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Newsletter #5 • September 2010
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The Importance of Planned Giving

As the end of the year quickly approaches, it is essential to recognize the importance of planned giving and its benefits for those with taxable or rapidly growing estates. This newsletter will discuss the opportunities available to reduce your taxable estate while maximizing your assets for your benefit and the benefit of your loved ones.

The Exemptions

There are two available exemptions that must be considered when determining whether planned giving will benefit you. Any lifetime gifts beyond these exemptions will be taxable gifts up to a rate of 45% in 2010.

First, the **annual gift tax exemption** allows the donor to give up to $13,000 annually to any individual without incurring any Gift Tax. Note that there is no limit to the number of individuals to whom such gifts may be made. Couples may give up to $26,000 by using a technique called "gift-splitting," further amplifying the benefits of such gifts.[1] This exemption expires at the end of each calendar year and may not be carried over. Therefore, the earlier that planning begins, the greater the benefit incurred.

Second, the **lifetime exemption** allows the donor to give up to $1 million to one or more individuals during the life of the donor. This exemption is only utilized after the annual exemption for the year of the gift has been used.[2] Note that the lifetime Gift Tax exemption does reduce the total Estate Tax exemption available to the donor at death. In other words, if John Smith used his $1 million Gift Tax exemption in full and then died in 2009 (when the Estate Tax exemption was $3.5 million), only $2.5 million of his Estate Tax exemption would be available to his estate at death.

Together, these exemptions can provide a significant reduction of the taxable estate of an individual or couple.

In addition to the annual and lifetime exemptions, **gifts of medical and educational expenses** are exempt from Gift Tax. However, these payments must be made directly

1. A Gift Tax return (IRS Form 709) must be filed for any year in which (a) gifts exceeding the annual exclusion amount are made to any individual, (b) gift-splitting is utilized or (c) the lifetime exemption is utilized.

2. Gifts utilizing the lifetime exemption must be recorded on each Gift Tax return that is filed during the life of the donor. The return must state the amount of the gift made in the present year as well as the total exemption amount used as of the date of the return.

to the institutions providing such services and may not be made as a reimbursement for such expenses.

The Benefits of Planned Giving

Planned giving can significantly reduce the donor's taxable estate. Although $13,000 per year may not seem like a large amount, the annual exemption can quickly multiply when combined with gift-splitting and utilization of multiple generations of beneficiaries. If the donor takes control of these opportunities early and with proper counsel, the gifts can provide significant benefits to his or her descendants for many years to come while bypassing the burden of transfer taxes.

In addition to the tax benefits, planned giving can alleviate the financial burdens that are incurred at the donor's death or supplement the donor's income for his or her dependents. Many donors also prefer to see beneficiaries enjoy their gifts during life but are wary of making outright gifts to these individuals. An irrevocable trust can be used to achieve these goals while also allowing the Grantor to determine when and how the gifted assets will be used.

Planned Giving Techniques

Estate Plan

The first and most important step in utilizing the benefits of planned giving is to discuss your goals with an Estate Planning Attorney and have **a basic estate plan** (consisting of a Revocable Living Trust, a Pourover Will and Powers of Attorney for Health Care and Property) prepared. This step will help you maximize your Estate Tax exemption and provide for your loved ones and is essential before any advanced planning can begin.

Irrevocable Life Insurance Trust

An Irrevocable Life Insurance Trust ("ILIT") can provide significant benefits to the beneficiaries of an estate that either has a significant estate tax liability or whose beneficiaries were dependent on the income of the decedent. The death benefit of any insurance policy owned by the decedent is included in his or her estate, and thus subject to the Estate Tax. However, if the ILIT is the owner of the policy, then the death benefit will remain outside of the decedent's estate, thus avoiding any Estate Tax.

One of the primary benefits of life insurance as an estate planning tool is that it creates liquidity when it is needed most for many clients—at death in order to supplement income or pay the estate tax, which is due nine months after death. Therefore, life insurance can provide a safety net for many clients, especially those with a majority of their assets tied up in a small or closely-held business, and help alleviate some or all of the taxes and expenses due after death. However, there are many strict requirements that must be adhered to in order for the gift to qualify as a present gift—the primary requirements being that the Grantor must not retain any incidents of ownership over

the trust assets and that the beneficiaries of the trust must be given notice of the right to withdraw their share of the gift (known as a Crummey Notice—see below).

Similar to a Revocable Living Trust, the proceeds of the life insurance do not have to be distributed immediately to the beneficiaries, but can instead be distributed as the Grantor chooses and instructs in the ILIT document. At the Grantor's death, the trustee collects the proceeds, income tax free, to be distributed according to the ILIT's terms. Additionally, by establishing an ILIT to own the life insurance policy, the premiums that are gifted to the trust are removed from the taxable estate and the proceeds paid out at death will not be included in the decedent's taxable estate.

Gift Trust

Another irrevocable instrument for providing for your beneficiaries while also reducing your taxable estate is the **Gift Trust**. Similar to an ILIT, gifts to a Gift Trust are made using the annual exemption first, and then the lifetime exemption if it is deemed to be beneficial to the client and his or her estate. A Gift Trust allows the Grantor to determine when and for what purposes distributions will be made to the beneficiaries of the trust. As opposed to a 529 Plan, which can only be used for educational expenses, or an UTMA account, which is distributed outright to the beneficiary at age 21 in Illinois, a Gift Trust provides the trustee with great flexibility and control over the trust assets. Again, there are several requirements which must be followed in order to ensure that the gifts made to such a trust will be treated as present gifts and thus will not be included in the donor's estate.

Further Planning

In addition to the techniques discussed above, further planning options, such as Qualified Personal Residence Trusts, Grantor Retained Annuity Trusts and Charitable Giving, are available and can further reduce the taxable estate. Please look for in-depth discussions of these tools in upcoming newsletters and consult your Estate Planning Attorney for further information regarding these wealth transfer techniques.

Definition of the Month: *Crummey Notice*

The Crummey Notice takes its name from the 1968 decision in *Crummey v. Commissioner*, 397 F.2d 82, 88 (9th Cir. 1968) in which it was established that a gift in trust qualifies for the annual Gift Tax exclusion *as long as the trust's beneficiaries have the power to withdraw the gifted assets*. The beneficiaries must have actual notice of such power, but not necessarily written notice unless required by the trust document. Crummey Notices come into play with irrevocable trusts, such as ILITs and Gift Trusts, where the Grantor intends to make a present gift. Generally, it is recommended that the beneficiary be given a window of at least 30 days to withdraw the assets prior to the trust investing them elsewhere.