



# Wealth Transfer Planning Opportunities in 2013

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# Wealth Transfer Planning Opportunities in 2013 and 2014

- Lifetime gifting
- Grantor Retained Annuity Trust (GRAT)
- Dynasty trust
  - Intentionally Defective Grantor Trust (IDGT)
- Installment sales
- Irrevocable Life Insurance Trust (ILIT)
- Spousal Lifetime Access Trust (SLAT)
- Forgiving intra-family installment notes

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# Lifetime Gifting – Annual Exclusion Gifts

- Each year a taxpayer may gift up to a specified amount (\$14,000 in 2013) to another person (a.k.a. “donee”) without the gift being subject to gift tax
  - This transfer is referred to as an “annual exclusion gift”
- For married taxpayers, the annual exclusion gift per each donee is basically doubled (i.e. \$28,000 per donee in 2013)
- Neither the gift, nor the future appreciation on the gift is included in the taxpayer’s gross estate

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## Dynasty Trust

- A dynasty trust is a type of trust which benefits multiple generations where none of the assets held by the trust are included in either the grantor's taxable estate or any of the beneficiaries' taxable estates.
  - However, under the tax law, whenever a transfer is made by the grantor to a "skip person" (e.g. grandchild, great-grandchild, etc.) or a trust for their benefit (e.g. dynasty trust), a second level of tax is imposed on the transfer in addition to gift tax
  - Notwithstanding, a grantor is allowed a lifetime GST exemption on the first \$5,250,000 of taxable transfers to "skip persons"

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## Intentionally Defective Grantor Trust (IDGT)

An Intentionally Defective Grantor Trust (IDGT) is a type of dynasty trust where all income earned by the trust is taxed to the grantor because the trust is "defective" for income tax purposes, thus allowing for a "tax-free" gift to the trust's beneficiaries.

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## Irrevocable Life Insurance Trust (ILIT)

- A Irrevocable Life Insurance Trust (ILIT) is a type of trust which holds a life insurance policy on the grantor's life so as to benefit the grantor's children (and/or grandchildren and/or future generations) without the imposition of future estate, gift and/or GST tax
- To the extent that the grantor's estate has insufficient liquid assets to cover the estate tax liability, trust assets can be lent to the estate or used to purchase assets from the estate
- To the extent that the grantor does not hold any "incidents of ownership", none of the trust assets will be included in his/her taxable estate

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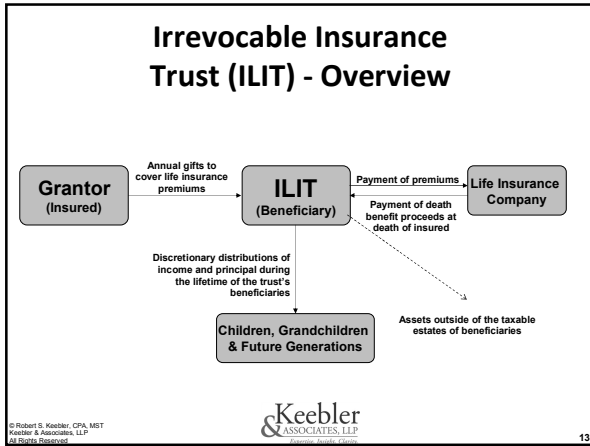
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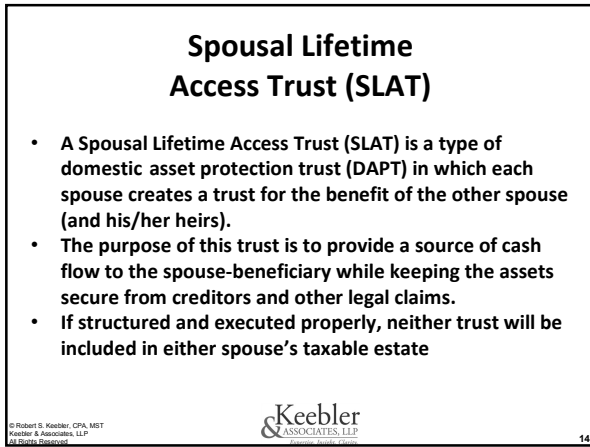
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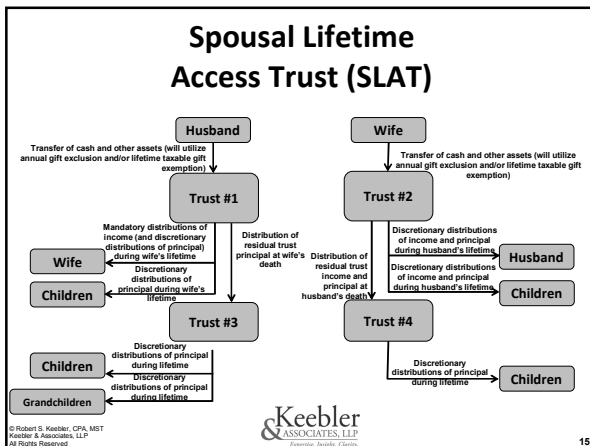
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## Forgiving Intra-Family Installment Notes

- Over the last 10+ many taxpayers have undertaken intra-family sales to junior generations (or trusts for their benefit)
- As the economy has languished over the last few years, investment performance on the underlying assets sold may be less than the interest rate on the installment note(s)
  - This would create an “upstream transfer” to the senior generation

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## Forgiving Intra-Family Installment Notes

- Consequently, with the gift and GST exemption both \$5,250,000 in 2013, now may be the time to unwind the sale transaction by forgiving all or a portion of the installment note(s)
  - If done correctly, this shouldn't result in any adverse income tax consequences

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## Sophisticated Planning for High Net Worth Clients

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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***It's a Balancing Act...  
Bet to Live? Bet to Die?***

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**IMPACT OF POTENTIAL FUTURE LEGISLATION**

Starting as early as the 2013 tax year, there is a possibility that certain estate planning opportunities may be diminished or possibly eliminated. These opportunities include (albeit not all-inclusive):

- Mandatory minimum GRAT term of 10 years
- No "zeroed-out" GRATs
- No multi-generational dynasty trusts
- No valuation adjustments on transfers of closely-held interests

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**KEY STRATEGIES**


**"Bet-to-Live" Strategies**

- Lifetime Gifts
  - Annual Exclusion Gifts
  - Lifetime Gift Tax Exemption Gifts
  - Taxable Gifts
- Grantor Retained Annuity Trust (GRAT)
- Dynasty Trust
- Sale to an Intentionally Defective Grantor Trust (IDGT)

**"Bet to Die" Strategies**

- Self-Canceling Installment Note (SCIN)
- Private Annuity

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**LIFETIME GIFTS**



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**LIFETIME GIFT TAX EXEMPTION GIFTS**

- During a taxpayer's lifetime, he/she may make "taxable gifts" (i.e. gifts that exceed the annual exclusion gift amount) up to a specified amount (\$5,250,000 in 2013) without having to pay gift tax
  - This transfer is referred to as an "lifetime gift tax exemption gift"
  - For married taxpayers, the aggregate lifetime gift tax exemption is basically doubled (i.e. \$10,500,000 in 2013)



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**LIFETIME GIFT TAX EXEMPTION GIFTS**

- Although lifetime taxable gifts may be sheltered from gift tax because of the lifetime gift tax exemption, the aggregate of such lifetime taxable gifts made by the taxpayer is included in the taxpayer's gross estate
  - However, only the original values of the taxable gifts are included in the gross estate (not the current values of the gifts)
- The post-gift future appreciation is ***not*** included in the taxpayer's gross estate



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**TAXABLE GIFTS  
ESTATE INCLUSION ISSUE**

- To the extent that a taxpayer pays gift tax on a taxable gift, his/her gross estate must include the value of the gift tax paid if the taxpayer dies **within 3 years of the gift**
  - The effect is to "gross up" the taxpayer's gross estate as if the original gift didn't take place

