Planning for Your Future

A Personal Estate-Planning Course

UNIVERSITY *of* ROCHESTER

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PLANNING FOR YOUR FUTURE

LESSON ONE: Why You Need an Estate Plan

NO ONE CAN CONSTRUCT AN EFFECTIVE ESTATE PLAN ON A HUNCH—or delegate the planning process to friends, relatives, financial advisors, or the government—and hope to be satisfied with the results. Only you are able to determine the most advantageous disposition of your estate.

Surprisingly, however, more than half of adult Americans do not have even a basic will. This leaves their estate plan in the hands of state government, which distributes the estate according to an inflexible formula. Only with a carefully considered estate plan can you ensure that your personal financial and philanthropic objectives are fulfilled in accordance with your wishes and not the impersonal mandate of your state's laws.

We are pleased to bring you this first of five lessons in a short estate-planning course designed to highlight some of the considerations to keep in mind as you begin, or perhaps review, your estate plan; this course is offered for general informational and educational purposes. We urge you to consult with your financial and legal advisors as you go through the estate-planning process.

What Is Estate Planning?

Estate planning is a lifelong process that allows you to derive maximum value and enjoyment from your property during your lifetime and facilitates the final distribution of that property to beneficiaries of your own choosing.

Five basic steps for creating an estate plan:

FIRST: You must inventory your assets. What types of property do you own? How much is it worth? How is the property held—with you as the individual owner or perhaps jointly with your spouse?

SECOND: You must determine your objectives. Whom do you wish to benefit? What and how much should each beneficiary receive? When should each beneficiary receive his or her share? And how should the property be transferred?

THIRD: You should seek financial and legal counsel to find the planning vehicles that meet your objectives. The cost in terms of taxes, risk, and other expenses may vary considerably.

FOURTH: Once you have defined your objectives and determined the most effective plan, you need to prepare the necessary legal instruments. A basic will is essential for everyone; if your estate is more complex, you may need one or more trust agreements.

FIFTH: You must review your estate plan from time to time. Because estate planning is a lifelong process, there will be changes along the way that may require revisions of your original plan.

Getting Started

With your overall objectives in mind, you need to take a careful inventory of your assets before you can make wise decisions.

Surprisingly, few of us have a very accurate picture of our assets. Certain things come readily to mind—the family home, savings accounts, and stocks and bonds. Other items, such as automobiles, furniture, and appliances, are easier to think of as necessities of daily life rather than as assets of an estate.

Still others are easily overlooked altogether. Intangible assets such as life insurance and retirement benefits are among those most likely to fall into this category. Yet these assets often make up a significant portion of an estate.

Whether you are taking stock of your house or some other asset, the important point is this: Once you have a current, objective assessment of the value of all of your assets—regardless of how obvious or obscure—you will need a realistic projection of future increases in value on which to base your planning.

Take real estate, for example. A personal residence is often considered to be one of the best investments an individual can make. As your mortgage balance declines and your property appreciates in value over time, your equity likely increases year after year.

The following worksheet may help you to make a quick calculation of the basic value of your estate.

Assets

Personal residence $________________

Vacation home $__________________

Savings/money market accounts
$________________________________

401(k)/pension plans $______________

IRAs $___________________________

Stocks and bonds
$________________________________

Life insurance $___________________

Automobiles $_____________________

Personal property $________________

Collectibles and jewelry $___________

Business interests $________________

Total assets $_____________________

Liabilities

Mortgages $______________________

Other loans $______________________

Credit cards $______________________

Other debts $______________________

Total liabilities $__________________

Net worth

Assets minus liabilities $___________

Determining Your Objectives

Whom do you wish to benefit?

If you have a spouse and children, providing for them is probably your highest priority. However, if you have not concluded an estate plan, the amount and timing of the distributions to them may be in accordance with state law and not as you would have wished. For example—depending on the state where you reside—if you have not executed a will or living trust, at your death one-third of your assets might go to your spouse and two-thirds to your children. If you are married but have no children, part of your assets might go to your surviving parent(s). If you wish to benefit other family members, friends, or charitable organizations, estate-planning documents are essential.

What and how much should each beneficiary receive?

As noted above, if you haven't made adequate plans for your beneficiaries, your assets could be divided in ways you never intended. If you have items or property that you want to go to specific individuals or organizations, they need to be addressed in your estate plan. Because the value of your estate will be constantly changing over time, you may wish to consider making your provisions in terms of a percentage of your estate rather than a specific amount. That way your beneficiaries can be protected in the event the value of your estate falls—and they could benefit to a greater extent as your estate increases in value.

When and how should each beneficiary receive his or her share?

If you have minor children, you may want to establish a trust for their care in the event that neither you nor your spouse survives. Principal distributions can be delayed until whatever age you judge them to be mature. You could also use a charitable lead trust to provide for a favorite charitable organization for a period of years, with principal distributed to children or grandchildren at the end of that period.

If you have one child who manages money well and another who doesn't, you could leave one a lump sum and the other a stream of income through a trust or an annuity. Likewise, if you have a child with disabilities, the best arrangement may be a trust in which the trustee has discretion to make distributions for special needs and residential care.

Working with Your Estate-Planning Advisors

Once you have a clear picture of whom you want to benefit and how much each should receive, you will want to get in touch with your financial and legal advisors. Each of these individuals will have an important role as you put your plan in motion.

- **Your attorney** will be able to draft the necessary legal instruments to carry out your plans. At a minimum you will execute a will—or change it if you already have one in place. If your estate is more complex, you may need one or more trust agreements to fulfill your objectives; the counsel of an experienced trust officer can help you understand the investment and management benefits of a fiduciary relationship.
- **Your accountant and financial advisor** will be able to provide you with the most complete and accurate picture of your current situation and perhaps suggest ways to improve that picture in the future.
- **Your life insurance representative** can help you assess the risks you face, suggest ways to protect your plans against those risks, and show you how life insurance can help you build your estate and adequately provide for your beneficiaries.
- **A gift-planning officer** with the organization or organizations you wish to benefit can provide valuable insight into how your gift can be used, as well as ways various gift arrangements can address some of your estate-planning concerns.

Although individuals today have much greater access to information, advice, and documents via the Internet—some of which might bring to mind questions about your plan—there is no substitute for the guidance and counsel of experienced advisors.

The Tools of Estate-Planning Transfers

The following are helpful tools to keep in mind in your estate-planning process.

YOUR WILL: Undoubtedly, the cornerstone of any good estate plan is a carefully planned will. A will is a powerful document that gives you control over many important matters.

With a will you can make provisions for beneficiaries such as friends and charitable organizations who would receive nothing from your estate through your state's assignments. A will also gives you the opportunity to name the person who will serve as personal representative of your estate. Further, a will entitles parents of minor children to choose a guardian should the need arise.

UNDOUBTEDLY, THE CORNERSTONE OF ANY GOOD ESTATE PLAN IS A CAREFULLY PLANNED WILL.

