Virtual Seminars

Charitable Gift and Estate Planning After the 2010 Tax Changes

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I. Planning Ideas after the 2010 Tax Changes

Recent tax legislation, chiefly the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("the 2010 Act), will affect the planning of inter vivos and testamentary charitable contributions in 2011 and beyond. This presentation will examine several strategies available to donors under the new rules.

IRA QCDs Sub for RMDs, Cut AGI (and that's OK)

The 2010 Act extended for 2010 and 2011 the law permitting donors over age 70½ to arrange qualified charitable distributions (QCDs) from IRAs, up to a maximum amount of $100,000 [IRC §408(d)(8)]. QCDs count toward the minimum distributions required of individuals over age 70½and can therefore reduce taxable income, even for donors who do not itemize deductions. Unfortunately, many taxpayers had already taken required minimum distribution for 2010 when the law was renewed in late December. IRA owners will have all of 2011 to consider making QCDs for 2011, thanks to early reauthorization by Congress.

QCDs come with a bonus: To the extent contributions satisfy IRA required minimum distributions, they reduce not only taxable income, but also *adjusted gross income*, which may create further tax savings. AGI is the yardstick by which the IRS applies various unfortunate tax consequences. A high AGI can:

- expose more of a donor's social security benefits to taxation;
- affect eligibility for the savings bonds interest exclusion,;
- reduce or eliminate eligibility to make contributions to a Roth IRA;
- mean losing an exemption from rules disallowing passive activity losses and credits;
- result in higher state income taxes in states with income taxes.

A high AGI can also limit how much taxpayers can deduct for certain expenses:

- miscellaneous itemized deductions are allowed only to the extent they exceed 2% of AGI;
- casualty losses can be written off only in the amount exceeding 10% of AGI;
- only the excess of medical and dental expenses above 7.5% of AGI may be deducted½.

Finally, a high AGI (or in some cases, "modified AGI") can reduce or eliminate a variety of tax credits, such as the child tax credit and adoption credit. Strategies for reducing AGI are exceedingly scarce, so QCDs arguably may be the best avenue a donor has for satisfying charitable obligations.

Transfer Tax Changes and Charitable Planning

The 2010 Act created $5 million applicable exclusion amounts for gift, estate and generation skipping transfer tax purposes, meaning only a handful of estates will face estate tax through the end of 2012. On the other hand, all donors, regardless of wealth, should be reminded that estate planning involves much more than transfer tax planning, and that they need to plan for thoughtful distribution of their assets at death, assistance to beneficiaries with special needs, and reduction of estate expenses such as probate, state death taxes and income taxes on retirement accounts.

Federal "Transfer Taxes" Remain Unsettled

	2010	**2011-2012**	**2013**
Estate Tax Exemption	($5 million)*	$5 million	$1 million
Top Estate Tax Rate	(35%)*	35%	55%
Gift Tax Exemption	$1 million	$5 million	$1 million
Top Gift Tax Rate	35%	35%	55%
GST Tax Exemption	($5 million)	$5 million	$1 million
GST Tax Rate	(0%)	35%	55%

*Executors of 2010 taxable estates can *elect* to be exempt from estate taxes.

Charitable Lead Trusts Can Magnify the Gift Tax Exemption

The new $5 million applicable exclusion amount may not be of much help to individuals with $50 million or $100 million taxable estates. High net worth donors who are charitably minded might want to consider inter vivos charitable lead annuity trusts designed to balloon the $5 million gift tax exemption into protection worth $10 million, $20 million or more.

Take the case of Genevieve, who lost her husband in 2009. Her estate is currently valued at $60 million, consisting largely of high basis securities she inherited from her husband. She has three children who are in their early 40s, to whom she plans to leave the bulk of her estate.

Genevieve is considering establishing a $10 million charitable lead annuity trust in her husband's memory that would pay $400,000 annually to several organizations for 16 years, and then distribute all assets to her children. The gift tax charitable deduction would be just over $5 million (assuming a §7520 rate of 3.0%), and the remainder interest gift to the children would be sheltered by her gift tax applicable exclusion amount. The children would receive all the trust assets when they are in their mid- to late-60s. If the trust were to grow to $15 million or more, no further gift or estate tax would be due. Also, Genevieve would no longer be taxable on the income from the investments placed in trust, and she has the satisfaction that $6.4 million would be made available to worthwhile causes over the next 16 years. Alternatively, Genevieve could set up the $10 million lead trust in her will, but she could not be certain if §7520 interest rates would be at the low levels now in effect (higher rates mean lower charitable deductions). Furthermore, appreciation in the $10 million from now until her death would all be taxable for estate tax purposes.

