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Creative Tax and Estate Planning Ideas – A Case Study

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Creative Tax and Estate Planning Ideas – A Case Study

Mary Smith passed away unexpectedly at the age of 70. She was married to David, age 65, and they had two children, Todd, age 40, married with 2 kids of his own (10 and 7) and Gail, age 38 who suffers from various disabilities but is able to live independently. She is not married and has no children. Todd does not want to be responsible for her. Privately, he resents all of the attention paid to her over the years. He loves her but does not wish to be "her keeper."

Mary owned a widget company (S Corporation) and the real property (Mary's name) on which it was situated. She died with a simple Will that was written after Todd was born leaving everything outright to David. David is the executor. She had no succession plan for the business. However, Todd has been working with Mary at the widget company for the past 10 years.

Mary also owned several bank and brokerage accounts, some of which were in her name and some of which were in joint name with David. The family home is in their joint names and the mortgage has been paid off.

SUMMARY OF ESTATE TAX LAW

This year, the federal estate tax exemption is equal to $5,250,000 million. New York law remains unchanged with a $1,000,000 credit. Federal gift and estate tax are unified. Therefore, the lifetime gift tax exclusion is $5,250,000. Gifts in excess of $5,250,000 remain taxable. In addition to the lifetime exclusion, client's can each give away $14,000 per person per year to as many different persons as they want. These annual exclusion gifts have no impact on the client's lifetime exclusion. Gifts between spouses are unlimited and not taxable.

MAXIMIZING APPLICABLE EXCLUSION AMOUNT PLANNING

Each person has an applicable exclusion amount (unified credit) ($5,250,000) which can be gifted during lifetime without paying a federal gift tax (current rate is 40% and is usually paid by donor). The available applicable exclusion upon death is currently $5,250,000 and will be reduced by amounts used to shelter lifetime gifts from federal gift tax.

In planning for use of a donor's lifetime exemption, the attorney should inform the donor that assets can be transferred during lifetime to a trust and still qualify for the exemption. Therefore, the donor has more gifting options available than simply making outright gifts. Additionally, beginning in 2011, a surviving spouse can make a portability election and use the Deceased Spousal Unused Exclusion ("DSUE") amount if an election was made on the deceased spouse's Form 706 which includes a computation of the DSUE amount (Sections 302(a)(1) and 303(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296, 3302 (2010), amended the Internal Revenue Code of 1986, as amended (the "Code" or "IRC") §2010(c)). IRC §2010(c)(2) defines the applicable exclusion amount as the sum of the basic exclusion amount ($5,000,000 adjusted for inflation IRC §2010(c)(3)) and, in the case of a surviving spouse, the DSUE amount. IRC §2010(c)(4) defines the DSUE amount as the lesser of (A) the basic exclusion amount or (B) the excess of the basic exclusion amount of the last deceased spouse of the surviving spouse over the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse.

A Will can contain a disposition of the decedent's applicable exclusion amount through use of a Credit Shelter Trust. Any amount placed in this Trust (and any growth on those assets) will pass free of Federal Estate tax on both testator's death and spouse's death. The Trust can contain an exclusive special power of appointment to the surviving spouse to allow for flexibility in distributing assets to surviving issue upon death of spouse (NY Estates, Powers and Trusts Law ("EPTL") §10-3.2). In general, the Credit Shelter Trust is funded with a pre-residuary pecuniary amount equal to the testator's available unified credit in case the estate assets decrease in value during the administration of the estate. Use of this Trust is common when the residuary estate is anticipated to be larger than this amount. The Trust can also be created as a disposition of the residuary estate and is drafted in this manner when the property is eligible for special use valuation under IRC §2032A because the property may be valued at date of distribution value. Otherwise, the property would be valued at fair market value if used to fund pre-residuary pecuniary amount. This type of Credit Shelter Trust is also used when property is expected to increase so that increase passes to Trust by using date of death values. There are times when the Credit Shelter Trust is drafted as a fractional share of the residuary estate. In this scenario, each share participates in increase or decrease of estate assets and avoids capital gains tax upon funding with appreciated property. However, the fraction cannot be ascertained until administration is complete (which can be several years). Some Wills limit the size of the Credit Shelter Trust to New York's $1 million credit to avoid paying New York estate tax.

Because the estate tax law is so much in flux, many estate planners are using Disclaimer Trusts in place of the mandatory Credit Shelter Trust. Fully funding a Credit Shelter Trust may have an adverse financial impact on the surviving spouse especially in time of economic uncertainty. These Disclaimer Trusts offer the same benefit of the Credit Shelter Trust but have the added benefit of allowing the surviving beneficiaries, usually the spouse, to decide how much to protect from estate tax after first spouse dies. The disclaimer of assets into the Disclaimer Trust must be made within nine months of the Grantor's date of death.

The Disclaimer Trust is often created for the benefit of surviving spouse but can be created for the benefit of children or grandchildren or a class of beneficiaries consisting of the spouse and children. The disclaimed amount placed in this Trust (and any growth on those assets) will pass free of Federal Estate tax on both Grantor's death and the spouse's death. This trust will not pass through probate on the death of the surviving spouse.

Therefore, the Will may include a provision that allows the surviving spouse to disclaim inherited property, real or otherwise (whether by operation of law or through the Will), so that it can be added to a Disclaimer Trust which would use the testator's applicable exclusion amount.

In both the Credit Shelter Trust and in the Disclaimer Trust, the Will can provide that the spouse has a limited power to withdraw principal, such as a 5/5 power. A 5/5 power gives the surviving spouse the non-cumulative right to withdraw from the principal, the greater of $5,000 or 5% of the principal each year (or a lesser amount) (IRC §2041(b)(2)). The spouse has the freedom to withdraw funds with "no questions asked" by Trustees. In that way, the spouse will still have access to the disclaimed assets without having to always ask the Trustee for a “hand-out.” However, on the death of the surviving spouse, 5% of the principal will be included in the surviving spouse’s estate (Estate of Kurz, 68 F.3d 1027 (1995)).

Both trusts can incorporate a Sprinkling Disclaimer Trust for the benefit of the surviving spouse and issue which would allows for distributions based on differing needs of family members. This type of Trust also enables issue to receive assets sooner. These Trusts can also hold retirement accounts. The benefit to this beneficiary designation is that it allows for the application of the decedent’s unified credit against retirement assets. Also, it ensure that assets pass to specific beneficiaries upon death of spouse (i.e., children from first marriage) as opposed to the surviving spouse rolling over the retirement assets into his or her name. The retirement assets will be protected in case the surviving spouse remarries. There is also ease administration of assets if the spouse is disabled or elderly.

In order to fund the Disclaimer Trust, the surviving spouse must file a disclaimer, also called renunciation, which is a form of post mortem planning allowing for altering the beneficial interests of the beneficiaries by the beneficiary refusing to accept the bequest. The requirements for a qualified disclaimer are contained in EPTL §2-1.11(c)(2), the IRC §2518(b) and in Treas. Reg. §25.2518-2 and a form of disclaimer is attached hereto as Exhibit A:

- Irrevocable
- In writing.
- Within 9 months of taxable transfer.
- No acceptance of interest or benefits
- Disclaimed interest passes without direction and pass to someone other than disclaimant (unless it is for the benefit of the surviving spouse).

A beneficiary can disclaim interests under the decedent's Will or any other non-testamentary assets (i.e. trust agreement, life insurance, retirement accounts and plans, joint or totten trust accounts, etc). Additionally, powers of appointment can be disclaimed as can a distributive share under EPTL §4-1.1 and Treas. Reg. §20.2041-3(d). Such an interest can be pecuniary (Treas. Reg. §25.2518-3(c)), an interest in a trust, a specific asset, life insurance and retirement benefits (PLR 200105058). See also, EPTL §2-1.11(b)(1).

Since the qualified disclaimer must be in writing, the writing must identify the interest in property being disclaimed and be signed either by the disclaimant or by the disclaimant's legal representative (Treas. Reg. §25.2518-2(b)(1)). It must be delivered to the transferor of the interest, the legal representative of the transferor or the holder of legal title to the property to which the interest related (Treas. Reg. §25.2518-2(a)(3) and (b)(2).

The effect of a qualified disclaimer for a Federal estate, gift and generation-skipping, transfer tax, is that the property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead it passes directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Treas. Reg. §25.2518-1(b).

