Morgan Stanley

Taking Charge of Your Wealth

How to Plan for Your Life and Your Legacy

INTRODUCTION

A well-built strategic wealth plan should incorporate the most appropriate and effective wealth management strategies available to you, so that your resources benefit the people and the causes you care about. To develop such a plan, you need to carefully consider what you have and your specific circumstances, the effect of taxes, and how to structure your wealth and any contributions to support the future you envision — all while avoiding family conflict and unnecessary, expensive administrative burdens. With dedicated professional support, these measures present an opportunity to take stock of what you have and take control of your life and your legacy.

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TAKE CHARGE OF YOUR ESTATE PLAN

An estate plan is a series of conscious choices that build toward a future that is sound and a legacy that reflects your life and values.

Everyone Needs a Plan

Key Questions

DO you have the basic tools in place?

DO you have a clear picture of your net worth?

ARE your assets properly titled?

WHAT future circumstances will your estate need to address?

Taking charge of your wealth means more than saving on estate taxes. An estate plan that is truly customized to your needs will reflect the particular circumstances of you and your family—and should take into account as many contingencies as possible. It is an opportunity to pass on values, communicate about those values and protect against things that can get in the way, like outdated strategies, administrative burdens and conflict among heirs.

If you do not have a plan, your state and the federal government will make a plan for you. So, for example, if you die without leaving a will, state law will decide who gets what after your debts are repaid. Even if you have a will, a lack of planning may lead to substantial tax burdens and time delays, potentially causing a significant reduction in the amount of your wealth that can be transferred to your intended beneficiaries. Please contact your legal and tax advisors for assistance.

The Basic Tools

An estate plan uses an array of specialized financial and legal tools. The tools summarized below are commonly found in estate plans, and you may find some of them useful for your plan.

A will is a legal document that provides instructions, upon your death, for the distribution and management of your property. If you die without a will, your assets are distributed according to state law, which may not correspond with your wishes. Take the case of a business owner who dies without a will. A judge could decide to split ownership of the firm between the business owner's three children. It turns out that two of the children want to run the business while the third wants to be bought out of his ownership interest—even if the company has to be sold. Effective estate planning starts with a well thought out will and can better prepare your heirs for the future. You should work with your attorney to execute an effective will.

A power of attorney is a legal document that can give another person legal authority to act on your behalf. Depending on your state of residence, the individual you name as attorney-in-fact may have limited or more general powers. If you wish the person you chose to have the legal capacity to act on your behalf should you become incapacitated, you should establish a durable power of attorney (DPOA), which maintains effect in the case of incapacitation. Both a power of attorney and DPOA end at death. Another choice is a springing power of attorney, which takes effect only when you become incapacitated or upon another triggering event. If you choose this option, be sure the document clearly spells out the circumstances under which the power of attorney would "spring" into effect.

A trust agreement is a legal document that creates a trust—i.e., a separate entity for the purpose of managing assets. As grantor (also called creator, settler or trustor), you name a trustee who is responsible for overseeing the management of the trust assets and the fiduciary requirements of the trust agreement, as well as a successor trustee who may step in should the initial trustee be unable or unwilling to serve as trustee. Finally, you choose one or more beneficiaries who will be entitled to receive assets from the trust. If you wish to maintain greater control over your assets, **a living trust** allows you to act as trustee until such a time as you become incapacitated or relinquish stewardship of the trust to your successor trustee.

An executor or personal representative is a person or institution named in a will and appointed by the probate court to carry out its instructions. The executor helps inventory possessions and determines their value. In addition, the executor helps to pay bills and debts, prepare final tax returns and ultimately distribute estate assets according to the will.

A conservator or guardian is an individual you name as being responsible for the care and well-being of another, often a minor child. If the conservator is named by a court, then court supervision will be required.

A health care proxy allows you to name anyone to act on your behalf to make health care decisions. Whether you choose to assign this power to a family member or other trusted individual, it is important to be aware of restrictions presented by the Health Insurance Portability and Accountability Act—a federal law passed to help protect health care information—that makes it more difficult for your proxy to deal with health matters once you have become incapacitated. Consider including a HIPAA Release Form, or adding HIPAA language into your health care proxy that allows your health care agent to access your health care information for dealing with insurance matters when you cannot do so.

ANSWERS TO THESE QUESTIONS MIGHT HELP DETERMINE THE ELEMENTS YOU NEED IN YOUR PLAN:

- Does your estate plan provide for an income stream for your spouse and/or children?
- Do your beneficiaries have the ability to carefully manage substantial inherited assets?
- Are your beneficiaries prepared to handle the taxes on your estate?
- If you have an estate plan, has it been updated to reflect recent tax law changes?
- Have you protected any government assistance being received by a child with special needs?
- Do you have a continuity of management plan in place for your assets should you become incapacitated?
- If you own a business, do you have a strategy in place for its smooth transition and continuous operation?
- Are you and your spouse U.S. citizens?
- Do you have a nontraditional or blended family?

YOUR ANSWERS MIGHT indicate that not all of your concerns will be addressed through the basic tools and titling of assets or that you are in need of more sophisticated planning. Your Financial Advisor can help provide solutions and to connect you with the right specialists to address your specific circumstances and priorities.

Calculating Your Net Worth

One of the first steps in the wealth planning process involves taking inventory of your current financial picture:

- What is your household income?
- What are the values of your securities, retirement plans and real estate?
- What is the death benefit of the life insurance you own?
- Which assets can be quickly converted to cash?
- What do you owe on your mortgage, home equity loan or other debt?
- If you are a business owner, what is the current value of your whole interest in the firm, including real estate holdings?