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**TAXABLE GIFTS  
ESTATE INCLUSION ISSUE EXAMPLE**

A taxpayer makes a \$5,000,000 taxable gift in 2013, utilizing her entire lifetime gift tax exemption amount. In 2014, the taxpayer makes an additional \$1,000,000 taxable gift, incurring a \$350,000 gift tax. Using these assumptions and assuming the taxpayer has \$10,000,000 of other assets included in her gross estate, below is a summary of the taxpayer's total taxable estate:

	Death Within 3 Years of Gift	Death More Than 3 Years After Gift
Other Assets	\$ 10,000,000	\$ 10,000,000
Gift Tax Paid	350,000	-
Gross Estate	\$ 10,350,000	\$ 10,000,000
Add-in: Prior Taxable Gifts	6,000,000	6,000,000
<b>Taxable Estate</b>	<b>\$ 16,350,000</b>	<b>\$ 16,000,000</b>
<b>DIFFERENCE</b>		<b>\$ 350,000</b>

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**GRANTOR RETAINED  
ANNUITY TRUST (GRAT)**

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### GRANTOR RETAINED ANNUITY TRUST STRATEGY OVERVIEW

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    graph TD
      Grantor[Grantor  
(Lead Beneficiary)] -- "Transfer of assets" --> GRAT[GRAT]
      GRAT -- "Annuity payments over a  
fixed term" --> Grantor
      Grantor -- "Payment of gift tax on present  
value of remainder interest  
transferred to children (should be  
at or near $0)" --> IRS[IRS]
      GRAT -- "At end of term, any residual  
assets remaining in the trust  
pass to the children free of any  
gift tax." --> Children[Children*  
(Remainder Beneficiaries)]
  
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\* Instead of naming the children as outright remainder beneficiaries of the GRAT, a grantor trust could be used (thus producing a greater estate tax benefit)

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### GRANTOR RETAINED ANNUITY TRUST GRAT EXAMPLE

Year	Beginning Balance	Taxable Income 10.00%	Annual Payment	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$(739,075)	\$ 10,260,925
2	\$ 10,260,925	\$ 1,026,093	\$(739,075)	\$ 10,547,943
3	\$ 10,547,943	\$ 1,054,794	\$(739,075)	\$ 10,863,663
4	\$ 10,863,663	\$ 1,086,366	\$(739,075)	\$ 11,210,954
5	\$ 11,210,954	\$ 1,121,095	\$(739,075)	\$ 11,592,975
6	\$ 11,592,975	\$ 1,159,298	\$(739,075)	\$ 12,013,198
7	\$ 12,013,198	\$ 1,201,320	\$(739,075)	\$ 12,475,443
8	\$ 12,475,443	\$ 1,247,544	\$(739,075)	\$ 12,983,913
9	\$ 12,983,913	\$ 1,298,391	\$(739,075)	\$ 13,543,229
10	\$ 13,543,229	\$ 1,354,323	\$(739,075)	\$ 14,158,477

**BENEFIT: \$14,158,477 transferred to beneficiaries estate/gift tax-free**

\*NOTE: Assuming a \$7,000,000 (after valuation adjustments) contribution

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### GRANTOR RETAINED ANNUITY TRUST WHY A GRAT WORKS

Payment of trust  
income taxes by  
the grantor

Valuation adjustments

Difference between actual rate of return and IRC §7520 rate

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### GRANTOR RETAINED ANNUITY TRUST WHY A GRAT WORKS – DIFFERENCE IN RATES OF RETURN

Year	Beginning Balance	Taxable Income 1.00%	Annuity Payment 1.055,821	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment 1.055,821	Ending Balance
1	10,000,000	100,000	(1,055,821)	9,044,179	1	10,000,000	1,000,000	(1,055,821)	9,944,179
2	9,944,179	99,442	(1,055,821)	8,978,800	2	9,944,179	994,418	(1,055,821)	9,882,776
3	8,978,800	89,788	(1,055,821)	7,103,767	3	9,882,776	988,278	(1,055,821)	9,815,232
4	7,103,767	71,038	(1,055,821)	6,119,983	4	9,815,232	981,523	(1,055,821)	9,740,935
5	6,119,983	61,199	(1,055,821)	5,124,352	5	9,740,935	974,093	(1,055,821)	9,659,207
6	5,124,352	51,244	(1,055,821)	4,119,775	6	9,659,207	965,921	(1,055,821)	9,569,307
7	4,119,775	41,198	(1,055,821)	3,105,152	7	9,569,307	956,931	(1,055,821)	9,470,417
8	3,105,152	31,052	(1,055,821)	2,080,382	8	9,470,417	947,042	(1,055,821)	9,361,637
9	2,080,382	20,804	(1,055,821)	1,045,365	9	9,361,637	936,164	(1,055,821)	9,241,980
10	1,045,365	10,454	(1,055,819)	-	10	9,241,980	924,198	(1,055,821)	9,110,357

**BENEFIT: \$9,110,357 transferred to beneficiaries estate/gift tax-free (of which \$2,094,955 is due to payment of income taxes by the grantor)**

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### GRANTOR RETAINED ANNUITY TRUST WHY A GRAT WORKS – VALUATION ADJUSTMENTS

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment 1.055,821	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment 1.055,821	Ending Balance
1	10,000,000	1,000,000	(1,055,821)	9,944,179	1	10,000,000	1,000,000	(739,075)	10,260,925
2	9,944,179	994,418	(1,055,821)	9,882,776	2	10,260,925	1,026,093	(739,075)	10,547,943
3	9,882,776	988,278	(1,055,821)	9,815,232	3	10,547,943	1,054,794	(739,075)	10,863,663
4	9,815,232	981,523	(1,055,821)	9,740,935	4	10,863,663	1,086,366	(739,075)	11,210,954
5	9,740,935	974,093	(1,055,821)	9,659,207	5	11,210,954	1,121,095	(739,075)	11,592,975
6	9,659,207	965,921	(1,055,821)	9,569,307	6	11,592,975	1,159,298	(739,075)	12,013,198
7	9,569,307	956,931	(1,055,821)	9,470,417	7	12,013,198	1,201,320	(739,075)	12,475,443
8	9,470,417	947,042	(1,055,821)	9,361,637	8	12,475,443	1,247,544	(739,075)	12,983,913
9	9,361,637	936,164	(1,055,821)	9,241,980	9	12,983,913	1,298,391	(739,075)	13,543,229
10	9,241,980	924,198	(1,055,821)	9,110,357	10	13,543,229	1,354,323	(739,075)	14,159,477

**BENEFIT: \$5,048,120 transferred to beneficiaries estate/gift tax-free**

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### GRANTOR RETAINED ANNUITY TRUST WHY A GRAT WORKS – PAYMENT OF TRUST INCOME TAXES BY GRANTOR

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment 739,075	Less: Taxes @ 40.00%	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment 739,075	Less: Taxes @ 6.00%	Ending Balance
1	10,000,000	1,000,000	(739,075)	(194,370)	10,156,555	1	10,000,000	1,000,000	(739,075)	-	10,260,925
2	10,156,555	1,015,656	(739,075)	(116,320)	10,326,264	2	10,260,925	1,026,093	(739,075)	-	10,547,943
3	10,326,264	1,032,626	(739,075)	(117,270)	10,498,409	3	10,547,943	1,054,794	(739,075)	-	10,863,663
4	10,498,409	1,049,841	(739,075)	(124,305)	10,894,869	4	10,863,663	1,086,366	(739,075)	-	11,210,954
5	10,894,869	1,089,487	(739,075)	(131,765)	10,882,516	5	11,210,954	1,121,095	(739,075)	-	11,592,975
6	10,882,516	1,088,252	(739,075)	(139,671)	11,092,022	6	11,592,975	1,159,298	(739,075)	-	12,013,198
7	11,092,022	1,109,202	(739,075)	(148,051)	11,314,099	7	12,013,198	1,201,320	(739,075)	-	12,475,443
8	11,314,099	1,131,410	(739,075)	(156,394)	11,549,209	8	12,475,443	1,247,544	(739,075)	-	12,983,913
9	11,549,209	1,154,920	(739,075)	(165,350)	11,739,023	9	12,983,913	1,298,391	(739,075)	-	13,543,229
10	11,739,023	1,173,903	(739,075)	(175,331)	12,083,522	10	13,543,229	1,354,323	(739,075)	-	14,159,477