Once the completed gift is made, the disclaimant has nine months to make the disclaimer (see Treas. Reg. §25.2518-2(c)(3) and (c)(5) at example 6 and EPTL §2-1.11(c)(2).) When the beneficiary is a minor, the disclaimer must be filed within nine months after the disclaimant attaining the age of twenty-one years (see Treas. Reg. §§§25.2518-2(c)(1)(ii), (d)(3) and (d)(4) at examples (9) and (11)). The Courts have held that an extension of time to file an estate tax return does not extend the nine month period for filing a disclaimer. This nine month time frame is hard and fast for filing qualified disclaimers. It is important to note that a disclaimer can be made after the nine month period by filing a petition with the court showing reasonable cause for the extension (EPTL §2-1.11(c)(2)). However, it will not be considered a qualified disclaimer and a taxable gift will occur upon the passing of the interest from the disclaimant to the next interested party.

Disclaimers are irrevocable once they are made (EPTL §2-1.11(h) and Treas. Reg. §25.2518-2(a)(1)). The beneficiary cannot disclaim any asset to which such beneficiary already accepted (Treas. Reg. §25.2518-2(d) and EPTL §2-1.11(g)). Accepting income from the property also will disqualify the disclaimer (see PLR 9243024). However, continuing to live in the residence which was jointly held does not constitute the acceptance of the decedent's half of the joint interest, whether as tenants-by-the-entirety or as tenants-in-common (Treas. Reg. §25.2518-

2(d)(4) at example (8), PLR 8508079). The IRS has found that in the case where the residence was owned solely by the decedent and the surviving spouse continues to live it, such continued residency constitutes acceptance of the asset (PLR 8817061).

In general, under Treas. Reg. §25.2518-2(c)(4)(i), a disclaimer of an interest in joint tenancy must be made within nine months of the transfer creating the joint tenancy not at its vesting (see also, Estate of Edward J. O'Brien, T.C. Memo 1988-240 (May 26, 1988). However, a qualified disclaimer can still be made of the survivorship interest passing by operation of law upon the death of the first joint tenant so long as it is within nine months of the death of the joint tenant and is severable. This result was due to the IRS issuing an Action On Decision 1990-06 when it acquiesced in McDonald v. Comm'r, 853 F.2d 1494 (8th Cir. 1988). In this Decision, the IRS stated that:

> Where a joint tenant has the right to sever the joint tenancy or cause the property to be partitioned under state law, the Service will no longer litigate that the transfer relative to which the timeliness of the disclaimer of a survivorship interest is measured refers to the transfer creating the joint tenancy. The Service will also no longer contend that a joint tenant cannot make a qualified disclaimer of any portion of the joint interest attributable to consideration furnished by that joint tenant.

The final regulations reiterated this decision in Treas. Reg. §25.2518-2(c)(4)(i)-(iii) and adopted the rationale of the Fourth, Seventh and Eight Circuits laid out in Kennedy v. Commissioner, 804 F.2d 1332 (7th Circuit 1986), McDonald v. Comm'r, 853 F.2d 1494 (8th Cir. 1988) and Dancy v. Commissioner, 872 F.2d 84 (4th Circuit 1989). Additionally, tenancy-by-the-entirety was given the same treatment as a joint tenancy with right of survivorship because of the concern that couples do not focus on the impact of their decision on their future ability to disclaim when they buy a home (see also Treas. Reg. . §25.2518-2(c)(4)(ii)).

If the person funding a joint bank account can withdraw all of the money then there is no completed gift to the other joint tenant (Treas. Reg. §25.2518-2(c)(4)(iii)). The surviving joint tenant can disclaim the entire account within nine months of the death of the funding joint tenant (Treas. Reg. §25.2518-2(c)(5) example (9)). However, if the surviving joint tenant contributed assets to such account, then such contributed property may not be disclaimed. Under Treas. Reg. §25.2518-3(b), the disclaimant can disclaim an undivided portion. EPTL §2-1.11(c)(1) covers disclaimers of jointly held interests.

The final component to the disclaimer is that the disclaimed interest must pass without any direction on the part of the disclaimant (Treas. Reg. §25.2518-2(e)). Additionally, it cannot pass in any form to the disclaimant. For example:

> $100,000 is left in trust for John but if he predeceases, the bequest lapses and becomes part of residuary. The residuary is left to the Decedent's two children, one of whom is John.
>
> John cannot receive his share of the $100,000 as part of the residuary. He would need to file a second renunciation disclaiming his one-half interest in the $100,000 under the residuary clause.

There is an exception to this criteria and that is if the disclaimant is the spouse (Treas. Reg. §25.2518-2(e)(2)). For example:

> Residuary is left entirely to the surviving spouse. If spouse disclaims some or all of the residuary, then disclaimed amount passes into disclaimer trust for benefit of surviving spouse. However, the surviving spouse cannot retain the right to direct the beneficiary enjoyment of the property. Therefore, the disclaimer trust cannot contain a power of appointment exercisable by the spouse. Treas. Reg. §25.2518-2(e)(2) and §25.2518-2(e)(5) example (4) and EPTL §2-1.11(f).

Disclaimers are filed in Surrogate's Court and must be accompanied by an affidavit of the disclaimant that he or she has not received any consideration for making such disclaimer from someone whose interest is accelerated by the disclaimer (a copy of which is attached hereto as Exhibit B). Notice of the renunciation, including a copy of the renunciation, must be served personally on the fiduciary directed to make the disposition or upon the person or entity having custody of the disclaimed asset(s) and by mail on all persons interested in the matter (a copy of which is attached hereto as Exhibit C together with an affidavits of service). Once the disclaimer is accepted by the Court, the filing of the disclaimer has the same effect as those the disclaimant had predeceased the creator of the interest or the decedent, as the case may be (EPTL §2-1.11(e)).

In addition to the person with the interest in the asset to be disclaimed, when authorized by the Court a renunciation may be made by the guardian of an infant, a committee of an incompetent, the conservator of a conservatee, a guardian under MHL Article 81 and by the personal representative of a decedent (EPTL §2-1.11(d)) (a copy of a Petition requesting permission to file a disclaimer on behalf of a decedent is attached hereto as Exhibit D). Additionally, if a power of attorney gives the attorney-in-fact the authority to make a disclaimer, then such a disclaimer is authorized. However, if the grantor of the power of attorney is disabled at the time of the disclaimer, then court permission is required under EPTL §2-1.11(d)(6).

Treas. Reg. §25.2518-3(a) covers partial disclaimers as does EPTL §2-1.11(c)(1) and (f). Additionally, a disclaimant may accept one disposition and disclaim another. Renouncing a fractional interest only serves to renounce that specific part of the interest and not the entire interest. For example:

> $100,000 is bequeathed to John but if he predeceases, the bequest lapses and becomes part of residuary. John can renounce $50,000 and accept $50,000.

Additionally, if an income interest and a remainder interest are bequeathed to a person, such person can disclaim the income interest and keep the remainder interest. If the beneficiary disclaims an income interest and a remainder interest in specific trust property, then those specific assets must be removed from the Trust in order for the disclaimer to be qualified (Treas. Reg. §25.2518-3(a)(2)). The examples found at Treas. Reg. §25.2518-3(d) illustrate the provisions of partial disclaimers.

BUSINESS ENTITIES

Family Limited Partnership (FLP) or Limited Liability Company (LLC) under state law to carry on a business purpose can be used to shield client from personal liability by transferring ownership of the property from individual names into the FLP or LLC. In general, the donor's family members are the limited partners. The general partner (GP) is liable fully for all partnership debts and controls the partnership. The GP can be a corporation or a limited liability corporation to minimize exposure. The liabilities of the limited partners are limited to interest owned and they are not personally liable for partnership debts.

Gifts of the partnership interests to the family members qualify for minority interest and lack of marketability discounts because the limited partners have minority interests, lack control of the entity and have restrictions on transferability. Proposed legislation has been introduced to deny discounts for Family Limited Partnerships and Limited Liability Companies funded with marketable securities. The law will not be retroactive. The attractive feature of this gifting strategy is that successful leveraging of annual exclusion gifts can transfer greater interests in the FLP to family members each year. However, the IRS has successfully challenged some of FLPs under the argument the donor still retained control of the transferred assets so no completed gift was made. Therefore, the assets are includable in the donor's estate. Caution should be used with this plan because of the great risk of audit.

When a donor gives away a partial interest in an asset such as real estate, a partnership or a limited liability company, the donor is able to take a discount for lack of marketability and/or control. This gift of this minority interest allows the donor to give away more of the asset without having to use more of his or her annual exclusion, lifetime gift tax exclusion and Generation Skipping Transfer ("GST") tax exemption. For example:

> Partnership is valued at $1,000,000. Donor wishes to give his three children and five grandchildren annual exclusion gifts of his interest in the partnership. Therefore, the donor can give this class of beneficiaries a total of $112,000 in annual exclusion gifts ($14,000 x 8). He can split this gift with his wife and give away a total of $224,000.
>
> However, if the donor has the partnership appraised and the appraisal values the effect of the lack of marketability and the lack of control present in the gifted interests to the donor's children and grandchildren, then the appraisal will show that the donor is entitled to take as much as a 35% discount with respect to the transfer. The donor can now give away an interest valued at $172,308 (before the discount is applied) to this class of beneficiaries and for split gift purposes he and his wife can give away $344,616. By utilizing this discount technique, the donor and his wife are able to gift an additional $120,616 to their children and grandchildren without having to use any of their lifetime gift tax exemption or lifetime GST tax exemption.