Put simply, to determine your net worth, add your assets, then subtract your liabilities (see worksheet, page 9). Assets typically include checking and savings accounts, stocks, bonds, real estate, closely held businesses, limited partnerships, jewelry, artwork and other valuable personal possessions, annuities and insurance policies. Liabilities include all personal debts (e.g., mortgages and home equity loans, credit card balances, car and personal loans).

The Value of Liquidity

A timely opportunity, an unplanned expense or ongoing cash flow needs can all mean that you find yourself requiring more liquidity. Instead of selling assets and potentially disrupting your long-term investment goals, you may want to consider borrowing what you need via a mortgage, securities-based loan or tailored loan. In the case of an investment, a comparison between the projected potential rate of return with the interest rate on a loan can help guide your decision. If you have embedded capital gains in your portfolio, a loan can allow you to meet your tax liability without disrupting your investment strategy. Borrowing also can help reduce exposure to income, capital gains, inheritance and wealth taxes. In some cases, families choose to borrow money and lend it to their children through intra-family loans so as not to part with specific assets—such as a business—that they want to own or control throughout their lives for tax purposes or other reasons. Further, parents can forgive the loan over time using their annual gift tax exclusion. Please consult your legal or tax advisor for assistance.

Consider a Life Insurance Trust

When your life insurance policy is owned by an irrevocable trust rather than by you, the life insurance proceeds paid at your death are not considered part of your taxable estate. Most often, you would choose to make one time or annual gifts to the trust to cover the insurance premiums, and the beneficiaries you name in the trust will receive the death benefit proceeds through the trust. Generally, they will receive the death benefit income tax free and estate tax free. You may choose to start with an existing policy in which you are the owner and the insured and then transfer it to an irrevocable life insurance trust. In this scenario, a

Insure for the Known and the Unknown

INSURANCE CAN BE A POWERFUL ASSET

Key Questions

HAVE you incorporated life insurance into your legacy planning?

WOULD a life insurance trust better protect your beneficiaries?

HAVE you taken steps to protect your estate from health care costs?

COULD life insurance help you transfer your business to children or fund your charitable objectives?

Life insurance and other types of insurance can effectively remove assets from your estate, help protect your heirs from debt or estate tax obligations and help prepare you for unforeseen health events that can quickly drain funds intended to last beyond your lifetime. However, any life insurance policy owned by you generally will be included as part of your taxable estate. Be sure to consult with your tax advisor when considering insurance strategies.

"three-year look-back rule" applies. This rule states that if you were to die within three years of the date of the policy's ownership transfer, the death benefit would be included as part of your taxable estate. Additionally, if you are transferring ownership of an existing policy that has cash value to an irrevocable life insurance trust, it may create a gift tax problem, so consult with your tax advisor before making a transfer of this type.

Another issue involves how premiums are paid. Though you can make annual gifts to the trust to cover premium payments, these gifts must be considered "present interest" gifts (not "future interest" gifts) to qualify for the annual $14,000* gift tax exclusion. To make the gifts "present interest" gifts, beneficiaries of the trust must have limited power to withdraw the gifted funds (Crummey Powers). Written notice (Crummey Letters) must be given to the beneficiaries of the trust relaying that they have a right, within a certain amount of time (usually 30 days), to withdraw their share of the gifted funds from the trust.

*$14,000 is the annual gift tax exclusion for 2014. This amount is indexed for inflation.

Protect Your Beneficiaries

Beneficiaries named in a life insurance trust (usually family members) receive life insurance proceeds promptly, income-tax free and without the payouts becoming a matter of public record. Also, life insurance proceeds often represent a better source of funds for increased liquidity when compared with other alternatives to raising money, such as the forced sale (likely at a discount) of existing assets or borrowing. The following are common uses of life insurance proceeds for your estate:

- **Liquidity for Estate Settlement Costs.** Life insurance helps to ensure your family is not burdened by significant debt from taxes or estate-related liabilities. Keep in mind that estate taxes generally must be paid within nine months of your death, in cash, although with proper planning (discussed below), a married couple may be able to defer payment of estate tax until nine months after the second death. Borrowing is another option for liquidity to pay estate taxes, which would allow the portfolio of the deceased to remain intact. These options should all be weighed by you and your tax advisors.
- **Funds for Medical and Funeral Costs.** The high cost of medical and assisted living care is often passed to a decedent's family. Funeral expenses could also be absorbed by family members. Life insurance is one way to provide funds to pay these debts.
- **Income for Family Members.** Proceeds from life insurance can be used by your spouse, children, grandchildren or other family members who need continued financial support.
- **Funds for a Family Foundation or Family Business.** Life insurance can be used to fund the transfer or continuous management of your business — or to fund the formation of a family foundation.

Combine Strategies

Charitable Remainder Trusts. Combining a life insurance trust with a charitable remainder trust is a common strategy used by individuals to replace the wealth that will eventually be transferred to the charity. Family members are often named as beneficiaries of the life insurance trust, and may receive the insurance proceeds income and estate tax free. In addition, they would be the income beneficiaries of the charitable remainder trust.

Survivorship Life Insurance. If both you and your spouse are U.S. citizens, using your unlimited marital deduction, you can leave any amount of assets to your surviving spouse free of gift or estate tax. However, this merely postpones estate taxes until the death of the surviving spouse.

One way to lessen this burden is to purchase survivorship life insurance or "second-to-die" insurance. As its name suggests, this type of insurance covers two lives with proceeds payable only after the second death. Some advantages include:

- Potentially lower premiums.
- Medical underwriting standards that may be eased because proceeds are paid at the second death.
- A longer period of coverage for the surviving spouse.

Additional Insurance Planning

The rising cost of health care and the risk of becoming disabled at some point in your life make health events a particularly important aspect of your estate plan. Further, many people do not consider that their future stream of income is one of their most valuable assets. If not properly planned for, prolonged illness or disability can severely lessen the funds available for other elements of your wealth plan and substantially diminish the size of your estate, upsetting tax and other strategies you may have put in place.

