INSIGHT ON ESTATE PLANNING

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A charitable trust that takes the lead

Are you inclined to help a charity for a period of time without ultimately giving up the property? Consider the benefits of a charitable lead trust (CLT). This type of trust is essentially the opposite of the charitable remainder trust (CRT), a better-known alternative (see "Is a CRT a Better Option?" below). With a CLT, the property reverts to family members — not the charity.

At the same time, the CLT provides a stream of annual income to the charity for a term of years. So everyone wins.

How it works

A CLT may be funded during your lifetime or a testamentary trust can be created through your will or other estate planning documents. In either case, the trust is irrevocable. You can incorporate this technique into your estate plan to accommodate charitable intentions.

The basic premise is relatively simple although the mechanics can be complicated. Generally, you contribute property to the trust set up to last for a specific number of years. The charity (or group of charities) designated as the income beneficiary receives payouts during

Is a CRT a better option?

Consider whether a charitable remainder trust (CRT), a close cousin to the charitable lead trust (CLT), is a preferable option for your situation. With a CRT, the trust typically pays out income to the designated beneficiary or beneficiaries — for example, the trust creator or spouse — for life or a term of 20 years or less. If it suits your needs, you may postpone taking income distributions until a subsequent date. In the meantime, the assets in the CRT continue to appreciate.

When you transfer assets to the CRT, you qualify for a current tax deduction based on several factors, including the value of the assets at the time of the transfer, the ages of the income beneficiaries and the federal Section 7520 rate. When structuring a CRT, keep in mind that the greater the payout, the lower the deduction.

There are two types of CRTs: The charitable remainder annuity trust and the charitable remainder unitrust. With either version, the income beneficiary must be entitled to annual payments for his or her lifetime or a period of no more than 20 years. In addition, other tax law requirements apply.

Finally, like a CLT, a CRT is irrevocable. In other words, once it's executed, there's no going back and you can't make other changes. So, you must be fully committed to this approach.

the trust term. Depending on the CLT's structure, payments are made as fixed annuity payments or a percentage of the trust. When the trust term expires, the remaining assets are distributed to the designated beneficiaries — typically your children or grandchildren.

Traditionally, the property transferred may include assets like publicly traded securities, real estate, business interests and even private company stock. In some cases, property may be sold to produce the desired revenue. Caveat: Depending on the way that the CLT is structured, a sale may result in a capital gain that's immediately taxable.

Charitable deduction implications

One of the main attractions of a CRT is that you can claim a current tax deduction for the value of the remainder interest. However, if you use a CLT, your deduction may be limited or nonexistent, depending on whether it's a grantor or nongrantor trust.

With a grantor CLT, you can claim a current deduction for the present value of the future payments to the charitable beneficiary, subject to other applicable deduction limits. However, there's a downside to this arrangement: The investment income generated by the trust is taxable to the grantor during the term.

Conversely, if the CLT is set up as a nongrantor trust, the trust itself — not the grantor — is treated as the owner of the assets. As a result, the trust is liable for the tax due on the undistributed income. Thus, the trust, but not the grantor, can claim the charitable deduction for distributions to the organization.

Each situation is different, but the resulting income tax liability for a grantor trust often outweighs the benefit of the current tax deduction. Furthermore, any charitable deduction for contributions of property is limited to 30% of adjusted gross income. For these reasons, you may prefer the nongrantor trust setup.

Note that a properly structured CLT will produce a gift or estate tax deduction for the value of that portion of the trust designated for charity. This makes it possible to transfer a remainder interest to family members at a relatively low tax cost.

Ins and outs

The CLT must provide annual payments to at least one designated charity for a specific number of years, the life of one or more individuals, or a combination of the two. Unlike CRTs, there's no mandatory timeframe of 20 years, nor does the trust have to impose maximum or minimum requirements each year.

When the trust term finally expires, the remainder passes to the designated beneficiaries named at the outset. Accordingly, the assets eventually wind up in the hands of those whom you most want to have them.

Is a CLT right for you? It depends on your circumstances. Discuss this option with your estate planning advisor. •

Add estate planning flexibility with powers of appointment

The best laid plans can go awry. Consider the estate plan you may have carefully crafted by taking into account the needs of your family members. After you're gone, events may transpire that you hadn't anticipated or couldn't have reasonably foreseen. For example, a grandchild may suffer a severe disability or creditors may come after your adult child's fortune.

