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Motivations for Charitable Giving – Simple Estate Tax Planning

An introductory class presented for Northwest Planned Giving Roundtable

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1. Transfer Taxes

(a) Federal Gift Tax

Federal government imposes a tax on the privilege of gratuitously transferring wealth during the donor's lifetime.

Main exclusions: no gift tax on (i) transfers to spouse, (ii) payments to or for dependant when there's duty of support, (iii) payment to education institution for tuition of anyone, or (iv) payments to health care provider for medical services to anyone.

Tax rate on taxable gifts is 40% of value of the gift. Taxable gifts must be reported on IRS Form 709, and the tax must be paid by April 15 of the year following the taxable gift.

Gift tax first enacted by Congress in 1924, as a protective measure to minimize estate and income tax avoidance, and not for its direct revenue yield. At its peak in fiscal year 1999, it raised $4.6 billion in revenues, a relatively miniscule amount.

(b) Federal Estate Tax

Federal government imposes a tax on the privilege of transferring wealth at death. For estate tax purposes, decedent's estate generally consists of all of decedent's assets, including home equity, investments, life insurance proceeds, retirement funds, inheritances, vehicles, jewelry, artwork, and other personal property.

Tax rate on taxable estates is 40% of the value of the taxable estate. Taxable estates must be reported on IRS Form 706. All death taxes must be paid within nine (9) months after date of death.

Congress adopted numerous versions of a "death tax" beginning in 1797, until the modern Federal Estate Tax enacted by Congress in 1916. At its peak in the late 1990s, Federal Estate Tax raised about $25 billion in revenues. With few exceptions, combined revenue from federal estate *and* gift taxes has lingered between 1% and 2% of federal budget receipts since 1945, reaching a post-war high of 2.6% in 1972. In recent years, federal estate and gift taxes have made up about 1% of total budget receipts.

(c) Federal Generation Skipping Tax

In 1976, Congress enacted an entirely separate tax, called the generation-skipping transfer tax ("GST Tax"). In effect, this is a "phantom" estate tax imposed when transfers bypass a generation. The tax is imposed at the maximum regular estate tax rate (currently 40%) on the amount received by the recipient younger generation.

Several types of transfers give rise to GST tax; simplest and most common is "direct skip" - a transfer to an individual who is in a generation two or more generations below that of the transferor. Fortunately, there is a GST Tax exemption allowed to each transferor. The amount of such exemption under current law is equal to the current federal estate tax exemption, $5,430,000 per transferor. (This GST exemption is not increased by the DSUE, discussed below.) Thus, lifetime or testamentary distributions to grandchildren will not incur the GST Tax, provided the cumulative total of all such transfers is less than $5,430,000 under current law.

(d) State Estate Tax (Oregon, Washington, Hawaii, and others)

Oregon and Washington also impose a tax on the privilege of transferring wealth at death. There is an exemption in Oregon for estates under $1 million, and in Washington the current exemption is $2,054,000. Amounts over the exemption are subject to the state death tax. The rates for Oregon estate tax range between 10% and 16%, and this tax applies to all amounts over the $1 million exemption. The rates for Washington estate tax range between 10% and 20%, and this tax applies to all amounts over the current $2,054,000 exemption. Again, all death taxes must be paid within nine (9) months after the date of death.

2. Estate Tax Planning Basics

(a) Federal Lifetime Exemption

Under current law, each decedent is entitled to a federal exemption of $5,430,000, or $10,860,000 for married couples. In 2010, a law was enacted to create "portability" for an unused exemption. Specifically, a surviving spouse can now make use of the unused portion of the exemption of the first spouse to die. The surviving spouse effectively ports the decedent spouse's unused exemption ("DSUE"), and adds it to his or her own federal exemption.

(b) Unlimited Marital Deduction

Decedent's gross estate is reduced by amounts passing at death to surviving spouse. Estate gets a "marital deduction" for any such transfers at death.

There is no limit, so any amount of assets can pass from a decedent to a surviving spouse free of state and federal death taxes on death of first spouse to die.

