THE
DENNIS
CONSERVATION
LAND TRUST

ESTATE PLANNING

Charity, Revocable Trusts, and Irrevocable Trusts

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Charitable
Planning

Lifetime Gift Exclusion
Federal: $13,610,000 in 2024
Mass: $2,000,000 in 2024
Discounting gift techniques

Irrevocable Trust-should own any life insurance
if the estate is taxable
Annual Exclusion gifts: $18,000 per year per beneficiary (2024)

Durable Power of Attorney; Health Care Proxy; Living Will; Last Will & Testament;
Revocable Trust; Deed Real Property to Trust and other re-titling of assets to the Revocable
Trust

CHARITABLE PLANNING

OBJECTIVES:

1. To meet your charitable objectives with the most tax efficient plan.
2. To reduce the value of the taxable estate and/or reduce income tax consequences for capital gain tax purposes and provide for charitable beneficiaries. (Note: At times, this charitable planning can also provide additional benefits to you and your family.)

VARIOUS STRATEGIES:

1. **Required Minimum Distributions from Traditional IRAs to Charity**

Once you, as the owner of a Traditional IRA (not a Roth IRA), reach age 73, (some folks had to begin at age 70.5) you must begin to take required minimum distributions (RMDs) from your Traditional IRA. These distributions are based on your age and the amount held in your IRA.

These RMD amounts are added to your taxable income each year.

For those persons who must take RMDs, over age 70.5 (required before the age change and over age 73 after the change), and who wish to make annual contributions to a charity, it makes sense to have the charitable distribution go directly from the IRA to the charity, a "qualified charitable distribution" (QCD.)

These "qualified charitable distributions" (QCDs) result in a 100% tax deduction (for QCDs of up to $100,000.00) because the RMD is never added to taxable income.

Compare the following charitable gifts:
You write a $100,000.00 check to charity. Assume that this gift is made to a 50% charitable organization (not a private foundation) and assume that your Adjusted Gross Income (AGI) is $150,000.00. (Also assume that $100,000.00 of this income was an IRA RMD.) Based on these numbers, the amount that will be deductible on

your income tax return will be $90,000.00 (60% of AGI.) The additional amount not deductible immediately is not lost, however, it may be carried forward by you for use on future income tax returns for up to 5 years.

If instead, you make a QCD directly from your IRA to the charity, your income would have been only $50,000.00. In effect the QCD operates as a 100% charitable deduction. For many taxpayers, additional benefits relating to the taxation of social security and Medicare premiums may be realized with this strategy.

2. Capital Gain Assets to Charity

A gift to charity of an asset that would be subject to a capital gain tax in the hand of the Donor escapes that tax when the asset is given directly to the charity.

Donor wants to make a charitable gift of $10,000.00 to his or her favorite charity. Assume that the Donor sells a stock that was subject to a 20% capital gain tax to make the gift to charity. The capital gain tax must be paid, and then the charitable deduction is subject to the 60% AGI limitation.

Now compare this result with a better strategy of transferring the stock directly to the charity. The Donor still receives the deduction equal to the value of the appreciated stock, but never pays the capital gains tax.

3. Qualified Conservation Contributions

A deduction is allowed for gifts of qualified conservation contributions, defined as a gift of qualified real property made to a qualified organization and used for conservation purposes.

Qualified real property is defined as either: a remainder interest in real property, a perpetual restriction on the use of the property or the donor's entire interest in the property (the right of a donor to retain access to minerals other than surface mining may be retained by a donor.)

The donee charity must be a governmental unit or a public conservation charity that is committed to enforcing easements.

And the purpose of the contribution must be for conservation. Examples of conservation purposes include preservation of land for public recreation, public education, protection of natural ecosystems, preservation of open space and preservation of historic sites. A contribution will not be treated exclusively for conservation purposes unless the conservation restriction is perpetual. The deduction is equal to the fair market value of the contribution established by qualified appraisal.

4. **Charitable Remainder Trust Planning (CRT)**

You may have favorite charities that you make gifts to each year. You receive an income tax deduction for those gifts.

