# U.S. ESTATE PLANNING FAQS

By Procopio, Cory, Hargreaves & Savitch LLP's Tax Team

Since estate planning touches virtually every practice area of the firm and many of our clients face significant estate planning issues, attorneys of the Tax Team are often asked estate planning questions by other attorneys at the firm. To follow are some of the questions frequently asked by attorneys at the firm and brief answers to those questions and focus on estates of U.S. citizens and persons with U.S. domicile. The answers do not attempt to cover the subject matter of each question in depth, and the answers to the questions may vary depending on the particular facts of a particular person's situation. This general information should not be relied upon for specific legal advice.

**I THOUGHT CONGRESS REPEALED THE U.S. ESTATE TAX SO WHY DO I NEED TO BE CONCERNED ABOUT ESTATE PLANNING?**

One of the great myths circulating in the popular press is that The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") has repealed U.S. estate and gift taxes. [hyperlink to PCHS' Act overview]. The gift tax is not repealed by the Act and the estate tax may only be repealed in the year 2010 (but will be reinstated in 2011 by the terms of the Act)! Importantly, the temporary repeal of the estate tax for one year, if it happens, is accompanied by the repeal of the step-up in tax basis rule and instead is replaced by a modified carry-over tax basis rule.

As government tax revenue surpluses are decreasing, we think it is likely that many of these provisions will be suspended prior to their full implementation.

Maybe the New York Times got it right when they titled a recent article *Lawyers and Accountants Expect Windfall from Estate Tax Repeal*, June 14, 2001. The complexities of the Act (and the temporary implementation of various provisions) will merely increase the need to carefully plan for ones estate.

The current gift tax rates correspond with the estate tax rates (i.e., unified rates) relating to lifetime transfers or transfers at death, respectively. A U.S. person can make annual gifts of up to $10,000 to any one individual and not be subject to gift tax. Additionally, a unified credit exempts from taxation lifetime transfers (in the case of the gift tax) or transfers at death (in the case of the estate tax). The current unified credit for 2001 effectively exempts $675,000 of lifetime transfers from taxation and is scheduled to increase to $1 million in lifetime transfers beginning in 2002. The Act does reduce the estate and gift tax rates and accelerates this unified credit beginning in 2002, exempting a larger amount of lifetime transfers through the year 2009. See FAQ - Is it true I can give $675,000 to each person in the world free of estate tax?

Importantly, in 2011, the Act will expire, and the estate and gift tax will be reinstated in its current form. Our view is that the Act will likely be modified significantly (if not repealed) prior to 2010, due to the slow down of the U.S. economy and reductions in projected government budget "surpluses."

What does this mean for PCHS's clients? In most simple terms, your estate plans most likely need to be reviewed in light of the changes brought on by the Act.

**HOW SHOULD A MARRIED COUPLE HOLD TITLE TO THEIR RESIDENCE?**

A married couple should normally hold title to their residence as husband and wife as community property, assuming that the residence is not the separate property of one or the other of them. However, many married couples in California who own real property choose to set up a living trust to hold title to their real property as well as to effectuate their dispositive intentions with respect to all of their property, both real and personal.

**WHAT IS A REVOCABLE LIVING TRUST?**

A trust that is created during life (as opposed to a trust created after death, by Will, through a probate proceeding) that usually serves as a substitute for a Will.

**DO I NEED A LIVING TRUST IF I ALREADY HAVE A WILL?**

A Will assures that, after your death, your assets are disposed of in accordance with your wishes as expressed in the Will. If, however, your assets would require probate at your death and you wish to avoid this requirement, you should have a revocable living trust and transfer your assets to it. An additional potential advantage of a living trust is that, in the event of incompetence, the trust assets can be administered by the trustee without court supervision

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(that is, without a conservatorship). Even if you have a living trust, you should also have a Will to dispose of any of your assets that are not held in trust at the time of your death.

#### CAN I BE THE TRUSTEE OF MY OWN LIVING TRUST?

Yes, and usually people name themselves as trustee of their revocable living trusts. When an irrevocable living trust is created, tax objectives sometimes dictate that you not be the trustee.