It is just as important to realize what a will cannot do. The distribution of some assets is determined by law. For example, property owned jointly with a right of survivorship passes automatically to the surviving joint owner. Any provisions regarding the distribution of such property in a will are ineffectual.

Similarly, property acquired during marriage in certain states is deemed to be "community property," which means that each spouse owns an undivided one-half interest. A spouse can dispose of only his or her half interest as he or she pleases.

LIFE INSURANCE POLICY AND RETIREMENT PLANS: The passing of some assets is a matter of contract. A prime example is a life insurance policy. The policy is a contract between the policy owner and the insurance company. The beneficiary designation in the policy takes precedence over conflicting provisions in a will.

The same is true of retirement-plan benefits and assets placed in trust. Provisions in the contracts control distribution of the assets, so you should exercise your right to change beneficiaries to fit in with your changing estate plan.

A LIVING TRUST: Another effective estate-planning tool is a living trust working in combination with a so-called pourover will. The will simply states that the remainder of the estate after payment of debts, taxes, and estate-settlement costs is to pour over into a trust you created during life. Even life insurance proceeds and retirement-plan benefits can be paid to the trust, which coordinates all estate assets under a single instrument.

This arrangement can be designed to permit your beneficiaries to enjoy income from the trust property—as long as necessary—without having to manage the property.

LIFETIME GIFTS: Your estate plan could also incorporate gifts during life. Lifetime giving is one way to reduce the size of an estate that might be subject to estate taxes and can also allow you to see how your beneficiaries might handle a larger bequest from your estate.

Each of these tools should work together to achieve your estate-planning objectives. For instance, assume your intention is to divide your estate equally between your spouse and your child. A provision in your will giving half your assets to each will not meet your objectives if your spouse is also the beneficiary of a large insurance policy.

Take time to determine what passes to each of your beneficiaries by law, by contract, and by will. Then review the totals to be sure your estate plan reflects your intent.

The Effect of Taxes on Your Estate Plan

One of the two certainties in life—as noted by Benjamin Franklin—is taxes. And almost as certain as the inevitability of taxes is the fact that they are subject to frequent change. Whether your estate will be subject to tax, either federal or state, will depend on tax law in effect at the time of your death. But most advisors recommend that when creating your estate plan, you should assume that the tax structure currently in place is the one that will impact your estate. Therefore, as frequently as the tax picture changes, you should reexamine your plan to see the impact of the latest tax laws.

Final Note

The importance of estate planning cannot be overemphasized, both for your own peace of mind and for that of your beneficiaries. If you don't yet have a plan, today is a good time to begin. If you already have a plan, today is a good time for a review.

QUIZ ON LESSON ONE

PLEASE SELECT THE ANSWER YOU BELIEVE TO BE CORRECT. (CORRECT ANSWERS ARE LISTED BELOW.)

1. **Estate planning**
   A. Can be delegated to your financial advisors.
   B. Is a lifelong process.
   C. Is not really necessary.

2. **If you do not have a will**
   A. All of your estate will automatically go to your spouse.
   B. Most of your estate will be consumed by taxes.
   C. Your state of residence will decide who gets what.

3. **To start the estate-planning process, you should**
   A. Take an inventory of your assets.
   B. Call your lawyer.
   C. Find a Web site with basic will documents.

4. **Once you have made a will, you should**
   A. Be thankful the process is over.
   B. Review it frequently.
   C. File it away.

5. **Your attorney is the only qualified advisor to**
   A. Provide a complete picture of your financial situation.
   B. Assess your financial risks.
   C. Draft your will.

6. **In your will you can**
   A. Specify who will receive your life insurance proceeds.
   B. Name a guardian for your children.
   C. Name the beneficiary of your retirement-plan benefits.

7. **Using a trust as part of your estate plan**
   A. Makes a will unnecessary.
   B. Will eliminate the threat of taxes.
   C. Can coordinate all of your assets under a single instrument.

8. **You should review your will**
   A. When there is a change in the tax law.
   B. When your family situation changes.
   C. Both A and B.

Answers: 1. B; 2. C; 3. A; 4. B; 5. C; 6. B; 7. C; 8. C

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LESSON TWO: Your Will—An Opportunity of a Lifetime

One of your most precious legal rights is the opportunity to specify how you wish to have your assets distributed. You've spent a lifetime accumulating your estate, caring for your family, providing for loved ones, and supporting those causes and organizations in which you believe. Don't miss the opportunity of a lifetime by not writing a valid will.

What Your Will Can Do:

- **DIRECT** how debts, administrative expenses, and taxes are to be paid.
- **SPECIFY** that certain personal items and possessions should go to those individuals and family members you choose.
- **CONTINUE** a monthly income to your surviving spouse that will commence at your death until other income begins to flow.
- **NAME** a guardian of your choosing for minor children and invest him or her with the power to act in the best interests of the children.
- **SELECT** an executor to collect, manage, and distribute your estate's assets in accordance with your wishes.
- **ENSURE** that each of your heirs is treated appropriately, providing more assistance for those with greater need.
- **SUPPORT** charitable causes and organizations that were important to you during your lifetime.

Where to Start

To begin, make a list of all of your property and its approximate value. Don't overlook retirement benefits and life insurance. Then decide to whom you want to leave your property and in what manner.

Another consideration is the probate process and whom to name as executor of your estate. Experience, responsibility, and fairness—together with financial acumen and ability to maintain detailed accounts—are all essential attributes of a good executor. Although it may appear that a family member is a logical choice as executor, keep in mind the complexities and highly technical nature of the executor's duties. Careful consideration should be given to having a bank or attorney act as your executor because of their experience and expertise, especially when the estate consists of complex assets.

Note: If you wish, a family member can be named as co-executor, provided the individual named is qualified and able to participate constructively in the estate-settlement process.

Understanding Probate

Probate is a legal process in which a court establishes the validity of a document presented to it as the last will and testament of a decedent. This definition is fairly narrow, as it covers only one step—proving the will—in what is sometimes a long and complicated process. More generally, the term "probate" refers to all of the steps necessary to settle an estate, beginning with locating and presenting the will to the court and ending with the final distribution and accounting by the executor.

Note: Although our discussion focuses on the probate process, it is important to remember that a will does not control the distribution of all estate assets. Life insurance and retirement-plan proceeds as examples, are payable according to the terms of the contract and will not be included in probate if paid to a named beneficiary other than the executor of the estate.

General Requirements for a Valid Will

1. Under the laws of most states, you must be 18 or older and of sound mind.

2. The document should state that it is the last will and testament and that it supersedes any previous wills that might have been written.

3. The document must be signed by the testator (maker of the will).

4. The document must be signed by two witnesses, both of whom saw the testator and each other sign the will.

Your attorney is the only advisor qualified to draft your will. Although standardized forms are available from a number of sources, having the document drafted by your attorney is the only way to ensure a valid will that the probate court will accept.