Often benefactors will continue this lifetime tradition and leave gifts to those same charities. Although the estate receives an estate tax deduction, there is no income tax deduction. A CRT can provide both income tax and estate tax benefits.

A CRT is an Irrevocable Trust. You act as the Trustee and you (and other beneficiaries possibly) receive an income stream from the CRT. Because your charities ultimately receive the CRT assets, you receive a current income tax deduction. Because a CRT is considered a charitable entity, there is no income tax payable by the Trustee. Thus, if you own appreciated assets that you wish to sell, the CRT is a great vehicle to accomplish the sale, tax free. You contribute those appreciated assets to the CRT and then the Trustee sells those assets. The Trustee will pay no capital gain tax and all the proceeds from the sale are available to pay the income stream to the non-charitable beneficiaries.

Often, this plan also includes a life insurance component. If you are insurable, a life insurance policy that is held in an Irrevocable Trust that is not part of the taxable estate is purchased using a of the income stream received from the CRT. This life insurance benefit replaces the value of the assets that goes to charity.

There are two types of CRT: the Charitable Remainder Annuity Trust (CRAT) and the Charitable Remainder Unitrust (CRUT). The difference between the CRAT and the CRUT is how the income stream is calculated. With the CRAT, you contribute assets with a certain value to the CRAT and choose an interest rate. Every year

thereafter, the income you receive is set and never changes. For example, if you put $100,000 into a CRAT and selected an 8% interest rate, then every year you would receive $8,000 ($100,000 x 8%). Because you receive this set amount every year (regardless of the value of the CRAT assets), the named charities bear the risk of depreciation in value.

In a CRUT, the interest rate chosen is applied to the fair market value of the assets in the CRUT at the beginning of each year. As a result, the income that you receive changes every year. For example, if you put $100,000 into a CRUT and selected an 8% interest rate, then in year one you would receive $8,000. At the beginning of the next year, the assets are re-valued. Assuming no change in value, you would apply the 8% interest rate to the CRUT value of $92,000.00 and would receive $7,360 ($92,000 x 8%). Because the CRUT distributes a changing amount every year to the non-charitable beneficiary (you and/or your beneficiaries), it is the non-charitable beneficiary who benefits from any appreciation in value of the CRUT assets and who suffers from any depreciation in value.

The steps for creating a CRT are as follows:

1. Determine the type of income stream desired – a set amount or variable amount. (Must be at least 5 %.)
2. Name the charities, execute the trust, and contribute the assets to the CRT.
3. Calculate the income tax deduction. Although a CRT is irrevocable, the Donor may change the designated charities at any time.
4. Calculate the first year's income amount if a CRUT, or the income for the entire lifetime of the CRAT. Make payments to the Donor as scheduled.

Benefits of the CRT:

1. Your charitable bequests are settled, but you retain the right to change the charitable beneficiaries.
2. You receive an income tax deduction today that you would otherwise never receive.
3. You have the full value of appreciated assets working to provide you with an income stream (no capital gain tax reduction).
4. You receive the income stream!

5. Charitable Lead Trust Planning (CLT)

The Charitable Lead Trust ("CLT"), which is an alternate form of charitable planning using an Irrevocable Trust, can meet not only your charitable objectives, but also reduce your estate tax and provide benefits to your family.

In the CLT, you, as the Settlor, identify charitable beneficiaries and non-charitable beneficiaries. You make a gift of assets to the CLT Trustees. During the CLT term (a term chosen by you), the Trustee makes distributions to the named charitable beneficiaries. At the end of the CLT term, the remaining CLT assets are distributed to the named non-charitable beneficiaries (e.g., your children or other individual beneficiaries).

The benefits of a CLT include the ability to: (i) make a gift to non-charitable beneficiaries at a discounted valuation for gift tax purposes; (ii) reduce your taxable estate; and, (iii) satisfy your charitable objectives Using a CLT in an estate plan works especially well when the Settlor is currently making annual contributions to one or more charitable organizations.

