



Toledo  
Community  
Foundation

Inspiring and Connecting Thoughtful Giving

## Toledo Community

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### About Your Foundation

Since 1973, **Toledo Community Foundation** has provided individuals, families and businesses interested in the well-being of our community with an *efficient, effective, low-cost, professionally managed* mechanism to achieve their charitable goals.

For philanthropists wishing to maximize the impact and life of their charitable gifts, the Foundation provides *resources for thoughtful giving*. Using its expertise and personalized services, **Toledo Community Foundation** helps donors transform their philanthropic impulse to measurable community impact. Beyond the gifting of assets, the Foundation helps donors identify issues of importance to them and *inspires engagement* with community organizations addressing these issues, thereby maximizing the impact of charitable gifts and creating a greater sense of fulfillment.

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**DOWJONES**

## The \$5 Million Tax Break

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### THE WALL STREET JOURNAL

Largely lost amid all the political drama surrounding December's historic tax legislation was a sweet deal for families.

For the next two years, the gift-tax exemption jumps to \$5 million from \$1 million for individuals and to \$10 million from \$2 million for couples -- meaning people can give away that much without paying a penny in taxes.

What's more, the tax rate on gifts above those amounts fell to 35% from a scheduled 55%, a boon to ultrawealthy people who want to give away even more money.

Washington's unexpected largess is prompting many taxpayers to throw away their estate plans and craft new ones before the favorable terms expire. But while anyone with significant assets should consider retooling their strategies, there are many important considerations, financial and emotional alike.

The gift tax has long been a feature of the U.S. system. It is linked with the estate tax, in order to prevent the wealthy from draining their estates before death to avoid levies. Over time, gift-tax rates have often tracked those of estate taxes, but in recent years the exemption has usually been far lower -- which discouraged people from making big gifts. (This exemption is separate from the annual gift exclusion, currently \$13,000.)

The current gift-tax break could affect a broad swath of American families. According to the most recent Federal Reserve Survey of Consumer Finances, in 2007, 5.4 million households had net worth of \$2 million or more.

Ray Maggi is taking advantage already. Coming from modest beginnings, Mr. Maggi, 69 years old, worked for decades to amass considerable wealth by building a successful real-estate company in which he is still active. Now he is about to give much of his firm to his two children and two grandchildren.

"This is a golden window to move as much out of our estate as we can," says Mr. Maggi, the founder of MPMS Inc., which owns and manages apartments in Orange County, Calif. "Why should a guy who worked long hours and took a lot of risk have to pay tax on what he wants to pass to his children?"

Congress also changed the rules on estate taxes last year, raising the exemption to \$5 million and lowering the rate to 35%, also for two years. Taken together, the new estate and gift rates are the most generous since 1931, according to tax historian Joseph Thorndike. (See "The

Estate Tax: What You Need to Do," left.)

The new rules provide many reasons for people to consider making hefty gifts -- soon.

Most important for people like Mr. Maggi, the recent changes align estate, gift and generation-skipping taxes, which are imposed when givers try to avoid layers of estate tax by leaving assets to heirs two or more generations removed. That means a married couple can "spend" their combined \$10 million exemption to avoid a combination of the three taxes.

Defying the expectations of tax experts, lawmakers also refrained from restricting several specialized techniques that can help people amplify the size of their gifts.

There may be reason to act swiftly: While many hope lawmakers will extend the current regime beyond 2012, other events -- such as a debt crisis -- could render the tax breaks temporary.

State taxes, which always are a worry, present little problem here: Only Tennessee and Connecticut impose gift taxes.

This combination of factors -- future uncertainty plus big current exemptions plus leverage techniques plus no state gift tax -- seems almost designed to encourage large gifts to heirs.

"In the next two years, wealthy people have an unprecedented opportunity to push a lot of the value of their assets out of the estate-tax system," says Philip Kavesh, an attorney at Kavesh, Minor & Otis in Torrance, Calif.

The open window for gifts raises gnarly questions for taxpayers, however. The most obvious: who is wealthy enough to need to benefit from the new gift-tax rules? Experts say the answer varies, but that people with assets approaching the current \$5 million or \$10 million exemptions should think hard. Making the gift now, tax-free, shields future appreciation from taxes.

"If you are single with assets of \$4 million or more, or married with \$8 million or more, you should definitely look at making gifts," Mr. Kavesh says.

Below that level, making gifts still could be a smart tax move for people who might get caught if the individual estate exemption drops back to \$3.5 million (its 2009 level) or even \$1 million, as the 2013 law now stands.