**BENEFIT: \$2,094,955 transferred to beneficiaries estate/gift tax-free**

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**GRANTOR RETAINED ANNUITY TRUST  
99-YEAR GRAT**

- As a way to reduce the grantor's estate tax exposure during a GRAT term, one plausible solution is to create a GRAT with a term that is very long (e.g. 50+ years).
- While death during the GRAT term is almost certain, because of the very long length of the GRAT term, the amount of the GRAT included in the grantor's gross estate could be significantly less than the FMV of the GRAT's assets

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**GRANTOR RETAINED ANNUITY TRUST  
99-YEAR GRAT EXAMPLE**


**Facts**

Amount contributed to GRAT:	\$10,000,000
FMV of GRAT assets at death:	\$12,500,000
GRAT term (years):	99
IRC §7520 rate at contribution:	1.2%
IRC §7520 rate at death:	6.0%
Annual GRAT annuity payment:	\$173,158

**Estate Inclusion Calculation**

1) FMV of GRAT assets at death:	\$12,500,000
2) Value of GRAT annuity paid into perpetuity:	\$2,885,967

**ESTATE INCLUSION AMOUNT (Lesser of 1 or 2): \$2,885,967**

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**GRANTOR RETAINED ANNUITY TRUST  
ADVANTAGES**

- Annuity payments provide income stream to the grantor
- Ability to make gifts of substantial amounts of property tax-free
- Grantor pays income tax on trust income, leaving more assets in the GRAT for remainder beneficiaries
- Reduces the taxable estate of the grantor
- Valuation adjustments increase effectiveness of sale for estate tax purposes

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**GRANTOR RETAINED ANNUITY TRUST  
DISADVANTAGES**

- If the grantor dies before the end of the GRAT term, the assets in the GRAT are included in the grantor's gross estate
- The remainder beneficiaries will have the same basis in the property transferred to the GRAT as the grantor had at the time the property was transferred (no step-up in basis)
- Risk that rate of return will not exceed interest rate resulting in no assets being transferred to remainder beneficiaries

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**DYNASTY TRUST**

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**DYNASTY TRUST  
STRATEGY OVERVIEW**

Parent

Gift\*

→

Dynasty Trust

No transfer tax paid. ←

↓

Discretionary Distributions  
to Children for Life

No transfer tax paid. ←

↓

Discretionary Distributions  
to Grandchildren for Life

No transfer tax paid. ←

↓

Discretionary Distributions  
to Great-Grandchildren  
for Life

No transfer tax paid. ←

↓

Future Generations

**Advantages**

- Creditor protection
- Divorce protection
- Estate tax protection
- Direct decedent protection
- Spendthrift protection
- Consolidation of capital

\* Gift should take advantage of any remaining Unified Credit / GST exclusion remaining.

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<b>Balancing Bet-to-Live and Bet-to-Die Strategies</b>			
<b>DYNASTY TRUST</b>			
<b>TAX SAVINGS FROM AVOIDING ESTATE TAX</b>			
	<b>5% Growth</b>	<b>7% Growth</b>	<b>9% Growth</b>
Value of Trust in 20 years	\$ 13,266,489	\$ 19,348,422	\$ 28,022,054
Estate Tax Savings @ 40%	\$ 5,306,595	\$ 7,739,369	\$ 11,208,822
Value of Trust in 40 years	\$ 35,199,944	\$ 74,872,289	\$ 74,872,289
Estate Tax Savings @ 40%	\$ 14,079,977	\$ 29,948,916	\$ 29,948,916
Value of Trust in 60 years	\$ 93,395,929	\$ 289,732,134	\$ 880,156,460
Estate Tax Savings @ 40%	\$ 37,358,372	\$ 115,892,854	\$ 352,062,584
Value of Trust in 80 years	\$ 247,807,205	\$ 1,121,171,938	\$ 4,932,758,341
Estate Tax Savings @ 40%	\$ 99,122,882	\$ 448,468,775	\$ 1,973,103,336
<b>Initial investment of \$5,000,000</b>			
			
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<b>Balancing Bet-to-Live and Bet-to-Die Strategies</b>			
<b>DYNASTY TRUST</b>			
<b>ADVANTAGES</b>			
<ul style="list-style-type: none"> <li>• Takes maximum advantage of the \$5,250,000 lifetime gift tax exemption</li> <li>• Takes maximum advantage of the \$5,250,000 GST tax exemption</li> <li>• Appreciation of assets will be free from estate tax</li> <li>• Provides a layer of asset protection from the beneficiaries' creditors</li> <li>• No estate/gift/GST tax will be paid at the death of the grantor's descendants</li> <li>• Future trustees can be given the discretion to make distributions as appropriate, given the circumstances that exist at the time the distributions are made</li> <li>• Grantor can use the trust to positively affect future behavior</li> </ul>			
			
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<b>Balancing Bet-to-Live and Bet-to-Die Strategies</b>			
<b>SALE TO AN INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT)</b>			
			
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**SALE TO AN IDGT**  
**INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT)**

An IDGT is a type of dynasty trust where all income earned by the trust is taxed to the grantor because the trust is “defective” for income tax purposes, thus allowing for a tax-free gift to the trust’s beneficiaries.

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**SALE TO AN IDGT**  
**SUMMARY OF STRATEGY**

- A type of transaction whereby a grantor sells a highly-appreciating asset to an IDGT in exchange for an installment note.
  - However, the grantor should make an initial gift (at least 10% of the total transfer value) to the trust so that it has sufficient capital to make its payments to the grantor.
- To the extent that the growth rate on the assets sold to the IDGT is greater than the interest rate on the installment note taken back by the grantor, the “excess” is passed on to the trust beneficiaries free of any gift, estate and/or GST tax.
- No capital gains tax is due on the installment sale to the trust because the trust is “defective” for income tax purposes.
- Interest income on installment note is not taxable to the grantor because the trust is “defective” for income tax purposes.

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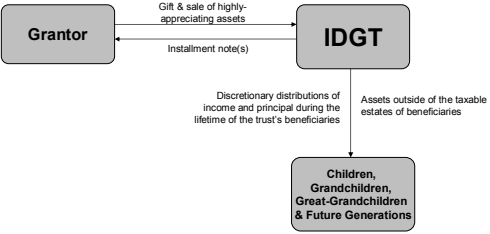
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**