Disability Income Insurance. If you are working and responsible for some or all of your family's financial security, you may want to consider purchasing disability income insurance. Disability insurance helps to replace a portion of lost income that occurs as a result of a long term illness, thereby helping you avoid bankruptcy or the loss of a significant amount of your wealth to pay for living and medical expenses.

Long Term-Care Insurance. A prolonged illness can pose a major threat to the future well-being of your estate if you are not prepared to pay for necessary care over time, such as daily living assistance or nursing home care. One way to protect your estate from a potentially devastating loss of a significant amount of your wealth is through the purchase of long-term care insurance. Many policies cover in-home care as well as nursing home care. Long-term care policies usually require an annual premium for life, but some insurance companies offer limited-pay options that are paid up in 10 years.

Maximize Your Retirement Assets

Key Questions

DOES your retirement income plan account for federal, state and transfer taxes?

ARE you positioned against potentially high income taxes and estate taxes?

DO your stock options present an undue risk?

HAS your retirement income plan been updated to reflect recent tax law changes?

How you handle distributions matters

Retirement assets may be among the major components that make up your estate, and federal and state income taxes and transfer taxes can be significant. One way to avoid the possibility of having your retirement assets taxed at your death is to use them or give them away during your life. After all, the primary reason individuals save for retirement is to have a ready source of money available when they stop working.

Minimize Income and Estate Taxes

Both you and your beneficiaries can enjoy income-tax free distributions if you have converted any assets held in a qualified retirement plan or Traditional IRA to a Roth IRA. Your choice of a beneficiary for your retirement assets also can impact whether any taxes are due on non-Roth assets that are inherited. Deferring any tax liability might be possible, depending on the beneficiary.

YOUR SPOUSE. Your surviving spouse who inherits your IRA can roll over the funds from your IRA into his or her existing IRA or establish a new IRA and name his or her own beneficiaries.

NONSPOUSE. You can name someone other than your spouse as beneficiary of your IRA and that individual may be able to stretch out distributions from the IRA over their own life expectancy. This may allow for smaller payments from the IRA and a longer period of income tax deferral within the IRA.

MULTIPLE BENEFICIARIES. You may be able to name multiple beneficiaries of your IRA. This will generally allow separate inherited IRA accounts to be established for each designated beneficiary. Minimum distribution requirements applied to each beneficiary may be based on his or her own life expectancy, not the group as a whole.

TRUSTS. For maximum control of retirement assets, you may want to consider naming a trust as beneficiary of your IRA. To avoid acceleration of the required minimum distribution of the retirement assets, all of the following conditions must be met:

1. The trust must be irrevocable at your death and valid under state law.
2. The beneficiaries of the trust must be identifiable.
3. All beneficiaries must be individuals.
4. A copy of the trust must be provided to the custodian of the IRA.

If you are choosing a beneficiary for your retirement account or if you have inherited assets in a retirement account, be sure to seek the advice of a qualified tax professional before making any decisions that may have tax consequences.

Unless your estate is named as the beneficiary, your retirement accounts will not have to go through probate. The beneficiaries you name will notify the account custodian whether they wish to roll over the retirement accounts into an IRA, if allowable, or take a lump-sum distribution.

CHARITIES. You may wish to name a charity as beneficiary of your retirement assets to avoid estate and income tax issues at your death. If one or more charities are the only beneficiaries of your IRA, you will qualify for a charitable deduction against the value of your gross estate.

Time Your Distributions

The IRS requires that you begin withdrawing from your non-Roth retirement accounts by April 1 in the year following attainment of age 70½. However, certain individuals who are still working may be able to defer distributions from their qualified retirement plans. The amount the IRS mandates that you withdraw (called a "required minimum distribution") depends on a number of factors, such as life expectancy.*

Manage Your Employee Stock Options

Employee stock options may represent a significant portion of your current or future wealth, but options involve certain risks, including:

- Failure to exercise in-the-money stock options while still employed, thus allowing them to expire.
- Failure to exercise the options upon termination of employment, retirement, disability or death within allowed time frames.
- Failure to contact a tax advisor regarding the tax implications of exercising stock options (an important consideration if the alternative minimum tax applies).
- Failure to diversify a portfolio composed too heavily of company stock.

YOUR MORGAN STANLEY FINANCIAL ADVISOR CAN WORK WITH YOU AND YOUR TAX ADVISORS ON SPECIFIC STRATEGIES INVOLVING STOCK OPTION HOLDINGS.

Incentive Stock Options (ISOs): Ordinary income taxes do not apply to ISOs at either the grant or exercise of the options. ISOs may enjoy more favorable capital gains tax treatment when the acquired stock is sold, providing the holding requirements of two years from the date of grant and one year from the date of exercise — which can run concurrently — have been met. ISOs cannot be transferred.

Nonqualified Stock Options (NSOs): With NSOs, ordinary income taxes do not apply when the options are granted, but they do apply when the options are exercised. Capital gains taxes may apply when the acquired stock is sold.

Bargain Element: This is the difference between the exercise price and the market price at the date of exercise and is a preference item for calculating the alternative minimum tax (AMT).

* Exceptions from distribution rule

Title Your Assets

Title is how you own something, which helps to determine how you can give it away, sell it, borrow against it, mortgage it, use it during your life and pass it on to heirs at your death. During your planning process, you may decide to retitle some of your assets to protect them from taxes or ensure a smoother transition to beneficiaries. Titling assets in certain revocable and irrevocable trusts may provide you with more control and flexibility to accomplish these goals.

Regardless of the size of your estate and its complexities, it's a good idea to meet with your attorney to review your current situation and the possibility of retitling assets.