The discount in the valuation of the gifted asset depends on the trust term (how long the trust lasts) and the annual percentage distributed to the charities. As an example, assume that a single Massachusetts Donor has an estate of $2,200,000. The first $2,000,000 may pass free of Massachusetts and Federal estate tax. Of the $200,000 over the exemption amount, after payment of approximately $90,000 in Massachusetts estate tax, the Donor's beneficiaries would receive approximately $104,000 plus the $2,000,000 exemption amount.

If, however, the Donor gifted $200,000 to a CLT, with the term of the CLT being ten years and the named charities receiving 5% of the trust value annually, then the discounted value of the gift to the CLT is $120,676.00. If the CLT assets earn 8% annually, then at the end of the trust term the value of the remaining assets distributed to the children equals $264,895.00. The Donor has transferred $264,895.00 to her beneficiaries at a cost of approximately $88,000, the approximate MA estate tax. If the CLT only earned 6%, then the amount to the beneficiaries would be $218,475. Although this example shows an 8% and 6% investment return, the actual investment return will vary over the term of the trust, based on investment choices. The beneficiaries receive respectively, $104,000 with no planning, $176,895 with the planning and an 8% yield, or $130,475 with the planning and a 6% yield.

In the alternative, a CLT may be created for the lifetime of the Settlor rather than a term of years. Using a term that is equal to the life of the Settlor, however, introduces additional variables when planning since we do not know when the individual will pass away. The beneficiaries may need to wait longer for their distribution if the Settlor surpasses his or her life expectancy or the charities may receive less if the Settlor passes away sooner than expected.

Another way to reduce estate taxes and meet your charitable objectives with a CLT is to include in your estate plan the requirement that a CLT be created upon your death with an amount that will either reduce or eliminate entirely the estate tax payable. The CLT would then be created to meet these objectives using the IRS formula and interest rates in effect on the date of death.

The benefits of the CLT include, meeting your charitable objectives, beneficiaries pay a lower estate tax and the assets pass to the beneficiaries at the end of the trust term.

6. Use a Separate Charity Trust and Qualified Plan Retirement Assets for Charitable Bequests

When you are leaving assets in your estate plan between charities and family members, certain assets are more valuable to family members than other assets, even when the value of the assets is the same.

IRA, 401(k), 403(b), and annuity assets (qualified retirement plan assets) are subject to both estate tax and income tax. (ROTH accounts are not subject to income tax.) For example, when you leave a qualified plan asset to your beneficiaries, they will pay income tax as they are required to take distributions. (Non-spousal beneficiaries are required to take distributions from an inherited retirement account based on his/her age for ten years and then by December 31 of the 10th year following the death of the original account owner, the balance must be withdrawn and the income tax paid.)

Certain assets that are a part of your taxable estate (which value may or may not incur an estate tax) receive a step-up in basis for capital gain tax purposes (under current law.) The result is that when the beneficiary sells the asset, his or her basis will be the date of death value of the asset. If the asset is sold close in time to the date of death,

there may be zero capital gain tax. These assets include real estate, stocks and bonds that are not a part of a qualified plan (not part of an IRA, 401(k), 403(b) or a deferred annuity account.)

In addition, for depreciable property (rental property for instance), the step-up in basis means that the beneficiary begins to depreciate the asset from the new fair market value (depreciation recapture is eliminated.)

Roth IRAs are part of the owner's taxable estate and can create estate tax. If the spouse is the beneficiary, there will be no estate tax on the value of the IRA (both traditional and Roth IRAs) but at the surviving spouse's death, whatever remains in these IRAs will be subject to estate tax.

Under the Secure Act of 2020 now amended to become effective 2023, the owner's spouse can become the owner of the traditional IRAs and Roth IRAs. The spouse will have required minimum distributions from the traditional IRA but not the Roth IRA, which may continue to grow income tax free. The age at which required minimum distributions must be taken by the traditional IRA owner has been indexed and is no longer age 70.5 For example the age is changed to age 73 for persons who have not reached age 70.5 by 2023.