**SALE TO AN IDGT**  
**STRATEGY OVERVIEW**



```

    graph TD
      Grantor[Grantor] -- "Gift & sale of highly-appreciating assets" --> IDGT[IDGT]
      IDGT -- "Installment note(s)" --> Grantor
      IDGT -- "Discretionary distributions of income and principal during the lifetime of the trust's beneficiaries" --> Beneficiaries["Children, Grandchildren, Great-Grandchildren & Future Generations"]
      IDGT -- "Assets outside of the taxable estates of beneficiaries" --> Beneficiaries
  
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**SALE TO AN IDGT**  
**CURRENT APPLICABLE FEDERAL RATES (AFRs) – 1/2013**

Short-Term AFR (3 years or less)	.21%
Mid-Term AFR (over 3 years, up to 9 Years)	.87%
Long-Term AFR (over 9 years)	2.31%

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**


**SALE TO AN IDGT**  
**SALE TO AN IDGT EXAMPLE**

Year	Beginning Balance	Taxable Income 10.00%	Annual Payment	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$(161,700)	\$ 10,838,300
2	\$ 10,838,300	\$ 1,083,830	\$(161,700)	\$ 11,760,430
3	\$ 11,760,430	\$ 1,176,043	\$(161,700)	\$ 12,774,773
4	\$ 12,774,773	\$ 1,277,477	\$(161,700)	\$ 13,890,550
5	\$ 13,890,550	\$ 1,389,055	\$(161,700)	\$ 15,117,905
6	\$ 15,117,905	\$ 1,511,791	\$(161,700)	\$ 16,467,996
7	\$ 16,467,996	\$ 1,646,800	\$(161,700)	\$ 17,953,095
8	\$ 17,953,095	\$ 1,795,310	\$(161,700)	\$ 19,586,705
9	\$ 19,586,705	\$ 1,958,670	\$(161,700)	\$ 21,383,675
10	\$ 21,383,675	\$ 2,138,368	\$(7,161,700)	\$ 16,360,343

**BENEFIT: \$16,360,343 transferred to beneficiaries estate/gift tax-free**

**\*NOTE:** Assuming a \$7,000,000 (after valuation adjustments) interest only, balloon payment feature installment note with a 2.31% annual interest rate (long-term AFR)

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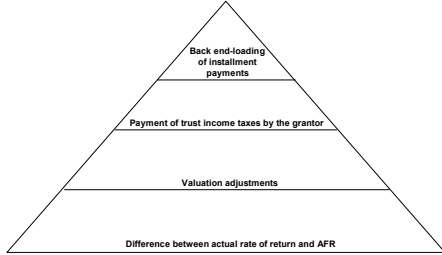
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**Balancing Bet-to-Live and  
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**SALE TO AN IDGT**  
**WHY AN IDGT SALE WORKS**



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**Balancing Bet-to-Live and  
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**SELF-CANCELING  
INSTALLMENT NOTE (SCIN)  
SALE TO AN IDGT**



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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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**SCIN SALE TO AN IDGT  
SELF-CANCELING INSTALLMENT NOTE (SCIN)**

- Transaction similar to an ordinary installment sale to an IDGT
- Cancellation-at-death feature added to note
- Premium must be paid, either in the form of additional principal or increased interest rate to compensate for the cancellation-at-death feature

**OBJECTIVE:** Reduction of estate tax if premature death occurs



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**Balancing Bet-to-Live and  
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**SCIN SALE TO AN IDGT  
TYPES OF SCINS**

- **Hedge SCIN** – A SCIN designed to hedge against the possibility of death during a bet-to-live strategy (taxable gifts, GRAT, etc...)
- **Mortality SCIN** – A SCIN designed for those who have a high likelihood of dying within a short period of time



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## Balancing Bet-to-Live and Bet-to-Die Strategies

### SCIN SALE TO AN IDGT

#### SAMPLE OF SCIN INTEREST RATE RISK PREMIUMS

SINGLE LIFE				JOINT LIFE				
Age	SCIN Risk Premium	AFR	Total Interest Rate	Age 1	Age 2	SCIN Risk Premium	AFR	Total Interest Rate
53	0.870%	2.310%	3.180%	53	53	0.067%	2.310%	2.377%
58	1.346%	2.310%	3.656%	58	58	0.153%	2.310%	2.463%
63	2.042%	2.310%	4.352%	63	63	0.332%	2.310%	2.642%
68	3.183%	2.310%	5.493%	68	68	0.742%	2.310%	3.052%
73	5.115%	2.310%	7.425%	73	73	1.675%	2.310%	3.985%
78	8.211%	2.310%	10.521%	78	78	3.554%	2.310%	5.864%

**\*Assumptions**  
 Term of Note: 10  
 AFR: 2.31%  
 Payment Frequency: Annually  
 Type of Note: Interest Only with Balloon Payment



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## Balancing Bet-to-Live and Bet-to-Die Strategies


### SCIN SALE TO AN IDGT

#### SCIN SALE TO AN IDGT EXAMPLE

Year	Beginning Balance	Taxable Income 10.00%	Annual Payment	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$(736,470)	\$ 10,263,530
2	\$ 10,263,530	\$ 1,026,353	\$(736,470)	\$ 10,553,413
3	\$ 10,553,413	\$ 1,055,341	\$(736,470)	\$ 10,872,284
4	\$ 10,872,284	\$ 1,087,228	\$(736,470)	\$ 11,223,043
5	\$ 11,223,043	\$ 1,122,304	\$(736,470)	\$ 11,608,877
6	\$ 11,608,877	\$ 1,160,888	\$(736,470)	\$ 12,033,295
7	\$ 12,033,295	\$ 1,203,329	\$(736,470)	\$ 12,500,154
8	\$ 12,500,154	\$ 1,250,015	\$(736,470)	\$ 13,013,700
9	\$ 13,013,700	\$ 1,301,370	\$(736,470)	\$ 13,578,600
10	\$ 13,578,600	\$ 1,357,860	\$(736,470)	\$ 7,199,990

**BENEFIT: \$7,199,990 transferred to beneficiaries estate/gift tax-free**

**\*NOTE:** Assuming a 78-year-old seller and a \$7,000,000 (after valuation adjustments) interest only, balloon payment feature installment note with a 10.521% annual interest rate (2.31% long-term AFR + 8.211% mortality risk premium)



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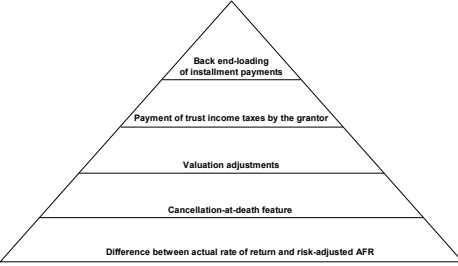
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## Balancing Bet-to-Live and Bet-to-Die Strategies

### SCIN SALE TO AN IDGT

#### WHY A SCIN SALE TO AN IDGT WORKS





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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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**SCIN SALE TO AN IDGT  
ADVANTAGES**

- Future appreciation above the note interest rate, including the risk premium, is removed from the grantor's estate
- Asset not included in grantor's estate in case of premature death during SCIN term
- Value of assets transferred out greatly exceeds value of payments coming back into the estate of the grantor if he/she passes away prematurely
- No gain or loss on sale
- Trust income taxable to grantor allows for greater appreciation to inure to future generations, thereby creating an additional tax-free gift
- Valuation adjustments increase effectiveness of sale for estate tax purposes

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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**SCIN SALE TO AN IDGT  
DISADVANTAGES**

- Complex calculation of risk premium
- Possible gift tax exposure if SCIN risk premium is inadequate
- Possible gift tax exposure if trust is insufficiently funded
- Possible taxable estate inclusion under *Karmazin* (retained life estate)
- No step-up in basis at grantor's death
- Possible acceleration of capital gain at grantor's death
- Trust income taxable to grantor during his/her life could cause a cash flow problem if there is there is not sufficient income earned by the grantor
- Possible upstream transfer if the grantor survives the term of note (or lives a significant portion of the term and/or is relatively old)

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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**PRIVATE ANNUITY**

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### PRIVATE ANNUITY

The seller's age and the current IRC §7520 rate are used for purposes of determining the amount of the annuity.

Provided that the annuity is calculated correctly, the future value of the assets sold less the future value of the payment stream retained by the seller inures to the buyer (beneficiaries) free of transfer taxes, thus effectively freezing the growth of assets at the IRC §7520 rate.

The IRC §7520 rate for January 2013 is 1.0%.

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### PRIVATE ANNUITY

#### SAMPLE OF PRIVATE ANNUITY AMOUNTS\*

Age	Private Annuity Amount
53	\$ 300,262
58	\$ 347,508
63	\$ 409,992
68	\$ 495,526
73	\$ 617,900
78	\$ 794,588

**\*Assumptions**  
 Value of Assets Sold \$7,000,000  
 IRC §7520 Rate 1.00%  
 Payment Frequency Annually  
 Timing of Payment End of Period

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### PRIVATE ANNUITY

#### PRIVATE ANNUITY EXAMPLE

Year	Beginning Balance	Growth 10.00%	Annual Payment	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$(794,588)	\$ 10,205,412
2	\$ 10,205,412	\$ 1,020,541	\$(794,588)	\$ 10,431,365
3	\$ 10,431,365	\$ 1,043,137	\$(794,588)	\$ 10,679,914
4	\$ 10,679,914	\$ 1,067,991	\$(794,588)	\$ 10,953,317
5	\$ 10,953,317	\$ 1,095,332	\$(794,588)	\$ 11,254,061
6	\$ 11,254,061	\$ 1,125,406	\$(794,588)	\$ 11,584,879
7	\$ 11,584,879	\$ 1,158,488	\$(794,588)	\$ 11,948,779
8	\$ 11,948,779	\$ 1,194,878	\$(794,588)	\$ 12,349,069
9	\$ 12,349,069	\$ 1,234,907	\$(794,588)	\$ 12,789,388
10	\$ 12,789,388	\$ 1,278,939	\$(794,588)	\$ 13,273,738

**Benefit: \$13,273,738 Transferred to Beneficiaries Tax-Free**

\* Assuming a 78-year-old seller and a \$7,000,000 (after valuation adjustments) sale price

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### PRIVATE ANNUITY ADVANTAGES

- Provides an income stream to the seller for life
- Asset not included in seller/grantor's estate in case of premature death during the annuity term
- Value of assets transferred out of the seller's estate greatly exceeds value of payments coming back if he/she passes away prematurely
- Valuation adjustments increase effectiveness of sale for estate tax purposes

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### PRIVATE ANNUITY DISADVANTAGES

- Under the Proposed Treasury Regulations, an immediate gain would be recognized by the seller
- The buyer's payments are not deductible as "interest", thus causing more ordinary income to be recognized (double taxation)
- Potential upstream transfer if seller lives for a long period of time (especially if the seller lives longer than his/her life expectancy)
- If assets are sold to a trust, possible gift tax exposure could occur if the trust has inadequate assets to support the payments

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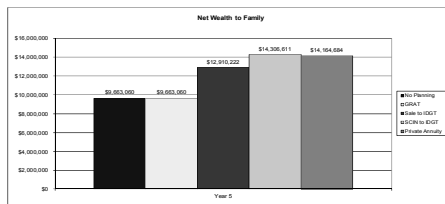
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## Balancing Bet-to-Live and Bet-to-Die Strategies

### COMPARISON OF STRATEGIES GRANTOR DIES MIDWAY THROUGH TERM



**Assumptions**  
 Grant Value of Assets Transferred \$10,000,000  
 Net Value of Assets Transferred \$7,000,000  
 IRC §7520 Rate 1.00%  
 APFR 2.31%  
 Term of Life Expectancy 10 Years  
 Payment Frequency Annually  
 Type of Payment (Installment Note/SCIN) Interest Only with Balloon Payment  
 Age of Seller / Annuitant 75  
 Estate Tax Rate 40%

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### COMPARISON OF STRATEGIES GRANTOR SURVIVES ENTIRE TERM

Net Wealth to Family

Strategy	Net Wealth to Family
No Planning	\$16,582,450
GRAT	\$21,225,844
SCIN to IDIT	\$22,106,550
Irrevocable Annuity	\$20,871,950

**Assumptions**

Gross Value of Assets Transferred	\$10,000,000
Net Value of Assets Transferred	\$7,000,000
IRC 57520 Rate	1.00%
APR	2.31%
Term of Life Expectancy	10 Years
Payment Frequency	Annually
Type of Payment (Retirement Note/SCIN)	Interest Only with Balloon Payment
Age of Spouse / Annuitant	75
Estate Tax Rate	40%

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### OTHER PLANNING CONSIDERATIONS & IDEAS

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## Balancing Bet-to-Live and Bet-to-Die Strategies

### OTHER PLANNING CONSIDERATIONS & IDEAS

**Additional "Bet-to-Live" Strategies**

- Charitable Remainder Trust (CRT)
- "Tax Burn" Strategy

**Additional "Bet-to-Die" Strategies**

- Irrevocable Life Insurance Trust (ILIT)
- Charitable Lead Trust (CLT)

**Combination of "Bet-to-Live"/"Bet-to-Die" Strategies**

- "Tax Burn" SCIN

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**CHARITABLE REMAINDER TRUST (CRT)  
SUMMARY OF STRATEGY**

A Charitable Remainder Trust (CRT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is usually paid out to the grantor (or some other non-charitable beneficiary). At the end of the trust term, the remainder (whatever is left in the trust) is paid to the charity or charities that have been designated in the trust document.

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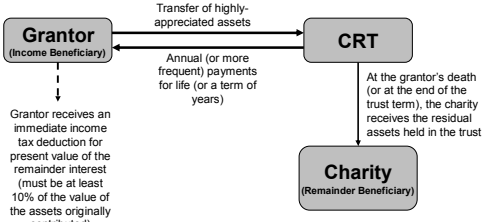
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**CHARITABLE REMAINDER TRUST (CRT)  
STRATEGY OVERVIEW**



