

MEMORANDUM

This memorandum addresses common legal questions regarding the legal expense fund established for Sarah Palin (the "Legal Expense Fund"). The Legal Expense Fund will be established as a trust for certain limited purposes as set forth in the trust document.

1. Under What Section of the Internal Revenue Code is the Legal Expense Fund Established?

Trusts are not established under the Internal Revenue Code of 1986, as amended (the "Code"), but rather are created and operated pursuant to state law. The Legal Expense Fund is established under the laws of the State of Alaska and will have its principal place of administration in the State of Alaska and accordingly, will be subject to the laws of Alaska governing trusts. Specifically, the Legal Expense Fund will generally be governed by Title 13, Chapters 36 and 38 of the Alaska Statutes. Trusts, however, are considered separate taxable entities for federal income tax purposes, similar to a corporation or an estate, and thus, are subject to tax on their income under Section 641 of the Code. Based upon the current structure of the trust agreement, the Legal Expense Fund will be subject to income taxes for interest earned on funds or other earned income.

2. How Many People Can Contribute to the Legal Expense Fund?

As with all trusts, there is no limit to the number of people who can contribute to the Legal Expense Fund.

3. Are Donations to the Legal Expense Fund Tax Deductible?

Donations are generally only tax deductible if they are made to certain charitable organizations as defined in the Code. The Legal Expense Fund does not qualify as a charitable organization under the Code; accordingly, donations to the Legal Expense Fund are not tax deductible.

Donations to the Legal Expense Fund will be, however, classified as gifts for purposes of the federal gift tax. A transfer tax is imposed under Section 2501 of the Code on all gifts made by an individual during his or her life. However, there are certain exclusions available to an individual making a gift.

Absent the self-imposed limitation of the Trust, an individual can make gifts of up to \$13,000 per year, gift tax free. Section 2503 of the Code allows an individual an exclusion from the gift tax of the first \$13,000 (for 2009) of gifts made by the individual per donee per year (called the annual gift tax exclusion). For a gift to qualify for the annual gift tax exclusion, the gift must be of a present interest in property. Generally, a gift is of a present interest in property if the recipient has the unrestricted right to freely use, possess, or enjoy the property. The traditional structure of a trust is such that the beneficiaries do not have the unrestricted right to freely use, possess, or enjoy property held in the trust. Consequently, transfers to most trusts,

including the Legal Expense Fund, will not qualify for the annual gift tax exclusion because the transfer will not be of a present interest in property.

A common exception to this rule regarding transfers in trust is to allow the beneficiaries of the trust to have certain “*Crummey*” withdrawal powers. *Crummey* withdrawal powers are those that give beneficiaries of the trust the right to withdraw a limited amount of property held in the trust. Because *Crummey* powers give beneficiaries a present right to use, possess, or enjoy property held in the trust, donations to the trust would be considered donations of a present interest in property, regardless of whether the right of withdrawal is exercised.

Consequently, because the Legal Expense Fund will have certain *Crummey* powers, any individual can donate up to \$13,000 per year to the Legal Expense Fund without triggering the gift tax.

4. Are Donations to the Legal Expense Fund Income to the Settlor?

Donations to trusts are not included in the income of the settlor, but are considered gifts to the beneficiaries. Section 102 of the Code excludes from income the value of property acquired by gift. Donations to the Legal Expense Fund will therefore not be income to the settlor because these donations will be considered gifts.

5. Can Money Held in the Legal Expense Fund be used for Personal Purposes?

Pursuant to the trust document governing the Legal Expense Fund, funds may only be used for certain limited purposes including providing for all reasonable, necessary, and appropriate fees or charges incurred by (a) Sarah Palin as a result of the fact that she is Governor of the State of Alaska or as a result of the performance of her duties as Governor of the State of Alaska and (b) certain individuals that the trustee of the Legal Expense Fund may select as a result of or arising out of their association or relationship with or employment by Sarah Palin, in her capacity as Governor of the State of Alaska. In addition, in order to allow for donations to the Legal Expense Fund to be eligible for the annual exclusion, beneficiaries have been given a limited power to withdraw property held in the Legal Expense Fund for their benefit. Beyond these limited purposes, funds cannot be otherwise used for personal purposes.