

# The Guttenberg Press

*Preserving Your Assets ... Planning Your Future*

LAW OFFICES OF ARYEH GUTTENBERG • 1777 REISTERSTOWN ROAD • BALTIMORE MARYLAND 21208 • 410-484-7711

Spring 2005



Dear Friend:

We hope you are enjoying the Spring.

In this issue, we begin to explore the strategic uses of charitable trusts as a vehicle for both passing assets to family members at a low tax cost and providing for the immediate/ongoing needs of your favorite charity. In a low interest environment, the "Charitable Lead Trust" can accomplish those objectives. The lead article should give you a flavor of the CLT in order to assess whether it is an appropriate vehicle for you. We also explore the "hot" strategy of a "stretch IRA" - not only for children, but for grandchildren in order to maximize your legacy on a tax-deferred basis. Your advisor needs to be consulted, particularly since this strategy involves an integration of the rules regarding IRA payouts, disclaimers and use of generation-skipping exemption.

In future issues, we will explore the upshot of the *Schaivo* matter and living wills, as well as a recent case which purports to provide a scare as to the use of life insurance trusts. This trust remains an excellent planning strategy and we hope to explore the case and advise you of developments. Of course, please advise us if you have any questions in the interim.

*Let's stay in touch!*

## Locking in Low Interest Rates Now for Charitable Lead Trusts

Increases in the "§7520 Rate" provide an important current opportunity for use of Charitable Lead Trusts as a strategic vehicle for estate tax savings and charitable gift planning. The §7520 Rate is provided by the IRS on a monthly basis and affects the computation of income, gift and estate tax charitable deductions for transfers to split interest charitable vehicles. One of the most effective charitable giving vehicles during low interest rate environments is the Charitable Lead Trust (we will refer to it as "CLT").



Let's explore the use of the CLT and provide examples of its increased benefit, particularly when interest rates are low but are "on the rise."

### What is a Charitable Lead Trust

The CLT is a strategic charitable trust vehicle designed to make a transfer of assets to the donor's heirs at a significantly reduced gift and estate tax cost, while supporting the charity with the income during the term of the trust. During a specified number of years, an annuity or fixed percentage of the trust assets is paid to the charity. At the end of the trust term, the assets pass to the beneficiaries named by the donor.

### Benefits of a CLT

**Benefits to Donor- Leveraged Gift and Estate Tax Savings.** The most significant benefit of the CLT is the potential for significant reduction of estate taxes. The reason is that when the donor makes a gift to the trust, the value of that gift is reduced by the present value of the income stream provided to the charity. In addition, the value of the CLT's asset is fixed at the time the trust is established - any subsequent increase in the value of the assets is outside the donor's estate and thus free of gift or estate tax.

**Benefits to the Charity -** the Charity receives immediate /ongoing contributions that can be used to fund capital projects, endowments, etc.

### Practical Uses - Best Candidate and Uses for a CLT

The best candidate for a CLT is a donor who:

- (1) has a significant estate tax exposure who is more concerned about preserving his estate for his children than about increased income or current income tax savings; and
- (2) who wishes to provide for a particular charity during his or her lifetime.

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# CLT VS. NO GIFT

Comparison of benefits	6% Lead Trust	No Gift
Principal	\$500,000	\$500,000
6% Annuity for Hospital (20 years)	\$ 30,000 annually	-0-
Asset Value (including appreciation) Subject to Gift & Estate Tax in 2025 <sup>1</sup>	-0-	\$1,770,175

Gift Tax Deduction - 2005	6% Lead Trust	No Gift
2005 Gift Tax Deduction = Present Value of 20 Year Annuity to Hospital	\$400,000	-0-
Asset Value Subject to Gift & Estate Tax in 2005	\$99,416	-0-
Gift & Estate Tax in 2005 (Assume Rate of 47%)	\$46,725	-0-

Benefits Summary - 2025	6% Lead Trust	No Gift
Total Distribution to Family <sup>1</sup>	\$957,620	\$938,193 (net of 47% tax)
Total Distributions to Hospital (2005-2025)	\$600,000	-0-
Total Family and Hospital Benefits	\$1,557,620	\$938,193 (net of 47% tax)

<sup>1</sup>In 2005 the top Gift and Estate Tax Rate is 47%. Tax Rates are projected to decline steadily through 2009. In 2010 Estate Tax is scheduled for complete repeal, and the Gift Tax will be 35%. Gift and Estate tax can be reinstated, however, after 2010, due to a Sunset Clause in the current law.

