ArrowPoint TAX SERVICES

Arrow Point Tax Services

on

Lifetime Estate & Gift Exemption

Duncan Kelm

707.280.0824

duncan@arrowpointtaxes.com

Taxpayers may or may not be familiar with the term Lifetime Estate and Gift Exemption (LEGE) and how it works. Under current law estate and gift exemption does not impact many, however with potential large changes, **anyone with a current net worth of $4M or more (all assets, real estate, liquid, retirement, etc.) in my opinion should follow closely.**

The LEGE is the amount someone can gift or leave to their heirs and avoid significant taxation. Under current law the federal estate tax is 40%, and there is a proposal of increasing this to over 60%. In 2017, with the passing of the Tax Cuts and Jobs Act (TCJA) the LEGE was dramatically increased with inflation adjustments from **$5.45M per life or $10.9M** for married couples to currently, in 2021, **$11.7M per life or $23.4M for married couples.** For most people in the United States, this is a level that eliminates tax on their estate completely. **If nothing changes, which is unlikely in my opinion, the increase will sunset in 2026 and revert to $5.49M/$10.98M.** Still a high number, but also significantly less than currently allowable.

Most taxpayers think the LEGE only applies at death. This is true only if no action is taken prior to death. When thinking about the LEGE, taxpayers should think of it like a ledger balance that can be drawn on at any point. Annual gifts at the $15K per person threshold do not impact the ledger, so often times people stay within this threshold. However, anything above that amount is a deduction against the ledger and requires IRS Form 709 to be filed in the year the gift was made.

So currently, the LEGE at $11.7M/$23.4M is an exceedingly high ledger balance that could quickly and easily be changed. Once changed, the leger amount would adjust to the new level. If funds had been drawn prior to the change the new ledger would likely (say likely because law could be rewritten) deduct what had already been taken and that is what is left to shield from any estate tax. If following current guidance from the IRS, if this calculation resulted in a negative value, there is unlikely to be any ramifications. See IRS Estate Publication 559 linked below for those details.

Currently taxpayers may draw on the higher ledger amount and move assets out of their estate or to their heirs sooner to protect against probable cuts to the ledger. While there is a lot to consider before gifting assets to heirs, there are many ways (See below) to move assets out of estate, take advantage of the high ledger balance, and still even maintain ownership and receive benefits from the assets.

It is my opinion that there is an extraordinarily strong likelihood that this level will be adjusted down sooner than 2026. Some Senators have even proposed reducing the LEGE to $1M/$2M. Therefore, in my opinion, those with a net worth greater than $4M should at least consider having an estate planning conversation. With current government spending not seen since WWII, this is a big revenue driver. Couple this with the elimination of Step-Up in Basis, and estate tax revenue would drastically increase over the coming years. While it is my opinion that removal of Step-Up is relatively unlikely, it is still being debated in the legislature.

I believe that the window to take advantage of the increase ledger of the LEGE is closing. There is a chance it may already be closed if a retroactive tax change is passed. Retroactive tax is possible and was passed most recently in 1993. However, the further we get into 2021 the less likely I believe that this outcome would occur. The strong likelihood is that changes would take effect in 2022 which gives taxpayers six months to plan. Also, the IRS has stated in their "Questions on Gift Taxes" (Publication 559), that those who take the exemption now "will not be adversely impacted."

When it comes to inheritance there are three groups wealth can transfer to. Those are heirs, charity, and government. Taxpayers may only choose two. Estate planning helps dictate which two.

******Before considering any of the following strategies speak with a tax planner and estate attorney******

In order of simplicity (My opinion)