Another crucial factor is potential growth: The faster an asset is appreciating, the more it can make sense to move it out of one's estate, now that giving is easier. Some also may want to put "sacred family assets" -- a beloved vacation home or pieces of furniture, art or jewelry -- into trusts to preserve them for future generations.

Beyond the level of your assets, there are emotional issues to consider. How does it feel to part with an asset, especially one the owner has worked a lifetime to build? And how will gifts affect their recipients, for better or worse? After all, William Shakespeare's bloody tragedy "King Lear" begins when a father gives his kingdom to his daughters, so that he may "unburdened crawl toward death."

In the past, planners have focused on tax strategies, but with higher exemptions the question of how much control a giver is willing to cede comes to the fore. "It becomes a more emotionally driven decision," says John Dadakis, an attorney at Holland & Knight in New York.

Estate expert Howard Zaritsky, a consultant attorney in Rapidan, Va., is even blunter on the subject of gifts, warning not to concentrate on "tax home runs" at the expense of more important factors. "I used to tell my clients, 'You will not get the money back, your heirs won't write you a thank-you note, and you won't approve of how they spend the money.'"

Different people will come to different decisions, of course. Randy Beeman, a 53-year-old managing director of the Wise Investor Group in Reston, Va., says he is unlikely to make huge

gifts now to a trust he set up for his daughter, 13, even though it might make sense tax-wise.

"I grew up without anything myself," he says. "While I want to provide for my daughter, I don't want to make things too easy for her." Instead he is contemplating making gifts to nieces, nephews and cousins for education expenses.

If you are in the Maggi camp, and want to exploit the new rules, there are other issues to keep in mind.

First, what happens to gifts made now if the exemption drops in the future? The answer is unclear. Congress might grandfather past gifts, or the law might "claw back" gifts greater than the exemption at the time the donor dies. But such a reversion would exempt any income or appreciation that occurs after the gift date, say experts.

Also be aware of the traditional tax drawbacks of gifts. Unlike assets left in an estate, the giver's original "cost basis" carries over to the recipient. (If left in an estate, an asset's cost basis rises to full market value at death.) If an asset is put in trust, the trust will owe income tax at the highest rates starting at a very low level (currently 35% at \$11,200).

Most people making a big financial gift choose to set up trusts, either to preserve control of the asset -- and prevent Junior from squandering it on sports cars -- or to magnify the gift using special techniques. But there are drawbacks.

Givers often need to use an institution as the trustee, especially when the trust will run for decades. But institutional trustees can charge hefty fees or move slowly, with a costly memo to the file for every phone call. Does your granddaughter need money from the trust to help pay for a wedding? A committee may have to decide how much is appropriate, charging the trust for its time.

For his part, Mr. Maggi has no hesitation about parting with his entire exemption, and he is using techniques to amplify it. His plan shows just how complicated the strategies can get, requiring sophisticated legal help.

The setup involves an existing trust, a sale of shares in his privately held property at a large discount, and a loan from Mr. Maggi -- among other things. And it depends in part on his business's cash flow holding up. There are other tax-saving moves as well.

Such elaborate maneuvering isn't for the timid, but Mr. Maggi is on a mission: "I'm going to get as much as possible to my kids."

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### How Risky Is Your Trust?

People often restrict gifts by placing them in trusts in order to control use, maximize value or provide creditor protection. Trusts can be funded with a variety of assets, from homes to life insurance to shares in family limited partnerships. As new laws have made gifts more attractive, here is a guide to commonly used trusts.

-- Anne Tergesen

#### STRATEGY: Charitable Lead Annuity Trust

DESCRIPTION: These can be set up in life or at death; they make annual income payments to charity for a set term. The remainder goes to heirs. Tax treatment depends on whether the donor claims a charitable deduction; low current interest rates help donors reduce gift taxes.

RISK RATING: Green

**STRATEGY: Credit-Shelter Trust**

**DESCRIPTION:** A couple sets up one for each spouse, ensuring that heirs benefit from the full estate-tax exemption for both partners. Under pre-2010 law, if a surviving spouse inherited all the partner's assets outright, the heirs could lose the benefit of the first spouse's exemption without a credit-shelter trust. They can still make sense under current law.

**RISK RATING:** Green

**STRATEGY: Dynasty Trust**

**DESCRIPTION:** Twenty-eight states plus Washington, D.C., permit irrevocable trusts with in-state trustees to endure for generations, and perhaps forever. If structured properly, such trusts can avoid estate or generation-skipping taxes.