## Effect of Using Higher \$7520 Rate on CLT's

You want your 3 children to inherit \$1,000,000 each; have made no prior gifts to them  
 You already make annual gifts to charity  
 You establish a CLT with \$3,000,000 for 15 years at a 5% annual payout rate

	March Rate	April Rate
Value of Gift to Children	4.6%	5%
Estimated Gift Tax Due	\$1,400,085	\$1,443,045
	\$167,037	\$185,509

Result: Just by virtue of a 1 month swing in the \$7520 rate, the gift was increased by over \$43,000. If the \$7520 rate continues to rise, we should be in position to effect an even larger gift using a CLT. Keep in mind that the \$7520 rates for May, 2004 was 3.8% and June, 2004 - 5%, a 1.2% swing. Let's keep monitoring the rate.

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The technique produces even greater benefits if appreciated assets are transferred (since the appreciation would avoid estate tax) and when the transfer is made while federal interest rates are low (see discussion below). Mechanically, the CLT would hold appreciating assets, pay income to the charity for a period of years and then pass the remaining principal to the donor's designated family members.

**CLT Example:** Donors, Joe and Sue, wish to preserve as much as possible of their assets for their children at death. Joe and Sue have a significant estate with no cash flow problems. They have been making annual gifts of \$30,000 a year to a hospital that saved Joe's life (the "Hospital"). Joe and Sue plan to otherwise make full use of lifetime gift tax exemption (\$2,000,000 combined exemption) and annual gifts to their children (\$22,000 per child) and are prepared to pay the gift tax on the leveraged transfer to the CLT.

Here's an example of the strategic use of a CLT to expand Joe and Sue's gift giving further - in a leveraged manner.

<b>Funding of CLT:</b>	Joe and Sue contribute assets valued at \$400,000 to a CLT.
<b>Payout to Hospital:</b>	20 years
<b>Payout Rate:</b>	6%
<b>\$7520 Rate:</b>	4.2% (12/04)
<b>Asset Total Return:</b>	8% (6% paid out as income, 2% reinvested)

## Results of CLT Strategy for Joe, Sue and Charity:

**Discounted Charitable Gift Deduction:** \$400,000 (deduction is based on (1) term of trust, (2) payout rate and (3) \$7520 rate)

**Appreciation** - grows tax-free and removed from the estate  
**Payout to Charity** - \$30,000 for 20 years

**Bottom Line:** Larger gift to charity without depriving family of inheritance. In fact, family could receive more than it would if asset was held by Joe and Sue and bequeathed to them. See chart on left for a remarkable comparison of the benefits of a transfer to a CLT with the results if no gift were made.

**Impact of "\$7520 Rate."** The reason to consider a CLT now - when interest rates have begun to rise - is a special "look-back" rule that exists for determining which rate to use. When you fund your CLT, you can use the \$7520 rate for either the month of transfer or either of the 2 previous months, whichever is more favorable.

Thus, if the CLT in the above example was set up in February, 2005 when the rate was 4.6%, the donor was permitted to use the rate of 4.2% for December. In April 2005, the \$7520 rate has jumped to 5%; therefore the donor can use the \$7520 rate for either February or March (4.6% for both months). With a lower \$7520 rate, the donor can receive a larger gift tax charitable deduction than he would for making a comparable gift when the rate is higher.

See the example at the left showing the differences.

## Timing of \$7520 Rate Can Provide Added Benefits

Keep in mind that deciding on whether or not to establish a CLT should not be solely based on interest rates or estate tax savings. Ideally, you are an excellent "candidate" for a CLT if you have significant assets that you wish to pass on to your family, but neither you nor your children require current income from the assets funding the trust. But if you are a good "candidate" and wish to benefit a charity (especially if you are anyway making current gifts to charity), added tax benefits can be derived from good timing with the \$7520 rate.

# Using IRA's as a Tool to Achieve Greater Family Wealth

When you set up an IRA or other tax-deferred retirement plan, consider including your grandchildren on the list of beneficiaries. This could save significant overall estate tax and allow the retirement plan (we'll assume for this purpose, it's an IRA) to grow even greater on a tax-deferred basis.

## Typical Designations:

The typical designations for an IRA are:

**Married** - if you are married, probably your spouse. In addition to providing for your spouse, this provides the greatest tax benefits and flexibility in that it allows the surviving spouse to roll over the inherited IRA and name new beneficiaries.

**Divorced, Widowed, Never Married** - typically the children are named. After your death, your children can "stretch out" minimum distributions over their life expectancies.

## Alternate Designations for Larger Tax Savings

Naming your spouse or children may not always be the prudent course. For instance, your spouse or your children might not need the funds in your IRA, particularly if they are well off or otherwise provided for. If they inherit your IRA, they will have to take distributions over a relatively short life expectancy period, which accelerates the payment of income tax. And, the remaining balance in the IRA may become subject to estate tax when the IRA beneficiary (e.g., spouse, child) dies.