#### HOW MUCH DOES AN ESTATE PLAN COST?

An estate plan can cost anywhere from $2,000 to $20,000 or more, depending upon your family situation and your needs. For instance, if you have a child with a severe disability, a special needs trust may be created, which will increase the costs of drafting your estate plan. In addition, if you and your spouse have been married before and have children from prior marriages, the trust will be more complicated and take longer to draft, thereby raising the cost of drafting such a trust. Finally, if you have high net worth, i.e. in excess of $5,000,000, more sophisticated techniques will have to be used in implementing your estate plan to minimize your tax exposure, thereby raising the cost.

#### DOES A LIVING TRUST PROTECT MY ASSETS AGAINST CREDITORS?

No. A trust you create for someone else can, however, provide some protection of the trust assets against the beneficiary's creditors.

#### CAN ANY TYPE OF TRUST PROTECT ASSETS AGAINST CREDITORS?

Assets held in spendthrift trusts are generally protected against most creditors. A spendthrift trust is an irrevocable trust that one person establishes for the benefit of another person. The trust contains a spendthrift clause that prohibits the beneficiary from alienating his or her beneficial interest in the trust. Some jurisdictions in the U.S. and several foreign jurisdictions allow a person to establish a spendthrift trust for his or her own benefit. These types of trusts are typically referred to as "asset protection trusts." No case has tested the effectiveness of U.S. asset protection trusts, but many commentators believe that such trusts will not be effective against creditors. A U.S. District Court found that a foreign asset protection trust established by U.S. persons was a sham and held the U.S. persons in contempt of court for failing to repatriate the assets of the foreign trust.

#### I HAVE BEEN SUED, CAN YOU HELP ME TRANSFER MY ASSETS TO A TRUST THAT WILL PROTECT THEM FROM CREDITORS?

No. Transfer of assets to an irrevocable trust at these stages would likely be in violation of the Uniform Fraudulent Conveyance Act, which provides civil and criminal penalties for clients and attorneys who violate the Act.

#### HOW DO I TRANSFER PROPERTY TO A MINOR CHILD?

Assets should not be left to a minor child by Will or beneficiary designation, as then a court supervised guardianship will be necessary. Often assets are transferred to a custodian for the child under the California Uniform Transfers to Minors Act. If specified, the child's right to assets transferred in this manner can be postponed until age 21 (or until age 25, if the transfer is made at death, by Will or trust). One's own rules for distribution can be applied if the transfer to the child is made through a trust.

#### DO I NEED TO TRANSFER ALL OF MY ASSETS TO MY LIVING TRUST?

It is usually recommended that all assets be transferred to one's revocable living trust, except life insurance (for which the trust would often be named as beneficiary) and retirement plans. Often checking accounts are not transferred to the trust, with the expectation that they will pass by joint tenancy, by a payable on death arrangement, or under the small estate exception to the requirement of probate. Also, untitled tangible personal property of small value is often left outside of trust, to be divided up informally by family members.

#### WHAT IS PROBATE?

A court proceeding designed to assure that creditors are paid and the decedent's estate is distributed to those entitled to it (either under the decedent's Will or by the laws of intestacy that apply if there is no valid Will).

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**HOW LONG DOES PROBATE LAST?**

At least five months from the time a petition is filed to commence the proceeding. It must continue until all debts and taxes have been paid or provided for. When there are complications, such as illiquidity or contested claims, the proceeding can last for years.

**HOW MUCH DOES PROBATE COST?**

There is a statutory fee to which the personal representative and his or her attorneys are each entitled. In summary, this is $3,150 for the first $100,000 of estate value, plus 2% of value of estate assets between $100,000 and $1,000,000, plus 1% of the value of estate assets in excess of $1,000,000. In this connection, gross value is used, with no deduction allowed for debts of the estate. In addition to the statutory fees, the court can allow additional amounts for what it considers to be extraordinary services, and there are court filing fees, publication fees, and appraisal fees.