Genevieve could shelter even more from gift tax by choosing larger trust payments and/or lengthening the trust term. A $20 million CLAT would produce a $15 million gift tax charitable deduction if it paid charities a 5% annuity annually for 20 years, with the remaining $5 million

covered by her gift tax exemption.

Charitable Formula Clauses May Need a Second Look

Donors sometimes suggest that their estate plans leave any portion of their estates to charity that exceeds the estate tax exemption, thus ensuring zero federal estate tax. The drawback to this plan is that charity may receive nothing, which might not be the donor's intent – especially in light of enactment of the $5 million exclusion amount for 2011 and 2012. In the unlikely event that the exemption reverts to $1 million after 2012, such a clause could also leave charities with too much, resulting in partial "accidental disinheritance" of other beneficiaries.

Assuming a donor genuinely wants to leave something to charity, formula clauses should be adjusted to provide for minimum and/or maximum dollar amounts or percentages that will pass to organizations, irrespective of the estate tax exemption in effect at the testator's death.

Charitable Remedies for a Bad Case of Modified Carryover Basis

IRS last December issued draft Form 8939, "Allocation of Increase in Basis for Property Received from a Decedent." The form will be of interest primarily to beneficiaries and executors of 2010 estates that elected exemption from federal estate tax. Those estates won't have the benefit of a 100% step-up in basis, and executors face the task determining the basis 2010 decedents had in their property, and then allocating the $1.3 million of basis step-up among various assets of the estate (IRC §1022). (Another $3 million of stepped-up basis can be allocated to assets passing to surviving spouses.)

Beneficiaries who receive assets burdened with significant capital gains might consider using such property to satisfy future charitable commitments, including funding of charitable remainder trusts and charitable gift annuities. Donors might fund charitable remainder unitrusts that include the right to make additional contributions in future years. Low basis assets could be cashed out by the trustee with no loss to capital gains taxes, with lifetime payments reserved to donors or others they select. Charitable deductions are an added bonus, and contributions can be repeated whenever the need arises to dispose of tax-burdened assets.

II. Charitable Planning after 2010 -- Where Federal Estate Taxes Are Not a Concern

A member of Congress remarked in 2009, after phase-in of a $3.5 million federal estate tax credit shelter, that a person would have to attend 200 funerals before finding one where the deceased had a taxable estate. What effect will a $5 million have on estate planning for most Americans? Only a few thousand estates would be exposed to estate tax each year. Will any charitable tax strategies be needed by the vast majority of donors? Are lifetime contributions now far more attractive than testamentary transfers? What other rewards may be available for philanthropic individuals who don't have to worry about federal estate taxes?

Inheritance/state estate tax savings. A total of 22 states and the District of Columbia impose estate taxes or inheritance taxes. Hawaii this year reinstated a stand-alone state estate tax to help with the state's budget crisis and other revenue-strapped states may follow suit. Furthermore, real estate and tangible personal property that donors own outside their home states may be taxable under various rules and rates (vacation homes and their contents may be a concern, for

example). All states with death taxes offer a charitable deduction or exemption that encourages charitable bequests.

Tax-burdened assets. Income in respect of a decedent (IRD) will continue to be a problem for beneficiaries of estates, even if federal or state death taxes are not a concern. Donors should be encouraged to leave IRAs, savings bonds and others items of IRD outright to charity. Charitable remainder trusts and gift annuities funded with IRAs or savings bonds could provide lifetime income to family beneficiaries without erosion from income taxes.

Nontax considerations. Donors who wish to benefit both charities and family members may be attracted to charitable remainder trusts or charitable gift annuities because of the money management or trusteeship services these vehicles provide to beneficiaries. If gift arrangements are established during life, they also avoid probate and reduce income taxes.

Lifetime gift arrangements become more important. Under the federal estate tax, married persons save no taxes by making charitable bequests when the first spouse dies because couples already possess a powerful tax shelter: the 100% estate tax marital deduction. Spouses, accordingly, are better advised to make *lifetime* contributions where feasible – including charitable remainder trusts – and enjoy income tax savings, capital gains tax avoidance and current recognition from charitable organizations. If higher credits effectively repeal the estate tax for 99.9% of the population, most unmarried persons would be in the same position as married couples and would be better served to establish inter vivos charitable gift annuities and charitable remainder trusts that reduce current taxes and provide lifetime income to beneficiaries selected by the donor.