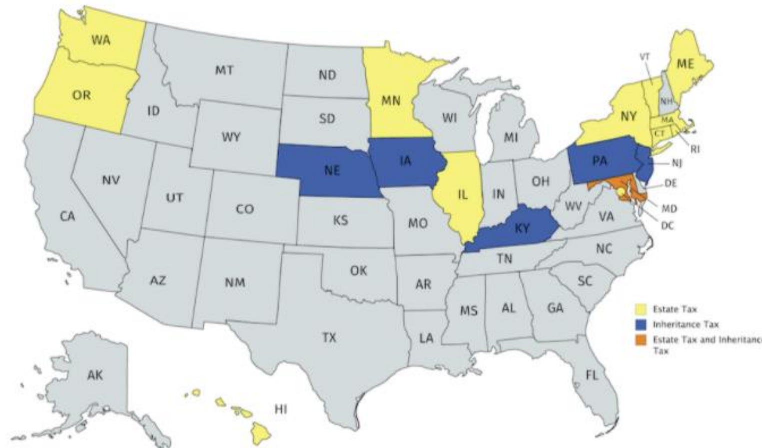
Estate Planning Strategies to Consider

- **Gift Directly to Charity –** Benefit; Allows taxpayers who are charitably minded to remove concern about the Lifetime Estate and Gift Exemption by giving their assets to charity
- **Annual Gifting Exclusion Max Out –** Benefit; Allows taxpayers who want to move assets to their heirs may gift $15K (2021 level) with no tax implications per person
    - At $15K per person a married couple may gift $30K annually to as many people as they wish
        - Ex: Grandma and Grandpa may gift $30K each to their son, daughter-in-law, and two grandchildren – effectively moving $120K out of their estate with no tax implications
    - As long as the amount stays below the $15K/$30K there is no impact to the Lifetime Gift Exemption and tax is avoided
        - Real estate interest, business interest, investments, etc.
        - If gifting business or illiquid asset need to be careful and consult an attorney
            - Often LLC or Corps are much better than S Corps
    - Need to be aware of any other strategy that uses this gift
    - No IRS form to file as long as the gift stays below the threshold
    - Exemption likely to rise slightly in coming years if last decade is precedent
    - https://smartasset.com/retirement/gift-tax-limits
    - https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-gift-taxes

- **529 Plans as an Estate Tax Strategy –** Benefit; allows taxpayers to move assets outside of their estate yet retain control and have funds grow tax advantaged;
  - 529 are generally college savings accounts, however their taxation and flexibility make them a very creative way to estate plan
  - Allowed to "accelerate funding" for five years and draw against the annual gift exclusion ($15K/$30K in 2021) without any impact to the Lifetime Estate and Gift Exemption (LEGE)
    - Ex: Grandpa opens 529 accounts for his three children and elects the five year fund gift rule and deposits $75K into each account
  - Under current tax law, 529 accounts ARE NOT included in a taxpayers estate, meaning it is not subject to the estate (death) tax
  - This strategy allows the taxpayer to retain ownership and not have to give up access to assets. Therefore it is one of the best strategies which moves assets outside of the estate yet ownership is retained
    - The taxpayer remains the owner and names their heirs as the beneficiary of the accounts
    - Can change beneficiary an unlimited number of times, so there is flexibility
  - These type of accounts are state sponsored accounts
    - Each state operates their own option and has slightly different rules to pay attention to
  - Because this is a "college" account there are options when a taxpayer withdraw funds
    - First, if used for education grade school, college, trade school, books, living expense, etc. there is no penalty and no tax due on the distribution
      - For generation skipping gifting this is a powerful tool to move assets out of an estate and fund the third generation education
    - Second, if funds are taken out and paid for non-education purposes, capital gains and a 10% penalty apply on any growth
      - So, if funded for $75K, but current value is $100K, $25K would be subject to capital gains and the 10% penalty
        - Tax is only applied to gain, return of principal is not taxed
      - Taxes are owed based on who receives the distribution; if you distribute to your child in low tax bracket then their tax rate will apply
      - Whatever funds you put into a 529 can always come out penalty and tax free similarly to a Roth IRA
    - Third, if funds are taken out due to the death, disability or scholarship, no 10% penalty is assessed, only gains taxes
      - However, under current tax law (2021) step-up in basis would eliminate capital gains tax on the passing of the owner essentially avoiding capital gain and estate tax while also missing the 10% penalty
  - Only cash may be used to fund these accounts
    - So if net worth is in illiquid or low basis assets then this may not be a good solution
  - Can have multiple accounts and can max fund the accounts up to fund limitations ($350K-$500K)

        - Can give annual gift limitation of $15K and so can spouse without any impact,
        - If you break into two calendar years then can forward fund five years ($15K * 5) = $75K * 2 = $150K
        - The rest of contribution would come against the taxpayer LEGE in 2021 this is $11.7M per life
        - Possible to own 50+ 529 accounts some with the same beneficiaries
    - This strategy eliminates costly estate planning and is a great vehicle to utilize in place of long term care contracts (disability is penalty free)
    - When a distribution is taken the fund company will just send a 1099Q with how much was principal and how much was income
        - There is no paper trail to what the money was spent on
        - Risk is if audited, have to substantiate why funds met guidelines under the IRS tax code
    - States which have estate tax reciprocity

Which states have an estate tax or an inheritance tax?