7 Major Steps in Settling an Estate

Although steps required to settle an estate will vary with the size and complexity of the estate, there are essential steps common to most proceedings. The following outline highlights the major steps and suggests ways to prepare for a swift and efficient settlement of an estate.

1. Locate the Will—The most important document in probate is the original will. If a will cannot be found, an estate will be distributed according to state intestacy rules. Your will should be kept in a safe place so that it won't be lost, stolen, or destroyed. Generally, the original will should be placed either in an attorney's vault or in a bank's vault if the bank is acting as executor. The will may also be placed in a safe-deposit box, but some states restrict the access to such boxes, which may cause delays.

2. Collect and Safeguard Assets—Once the executor has been duly appointed by the court and the will accepted for probate, the executor's major tasks begin—collecting, protecting, and valuing the estate's assets. In many cases, the executor is forced, quite literally, to go on a treasure hunt searching for bank accounts, stock certificates, safe-deposit boxes, insurance policies, business records, and other types of property. The executor must make a detailed record of all property and file a copy of the inventory with the court. In addition, the executor is responsible for notifying all creditors and debtors of the estate, collecting all debts owed, and investigating all claims.

Planning pointer: You will simplify your executor's job if you leave sufficiently detailed instructions on the location of all of your assets. In addition, you should note the location of your personal records, tax returns, bank statements, and other documents. Be sure to include information about digital assets and passwords.

3. Manage Property—Another important activity in the settlement of an estate is the interim management of the property. Although the end result of an executor's duties is the liquidation of an estate in favor of the decedent's beneficiaries, estate assets must be carefully managed in the interim. Dividends, interest, rents, or other income must be collected. Cash must be invested or distributed as required. Risky investments must be scrutinized and judged against the standard of preservation rather than for possible gain. Also, the sale of assets must be arranged under the most favorable terms possible.

4. Determine Cash Needs—Many estates, particularly those in excess of $500,000, suffer from a severe shortage of cash. The need for cash arises in the first stages of the estate-settlement process. Funeral and burial expenses must be paid. Attorneys' and appraisers' fees are incurred. The family must receive support. And debts, including taxes, must be paid.

Planning pointer: Advance liquidity planning cannot be overemphasized. As you periodically review your estate plan, reevaluate the cash position of your estate to make certain that funds will be available to meet the pressing cash needs of your estate.

5. Compile Tax Information—Entering the federal-, state-, and local-tax arena requires diligence by the executor, especially considering that the executor can be held personally liable for interest and penalties that may be assessed if the various returns are not filed properly and on time. To prepare the necessary returns, the executor must have access to numerous financial documents and records. Personal and real property records, investment records, previous tax returns, bank statements and canceled checks, insurance documents, notes due and payable, and evidence of any inheritance received may all be required to prepare the returns and substantiate them in the event of an audit.

6. Distribute Assets—Perhaps the executor's most pleasant task is distributing estate assets in accordance with the terms of the will. Here, too, caution must be exercised to ensure that sufficient funds and property are available to satisfy valid claims in proper order, pay taxes on time, and satisfy specific bequests. If the value of the bequests exceeds the value of the distributable estate, certain bequests may be reduced or even eliminated.

Planning pointer: To ensure that a specific item of property passes to a certain person, spell out your wishes in your will.

7. Prepare Final Accounting—While an executor may be the legal owner of estate property, the equitable or true owners are the beneficiaries and claimants. The executor owes a duty to the beneficiaries and to the court to prepare a final accounting of all actions taken during the process of settling the estate.

Charitable Estate Gifts

Through the years, many individuals have found gifts by will to be an excellent method of benefiting their favorite charitable organizations. Such gifts enable a person to make significant contributions that may not have been possible during his or her life. The flexibility afforded by such gifts has contributed significantly to their popularity. Estate gifts are potent estate-planning tools. Your charitable bequest can take various forms. Consider the following options when preparing your will.

General Bequest—A general bequest is one of the most popular ways to make a charitable gift by will. You simply leave a specified dollar amount to the designated charity. Example: "I give (INSERT DOLLAR AMOUNT OR PERCENTAGE OF ESTATE) to XYZ Charity to be used for its exempt purposes."

Specific Bequest—A specific bequest is another popular type of charitable bequest. With this bequest, you designate that a charity is to receive a specific piece of property. Example: "I give (INSERT DESCRIPTION OF PROPERTY) to XYZ Charity to be used for its exempt purposes."

Residuary Bequest—A residuary bequest gives the charity all (or a portion thereof) of an estate owner's property after all debts, taxes, expenses, and all other bequests have been paid. Example: "I give the rest of the property I own at my death to XYZ Charity to be used for its exempt purposes."

Contingent Bequest—When writing your will, it is important to plan for an event where a named bequest beneficiary dies before you or disclaims the bequest. Consider naming a charity as the alternate or contingent beneficiary. This ensures that the property will pass to the designated charity rather than pass to unintended beneficiaries. Example: "If (INSERT NAME) predeceases me or disclaims any interest in (DESCRIBE PROPERTY), I give such property to XYZ Charity to be used for its exempt purposes."

THROUGH THE YEARS MANY INDIVIDUALS HAVE FOUND GIFTS BY WILL TO BE AN EXCELLENT METHOD OF BENEFITING THEIR FAVORITE CHARITABLE ORGANIZATIONS.

Restricted Bequest—The bequest provisions suggested above are designed to provide unrestricted support for the named charity. However, you may prefer to restrict your bequest for a specific purpose. For example, if you wish to memorialize a family member or an honored colleague, you can establish a named fund that will provide support for a program in which you (or the honored person) are particularly interested.

You should make a restricted bequest in the broadest terms possible consistent with your interests. This guards against the possibility of the purpose of your

gift becoming obsolete. It is often best, if possible, to discuss your bequest intentions with a representative of the charitable organization. Example: "I give (INSERT DOLLAR AMOUNT OR DESCRIBE PROPERTY) to XYZ Charity. This gift shall be held as a permanent endowment to be known as the (INSERT PERSON'S NAME) Fund, only the income of which may be used to support the (INSERT EXEMPT PURPOSE FOR WHICH THE GIFT IS TO BE USED). If the president (or executive director) of XYZ Charity determines that it is not feasible or economical to use the income of the fund for the purpose stated above, the income of the fund may be used for such exempt purposes of XYZ Charity as the president (or executive director) directs."

Final Note

The importance of a well-drawn will cannot be overemphasized. Only through your will can you specify what, when, and to whom your assets will be ultimately distributed.

QUIZ ON LESSON TWO

PLEASE SELECT THE ANSWER YOU BELIEVE TO BE CORRECT.
(CORRECT ANSWERS ARE LISTED BELOW.)

1. **Your will can**
   A. Direct who will receive your life insurance proceeds.
   B. Name a guardian for your children.
   C. Cancel any debts you might have incurred.

2. **Generally, to have a valid will**
   A. It must be signed by two witnesses.
   B. It must treat heirs equally.
   C. It must be signed by your attorney.