**WHAT ASSETS MUST GO THROUGH PROBATE?**

All assets held in the decedent's name, with many exceptions. The principal exceptions are assets that pass by reason of the manner in which title is held (such as assets held in tenancy or payable on death), assets that pass by beneficiary designation (such as life insurance and retirement plans), and assets in trust. In addition, assets that pass to the decedent's spouse do not have to go through probate. If the total value of the assets that would otherwise require probate does not exceed $100,000, and real property is not involved, probate is not required.

**WHY DO I NEED TO AVOID PROBATE?**

Administration of a decedent's estate is usually more expensive where probate is involved, and this is the reason most people want to avoid probate. In addition, the decedent's plan of disposition (Will) and assets are exposed to public view, and court supervision can be frustrating and limiting. In some cases, however, probate can be beneficial, as court supervision provides quick and final resolution of disputes and assures that the decedent's assets will be properly disposed of.

**HOW MUCH ESTATE TAX DOES A LIVING TRUST SAVE?**

A living trust does not "save" any estate tax. It can, however, postpone any estate tax until the death of the second spouse to die. In addition, a properly drafted living trust helps to ensure that each spouse makes use of his or her "unified credit," as explained below.

**WHAT IS THE PURPOSE/POLICY OF FEDERAL ESTATE AND GIFT TAX?**

The purpose of the federal estate tax is to tax transfers of wealth from one generation to another. This tax, applied to at-death property transfers, is separate from the federal income tax. The estate tax is justified on the theory that because (1) the decedent may not have paid income tax on some or all of the value transferred at death, and (2) the recipient is not subject to income tax on the transferred property (by virtue of IRC §102). To ensure that the at-death transfer tax is not avoided by gift transfers during life, the estate tax is "unified" with the federal gift tax. The combined tax has the effect of a progressive wealth transfer tax with an exemption for estates of less than $675,000 (increasing to $1 million in 2002). In addition, a generation-skipping tax is imposed on some transfers from a grandparent generation to a grandchild's generation.

**HOW MUCH ARE ESTATE TAXES?**

The combined value of gifts made during life plus at-death transfers (through the decedent's estate) is subject to progressive rates ranging from 37 to 55 percent that will change beginning in January 1, 2002. The total federal estate tax paid depends primarily on the value of the estate. The "gross estate" is defined as "all property" at the time of the decedent's death, including some transfers made within three years of death. This is a very broad definition that comes as somewhat of a surprise to taxpayers who assume that the word "estate" refers only to property transferred under a will or by virtue of state inheritance law (i.e. the estate subject to probate).

Incidentally, non-citizens who are not domiciled in the U.S. are only subject to the tax on their "U.S. situs" property. [Hyperlink to Foreign Domiciles - Estate Tax.]

**DOES THE ESTATE TAX APPLY TO PROPERTY I GIVE TO MY CHILDREN?**

Yes. Property given to children is included in the gross estate.

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**DOES THE ESTATE TAX APPLY TO PROPERTY I GIVE TO MY SPOUSE?**

The estate tax does not apply to property given to a spouse who is a United States citizen, as there is an unlimited marital deduction. So although the property is initially included in the gross estate, if it passes to the decedent's spouse, there is an unlimited marital deduction which eliminates any estate tax to be imposed on it.

**DOES THE ESTATE TAX APPLY TO PROPERTY I GIVE TO MY GRANDCHILDREN?**

Yes. However, not only does the estate tax apply to property given to grandchildren, but an additional tax, known as a generation-skipping transfer tax, may be imposed on gifts and bequests to grandchildren. An essential premise of the federal estate and gift tax system is that the transfer of personal and familial wealth should be subject to taxation at least once in each generation. Therefore wealth transfers that skip a generation are taxed as if they had passed through the skipped generation. There is, however, an exemption from the generation-skipping transfer tax for the first $1,000,000 in such generation-skipping gifts and bequests. The applicable rate of tax on generation-skipping transfers is the maximum federal estate tax rate, i.e. 55%, calculated with reference to the amount of generation-skipping transfers to which the GST exemption has not been allocated.