The most common forms of ownership established with a title include:

SINGLE OWNERSHIP—This is the most basic form of ownership, under which one person owns the property. It is easy to establish, and generally offers no limits on selling, gifting or passing property on through your will or trust. However, it does not generally avoid probate, which is a public legal process and may well be a lengthy process.

JOINT TENANCY—Joint tenancy with right of survivorship (JTWROS) allows two or more individuals to own the same property. The property automatically passes to the surviving owner(s) upon one owner's death. This form is most commonly used by couples (married or not) to own bank and brokerage accounts and real estate, is usually available in noncommunity property states and is relatively easy to create. While the property avoids probate on the death of the first individual, probate is, in essence, merely postponed until the death of the surviving owner. There may be gift tax implications and problems may occur if a co-owner later becomes incapacitated.

TENANCY BY THE ENTIRETY—This form of ownership is exclusively for married couples. It is similar to JTWROS except that, generally, property cannot be sold to pay creditors unless judgment is entered against both spouses.

REVOCABLE LIVING TRUST—A legal arrangement wherein one arranges for the transfer of assets but maintains full use and control of assets during life. A revocable living trust is used primarily as a way to avoid probate. It offers privacy, assets are transferred quickly and it provides for a plan against incapacity. However, costs associated with creating the trust document can be high, and the trust usually does not reduce estate tax liabilities.

COMMUNITY PROPERTY—Assets acquired during marriage in certain states are community property, half owned by each spouse, usually excluding assets acquired by gift or inheritance. Upon death, only the decedent's half of community property is taxed. This is often thought to be the fairest system to both spouses.

Taking Inventory of Your Estate

ASSETS

Stocks, bonds, mutual funds	$_______________
Bank accounts	$_______________
Retirement accounts (IRAs, 401(k)s, etc.)	$_______________
Life insurance proceeds	$_______________
Annuities	$_______________
Real estate	$_______________
Personal property (jewelry, belongings, etc.)	$_______________
Automobiles and other vehicles	$_______________
Business interests	$_______________
Other/miscellaneous	$_______________
Total Assets	$_______________

LIABILITIES

Residential mortgages	$_______________
Personal debt (loans, credit cards, etc.)	$_______________
Business-related debt	$_______________
Total Liabilities	$_______________

NET WORTH

(total assets minus total liabilities)

Your resulting net worth is the approximate value of your taxable estate. $_______________

Protect Your Family's Assets

Key Questions

HAVE you safeguarded your assets?

DO you want control over your estate after you are gone?

WILL your assets be transferred to your heirs quickly and privately?

ARE you well positioned to minimize gift and estate taxes?

A good estate plan covers every aspect of your legacy. It is built on a series of choices focused on a conscious review of all discernible possible future circumstances, how you will meet those situations in your lifetime and how your legacy will be stewarded by your choices and by future generations. Trusts are one of the most flexible tools at your disposal for accomplishing all of this.

Trust strategies for transferring assets

Understand Your Needs

Trusts are tailored to meet varying personal, tax, financial, investment and estate planning needs. Some reasons you might consider establishing trusts include:

CONTROL—As grantor, you, along with your attorney, will draft a trust agreement that will govern the trust. The trust agreement will dictate how distributions are made (and to whom) and instruct how trust assets are used or managed. You also name the trustee, any successor trustees and beneficiaries. You decide how to fund the trust and can structure it to provide wealth management benefits during your life or after your death.

CONTINUITY OF MANAGEMENT—Trusts can provide you and your beneficiaries with uninterrupted management of your assets, and your personal and financial affairs can be maintained should you become incapacitated or unable to manage your affairs.

SAFEGUARDING ASSETS—Assets transferred to many trusts can be protected from family disputes, spendthrifts and creditors. Assets transferred to the trust must be retitled in the name of the trust.

AVOIDING PROBATE—Probate is the court-supervised process of transferring assets held in your name at your death, excluding contractual assets (e.g., life insurance policies, annuities and retirement plans), jointly owned assets and assets held in trust. Probate processes vary from state to state, can take several months to several years to complete and are a matter of public record. Assets retitled to most trusts avoid the time delays and publicity of probate.

ASSISTANCE WITH LIFE-CHANGING EVENTS—Trusts are typically established or updated in conjunction with life-changing events, such as births, marriages, serious illnesses or deaths, or to help address financial issues such as inheritances, the sale of a business, significant savings needs (e.g., retirement or college), the special needs of a disabled family member or tax law changes.

ASSET TRANSITION—Most trusts are used to transfer assets to beneficiaries in a prompt and efficient manner.

REDUCED TAX LIABILITIES—Revocable trusts do not generally have any impact in reducing tax liabilities. However, assets placed in most irrevocable trusts are not counted as part of your taxable estate (thus reducing estate tax liabilities), and certain trusts can provide you with significant tax deductions. There may be gift taxes, however, on the transfer of assets to the trust.

PROFESSIONAL ASSET MANAGEMENT— The trustee can work with your Morgan Stanley Financial Advisor to gain access to leading investment advisory platforms so that your trust assets can receive full time, experienced investment management services.

When Does Professional Trust Management Make Sense?

The many responsibilities of trust administration—making payments to beneficiaries, paying taxes, ongoing reporting—require an eye for detail. The job may last for decades and often involves many difficult decisions about how best to balance complex family and financial matters.

Charged with carrying out both the spirit and the letter of the trust, trustees are frequently chosen from among family members. In theory, this makes good sense. In practice, however, the demands of administering a trust can become cumbersome and the risks can be significant—sometimes including considerable financial liabilities.