3. Income Tax Considerations

(a) Double Taxation

Combination of income tax *and* G&E tax results in double taxation. (But lifetime charitable gifts produce income tax deductions *and* reduce the donor's taxable estate.)

(b) Immediate Consequences of Estate Planning

Signing a Will or Revocable Trust has no immediate impact on income taxes.

Adding a joint owner to an account causes the new owner to pay tax on share of income.

Gifting ownership interest in LLC or S-Corp causes recipient to pay tax on share of net profit, whether or not such profit is actually distributed to gift recipient.

(c) Post-Mortem Consequences

Recipient of inheritance from a decedent generally pays no income tax on the amount inherited.

Major exception: qualified retirement accounts are subject to income tax, if not rolled over into IRA account of recipient.

(d) Planning for Capital Gains

Long-term capital gain v. ordinary income: huge difference in federal tax rates.

LTCG rate for most individuals is 15%; for top bracket earners it's 20%.

Ordinary income rates are 25%, 28%, 33%, or 39.6%.

Measuring gain on sale of capital assets: BASIS.

Carryover basis for recipient of lifetime gift v. basis step-up to DOD value for inheritance.

Community Property – entire asset gets basis step-up at death, not just the half owned by deceased spouse.

(e) Incurring death taxes v. income taxes

Placing high value on estate assets at death can result in high estate taxes, but beneficiaries receive high tax basis, thereby reducing future income tax on sale of inherited property.

Placing low value on estate assets at death can result in low estate taxes, but beneficiaries receive low tax basis, thereby increasing future income tax on sale of inherited property.

If federal estate tax applies, usually cheaper to keep values low and pay less death taxes, but more income taxes.

If estate is below available exemption from federal estate tax, always place high value on estate assets, even if incurring state death taxes, in order to reduce eventual income taxes.

4. Tools and Techniques

(a) Maximize use of state and federal exemption

(i) Equalize asset ownership between spouses if unsure which spouse will survive.

(ii) Leave assets equal to exemption amount, to non-spouse beneficiary, or to exemption trust for benefit of spouse; such exemption trust was formerly the "A" of A-B trust; then became "credit shelter trust."

(iii) Post-mortem decision: leave it up to surviving spouse, using disclaimer trust. Surviving spouse disclaims (i.e., declines to inherit) part or all of what would pass to him/her from decedent's estate. Surviving spouse has 9 months after date of death, to decide. Disclaimed assets are captured by disclaimer trust, which is managed by surviving spouse and which distributes benefits to him or her if necessary. This strategy results in both (i) exclusion of disclaimed assets from taxable estate of surviving spouse and (ii) availability of disclaimed assets for benefit of surviving spouse.

(b) Preserve unused exemption

Surviving spouse files federal estate tax return for estate of deceased spouse, electing to add DSUE to exemption of surviving spouse (see 2(a) above).

(c) Lifetime Gifts to Reduce Taxable Estate

Common strategy: "thin down" taxpayer's estate by making lifetime gifts. This strategy works for only completed gifts; donor cannot retain any ownership or control over gifted property. Lifetime gifts remove gifted property from donor's estate, as well as all future earnings and appreciation.

Taxpayers can use annual exclusion from federal gift tax, to thin down estate without triggering federal gift tax. Current law allows taxpayer to make gifts of up to $14,000 per year per donee. Spouses can make joint gifts of up to $28,000 per year per donee. To be exempt, donor must completely transfer control of a present interest (i.e., no strings attached, and donee gets benefit of gift immediately).

Gifts in excess of annual exclusion are generally subject to federal gift tax. If a larger gift is made and would otherwise be taxable, the donor may elect to use part of his or her lifetime exemption from federal estate tax (currently $5,430,000 per person – see 2(a) above). The lifetime exemption can be used partially or completely to shelter (i) lifetime gifts, or (ii) transfers at death. This is why some refer to exemption as "gift and estate tax

exemption." However, depleting one's G&E exemption by making gifts shortly before death results in little or no tax savings.