3. **The executor of your estate**
   A. Cannot be compensated.
   B. Should be an attorney.
   C. Is responsible for the management of your estate during the probate process.

4. **Probate generally**
   A. May be completed within six months.
   B. Refers to the steps necessary to settle an estate.
   C. Is unnecessary except for the very wealthy.

5. **The probate process ends when**
   A. All estate property has been located.
   B. The executor has distributed all of the assets.
   C. The court accepts the executor's final accounting.

6. **You can simplify your executor's job if you**
   A. Leave your will in a safe deposit box.
   B. Leave detailed instructions about the location of all of your assets.
   C. Do not inform your executor in advance.

7. **Gifts to charitable organizations**
   A. Permit contributions that might not have been possible during life.
   B. Can only be made through an outright bequest.
   C. Can be made by your executor.

8. **A contingent bequest**
   A. Is a bequest of cash.
   B. Can distribute the remainder of your estate.
   C. Will ensure that in the event a named beneficiary does not survive you, your property will go to an individual or organization of your choice.

Answers: 1. B; 2. A; 3. C; 4. B; 5. C; 6. B; 7. A; 8. C.

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LESSON THREE: How Taxes Impact Your Estate Plan

The concept of an estate tax is not new. Evidence can be found tracing its roots back to ancient Rome, when Emperor Caesar Augustus imposed a tax on legacies. Death taxes were often imposed in medieval Europe. In this country the federal estate tax was permanently instituted in 1916 as part of a revenue act to raise funds for World War I. Prior to 1916 estate taxation in the United States was a temporary measure enacted by Congress to raise funds for the Civil and Spanish-American wars and to start the U.S. Navy. Over the years the top federal estate-tax rates have ranged from 10% to 77%, and the amount exempt from tax has climbed from $40,000 in 1941 to $5,490,000 today.

Although the amount of revenue raised by federal estate taxation is fairly small (1% to 2% of total tax revenues) and the number of individuals affected by the tax has been steadily decreasing, it is important to understand how the estate tax is determined and how it could impact your estate plan. Because federal estate-tax rates are constantly changing, we urge you to consult with your financial and legal advisors as you go through the estate-planning process.

What Is Federal Estate Taxation?

The federal estate tax is a tax on your right to transfer property at death. As a transfer tax, it is imposed on the estate itself rather than on the beneficiaries of the estate (as is the case with an inheritance tax).

All property you own and any property in which you have an interest at the time of death is valued at its fair-market value on the date of death to form the gross estate. Any allowable deductions —such as administration and funeral expenses, property passing to a surviving spouse, and gifts to charitable organizations—are subtracted from the gross estate to arrive at the value of the taxable estate. A tax is then imposed based on the value of the taxable estate.

What Will Be Included in Your Gross Estate?

As mentioned above, your gross estate includes all property you own at the time of death. Obviously, this will include cash, collections, personal property, automobiles, bank accounts, and securities, to name a few. Not as obvious are other types of property, such as the value of life insurance policies if you retain any incidents of ownership (e.g., the right to change beneficiaries). Retirement-plan benefits are also included, as are trust assets if you have a general power of appointment over the trust property. Even property you may no longer own (a life insurance policy given away within three years of death) can be included in your gross estate.

Lifetime Gifts as Part of Your Estate

The estate tax is only one part of a transfer-tax system that also includes noncharitable gifts you made during life. Gifts you made during your lifetime in excess of the gift-tax annual exclusion are added to the value of your estate at death to determine your gross estate. ***Example:*** Mrs. M has made taxable gifts to her nieces and nephews over the last several years totaling $800,000. If she were to die next year with property interests valued at $6 million, her gross estate—including her taxable lifetime gifts—would be valued at $6.8 million.

Planning pointer: For individuals who might be subject to federal estate taxation, making gifts during life that qualify for the gift-tax annual exclusion is an excellent way to reduce the size of the estate without having to use any of their $5.49 million exemption amount. You may give up to $14,000 each year to as many individuals as

Assets

Cash	$________
Marketable securities	________
Closely held stock	________
Real estate	________
Personal property	________
Life insurance	________
Pension plans	________
IRAs, etc.	________
Other property	________
Gross estate	$________

Deductions

Debt	________
Mortgage	________
Other________	________
Administration and funeral expenses (about 7% of gross estate)	________
Marital deduction	________
Charitable deduction	________
Total deductions	$________

Estate-Tax Liability

Gross estate	$________
Total deductions	- ________
Taxable estate	$________
Estate tax due *(estimated from chart)**	$________

***Note:** The amount of the estate tax does not reflect the impact of any lifetime taxable gifts.

Estate-Tax Chart

Taxable Estate	Tax Due
$1,000,000	-0-
$3,000,000	-0-
$5,000,000	-0-
$6,000,000	$204,000
$7,000,000	$604,000
$8,000,000	$1,004,000
$9,000,000	$1,404,000
$10,000,000	$3,404,000

you wish, free of gift tax. If you are married and your spouse agrees to split the gift with you, you may give up to $28,000 per year to each person. A couple with two children and four grandchildren could reduce their estate by $168,000 annually and still have their full exemption amount available for future use.

Placing a Value on Your Estate

All assets included in a gross estate are valued at their fair-market value as of the date of death. For some assets this value is relatively easy to determine. Listed securities are quoted in the newspaper and online, and cash is cash. Other types of property—such as a personal residence, the value of an annuity, or a business interest—may be considerably more difficult.

If you own a farm or have real estate used in a closely held business, your executor may elect to use the special-use valuation rather than fair-market value. With special-use valuation a farm could be valued based on its value per acre as a farm rather than a higher fair-market value as a residential development. However, there is a limit of $1.12 million on the amount of the reduction, and this limit is adjusted annually for inflation.

Your executor also has the option of selecting an alternative valuation date—which is six months after the date of death. This can be especially advantageous during periods of stock market decline or a falling real estate market.

Deductions to Reduce the Size of Your Estate

THE MARITAL DEDUCTION permits an individual to transfer an unlimited amount of property to his or her spouse during life or at death—provided both spouses are U.S. citizens—completely free of any federal estate or gift tax. The transfer can be outright and under certain conditions may also be made in trust. Taking advantage of the marital deduction allows the first spouse to completely escape tax and the surviving spouse to benefit from the full value of the estate undiminished by federal tax. However, all of the property that passes tax-free to the surviving spouse will be included in his or her estate and could be subject to federal estate tax at the death of the survivor.

A CHARITABLE DEDUCTION is available for transfers to qualified charitable religious, educational, scientific, and other organizations as described in Internal Revenue Code section 501(c)(3). Congress created the deduction to encourage contributions to those organizations that perform services to further the public good. The deduction is unlimited for estate-tax purposes. For estates that will be subject to federal estate tax, the charitable deduction can reduce the cost of a bequest by 40%.

Filing the Return and Paying the Tax

Generally, the federal estate-tax return (Form 706) is due nine months after the date of death. The IRS will grant a six-month extension if requested before the due date of the return. Any estimated tax is paid with the request for extension.