When considering who to choose as a trustee, it is particularly important to explain your views about the needs of the family and your perspective about the dynamics within the family. You want the trustee to have enough information so that he or she fully understands the responsibilities involved and can administer the trust as you would. Here are some of the most common tasks a trustee will be required to perform in accordance with the terms of your trust:

- Manage accounting functions such as quarterly reporting, allocation of receipts and expenses, filing of tax returns and segregation of income and principal.
- Disburse payments to beneficiaries.
- Collect income.
- Oversee investments, either by investing independently or by hiring a reputable outside manager.
- Maintain a fiduciary commitment to act solely in the best interests of the trust.

You may be best served by retaining a seasoned professional to shoulder these responsibilities. A professional trustee has the time, expertise, continuity and administrative skills and resources to properly manage your trust. A professional trustee is usually better able to not only manage your trust in an impartial manner, but also to be perceived as managing your trust in an impartial manner—an important consideration in avoiding potential disputes among children or other beneficiaries. Your Morgan Stanley Financial Advisor can connect you with a trust specialist who can assist in reviewing the needs of your trust and guide you to a number of solutions that may ensure that the provisions of the trust are met.

Customize a Trust Structure

Several excellent trust strategies exist to help you protect and transfer assets among your immediate family members. Some of these include:

Revocable Living Trust—A revocable living trust is a flexible estate planning tool, used to help individuals avoid probate and prepare against incapacity or death. It is "living" because it is created during your lifetime and "revocable" because you can change or terminate the revocable trust at any time. Upon death, the trust becomes irrevocable. Periodically, asset titles should be checked to verify they are held in the trust's name and that the trust is funded to take advantage of all estate planning benefits.

Irrevocable Trust—An irrevocable trust can be a tax planning tool. Unlike a revocable trust, assets in an irrevocable trust are generally not part of your estate and so would not be subject to estate taxes. Certain irrevocable trusts can also provide income tax savings. You cannot change the provisions of an irrevocable trust once it is established. However, you can usually change the trustee.

Testamentary Trust—A testamentary trust is established under your last will and testament and does not go into effect until your death. Assets are subject to probate because they are being transferred via your will. Like any other provision of your will, testamentary trusts can be changed at any time during your life, but become irrevocable at death.

Children's Trusts—Several different vehicles are used to make significant controlled gifts to children. Minor's trusts, known as 2503(c) trusts, often provide more flexibility and control of college savings than direct gifts and custodial savings accounts. Trusts that are structured to allow the beneficiaries to withdraw contributions, generally known as Crummey trusts, offer longer term control of assets and potentially greater income and estate tax-saving opportunities but carry higher administrative costs.

QTIP Trust—A qualified terminable interest property trust (QTIP) allows the deceased spouse to provide lifetime income for the surviving spouse and still control the ultimate distribution of trust assets for selected beneficiaries, and it qualifies for the estate tax marital deduction. A QTIP trust may help the decedent spouse protect his or her assets from being transferred to the surviving spouse's beneficiaries against the decedent spouse's wishes. QTIP trusts are also useful in second marriage situations when there is a desire to provide income and perhaps some principal to a surviving spouse during his or her life, with the assets remaining in the trust at the surviving spouse's death going to the children of the decedent.

Dynasty Trust—A dynasty trust is a multigenerational, irrevocable trust that seeks to provide income over time to beneficiaries, as well as to preserve the trust principal so it can grow over years and generations. While most states limit the period during which a trust can exist, when established in certain states, a dynasty trust can last for multiple generations, in perpetuity.

Credit Shelter Trusts—Also known as bypass trusts, unified credit trusts, family trusts and A/B trusts, this type of trust can ensure that each spouse's exemption from estate taxes is fully used. Credit shelter trusts are typically funded at death and established as a testamentary trust via a will or revocable living trust. The assets transferred are usually equal to the estate tax exemption for each individual.

Credit shelter trusts often pay income to the surviving spouse for life, and the trustee often has the right to invade principal for certain health, support and maintenance needs of a surviving spouse or children. Upon the death of the surviving spouse, the total amount of assets remaining within the trust often bypass the estate and are either distributed outright to designated beneficiaries, usually children, or held in further trust until some later time, free of federal estate taxes.

The Tax Payer Relief Act of 2012 established "portability" of the federal estate tax exemption between married couples. Portability means that if the first spouse dies and the value of his or her estate does not require the use of all his or her federal exemption from estate taxes, then the amount of the exemption that was not used for the deceased spouse's estate may be transferred to the surviving spouse's exemption. He or she can use the deceased spouse's unused exemption plus his or her own exemption. For example, suppose one spouse passes his entire estate to his spouse using the unlimited marital deduction and therefore does not use any of his $5,340,000 estate tax exemption. That amount will be added to the surviving spouse's $5,340,000 exemption, in turn giving the survivor a $10,680,000 exemption.*

Some may conclude that portability eliminates the need to set up a credit shelter trust. However, a credit shelter trust is still useful for removing appreciation from the estate of the spouse and to address state exemptions, affirmative election, complications upon remarriage, creditor protection and additional exclusions for gift or GST taxes.

*These amounts are indexed for inflation.

Establish a Tax and Giving Strategy

Key Questions

IF you are charitably minded, are you taking advantage of the tax benefits of charitable giving?

HAVE you protected trust beneficiaries from tax obligations?

CAN your family benefit while supporting causes you care about?

COULD a family foundation enrich your family and your legacy?

Gifting, giving and tax planning

More than just a matter of earmarking amounts, a comprehensive tax and giving strategy can offer benefits for you, your beneficiaries and the causes you care about. The way you structure your charitable contributions, as well as the form your gifts and contributions take, can determine whether a gift holds its value once it is transferred to the recipient, provides for you while you are living and effectively offsets your tax burdens to its fullest potential.