**WHAT IF THE CLIENT (OR THEIR FAMILY MEMBERS) IS NOT A U.S. CITIZEN, WILL THEIR ESTATE PLANNING NEEDS BE DIFFERENT?**

Yes. The estate planning needs of a person who is a U.S. citizen or U.S. domicile for estate an gift tax purposes is very different than the needs of a person who is not a U.S. citizen and not domiciled in the U.S. for estate and gift tax purposes. Whether a person is a U.S. domicile for estate and gift tax purposes is determined on a subjective test of whether the person intends to stay in the U.S. as his or her permanent home. This is very different than the objective test for income tax purposes that looks to the number of days out of a year the person resides in the U.S.

If a person is not a U.S. citizen but is a U.S. domicile for estate and gift tax purposes, then all of the person's worldwide assets will be subject to estate tax just as if the person was a U.S. citizen. However, there is one major difference between estate taxation of U.S. citizens and non-citizens who are domiciles. If a person transfers property to a spouse at death, the property will pass to the spouse free of estate tax if the spouse is a U.S. citizen. If the spouse is not a U.S. citizen, however, the property will not pass free of estate tax unless it is instead transferred to a special trust for the benefit of the spouse called a "qualified domestic trust" or "QDOT." This difference in taxation usually requires a substantial amount of planning for transfers to a spouse who is not a U.S. citizen. This planning is required even when the deceased spouse is a U.S. citizen.

If the person is neither a U.S. citizen nor a U.S. domicile for estate and gift tax purposes, then only the person's U.S. situs assets will be subject to estate tax. In such a case, the planning involves converting the form of assets from U.S. situs assets to foreign situs assets. A simple example is a personal residence. A personal residence is U.S. situs property subject to estate tax upon the death of a nonresident alien. However, a foreign corporation is not U.S. situs property. As a result, one planning technique would be to transfer the residence to a foreign corporation to protect it from estate tax upon the death of the nonresident alien. To the extent that a nonresident alien owns U.S. situs assets at his or her death, the estate tax credits and deductions available to the nonresident alien's estate are substantially different than the credits and deductions available to a resident alien's estate.

**ARE LIFE INSURANCE PROCEEDS SUBJECT TO ESTATE TAX?**

Possibly. Life insurance proceeds on the decedent's life where either the death benefits payable under the policy are receivable by the decedent's estate or where the decedent retained incidents of ownership over the policy at the time of his or her death are includible in the decedent's gross estate and are subject to estate tax. Otherwise, life insurance proceeds received by others on account of the death of the decedent are not subject to estate tax.

**WHAT IS A LIFE INSURANCE TRUST?**

A life insurance trust is created where the trustor transfers a life insurance policy to an irrevocable trust more than 3 years before his or her death and retains no "incidents of ownership" over the policy so that the trust assets may in effect be used to pay all of the trustor's debts and expenses, including expenses of last illness, due at the time of trustor's death and/or all federal and state death taxes due as a result of the trustor's death but without subjecting the proceeds to estate tax. This is accomplished by giving the trustee of the trust the power to buy assets from the trustor's estate at fair market value and upon commercially reasonable terms and/or to loan funds to the trustor's estate at a fair market rate of interest and upon adequate security. Carefully prepared irrevocable trusts, which will be acquiring life insurance on the trustor's life, should permit the trust assets to be used to make such purchases and/or loans but should not permit any other dealings with the trustor's estate or with any revocable trust created by the trustor. This is due to the fact that if the proceeds are receivable by the trustor's estate or executor, then the

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proceeds will be subject to estate tax. However, the mere power to buy assets/make loans will not cause the death benefits to be considered to be legally committed to discharge the obligations of the estate.

### ARE IRA, 401(K) PLAN, AND OTHER EMPLOYEE BENEFITS SUBJECT TO ESTATE TAX?

In general, the proceeds of a qualified plan paid to a beneficiary on account of the death of a decedent/participant are included in the decedent's estate for purposes of the federal estate tax.

The proceeds also are considered income in respect of a decedent and are includible in the income of the recipient. However, the beneficiary is eligible for an income tax deduction for the amount of additional estate tax (if any) attributable to the inclusion of the proceeds in the decedent's estate.