USING IRREVOCABLE TRUSTS TO PURCHASE LIFE INSURANCE

An Irrevocable Life Insurance Trust (ILIT) is a trust created to own one or more life insurance policies. The Trust can apply for a new policy or can receive an existing policy on the Grantor's life. Generally speaking, if the Grantor lives for more than three years after an existing insurance policy is transferred into the trust, the policy proceeds should not be included in the Grantor's estate. The applicable exclusion amount is allocated against the cash value of existing policies transferred into the trust and a Form 709 must be filed. This three year rule generally does not apply to new policies purchased by the Trustees of the trust. The ILIT serves to keep insurance proceeds available immediately upon death which enables the trust beneficiaries to have use of the money while the Grantor's other assets are tied up during the probate process. Additionally, by keeping the insurance out of the Grantor's estate upon his death, the Grantor's estate saves estate taxes.

During the Grantor's lifetime, the annual premium is contributed by the Grantor to the trust and then the Trustees pay the premium. In order for the premium contribution to qualify as an annual exclusion gift, *Crummey* Notices must be given to the beneficiaries of the trust. In Crummey v. Commissioner, (397 F.2d 82 (9th Cir. 1968)), the Court held that the withdrawal right was sufficient to convert the interest into a present interest that qualified for the annual exclusion under §2503(b) and that so long as each beneficiary held a valid and legal right to acquire the property for a reasonable period of time, there existed a present interest that qualified for the annual gift exclusion. The beneficiary must have notice of right of withdrawal (*Crummey* Notice) and have a reasonable amount of time to exercise right of withdrawal before it lapses. Rev. Rul. 81-7, 1981-1 C.B. 474. Knowledge of a contribution to a trust and right of withdrawal constitutes adequate notice. Holland Est. v. Comm'r, 73 T.C.M. (CCH) 3236 (1997). However, written notice is preferred. Transfers subject to a right of withdrawal, even by a contingent beneficiary, qualify for the annual exclusion. Cristofani Est. v. Comm'r, 97 T.C. 74 (1991); see also Kohlsaat Est. v. Comm'r, 73 TCM 2732 (1997). The ability to use contingent beneficiaries increases ability to shelter premium with annual exclusion gifts.

As the IRS dislikes this planning device, these signed Notices are important because acknowledged signed copies of the Notices might be requested at the time of the audit of the Grantor's estate tax return, if any. If the Notices cannot be produced, the IRS will claim that the annual contributions to the trust were unreported gifts and could not be sheltered with annual exclusion. Therefore, the IRS will calculate how much of the Grantor's applied exemption amount must be allocated to these gifts. Any amount allocated to the ILIT will not be available to be used under the Will. To the extent that the Grantor has used all of his or her applied exemption amount, then the IRS can charge interest and penalties on any gift tax owed on these transactions.

Upon the Grantor's death, the Trustees will collect the insurance proceeds and then administer them for the exclusive benefit of the trust beneficiaries (usually the surviving spouse and then the children). This ILIT provides for successful leveraging of annual exclusion gifts to yield non-estate taxable insurance proceeds.

Sample *Crummey* Notices and a Memo to the client discussing the *Crummey* Plan can be found at Exhibits E and F, respectively.

DISABILITY PLANNING

A Will should include a Supplemental Needs Trust provision in case a beneficiary becomes disabled at a future time. See EPTL §7-1.12, Omnibus Budget Reconciliation Act of 1993 (OBRA 93) Pub L 103-66, §13611[b], 107 US Stat 624, 525. 42 U.S.C. §1396p et seq., and Soc. Serv. Law §366.

When a third party is now receiving Medicaid or Supplemental Security Income (SSI), which are means tested, or may need these or other government sponsored means tested programs in the future, a client may wish to provide for additional funds for such person. To do so, the client creates a Supplemental Needs Trust either in his Will or during his lifetime. The trust assets will be available to help the party, but the trust will not render such person as ineligible for any such government program. When the assets do not belong to the beneficiary before they are contributed to the trust, the trust is considered to be a third party special needs trust. A trust funded with the disabled person's assets would be denoted as a first party trust and would be far more restrictive. While the disabled person is a minor, the parent's assets are deemed to be his. Therefore, a third party trust only works if the parent is contributing the assets to a child who is over 18. Upon the death of the beneficiary, the assets can be distributed to whomever the grantors wish. With a first party or self-settled trust, the assets must be first be used to pay back any funds expended by the state on behalf of the disabled person. In order to qualify as a self-settled trust, the trust must be created by: (i) the individual; (ii) the individual's spouse; (iii) a person, including a court or administrative body, with legal authority to act in place of or on behalf of the individual or the individual's spouse; (iv) a person, including any court or administrative body, acting at the direction or upon the request of the individual or the individual's spouse (42 U.S.C. 1396p(d)(2)(A)(i-iv)). Additionally, self-settled trusts can be created for disabled individuals if: (i) the trust is established for a disabled individual while he or she was under the age of sixty-five; (ii) the trust is established by a parent, grandparent, legal guardian, or court; and (iii) the trust provides that upon the death of the disabled individual the state will be paid back by the trust for the medical assistance it has provided, to the extent such amounts remain in the trust (42 U.S.C. 1396p(d)(4)(A) and Soc. Serv. Law §366 subd.2(b)(2)(iii)(A)).

The supplemental needs trust is irrevocable. Once the trust is established, the Grantors, cannot revoke the trust. Nor can the Grantors modify the trust. The trust can provide that the trustees have the power to modify the terms of the trust so as to ensure the beneficiary's eligibility for means tested programs.

Gifts to the trust do not qualify as annual gifts because a gift to a trust is not a gift to an individual. Gifts to this trust do not qualify as annual exclusion gifts and must be reported to the IRS on a gift tax return (Form 709) despite the fact that the gifts may be less than $14,000 in any calendar year. Gifts, for federal purposes are not taxable unless the total of reportable gifts exceeds $5,250,000. New York State does not impose a gift tax.

During the beneficiary's lifetime, the trust assets are to be used solely for the disabled beneficiary in a way that does not interfere with the beneficiary's eligibility for government sponsored programs. For example, the trust can purchase a specialized vehicle for the beneficiary's benefit. The trust can invest in housing for the beneficiary. The vehicle or the residence must be owned by the trust. The trust can also provide for family visitation, education, investment and insurance. Other powers can also be included.

SSI is an income supplement for food and shelter for persons who are blind or disabled. Persons who receive SSI also receive Medicaid. The reverse is not true. Therefore, to avoid the risk that the disabled beneficiary's SSI income could be reduced, the trust uses restrictive language with respect to housing, in particular. SSI is reduced by income "in kind" for housing. Income "in kind" refers to indirect income such as the parent paying rent on behalf of the disabled child. However, purchasing (or investing in) a house is not treated as income in kind. Medicaid does not recognize income in kind.

The trust may generate income, perhaps interest, dividends or capital gains. Income is taxable above a certain level and an accountant should prepare a return. The trust can pay these fees. Additionally, the trust does not require court approval of accounts.

Outside of a Will, trusts can be used to protect current and potential disabled family members. Irrevocable trusts can be used to protect assets. The creation and funding of this trust Irrevocable Income Only Medicaid Trust will create a five year period of time during which the client would be eligible for Medicaid for institutional care. The same is not true for home care as the creation and funding of the trust does not create any period of ineligibility for home based care under current law. The client needs to keep enough money available during the five year period to provide for his comfort and any potential health care needs.

The trust is irrevocable. Once the client transfers assets to the trusts, the client will have no right to demand the return of these assets. In fact, in order to protect the assets, the trust must provide that under no circumstances can the trustees exercise any discretion to return trust principal to the client. The client is entitled to income generated by the assets. With regard to a house transferred into the trust, the income is equivalent to the use and possession of the premises. During the client's lifetime, the client retains full right to use, occupy, etc. the house. The client will also remain responsible for taxes, insurance, upkeep and repair as well.