        -
    - https://attorney.elderlawanswers.com/529-plans-a-powerful-estate-planning-tool-1242
    - https://www.madisonadvisors.com/2021/05/29/529-college-savings-plans-can-be-effective-estate-planning-tool/
- **Spousal Lifetime Access Trust (SLAT) –** Benefit; allows a donor to "gift" assets to an irrevocable trust which will benefit a family member going forward. The growth on the gift as well as the gift itself (As long as less than remaining Lifetime Gift Exemption) is moved outside of the estate of the grantor hence forth, eliminating estate tax on these assets
    - SLATs allow donors to take advantage of the large estate tax exemption that currently exist with the Lifetime Gift Exemption
        - The donor must file IRS Form 706 at the time of creation and elect to take their lifetime gift exclusion
    - Created by one spouse who gifts property or assets to an irrevocable trust for the benefit of the other spouse
        - Can make the beneficiary children as well, but then lose rights to the income of the assets

- Must be very careful to avoid the reciprocal trust doctrine that applies when the IRS views two trusts as constructively similar and interrelated – see below for good rules to follow
- Lose step-up in basis after death
  - A work around for this is language in the trust that allows a beneficiary to "swap" assets of equal value with the trust
  - This creates a mechanism to remove low basis and substitute cash or assets with high basis
- SLATs may own a wide spectrum of assets including life insurance
- The spouse must stay married to the donor and be living
- The non-donor spouse can petition the trustee of the trust at anytime for distributions based on how the trust is written
- Each spouse theoretically can set up a SLAT
  - A few good rules to follow
  - Fund with different amounts
  - Fund with different assets
  - Create and fund at different times
  - Establish trusts in different states
  - Have different beneficiaries and successor beneficiaries for each trust
- Must file an annual 1041 for the trust
- Most SLATs are taxed to the grantor and not at the trust, this is a good thing and can be thought of in a way as a passthrough entity
- It is allowed to take loans against the assets if necessary to tap the trust for liquidity in a tax effective manner
- https://www.wealthenhancement.com/blog/spousal-lifetime-access-trust
- https://www.fidelity.com/viewpoints/wealth-management/insights/slat-estate-plan

- **Grantor Retained Annuity Trust (GRAT) –** Benefit; allows a grantor to transfer appreciating assets to the next generation with little to no gift or estate tax consequences.
  - It is a trust strategy that allows someone with a large estate to use a trust to freeze the value of their estate for a set period of time while transferring the future value of appreciation to future generations
    - Any value that is distributed from this trust is removed out of the grantor estate
      - If the grantor dies during the set term, then the value of remaining distributions remain in the grantor's estate
      - Any remainder interest yet to be paid also must be included in the grantor's estate
      - Remainder interest may move to a surviving spouse to qualify for the estate tax marital deduction
      - Trust must be in effect for two years minimum to receive any benefit
      - The greatest benefit is when grantor lives longer than the trust term
  - Best to use a single asset GRAT, so only want one large position in there each
    - If property was owned would want to consider placing each property in a separate GRAT to hedge again against the risk of one asset pulling down all the others