Beneficiaries of traditional IRAs and Roth IRAs who are not the owner's surviving spouse, those beneficiaries are required to take distributions from the inherited retirement account based on his/her age for ten years and then by December 31 of the 10th year following the death of the original account owner, the balance must be withdrawn and the income tax paid.

To the extent that an estate tax was due on the value of a taxable qualified plan account, that estate tax is a deduction against the income tax payable by the beneficiary. (No benefit to a ROTH.)

If the estate plan includes a charitable objective, it makes sense to give assets to the charity that have the greatest built in income tax consequence. Recommendation: a separate trust naming your charitable organizations as the designated beneficiary of all or a portion of a taxable traditional IRA. (Named on the beneficiary form and sent to the IRA administrator.)

7. Part Sale/Part Gift Transaction

Many individuals would like to sell a property they own to protect it from development but they cannot give up 100% of the value of the property.

In such cases, consider a part sale and part gift transaction. To the extent that the sale is for consideration, the sel8.ler will receive the funds and be responsible for any capital gains tax consequences. To the extent that there is a gift, which can be deductible as a charitable transfer if all of the requirements are met for deduction, e.g., the taxpayer proves the value of the gift by qualified appraisal.

8. Combinations of Strategies

When considering which of the above-described strategies should be implemented, sometimes a combination of one or more is ideal.

REVOCABLE TRUST PLANNING

In general, a trust is a written agreement where the Trustee pledges to hold the trust property for the benefit of the beneficiaries, who are named in the trust document, according to the trust terms, which are a set of instructions.

Requirements:

- written agreement
- Settlor: a person who creates the trust (sometimes also called the Donor or Grantor)
- Beneficiaries: persons who benefit from the trust
- Trustee: a person or entity, which manages the trust property
- trust property (either current or in future)

A Revocable Trust (also sometimes called a Living Trust):

- is created by the Settlor;
- names the Settlor as the current beneficiary;

* appoints a Trustee (usually the Settlor);
* gives the Settlor the power to revoke/amend the trust at any time; and
* instructs the Trustee as to how to distribute the trust property at the Settlor's death. These distribution instructions can be quite detailed and can account for varying circumstances. This trust may also incorporate separate tax planning sub-trusts.

How does a Revocable Trust avoid probate?

If the Settlor has re-titled his or her assets into the Trust, then upon the Settlor's death there is no need to re-title assets through the probate process. A trust does not die. The Trustee has immediate access to the trust assets and may begin to follow the Settlor's instructions without the requirement of a court order.

How does Revocable Trust planning reduce estate tax for married persons?

Each spouse creates his/her own Revocable Trust. The Trust provides that at the death of the first spouse, the assets held in deceased spouse's Trust are held in three separate sub-trusts depending upon the value of those assets.

Sub-trust C is funded with the maximum amount that can pass free of State estate tax (the MA amount is $2,000,000 at this time). The surviving spouse is the beneficiary of this Sub-trust C, but when the surviving spouse dies, the value of the assets held in Sub-trust C are not included in the taxable estate of the surviving spouse.

Sub-trust B is funded with an amount that when Sub-trust C and Sub-trust B asset values are added together, the two Sub-trusts have total assets valued at the amount that can pass free of federal estate tax (total of $13,610,000 in 2024). Sub-trust B names the surviving spouse as the sole beneficiary. When the surviving spouse dies, the value of the assets in this Sub-trust B are not included in his/her federal taxable estate but are included in his/her State taxable estate.

Sub-trust A is funded with any other assets held in deceased spouse's trust. Sub-trust A names the surviving spouse as the sole beneficiary. All these assets are included in the taxable estate of the surviving spouse for both federal

and State estate tax purposes.
As a result of this planning, assets are sheltered from estate tax at the death of the surviving spouse.

Note: Even though under the new federal estate tax law now in effect a surviving spouse may use the federal estate tax free amount that the first spouse to die did not use, this carry-over is not available under MA law and does not cover the generation skipping tax exemption of the first spouse to die. As a result, planning for married couples continues to require the use of two Revocable Trusts where the value of their assets exceeds $2,000,000.