Payment of taxes due is to be made within nine months after the date of death, and the IRS can grant an extension of up to 12 months for payment. If the executor can demonstrate reasonable cause, the time for payment can be extended up to ten years. If the estate includes a farm or closely held business valued greater than 35% of the total value of the adjusted gross estate, the executor may elect to pay the tax in up to ten annual installments and delay the first payment for up to five years.

Will Your Estate Be Subject to Federal Estate Taxation?

As mentioned earlier, federal estate taxation has undergone numerous changes since it was introduced to the tax code in 1916. Congress repealed the estate tax for 2010, reinstated it, and once again made it permanent in 2012. The exemption is now $5.49 million per person, and the top tax rate is now 40%.

Perhaps even more important, married couples benefit from a portability provision added to the tax code. This provision generally allows any unused exemption amount at the death of the first spouse to be available to the surviving spouse and added to his or her own exemption. Thus a married couple can pass up to $10.98 million free of tax. The first spouse could leave $10.98 million tax-free to the surviving spouse under the marital deduction, and the survivor could use his or her $5.49 million exemption amount plus the unused first spouse's $5.49 million exemption amount to pass $10.98 million free of federal estate tax to heirs.

Does this mean that tax consequences will no longer be a consideration in estate planning? Not really. Individual states also impose inheritance and estate taxes, with rates ranging from 7% to 20%. In addition, there are income-tax and capital-gain tax consequences attached to the distribution of certain types of property.

We mentioned earlier that retirement-plan benefits are includable in an individual's gross estate. Generally, these benefits have accrued without being subject to federal income tax. However, when they pass to a beneficiary at death, they can be subject to both federal income tax and, in larger estates, to federal estate tax as well.

Example: Mrs. M's estate is not currently subject to federal estate tax, and she plans to make bequests to her niece and to a charitable organization for which she volunteers. Her niece is currently listed as the beneficiary of her $100,000 IRA. Mrs. M also has appreciated stock worth $100,000 with a basis of $40,000 that she would like to give to the charitable organization. After discovering that her IRA will be subject to federal income tax, she changes the beneficiary designation of her IRA to the charity and bequeaths the stock to her niece. *Tax results:* There will be no income tax due on the IRA distribution to charity (a potential federal tax savings of $39,600), and the basis of the stock her niece receives will be stepped up to the date-of-death value, which can eliminate capital-gain tax on any appreciation (a further potential tax savings for the niece of up to $14,280).

MARRIED COUPLES BENEFIT FROM A PORTABILITY PROVISION ADDED TO THE TAX CODE.

Final Note

Because of the increase in the exemption amount and the portability of any unused exemption between spouses, only a small number of the wealthiest Americans currently face the threat of federal estate tax. For the most part, these two changes free most individuals from having to deal with sophisticated transfer-tax techniques that are designed to reduce the impact of transfer taxation. Most individuals can now shift their primary planning focus to the *who, what, when, and how* of asset distribution.

QUIZ ON LESSON THREE

PLEASE SELECT THE ANSWER YOU BELIEVE TO BE CORRECT.
(CORRECT ANSWERS ARE LISTED BELOW.)

1. **Tax levied on estates**
   A. Is a relatively new idea.
   B. Raises a lot of money for the federal government.
   C. Helped fund the Spanish-American War.

2. **The federal estate tax**
   A. Is a tax on the transfer of property at death.
   B. Applies only to property mentioned in a will.
   C. Must be paid by the beneficiaries of the estate.

3. **A gross estate includes**
   A. Cash and bank accounts.
   B. Life insurance owned by the decedent.
   C. Retirement-plan benefits.
   D. All of the above.

4. **Gifts to individuals made during life**
   A. Are excluded when determining the value of a gross estate.
   B. May qualify for an annual gift-tax exclusion.
   C. Are tax-free, if made to family members.

5. **Property that passes to a surviving spouse**
   A. Can pass tax-free under the marital deduction.
   B. Will never be subject to tax.
   C. Can never be made in trust.

6. **A charitable deduction**
   A. Is available for transfers to qualified charitable organizations.
   B. Was created to encourage support for organizations that further the public good.
   C. Is unlimited for estate-tax purposes.
   D. All of the above.

7. **A federal tax return**
   A. Must always be filed within nine months of death.
   B. Must be filed for every estate.
   C. Can have its filing deadline extended by six months.

8. **The current exemption equivalent amount is**
   A. $5.49 million.
   B. $3.5 million.
   C. $1 million.

9. **Estate taxes**
   A. Are no longer a consideration in estate planning.
   B. Are the primary reason for having an estate plan.
   C. Are imposed by some individual states.

Answers: 1. C; 2. A; 3. D; 4. B; 5. A; 6. D; 7. C; 8. A; 9. C

PLANNING FOR YOUR FUTURE

LESSON FOUR: A Trust Can Add Flexibility to Your Estate Plan

Although centuries old, the current popularity of the trust is the result of three 20th-century developments: the spread of material well-being within an ever-growing segment of our society; the increasing complexity of investment decisions and property management; and the introduction of federal income, gift, and estate taxes. A trust can relieve the tension of complex decisions. When including charitable beneficiaries, it also offers a number of attractive planning opportunities.

WHAT IS A TRUST? Basically, a trust is an arrangement whereby a trustee holds legal title to property and manages it for the benefit of someone else. The creator of the trust, known as the grantor, can name as trustee a bank trust department or other qualified institution, an attorney, or any other individual—even himself or herself. The grantor can also specify those administrative powers he or she wishes the trustee to exercise.

HOW A TRUST WORKS: Typically, a trust provides for distribution of income from property to one or more designated beneficiaries for a stated period and then for distribution of the property to another party, the remainderman. The trust may be an "inter vivos" trust (a lifetime trust, created during the lifetime of the grantor) or a "testamentary" trust (created by a will). The trust may be revocable or irrevocable.

WHY A TRUST IS EFFECTIVE: What makes the trust an effective planning tool is its remarkable flexibility. A trust can be an effective means of meeting a variety of needs. For example, the increasing complexity of modern investments may bring about a need for investment assistance in the event of disability. An individual might want to create a trust to provide for his or her future financial needs.

More often, though, a trust is established to include concern for someone else's needs. In this case, other persons are named as beneficiaries—in addition to or in place of the grantor.

Trust Advantages

There are many advantages of a trust for both grantor and beneficiary. Some trust benefits are listed below.

INCOME: The investment profile of the trust can be adjusted from time to time to provide income in the most appropriate form and amounts for the beneficiaries. The grantor can be assured that income will continue to his or her named beneficiaries without interruption.

CONTINUITY OF MANAGEMENT: The trustee will continue to direct the investments, distribute income, and perform other duties regardless of changes in the status of the grantor or beneficiaries.

CHANGING CONDITIONS: A lifetime trust when coupled with a will that "pours" assets into the trust is especially adaptable to changing conditions. You can reserve the right to revise or revoke the trust in case you decide to change your estate distribution plans. You can also specify that the trust become effective only upon the occurrence of certain events, such as your disability or a beneficiary's disability.