A. Overview of State Death Taxes

At last count there were 22 states, plus the District of Columbia, that imposed an inheritance tax, a free-standing state estate tax, or a "decoupled" remnant of the former credit estate tax. Two of the 22 states (Illinois and North Carolina) have estate taxes that are "hibernating" during the 2010 federal estate tax repeal.

Inheritance Taxes. Seven states impose inheritance taxes, in which heirs are divided into beneficiary classes. Those with the closest relationship typically receive larger exemptions and pay tax at lower rates.

State Estate Taxes. Several states have a "stand alone" or "free-standing" estate tax similar to the federal estate tax system, but with no connection to the credit estate tax described below. This tax is not affected by the relationship of beneficiaries to the decedent, although transfers to surviving spouses generally are fully deductible.

Credit Estate Tax. At one time, almost every state had a "credit estate tax" (sometimes called a "pick up tax") that amounted to a form of revenue sharing between the federal estate tax collector and the states. The IRS published a table of state death tax credits that it would allow in computing federal estate taxes. States responded with laws that said: "We will impose a state death tax exactly equal to the credit allowed by the federal government against federal estate taxes." The result was that states essentially received a share of the federal

estate tax, at no additional cost to a decedent's estate. That credit was phased out and replaced by a *deduction* for state death taxes in 2005. A number of states, however, decoupled from the federal system and installed an estate tax based on the credits and tax rates that existed before the law was changed. The estate tax credit for state death taxes is scheduled to reappear in 2031 unless Congress acts. At that time a majority of states presumably would once again adopt a credit estate tax.

CREDIT FOR STATE DEATH TAXES (2001 LEVELS)

Equaling	But Not Exceeding	Credit on Col. 1	Plus Rate on Excess
$ 40,000	$ 90,000	$ –	.8
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000		1,082,800	16.0

Gift Taxes and Generation-Skipping Transfer Taxes. A few states impose gift tax on transfers during life, similar to the federal estate tax, and/or a generation-skipping transfer tax patterned after the federal rules.

States generally apply inheritance and estate taxes to the in-state real estate and tangible personal property of their residents and to intangible personal property wherever located. A state's death tax typically applies to nonresidents' real and tangible personal property located within the state, which can present planning challenges for donors who own vacation homes and other assets outside their home states. Marital deductions or exemptions are usually allowed for transfers to surviving spouses, but some states with stand-alone death tax laws do not provide marital

deductions for qualified terminal interest property (QTIP) trusts unless a QTIP election was made on a federal return.

All states provide exemptions or deductions for transfers to qualified charitable organizations, including charitable remainder trusts. Note, however, that transfers to nonqualified charitable remainder trusts arranged as QTIP trusts under IRC §2056(b)(7) (all income to the surviving spouse, remainder to charity) may have poor tax results in states with stand-alone death taxes that do not provide for a QTIP election. No QTIP election is required, however, for testamentary transfers to *qualified* charitable remainder trusts, where marital deductions are available as a matter of law under IRC §2056(b)(8).

"DEATH TAXES" STATE BY STATE

Below is a listing of states with "death taxes." More detailed state-by-state information is provided in the appendix at the end of this paper.

State	Type of Tax	Exemptions	Tax Rates
Connecticut	Estate and gift tax	Estates under $3.5 million	7.2% to 12%
Delaware	Estate tax	Estates under $3.5 million	Top rate of 16%
District of Columbia	Estate tax	Estates under $1 million	Top rate of 16%
Hawaii	Estate tax	Estates under $3.5 million	9.4% to 16%
Illinois	Estate tax*	Estates under $2 million	Top rate of 16%
Indiana	Inheritance tax	Spouses, 100%; $100,000 for descendants and parents	1% to 20%
Iowa	Inheritance tax	Spouses and descendants, 100%	5% to 15%
Kentucky	Inheritance tax	Spouses and descendants, 100%	4% to 16%
Maine	Estate tax	Estates under $1 million	Top rate of 16%
Maryland	Inheritance tax	Spouses and descendants, 100%	10% for others
	Estate tax	Estates under $1 million	Top rate of 16%
Massachusetts	Estate tax	Estates under $1 million	Top rate of 16%
Minnesota	Estate tax	Estates under $1 million	Top rate of 16%
Nebraska	Inheritance tax	Spouses, 100%; $40,000 for Descendants, parents, siblings	1% to 18%
New Jersey	Inheritance tax	Spouse/partner/descendant, 100%; Siblings, children's spouses, $25,000	11% to 16%
	Estate tax	Estates under $675,000	Top rate of 16%
New York	Estate tax	Estates under $1 million	Top rate of 16%
North Carolina	Estate tax*	Estates under $3.5 million	Top rate of 16%
Ohio	Estate tax	Estates under $338,333	6% to 7%
Oregon	Estate tax	Estates under $1 million	Top rate of 16%
Pennsylvania	Inheritance tax	Spouses 100%	4.5% to 15%
Rhode Island	Estate tax	Estates under $850,000	Top rate of 16%
Tennessee	Estate tax	Estates under $1 million	5.5% to 9.5%
	Gift tax	Close relatives, $13,000 annually	5.5% to 16%
Vermont	Estate tax	Estates under $2 million	Top rate of 16%
Washington	Estate tax	Estates under $2 million	10% to 19%