Maximize Charitable Giving

How you structure the portion, if any, of your estate centered on charitable giving will usually involve a combination of approaches. Here are a few of the options available to you as you construct your giving strategy:

Planned Giving Strategies—Since the early 1900s, Congress has encouraged philanthropy by granting favorable tax treatment to most charitable contributions. Individual donors generally make up the lion's share of charitable contribution sources because of the tax advantages available for making such gifts. Planned giving arrangements not only ensure that your favorite charity or institution receives a portion of your estate, but they also provide you and your family with a tax efficient way to leave a lasting legacy.

Outright Gift—An outright gift to a favorite charity can produce an income tax deduction if the gift is made during your lifetime, or it can reduce your taxable estate if made at your death. However, you generally have no control over how the gift is used, nor can you receive any other financial benefits from this strategy.

Donor-Advised Fund—As a tax-qualified public charity, a donor-advised fund allows you to recommend (but not command) how contributions will be distributed to the various charitable organizations you select. Contributions to a donor-advised fund are tax deductible in the year the contribution is made. A donor-advised fund does not provide you with an income stream from the contributions you make to the fund.

Charitable Gift Annuity—With a charitable gift annuity, you can receive guaranteed distributions for life in exchange for making a direct gift to a charity. Distributions are paid in the form of an annuity that provides periodic payments to you in equal amounts. Part of each payment is a return of your gift, so only a portion is taxable as ordinary income. You can take a charitable income tax deduction in the year you make the gift regardless of when you begin receiving income, but the deductible amount is reduced by the value of the annuity you retain.

Charitable Remainder and Charitable Lead Trusts

Charitable Remainder Trust

- A **charitable remainder trust** allows you to donate funds qualified for the charitable contribution deduction and then pay distributions to you, your spouse or other beneficiaries for a predetermined period before transferring the remaining amount in the trust to the charity or charities of your choice. Created by Congress in 1969 (Tax Reform Act of 1969), a charitable remainder trust is most often employed by families looking to provide for charity while at the same time providing an economic benefit to themselves. These trusts remain very popular as a result of the significant financial and estate planning benefits they offer and their income tax, estate tax and capital gains tax advantages.

Charitable remainder trusts are irrevocable trusts that can help you accomplish the following:

- Defer capital gains taxes on the sale of highly appreciated assets. Because a charitable remainder trust is a tax-exempt trust, appreciated assets that you transfer to it may be sold by the trustee within the trust without incurring immediate capital gains taxes.
- Increase spendable income from unproductive investments, while diversifying those investments. Proceeds from the internal sale of assets transferred to a charitable remainder trust can be reinvested in more diversified, income-producing investments. You, your spouse or the other beneficiaries you name can receive distributions from the trust for either a term of years, not to exceed 20, a lifetime or, in some cases, for multiple lifetimes.

The distributions can be either an annuity interest **(charitable remainder annuity trust)** or a unitrust interest (charitable remainder unitrust). Each has liabilities and benefits. You can make additional contributions to a charitable remainder unitrust, while you cannot make additional contributions to a **charitable remainder annuity trust**, because the annuity payment is for an established amount and cannot be changed. However, with a charitable remainder unitrust, there is always the possibility that investment performance of the trust's assets and prior distributions could decrease the payout amount in any given year.

- Qualify for a current year charitable income tax deduction. Even though the charity will not receive your contribution until a future date, a portion of your irrevocable gift qualifies for a charitable income tax deduction in the year in which you fund the trust.
- Make a substantial contribution to your favorite charity or charities. After your charitable remainder trust helps you and your family, the remaining assets may help a worthy cause of your choosing, which will be named as a charitable remainder beneficiary under your trust. This enables you to leave a lasting legacy to your favorite philanthropic organization.

Reduce or eliminate estate tax liabilities. If the income beneficiary, or beneficiaries, of a charitable remainder trust is the donor or the donor and his or her spouse, then assets transferred to a charitable remainder trust at the time of your death may not be taxed as part of your net estate. Your estate or your surviving spouse's estate will be entitled to a charitable deduction against the value of your gross estate. Thus, charitable remainder trusts may be useful estate tax-saving tools.

Charitable Lead Trust

- A charitable lead trust is essentially the opposite of a charitable remainder trust. Using either an annuity or unitrust income payout structure, a charitable lead trust pays the charities first. At the end of the trust's term, the remaining assets are usually transferred to the donor's beneficiaries. Significant federal gift tax benefits may result if you establish a nongrantor charitable lead trust during your lifetime.

Family Foundations

You may wish to establish a family foundation, or contribute to a public one, during your lifetime or upon your death. Either choice offers the opportunity to create or access a perpetual vehicle for the management of your charitable wishes. Advantages of each type of foundation include the following:

PRIVATE FOUNDATION

- Funded solely by the grantor and his or her family.
- Contributions are generally tax deductible.
- Allows you to participate in the investment strategy and management of any distributions.

PUBLIC FOUNDATION

- Must be publicly supported rather than privately funded.
- Contributions are generally tax deductible.
- Can offer additional tax advantages.

A family foundation is a private foundation having a board consisting of family members. This structure offers the opportunity to organize the family foundation's mission around the values of your family, as well as create a space for family members to work together toward common goals while building a lasting legacy. Most family foundations are also flexible enough to evolve with your family over time, even across generations, all while providing substantial tax advantages.

Your tax advisor should explore with you whether creating a family foundation or supporting an existing public foundation makes sense for you, either during your life or at your death. If you choose to explore establishing your own foundation, your Financial Advisor can introduce you to a wealth of exclusive resources designed to help you create an institution that will have the impact you desire on your family and the causes you hold dear.

Keeping Money in the Family

Several effective family gifting strategies are available that allow you to transfer significant assets to family members while also retaining some control over the process and the use of those assets.