```

graph TD
    Grantor["Grantor  
(Income Beneficiary)"] -- "Transfer of highly-appreciated assets" --> CRT["CRT"]
    CRT -- "Annual (or more frequent) payments for life (or a term of years)" --> Grantor
    CRT -- "At the grantor's death (or at the end of the trust term), the charity receives the residual assets held in the trust" --> Charity["Charity  
(Remainder Beneficiary)"]
    Grantor -- "Grantor receives an immediate income tax deduction for present value of the remainder interest (must be at least 10% of the value of the assets originally contributed)" --> Grantor
  
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**CHARITABLE REMAINDER TRUST (CRT)  
TWO MAIN TYPES OF CRTS**

- Charitable Remainder Annuity Trust (CRAT)
  - The beneficiaries receive a stated percentage of the initial value of the trust assets each year
    - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)
- Charitable Remainder Unitrust (CRUT)
  - Income beneficiaries receive a stated percentage of the trust's assets each year, recalculated annually
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**CHARITABLE REMAINDER TRUST (CRT)  
TAXATION OF CRT DISTRIBUTIONS**

The character of income received by the recipient is subject to and controlled by the tier rules of IRC §664(b).

- First, distributions are taxed as ordinary income.
- Second, distributions are taxed as capital gains.
- Third, distributions are taxed as tax-exempt income (e.g. municipal bond income).
- Finally, distributions are assumed to be the non-taxable return of principal.

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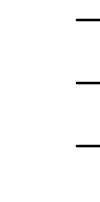
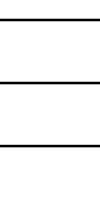
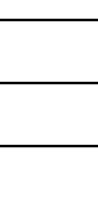
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

**CHARITABLE REMAINDER TRUST (CRT)  
TAXATION OF CRT DISTRIBUTIONS**

STEP 1: Current Ordinary Income	STEP 2: Accumulated Ordinary Income	STEP 3: Current Capital Gains	STEP 4: Accumulated Capital Gains	STEP 5: Current Tax- Exempt Income	STEP 6: Accumulated Tax-Exempt Income	STEP 7: Return of Capital
						

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**Balancing Bet-to-Live and  
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**“TAX BURN” STRATEGY  
SUMMARY OF STRATEGY**

The “tax burn” strategy basically involves an installment sale (or other transfer) to a grantor trust. The purpose of this strategy is to reduce the grantor’s gross estate by having him/her pay the annual income tax liability on behalf of the trust. In turn, the grantor’s payment of income tax on the trust’s behalf is a tax-free gift to the trust (see Rev. Rul. 2004-64).