- Also, best to use the WALTON GRAT which attempts to zero out the lifetime gift exemption that may otherwise be taken dependent on the performance of the trust
- These trusts are locked and grandfathered if the law changes
- Trust must meet IRC Section 2702 requirements of irrevocability
- Also need to follow IRC Publication 1457 which governs Annuities, Life Estates and Remainders
- These trusts gift future interest in an asset, because of this, the gift does not impact the annual gift exclusion ($15K per person per year = 2021)
- These are irrevocable trusts created for a fixed term and work VERY WELL when interest rates are low
- Over the course of the term, the grantor receives income from the trust, and pays the taxes on this income
    - At the end of the term the assets are distributed to heirs or designated parties
- GRATs should NOT be used in a generation skipping-transfer (GST), as the value of a skipped gift is not determined until the end of the trust term, which is completely unknowable
- Assets DO NOT receive a step up in basis, therefore it is appropriate to contribute higher-basis assets
- These trusts are impacted by IRC Section 7520 which sets the rate of return the assets should generate based on the month the assets are transferred into the trust
    - Rates are found here: https://pmstax.com/afr/rr20206.pdf
    - Any appreciation above this rate passes to the beneficiaries free of gift tax
- If assets fail to outperform the rate of return the assets return to the grantor
    - There are no adverse tax consequences if a GRAT underperforms, just start up and maintenance costs of the trust themselves
- Any transactions between the trust and the grantor are ignored, so funds can be exchanged with no gain or loss recognition
- Downside; if the trust fails to appreciate and beat the hurdle rate that was set at the time the trust was put in place, then a grantor may pay gift tax or deduct against their lifetime gift exemption
- Additional strategy to increase benefit: Applying Regs. Sec. 25.2702-3(b)(1) the annuity payment is allowed to increase by 20% per year, meaning that as long as the term and the overall value of the trust is set, e.g. $250K per year for 10 years, the grantor can draw smaller amounts in the earlier years which allows the assets to grow and potentially further benefit the heirs
    - ***Example 2:*** A grantor contributes $5 million in assets to a GRAT. The grantor will receive a stream of annuity payments beginning with $192,614 and increasing by 20% each year. This annuity stream will result in a higher gift tax valuation for the remainder interest of $1,017,681 because with a growth rate equal to the Sec. 7520 rate, the beneficiaries will receive $1,421,730 at the end of the GRAT term rather than the $1,146,484 in the standard GRAT (see Table 1). If the assets grow at 8%, the remainder payout is $4,321,492 (but with the same gift tax valuation of $1,017,681) (see Table 2).

Table 1: Basic GRAT with increasing payments and return of 3.4%

Year	Beginning value	Growth	Payment	Ending value	
1	$5,000,000	$170,000	$(192,614)	$4,977,386	
2	4,977,386	169,231	(231,137)	4,915,481	
3	4,915,481	167,126	(277,364)	4,805,243	
4	4,805,243	163,378	(332,837)	4,635,785	
5	4,635,785	157,617	(399,404)	4,393,998	
6	4,393,998	149,396	(479,285)	4,064,109	
7	4,064,109	138,180	(575,142)	3,627,147	
8	3,627,147	123,323	(690,170)	3,060,300	
9	3,060,300	104,050	(828,204)	2,336,146	
10	$2,336,146	$ 79,429	$(993,845)	$1,421,730	
Present value of distribution to beneficiaries at 3.4%					$1,017,681

▪

Table 2: Basic GRAT with increasing payments and return of 8%

Year	Beginning value	Growth	Payment	Ending value	
1	$5,000,000	$400,000	$(192,614)	$5,207,386	
2	5,207,386	416,591	(231,137)	5,392,840	
3	5,392,840	431,427	(277,364)	5,546,903	
4	5,546,903	443,752	(332,837)	5,657,818	
5	5,657,818	452,625	(399,404)	5,711,039	
6	5,711,039	456,883	(479,285)	5,688,637	
7	5,688,637	455,091	(575,142)	5,568,586	
8	5,568,586	445,487	(690,171)	5,323,902	
9	5,323,902	425,912	(828,205)	4,921,609	
10	$4,921,609	$393,729	$(993,846)	$4,321,492	
Present value of distribution to beneficiaries at 3.4%					$3,093,345

▪

- Using a **WALTON GRAT**; named after Walton tax court case, 115 T.C. 589 (2000)
  - This strategy set's the trust up in a way that the annuity payments are equal to a net present value of zero, so if the hurdle rate of return is not hit, then there is no cost to the lifetime estate gift
  - In general these trusts are done for a short period to hedge against market moves and volatility
    - It is best to run these in two year increments,
    - However this foregoes the ability to lock in the low interest rate
  - With these trusts grantors are able to zero out their lifetime gift exemption impact, and estate tax
    - Can run this repeatedly for two year increments to reach desired objective while hedging the risk
    -
  - *Example 3:* A grantor contributes $5 million to a zeroed-out GRAT in exchange for a 10-year annuity of $598,179. The value of the remainder interest for gift tax purposes is $12. If the assets in the GRAT appreciate at a 3.4% Sec. 7520 rate, the beneficiaries will receive $17 (see Table 3). However, if the assets in the GRAT appreciate at 8%, the beneficiaries will receive $2,129,068, but the gift tax value of the remainder interest will remain $12 (see Table 4).