**RISK RATING:** Green

**STRATEGY: Grantor Retained Annuity Trust**

**DESCRIPTION:** Over a preset term, these return principal to the giver. If the asset appreciates, the trust pays the donor a preset interest payment; extra appreciation is tax-free to beneficiaries. GRATs are appropriate for donors who don't want to part with principal or those who want to transfer more than their individual exemption, as they can be structured with no gift-tax consequences.

**RISK RATING:** Green

**STRATEGY: Grantor Trust**

**DESCRIPTION:** Grantor trusts allow donors to pay capital-gains and income taxes on investments in the trust on behalf of beneficiaries. Because the IRS doesn't consider these payments a gift, they can be a good way to transfer wealth.

**RISK RATING:** Green

**STRATEGY: Qualified Personal Residence Trust**

**DESCRIPTION:** Donors may give a home to beneficiaries at a discount to current market value and also transfer future appreciation free of taxes. The donor remains the home's owner for the trust's term. After that he or she must move or pay rent, which can be another way to give more to heirs.

**RISK RATING:** Green

**STRATEGY: Qualified Terminable Interest Property Trust**

**DESCRIPTION:** Often used by those with children from a prior marriage, these trusts provide a surviving spouse with income, and sometimes principal, free of estate tax. The donor retains control over who inherits the remaining assets after the survivor dies; those assets are then subject to estate tax.

**RISK RATING:** Green

**STRATEGY: Sale to an Intentionally Defective Grantor Trust**

**DESCRIPTION:** A way to transfer more than \$5 million per individual to heirs. The donor starts a trust with a gift and then lends it up to 10 times more to buy an asset. As long as the asset

appreciates, the trust can cover the loan, with what is left going to the beneficiaries. Risk: not explicitly allowed by the tax code, and the IRS sometimes challenges them.

RISK RATING: Yellow

STRATEGY: Spousal-Access Trust

DESCRIPTION: Some planners advise those who are worried about making irrevocable gifts to name a spouse as beneficiary, in addition to other heirs. Risks: divorce; trustee denial of spousal payouts; and IRS scrutiny if spousal payments are too predictable.

RISK RATING: Yellow

STRATEGY: Self-Settled Trust

DESCRIPTION: These provide trustees the discretion to distribute assets to the donor. If properly structured and located in a favorable jurisdiction, the trust can be excluded from the donor's estate, says Jonathan Blattmachr, director of estate planning for the Alaska Trust Co. Risk: The sole authority is a nonbinding IRS letter ruling.

RISK RATING: Red

Source: WSJ research

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### The Estate Tax: What You Need to Do

Even if you can't or don't want to make large gifts now that the government has expanded the gift-tax and estate-tax exemptions to \$5 million, experts urge reviewing your will -- especially if it has one or more trusts.

Over the past 26 months four sets of estate-tax rules have been in effect, with the individual exemption bouncing from \$2 million (2008) to \$3.5 million (2009) to unlimited (2010) to \$5 million (2011).

Most worrisome are what is known as "formula clauses." These are provisions tying bequests to the amount of the estate-tax exemption, and in the past attorneys used them to maximize the amount a couple could pass on tax-free. Through 2009, the value of one exemption was lost if assets passed directly to a surviving spouse.

The trouble arises because this year's \$5 million exemption is a far cry from, say, the \$1.5 million level of 2005, and it was unexpected until this past December. So if a spouse dies this year with a \$3 million estate and unchanged formula clauses, a surviving spouse might get nothing outright because all assets would go into a trust.

Another profound change in the new estate rules, called "portability," has long been sought by American Institute of CPAs, and many hope it stays in the law even if rates or exemptions change after 2012. Portability allows each partner of a married couple to use the rest of the other's estate-tax exemption. It especially eases planning when one spouse has a large, indivisible asset.

Example: David's assets include an interest in several businesses worth \$3.5 million and a \$2.5 million individual retirement account. His wife Kathy has assets of her own worth \$1.2 million. Under that old law, planners would have had a hard time equalizing assets (IRAs have only one owner) to take advantage of the couple's current \$10 million exemption. Portability means that if Kathy died this year, her unused exemption would be reserved for use at David's death. If David died this year, there is no problem, either.

Although portability eases post-death planning and may eliminate the need for trusts, especially for couples with assets well below \$10 million, enough wrinkles remain on cost basis and other issues that estate planners aren't likely to starve. And tax writers did include what some are calling the "black widow provision," which prohibits a taxpayer from piling up many \$5 million exemptions through serial marriages.

-- Laura Saunders

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