CONTROL: Placing property in trust does not mean that you have to relinquish control. If you wish, you can retain control over investment decisions regarding trust property, and with a revocable lifetime trust you can cancel the agreement at any time. A trust also permits you to control the future disposition of both income and property. You can provide income support for several individuals and then distribute the trust property as you choose.

PRIVACY: The lifetime trust document is not subject to public scrutiny. Assets pass directly to the heirs without any publicity. A lifetime trust arrangement can avoid the costs and delays

inherent in the probate process. Testamentary trust provisions are contained in the will, which is a matter of public record.

FUNDING: Virtually any type of property can be placed in a trust (e.g., cash, securities, real estate, and life insurance).

In designing a trust, it is important to build in as much flexibility as possible to enable the trustee to attain your objectives. For example, the inclusion of "sprinkling provisions" allows the trustee to distribute trust income according to beneficiaries' needs and circumstances that may change after the trust is created. Similar discretionary provisions can be included for the trust principal.

IN DESIGNING A TRUST, IT IS IMPORTANT TO BUILD IN AS MUCH FLEXIBILITY AS POSSIBLE.

The Pourover Trust

The process of estate planning may seem like piecing together a jigsaw puzzle. After reviewing your assets and the needs of your beneficiaries, you may find it exceedingly difficult to match the right asset with the right beneficiary. The pourover trust—created during life to receive assets "poured over" from other sources at death—may help coordinate your assets to meet your objectives as well as your family's needs.

For example, you could name a pourover trust as the beneficiary of your life insurance policies or direct that benefits from a qualified employee-benefit plan be paid to the trust. Assets could also be poured over from your will. If you fund the trust during your life, it could provide continuous payments to your surviving spouse during the period of estate administration. As assets are added to the trust, your other beneficiaries can be provided for according to your instructions in the trust agreement.

Choosing the Trustee

Your choice of trustee is an extremely important consideration. The trustee is responsible for the prudent management of all trust property for the benefit of the trust's beneficiaries. You may name an individual, an institution such as a professional trust company, or a combination of both to serve as trustee. You can even serve as your own trustee, assuming you feel you have the skill, the time, and the interest to do so. For that matter, if you prefer, you may serve as a co-trustee with a legal or fiduciary partner of your choosing; thus you are still "in charge" but can leave the details for someone else to handle (for a fee, of course). Such a strategy gives you greater latitude in addressing your planning objectives. You can even name a successor trustee to make certain that there is continuing management of your assets *without court involvement* in the event of your illness or incapacity.

Planning Opportunities with Charitable Trusts

The financial- and estate-planning flexibility available through the use of charitable trusts has been expanded in recent years because of the growing popularity of charitable remainder trusts.

The distinguishing characteristic of a charitable remainder trust is that a charitable organization is named as remainder beneficiary. The trust may be created during your life or by a will provision.

Because Congress encourages gifts to charity by allowing various federal income- and estate-tax deductions for such gifts, charitable remainder trusts offer a variety of attractive planning opportunities. An immediate income-tax charitable deduction is generated by a qualified charitable trust created as a lifetime trust. The gain in appreciated property will not be taxed when the property is transferred to or sold by the trust.

To qualify for favorable tax treatment, however, a charitable remainder trust must be irrevocable—in the form of either an annuity trust or a unitrust. Both offer features that can be used effectively to achieve financial- and estate-planning objectives.

Charitable Annuity Trust: This trust provides for the payment of a fixed amount annually—or at more frequent intervals—to a designated beneficiary or beneficiaries. The amount must

equal at least 5% of the initial fair-market value of the trust. At the death of the last payment beneficiary, the trust principal is distributed to a designated charitable organization.

Charitable Unitrust: This trust provides for payment to a designated beneficiary or beneficiaries of an amount equal to at least 5% of the trust's value as it is valued each year—to be paid annually or at more frequent intervals. At the death of the last payment beneficiary, the trust principal is distributed to a designated charitable organization.

The key difference between charitable unitrusts and charitable annuity trusts is in the nature of the payments. Payments from an annuity trust are fixed and do not change even though the value of the trust may change. Payments from a unitrust fluctuate according to changes in the value of the unitrust.

Example: Mrs. C establishes a $100,000 charitable annuity trust that provides for annual payments of $5,000 to her sister. If the trust appreciates in value to $110,000, her sister receives $5,000. If the trust goes down in value to $90,000, her sister still receives $5,000.

If Mrs. C establishes a $100,000 charitable unitrust providing for annual payments of 5% of the trust as it is valued each year, payments will vary with the value of the trust. If it appreciates to $110,000, her sister will receive $5,500; if it goes down to $90,000, her sister will receive $4,500.

The choice of trusts depends upon the objectives of the trust's creator. An annuity trust may be appropriate in situations when the security of a fixed, unchanging stream of income is suitable to the needs of the beneficiary. The unitrust, with its variable payments, may provide a hedge against inflation and be more suitable when some investment flexibility is desired.

The QTIP Trust—A Flexible Planning Option

The QTIP trust is a planning option for individuals who wish to make a significant charitable gift but are reluctant to create an annuity trust or a unitrust because of a concern that the surviving spouse may require more than the payment interest such trusts generally provide.

QTIP stands for qualified terminable interest property. In the past only interest in property with no strings attached (*known as nonterminable interests*) qualified for the estate- and gift-tax marital deduction. With the creation of the QTIP certain terminable interests qualify for the marital deduction as long as the surviving spouse has an interest in at least all of the income from the property, payable at least annually. The survivor can be given additional rights to invade the principal.

If these conditions are met, the entire value of the property qualifies for the marital deduction in the estate of the first spouse to die and is included only in the survivor's estate when he or she dies. Combining a QTIP trust with your charitable estate planning can result in significant tax savings.

Example: Mr. B creates a $100,000 QTIP trust that will take effect upon his death and will pay all of its income to his wife for as long as she lives. Under the QTIP arrangement Mrs. B will have the right to invade the principal of the trust should she need to for her support. Any remaining principal at her death will pass to charitable organizations designated by Mr. B.

By giving her the right to invade principal, Mr. B has, in effect, deferred to his wife the power to revoke the trust.

THE CHOICE OF TRUSTS DEPENDS UPON THE OBJECTIVES OF THE TRUST'S CREATOR.

Tax consequences: First, there is no tax liability at Mr. B's death because the entire value of the QTIP trust qualifies for the unlimited marital deduction. And second, even though the trust principal is included in Mrs. B's gross estate, there will be no tax liability because the remaining principal will pass to charity and qualify for the estate-tax charitable deduction.

Transferring Property with a Charitable Lead Trust

Those with major charitable goals have discovered they can transfer substantial assets to intended beneficiaries at minimal or no transfer-

tax cost by using a special type of trust called a *nongrantor charitable lead* trust. Under this plan you put assets into a trust that will make payments to a charity for a designated period of time; the remaining trust assets will then pass to your heirs. This strategy is sometimes used to delay an inheritance to grandchildren until they reach an appropriate age.