The amount included is reduced if any part of an annuity payment is attributable to the contributions of any person other than the decedent. However, contributions made by an employer (or former employer) by reason of the employment of the decedent/annuitant are deemed to have been made by the decedent, so there is no reduction for most retirement plans.

Death benefits paid by an employer other than under a retirement plan are not subject to estate tax if the benefit is provided as part of an employment contract and the employee retains no rights with respect to the benefit. The payment of the death benefits is not a gift by the decedent to the recipient.

A decedent dying after 1984 can exclude up to $100,000 of payments from qualified plans and IRAs from his gross estate if he made an irrevocable election before July 18, 1984, and received at least one payment before 1985.

The exclusion is available for qualified plan benefits attributable to employer contributions, including Code Section 401(k) benefits, if they were not includible in the employee's gross income for income tax purposes and were paid to a beneficiary (other than the decedent's estate) on account of the deceased employee's death.

If the plan was non-contributory, the entire value of the beneficiary's benefit is potentially excluded. If employee contributions were made, the amount that is potentially excludable is equal to the value of the survivor's benefit on the date of the decedent's death times the ratio of the employer's contribution to the total contribution.

### IS IT TRUE THAT I CAN GIVE $675,000 TO EACH PERSON IN THE WORLD FREE OF ESTATE TAX?

Not exactly. It is true that you can give away up to $675,000 total without incurring a gift or estate tax in. This amount is increased under the Act to $1 million starting in 2002 until it reaches a maximum "exclusion amount" of $3 million as follows:

***1.***

| *Death in year* | *Estate and Gift Tax*<br>*Life Time Exemption Equivalent for Non-U.S. Citizens with Foreign Domicile* | *Estate and Gift Tax*<br>*Life Time Exemption Equivalent for U.S. Citizens of U.S. Domiciles* | *Highest estate and gift tax rate* |
|---|---|---|---|
| 2002 | $60,000 | $1,000,000 | 50% |
| 2003 | $60,000 | $1,000,000 | 49% |
| 2004 | $60,000 | $1,500,000 | 48% |
| 2005 | $60,000 | $1,500,000 | 47% |
| 2006 | $60,000 | $2,000,000 | 46% |
| 2007 | $60,000 | $2,000,00 | 45% |
| 2008 | $60,000 | $2,000,000 | 45% |
| 2009 | $60,000 | $3,500,000 | 45% |
| 2010 | Estate Tax - Repealed<br>Gift Tax Rate - Equal to Income Tax Rate | Estate Tax - Repealed<br>Gift Tax Rate - Equal to Income Tax Rate | N/A |
| 2011 | $60,000 | $675,000 | 55% |

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For filing purposes, the exclusion amount, which is really an exemption amount (and which also acts as a minimum filing threshold for the filing of an estate tax return) is not stated as an exemption but as a tax credit that is equivalent in value to the exemption amount. Use of a credit rather than an exemption (or exclusion, or deduction) is convenient because of the unification of the estate and gift taxes. The amount of the credit which is the equivalent in value to the exemption amounts indicated above is known as the "unified credit."

### HOW MUCH CAN I GIVE TO MY CHILDREN WITHOUT GIFT TAX?

Each spouse may give up to $10,000 worth of gifts of present interests to each of his or her children (or any other donee, for that matter) each year free from gift tax pursuant to I.R.C. §2503(b). This amount is known as the "annual exclusion." A gift is considered a present interest if the donee has all the immediate rights to use, possession, and enjoyment of the property and income from the property. Outright gifts of cash are present interests. A gift is considered a future interest if the donee's rights to the use, possession, and enjoyment of the property will not begin until some future date, such as reversionary or remainder interests in property. A gift to a minor is considered a present interest if (1) the property and its income may be expended for the minor before the minor reaches 21, (2) all the remaining property and its income must pass to the minor on the minor's 21st birthday and (3) if the minor dies before reaching age 21, the property and its income will be payable to either to the minor's estate or to whomever the minor has designated.