Grantor Retained Annuity Trust—A sophisticated gifting strategy, this irrevocable trust "freezes" the value of assets transferred to the trust for tax purposes at the time the trust is established. As the grantor, you still retain an interest in the assets transferred to the trust. The gift is the remainder interest in the trust assets that is designated to go to the named beneficiaries of the trust. If, over the term of the trust, the assets appreciate at a rate greater than assumed by the applicable IRS table (a rate established at the time the trust is set up), any excess appreciation passes to your beneficiaries free of gift and estate taxes. The tax-advantaged transfer to the trust is accomplished by the grantor retaining a stream of payments from the trust during its term, which is usually a set number of years. The grantor must survive the trust term for the gift (transfer) to be considered completed.

Qualified Personal Residence Trust—As one of the largest components of your estate, your home (or vacation home) may be an estate tax liability. A qualified personal residence trust (QPRT) may allow you to remove the value of your home from your estate while maintaining the right to live in the home for a number of years before ownership is transferred to your children, as beneficiaries of your trust, or another trust beneficiary.

A QPRT may hold title to your principal residence or vacation home if it qualifies as a personal residence for a term of years that you select. At the end of the term, the trust terminates and the residence is transferred to a beneficiary you name in the trust. During the term of the trust, you may continue to live in your home as you did prior to the transfer.

The QPRT can be drafted to include an arrangement that will allow you to continue living in the home, but you will have to agree to pay rent to the trust beneficiaries. The rent paid must be fair market value for a property of that type in that location. As long as you outlive the term of the trust, the value of your home will be excluded from your taxable estate. Plus, your retained interest in the home is subtracted from its fair market value subject to gift taxes and, if the home increases in value, the appreciation will not be subject to estate taxes.

"A qualified personal residence trust (QPRT) may allow you to remove the value of your home from your estate while maintaining the right to live in the home for a number of years before ownership is transferred."

Consider Your Special Circumstances

Key Questions

ARE you protected against legal claims and creditors?

IS there a transition strategy in place for your business?

IS there anyone in your life with special needs?

DO you have relationships that may not be fully recognized under current laws?

Account for those who depend on you

The management, protection and transition of your wealth is a unique and highly personal process based on your specific situation. Some needs and circumstances require more specialized estate planning solutions. The following represent strategies for special estate planning situations.

Protect Against Legal Liability

In today's litigious society, protecting assets from the claims of creditors is of growing concern. Asset protection planning involves organizing your personal and business affairs in a manner that protects assets from creditors without compromising your estate and financial plans already in place. Your homeowner, automobile and professional insurance policies may provide you with coverage that gives a certain level of protection. However, irrevocable trusts, family limited partnerships, limited liability companies and the titling of assets may represent more effective ways to protect your assets. Consultation with an asset protection specialist would be advisable to explore possible asset protection scenarios.

Safeguard Your Business

If a family-owned business constitutes a large part of your taxable estate, the lack of a transition strategy can result in the forced liquidation of family assets or sale of the business itself to cover estate taxes. Luckily, there are tools available to help you prepare.

BUY-SELL AGREEMENT—The primary purpose of a buy-sell agreement is to maintain the continuity of the business so that your designated successor avoids interference from other family members, while the value of your share of the business is shared among your beneficiaries in the proportions that you choose. A common funding vehicle for a buy-sell agreement is life insurance purchased by the business on the lives of the business owners.

FAMILY LIMITED PARTNERSHIP—This powerful tool features a variety of strategies including gift and estate tax planning, valuation discounting and creditor protection. If you name yourself as the general partner, you keep control of the assets and may then make gifts of limited partnership interests to children, grandchildren or other family members. Because limited partners have little influence on the business, limited partnership interests may be given at a discount, for tax purposes, which is meant to compensate for lack of share marketability and the limited partners' lack of control.

Account for Special Circumstances

Sometimes the circumstances of a specific heir call for additional legal attention. The following are just a few examples of situations that fall outside of conventional allowances and require specific provision in your estate plan.

DISABLED FAMILY MEMBER—Many disabled individuals receive government assistance that is based on family income and available resources, and gifts or financial support provided to the disabled individual may disqualify him or her from government assistance. A well-structured special needs trust with a third-party trustee is designed to provide benefits to the disabled individual that supplement, rather than supplant, government assistance. This type of planning can enable a disabled child or loved one to receive your support without causing the loss of this vital public benefit.

Unmarried Couples

Unmarried couples may need to be more aggressive with how they plan for their assets, both during lifetime and at death, and "basic" estate planning strategies may take on greater importance:

WILL—Include a "no contest" clause to prevent challenges from family members.

MEDICAL DURABLE POWER OF ATTORNEY—In some instances, in the absence of a health care proxy, only family members are allowed to make medical decisions on behalf of an ill partner. A health care proxy (also known as a medical durable power of attorney) allows an individual to name anyone to act on his or her behalf to make these decisions.

GUARDIANSHIP OF CHILDREN—For someone other than a biological or adoptive parent to have custody of a child, provisions in the biological mother's or father's will must explicitly appoint that person as guardian.

LIFE INSURANCE—If both partners already have life insurance, then separate irrevocable life insurance trusts can be created with the survivor and/or children as beneficiaries. In this scenario a "three-year look-back rule" applies. This rule states that if you were to die within three years of the date of the policy's ownership transfer, the death benefit would be included as part of your taxable estate. Additionally, if you are transferring ownership of an existing policy that has cash value to an irrevocable life insurance trust, it may trigger a gift tax, so consult with your tax advisor before making a transfer of this type.

DOMESTIC PARTNERSHIP AGREEMENT—This legal contract outlines the distribution of assets upon the termination of the relationship prior to death.