IRREVOCABLE TRUST PLANNING

OBJECTIVE: To reduce the value of the taxable estate (for state and/or federal estate tax purposes) and/or to protect assets from long term medical care costs.

Estate tax reduction: Estate tax law allows every person to give assets away during lifetime. These gifts are subject to federal gift tax law with certain exclusions and exemptions. Charitable gifts are not subject to gift tax at all.

Gift tax free summary:

- Annual exclusion gifts (now equal to $18,000 per grantor per beneficiary as of 2024) – reduces the taxable estate immediately
- Lifetime exemption amount – For federal calculations in 2024 this amount is equal to $13,610,000 per grantor and is indexed for inflation annually until December 31, 2025, then for gifts and deaths on or after January 1, 2026, the exemption will be one-half of what it was at the end of December 2025; and in Massachusetts, the exemption is $2,000,000 (changed from $1,000,000 in 2023.)

Where are gifts going?

We recommend the use of Irrevocable Trusts as the recipient for gifted assets. Why?

- Trusts provide additional benefits to the beneficiaries that include creditor protection and estate tax protection in the beneficiary's estate. In other words, the assets that are held in trust for a beneficiary cannot be accessed by that beneficiary's creditors (divorcing spouse, tort liability, employment related exposure and/or future long-term health care costs). In addition, if the Settlor of the trust allocated his or her generation skipping tax exemption to the trust for that beneficiary, then when that beneficiary dies, none of the assets in that trust are subject to estate tax in the estate of the beneficiary.
- Trusts also keep the gifted assets under the control of the Trustee, an advantage when the Settlor has a particular plan for the assets or the beneficiary needs assistance with asset management or has special needs.
- Trust planning for spouses can allow each spouse access to an Irrevocable Trust created by the other spouse (caution must be used to avoid the reciprocal trust doctrine) resulting in estate tax savings, but with the possibility that the Trustees will exercise their discretion and make distributions of gifted assets back to a spouse if necessary.
- Tax law provides that certain types of irrevocable trusts have additional benefits, such as income being taxable to the Settlor, which will further reduce the value of the Settlor's estate.

What assets should be considered for gifts?

- Assets that have the greatest potential for appreciation over time.
- Assets that have the greatest potential for valuation discounts.
- Assets that do not have a tremendous amount of built-in capital gain tax.
- Assets that will have a minimal impact on the grantor's lifestyle after those are given away.
- First asset that comes to mind is life insurance – appreciates dramatically at death, lifetime value is discounted compared to at death value and death proceeds will never benefit the insured.

Long term care costs:

Irrevocable trusts can shelter assets from being spent down for nursing home care.

One type of Irrevocable Trust can shelter the principal of the Irrevocable Trust from a nursing home "spend down" by giving the Settlor of the trust the right to receive all income. The income would be used to pay for nursing home costs, but the principal could be protected assuming that the trust does not allow distributions of principal to the Settlor (and Settlor's spouse) and a five year look back period has expired. (Current Medicaid law considers any asset given away in the five-year period that precedes the Medicaid application as available to the applicant.)

Another type of Irrevocable Trust can shelter the income and principal of the Irrevocable Trust from a spend down, but the Settlor (and Settlor's spouse) cannot have any interest in the Trust at all. For example, a mother creates an Irrevocable Trust for her children and then makes a gift of an investment account. Five years from the date of the transfer to the Irrevocable Trust, this investment account will not be an asset subject to spend down if mother needs nursing home care and has no other assets.

Medicaid eligibility requirements:

- Applicant can have no more than $2,000 in his or her name
- Applicant's spouse can have no more than $154,140 of assets
- The equity in the Applicant's house, exceeding $1,071,000, is not counted towards his or her asset limit if the Applicant has a spouse, a child under 21 years of age or a blind or disabled child (regardless of age) residing in the property; otherwise, the excess equity will be counted
- There are no transfers/gifts within 5 years of the date of the Medicaid application