Be aware that scheming to gift to other's children and having others gift to your children in return in order to maximize your annual exclusion gift-giving will not necessarily work. In *U.S. v. Grace*, 395 U.S. 316 (1969), the donor contributed $10,000 each to his child and to his niece and the donor's sister contributed $10,000 each to her child (the donor's niece) and to the donor's child. The Supreme Court, by reviewing the substance and not merely the form of the transaction, found that the donor actually transferred $20,000 to his child, $10,000 of which was covered by the annual exclusion and the balance of which was a taxable gift by the donor to his child, and that the same result applied to the donor's sister.

In addition to the annual exclusion, you may make an unlimited amount of payments on behalf of an individual for tuition or for medical care as long as you make the payments directly to the educational organization or directly to the person or institution that provided the medical care. These exclusions from the gift tax are known respectively as the "education exclusion" and the "medical exclusion." It is important to note that the payments to be made directly to the educational organization must be for **tuition**, i.e., no education exclusion is allowed for amounts paid for books, supplies, room and board, or other similar expenses that do not constitute direct tuition costs (although these amounts may be offset by the annual exclusion if it is otherwise available).

Amounts given away that are in excess of the annual exclusion, education exclusion, and medical exclusion are "taxable gifts." Any taxes computed on your taxable gifts may be applied toward your unified credit, with the effect that no gift tax will be due until one's unified credit is extinguished.

### HOW MUCH CAN I GIVE WITHOUT HAVING TO FILE A GIFT TAX RETURN?

A gift tax return is not required if you gave no more than $10,000 during the year to any one donee, and all of the gifts you made were of present interests.

### WHAT IS A CRUMMEY TRUST?

Contrary to the name, a "Crummey" trust is not a poorly drawn trust. A Crummey trust is a term commonly used to describe an irrevocable trust designed to receive $10,000 annual exclusion gifts. Generally, a gift to an irrevocable trust does not qualify for the $10,000 annual exclusion because it is considered a gift of a future interest. Only gifts of present interests qualify for this exclusion. In order to convert the future interest gift into a present interest gift, the trust instrument gives the beneficiary the power to withdraw the entire amount of the contribution for a short period of time after the contribution. This power of withdrawal was first held to be effective in the Ninth Circuit case of *Crummey v. Commissioner*, which explains the unusual nickname for these trusts.

### ARE TRUSTS SUBJECT TO INCOME TAX?

The short answer to this questions is that some are and some are not. For income tax purposes, there are two primary types of trusts, a grantor trust and a non-grantor trust.

A grantor trust is one in which the creator of the trust has retained a beneficial interest in the trust or, in a non-fiduciary capacity, a certain amount of administrative power over the trust. Because of this retained interest or power, the creator of the trust is treated as the owner of the trust for income tax purposes and is taxed on all income

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of the trust. All revocable trusts are grantor trusts, and some irrevocable trusts are grantor trusts. Although a creator of a grantor trust is consider an owner for income tax purposes, that is not necessarily the case for gift tax purposes. As a result, a sale of assets by a person to a grantor trust created by the person will not be treated as a sale for income tax purposes, but it will be treated as a sale for gift and estate tax purposes. This difference in treatment between the different taxes creates several tax planning opportunities.

A non-grantor trust is, of course, a trust that is not a grantor trust. All non-grantor trusts are irrevocable trusts. These trusts are subject to income tax on all undistributed income of the trust. To the extent a non-grantor trust distributes income to beneficiaries, the beneficiaries are taxed on the income. A non-grantor trust is taxed at the same marginal rates as individuals, although the brackets are more compressed than individual brackets. For example, a trust reaches the highest marginal rate of 39.1% at $7,500 of income.