Table 3: Zeroed-out GRAT with return of 3.4%

Year	Beginning value	Growth	Payment	Ending value	
1	$5,000,000	$170,000	$(598,179)	$4,571,821	
2	4,571,821	155,442	(598,179)	4,129,084	
3	4,129,084	140,389	(598,179)	3,671,294	
4	3,671,294	124,824	(598,179)	3,197,939	
5	3,197,939	108,730	(598,179)	2,708,490	
6	2,708,490	92,089	(598,179)	2,202,399	
7	2,202,399	74,882	(598,179)	1,679,102	
8	1,679,102	57,089	(598,179)	1,138,012	
9	1,138,012	38,692	(598,179)	578,526	
10	$ 578,526	$ 19,670	$(598,179)	$ 17	
Present value of distribution to beneficiaries at 3.4%					$12

▪

Table 4: Zeroed-out GRAT with return of 8%

ADVERTISEMENT

Year	Beginning value	Growth	Payment	Ending value	
1	$5,000,000	$400,000	$(598,179)	$4,801,821	
2	4,801,821	384,146	(598,179)	4,587,788	
3	4,587,788	367,023	(598,179)	4,356,632	
4	4,356,632	348,531	(598,179)	4,106,983	
5	4,106,983	328,559	(598,179)	3,837,363	
6	3,837,363	306,989	(598,179)	3,546,173	
7	3,546,173	283,694	(598,179)	3,231,688	
8	3,231,688	258,535	(598,179)	2,892,044	
9	2,892,044	231,364	(598,179)	2,525,228	
10	$2,525,228	$202,018	$(598,179)	$2,129,068	
Present value of distribution to beneficiaries at 3.4%					$1,523,997

▪

- It is possible to combine the above two examples

  Example 4: The grantor transfers $5 million to a GRAT and receives a payment of $241,836 in the first year, with a 20% larger payment in the following year. If the assets appreciate at the Sec. 7520 rate, the beneficiaries will receive $7, and the taxable value of the gift in the year of creation would be $5 (see Table 5).
-

Table 5: Zeroed-out GRAT with increasing payments and return of 3.4%

Year	Beginning value	Growth	Payment	Ending value	
1	$5,000,000	$170,000	$ (241,836)	$4,928,164	
2	4,928,164	167,558	(290,203)	4,805,518	
3	4,805,518	163,388	(348,244)	4,620,662	
4	4,620,662	157,103	(417,893)	4,359,872	
5	4,359,872	148,236	(501,471)	4,006,637	
6	4,006,637	136,226	(601,765)	3,541,097	
7	3,541,097	120,397	(722,118)	2,939,376	
8	2,939,376	99,939	(866,542)	2,172,772	
9	2,172,772	73,874	(1,039,851)	1,206,796	
10	$1,206,796	$ 41,031	$(1,247,821)	$ 7	
Present value of distribution to beneficiaries at 3.4%					$5

Table 6: Zeroed-out GRAT with increasing payments and return of 8%

Year	Beginning value	Growth	Payment	Ending value	
1	$5,000,000	$400,000	$ (241,836)	$5,158,164	
2	5,158,164	412,653	(290,203)	5,280,614	
3	5,280,614	422,449	(348,244)	5,354,819	
4	5,354,819	428,386	(417,893)	5,365,312	
5	5,365,312	429,225	(501,471)	5,293,066	
6	5,293,066	423,445	(601,765)	5,114,746	
7	5,114,746	409,180	(722,118)	4,801,807	
8	4,801,807	384,145	(866,542)	4,319,410	
9	4,319,410	345,553	(1,039,851)	3,625,112	
10	$3,625,112	$290,009	$(1,247,821)	$2,667,300	
Present value of distribution to beneficiaries at 3.4%					$1,909,266

- Comparative analysis of the three

Table 7: Comparison of GRAT structures

ADVERTISEMENT

GRAT structure	Return on assets		Value of gift for gift tax purposes
	3.4%	8%	
Basic GRAT (Example 1)	$1,146,484	$3,551,344	$ 820,650
Basic GRAT with increasing annuity payments (Example 2)	1,421,730	4,321,492	1,017,681
Zeroed-out GRAT (Example 3)	17	2,129,068	12
Zeroed-out GRAT with increasing annuity payments (Example 4)	$ 7	$2,667,300	$ 5