The trust is a "Grantor Trust" which means that the client will each be taxed for income tax purposes as though the client continues to own the assets. Every year, the accountant will prepare trust "fiduciary" returns showing all income, including interest, dividends and capital gains, if any. However, the trusts will not pay tax. Instead, the accountant will prepare a 1099 for the client on behalf of the trusts, which will show that the client remains responsible for all income tax, if any. If the only asset is the house, then there will be no income earned on the Trust.

Trust assets, although gifted to the trust, will remain in the client's taxable estate. The benefit is that any assets ultimately distributed to the children on the second death will be treated as inherited. Accordingly, the children will receive a step-up in basis for all such assets to the fair market value. The trust can contain one or two provisions which would give the client the right to change the final disposition of the trust assets. One is exercisable during the client's lifetime and the other by his last will and testament. These powers have several advantages besides the obvious consideration of giving the client the right to change who will ultimately benefit. The gift to children is uncertain, which renders the gift to them as incomplete, so that there will be no gift tax upon the transfer of assets to the trust. It may be prudent to file a gift tax return which will show no tax due. If the clause exercisable during the client's lifetime specifically provides that the client can exercise the power during his lifetime by attorney-in-fact, then the client's attorney in fact, who may be his child, will have the power to impact the client's estate plan, at least with respect to trust assets.

In order for the client to receive any trust principal, the trustees can make cash distributions to the client's children who in turn can voluntarily gift assets back to the client or pay for the client's care.

EDUCATION TRUSTS FOR CHILDREN AND GRANDCHILDREN

One can make gifts while preserving the ability to make annual exclusion gifts and use applicable exclusion amount, by making gifts for tuition expenses (IRC §2503(e)). Gifts for tuition expenses involve an unlimited amount paid to an educational institution on behalf of any person regardless of age or type of school (primary, secondary, vocational, graduate, parochial, etc.). There is no limit on how many people or to whom the donor may benefit. The gift is limited to tuition only, and does not include books, supplies, dormitory fees, etc. The donor does not use annual exclusion or applicable exclusion amount with these tuition gifts.

Another way to benefit a minor is a gift to §529 Qualified Tuition Plan. These plans are regulated by both state and federal law and allow for tax free growth on the contributed assets. The account owner does not make investment decisions, but chooses among alternatives offered by the particular state's plan. The donor has the ability to provide for a contingent account owner in case of the disability of the donor/account owner.

Some states have contribution limits (New York is $375,000 per beneficiary). Contributions are not deductible under federal tax law. New York does allow deductions up to $5,000 of contributions made to New York Plan ($10,000 for a married couple filing jointly). Earnings of the fund are not taxable and withdrawals from the plan are not taxable if used for qualified educational expenses for the beneficiary. The money in the account can only be used for tuition, room and board, books, supplies, and other qualified higher education expenses at post-secondary school (college, graduate school and vocational school). If the beneficiary does not need the money in the account, then donor can name another eligible family member as beneficiary on the account and use the 529 assets to pay for that person's education or donor can close the account and earnings will be subject to federal income tax and an additional 10% federal income tax, as well as state and local income taxes.

The donor can make five years of annual exclusion gifts at one time for each beneficiary without incurring federal gift tax. At present time that is $70,000 (5 x $14,000 = $70,000) or $140,000 for a married couple filing jointly. The one caveat is that such donor cannot make any other annual exclusion gifts to that child for five years. The plan assets are usually not included in the estate of the contributor. However, if the five year election is made, the payments will be included in the donor's estate if the donor dies before the expiration of the five year period.

When a donor contemplates the gift to be used for expenses in addition to education expenses or wants greater investment options for the gift, instead of making a gift to the §529 Plan (or in addition to), the donor may wish to make a gift to §2503(c) Trust. The Trust is created to receive annual exclusion gifts for a child or grandchild. Upon the beneficiary attaining the age of 21, the beneficiary must be given at least 30 day notice of right to withdraw all trust assets. If beneficiary chooses not to withdraw trust assets, the trust can continue for the benefit of the beneficiary. This trust passes money to the next generation and avoids probating these assets. The beneficiary's enjoyment of the proceeds is not tied into waiting for the donor to die or for appointment of an Executor or Testamentary Trustee. Additionally, the use of such a trust passes assets outside of the donor's estate before he dies causing there to be less available assets subject to estate taxes and probate upon the donor's eventual death. However, there is a risk inherent with this plan that the beneficiary will take the assets at 21 and not leave them in the trust. Careful guidance must be given to the donor and the beneficiary as to why leaving the assets in the trust is beneficial.

For an older child, the donor may wish to make a gift to a traditional or Roth IRA in the donee's name. The donee must be at least 18 years of age and have earned income. The income tax penalties from early withdraw may discourage such action.

Alternatively, the donor may wish to make a gift to a custodial account for the benefit of a minor (person under the age of 21) pursuant to the Uniform Transfer to Minors Act in New York (UTMA). If the donor names someone other than self as custodian, then the account will not be includable in donor's estate if the donor dies before the minor attains the age of 21.

GENERATION SKIPPING TRUSTS

The GST tax was originally enacted in 1976 in an effort to prevent passing assets to grandchildren to escape estate tax owed at the child level. Under the current law, each person has a GST tax exemption amount which can be used during lifetime or upon death to avoid payment of federal GST tax (current rate is 40% and is usually paid by donor). Currently, up to $5,250,000 can be gifted during lifetime to a grandchild or more remote descendant, or to an individual 37 1/2 years younger than the donor who is not a family member. Upon death, the rules provide that up to $5,250,000 can be transferred to a grandchild or more remote descendant, or to an individual 37 1/2 years younger than the donor who is not a family member. However, this amount will be reduced by any amount used to shelter lifetime gifts from federal GST tax.

In planning for use of a donor's GST tax exemption during lifetime, the attorney should inform the donor that assets can be transferred during lifetime to a trust and still qualify for the exemption. Therefore, the donor has more gifting options available than simply outright gifts to grandchildren.

During the current economic conditions, many assets are undervalued. By gifting them in today's market at the lower values, the donor is able to transfer what would otherwise be highly valued assets at reported values well under expected future worth. The donor will use less of his or her annual exclusion, lifetime gift tax exclusion and GST tax exemption on the gift. The donor can minimize gift and GST taxes by taking advantage of these lower values. Additionally, the donor can give away a larger percentage of that asset or additional assets by gifting the asset at its depressed value.

- GST Tax planning using GST Tax exemption amount which is the same as the available unified credit which is $5,250,000, subject to change by future legislation (less any amount used by testator to shelter lifetime gifts from federal generational skipping transfer tax). (IRC §2631).
  - GST Tax exemption placed in Trust for spouse and issue or spouse then issue.
  - Outright bequest of GST Tax exemption to issue.
  - Can be applied against Credit Shelter Trust.
  - Issue can be given general power of appointment in Descendant's Trust in case of death before trust terminates to avoid application of GST tax.

By using the GST Trust as part of the plan, the testator can protect grandchildren from creditors, preserve assets in the case of divorce, shield assets in the event of a business failure and assist the grandchildren in asset management. The GST Trust also preserves assets and prevents grandchildren from rushing to sell them upon inheritance. The GST Trust also enables the testator to ensure that there are sufficient funds available for education if the grandparent dies before the grandchild's education is completed.

FUNDING THE TRUST

Each person has an applicable exclusion amount (unified credit) ($5,250,000) which can be gifted during lifetime without paying a federal gift tax (current rate is 40% and is usually paid by donor). The available applicable exclusion upon death is currently $5,250,000 and will be reduced by amount used to shelter lifetime gifts from federal gift tax. Additionally, as discussed, each person has a GST tax exemption amount which can be used during lifetime or upon death to avoid payment of federal GST tax.

To fund both revocable and irrevocable trusts, a new bank account is created for the trust in the name of this trust typically under the employer identification number assigned to the trust. However, Revocable Trusts and some irrevocable Grantor trusts use the tax identification number of the Grantor. The assets are transferred from one bank account to the other to fund the trust. To the extent that partnership interests or share in a corporation or limited liability company are transferred, assignment and assumption agreements are also signed. Real estate is transferred into a trust by transferring the real estate with a deed and related transfer documents. Sometimes a nominee agreement is used such as when a co-op board will not approve the transfer. The IRS has approved the use of a nominee agreement which states that the Grantor retains title on behalf of the Trust. (see Private Letter Rulings 9249014, September 4, 1992 and 9433016, May 18, 1994). New York County Surrogate's Court has even held that a transfer of an interest in a residence to the donor's children by delivering the stock certificate to them qualified as a completed gift even though the co-op board did not approve the transfer (Matter of Katz, 142 Misc. 2d 1073, 539 NYS2d 659 (1989); see also Matter of the Accounting by Carniol, 20 Misc. 3d 887, 890, 861 NYS2d 587, 589 (2008) (reiterating the holding in Katz).