#### CAN I SELL PROPERTY AFTER MY SPOUSE'S DEATH WITHOUT CAPITAL GAINS TAX?

When a person dies, the tax basis of all property owned by the person at death is increased to fair market value as of the person's date of death. This adjustment is referred to as a "step-up" in basis. This rule is currently scheduled to change in 2010 under the Act. Generally, when a husband and wife own property together and one spouse dies, only the deceased spouse's one-half interest in the property receives a step-up in basis. An exception exists for community property. When one spouse dies, 100% of community property owned by the spouses receives a step-up in basis. As a result, if one spouse dies, and the surviving spouse sells community property shortly after the death, capital gains tax will be triggered only to the extent that the value of the property increased after the date of death of the deceased spouse.

#### SINCE MY SPOUSE DOES NOT WORK, IS ALL OF THE PROPERTY I ACCUMULATE DURING OUR MARRIAGE MY SEPARATE PROPERTY?

No. All property received by a husband or wife during a marriage other than by gift or bequest is community property in California. This can only be altered by a properly drafted and executed premarital agreement. If separate property is acquired during marriage, then any income or appreciation in value of such separate property generally remains separate property.

#### WHY DO I NEED A PRE-MARITAL AGREEMENT?

If you own significant assets going into a marriage, then you should consider getting a pre-marital agreement to protect to separate property character of your assets. Without such an agreement, your spouse may be able to argue that income or appreciation from separate property should be characterized as community property if your community labor is used to generate the income or appreciation. In particular, if you own a business, a community property element can be created in the business absent a pre-marital agreement. The issue of whether a community property element is created in a business is often the most litigated issue in a divorce, and your spouse may be able to force you to divulge your business' financial information during the course of discovery. In some industries, having this type of information available to your competitors could put you in a competitive disadvantage.

#### CAN I GET A CHARITABLE DEDUCTION FOR MONEY I GIVE TO ALL TAX EXEMPT ORGANIZATIONS?

No. In order for you to receive an income tax charitable deduction, the organization must be qualified under Section 170 of the Internal Revenue Code. Generally, this includes charitable and educational organizations. If you have any doubt about an organization's qualification under Section 170, ask for the organization's exemption letter. There are special rules that apply to Canadian or Mexican Charitable organizations under the respective U.S. income tax treaties.

#### WHAT IS A PRIVATE FOUNDATION?

A private foundation is a charitable organization established and supported by a small group of individuals, such as a family. Since it is controlled by a small group of individuals and all funds are received from a small group of individuals, a private foundation receives less favorable tax treatment than a public charity.

#### HOW MUCH MONEY SHOULD I BE ABLE TO SET ASIDE FOR CHARITABLE PURPOSES BEFORE A PRIVATE FOUNDATION MAKES SENSE?

Since a private foundation is a separate charitable entity with all of the associated administrative and compliance expenses, you must be willing and able to donate a substantial amount of money before a private foundation is cost effective. Generally, a private foundation makes sense when the total amount of funds to be held by it are $1,000,000 or more. For smaller gifts, community foundations offer an alternative to private foundations under which the donors retain a substantial amount, although not exclusive, control.

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**HOW CAN I DEFER CAPITAL GAINS TAX ON THE SALE OF APPRECIATED ASSETS?**

One method of deferring capital gains on the sale of appreciated assets is by donating the property to a charitable remainder trust and selling the asset inside the charitable remainder trust. After the sale, the donor will be entitled to receive a certain percentage of the trust assets for life or a period of years. After the donor's death or the expiration of the period of years, the trust terminates and distributes the balance of the trust assets to a charity designated by the donor. The donor receives a charitable deduction upon creation of the trust for the actuarial value of the remainder interest, and the donor does not recognize capital gains until distributions are made from the trust.

**SHOULD I LOOK INTO ESTATE PLANNING TECHNIQUES BEFORE MY COMPANY IS SOLD OR GOES PUBLIC?**

Yes. Before any large capital gain recognition event, you should consult a tax advisor to determine whether any capital gain deferral technique, such as a charitable remainder trust, may be appropriate for you. Also, before any potential increase in the value of assets, we can employ advanced estate planning techniques to shift the future appreciation in the assets to your children or grandchildren free of gift tax. Techniques used for this purpose include a grantor retained annuity trust and an installment sale to an intentionally defective grantor trust. A discussion of these techniques is beyond the scope of these materials.

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