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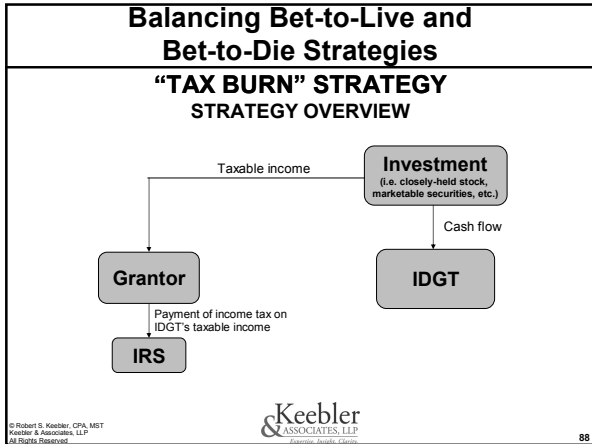
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### Balancing Bet-to-Live and Bet-to-Die Strategies

#### “TAX BURN” STRATEGY “TAX BURN” CONCEPT

To the extent that the income tax liability on IDGT's income is greater than installment payments received back from the trust, the excess income tax liability will reduce the grantor's taxable estate (i.e. "tax burn").

Year	Income Tax on IDGT Income*	Installment Payment Received From IDGT**	"Tax Burn"	Cumulative "Tax Burn"
1	\$ (400,000)	\$ 378,000	\$ (22,000)	\$ (22,000)
2	\$ (440,000)	\$ 378,000	\$ (62,000)	\$ (84,000)
3	\$ (484,000)	\$ 378,000	\$ (106,000)	\$ (190,000)
4	\$ (532,400)	\$ 378,000	\$ (154,400)	\$ (344,400)
5	\$ (585,640)	\$ 378,000	\$ (207,640)	\$ (552,040)

\* \$10,000,000 FMV of assets held in IDGT x 1% return x 40% tax rate (compounded by 1% per year)  
\*\* \$6,300,000 SCIN principal (discounted) x 6% interest rate (AFR + mortality risk premium)

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### Balancing Bet-to-Live and Bet-to-Die Strategies

#### “TAX BURN” STRATEGY COMPREHENSIVE EXAMPLE

FMV of closely-held family business: \$10,000,000  
Pre-tax rate of return on closely-held family business: 10%

FMV of "other" assets: \$10,000,000  
Pre-tax rate of return on "other" assets: 10%

Sale price of closely-held family business: \$6,500,000  
(\$10M sale less 35% discount)

Installment note interest rate: 4.5%

Income tax rate: 40%

Estate tax rate: 40%

Estate tax exemption: \$3,500,000

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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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**CHARITABLE LEAD TRUST (CLT)  
SUMMARY OF STRATEGY**

A Charitable Lead Trust (CLT) is a split interest trust consisting of a lead income interest and a remainder interest. During the term of the trust, the income interest is paid out to a named charity. At the end of the trust term, the remainder (whatever is left in the trust) is paid to non-charitable beneficiaries (e.g. children of the donor) that have been designated in the trust document.

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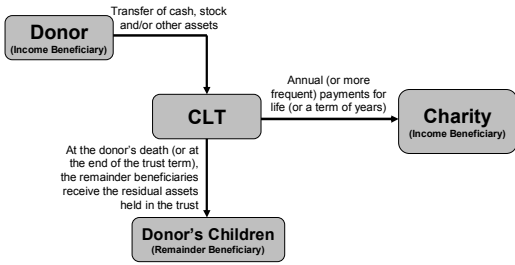
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**


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**CHARITABLE LEAD TRUST (CLT)  
STRATEGY OVERVIEW**



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graph TD
    Donor[Donor  
(Income Beneficiary)] -- "Transfer of cash, stock  
and/or other assets" --> CLT[CLT]
    CLT -- "Annual (or more  
frequent) payments for  
life (or a term of years)" --> Charity[Charity  
(Income Beneficiary)]
    CLT -- "At the donor's death (or at  
the end of the trust term),  
the remainder beneficiaries  
receive the residual assets  
held in the trust" --> Children[Donor's Children  
(Remainder Beneficiary)]
  
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**Balancing Bet-to-Live and  
Bet-to-Die Strategies**

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**CHARITABLE LEAD TRUST (CLT)  
TYPES OF CLTS**

- Charitable Lead Annuity Trust (CLAT)
  - The charitable beneficiary receives a stated percentage of the initial value of the trust assets each year
    - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)
- Charitable Lead Unitrust (CLUT)
  - The charitable beneficiary receives a stated percentage of the trust's assets each year, recalculated annually
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn

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## 2013 Ordinary Income Tax Rates

10%, 15%, 25% and 28% rates from Bush Administration tax cuts made permanent

33% and 35% rates made permanent up to certain threshold levels—

Single taxpayers	\$400,000
Head of households	\$425,000
Married filing jointly or surviving spouse	\$450,000
Married filing separately	\$225,000

Amounts of income above these threshold levels taxed at 39.6%

Threshold amounts adjusted for inflation

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## 2013—Long-Term Capital Gains & Dividends

- Tax rate increases to 20% for taxpayers with income above the threshold amounts listed on the previous slide
  - As these taxpayers will be above the threshold amounts for the 3.8% surtax, their capital gain rate will actually be 23.8%
- Maximum rate stays at 15% for taxpayers with lower incomes
- Qualified dividend treatment is made permanent

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## Phase-out of Personal Exemptions and Itemized Deductions

- Phase-out of personal exemptions (PEP) and limitations on itemized deductions (Pease) as income rises above the following threshold amounts--

Single taxpayers	\$250,000
Head of households	\$275,000
Married filing jointly or surviving spouse	\$300,000
Married filing separately	\$150,000

- Amounts will be indexed for inflation

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## Phase-out Of Personal Exemptions and Itemized Deductions

- PEP reduces personal exemption by 2% for-
  - every \$2,500 of income above the threshold amount for single taxpayers
  - every \$1,250 of income above the threshold amount for married taxpayers filing separately
  
- Reinstatement of the phase-out could have been worse
  - If the full sunset occurred, the applicable threshold amounts would have been \$178,150 for single taxpayers and \$267,200 for married taxpayers filing jointly

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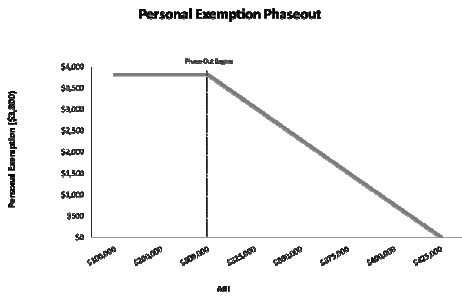
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## Phase-out Of Personal Exemptions and Itemized Deductions



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## Pease Limitation

- Pease cuts itemized deductions by 3% of AGI above the threshold amounts up to a maximum of 80%
  
- Deductions not included:
  - Investment Interest
  - Medical Expenses
  - Casualty, theft and wagering losses
  
- With the full sunset, the threshold amounts would have been the same \$178,150 for single taxpayers and \$267,200 for married filers

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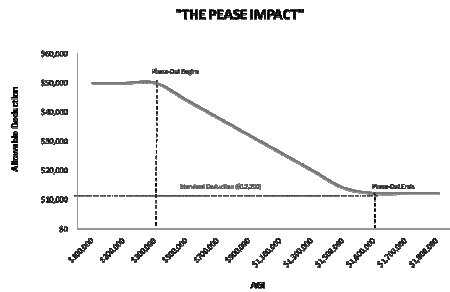
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## Pease Limitation



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## Healthcare Surtax Beginning Jan. 1, 2013

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## 3.8% Medicare "Surtax" Overview

### Investment Income

- Beginning with the 2013 tax year, a new 3.8% Medicare "surtax" will apply to all taxpayers whose income exceeds a certain "threshold amount". This new "surtax" will, in essence, raise the marginal income tax rate for affected taxpayers.
- Thus, a taxpayer in the 39.6% tax bracket (i.e. the highest marginal income tax rate in 2013) would have a marginal rate of 43.4%!

