As we enter the fourth quarter of 2012, it becomes increasingly likely that Congress will not act before year end to prevent the statutory January 1, 2013 reduction of the gift and estate tax from its current $5.12 million ($10.24 million for a married couple) to $1 million, and the increase of the estate and gift tax rates from 35 percent to as much as 55 percent. What this means is that beginning January 1, 2013, under current law, your gift and estate tax exemption will shelter only $1 million of taxable gifts or estate assets. As of January 1, 2013, you could pay the U.S. Treasury estate or gift tax of 55 cents on the dollar, leaving only 45 cents of that dollar to your loved ones. Adding insult to pecuniary injury, you may look back and know that if you had implemented planning in 2012 you could have moved $5.12 million ($10.24 million for a married couple) free of gift and estate tax.

Because of this upcoming significant change, if ever there was a time to plan, that time is now. The good news is that it is not yet too late to act. The following are some estate planning ideas that you can still implement in 2012, while the $5.12 million estate and gift tax exemption is in place.

► Gift to a Trust for your Spouse. Assets gifted to an irrevocable trust for your spouse are removed from your (and your spouse’s) taxable estate, but are available to your spouse for your spouse’s lifetime. As long as your spouse is a sharing person, the gifted assets remain available to you and your family. Your spouse can even be the trustee of this trust. Your children and later-generation descendants also can be beneficiaries and trustees of this trust, either during or after your spouse’s lifetime, all of which make this type of trust a very flexible gifting vehicle. Moreover, with proper planning, the trust assets and all appreciation thereon can pass gift and estate tax free to your descendants for generations.

► Gift to a Trust for your Descendants. If you and your spouse have sufficient other assets for your lifetimes, you could gift funds to an irrevocable trust for your descendants. The trust funds can be available for your children’s and/or other descendants’ benefit without ever being included in their taxable estates. And, again, with proper planning, the benefits of this trust can continue estate tax free for generations to come.

► Fund an Insurance Trust. Purchasing life insurance in an irrevocable trust has many estate tax benefits. Often, the trust receives annual gifts from the insured, which the trust then uses to pay the life insurance premiums. The size of the policy is frequently limited to what can be purchased within the annual gifting limits. Using some of the $5.12 million exemption to fund a new or existing life insurance trust in 2012 would not only remove the assets from your taxable estate, it could also increase the size of the life insurance policy purchased, ensure that there are sufficient assets to pay future premiums, and enable the eventual death benefit to pass to the trust beneficiaries and to future generations free from estate taxes for many, many years.

► Create a QPRT. QPRT stands for “qualified personal residence trust.” A QPRT is created to receive a gift of your primary home or vacation home. You retain the right to live in and control

Continued
Worth Considering: Early Termination of Charitable Remainder Trusts

Many charitably inclined individuals have established a charitable remainder trust (CRT), designed to benefit themselves or their loved ones (the donor) for a time and to then pass the CRT assets to a charity. In the year the CRT is established, the donor receives an income tax charitable deduction based on the value of the assets that will eventually pass to the charity. During the life of the CRT, the donor receives a certain amount or percentage from the CRT each year for a stated term. At the expiration of the donor’s term, the charity receives the CRT assets remaining.

What donors may not know is that it is possible to effectuate an “early termination of a CRT” and distribute all of the CRT assets right now. In an early termination of a CRT, the CRT donor and the designated charity both receive their share of the CRT assets in lump sums, determined as of the date of the early termination. Moreover, the CRT donor often has retained a power to change the CRT charity and, in the termination process, can name the current charity(ies) of his or her choice to receive the charitable share.

Early termination may be desirable in situations where the CRT is not producing income sufficient to make the distributions to the beneficiary for the stated term. If the CRT was created, as many were, when interest and dividend rates were higher, the objective of retaining an income stream and then passing assets to a charity may no longer be attainable. Early termination also may be desirable when the donor simply could use the cash now, wants to be relieved of the CRT administrative requirements, wants to take advantage of current favorable capital gain tax rates, or simply wants to benefit a chosen charity now rather than later.

The early termination of a CRT can be accomplished by an agreement between the donor and the chosen charity, without IRS or court approval (an attorney’s assistance is advisable). The amounts the donor and charity will receive are determined based on the present value of the remainder interest passing to the charity, which is calculated using methods established by the Treasury and the Internal Revenue Code. Once the charity’s remainder interest is determined, the rest (typically the larger share) belongs to the donor. When the CRT assets are distributed to the donor and the charity, the CRT terminates. Capital gain tax is assessed on the entire portion passing to the donor, but it can be offset by capital losses (or further contributions to charity).

If you have a CRT, you may want to consider whether early termination under the current capital gain tax rate makes sense for you. In addition to the CRT funds, you will receive the satisfaction of seeing your chosen charity benefit from your contribution.

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the home for a set number of years. After that time, the home passes in trust to the QPRT remainder beneficiaries (your children or spouse or other loved ones), who can then rent you the home. The beauty of the QPRT is that the home and all appreciation on the home are removed from your taxable estate for estate tax purposes, you continue to live in the home for the retained term, you can further reduce your taxable estate by paying rent (likely to your children) after the retained term, and you manage to achieve all of this without relinquishing any liquid assets and most likely without paying a dime in gift taxes. The value of the QPRT gift for gift tax purposes is essentially the current value of the home, reduced by the current value of your right to live in the home for the stated time period. As long as that value is less than your available 2012 gift tax exemption, you will not pay gift taxes on the QPRT gift.

Create a Charitable Lead Annuity Trust. A charitable lead annuity trust (CLAT) involves a CLAT trust agreement (1) providing for your chosen charity to receive an amount (the annuity) from the CLAT for a specified term, (2) naming beneficiaries (your loved ones) to receive the CLAT assets remaining at the end of the specified term, and (3) receiving your gift to the CLAT. Only the remainder portion of the CLAT, the part passing to your loved ones, is a taxable gift. You can receive an income tax deduction for the value of the annuity interest passing to the charity, and the taxable gift of the remainder is covered by your $5.12 million exemption. The unprecedented size of the 2012 gift tax exemption enables very large amounts to be placed into CLATs without payment of gift taxes. The CLAT donor can see the chosen charity receive and make use of the annuity amounts, knowing that the remainder will pass to his or her loved ones (perhaps grandchildren, or children who are otherwise well provided for) at a future date.

These are only a few of the options available for taking advantage of the current gift and estate tax exemption while it exists. Variations on these options and other options exist and can be implemented in 2012. There is still time to plan, but, barring an act of Congress, that time expires January 1, 2013.

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