- Another more aggressive strategy, do a 99-year GRAT
  - Anything that is not used remains in the estate anyway as if you didn't use it
  - This is a strategy that again, hedges and ensures that some component of the estate may move to heirs in a more effective tax manner
- GRITs, Grantor Retained Interest Trust, may be used only for non-family memebers
- https://www.journalofaccountancy.com/issues/2019/oct/wealth-transfer-grantor-retained-annuity-trusts.html
- https://www.aicpa.org/news/aicpatv.6039870795001.html/p/5716732016001/c/Personal-Financial-Planning/

- **Intentionally Defective Grantor Trust (IDGT) –** Benefit; depending on the specific type of trust, it allows a grantor to place assets in a trust for their heirs or beneficiaries and let the income or gains of that trust accrue to their benefit without impacting the lifetime gift tax
  - A unique type of irrevocable trust structure where the income of the trust is still the grantor's for income tax purposes, but the assets of the trust are excluded from his/her estate for estate tax purposes
    - In other words, the trust is "effective" for estate taxes, but "defective" for income taxes
  - Income and gains taxes are still owed on the trust and must be paid, but they are paid by the grantor out of "other funds"
    - Because the trust is receiving the income but not paying the tax, it is critical that the grantor have other means to pay the taxes
  - This strategy allows for assets to move to heirs beyond the gift limitations of the government – the assets of the trust are not treated as the grantor's property for estate tax purposes
  - A common planning technique with IDGTs is the sale by the grantor of assets to the trust in return for a promissory note aka "sale to a defective trust"
    - Under current law this does not create a taxable sale as the grantor is seen as making the sale to themselves
    - In order to properly execute this strategy, the trust must pay interest at the prescribed IRS rate (https://www.irs.gov/pub/irs-drop/rr-20-20.pdf)

- This is not a deferral mechanism or tax shelter mechanism for income and gains taxes, those taxes are owed each year
  - At current lifetime gift amounts $11.58 million per life, it may not be worth the effort of creating a trust like this. If the lifetime gift were to drop then it might
- Most IDGT allow for the grantor trust status to be turned on or off – giving the grantor flexibility
- https://www.kitces.com/blog/idgt-installment-sale-to-intentionally-defective-grantor-trust-rules/
- https://www.lbmc.com/blog/grantor-trust-tax-strategy/
- https://www.journalofaccountancy.com/issues/2019/oct/wealth-transfer-grantor-retained-annuity-trusts.html

- **Charitable Lead Trust (CLT) –** Benefit; depending on the type of CLT, it allows for deferral or deduction of taxes as these trusts provide income payments to qualified charitable organizations for a set number of years, or some other milestone, at which point the assets are paid out to beneficiaries which can include yourself, your children, or other third party beneficiaries
  - These are irrevocable trusts set for a set number of years and allow the assets to revert back to the grantor or family
  - Unlike charitable remainder trusts and pooled income funds, charitable income trusts are not conditionally exempt from income taxes; rather, they or their grantors are taxable from inception
  - Dependent on the type of CLT chosen, the tax implications vary
    - Some offer estate tax benefits
    - Some offer gift income deductions
    - Much of the benefit is tied to the NPV of future charitable distributions, low
  - Four main types of CLTs each with different tax benefits
    - **Qualified reversionary grantor trust CLT**
      - Created during life of donor to pay income interest to charity for a term defined in the trust after which the remainder reverts to the grantor
      - Receive a charitable income tax reduction in the year the trust is created for an amount equal to the NPV of the income interest passing to charity (low interest rates = good thing)
      - Grantor must be treated as the owner of the income in order to receive benefit
        - Governed by Grantor Trust rules IRC 671-678
        - All income produced by trust is taxable to charity (Muni Bonds create tax free income)
      - Great for people who make multi-year charitable pledge and want the benefit of accelerated charitable deductions
      - **Example**: Mrs. Green is considering a $50,000 annual pledge to Charity ABC for a period of five years. In the absence of a charitable lead trust, she can claim a charitable contribution income tax deduction for the payments to charity in each year they are actually made. As an alternative, Mrs. Green transfers $1,000,000 in tax-exempt bonds to a grantor charitable lead

annuity trust. The trust is designed to pay $50,000 per year to Charity ABC for a period of five years; after which, the trust will terminate and return its assets back to Mrs. Green.