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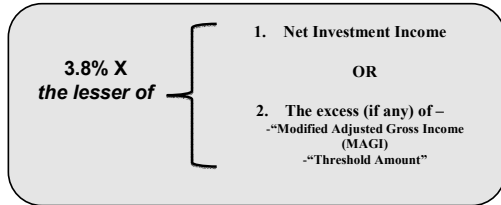
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### 3.8% Medicare "Surtax" Overview

#### APPLICATION TO INDIVIDUALS

The Medicare Surtax is equal to:



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### 3.8% Medicare "Surtax" Overview

Three critical terms associated with the 3.8% Medicare surtax:

- “Net investment income” (NII)
- “Threshold amount” (TA)
- “Modified adjusted gross income” (MAGI)

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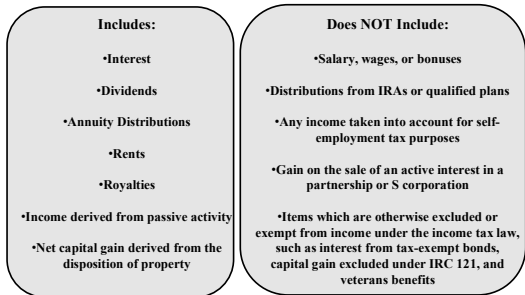
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### 3.8% Medicare "Surtax" Overview

#### NET INVESTMENT INCOME



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## Income Shifting Strategies

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## Key Concepts

- Income tax and capital gain brackets
  - Individuals
  - Trusts
- 3.8% Surtax
- PEP and PEASE adjustments
- Kidde tax
- AMT – phase out

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## Key Transactions

- Outright gifts to children
- LLC and partnership gifts
- Gifts to “non-grantor” trusts for family
- Gifts to charitable remainder trusts for family
- Distributions from existing trusts
- Conversion of grantor trusts to non-grantor trusts
- Charitable trust for benefit of family members

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**Roth Conversions**

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**Roth IRA Conversions**

**Reasons to Convert**

- 1) Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), high basis non-deductible traditional IRAs, etc.
- 2) Suspension of the minimum distribution rules at age 70½ provides a considerable advantage to the Roth IRA holder.
- 3) Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax.

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**Roth IRA Conversions**

**Reasons to Convert**

- 4) Taxpayers who can pay the income tax on the IRA from non-IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields.
- 5) Taxpayers who need to use IRA assets to fund their Unified Credit bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds.
- 6) Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.

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## Roth IRA Conversions

### Steps to Planning

- Step 3: Develop a series of “bracket-crossing conversions” analysis. Each analysis must be measured autonomously standing on its own and take into account the various taxes.
- Step 4: Repeat the above taking into account changes in value and the opportunity to recharacterize

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## Charitable Trusts

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## Charitable Giving Vehicles

- Direct contributions
- Donor advised funds
- Charitable Trusts
  - Charitable Remainder Trusts (CRTs)
  - Charitable Lead Trusts (CLTs)

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## Donor Advised Fund (DAF)

- A donor advised fund (DAF) is a private fund administered by a third party and created for the purpose of managing charitable donations on behalf of an organization, family, or individual
- DAFs offer the donor ease of administration, while still allowing him/her to maintain significant control over the placement and distribution of charitable gifts
- Further, the donor is entitled to an immediate income tax deduction in the year of contribution for the amount of the transfer to the fund
- No income tax or surtax on earnings of DAF

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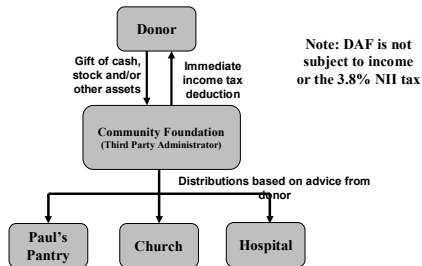
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## Donor Advised Fund (DAF)



Note: DAF is not subject to income or the 3.8% NII tax

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## Charitable Remainder Trust (CRT)

A Charitable Remainder Trust (CRT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is usually paid out to the donor (or some other named beneficiary). At the end of the trust term, the remainder (whatever is left in the trust) is paid to the charity or charities that have been designated in the trust document.

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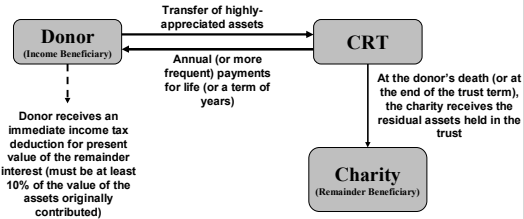
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## Charitable Remainder Trust (CRT)



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## CHARITABLE REMAINDER TRUSTS

- Charitable remainder trusts can be used to reduce or avoid surtax and incremental capital gains tax by smoothing out income
- CRTs are particularly useful when a taxpayer has a large capital gain that pushes income above the applicable threshold amount (ATA)
- Before explaining how the planning works, it will be helpful to look at some background information

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## CRTs – Taxation

- The donor will NOT realize gain or loss when property is transferred to the trust
- However, the grantor may be required to recognize gain if:
  - Property transferred is subject to indebtedness that exceeds grantor basis
  - Grantor receives property from the trust in exchange for the transfer to the trust.
- The donor will NOT realize gain or loss if and when the transferred assets are subsequently sold by the trustee of the CRT

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## CRTs – Taxation

- The character of income received by the recipient is subject to and controlled by the tier rules of IRC §664(b)
  - First, distributions are taxed as ordinary income
  - Second, distributions are taxed as capital gains
  - Third, distributions are taxed as tax-exempt income (e.g. municipal bond income)
  - Finally, distributions are assumed to be the non-taxable return of principal
- CRTs are not subject to the 3.8% surtax
- CRTs are not subject to the new 5.0% incremental capital gains tax

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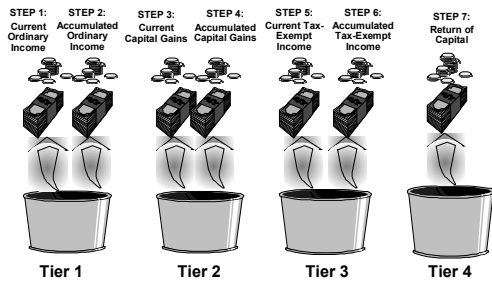
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## CRTs – Taxation



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## SURTAX PLANNING WITH CRTs

- *Example 1—No Planning*
- Ken is a single taxpayer with salary income of \$160,000 and no NII.
- In 2013 Ken sells Greenacre, vacant land with a basis of \$100,000 for \$500,000, recognizing a capital gain of \$400,000
- The gain is NII under the surtax
- Ken will have \$560,000 of MAGI (160,000 + 400,000) and \$400,000 of NII in 2013
- The amount subject to the surtax will be the lesser of NII (\$400,000) or MAGI – ATA (\$360,000)
- Ken will pay surtax of \$13,680 (.038 x \$360,000).

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## SURTAX PLANNING WITH CRTs, CONT'D

- *Example 2—Planning with a CRT*
  - Now assume instead that Ken donated Greenacre to a 15-year CRAT with an annuity payment of \$40,000/year
  - The CRAT sells the property and recognizes no gain because it is tax-exempt
  - The CRAT has \$400,000 of current NII, however, that could be subject to the surtax when it is distributed to Ken.