## Intergenerational Strategy

Consider naming your children as IRA beneficiaries and your grandchildren as contingent beneficiaries. Or, you can name a spouse as IRA beneficiary and your grandchildren as contingent beneficiaries. Alternatively, you can get a bit more creative and use a "cascading" designation - with your spouse as primary, your children as secondary and your grandchildren as tertiary beneficiaries.

**Caution:** One must be careful not to name minors outright as any type of IRA beneficiary. The advisable course is to designate a trust (probably a trust set up under your Will) where the minor is the trust beneficiary.

## Effecting the Solution with a Disclaimer

After your death, the primary beneficiary will have until the earlier of (1) September 30th of the calendar year after you die or (2) 9 months after your death, to decide whether to disclaim the IRA to the contingent beneficiary. And with a cascading designation, the contingent beneficiary can disclaim in favor of a tertiary beneficiary (i.e., grandchildren).

**Example:** Mary dies owning an IRA. Son, Jim, designated as beneficiary, inherits the IRA when he is 60 years old. Under current IRS life expectancy tables, he has a 25 year life expectancy. Therefore, Jim must withdraw at least 4% (i.e., 1/25) of the IRA in the first year. After 25 years, the IRA will be depleted.

*If Jim disclaims in favor of Candy, his 23 year old daughter and secondary beneficiary, she will have a 60 year life expectancy. That means that Candy must withdraw 1.67% of the IRA the first year. She will enjoy an extra 35 years of the tax-differed compounding. Depending upon the investment results of your IRA over those 35 years, the total cash flow to the granddaughter could be significant.*

## Use of Increasing GST-Exemption

The key tax trap to be concerned about is the "generation-skipping transfer tax." This is a tax in addition to the estate tax on assets passing from grandparent to grandchild (i.e., assets which skip a generation). However, in 2005, there is a "generation-skipping tax" exemption of \$1,500,000 which can be used to shield the transfer from GST tax. See summary in the inset below.

**Bottom Line:** IRA participants should consider maximizing this exemption to preserve greater wealth and tax deferral by creating a "stretch IRA" for grandchildren.



"Yes, you can afford a comfortable retirement.

Spend your money on a good sleeping bag  
and you'll be comfortable anywhere."

## **GST Tax and the GST Exemption: Nuts & Bolts**

GST Tax Rate under current law - 47% in 2005, to drop to 45 % by 2007, disappear in 2010, and reappear at 55% in 2011 (same as estate tax rates.)

GST Exemption under current law - \$1,500,000 in 2005, scheduled to increase to \$2,000,000 in 2006, \$3,500,000 in 2009. (GST tax, like estate tax, is scheduled to be phased out in 2010 and reappear in 2011).

**Example:** Mary dies in 2005, leaving \$2 million to granddaughter Candy. Result: \$1.5 million would be exempt from GST tax; but the other \$500,000 would be taxed at 47%. The GST tax would be in addition to the federal gift and estate tax. It is a tax that could be avoided by structuring your dispositive estate plan to ensure that only the GST exemption amount (\$1.5 million) passes to grandchildren.

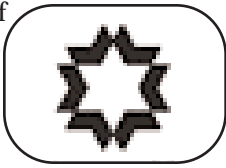
## Things We've Been Up to Lately



On February 15, 2005, Aryeh delivered a presentation for the Board of University of Maryland Medical System and affiliated entities on "Charitable Giving Strategies." Please let us know if you would like to receive a copy of the

PowerPoint presentation materials.

Aryeh has been named as the Chairman of the Executive Board of the Mid-Atlantic Region of Shaare Zedek Medical Center of Jerusalem. The new Shock Trauma Unit at the Hospital was dedicated and funded in significant part by the Baltimore Committee.



The 2005 Supplement of our book on "Maryland Estate Planning, Wills and Trusts Library" has been published. The major change deals with the application of Maryland's new "decoupled" estate tax. Please let us know if you would like to receive an excerpt from the supplement.

Our office has been busy updating and modifying Wills and Revocable Trusts for our clients to afford the necessary flexibility and integrated planning for the increasing federal exemption and the new Maryland estate tax. We urge those clients who have "Bypass Trusts" in place to call us to review their documents.



TELEPHONE: 410-484-7711

FAX: 410-484-3533

EMAIL: [aryeh@guttenberglaw.com](mailto:aryeh@guttenberglaw.com)

### ESTATES AND TRUSTS

- Estate and Trust Planning
- Will and Trust Preparation
- Estate and Trust Administration
- Charitable Gift Planning

### BUSINESS

- Formation – Corporations, Partnerships, Limited Liability Companies
- Planning and Structuring
- Business Succession Planning
- Business Agreements
- Mergers and Acquisitions

### TAX

- Planning and Structuring
- Representation Before IRS and Federal Courts
- Private Foundations

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