Same-Sex Married Spouses

Even given that the U.S. Supreme Court has overturned the federal Defense of Marriage Act, do not assume that living in, or having been married in, a state that allows same-sex couples to wed is sufficient for equal marriage benefits in all jurisdictions. Visiting or moving to a state that does not permit or recognize same-sex marriages can still create risks for legally married same-sex spouses. Examples include a lack of visitation and medical determination rights for a spouse, in the case of hospital admission, or a lack of parental rights for the nonbiological parent of a child in the household. Special consideration should be given to having on hand appropriate documents (e.g., health care proxies, powers of attorney, and children's birth certificates or adoption records) when traveling.

Noncitizen Spouse

If your spouse is not a U.S. citizen and thus does not qualify for the unlimited marital deduction, transfers above the exemption amount will be subject to estate taxes. A qualified domestic trust (QDOT) can enable estate taxes to be deferred until the death of the second spouse, just as they would be if both spouses were citizens. Special requirements apply, so be sure to consult with your tax advisor.

Alleviate Family Conflict

Between the evolving care needs of aging parents, the complexities of estate and trust administration and varying philanthropic passions, differences of opinion among your heirs are all but inevitable. Even greater than any tax impact, family conflicts carry a layer of emotional intensity that can complicate and derail even the most well thought out estate plan. More important, these conflicts can negatively affect the people and relationships you care about most.

However, while disagreements are more than likely, animosity and irreconcilable conflicts can be avoided. Whether consciously realized or not, your heirs each have expectations for how your legacy will affect them. As difficult as these conversations may be, discussing concerns and deciding on a process now can help avoid surprises down the road when the added stress of a major life transition makes communication even more difficult.

Your Financial Advisor can facilitate these important discussions so that these issues are addressed and such that each family member feels heard. He or she can also help you construct Family Mission Statements and other documents that provide clarity and structure to the process of resolving issues.

Update Regularly to Reflect Tax Law Changes

Outdated Provisions Undermine Your Legacy

Current Rates, Exclusions and Exemptions	2014
Maximum Gift, Estate and GST Rate	**40%**
Annual Exclusion for Gifting	**$14,000**
Applicable Estate, Gift and GST Examptions	**$5,340,000**
Annual Exclusion for Present-Interest Gifts From U.S. Citizen to Non-U.S. Spouse	**$145,000**

The balance achieved among trust, giving and insurance strategies for managing your wealth is specially structured to take full advantage of the limits and allowances provided for by tax laws. It is essential when new tax legislation is implemented or rates and limitations change that your plan is revisited to fully reflect the new laws.

You tax advisor can make sure you are aware of these changes when they occur and then, in conjunction with your Financial Advisor, you can discuss your options. Specific areas to revisit regularly include:

ESTATE TAX EXCLUSION—This is the amount excluded from federal estate taxes, which will continue to be indexed for inflation. Higher exemption amounts mean that formula clauses in wills may lead to unintended consequences, and the applicable exclusion is the same for the gift tax and generation skipping tax (GST).

MARGINAL RATES—For high-earning individuals, it is important to be aware of the rates that apply to different portions of your income so that you can appropriately manage how that income is allocated and, as much as possible, avoid the highest marginal rates.

PORTABILITY RULES—Portability of the federal estate tax exemption between married couples means that if the first spouse dies and the value of his or her estate does not require the use of all his or her federal exemption from estate taxes, then the amount of the exemption that was not used for the deceased spouse's estate may be transferred to the surviving spouse's exemption. This enables the surviving spouse to use the deceased spouse's unused exemption *plus* his or her own exemption when the surviving spouse later dies. As described in "Protecting Your Family's Assets," portability does not eliminate the many advantages of credit shelter trusts.

TRANSFER TAX LAWS—Transfer tax rates can affect the taxes owed on money that is transferred as a gift in a given year.

STATE LAWS—State death taxes can cause an additional expense in states that have death taxes that are not "coupled" with federal taxes, and these state taxes often present an added cost even if it is determined that no federal estate taxes are due.

New legislation usually requires that you ask yourself some new questions. In this instance:

HOW will you deal with transfer tax systems in states that impose estate taxes not coupled to the federal estate tax?

HOW can you most effectively use your federal estate tax exclusion?

GIVEN changes in exclusion amounts, is gifting now the most attractive way to reduce your taxable estate? If so, what level of gifting is affordable for you and how should that gifting be structured?

What Morgan Stanley Can Do for You

Morgan Stanley has long been associated with financial strength, stability, integrity, quality and innovative thinking. Your Morgan Stanley Financial Advisor can make available to you a vast array of knowledge and resources, including specialists in family dynamics, estate planning, insurance, trusts and liabilities management, as well as portfolio analysis, traditional and alternative assets, derivatives and tax sensitive investing. We review carefully every aspect of your wealth with the goal of helping you manage your lifestyle, control your risks and take a strategic approach to what you own as well as what you owe.

Your Morgan Stanley Financial Advisor is committed to helping you prepare for the future. We look forward to working with you as you plan for your life and your legacy.

Key Questions

DO you have access to resources appropriate to your level of wealth and responsibility?

IS your current financial advisor committed to your goals and objectives?

DO you feel confident that your legacy will unfold according to your goals and objectives?

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Since life insurance is medically underwritten, you should not cancel your current policy until their new policy is in force. A change to your current policy may incur charges, fees and costs. A new policy will require a medical exam. Surrender charges may be imposed and the period of time for which surrender charges apply may increase with a new policy. You should consult with your own tax advisors regarding any potential tax liability on surrenders.

Long term care insurance is medically underwritten. As such, your actual premiums are not guaranteed and may vary from any initial quotation you receive. You should not cancel your current coverage until your new coverage is approved and in force. A change in contract may be subject to additional insurance fees as well as increased risks, and may also require a medical exam.

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