For many estates, lifetime gifts can be used to eliminate state death tax. Neither Oregon nor Washington impose a tax on gifts. Thus, taxpayer can use lifetime gifting to reduce the estate below the state exemption amount ($1 million in Oregon, and $2,054,000 in Washington), without triggering state gift tax. Those same gifts can be sheltered from federal gift tax using either the annual exclusion of $14,000 per year per donee, or the federal G&E exemption. In Oregon, the ideal estate size for this strategy is between $1 million and $5,430,000, and in Washington the ideal size is between $2,054,000 and $5,430,000. Just use gifting to thin down the estate below the state exemption, and exempt such gifting from federal gift tax by electing to use part or all of the G&E exemption of $5,430,000.

But always remember: the basis in property carries over to the recipient of a lifetime gift, whereas the recipient of property from a decedent acquires a stepped-up basis equal to the fair market value of the property at date of death. With gifting, you may win the battle of avoiding death taxes, but lose the war against overall taxes due to low basis.

(d) Charitable Giving

Lifetime gifts to qualified charities effectively "thin down" the donor's estate, *and* often produce income tax deduction as well.

IRA Charitable Rollover - Under federal law that expired 12/31/14, owner of IRA who was over age 70½ could transfer up to $100,000 directly to qualified charity. Congress has extended this provision many times in the past, but it remains unclear if Congress will do so again. Added benefit of such rollover: normally, IRA withdrawals are added to gross income of IRA owner, but the federal law allowed exclusion of these direct transfers from income, thereby avoiding a surge in AGI that might otherwise trigger Alternative Minimum Income Tax.

Charitable gifts at death are allowed as deduction from gross estate, without limit. Even the largest estate can pass to charitable organization and escape G&E tax.

(e) QTIP Trust

The marital deduction, mentioned at Section 2(b) above, is available only for property passing from the deceased spouse to the surviving spouse outright, with no strings attached. An exception to this rule allows certain restrictions to be placed on property passing to the surviving spouse, and yet still qualify for the marital deduction. Such property is called Qualified Terminable Interest Property (QTIP). For any or all of the QTIP property, the trustee has the power to choose, during the nine-month period after death of first spouse to die, between (i) allowing the QTIP property or any portion of it to be taxed in estate of deceased spouse, or (ii) making the QTIP election for such property, causing it to be taxed in the estate of the surviving spouse. This creates greater flexibility by allowing a "second look" after the death of the first spouse to die.

In order to qualify as QTIP property, the surviving spouse must be given at least all income earned on the property paid quarterly or more frequently. The spouse may, or may not, be entitled to principal, but must be entitled to all income.

Most QTIP trusts are set up to make certain assets available to the surviving spouse for his/her use during the remainder of his/her lifetime, and to mandate in advance that such assets pass to a predetermined beneficiary (commonly children from a former marriage) upon the death of the surviving spouse.

(f) Life Insurance

Taxpayer may purchase, or already own, life insurance on his or her own life. Estate tax generally applies to life insurance proceeds, but only if the decedent had some ownership or control (referred to as "incidents of ownership") at the time of death. Common strategy is to transfer ownership of the policy to adult children, and name them as the beneficiaries. This removes the death benefit from the taxpayer's estate for tax purposes.

As an alternative to having one's children own the policy, taxpayer may place the policy in a life insurance trust. If done correctly, this too removes the death benefit from the taxpayer's estate, while protecting the policy from premature liquidation, or inadvertent cancellation due to neglect. Such a trust must be irrevocable, so it is called an irrevocable life insurance trust ("ILIT"). In its simplest form, the ILIT is used to own a paid-up single premium policy. But if the taxpayer plans to make additional contributions to the ILIT (to cover future premium payments), an added feature is required: Crummey Powers.

