains 28 years of age - factor 7 years.
.665057 - as determined
above - \$4,870.74

\$19,547

\$9,457.13

for the contingent tax that will become
payable when the daughter-in-law/
female domestic partner of a son
(after 07/10/2004)/female civil union
partner of a son (after 02/19/2007)
attains 28 years of age - factor 7 years.
.665057 - as determined
above - \$4,870.74
for the contingent tax that will become
payable when the daughter-in-law/
female domestic partner of a son
(after 07/10/2004)/female civil union
partner of a son (after 02/19/2007)
attains 35 years of age - factor 14
years - .442301 - as determined
above - \$2,162.14

for the contingent tax that will
become payable when the
daughter-in-law attains 40 years of age -
current age 21 - factor 19 years
(21 to 40) - .330513.

Remainder interest passing in final
distribution -
[\$66,680 (\$200,000 - \$133,320)
@ 11%] \$7,334.80

$$\begin{array}{r} \times .330513 \\ \hline 2,424.25 \end{array}$$

Probability of the various contingent taxes

The most probable contingent tax is \$19,547 (P.V. \$9,457.13). This is the amount of tax that will become due if the decedent's daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a

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son (after 02/19/2007) survives to 40 years of age. The other three possible contingent taxes have low probabilities of occurrence.

Computation of the compromise tax

The compromise tax offered in this estate will be determined by assigning a percentage chance of probability to the present value to each possible contingent tax. The proposed compromise tax would be \$9,727.95, determined as follows:

	Present value of <u>contingent tax</u>	Percentage probability <u>of occurrence</u>
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies before attaining 28 years of age	\$21,113.27 x	1.5% = 316.70
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies between the ages of 28 and 35	13,651.24 x	1.75% = 238.90
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) dies between the ages of 35 and 40	10,747.26 x	1.75% = 188.08
Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) survives to the age of 40	\$9,457.13 x	95% = <u>8,984.27</u>
		<u>\$9,727.95</u>

8) Devise of real property to husband and wife/domestic partner (after 07/10/2004)/ civil union partner (after 02/19/2007) as tenants by the entirety

The decedent devises a parcel of real property to his son and daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) as tenants by the entirety.

Value of real property - \$300,000

Age of son - 50 years

Age of daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) - 45 years

Life estate factor for a male, age 50 - .75227

Life estate factor for a female, age 45 - .84206

Life expectancy of son - 27.79 years

GUIDE FOR COMPUTATION OF THE COMPROMISE TAX

Life expectancy of daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) - 36.31 years

Contingent portion of the devise

The contingent portion of the devise of real property to a husband and wife/domestic partner (after 07/10/2004)/civil union partner (after 02/19/2007) as tenants by the entirety is determined in accordance with the provisions of N.J.A.C. 18:26-8.12. A life estate in the real property is computed on the basis of the devisee with the lesser life expectancy and the value of the life estate is vested in the husband and wife/domestic partner (after 07/10/2004)/civil union partner (after 02/19/2007) in equal shares. The tax on this portion of the real property is immediately due and payable. The contingent portion of the devise is then determined by subtracting the life estate from the value of the property.

Value of real property	\$300,000
x Life estate factor for the decedent's son; the devisee with the lesser life expectancy	<u>x .75227</u>
Value of a life estate to a male, age 50	\$225,681

Value of real property	\$300,000
Less: Value of life estate to a male, age 50	- 225,681
Value of the contingent portion of the devise (amount to be reported on line 8 of the inheritance tax return)	\$74,319

Possible contingent taxes

If the decedent's son survives the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) and acquires the remainder interest (the contingent portion of the devise) in the property, there will be no contingent tax payable on the contingent portion of the estate.

If the decedent's daughter-in law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) survives the son and acquires the remainder interest in the property, the contingent tax will be \$8,175.09 (\$74,319 x 11%).

If the remainder interest in the property is shared equally by the decedent's son and daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) as a result of a sale of the property during their joint lifetimes or the entry of a judgment of divorce, the contingent tax will be \$4,087.55 [(\$74,319 ÷ 2) x 11%].

Present value of possible contingent taxes

	<u>Contingent tax</u>	<u>Contingent Tax</u>
Son survives the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) and acquires the remainder interest in the property	-0-	-0-

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Daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) survives the son and acquires the remainder interest in the property	\$8,175.09	\$1,599.29
Present value - based upon the life expectancy of the decedent's son - 28 years - factor 28 years - .195630		
Remainder interest in the property shared equally by son and daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007)	\$4,087.55	\$2,282.47
Present value - based upon a sale of the property or a divorce - assume sale or divorce in 10 years - factor 10 years - .558395		

Probability of possible contingent taxes

The most probable contingent tax (\$4,087.55) will result from the passage of the remainder interest in the property to the decedent's son and daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) in equal shares as a result of a sale or divorce. The contingent tax (\$8,175.09) resulting from the decedent's daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) surviving the son and acquiring the remainder interest in the property also has a relatively high probability of occurrence. The probability of the decedent's son surviving the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) and acquiring the remainder interest in the property, which would result in no contingent tax liability, is, however, very low.