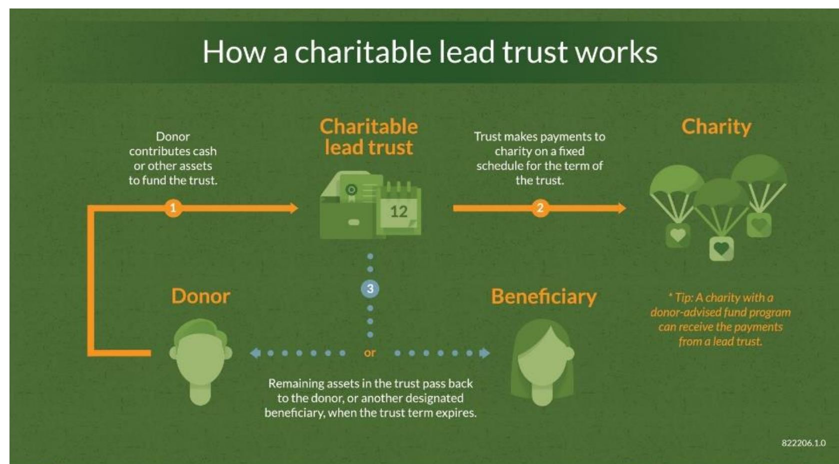
Under this scenario, Mrs. Green will receive a charitable contribution deduction equal to the present value of the income interest being transferred to charity. The total amount to be distributed to charity over the five-year period is $250,000. The present value of the income interest is calculated to be $205,524. The deduction can be used by the grantor subject to the percentage limitation and reduction rules of IRC §170.4

- **Qualified non-revisionary non-grantor CLT**
  - Most common form of CLTs; income is paid to a charity for a number of years at which point the remaining interest is distributed to one or more non-charitable beneficiaries, e.g children or grandchildren
  - There is no income tax deduction for this type of trust, however the income generated by the trust are not taxable to the grantor
    - These are taxed by the IRS as a "complex trust"
  - If the nongratnor trust is created on an inter vivos basis (tied to life of grantor), a fit tax charitable deduction in an amount equal to the NPV of annuity income payment payable to charity
  - If the trust is created on a testamentary basis, the settlor's estate receives an estate tax charitable deduction as well, also based on the NPV of the income interest
    - Can back into the NPV value that equals amount transferred thereby creating a gift and estate tax free-free transfer
  - **Example**: Mrs. Peterson has an estate valued at $10 million. She is very committed to the mission of Charity ABC and provides it with significant annual financial gifts. She is also interested in transferring assets to her children in the most tax-efficient manner possible.

    Mrs. Peterson will transfer a $2,000,000 apartment complex to a charitable lead annuity trust. The trust will pay a $140,000 annuity amount to Charity ABC for a period of fifteen years, ten months; after which, the trust assets will be distributed to the her children. Based on this scenario, Mrs. Peterson will receive a charitable contribution gift tax deduction in an amount of $1,375,000. The net taxable gift is $625,000 and can be offset by Mrs. Peterson's unified gift and estate tax credit. As a result, the children will receive the property, including any appreciation that occurs over the trust period; completely gift and estate tax free.
  - Non-reversionary non-grantor CLTs can also be used to leverage the generation-skipping transfer tax exemption for transfers to grandchildren and other skip persons. The benefits of wealth transfer can be amplified by funding the trust with assets that qualify for valuation discounts such as

units in family limited partnerships and other types of minority fractional interests in property.