(g) Crummey Trust

In order to fund payment of annual premiums, the taxpayer must contribute annually to the ILIT. Direct payments of premiums by the taxpayer would be deemed to be "incidents of ownership" and would therefore cause inclusion of the life insurance proceeds in the taxpayer's estate. The annual contributions to the ILIT are deemed to be gifts, which would be hit with the 40% gift tax. In order to exempt the contributions from gift tax, the amount must be under $14,000 per year, per donee, and be immediately available to a donee in order to qualify as a present interest (see Section 2(c) above). The solution: each contribution is available for withdrawal from the ILIT during the first 30 days after contributed, then the right to withdraw such contribution is forever forfeited. The same right to withdraw (referred to as "Crummey Powers") applies to each annual contribution. Assuming the beneficiary declines to withdraw the funds contributed, the trustee uses the funds to pay the annual premium. This technique was challenged by the IRS, but the taxpayer prevailed in the 1968 Ninth Circuit Court case of *Crummey v. Commissioner.*

(h) Discounting

(i) *Family Company* – place family investment property in a limited liability company, and transfer minority interests in the company to children and

grandchildren on an annual basis. Such transfers are gifts, but are valued for gift tax purposes at a discount, reflecting the minority nature of the ownership interest, and the lack of marketability of the interests. Eventually, the taxpayer has gifted away a majority of the company, the minority interest retained at death is also subject to a discount for lack of control and lack of marketability. Successfully defended discounts have been in the range of 20% to 90% below the full value of the gifted interest.

(ii) *Tenants in Common* – similar to transferring minority interests in a family company, adding children and grandchildren to ownership of investment property or investment accounts can result in discounts for lack of control and lack of marketability.

5. Charitable Strategies

(a) Lifetime Direct Gifts – as mentioned above, lifetime gifts to qualified charities reduce the taxpayer's estate, *and* produce income tax deduction as well. An especially effective strategy involves gifting greatly appreciated assets to a charity. Taxpayer avoids capital gains taxes and the recent 3.8% surtax on net investment income. Taxpayer gets income tax deduction equal to fair market value of donated property that was held over one year (subject to certain limitations based on adjusted gross income), and charity can sell the property and pay no income tax because charities are tax exempt, usually under IRC 501(c).

(b) Testamentary Gifts – again, charitable gifts at death are allowed as deduction from gross estate, without limit.

(c) Charitable Remainder Trusts (CRT)

One of the most popular forms of nondirect charitable gifts. Authorized by Congress in 1969. Trust provides for specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity. The distribution must be paid at least annually for life or for a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, one or more qualified charities. The specified distribution must be either (i) a sum certain, which is not less than 5% and not more than 50% of the initial net fair market value of all property placed in trust (a charitable remainder annuity trust), or (ii) a fixed percentage, which is not less than 5% and not more than 50%, of the net fair market value of the trust assets, valued annually (a charitable remainder unitrust).

(d) Charitable Lead Trusts (CLT)

These trusts are designed to provide income payments to at least one qualified charitable organization for a period measured by a fixed term of years, the lives of one or more individuals, or a combination of the two, after which trust assets are paid to either the grantor or to one or more noncharitable beneficiaries named in the trust instrument. Also referred to as a "charitable income trust," the term "charitable lead trust" is used more

commonly because the payment of the income interest to charity leads or precedes the payment of the remainder interest.

In theory, charitable lead trusts can be thought of as the inverse of charitable remainder trusts. In practice, however, many of the rules that govern the operation and taxation of charitable lead trusts differ significantly from those for charitable remainder trusts. For example, CLTs are not tax-exempt entities as are charitable remainder trusts. The rules governing charitable remainder trusts are designed to protect the charitable remainder interest, whereas the rules governing charitable lead trusts protect the charitable income interest.

(e) Conservation Easements and Contributions

Charitable contributions of conservation easements allow taxpayers to obtain a federal tax benefit while helping to conserve land for public use or enjoyment or to preserve a historic structure. Through the use of these easements, ownership of land or a historic building is kept in private hands but with restrictions on its use. The easement creates a discounted value for the property that provides a charitable contribution tax deduction and tax savings for the owner of these properties, while the public benefits from the conservation objectives.

Taxpayers can take a charitable deduction for qualified conservation contributions, which are contributions of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest for this purpose can be the taxpayer's entire interest in the property, a remainder interest, or an easement that restricts the use of the property in perpetuity. Conservation purposes are (1) preserving land for outdoor recreational use by, or education of, the general public; (2) protecting relatively natural habitats of fish, wildlife or plants; (3) preserving open space (including farmland or forest space) for scenic enjoyment of the general public or under a governmental conservation policy yielding significant public benefit; and (4) preserving a historically important land area or a certified historic structure.