Computation of the compromise tax

The compromise tax offer in this situation will be determined by assigning a percentage chance of probability to the present value of the contingent tax resulting from each possible distribution of the remainder interest in the real property. The proposed compromise tax would be \$1,895.08 determined as follows:

	Present value of contingent tax	Percentage probability of occurrence
Son survives the daughter-in-law/female domestic partner of a son (after 07/10/2004)/female civil union partner of a son (after 02/19/2007) and	-0- x	5% = -0-

GUIDE FOR COMPUTATION OF THE COMPROMISE TAX

acquires the remainder
interest in the property
Daughter-in-law/female
domestic partner of a son
(after 07/10/2004)/female
civil union partner of a son
(after 02/19/2007) survives
the son and acquires
the remainder interest in the
property

1,599.29 x 40% = 639.72

Remainder interest in
property shared equally by
son and daughter-in-law/
female domestic partner of
a son (after 07/10/2004)/
female civil union partner
of a son (after 02/19/2007)

\$2,282.47 x 55% = 1,255.36

\$1,895.08

Points to Remember

1) If distributions, at the discretion of a trustee, may be made from a trust for the education, health and/or support of a beneficiary, the estate representative should, to the extent possible, advise the Branch of the status of the beneficiary's education, health and/or financial condition.

2) If the probability of a tax becoming payable on the contingent portion of an estate is remote, the Branch may determine that the probability of tax is too remote to compromise and exempt the contingent portion of the estate from tax.

3) If the amount of contingent tax that will become payable upon the occurrence of contingencies is known (for example, all potential beneficiaries are Class D and will receive at least \$500 but less than \$700,000 each), a compromise tax offer may be made on the basis of the present value of the tax. Situations of this nature are contingent because, although the amount of the tax liability is known, the date upon which it will become payable, the beneficiaries, and the amount to be received by each beneficiary is dependent upon the occurrence of contingencies.

4) A beneficiary's unrestricted power to invade the principal of a trust subjects the principal of the trust to the immediate assessment of tax. *Laffey Estate v. Taxation Division Director*, 8 N.J. Tax 100.

5) The right of a beneficiary to request that a limited sum be paid to him or her annually, but with no right to terminate the trust, is a contingent interest for inheritance tax purposes. N.J.A.C. 18:-8.21(b).

6) When real property is devised or transferred to a husband and wife/domestic (after 07/10/2004)/civil union partner (after 02/19/2007) as tenants by the entirety, a life estate computed on the basis of the devisee or grantee with the lesser life expectancy is vested, in equal shares, and subject to the immediate assessment of tax. The remainder is contingent in nature and may be settled by the agreement to and payment of a compromise tax. N.J.A.C. 18:26-8.12

7) A subsequent life estate (life estate taking effect upon the death of a prior life tenant) is always a contingent interest. It is contingent because the subsequent life tenant must survive the original life tenant in order to acquire his

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or her subsequent life estate. The value of a subsequent life estate is determined by subtracting the value of the life estate of the original life tenant from the value of the life estate of the subsequent life tenant. If the subsequent life tenant has a life estate factor equal to or less than the original life tenant, his or her subsequent life estate has no value for inheritance tax purposes. The present value of the contingent tax that may become payable on a subsequent life estate is based upon the life expectancy of the original life tenant.

8) Interests in an estate which are subject to a power of appointment are usually contingent in nature and the tax on these interests does not become due and payable until the power is exercised. If, however, a general power of appointment may be exercised during the lifetime of the holder of the power in favor of himself, his estate, his creditors, or the creditors of his estate, the tax is immediately due and payable. N.J.S.A. 54:36-4, N.J.A.C. 18:26-5.12 and N.J.A.C. 18:26-8.24.

9) If a possible contingent tax is based upon equal annual distributions from a trust to a beneficiary during his or her lifetime, the Branch uses one-half of the beneficiary's life expectancy in the determination of the present value of the tax. If, however, the beneficiary of a trust acquires a right to a distribution only upon the death of a life tenant, the full life expectancy of the life tenant is used in the determination of the present value of the tax.

10) If two or more years have elapsed since the decedent's date of death, the current ages of life tenants and beneficiaries should be used in calculating the present value of the tax that may become due upon the occurrence of contingencies.

11) If tax on the contingent portion of an estate is not settled by the payment of a compromise tax, the administrator, executor, trustee, or other proper representative of an estate must file a bond, subject to the approval of the Director, Division of Taxation, in twice the highest amount of tax that may become payable upon the occurrence of the contingencies. N.J.S.A. 54:36-6 and N.J.A.C. 18:26-9.16(c)