

Estate Planning

The primary emphasis is properly on the individual's objectives. Sometimes, however, the objectives (including charitable goals) are not clearly framed. A good professional advisor can help bring those objectives into clear focus.

The tax laws, of course, sometimes tend to shape the estate plan. Due to major tax legislation enacted in recent years, estate plans may need to be examined in light of the fact that many more persons are no longer subject to the same level of gift and estate taxes as in past years. Careful planning can help reduce or eliminate any estate and gift taxes that may still be due.

When it comes to charitable gifts and bequests, there is a broad range of options afforded by the tax law. These often include one or more very attractive ways to achieve important non-charitable objectives, such as providing for one's spouse, children or other special person, while achieving substantial tax savings.

In any event, for many persons estate plans cannot be called complete unless charitable giving wishes have been considered.

Federal Estate and Gift Tax Considerations

One of the most important aspects of the Economic Growth and Tax Relief Reconciliation Act of 2001 was the provision for gradual relief from the federal estate tax. Under the 2001 act, the amounts exempt from estate tax gradually increased through 2010, when the estate tax was repealed for one year. The top estate tax rate was reduced from 55% to 45% between 2002 and 2009.

In December 2010, Congress acted to reinstate the federal estate and gift tax retroactive to January 2010.

Estates of persons dying in 2010 were given a choice of whether to apply a modified estate tax or opt for the conditions in place as part of the one-year repeal in 2010.

The 2010 revisions raised the exemption to \$5 million per person and lowered the maximum tax rate to 35%.

The gift and estate rates and exemption amounts were reunified and the lifetime gift tax exemption was raised from \$1 million to \$5 million, the same level as the estate tax exemption. These provisions were in effect until the end of 2012, at which time the 2001 tax law provisions were scheduled to return unless Congress acted to make the 2010 or other changes permanent.

Under the provisions of the American Taxpayer Relief Act of 2012, effective January 1, 2013, the 2010 estate and gift tax revisions were made permanent with the exception of an increase in the maximum federal estate and gift tax rate to 40%.

Under the 2012 legislation, it continues to be possible to transfer unlimited amounts to a spouse during one's lifetime and at death, so with proper planning it will be unnecessary for married couples to pay estate tax at the death of the first spouse. The changes in the law enacted in 2010 now make the \$5 million exemption (adjusted for inflation) "portable" between spouses, making it possible for a surviving spouse to use any portion of the exemption not used by the first spouse to die, assuming this option was claimed in appropriate tax filings by the estate of the predeceased spouse. This makes it possible for a married couple to make maximum use of their combined exemption amounts of \$10 million (as adjusted for inflation) without requiring the use of trusts and other complex planning devices.

As in the past, unlimited amounts can still be transferred for charitable purposes free of estate and gift taxes.

The reduction of estate and gift taxes at the federal level on amounts left to family and other loved ones may now mean that more is available to make charitable gifts during lifetime and at death by those who are charitably inclined.

Treatment of "stepped-up basis"

As part of the elimination of estate taxes for 2010, property inherited by heirs would be subject to capital gain taxes when it is sold, as there was to no longer be a "step-up" in basis for property inherited from others, as was the case under prior law. With the retroactive reinstatement of the federal estate tax enacted in 2010, the stepped up basis provision was restored and heirs are not subject to capital gains tax on a future sale on the appreciation that occurred in property before they inherited it. For estates of persons who died in 2010, there was a choice as to whether to opt for no estate tax and no stepped up basis or to apply the estate tax as retroactively restored for 2010 and enjoy a stepped up basis.

As a result of the 2012 tax law revisions, the process of estate planning will assume new dimensions. Many who have delayed planning due to prior uncertainty will want to make appropriate revisions to their estate plans now that rates and exemptions appear to be permanent for the foreseeable future. For those who still anticipate that their estates will be subject to estate and gift taxes due to size, planning tools that help transfer assets tax effectively to loved ones and charitable interests during lifetime and/or at death may assume even greater importance. These plans can make it possible in some cases to increase the amount of property that can be transferred under gift and estate tax exemptions.

Annual gift exclusion: In addition to the amounts shown in the previous charts, an individual can give up to a certain amount each year to as many other persons as he or she wishes without having to pay tax on the gifts ([IRS section 2503\(b\)](#)). For many years, the annual gift exclusion amount was \$10,000. Since 1999, however, it has been indexed for inflation. In 2009 the amount was raised to \$13,000. Check for the current amount before completing gifts.

The annual gift exclusion, however, is available only with respect to gifts of “present interests.”

Gift-splitting: Gift-splitting by spouses permits a gift made by one spouse to be treated as having been made one-half by each spouse ([IRC section 2513](#)). Gift-splitting allows the annual exclusion to be effectively doubled. It also “shifts” half of any taxable portion of the gift to the non-donor spouse for purposes of the unified gift and estate tax credit.

Gift-splitting can be accomplished only by filing a timely federal gift tax return ([Form 709](#)) and signifying consent to gift-splitting on the return ([IRC section 2513\(b\)](#)). An election to split gifts applies to all gifts made during the calendar year by the spouses ([IRC section 2513\(a\)\(2\)](#)).