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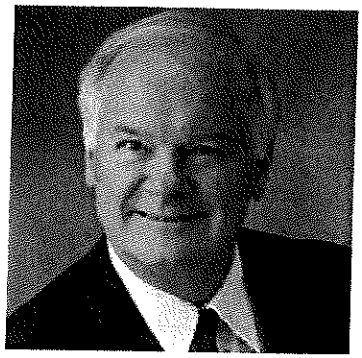

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Education
University of Santa Clara (J.D., 1978)
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Admissions
Oregon State Bar

Professional Associations
- Oregon State Bar Association
- Oregon State Bar Client Security Fund Committee
- Martindale-Hubbell AV® Preeminent™ 5.0 out of 5 Peer Review Rated

Steven R. Bennett
Shareholder

LAW PRACTICE

For over 35 years, Steve has offered clients efficient, practical solutions to their business, real estate, and estate planning needs. One of his greatest skills is achieving clients' objectives and managing their expectations through frequent and straight-forward communication.

On the business side, Steve emphasizes keeping the deal on track and moving forward. He represents both buyers and sellers in the following types of transactions:

- Sales
- Mergers
- Acquisitions
- Stock transfers
- Entity formation, governance, and dispositions

Real estate is an active part of Steve's practice. He provides analysis and expert advice on a broad range of real estate issues, both residential and commercial, including easements, encroachments, investments, sales, leasing, and financing.

In his estate planning practice, Steve regularly helps create estate plans tailored to client objectives, and reviews existing estate plans to ensure they are up-to-date with state and federal tax laws, applicable state laws, and evolving family structures and goals. He represents singles and couples (and particularly high net-worth clients) in the following specific areas:

- Wills
- Trusts
- Probate
- Tax planning
- Asset transfers and ownership analysis
- Estate and trust litigation
- Business succession planning

REPRESENTATIVE MATTERS

Business and Real Estate Transactions:

Represented owner of commercial property in negotiation of lease terms with purchase option and carry-back financing; deal closed efficiently to the satisfaction of all parties

Represented seller of an apartment complex where the buyer was unable to line up lender financing so negotiated for the seller to carry the financing by a note and trust deed from the buyer – the transaction closed quickly and smoothly and all parties were pleased with the outcome

Represented buyer in an acquisition of a competitor by negotiating asset purchase and non-compete agreements – client was pleased we were able to restrict the seller's ability to compete with our client

Estate Planning and Litigation:

Performed review and update of living trust and related documents for high net-worth couple; found many out-dated provisions and added useful new features to achieve clients' goals

Advised client to update the family trust to eliminate numerous obsolete provisions and presented client with a list of proposed changes and a realistic budget – project was completed on time and within budget and the client was relieved to have an updated set of documents to achieve his estate planning objectives

Represented a widow in the administration of her husband's estate following his unexpected death – the husband had recently signed updated estate planning documents so we were able to efficiently resolve all asset transfers and estate issues, resulting in no state or federal death taxes, minimal income taxes, and limited legal fees

Represented client in challenge of will where there was evidence of undue influence; negotiated mutually agreeable compromise settlement

SPEAKING ENGAGEMENTS

Steve has served as speaker at numerous presentations on business law, real estate, and estate planning. He has spoken on the practical aspects of business mergers and acquisitions at a Multnomah County Bar presentation to fellow bar members. Steve has also written several articles on a wide variety of facets relating to business law, real estate, estate planning, and estate administration.

COMMUNITY INVOLVEMENT

Steve is on the Client Security Fund Committee operated by the Oregon State Bar, and served as Chairman in 2013. The Committee reviews and processes claims by clients located throughout Oregon who were the victims of lawyer dishonesty. His role on the Committee has broadened his perspective of client needs and the ways in which those needs can be met.

PERSONAL

In addition to spending time with his wife and son, Steve enjoys active recreation, including running, swimming, cycling, weight training, golfing, skiing and snowboarding (fast, but not crazy and always courteous!).