The key to this strategy is that the present value of the payments to charity is deducted from the total amount transferred to the trust, and only the difference—if any—is subject to transfer (estate or gift) tax. For instance, if you put $1 million into a trust that pays a charity $65,000 for the next 20 years and then distributes the remainder to your children, the present value of the charitable interest is more than the value of the property placed in trust. This means that none of the $1 million you put in trust is treated as a taxable gift to your children. If the trust appreciates in value, the original principal—as well as all of the appreciation—will be distributed to your children tax-free.

Final Note

Over the years trusts have proved to be wonderfully versatile planning vehicles. You may find that a trust can be a valuable addition to your own plan.

QUIZ ON LESSON FOUR

PLEASE SELECT THE ANSWER YOU BELIEVE TO BE CORRECT.
(CORRECT ANSWERS ARE LISTED BELOW.)

1. **A trust is**
   A. A recent development in estate planning.
   B. A substitute for a will.
   C. An arrangement whereby a trustee holds legal title to property and manages it for the benefit of someone else.

2. **A trust may be funded with virtually any type of property.**
   A. True.
   B. False.

3. **Which of the following are advantages of using a trust?**
   A. Continued income for a beneficiary.
   B. A trust document is not subject to public scrutiny.
   C. Adaptable to changing conditions.
   D. All of the above.

4. **A trustee**
   A. Is responsible for the prudent management of all trust property.
   B. Must also be an attorney.
   C. Cannot be the person who creates the trust.

5. **To qualify for favorable tax treatment, a charitable remainder trust**
   A. Can be created only during life.
   B. Must be irrevocable.
   C. Can be created only by will.

6. **A charitable remainder unitrust**
   A. Must pay out all of its income.
   B. Must pay out at least 5% of the annual value of the trust.
   C. Can pay out no more than 5% of the initial value of the trust.

7. **A QTIP trust**
   A. Must pay out at least all of its income annually.
   B. Cannot qualify for the marital deduction.
   C. Cannot distribute trust principal.

8. **A charitable lead trust**
   A. Distributes trust principal to a charity.
   B. Makes annual payments to charity for the duration of the trust.
   C. Will not qualify for a gift-tax deduction.

Answers: 1. C; 2. A; 3. D; 4. A; 5. B; 6. B; 7. A; 8. B

PLANNING FOR **YOUR FUTURE**

LESSON FIVE: Estate and Financial Planning with Gifts That Give Back

A primary estate-planning objective for most of us is to ensure the financial security of our loved ones. Rightly, we do not feel comfortable addressing other goals until we are satisfied that they are provided for and their standard of living won't be impaired. Although this objective seems to conflict with significant charitable objectives, fortunately there are charitable life-income arrangements that can protect your loved ones' security and plan support for those charitable organizations that are important to you.

Charitable Remainder Trusts

In our last lesson we briefly touched on charitable remainder trusts and how they can add flexibility to your estate plan. We will examine these trusts in more detail below and highlight some of their uses.

The Charitable Remainder Unitrust

The charitable remainder unitrust is a highly flexible planning arrangement that can be adapted to meet a variety of financial goals. Basically, you contribute assets to a charitable trust that will pay you and/or anyone else you choose a percentage that you predetermine (at least 5% of the trust value each year). The payments can last for the lifetime of the beneficiary(ies) or may be set up for a period not to exceed 20 years. You can make additional contributions to the trust to increase the size of payments. When the unitrust term ends, the remaining trust assets go to the charitable organization(s) you have designated.

The distinguishing feature of the unitrust is that it offers potential for growth and for protection from inflation. ***Example:*** If you transfer $100,000 to a 5% unitrust, it will pay $5,000 during the first full year. If the trust assets grow to $108,000 by the beginning of the next year, the unitrust will pay 5% of $108,000—or $5,400. Of course if the assets drop in value, the payments will decrease.

There are several types of unitrusts that may work effectively to meet different objectives.

- ***A straight unitrust*** begins paying the percentage amount immediately. If the income earned by the trust is insufficient for this purpose, the balance is paid from principal.
- ***A net-income unitrust*** limits payments to the net investment income if that income is less than the percentage amount. Principal will never be used to make the payments. The trust could include a make-up provision that allows making up any past deficiencies in payments in later years when trust income exceeds the stated percentage rate. The net-income unitrust is commonly used when a trust is to be funded with illiquid assets such as real estate or closely held stock or when the trust beneficiary does not need current income.
- ***A "flip" unitrust*** starts as a net-income unitrust, and then upon the occurrence of a permissible triggering event in the future it switches to a *straight unitrust*. Permissible events include a specific date in the future; a specific event like marriage, divorce, death, or birth; and the sale of assets without a ready market, such as real estate.

A Charitable Deduction

In addition to receiving a stream of income with a unitrust, you also get a significant charitable deduction for the value of the charity's remainder interest in the trust. The size of the deduction depends on several factors, including the ages and number of beneficiaries, the payout rate, and the value of the property placed in the trust.

Because property of significant value is commonly used to fund unitrusts, such a gift may generate a substantial deduction.

With a charitable life-income arrangement you may be able to achieve some or all of the following objectives simultaneously:

1. Income for yourself and other beneficiaries, some of which may be tax-free.
2. Federal income-tax savings and possibly federal estate-tax savings as well.
3. Avoidance of capital-gain tax.
4. Substantial support for your favorite charitable organizations.

If you make a cash contribution, the maximum deduction in the year of the gift is 50% of your adjusted gross income. If you contribute long-term capital-gain property, the limit is 30%. In either case you may carry forward any excess deduction for up to five years, subject to the same limitations.

Possible Uses of a Charitable Remainder Unitrust

There are several possible beneficial uses of a charitable remainder unitrust.

TO INCREASE SPENDABLE INCOME. You may own highly appreciated securities that pay little or no dividends, or you may own nonproductive real estate that generates no income but comes with an annual property-tax bill. You could sell the asset and invest the proceeds for income, but you would incur significant capital-gain tax.

If you transfer the asset to a charitable remainder unitrust, the trust can make the sale without incurring capital-gain tax because the trust is a tax-exempt entity. The trust will then begin paying you your specified percentage amount.

TO SUPPLEMENT YOUR RETIREMENT PLAN. If you are in your peak earning years and are prohibited from making additional contributions to a qualified retirement plan, you can create a charitable remainder unitrust and make annual contributions to the trust. The trustee can invest for growth until your retirement and thereby maximize the accumulations and minimize current income. The growth in trust assets is not currently taxed to you.

Your contributions are not fully deductible as they would be with contributions to a qualified retirement plan. Most likely, the deduction will be in the range of 15% to 30% of your contribution. However, unlike with a qualified retirement plan, with a charitable remainder trust your contribution amount is not limited and you may contribute property as well as cash. When you contribute long-term appreciated property, you receive the double benefit of an income-tax deduction and avoidance of capital-gain tax.