Of course, there's no way of predicting the future, but you can supplement your existing estate plan with a trust provision giving a designated beneficiary a "power of appointment" over some or all of the trust property. Essentially, this person will have the discretion to change distributions from the trust or even add or subtract beneficiaries.

Power of appointment in action

Assuming the holder of this power fulfills the duties properly, he or she can make informed decisions when all the facts are known. This creates more flexibility and adaptability within your estate plan.

Typically, the trust will designate a surviving spouse or an adult child as the holder of the power of appointment. After you die, your surviving spouse has authority to make changes consistent with the language contained in the power of appointment clause. This may include the ability to revise beneficiaries.

For instance, if you give your spouse this power, he or she can later decide if grandchildren are capable of managing property on their own or if property should be transferred to trusts managed by professional trustees. The power of appointment can be used to discourage spending sprees of offspring who haven't demonstrated the ability to handle newfound wealth.

2 types of powers

If you take this approach, note there are two types of powers of appointment:

1. "General" power of appointment. This allows the holder of the power to appoint the property for the benefit of anyone, including him- or herself, his or her estate or the estate's creditors. The property is usually included in a trust but may be given to the holder outright. Also, this power of appointment can be transferred to another person.

2. "Limited" or "special" power of appointment. Here, the person holding the power of appointment can give the property to a select group of people who've specifically been

identified by the deceased. For example, it might provide that a surviving spouse can give property to surviving children, as he or she chooses, but not to anyone else. Thus, this power is more restrictive than a general power of appointment.

Whether you should use a general or limited power of appointment depends on your circumstances and expectations.

Tax impacts

The resulting tax impact may also affect the decision to use a general or limited power of appointment. The rules are complicated, but property subject to a general power of appointment is typically included in the taxable estate of the designated holder of the power. However, property included in the deceased's estate receives a step-up in basis to fair market value on the date of death. Therefore, your heirs can sell property that was covered by a general power of appointment with little or no income tax consequences.

In contrast, property covered by a limited power isn't included in the holder's estate. However, the new heirs inherit the property with a carryover basis and no step-up in basis. So, if the heirs sell appreciated property, they face a potentially high capital gains tax.

This requires an in-depth analysis by your estate tax advisor. But remember that property subject to estate tax can be sheltered by the federal gift and estate tax exemption. Currently, the exemption is $10 million (indexed to $11.7 million for 2021) but is scheduled to revert to $5 million after 2025. If estate tax isn't a concern, a general power of appointment may be preferable.

Conversely, a limited power of appointment may be used if capital gains will be relatively small or postponed indefinitely. This may be the case for, let's say, a seaside cottage that has remained in the family for generations.

A word of caution

Be aware that even though a power of appointment has advantages, it isn't for everyone. Consult with your estate planning advisor to determine if adding a power of appointment is right for you. •

What does "probate" mean?

The term "probate" is one you may have heard and might associate with negative connotations, but you don't fully understand what it is. For some, the term conjures images of lengthy delays waiting for wealth to be transferred and bitter disputes among family members. Others, because the process is open to the public, worry about their "dirty laundry" being aired out in the open. The good news is that there are strategies to employ to keep much or all of your estate out of probate.

Probate defined

For starters, be aware that probate is predicated on state law, so the exact process varies

from state to state. This has led to numerous misconceptions about the length of probate. On average, the process takes no more than six to nine months, but it can run longer for complex situations in certain states. Also, some states exempt small estates or provide a simplified process for surviving spouses.