Assets do not receive a step-up in basis on the date of the gift but do receive a step-up in basis if transferred upon death. Therefore, the donor must weigh benefit of giving away highly appreciated assets during lifetime to reduce potential estate tax against the loss of the step-up in basis the donee would have received had the donor passed the same asset to the donee upon death (IRC §1014). In general, the capital gains tax the donee will have to pay upon sale of the asset will be less than the estate tax owed on the same asset if the donor's estate will be subject to estate tax. This analysis becomes very important when planning with a Qualified Personal Residence Trust. Therefore, the attorney should be sure to ascertain the basis of the house when discussing the transaction with the client. Assets transferred to a Revocable Trust retain the Grantor’s basis since these assets are not removed from the Grantor’s taxable estate.

In planning for a gift of an appreciated asset to an irrevocable trust, the donor should obtain an appraisal of the asset. Appraisals are essential for hard to value assets such as real estate, art, collectibles and closely held business interests. These appraisals will be the basis for determining the fair market value of the gift and can be challenged by the IRS. Therefore, the donor should work with the attorney to consult a valuation expert knowledgeable about the specific asset to be gifted.

Gifting highly appreciated assets makes sense when the donor is in a higher tax bracket than the donee. By doing so, the donee can sell the asset and be taxed in a lower tax bracket than the donor. Conversely, when an asset depreciates, the donor should first sell the asset if the donor can take advantage of the capital loss on his own return. Following the sale, the donor then gifts the sale proceeds to the donee.

Since the gift is valued as of the date of the gift for gift tax purposes, any post-gift increase in the value of the property escapes the donor's estate which will reduce estate tax owed upon the donor's death. Therefore, in deciding which assets to gift, consideration should be given to how much the asset is expected to appreciate in the future in addition to the present value of the gift and its appreciation to date.

During the current depressed economic conditions, many assets are undervalued. By gifting them in today's market at the lower values, the donor is able to transfer what would otherwise be highly valued assets at reported values well under expected future worth. The donor will use less of his or her annual exclusion, lifetime gift tax exclusion and GST tax exemption on the gift. The donor can minimize gift and GST taxes by taking advantage of these lower values. Additionally, the donor can give away a larger percentage of that asset or additional assets by gifting the asset at its depressed value.

When a donor gives away a partial interest in an asset such as real estate, a partnership or a limited liability company, the donor is able to take a discount for lack of marketability and/or control. This gift of this minority interest allows the donor to give away more of the asset without having to use more of his or her annual exclusion, lifetime gift tax exclusion and GST tax exemption.

The Form 709 must be filed in April of the year following the date of the gift if more than the annual exclusion is gifted or if a discount was taken when valuing annual exclusion gifts. On the Form 709, the donor reports the fair market value of the gift on the date of the transfer, the tax basis (as donor) and the identity of the recipient. The donor must attach supplemental documents to support the valuation of the gift, such as financial statements and appraisals.

Treas. Regulation §20.2031-1 defines fair market value as:

> The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate.

There is no joint gift tax form. If a husband and a wife each make a taxable gift, each spouse must file a Form 709. If husband and wife are splitting an annual exclusion gift, then each of them must file a Form 709 to reflect the split gift.

The gift tax is a tax on the transfer of any type of property by one individual to another while receiving nothing, or less than full value, in return. The taxable transfer includes a gift of the use of or income from property, the sale of an asset for less than its full value and an interest-free or reduced-interest loan. The tax applies once the donor has exhausted his lifetime applicable credit amount.

By filing the Form 709, the three year statute of limitations begins to run on the transaction. If the donor chooses not to file a gift tax return, the IRS can question the valuation of the transferred property at any time in the future. Therefore, even in the case of a transfer limited to the annual exclusion or sale of property for full fair market value, the transferor may still wish to file a Form 709 if the value of the transfer could be contested in the future (such as in the case of hard to value assets like heirlooms, business interests and artwork).

The Form 709 should be prepared by the donor's attorney or by the donor's accountant with review by his attorney. A copy of the Form 709 should be keep in the donor's file at the attorney's office since copies will be needed upon the death of the donor and in the event the donor intends to make future gifts.

METHODS OF DESIGNATING FIDUCIARIES

Typically, the decedent's Will contains an article which names the Executor. The Executor (or Executrix in the case of a woman, although the term Executor is often used for both genders) is the person who carries out Testator's wishes upon death of Testator upon receipt of Letters Testamentary from Surrogate's Court (NY Surrogate's Court Procedure Act ("SCPA") §103(20)). All persons are able to qualify as Executor, except for infants, incompetents, non-domiciliary alien (other than a foreign guardian under SCPA §1716(4) or one who serves with multiple fiduciaries at least one of whom is a New York resident), felon, someone who has a history of substance abuse, dishonesty, improvidence, want of understanding or otherwise unfit for office or someone who cannot read and write English (SCPA §707).

Under SCPA §2307 the Executor is entitled to a commission as follows:

5% on the first $100,000
4% on the next $200,000
3% on the next $700,000
2.5% on the next $4,000,000
2% on the remaining sums over $5,000,000

The Will can override these provisions by providing that no commissions are allowed, by changing the tiered structure or by stating a flat fee.

The attorney can assist the client in choosing the fiduciaries. A client may believe that he or she must name the surviving spouse or the eldest child as executor. Therefore, the attorney must convey that the person designated must be the person most capable of handling the responsibilities to which he/she will be assigned and must have the time and ability to carry out the estate administration. Technically, the executor is responsible for gathering all assets, closing all of the decedent's accounts, collecting and paying bills presented to the estate, filing paperwork, disposing of tangible personal property, distributing assets according to the Will and preparing tax returns. However, more often than not, the executor hires an attorney and/or accountant to handle such actions.

The client should consider possible conflicts when naming someone as the executor. For example, the executor who also is a beneficiary (such as the oldest child), has a potential conflict when the executor has the authority to divide tangible personal property in the event of a disagreement among the testator's children. To mitigate possible conflicts or fighting between children as to who was named as fiduciary and who was not, the client may consider naming multiple fiduciaries. However, multiple commissions are payable if more than one fiduciary is named (SCPA §§2307, 2309 and 2313). When there are disputes between fiduciaries, the majority makes the decision unless otherwise provided in the Will (EPTL §10-10.7). As an alternative, naming an impartial non-family member or other relative may be wise.

Fiduciaries may have personal interests in the estate or trust which conflict with their fiduciary role. Therefore, the client must determine if the named individual will be able to handle the conflict and whether the other beneficiaries will be comfortable with the arrangement. Also, a trustee who is a beneficiary cannot make discretionary distributions to himself (EPTL §10-10.1). Therefore, the client must name a co-trustee to serve with such a beneficiary.

The client should consider the merits of naming the attorney as fiduciary. It is generally unethical for an attorney to suggest that the client should nominate the attorney as executor. However, if the client truly believes that the attorney is the best person for the job, then the client can name the attorney to such role, such as when the attorney has unique knowledge of the client's personal affairs or there is a lack of family members appropriate for the position. Under SCPA

§2307-a, when a client nominates the attorney as executor, the client must sign an acknowledgment of disclosure (Exhibit G) stating that the client was informed that:

- Any person can serve as an executor;
- Any person serving as an executor is entitled to statutory commissions;
- Any attorney, including the attorney-executor, is entitled to legal fees for legal work performed on behalf of the estate; and
- Absent execution of the acknowledgment of disclosure, an attorney who serves as executor will be entitled to only one-half of the statutory commissions he would otherwise be entitled to receive.

A client may also consider naming a corporate fiduciary if no family members would be appropriate. The client may believe that the corporate fiduciary has certain expertise that would then make it the logical choice for acting as fiduciary. However, in general, a corporate fiduciary will be more conservative and less flexible than a family member. Such behavior may be a positive to the client, but none-the-less, should be considered. Additionally, a corporate fiduciary may not have a relationship with family members other than the client. The corporate fiduciary may not be in the best position to make distribution decisions since the corporate fiduciary lacks important personal knowledge about the beneficiaries. Also, since financial advisors frequently change institutions, if a client names a particular corporate fiduciary because of his relationship with the financial advisor, the client must remember to change the corporate fiduciary in his Will when such advisor switches firms. Potentially, the advisor could switch firms during the administration of the estate or the testamentary trust. If that is the case, the estate or beneficiaries will not be able to follow the advisor to his new institution unless the corporate fiduciary is willing to resign and designate the advisor's new firm as the successor or unless the Will contains provisions that contemplate this scenario. If the client owns a business, the corporate fiduciary may have certain policies in place with regard to continuing such business. The attorney should encourage evaluating such policies before naming such institution as a fiduciary. Because of these inherent problems, careful drafting of fiduciary appointment provisions is of utmost importance.