TO MEET THE NEEDS OF A SURVIVOR. A unitrust created under your will is an excellent way to fulfill both family and charitable objectives. It provides no income-tax advantages, but your estate will receive an estate-tax charitable deduction for the value of the charity's remainder interest. If the beneficiary is your surviving spouse, the entire value of the trust will be deductible. In addition to the charitable deduction, your spouse's income interest will qualify for the estate-tax unlimited marital deduction.

The Charitable Remainder Annuity Trust

The security of knowing exactly how much income to expect may be more important than the possibility of a hedge against inflation. For those who desire this kind of assurance and are looking for a way to make a significant charitable gift, the charitable remainder annuity trust is an excellent vehicle. The charitable remainder annuity trust shares the same tax benefits as the unitrust: an income-tax charitable deduction for the value of the charity's remainder interest and the avoidance of capital-gain tax on the transfer of long-term capital-gain property. Unlike the unitrust, the payments from the annuity trust are fixed at the

time the trust is created. The payments must equal at least 5% of the initial value of the trust and remain constant as long as the trust is in effect. The fixed-payout feature of the annuity trust makes it particularly well-suited to meet the financial needs of an older beneficiary who needs the security of a guaranteed stream of income.

A Remainder Interest That Won't Make Payments but Can Reduce Your Taxes

If you wish to make a charitable gift of real estate but need your residence as a place to live or need your land for providing a livelihood, then another planning option is available—without giving up immediate possession of the property.

Under this gift arrangement you transfer the property deed to a charitable organization and retain in the deed the right to possession and use of the property for your lifetime (and the lifetime of a survivor if you wish). Although such a transfer will not result in income payments to you, there will be no disruption in your lifestyle; you can continue to occupy the residence or operate the farm as before.

You Also Realize Immediate Favorable Tax Benefits. As with other charitable transfers, you escape any potential capital-gain tax on your property's appreciation in value. Your gift also creates an immediate income-tax deduction based on the present value of the charity's remainder interest in the property. The tax savings created by the deduction means you have more dollars to use for living expenses or investment purposes.

Benefits of a Charitable Gift Annuity

Tax benefits and a steady, reliable stream of income have long made the gift annuity a favorite giving vehicle for many people—especially those individuals who are not as concerned with increasing assets as with finding ways to ensure a predictable income.

As the name implies, a charitable gift annuity is part gift and part annuity. In exchange for a transfer of cash or securities, a charitable organization agrees to pay a fixed sum of money to you (or to you and another person) for life. Those payments, which are backed by all of the assets of the charity, will continue for as long as you live. Your payments are fixed and do not decrease during unsettled economic times when interest rates fall or the stock market declines.

As a result of your gift, you can claim a current income-tax deduction for a portion of your gift. Depending on your age at the time you create a gift annuity, the deduction could range from 20% to 50% of the gift amount. In addition, a substantial portion of each annuity payment, sometimes more than half, may be free of income tax—particularly when the annuity is funded with cash.

When you fund your gift annuity with long-term appreciated property, part of the appreciation escapes taxation entirely. In addition, the portion of capital gain that is reportable may be spread out over your life expectancy. If you fund a gift annuity with appreciated property for someone else (and you are not also an annuitant), you must recognize all of the reportable capital gain in the year you make the gift.

TAX BENEFITS AND A STEADY, RELIABLE STREAM OF INCOME HAVE LONG MADE THE GIFT ANNUITY A FAVORITE GIVING VEHICLE FOR MANY PEOPLE.

Defer Your Annuity Payments for Retirement

The deferred-payment gift annuity is designed to appeal to a younger donor with a high current income who can benefit from a current income-tax deduction and is interested in augmenting retirement income on a tax-favored basis. The deferred-payment charitable gift annuity involves the current transfer of cash or marketable securities in exchange for an annuity that will start at a future date—often at retirement age.

You realize an immediate income-tax deduction for the gift portion of each transfer to a gift annuity. In addition, a portion of each annuity payment—when payments begin—will be considered a tax-free return of principal.

For example, a 50-year-old donor could receive a tax deduction of about 39% of the value of the gift for an annuity that is to begin payments at the age of 67. When the annuitant begins receiving payments at the age of 67, approximately 40% of each payment will be tax-free.

Final Note

America's spirit has always been a philanthropic one. Through periods of peace and prosperity as well as wars and recessions, the total amount of giving in this country increases almost every year. As Americans, we can take pride in our generosity and philanthropy—even as we realize that there are still charitable organizations that need our help.

How best to leave your mark? How best to use excess wealth to benefit others and improve life in your community? These decisions reflect the values and organizations you care about the most. By making a charitable gift, you transfer more than just a portion of your wealth. You impart a significant gift for the good of society, and you become part of a legacy that will continue to thrive and help causes long after you are gone.

We hope that you benefit from the lessons in this brief estate-planning course and that you will proceed with creating your own plan—or once again review the plan you already have in place.

QUIZ ON LESSON FIVE

PLEASE SELECT THE ANSWER YOU BELIEVE TO BE CORRECT.
(CORRECT ANSWERS ARE LISTED BELOW.)

1. **A primary estate-planning objective for most people is**
   A. To avoid taxes.
   B. To ensure the financial security of loved ones.
   C. To avoid probate.

2. **With a charitable life-income arrangement, you may be able to**
   A. Receive income for yourself and/or other beneficiaries.
   B. Generate federal tax savings.
   C. Support your favorite charitable organizations.
   D. All of the above.

3. **A charitable remainder unitrust**
   A. Must pay out at least 4% of its value every year.
   B. Can be created only by will.
   C. Is a highly flexible planning arrangement.

4. **A net-income unitrust**
   A. Limits payments to net investment income.
   B. Can include a make-up provision.
   C. Is commonly used when illiquid assets fund the trust.
   D. All of the above.

5. **The deduction for a charitable remainder trust**
   A. Equals the value of the property placed in trust.
   B. Can always be taken in full for the year the trust is created.
   C. Depends in part on the age(s) of the beneficiary(ies).

6. **You may deed your residence to charity but still live in the house for as long as you live.**
   A. True.
   B. False.

7. **A charitable gift annuity**
   A. Will appeal to someone who wants to see his or her assets grow.
   B. Is part gift and part annuity.
   C. Does not qualify for a charitable deduction.

8. **A deferred-payment gift annuity**
   A. Often appeals to older donors.
   B. Allows the donor to choose when annuity payments begin.
   C. Does not qualify for a charitable tax deduction.

Answers: 1. B; 2. D; 3. C; 4. D; 5. C; 6. A; 7. B; 8. B

The information contained herein is offered for general informational and educational purposes. The figures cited in the examples and illustrations are accurate at the time of writing and are based on federal law as well as IRS discount rates that change monthly. State law may affect the results illustrated. You should seek the advice of an attorney for applicability to your own situation.

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