Charitable gifts and bequests: In general, any amount can be given to a qualified charity during life or at death free of federal gift and estate taxes, because of the unlimited gift and estate tax charitable deductions ([IRC sections 2055](#) and [2522](#)).

In the case of an outright donation in excess of the annual exclusion amount, the first portion of the gift qualifies for the annual gift exclusion under [IRC section 2503\(b\)](#); the balance of the gift qualifies for the gift tax charitable deduction.

Combined charitable and marital deduction planning techniques: Federal estate tax law allows an unlimited marital deduction for qualified transfers to one’s surviving spouse ([IRC section 2056](#)). Combining the benefits of the unlimited marital deduction with the benefits of the unlimited charitable deduction can be especially advantageous.

Example 1: Mrs. Taylor wishes to leave \$25,000 by will to a charitable organization. Rather than leaving the bequest directly to the charity, she includes the \$25,000 in the amount she leaves to her husband (tax free under the marital deduction).

Mr. Taylor then voluntarily gives the \$25,000 to the organization—saving personal income taxes. This plan can work well when both spouses share the same charitable objectives because it provides both estate and income tax savings.

Example 2: Mr. Smith wants to establish a trust under his will to provide an income to his wife for her life. He and his wife agree that the remainder interest in the trust should go to a favorite charitable organization. Mr. Smith’s will can establish, for example, either a “QTIP” trust with a charitable remainder ([IRC section 2056\(b\)\(7\)](#)) or a qualified charitable remainder annuity trust or unitrust, as defined in [IRC section 664](#).

In either case, assuming all applicable requirements are met, the assets left to the trust will be fully shielded from estate tax at both Mr. and Mrs. Smith’s deaths because of the unlimited marital and charitable deductions. In the preceding example, the QTIP trust would allow for considerable flexibility, in that Mrs. Smith would receive all trust income for life and could be given the right to receive trust principal under whatever terms and conditions Mr. Smith wished to provide.

Charitable remainder trusts: The charitable remainder annuity trust or unitrust, on the other hand, would provide Mrs. Smith with either (1) a fixed annuity type of payout or (2) a payout equal to a fixed percentage of the annually determined asset value of the trust. Apart from the annual payout, Mrs. Smith could not receive any amounts of trust income or principal.

Applicable law provides for a minimum payment percentage of 5%, a maximum payout rate of 50%, and a 10% minimum charitable remainder amount for charitable remainder trusts. Particular care should be given to drafting provisions of testamentary charitable remainder trusts.

Generation skipping transfer (GST) tax: The GST tax can play a major role in overall estate planning, as well as in charitable gift planning.

For example, if a grandparent establishes a charitable remainder unitrust under his or her will that is to make a payout to the grandchildren for a term of 20 years, the payments received by the grandchildren will be “taxable distributions” for GST tax purposes (as defined in [IRC section 2612](#)). If GST tax is in fact imposed on the payments, the grandchildren (or their guardians) will be responsible for paying the tax ([IRC section 2603\(a\)\(1\)](#)). The grandparent, however, can eliminate any GST tax on the payments by allocating a sufficient amount of the GST tax exemption ([IRC section 2631](#)) to the unitrust. This exemption was increased to \$5 million as part of the legislation enacted in 2010 and made permanent (as adjusted for inflation) by the American Taxpayer Relief Act of 2012. The amount of the exemption required to be allocated is equal to the amount of assets left to the unitrust minus the estate tax charitable deduction allowed with respect to the trust ([IRC section 2642\(a\)](#)).

Charitable lead trusts: A charitable lead trust is a trust that makes an annuity or unitrust payout to a qualified charitable organization for a specified term of years (or for a life or lives) and then distributes its assets, usually to the donor’s children or grandchildren (see [IRC sections 2055\(e\)\(2\)\(B\)](#), [2522\(c\)\(2\)\(B\)](#)).

The initial present value of the charitable payout qualifies for the gift or estate tax charitable deduction, as the case may be. The taxable transfer to the heirs, therefore, is equal to the difference between the amount given to the trust and this present value.

For a person who has a large estate—often an unmarried individual who cannot take advantage of the marital deduction—the lead trust is often an option well worth considering from gift and estate tax standpoints. The lead trust may offer welcome opportunities to reduce or eliminate estate and gift taxes that may still apply in the wake of the tax law changes in recent years.

In the case of a charitable lead annuity trust that distributes its assets to the donor's grandchildren or other "skip persons," special GST tax rules apply. For details, see [IRC section 2642\(e\)](#).

Power of attorney: In some cases, a donor has established a plan for making regular charitable gifts. If asked, the donor might well reply that he or she would like the plan to continue in the event he or she becomes incapacitated.

If this is the person's wish, assuming he or she creates a durable general power of attorney, an express provision should be included in the power directing the attorney-in-fact as to the making of contributions out of the donor's assets.

Contributions made pursuant to such a provision will be deemed to be made by the donor.

Conclusion

There are, of course, many more "technical" considerations involved in charitable estate and gift planning than those covered in this technical advisory section. Always consult appropriate advisors for recent changes in the law before making estate and financial plans that may have tax and other financial implications.

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