The attorney should also ensure that successors are named to each fiduciary position and that there are provisions in place for the successors to designate successors. The attorney may also find it prudent to allow the fiduciary to name additional persons to serve. Providing for the resignation of a fiduciary can be very important especially in the corporate fiduciary context as discussed earlier. When a trustee resigns, such trustee must submit a verified petition and decree to Court under SCPA §715. Successor trustees are appointed with a verified petition (can be done at the same time and in the same petition) under SCPA §706. When no successor is named under the Will, SCPA §1502 provides a mechanism for the Court to do so.

An additional item to be considered when drafting fiduciary Will provisions is that a surety bond is required by the fiduciary unless the client waives such a requirement in the Will. Usually, such a bond waiver provision is standard.

<u>OVERVIEW OF THE WEALTH TRANSFER CHARITABLE TAX DEDUCTION AND CONSIDERATIONS IN ASSETS TO DONATE</u>

The client may give an unlimited amount to a qualifying charity which is an organization described in §§170(6)(1)(A), 170(c) and 2055(a) of the Code. There is no gift or estate tax because the transfer qualifies for a charitable deduction. These not-for-profit corporations must have a charitable purpose and in New York, three directors are required. They are also called 501(c)(3) organizations and can be divided into two classes: <u>private foundations</u> and <u>public charities</u>.

Private foundations typically have a single major source of funding (usually gifts from one family or corporation) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs. The benefits of such an organization are control over investments and distributions, family involvement to ensure a legacy of family giving, immediate tax deduction for contributed assets (even though foundation does not distribute all of the assets immediately to other charities) and removal of low basis taxable assets out of estate without incurring capital gains taxes. The tax deduction is limited to 30% of adjusted gross income (AGI) for cash donations to the private foundation and 20% of AGI for appreciated securities. The Donor can carry forward any of the unused deduction for an additional 5 tax years. For valuation of the contributed asset, gifts of closely held stock held more than a year will be deductible only in the amount of the donor's basis.

All records are open to the public. Directors can receive compensation. However, there are some disadvantages to operating a private foundation. Directors must refrain from acts of self-dealing (§4941 of the Code), meet minimum distribution requirements of distributing 5% of its assets each year to other charitable causes (§4942 of the Code), abstain from "excess business holdings" (§4943 of the Code), abstain from "jeopardizing investments" (§4944 of the Code), refrain from making certain expenditures (§4945 of the Code) and pay tax on net investment income (§4940 of the Code).

For clients interested in an entity that expands its scope from the single family focus, a public charity may be a better choice of entity. Generally, public charities are organizations that meet the following criteria which can be found in §§509(a)(1), (2), (3) or (4) of the Code:

(i) Churches, hospitals, qualified medical research organizations affiliated with hospitals, schools, colleges and universities;

(ii) Fundraise and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations or other public charities;

(iii) Receive income from activities in furtherance of the organization's exempt purposes; or

(iv) Actively function in a supporting relationship to one or more existing public charities.

The tax deduction is limited to 50% of AGI for cash donations to a public charity and 20% of AGI for appreciated securities. The Donor can carry forward any of the unused deduction for an additional 5 tax years. For valuation of the contributed asset, gifts of closely held stock held more than a year will be deductible in the amount of its fair market value which is substantially better than the valuation offered for gifts to a private foundation.

All records are open to the public. Directors can receive compensation. Additionally, §642(c) of the Code allows public charities to establish and maintain pooled income funds. At least one-third of the funding must come from a governmental unit or from direct or indirect contributions from the general public. The percentages are calculated by using total support as the denominator and public support as the numerator. The numbers used reflect a four year period. Public support can also come from gross receipts derived from an activity related to its exempt purpose. If the entity fails the one-third support test, then it can still qualify as a public charity under the facts and circumstances 10% test. Under this test, the organization must normally receive at least 10% of the total support from governmental units, from contributions made directly or indirectly by the general public, or a combination of the two. Additionally, the entity maintain a continuous and bona fide program for solicitation of funds from the general public, community, or membership group involved, or it can carry on activities designed to attract support from governmental units or other charitable organizations described in §509(a)(1) of the Code. This test also uses a four year period.

A <u>Pooled Income Fund (PIF)</u>, mentioned above, is run by a public charity. A donor makes a gift to an organization that runs a PIF and the gift is tax deductible. The PIF pays a monthly income to the donor or donors for their lifetime(s). Any income received from PIF is taxable income. The donor's applicable exclusion amount will need to be allocated to the gift if a child or grandchild is named as an income beneficiary. The applicable exclusion amount (unified credit) currently is $5,000,000 for 2011 and 2012, followed by a return to the exemption amount of $1,000,000, all subject to change by future legislation (less any amount used by testator to shelter lifetime gifts from federal gift tax). New York law remains unchanged with a $1,000,000 credit and at present there are no plans to adopt any changes. Also, the donor may need to allocate GST tax exemption to the gift which is the same amount as the available unified credit (Code §2631).

The balance remaining upon the death of the income beneficiary is then distributed to one or more pre-determined qualified charities chosen by the donor. The benefits are that a small amount can be used to fund the PIF account because the PIF combines the contributions of all donors in a single investment fund and removes low basis taxable assets out of estate without incurring capital gains taxes. The charitable tax deduction is based on the type of asset being contributed, the amount contributed, the age(s) and number of income beneficiaries and the PIF rate of return. The deduction is limited to 30% of AGI for appreciated securities and the donor can carry forward any of the unused deduction for an additional 5 tax years. No annual tax returns are due and records are not open to the public. No mandatory annual distributions required. The donor may name account advisors who will have the ability to recommend grants from the account. The donor can select successors, who can continue the charitable legacy by recommending grants beyond the donor's lifetime. Art work, collectables and real estate are usually not allowed as a gifted asset and the donor does not have say in specific investment decisions or donations.

Another charitable vehicle is the Charitable Gift Annuity in which the donor transfers cash or marketable securities to the charitable organization in exchange for a current income tax deduction and the organization's promise to make fixed annual payments to donor for life. The transaction is partly a charitable gift and partly a purchase of the income interest. Annuity payments can begin immediately or can be deferred to some future date. The older the designated annuitant is at the time of the gift, the greater the fixed income. The portion of the transaction that is considered a gift qualifies for a charitable deduction. The charitable tax deduction is limited to 30% of AGI for appreciated securities. The donor can carry forward any of the unused deduction for an additional 5 tax years. The tax treatment of the annuity is broken into a tax free portion, capital gain income and ordinary income for a period of years based on donor's life expectancy and then entire annuity is treated as ordinary income. In New York, charitable organizations offering gift annuities must maintain a separate reserve fund to ensure payment of annuity to donor.

Gifts of retirement assets can be a sound device for avoiding income tax on the assets held in the retirement accounts. The donor can give up to $100,000 of the annual required minimum distribution from an IRA, 401(k) and 403(b) directly to a charity this year. The charitable contribution is excluded from taxable income. However, the donor cannot claim a charitable deduction for the donation. In order to take advantage of this law, the donor should direct the financial institution to give the distribution from retirement accounts directly to charity. Additionally, a client can name a charity as the beneficiary of a retirement account so that upon death the assets pass to the named charitable beneficiary. By doing, so the client's family members avoid owing the income tax that would have otherwise been owed on such retirement account had the client named one or more family members as the beneficiary instead of the charity.

Other testamentary charitable planning can be made by the client making a specific bequest in his or her Will to a named charity or family foundation (EPTL §8-1.1). The client can even give his or her executor the discretion to choose the charity to receive such bequest which must be qualifying charitable organizations. The charitable bequest reduces the client's gross estate for purposes of calculating the estate tax.

When a donor makes a gift to a charitable organization that is held in perpetuity, it is called an Endowment/Endowed gift. The gift is invested by the organization, and only a portion of its average annual investment return is used for purposes specified by the donor. Any unused income is added to principal. The goal is to ensure that the principal maintains its value over time. Endowments offer donors the ability to have their names, or the name of a loved one, linked to an area of the organization in which they have a special interest or the gift can be unrestricted. Endowed gifts can be pledged over a period of up to five years.

