Amount to fund the gift annuity	$100,000
Current income tax deduction	$50,119*
Annuity payment per year	$7,800
Portion of payments that is tax-free	$5,039*

*Based on quarterly payments and a 5.8 percent charitable midterm federal rate

When the gift is funded with appreciated property such as stocks, some of the amount that would otherwise be free of tax becomes taxed at capital gains rates.

This donor, aged 79, is older than the donor who established a charitable remainder unitrust *(earlier example)* that pays a fluctuating income. Because the gift annuity payments are always the same, people in their late 70s and older benefit most from a charitable gift annuity because the purchasing power of the fixed payment will have less time to erode against inflation.

The Charitable Lead Trust

The charitable lead trust is another alternative for those who want to help a favorite charitable organization, perhaps fulfill a commitment to its capital campaign and eventually pass assets to family at a reduced tax cost. For families with large estates, it is a great way to provide an inheritance to children and have the advantage of seeing the results of the family's philanthropic efforts.

The lead trust provides an income to the charitable organization for a period of years (usually 10 to 20 years); after the trust's term is complete, the trust assets are transferred to family members. When an individual creates a lead trust to transfer assets to family members, the donor usually does *not* receive an income tax deduction but may reduce the estate or gift tax she would otherwise pay to transfer the assets to her children.

Example: A 67-year-old donor establishes a $1 million charitable lead annuity trust that pays $70,000 (7 percent) annually to a charitable organization for 20 years. At the end of that time, the trust dissolves, and its assets are distributed to her children. The donor receives no income tax deduction, but she may reduce the estate or gift tax she otherwise would pay to transfer the assets to her children with a gift tax charitable deduction of $816,090. This example assumes a 5.8 percent charitable midterm federal rate.

Using a lead trust, the charitable organization in the example above receives $70,000 annually—$1.4 million over 20 years. The donor's children receive nearly $1.4 million after 20 years, assuming an 8 percent rate of return on the trust's investments. Any excess appreciation passes to the children free of transfer taxes.

Because the trust provides for a charitable organization at a potential cost to donors' families, individuals should use the lead trust only if they can forgo income from the asset during the trust's term. Donors are advised to consult with their attorneys about the tax and nontax results of using the lead trust in their personal financial situation.

Retirement Assets

Many people have accumulated a great deal in retirement assets—IRAs, 401(k) plans and other retirement plans—that have grown in value over the years. Often, those assets are designated at death for children or others.

Retirement assets generate "income in respect of a decedent" (IRD). This means that in addition to estate taxes, the asset is subject to a final income tax. Thus, the asset is taxed twice.

Example: A donor dies in 2007 leaving $8 million, including $2 million of retirement assets. He leaves the retirement assets to his children; they receive only 36 percent of them.

Bequest to Children:	
Non-IRD assets	$6,000,000
IRD assets (retirement)	$2,000,000
Total estate	**$8,000,000**
Estate tax on non-IRD assets	$1,800,000
Estate tax on IRD assets	$900,000
Net income taxes on IRD assets	$385,000
Total taxes	**$3,085,000**
Amount transferred to children	$4,915,000
Value of IRD assets to children	$715,000
Effective tax rate on IRD assets	64%

Because of the donor's high marginal tax bracket of 35 percent, much of the tax could have been eliminated had the donor made a gift of the IRD assets to a charitable organization. True, the net to heirs would have been reduced from $4.9 million to $4.2 million, but the cost of making the $2 million gift to charity would have been relatively slight.

Gift of IRD Asset to Charitable Organization:	
Total estate tax	$1,800,000
Income tax	$0
Total taxes	**$1,800,000**
Charitable gift	$2,000,000
Amount transferred to children	$4,200,000

Examine Your Options

Several ways to plan your estate and include charitable contributions have been outlined in this brochure. For more information on these and other estate and charitable planning techniques, please feel free to contact us for a no-obligation consultation.

The information in this publication is not intended as legal advice. For legal advice, please consult an attorney. Figures cited in examples are based on current rates at the time of printing and are subject to change. References to estate and income tax include federal taxes only; individual state taxes may further impact results.

Estate Planning Strategies That Meet Your Needs

BON SECOURS HEALTH SYSTEM, INC.
Bon Secours Health System

Estate planning is a complex process that almost always requires the services of an estate planning professional. But your most important concern in planning your estate is to decide how you want others to benefit from the assets you will transfer at your death.

First, think of all the people to whom you are close, as well as the charitable organizations you would like to support, and determine what you would like to provide to each person and charitable organization. Then, when you do visit a professional estate planner, he or she will help you accomplish your goals by employing the best techniques to comply with the laws and reduce taxes.

If you are inclined to make a gift to a charitable organization, be advised to bring the matter up with him or her yourself. Following are a few ideas that might be employed when looking at your estate plans.

The Will and Bequests

A will is a legal document that tells your executor how you want your estate to be divided at your death. The easiest form of charitable estate planning is naming a charitable organization in your will—a bequest provision. Specify an asset, an amount of money, a percentage of your estate or a variety of other designations. The main benefit of a bequest is that your decision can be changed at any time. In the United States, about 90 percent of estate transfers to charitable organizations are made as a result of bequest provisions.