*Estate taxes in Illinois and North Carolina were suspended during the 2010 repeal of federal estate tax

B. Charitable bequests of tax-burdened assets

Where possible, all donors should bequeath to charity property that would create income tax liability for other beneficiaries – whether or not they are subject to state or federal death taxes. That generally means income in respect of a decedent (IRD): items of income earned by a decedent before death but paid to his or her estate after death. Such income is includable both in the taxpayer's gross estate and in the estate's income.

Charities usually do not pay income taxes and therefore keep every dollar of such tax-burdened bequests. Furthermore, a bequest of IRD can create both an estate tax charitable deduction and an income tax charitable deduction for the estate [IRC §642(c)(1)]. It's important, from a tax standpoint, for a donor's will to make specific bequests of items of IRD to charity, or to have IRD assets pass to charity as a residuary bequest. A donor can change the death beneficiary of a qualified retirement plan or IRA to a qualified charity, which is the preferred way to ensure favorable tax treatment. Satisfying pecuniary bequests to charity out of IRD items will generate an estate tax charitable deduction but the estate will have to include the IRD in its income [Treas. Reg. §1.691(a)-4(a)].

One commentator suggests the following provision: "I instruct that all charitable gifts, bequests and devises should be made, to the extent possible, from assets that constitute income in respect of a decedent, as that term is defined in the Internal Revenue Code." *Caution:* New proposed Treasury regulations under §642(c) state that an income-ordering provision under an estate or trust will be ineffective for tax purposes unless it has "economic effect independent of income tax consequences."

Examples of IRD items include:

1. Interest on U.S. savings bonds
2. Accounts receivable of a cash-basis individual
3. Renewal commissions of insurance agents
4. Deferred compensation, last salary check and bonuses
5. Accrued royalties under a patent license
6. A deceased partner's distributive share of partnership income up to date of death
7. Payments on installment obligations.
8. Death benefits from IRAs and other retirement accounts
9. Commercial annuities

Maximizing the value of savings bonds in an estate. Mr. P has been a patriotic saver and is proud to have accumulated $230,000 of U.S. savings bonds over his life. He plans to leave the bonds to Mrs. P in his will, to provide for her security, but was surprised to learn that Mrs. P will have to pay substantial income taxes on every bond she cashes.

Gift planning solution. Mr. P decides to leave the bonds to a tax exempt charitable remainder trust in his will. The trustee can cash the bonds without owing income tax, reinvest the proceeds and pay Mrs. P a good income for life. Mr. P's estate was too small to owe estate taxes, but the CRT makes sense from an income tax standpoint and his desire to help a worthwhile cause and provide for his wife.

Bequests from retirement accounts. Taxes can erode the retirement accounts of many donors after death, leaving only a fraction remaining for their beneficiaries. The full, date-of-death value of IRAs and qualified plans is subject to federal estate tax (IRC §§2001, 2031). Both federal income tax and state income tax (depending on the place of residence of the donor's beneficiaries) will eventually come due on distributions from traditional IRAs or other plans, costing as much as 40% or more, even when "stretched" over a designated beneficiary's life expectancy [IRC §691(a)(1)], and even though federal estate taxes are deductible [IRC §691(c)]. Generation-skipping transfer taxes also can apply when retirement accounts in excess of the current GST exemption pass to a grandchild or other "skip" person (IRC §§2601, 2613). On the other hand, distributions to a qualified charity would avoid all the foregoing taxes, creating significant benefit to the organization at relatively small cost to the decedent's other beneficiaries. Charitable bequests can be accomplished in a variety of ways:

Beneficiary change. Donors can name a charity as death beneficiary via a beneficiary designation form provided by the account custodian. This nonprobate arrangement ensures both an estate tax charitable deduction [IRC §2055(a)(2)] and avoidance of income tax on amounts distributed to the tax-exempt organization. If the donor is married, the spouse's written consent will be required to make charitable distributions from qualified retirement plans (not required for IRAs).

