

Preserving Wealth by Strategic Giving

You have had some success in life. As you have been accumulating wealth, you have naturally been concerned about how to invest to make your assets grow.

More recently you may be wondering about an equally important question: How will you transfer your assets so they are not unnecessarily consumed by taxes but instead preserved to benefit the individuals and institutions you care about?

If you have accumulated more than you need to live comfortably, you may be thinking about transferring part of your wealth during your lifetime. Of course, any transfers you don't make now will eventually occur at the end of your life.

A program of strategic giving requires careful thought and planning, just as accumulating and investing your original assets has. This issue of *our newsletter* suggests ways to ensure that maximum value is transferred to the people and charitable organizations important to you.

Protecting Your Assets from Gift and Estate Taxes

Anyone who has been financially successful knows how tax considerations affect financial planning. Just as taxes on earnings may influence your current decisions, both present and future tax consequences must be considered when you make plans to transfer your assets to others.

Under current law each person is allowed a gift-tax credit of \$345,800 that allows the tax-free transfer of the first \$1,000,000 of taxable transfers during life. At death, the estate-tax credit is

\$780,800, which offsets the estate tax on the first \$2,000,000 of taxable transfers but is reduced by any gift-tax credit utilized during life.

Note: In 2009 the amount effectively exempted from estate tax will increase to \$3,500,000, but only \$1,000,000 will continue to be shielded from gift tax. (The estate tax is repealed in 2010 but will return in 2011 unless the repeal is extended by new legislation.)

The effect of this interrelated system of gift and estate taxation is that each taxable transfer—whether made during your lifetime or through your estate—may be subject to successively higher gift- and estate-tax rates.

Example: *John T makes a gift of \$500,000 to his son Tom. Because John has made no previous taxable gifts and the tentative tax is less than the available credit, no tax is due.*

John dies in 2008, having made no other taxable gifts. He leaves his remaining \$1,900,000 estate to Tom. Added to his lifetime gift, this makes the total taxable transfer \$2,400,000.

The transfer tax on \$2,400,000 is \$960,800. Although John's estate can apply the \$780,800 credit against the tax, the estate still owes \$180,000 (i.e., \$960,800 - \$780,800).

TAX-FREE GIVING: THE ANNUAL EXCLUSION. As many parents and grandparents are aware, you can give each child, grandchild, or other individual a certain amount each year free of gift tax (so long as the recipient is able to make immediate use of the gift). For many years this amount was \$10,000, but it has risen to \$12,000 and can increase in future years, depending on inflation. Together, a married couple can give up to \$24,000 tax-free to as many persons as they desire.

Naturally, you won't want to give away assets you need to maintain your standard of living. But if your needs are otherwise met, it may make sense to give away certain assets—even if their value exceeds the annual exclusion amount.

If you give away an asset with significant potential for appreciation, you remove its current value from your estate—and you also remove any future appreciation. Remember, you will not actually have to pay any out-of-pocket transfer tax until you make more than \$1,000,000 in gifts not covered by annual exclusions. And any gift tax that you do pay will be removed from your estate, provided you live at least three years after making the gift.

Charitable planning pointer: Lifetime **outright gifts** to this institution are not only free from gift tax themselves but also reduce the amount of your remaining assets potentially subject to gift and estate taxes. Moreover, they generate *current* income-tax deductions that reduce your income-tax bill *this year*.

A gift of an asset that is producing little or no current income—perhaps growth stock or undeveloped real estate—generally results in a deduction equal to the full fair-market value of the asset. Better yet, you can usually avoid recognizing—and being taxed on—any of your paper gain.

Taking the Guesswork Out of Transfer Taxes

Those with major charitable goals have discovered they can transfer substantial assets to intended beneficiaries at minimal or no transfer-tax cost by using a special vehicle called a *nongrantor charitable lead trust*. Under this plan, you put assets into a trust that makes payments to charity for a designated period of time and then the remaining trust assets pass to your heirs. This strategy is sometimes used to delay an inheritance to grandchildren until they reach an appropriate age.

The key to this strategy is that the present value of the payments to charity is deducted from the total amount transferred to the trust and only the difference—if any—is subject to estate or gift tax. For instance, if you put \$1,000,000 into a trust that pays [this institution](#) \$85,000 for the next 20 years and then distributes the remainder to your children, the present value of our charitable interest is slightly more than \$1,000,000.

This means that none of the \$1,000,000 you put in the trust is treated as a taxable gift to the named beneficiaries. If the trust is able to achieve returns that approximate the historical average—say 10%—the beneficiaries will eventually

receive more than \$1,859,000 *totally free of estate and gift taxes.*

Right now is a particularly good time to create a nongrantor lead trust because current low interest rates will increase the present value of our interest in the trust, sheltering even more of your trust's value from estate and gift taxes.

Make a “Temporary Gift” and Save Current Taxes with a Grantor Lead Trust

While a lead trust typically is used to pass assets to other beneficiaries, a lead trust that returns assets to you may make sense under some circumstances. The primary benefit of this type of *grantor charitable lead trust* is that it allows you to take an *immediate charitable income-tax deduction* for the present value of the charitable income interest. This benefit comes with a price tag, though: the trust's income is taxed to you during the trust term.

However, if a donor contributes tax-free municipal bonds, this would avoid tax on the trust's income. In addition, creating the trust will result in a very large up-front charitable income-tax deduction. And the donor gets the trust assets back at the end of the specified trust term, including amounts distributed to charity.

The level of up-front charitable income-tax deduction generated by a lead trust is substantial due to the low-interest-rate environment we find ourselves in. As a result, donors who are in their peak earning years can establish a lead trust to generate the valuable up-front deduction, but then plan to have the assets returned to him- or herself sometime during retirement,

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for example, when income from assets may be needed.

Example: *George, aged 50, funds a 20-year lead trust with \$1,000,000 worth of municipal bonds that pay \$50,000 of interest each year that is tax-free for federal, state, and local tax purposes. Because the trust realizes only tax-exempt interest, George will owe no additional tax. Moreover, he is able to take an immediate income-tax deduction for the present value of the payments to [this institution](#)—in this case \$717,000—resulting in tax savings of more than \$250,000 in his 35% federal income-tax bracket. After retirement, at the age of 70, George gets the assets back to assist in maintaining his standard of living.*

We're Here to Help

Creative giving may have a place in your planning. If you would like to know more, we would be pleased to send you a complimentary copy of our booklet, ***The Charitable Lead Trust: Benefiting Charity and Then Your Heirs***. Just complete and return the [enclosed](#) card or call our office.

You should consult your attorney about the applicability to your own situation of the legal principles contained herein.