Utilize the Bypass Trust

A common mistake married people make when they want to leave everything to their spouse is not employing a basic estate tax-saving technique: the bypass trust.

Leaving your spouse everything outright is not always a good idea, especially for those whose estates are large enough to be subject to estate tax. Because everyone—*both* spouses—can transfer $2 million (in 2007) without estate tax, a person should establish a trust at death to protect that amount. Congress voted to gradually raise the exempt amount to $3.5 million by the year 2009.

Example: A woman with a $5 million estate can leave her husband everything without incurring a federal estate tax at her death. Her husband will then have (assuming no increase in value) a taxable estate of $5 million upon his death. If his death occurs in 2007, the federal tax on that amount, after his $2 million estate exclusion, is $1.35 million. This leaves the couple's children with $3.65 million. If the woman instead establishes a bypass trust of up to $2 million for her husband's benefit, assuming his death occurs in 2007, the total tax will decrease by $900,000.

Using the bypass trust, the woman divides her estate into two parts: One consists of the $2 million of assets in trust; the other consists of the remaining $3 million of assets. Her husband will inherit the remaining assets and also receive income from the $2 million trust. (He can also be given access to the trust principal if he needs it for his support.) In this way, the husband's estate includes only the remaining $3 million of assets because the $2 million of assets in trust bypass his estate entirely.

A proper estate plan must consider the possibility that the younger or healthier spouse may die first. The tax benefits in the example above are realized only if the woman dies first. If he dies first, she will still have all the assets in her estate, and she will be without the benefit of protecting one of the couple's two exemption amounts from taxes.

To ensure that taxes are not unnecessarily incurred, one spouse should have at least some assets in his or her own name. A spouse can give as much as he or she wishes to the other without incurring a gift tax because the tax laws allow unlimited gifts between spouses. Ideally, each spouse should own up to half the estate, and each person's will should include a bypass trust for the other's benefit.

The Charitable Remainder Trust

A charitable remainder trust provides income to the donor and/or others named by the donor. At the end of the trust's term, often at the end of the beneficiaries' lifetimes, what remains in the trust is transferred to the charitable organization(s).

Lifetime benefits include a substantial charitable income tax deduction, the avoidance of an up-front capital gains tax when the contributed asset is sold inside the trust to produce income, and, often, an increase in income from the asset. The benefit to the estate is a reduction in estate taxes because of the charitable estate tax deduction from the assets transferred to the charitable organization(s).

Example: A 65-year-old man establishes a charitable remainder unitrust that pays an income for the rest of his life and that of his 63-year-old wife, if she lives longer. The trust is designed to provide an income of 5 percent of the amount of the assets as they are valued each year. (The income can rise or fall depending on the trust's investment return.) This type of trust is chosen because, if wisely invested, it will generate income that over time can rise with inflation. Two people in their mid-60s have a life expectancy of approximately 26 years. A charitable trust whose annual income would stay the same could also be established, but such a flat income would dramatically lose its initial purchasing power over the years.

The donor gives $100,000 of appreciated stock to the trust. The stock currently generates an annual dividend of 2 percent. The donor wants to create more income for his and his wife's retirement years and also wants to make a substantial gift to a charitable organization someday. At the end of the trust term (when the second spouse dies), the asset is removed from the donor's and spouse's taxable estate.

Amount to trust	$100,000
Current income	2%
Cost basis	$20,000
Capital gains	$80,000
Current income tax deduction	$33,985*
Tax savings (35%)	$11,895
New income	5%
Increase in income	150%

*Based on quarterly payments and a 5.8 percent charitable midterm federal rate

The estate tax savings are equal to the taxes on the value of the assets when they are transferred to a charitable organization.

Replacing the asset with life insurance. A donor who establishes a charitable gift that provides a life income may replace the asset with life insurance. The heirs who otherwise would have received the asset in the charitable trust are normally the beneficiaries of the insurance policy. Money to pay all or part of the insurance premiums is generated by the savings from the income tax deduction, plus some or all of the increase in income created by the gift.

In the example, the additional annual income is initially $3,000 (stock was providing 2 percent of $100,000, or $2,000; the charitable trust provides 5 percent of $100,000, or $5,000). After federal and state income taxes of 35 percent, this leaves $1,950 in additional income. The deduction of $33,985 generates a tax savings of $11,895 that could also help increase the cash flow needed to purchase the life insurance. Often, the life insurance policy is placed in a special irrevocable trust that allows a donor to avoid including the insurance proceeds in the estate.

The Charitable Gift Annuity

A charitable gift annuity (not available in all states or from some charitable organizations) is a gift that generates lifetime payments to the donor—a flat dollar amount paid for one or two lifetimes. It's an agreement between a donor and a charitable organization; the payments are a continuing obligation of the organization no matter how the gift annuity's assets are invested.

If a donor creates an annuity for only one life, no estate tax is due at death. If spouses establish a two-life gift annuity, no estate tax is due at either death.

Example: A 79-year-old widower establishes a charitable gift annuity with $100,000 cash. He receives a charitable income tax deduction and payments for life of 7.8 percent per year of the initial gift amount. In addition, a portion of the annuity payment is tax-free for his life expectancy.