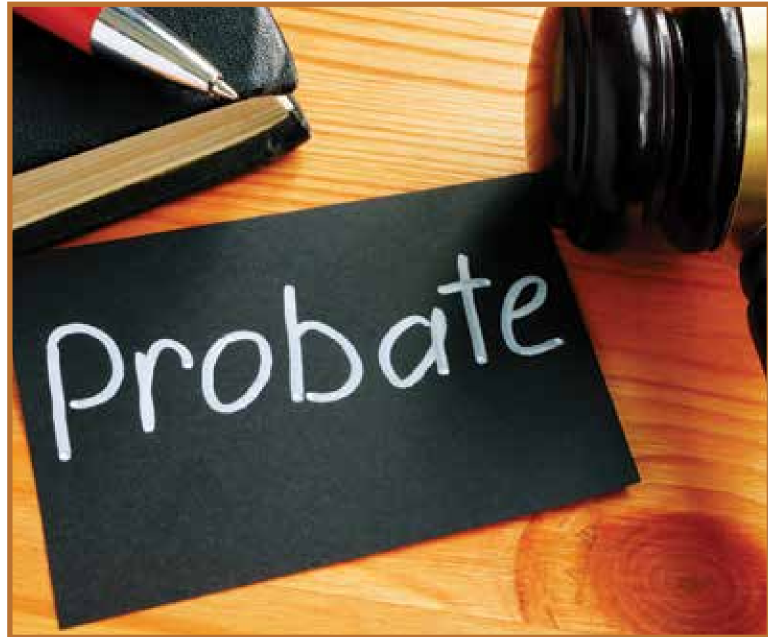
In basic terms, probate is the process of settling an estate and passing legal title of ownership of assets to heirs. If the deceased person has a valid will, probate begins when the executor named in the will presents the document in the county courthouse. If there's no will — in legal parlance, the deceased has died "intestate"— the court will appoint someone to administer the estate. Thereafter, this person becomes the estate's legal representative.

The process

With that in mind, here's how the process generally works. First, a petition is filed with the probate court, providing notice to the beneficiaries named in the deceased's will. Typically, such notice is published in a local newspaper for the general public's benefit. If someone wants to object to the petition, they can do so in court.

In basic terms, probate is the process of settling an estate and passing legal title of ownership of assets to heirs.

The executor takes an inventory of the deceased's property, including securities, real estate and business interests. In some states, an appraisal of value may be required. Then the executor must provide notice to all known creditors. Generally, a creditor must stake a claim within a limited time specified under state law. The executor also determines which creditor claims are legitimate and then meets those obligations. He or she also pays any taxes and other debts that are owed by the estate.



Ownership of assets is then transferred to beneficiaries named in the will, following the waiting period allowed for creditors to file claims. If the deceased died intestate, state law governs the disposition of those assets. However, before any transfers take place, the executor must petition the court to distribute the assets as provided by will or state intestacy law.

Ways to avoid probate

Certain assets, such as an account held jointly or an IRA for which you've designated a beneficiary, are exempt from probate. But you also may be able to avoid the process with additional planning. The easiest way to do this is through the initial form of ownership or use of a living trust.

In the case of joint ownership with rights of survivorship, you acquire the property with another party, such as your spouse.

The property then automatically passes to the surviving joint tenant upon the death of the deceased joint tenant. This form of ownership typically is used when a married couple buys a home or other real estate.

A revocable living trust may be used to avoid probate and protect privacy. The assets are typically transferred to the trust during your lifetime and managed by a trustee that you designate.

Protect your privacy

The reason so many dread the word probate is the fact that it's a public process. But by using the right strategies, you can protect your privacy while saving your family time, money and hardship. Your estate planning advisor can help you implement the right techniques. •

ESTATE PLANNING PITFALL

You don't meet the tax requirements for splitting gifts

The annual gift tax exclusion is a powerful tool in the estate planning toolbox. When using your annual exclusion, you don't owe any gift tax on amounts transferred to another person up to a specified limit. The limit is $15,000 per recipient for 2021 (the same as it was in 2020). You don't even have to file a gift tax return.

For instance, if you have three adult children and seven grandchildren, you can give each one $15,000 in 2021, for a total of $150,000, without any gift tax liability. This reduces the size of your taxable estate without having to use any of your federal gift and estate tax exemption.

Even better, you can double your tax pleasure by "splitting gifts" with your spouse. If he or she joins in the gift, the exclusion increases to $30,000 per recipient. Therefore, you can effectively shelter $300,000 from tax in our previous example.

However, you must meet certain requirements for gift splitting. Notably, each spouse must file a gift tax return where the other spouse makes an election to consent to the gift. Your spouse must be a U.S. citizen and you must be married to him or her at the time of the gift.

Also, you must give gifts of a present interest. The exclusion doesn't apply to gifts of a future interest like some gifts through a trust.

Your estate planning advisor can help you to be certain that you're taking all of the necessary steps to make sure that your split gifts comply with tax laws.

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