A donor can also make a gift to an organization that runs a Donor Advised Fund (DAF). The gift is tax deductible. Each year the money is distributed from the account to various charities which the donor can recommend. The benefits are that small amount can be used to fund the DAF account, the donor does not need to worry about naming directors, replacements, etc, it can be used to establish an endowment that can run automatically after the donor's death, there is an immediate tax deduction for contributed assets (even though the DAF does not distribute all of the assets immediately to other charities) and the donor can remove low basis taxable assets out of estate without incurring capital gains taxes. The tax deduction is limited to 50% of AGI for cash donations to the private foundation and 30% of AGI for appreciated securities. The donor can carry forward any of the unused deduction for an additional five tax years. No annual tax returns are due and records are not open to the public. No mandatory annual distributions required. The donor may name account advisors who will have the ability to recommend grants from the account. The donor can select successors, who can continue charitable legacy by recommending grants beyond donor's lifetime. Art work, collectables and real estate are usually not allowed as a gifted asset and the donor does not have say in specific investment decisions or donations.

Under the rules of the 2006 Pension Act, fractional gifts of art must be completed by shorter of donor's lifetime and ten years. If art has not passed to organization at the end of the term, then all of donor's charitable deductions are recaptured, plus a 10% penalty is assessed on recaptured amount. Charitable deductions are now based on lowest appraisal received as compared year to year during term of gift. In general, for gifts of unmarketable assets or hard to value assets valued at greater than $5,000, the donor must obtain a qualified appraisal. Failure to do so likely results in the disallowance of the income tax charitable deduction. Additionally, the IRS could impose negligence and other penalties.

A Charitable Lead Trust ("CLAT" or "CLUT") (Code §§664(d)(1) and (2) and EPTL §8-1.8) is an irrevocable trust created in a Will or during lifetime that will pay the charity an annuity for a period of time (or the charity can receive a percentage of the value of the assets re-calculated each year). Alternatively, the payments can continue for the life or lives of individuals alive at the time of the trust's creation or for a period which is the lesser of a term of years or a measuring life (plus a term of years). The measuring life must be that of the grantor, the grantor's spouse, a lineal ancestor of remainder beneficiary or the spouse of such ancestor.

The charity must be designated as the beneficiary at the time of the trust's creation and must qualify under Code §§170(c), 2055(a) and 2522(a). The trustee can have discretion to select a charity that satisfies this criteria or the grantor can name a specific charitable entity. The trust can also provide that the grantor's spouse or another family member has the power to pick the charity so long as such person did not contribute any assets to the trust. The trustee must have the ability to pick an alternate organization in the event the named charity ceases to qualify. The grantor should not have the power to change the charitable beneficiary if the CLT is a non-grantor CLT, discussed later, because of the risk of potential estate tax inclusion. One option is to name a DAF as the beneficiary which will indirectly give the grantor control over the charities receiving the payments.

A Charitable Remainder Trust ("CRAT" or "CRUT") (IRC §§664(d)(1) and (2) or (3) and EPTL §8-1.8) is an irrevocable trust designed to convert highly appreciated assets into a lifetime income stream without generating estate and capital gains taxes. The donor, trustee, and income beneficiary can be the same person. The only restriction is that at least one income beneficiary is not a charity. The CRT pays the donor (additional beneficiaries, if desired) an annuity for life or for a period of time not to exceed 20 years or the donor can receive a percentage of the value of the assets re-calculated each year. There can be more than one income beneficiary. To avoid making a taxable gift to the surviving beneficiary upon the death of the co-income beneficiary, the donor can keep the right exercisable by his or Will to revoke the survivor's payments. However, if the donor is not one of the income beneficiaries, then retaining this right will include the trust in his or her estate. Also, if the other income beneficiary is the donor's spouse, then a marital deduction is available and the gift will not be subject to gift tax.

When the amount paid to the income beneficiary is a fixed amount, the trust is called a Charitable Remainder Annuity Trust, or CRAT and when the amount is a fixed percentage of the trust's assets revalued annually, it is called a Charitable Remainder Unitrust, or CRUT. CRATs are commonly used when the income beneficiaries are not concerned that inflation will reduce the spending power of their other assets and therefore, the annuity payments. On the other hand, CRUTs provide a hedge against inflation but can prove costly if unmarketable assets are held in the trust which need appraisals each year. Under Treas. Reg. §1.664-1(a)(7), the trustee can value the unmarketable assets can be determined by either an independent trustee or a current qualified appraiser.

EXHIBIT A

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER

PROBATE PROCEEDING, Estate of JOHN DOE, Deceased.	RENUNCIATION AND DISCLAIMER OF INTEREST IN ESTATE File No. __________

I, MARY SMITH, residing at 123 Main Street, West Harrison, New York 10604, do hereby irrevocably renounce, disclaim and refuse to accept the bequest that would otherwise be payable to me due to the death of JOHN DOE on ________________ under Paragraph THIRD (I) of the Will of JOHN DOE dated ______________ and admitted to probate on ______________ (the "Will").

This renunciation and disclaimer is made with the understanding and expectation that it is irrevocable and will be treated as a qualified disclaimer under §2518 of the U.S. Internal Revenue Code and an effective renunciation under §2-1.11 of the New York Estates, Powers and Trusts Law so that all such property that is includable in the decedent's gross estate for estate tax purposes and that would otherwise be payable to me shall be distributed in accordance with the terms of the Will as if I had predeceased JOHN DOE, the decedent herein.

I hereby execute and acknowledge this renunciation and disclaimer in the presence of a notary public and direct that it be filed in the Surrogate's Court of Westchester, New York, which has jurisdiction of the estate of JOHN DOE, within nine (9) months of his death.

The remaining beneficiaries under the Will, JANE DOE and BOB SMITH (collectively, the "Beneficiaries"), will personally gain an interest by reason of this renunciation and disclaimer, as these renounced and disclaimed interests will become available assets to be distributed under the Will. I hereby direct that a copy of this renunciation and disclaimer be served upon each of the Beneficiaries as persons who will gain an interest by reason of this renunciation and disclaimer and upon JANE DOE as the Executor of the Estate of JOHN DOE. I hereby further direct that such service shall be made within nine (9) months after the death of the decedent.

_________, 20___

____
MARY SMITH

STATE OF NEW YORK)
) SS:
COUNTY OF WESTCHESTER)

On the _______ day of _________, 20___ before me, the undersigned, personally appeared MARY SMITH, personally known to me or proved to me on the basis of satisfactory evidence to be the individual whose name is subscribed to the attached Renunciation and Disclaimer of Interests in Estate and acknowledged to me that she executed the same and that by her signature on the instrument she executed the instrument.

____
Notary Public

EXHIBIT B

SURROGATE'S COURT OF THE STATE OF NEW YORK

COUNTY OF WESTCHESTER

PROBATE PROCEEDING, Estate of JOHN DOE Deceased.	AFFIDAVIT IN SUPPORT OF RENUNCIATION AND DISCLAIMER File No. _________

STATE OF NEW YORK)

) SS:

COUNTY OF WESTCHESTER)

MARY SMITH, residing at 123 Main Street, West Harrison, New York 10604, being duly sworn, deposes and states: I have executed simultaneously herewith an irrevocable renunciation and disclaimer of the bequest that would otherwise be payable to me due to the death of JOHN DOE on ______________ under Paragraph THIRD (I) of the Will of JOHN DOE dated ______________ and admitted to probate on ______________ (the "Will").

I hereby affirm that I have not received and will not receive any consideration in money or money's worth for such renunciation and disclaimer from any person or persons whose interest is created or accelerated by reason thereof.

____
MARY SMITH

Sworn to before me this _____
day of _________, 20___.

____
Notary Public

EXHIBIT C

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER
---X
PROBATE PROCEEDING,
Will of
JOHN DOE,

Deceased.
---X

NOTICE OF
RENUNCIATION
File No. __________

TO:

NAME	ADDRESS
Jane Doe	456 North Street Ossining, New York 10562
Bob Smith	123 Main Street West Harrison, New York 10604

PLEASE TAKE NOTICE, that by the annexed Renunciation and Disclaimer of Interest in Estate signed and acknowledged on ____________, 20____, MARY SMITH, pursuant to EPTL §2-1.11, irrevocably renounced the bequest that would otherwise be payable to her due to the death of JOHN DOE on ____________ under Paragraph THIRD (I) of the Will of JOHN DOE dated ____________ and admitted to probate on ____________.

Dated: _____________, 20___

Cuddy & Feder LLP
445 Hamilton Avenue
14th Floor
White Plains, New York 10601
(914) 761-1300

EXHIBIT D

SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER

In the Matter of the Application for Permission to File Renunciation by the estate of JOHN DOE, Deceased.	PETITION FOR PERMISSION TO FILE RENUNCIATION EPTL §2-1.11 File No. _______________

To the Surrogate's Court of the County of Westchester:

It is respectfully alleged that:

1. The name, citizenship and domicile of the petitioner are as follows:

   Name: Jane Doe
   Domicile: 456 North Street, Ossining, New York 10562
   Citizen of: United States

2. a. Pursuant to ITEM II of the Will of Jill Smith dated ____________, the Decedent, John Doe (the "Decedent"), inherited one-half (1/2) of the estate of his mother, Jill Smith, a domiciliary of 123 Main Street, Shohola, Pennsylvania, due to her death on ____________ (copy of Will attached as Exhibit A; copy of Death Certificate attached as Exhibit B). The petitioner inherited the remaining one-half (1/2) interest.

   b. Letters of Admr. Pendente Lite were issued to Jane Doe by the Register for the Probate of Wills and Granting Letters of Administration in and for Pike County, Commonwealth of Pennsylvania, on ______________ (copy attached as Exhibit C).