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## EXAMPLE 2, CONT'D

- The annuity payments from the CRAT will give Ken \$40,000 of NII in each of the years 2013 -2022
- The NII will not be subject to the surtax, however, because Ken's \$200,000 of MAGI (\$160,000 of salary income + \$40,000 of NII from the CRT) will not exceed his single taxpayer ATA of \$200,000
- By spreading out the NII over a period of years, Ken has eliminated all surtax and the incremental 5% capital gains

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## Charitable Remainder Trust (CRT)

### Two Main Types of CRTs

- Charitable Remainder Annuity Trust (Standard - CRAT)
  - The beneficiaries receive a stated amount of the initial trust assets each year
    - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)
- Charitable Remainder Unitrust (Standard - CRUT)
  - Income beneficiaries receive a stated percentage of the trust's assets each year.
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn

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## Types of CRUTS

- Stan-CRUT** Standard Charitable Remainder Unitrust
- NIMCRUT** Net Income with Makeup Charitable Remainder Unitrust. Pays only the net income to the beneficiary if that is less than the annual unitrust percentage. Any deficit in the distribution is to be made up in later years when and if the income received exceeds the stated unitrust percentage.
- FLIP-CRUT** A NI-CRUT or NIM-CRUT which changes over to a standard CRUT upon a specified date or event.

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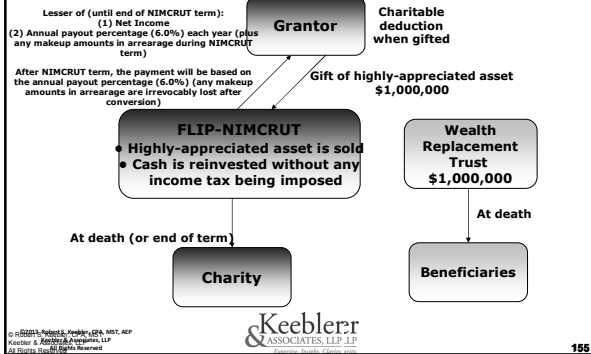
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## FLIP Net Income with Makeup Charitable Remainder Unitrust (FLIP-NIMCRUT)



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## Charitable Remainder Trust

### Tax Consequences to the Donor

- Gift Tax Consequences
  - Donor as beneficiary - not gift.
  - Spouse as beneficiary - marital deduction.
  - Another individual - gift made at time income interest created.
    - ◊ Is current gift if primary beneficiary.
    - ◊ If survivor/successor beneficiary named in two life the interest is not a current interest.

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## Charitable Remainder Trust

### Tax Consequences to the Donor

- Income Tax

- The donor will NOT realize gain or loss when property is transferred to the trust.
  - However, the grantor may be required to recognized gain if:
    - ❖ Property transferred is subject to indebtedness that exceeds grantor basis.
    - ❖ Grantor receives property from the trust in exchange for the transfer to the trust.
    - ❖ Bargain sale rules of section 1011(b) will apply if the transferred property is subject to an indebtedness.
- The donor will NOT realize gain or loss if and when the transferred assets are subsequently sold by the trustee of the CRT.
- Distributions to beneficiaries are taxable to the beneficiary under the Tier

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**Rules of IRC §664**  
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## 2013 Innovative CRT

### Strategies

1. Substantial Sale CRT (Standard CRT)
  - CRT to eliminate or reduce/defer the 3.8% surtax and 5% incremental capital gains tax
2. Retirement CRT (Flip – CRT)
  - CRT to harvest annual real estate and securities gains while harvesting losses in your outside account
  - Gains are deferred until retirement
  - Outside losses shelter gains
3. Income Shifting CRT (Standard CRT for children)
  - CRT to eliminate or reduce/defer the 3.8% surtax and 5% incremental capital gains tax while shifting the incidence of taxation to children and grandchildren

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## What is a FLIP CRUT

- Distinguishing Characteristics

- Initially, the trust is a NI-CRUT or NIM-CRUT
  - The payment to the beneficiary is the lesser of the specified percentage of the value or the trust income until the assets are sold - or some conversion point occurs
  - After sale of assets or triggering event (e.g. Retirement) the trust switches to a STAN-CRUT.
- The percentage payment method is used in the year after flip with no make-up provision.

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## What is a "Retirement" FLIP CRUT

- Advantages
  - Deferral until triggering event (e.g. Age 65)
    - No tax on sale
  - Personal losses harvested on individual level
    - Surtax eliminated or deferred
  - "5% incremental capital gain" eliminated or deferred
- Disadvantages
  - No make-up income provision allowed in FLIP NI-CRUT

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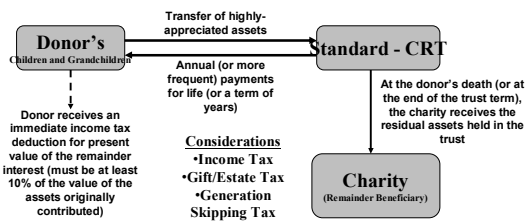
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## Charitable Remainder Trust (CRT) for Benefit of Donor's Children



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## Income Shifting CRT

- Shifts ordinary income to family
- Shift capital gains to family members
- Benefit charity

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# Charitable Lead Trusts

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# Charitable Lead Trust (CLT)

A Charitable Lead Trust (CLT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is paid out to a named charity. At the end of the trust term, the remainder (whatever is left in the trust) is paid to non-charitable beneficiaries (e.g. children of the donor) that have been designated in the trust document.

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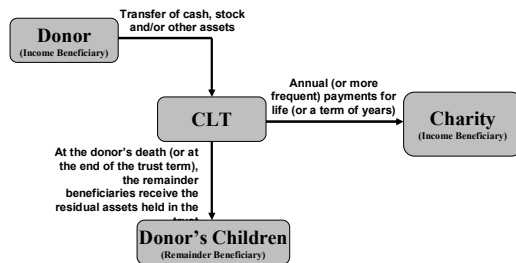
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# Charitable Lead Trust (CLT)



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## USING THE CHARITABLE DEDUCTION TO REDUCE THE SURTAX

- Charitable deductions don't help individuals with the surtax
- They don't reduce MAGI because they are below-the-line deductions taken on line 40 of Form 1040
- They don't reduce NII because only properly allocable deductions paid or incurred to produce the income can be deducted for surtax purposes and the charitable deduction is not a cost of producing the income
- The income tax charitable deduction can be used to reduce the surtax on charitable lead annuity trusts (CLTs), however

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## Charitable Deduction and the 3.8% Net Investment Income Tax

Individual IRC §170 Deduction		Trust - §642(c) Deduction	
Wage Income	\$260,000	Interest Income	\$100,000
Interest Income	\$100,000	Dividend Income	\$50,000
Dividend Income	\$50,000	MAGI	\$150,000
MAGI	\$410,000	Less: Charitable Deduction	(\$150,000)
Less: Threshold Exemption	(\$250,000)	AGI	\$0
Subtotal	\$160,000	NII Tax at 3.8%	\$0
Lesser of Excess over Threshold or NII	\$150,000		
NII Tax at 3.8%	\$5700		

1) Does not reflect PEP, PEASE, or the charitable limitations

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## NON-GRANTOR CLAT

- Donor retains no powers that make the CLAT a grantor trust
- Donor receives no income tax deduction when CLAT is created
- CLAT is subject to income tax and surtax
- CLAT receives a charitable deduction, however, under IRC § 642(c) when it makes its annual distributions to the charitable lead beneficiary

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## NON-GRANTOR CLAT

- NII distributed to meet charitable payout requirements avoids both income tax and surtax
- Because CLT income is not included in the donor's AGI, non-grantor CLTs may also help with the 3% limitation on itemized deductions
- Any excess NII retained by the trust is subject to surtax at the trust level to the extent trust AGI exceeds the trust threshold amount (\$11,950 in 2013)

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## NON-GRANTOR CLAT

- Another advantage of a non-grantor CLT is that it can be used to reduce the effect of the 3% limitation on itemized deductions
- CLT income is not part of the donor's AGI so shifting income to a CLT may reduce the phase-out

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## NON-GRANTOR CLAT

- A final advantage of a non-grantor CLAT is that the charitable deduction is not subject to the 20%, 30%, and 50% AGI limitations
- Thus, they enable taxpayers who have maxed out their applicable percentage limitations to make additional tax deductible gifts

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