- **Qualified non-revisionary grantor CLT**
  - This strategy produces both income and gift tax reductions
  - This type of trust intentional carries a drafting defect, the right held by the grantor on no-adverse party to the grantor to reacquire trust property by substituting other property of equivalent value
    - This causes the grantor to be considered the owner of the trust's income – which would mean charitable income tax deductions
  - A taxable transfer to heirs becomes complete when the trust is established
  - Assuming no estate tax interests, or strings, no portion of this trust is then included in the grantor's estate
  - **Example**: The facts are same as in previous first example except that Mrs. Green would like her son to be the remainder beneficiary. If Mrs. Green is treated as the income tax owner under the grantor trust rules, she will be entitled to a charitable income tax deduction for the present value of the income stream to charity -- $205,524. If the trust is a qualified charitable lead trust, she will also be entitled to a charitable gift tax deduction in the same amount for the present value of the income stream to charity. However, the present value of the son's remainder interest will be a taxable gift to her for gift tax purposes. The amount of the gift is determined by subtracting the present value of the income interest from the fair market value of the property transferred to the trust ($1,000,000 - $205,524 = $794,476). The trust assets should not be includable in her gross estate if she retains no applicable power or right.
- **Non-qualified non-grantor reversionary CLT**
  - This type does not grant income, gift or estate tax benefits. However, it is immaterial because the trust will revert to the grantor. The trust will be able to claim gift tax deductions for income amounts transferred to charity as they occur, similar to a regular deduction
  - None of the income is taxable to the grantor, these trusts are instead taxed as "compiled trusts" for which they can claim a deduction against their taxable income for the amount distributed to charity each period
  - Example 4: Mr. Smith owns a portfolio of corporate bonds. He desires to make a gift of income to charity and reduce his personal income taxes. Mr. Smith will transfer $500,000 in bonds to a charitable lead annuity trust. The trust will pay $35,000 annually to charity for a period of ten years; after which, the remainder interest will revert to Mr. Smith. The present value of the annuity interest is immaterial because no deduction is created. However, Mr. Smith will not have to include the interest income produced by the bonds on his personal tax return. Depending on the other elements of his income tax structure, an exclusion of this amount may drop Mr. Smith into a lower marginal income tax bracket.

- For the gift to be deductible, the income earned by the trust must remain taxable to the grantor
- Design of CLTs is based on two main things
  - Whether trust income is considered owned by the grantor and therefore produces an income tax charitable deduction
  - Whether the remainder interest reverts to the grantor, or is paid out to third parties such as children
- Structure the trusts in a way for a fixed number of years with a consistent percentage payout
  - These are strict and cannot generally be changed
  - Generally somewhere between 4-5%
- The lower the current IRS 7520 (Link) interest rate is, the higher the present value calculation for the stream of payments to the charitable beneficiary. This translates into:
  - A higher income tax deduction
  - A lower remainder value subject to fit and estate tax for Non-Grantor CLTs
- For donors seeking to benefit charitable causes during lifetime while enjoying gift and estate tax savings, a Non-Grantor CLT naming a DAF account as the lead beneficiary
- Many donors name their donor-advised fund account as the lead beneficiary. This allows the donor to maintain advisory privileges over the charitable funds to better strategize his/her charitable giving during lifetime and after death
- Can link to a Donor Advised Fund to auto-fund
- https://www.pgdc.com/pgdc/charitable-lead-trust
- 

- **Irrevocable Life Insurance Trust (ILIT) –** Benefit; Allows a trustor to create an irrevocable trust that holds ownership of an insurance policy and moves the face value outside of the grantor's estate
  - Must be an irrevocable trust and the trustor must fully relinquish all interest and ownership of the trust
  - The trust must be overseen by a third party trustee (Non family) or a corporate trustee to place appropriate arm's length between the trust and the trustor/grantor

- Generally, the ILIT itself is named the beneficiary of the insurance policy and would collect the proceeds on the death of the insured
    - These proceeds are generally used to either pay the estate tax associated with the remaining estate, or a mechanism to move a portion of wealth out of the estate
- Possible to transfer existing life insurance, but that policy will be subject to the three year rule
    - The policy death benefit will remain part of the trustors' estate for three years after the transfer
- Subject to the "Crummey Letter" rule which mandates that all beneficiaries of an ILIT receive an annual letter which and they have the right to withdraw the premiums which are annually contributed to the trust by the trustor (generally the insured)
    - This letter essentially makes a future gift a current gift
    - The annual premium up to $15K per beneficiary would be covered tax free with the annual gift limitation
    - The beneficiaries have 30 days to notify the trustee that they wish to withdraw the proceeds – the trustor/grantor intent is to not have anyone withdraw premiums
        - Anyone withdrawing premiums gives risk to the premiums going unpaid which would cause the trust and the insurance policy to lapse
- https://batsonnolan.com/irrevocable-life-insurance-trusts-crummey-letters/
- https://www.principal.com/individuals/insure/estate-planning-irrevocable-life-insurance-trusts