3. No distributions from the Estate of Jill Smith have been made to the Decedent since the death of Jill Smith.

4. The petitioner is the executor and the sole beneficiary under Article FOURTH of the Will of John Doe dated _______________ and admitted to probate on _______________ (the "Will") (copy attached as Exhibit D).

5. Pursuant to the Internal Revenue Code of 1986, as amended, section 2518(b)

> the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if --
>
> (1) such refusal is in writing,
>
> (2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after . . .
>
> (A) the date on which the transfer creating the interest in such person is made.

Therefore, the qualified disclaimer of the Decedent's interest in the Estate of Jill Smith must be filed by _________________, the date which is nine (9) months after Jill Smith's date of death.

6. Pennsylvania Probate, Estates and Fiduciaries Code §6202 provides that

> A disclaimer on behalf of a decedent . . . may be made by his personal representative . . . if . . . the court having jurisdiction of the estate authorizes the disclaimer after finding that it is advisable and will not materially prejudice the rights of creditors, heirs or beneficiaries of the decedent . . .

7. Pennsylvania Probate, Estates and Fiduciaries Code §6204(a) provides that "the disclaimer shall be filed with the clerk of the orphans' court division of the county where the decedent died domiciled . . . a copy of the disclaimer shall be delivered to any personal representative . . . in possession of the property."

8. The petitioner requests authorization from this Court to file the attached Renunciation and Disclaimer on behalf of the Decedent with regard to the estate of his mother, Jill Smith, in Orphans' Court of the Commonwealth of Pennsylvania, Pike County, as such disclaimer will not materially prejudice the rights of creditors, heirs or beneficiaries of the Decedent (copy of Renunciation and Disclaimer attached as Exhibit E).

WHEREFORE your petitioner prays that the Court grant authorization to file the disclaimer on behalf of the Decedent, in Orphans' Court of the Commonwealth of Pennsylvania, Pike County.

Dated: __________________, 20_____

Signature of Petitioner:

____

Name: Jane Doe

STATE OF NEW YORK)
COUNTY OF WESTCHESTER) ss.:

JANE DOE, being duly sworn deposes and says that I am the petitioner above named. I have read the foregoing petition and the same is true of my own knowledge except as to matters therein stated to be alleged upon information and belief and as to those matters I believe them to be true.

____
JANE DOE

On ________________, 20__, before me, the undersigned, personally appeared MARY SMITH, personally known to me or proved to me on the basis of satisfactory evidence to be the individual whose name is subscribed to the within instrument and acknowledged to me that she executed the same in her capacity, and that by her signature on the instrument, the individual, or the person upon behalf of which the individual acted, executed the instrument.

Sworn to by me this
_____ day of ____________, 20_____

____
Notary Public
Commission Expires:
(Affix Notary Stamp or Seal)

Signature of Attorney: ____

Print Name: Leslie Levin, Esq.

Firm Name: Cuddy & Feder LLP

Address of Attorney: 445 Hamilton Avenue, 14th Floor, White Plains, New York 10601

<u>EXHIBIT E</u>

CRUMMEY NOTICE FOR ADULT

Trust u/a John Doe Dated ______________, 20____
c/o Jane Doe, Trustee
987 West 6th Street
Apartment 5
New York, New York 43210

Date

Ms. Jill Smith
910 Madison Avenue
New York, New York 12345

Dear Jill:

This Notice is to notify you, that on ________(date)____________, a contribution was made to the trust created by your father dated ______________, 20____ (the "Trust") in the amount of $_______________. Under the Trust Agreement, you have the right to withdraw up to _____(fraction based on number of Crummey people)____ of this amount, subject to the limitations set forth in the Trust Agreement, or property of that value from the Trust. If you wish to exercise this power of withdrawal please contact me before December 31st.

Please acknowledge your receipt of this Notice by signing the enclosed copies of this Notice and by returning one fully signed copy of this Notice to (insert name of attorney) in the enclosed envelope and one to me in the enclosed envelope.

Sincerely yours,

Jane Doe, Trustee

ACKNOWLEDGEMENT OF RECEIPT:

By: ____________________
Jill Smith

Date:____________________

CRUMMEY NOTICE FOR MINOR

Trust u/a John Doe Dated ______________, 20____
c/o Jane Doe, Trustee
987 West 6th Street
Apartment 5
New York, New York 43210

Date

Mrs. Jane Doe, parent and
natural guardian of
George Doe, an infant
987 West 6th Street
Apartment 5
New York, New York 43210

Dear Jane:

This Notice is to notify you, that on ________(date)____________, a contribution was made to the trust created by John Doe dated ______________, 20____ (the "Trust") in the amount of $_______________. Under the Trust Agreement, George has the right to withdraw up to _____(fraction based on number of Crummey people)____ of this amount, subject to the limitations set forth in the Trust Agreement, or property of that value from the Trust. During the time period that he is a minor, you have the right to withdraw said amount on his behalf. If you wish to exercise this power of withdrawal on George's behalf please contact me before December 31st.

Please acknowledge your receipt of this Notice by signing the enclosed copies of this Notice and by returning one fully signed copy of this Notice to (insert name of attorney) in the enclosed envelope and one to me in the enclosed envelope.

Sincerely yours,

Jane Doe, Trustee

ACKNOWLEDGEMENT OF RECEIPT:

By: ____________________________
Jane Doe,
parent and natural guardian
of George Doe, an infant

Date:____________________________

EXHIBIT F

M E M O R A N D U M

TO: Grantor

cc: Trustee #1
Trustee #2

FROM: Attorney

RE: Trust u/a John Doe dated ___________, 20___

DATE:

The following information is a reference guide of the steps that need to be taken with regard to the Trust u/a John Doe dated ___________, 20___ which you created:

The IRS has assigned Employer Identification Number 12-1234567 to this Trust.

A non-interest bearing checking account will need to be opened with a nominal amount (i.e., $100) and with Trustee #1 and Trustee #2 as signatories on the account.

Premium Notices should be sent to Trustee #1.

When the premium comes due, you will contribute the amount of the premium to the insurance trust checking account. If you do so by check, you should write a check payable to the "Trust u/a John Doe dated ___________, 20___." Trustee #1 should then follow up with a Crummey Notice that will need to be signed by you as the parent of ______________. Once __________ and any other minor children you have in the future attain the age of 18, they will sign the Notices themselves. Original Notices should be sent to me for safekeeping and a copy kept by you and/or Trustee #1 for your records.

The required annual Crummey Notices allow you, as the grantor of the Trust, (or anyone else) to contribute funds to the Trust that will be considered to be present gifts and which will qualify for the annual Federal Gift Tax exclusion. The law requires __________ (and any other children you may have) to acknowledge that he knows that he has the right to withdraw the amount contributed by the grantor (or by others) to the Trust. These signed Notices are important because acknowledged signed copies of the Notices might be requested at the time of the audit of your estate tax return, if any.

Once the Crummey Notices have been sent, Trustee #1 will write a check from the Trust checking account payable to the Insurance Company for the amount of premium.

Please do not hesitate to contact me at 914-___________ or email address with any questions.

EXHIBIT G

I, JOHN DOE, have designated an attorney, ________________, as my Executor in my Will dated _________________, 20___.

Prior to signing my Will I was informed that:

(i) subject to limited statutory exceptions, any person, including an attorney, is eligible to serve as my executor.

(ii) absent an agreement to the contrary, any person, including an attorney, who serves as an executor for me is entitled to receive statutory commissions for executorial services rendered to my estate.

(iii) if such attorney serves as my executor and she or another attorney affiliated with such attorney renders legal services in connection with the executor's official duties, she is entitled to receive just and reasonable compensation for those legal services, in addition to the commissions to which an executor is entitled.

(iv) absent execution of this disclosure acknowledgment, an attorney who serves as an executor shall be entitled to one-half (1/2) commissions she would otherwise be entitled to receive.

___________________________ ________________________
(Witness) JOHN DOE

Dated: _________________, 20___

This presentation is for informational purposes only and is not intended as a substitute for legal, accounting or financial counsel with respect to your individual circumstances.