Fractional charitable designations. Donors can name charity as beneficiary of a percentage of their IRAs without the need to split the IRA into multiple accounts for family and charity. If a charity that is a co-beneficiary of a retirement account receives its distribution by September 30 of the year following the year of the donor's death, individual IRA beneficiaries may stretch distributions over their life expectancies. If charity fails to cash out in a timely manner, IRA payments would be accelerated as follows:

- ***Donor dies before required beginning date.*** IRA funds must be paid out within five years to all beneficiaries.
- ***Donor dies after required beginning date.*** Distributions will be made over five years or the life expectancy of a person the donor's age at his or her death, whichever is longer. That life expectancy will exceed five years for all individuals up to age 89.

Some donors reportedly have had difficulty arranging pecuniary bequests to charity ($25,000, for example) from IRAs, perhaps due to internal policies of custodians or trustees that permit only percentage or fractional distributions. One solution might be to state the pecuniary distribution as a fraction in which the numerator is $25,000 (or whatever) and the denominator is the date of death value of the entire account.

Qualified disclaimers. Donors should consider making charity the *contingent* beneficiary of IRAs and qualified retirement plans and giving heirs the power to disclaim distributions. Beneficiaries who understand the severity of the taxes may decide to let retirement accounts pass to a worthwhile cause, especially if it's one they support. A

spouse may disclaim in favor of a charitable remainder trust; however, children and others can disclaim to a CRT only if they are not trust beneficiaries.

Will or living trust. If an IRA or qualified plan is payable to the owner's estate, or passes to the owner's residuary estate for want of a beneficiary designation, the proceeds will pass under the terms of the owner's will or revocable living trust. Distributions to charity, if directed under the owner's will or trust instrument, should qualify for the estate tax charitable deduction. But favorable income tax treatment under IRC §642(c) will occur only if (1) retirement funds are specifically designated under the will or trust to pass for charity's benefit, or (2) the retirement account passes under a residuary clause in which charity is the sole residuary beneficiary. Satisfying pecuniary bequests from retirement accounts will result in the estate having to include IRD in its income [Reg. §1.691(a)-4(a)].

Addressing family concerns. Heirs may not miss the shrunken amounts remaining from retirement accounts after taxes. However, donors could make bequests of retirement accounts and purchase life insurance to replace what a family member would have kept. Or they could arrange for retirement accounts to pass to a charitable remainder trust that would make lifetime payments to family beneficiaries, with eventual benefit to charity. The trust would reduce federal estate taxes and absolutely no income taxes – state or federal – would be triggered upon death. Substantial tax savings also would occur if retirement assets were left to a charitable remainder trust from which income is paid to heirs over a term of years. A private letter ruling also approved a testamentary charitable gift annuity funded by an IRA distribution beneficiary (PLR 200230018).

Note that a charitable remainder trust is generally not feasible if the trust is to last for the lifetimes of very young beneficiaries, due to the 10% minimum charitable remainder requirement [IRC §§664(d)(1)(D) and 664(d)(2)(D), 664(d)(4)]. If the 10% test is a problem, donors might consider leaving charity a portion of the IRA outright with the remaining portion passing to an eligible "look-through" trust to benefit grandchildren or other young beneficiaries. A term-of-years charitable remainder trust would also be a solution, especially where the donor wishes to benefit a mix of older and younger individuals, if the donor is agreeable to limiting distributions to a maximum of 20 years.

Rather than fund a CRT with an IRA, one commentator has questioned whether all parties wouldn't be happier with a partial outright distribution to charity, with the balance passing to family members outright or in a family trust. One answer is that the CRT can receive other IRD assets (such as U.S. savings bonds), and provide inexpensive trusteeship if a charity serves as trustee. A term-of-years CRT might also be preferable where the donor wants to use an IRA to benefit family members with a wide range of ages – overcoming the rule that any stretch-out must be figured over the age of the oldest person.

A disadvantage for the CRT is that if the estate is subject to federal estate tax, the IRC §691(c) income tax deduction for estate taxes attributable to a decedent's retirement account is essentially unavailable if part or all of the account passes to a CRT (PLRs 9634019, 199901023,). Again, a solution would be to forego the charitable remainder

trust and instead make an outright bequest from the IRA of an amount equal to the anticipated charitable remainder interest. The rest of the IRA would be subject to estate tax, but could be configured as a stretch IRA that would entitle the beneficiary to an income tax deduction for any estate tax attributed to the IRA.

Providing for both spouses and charity. Donors who wish to use a retirement account to benefit both a spouse and charity have several choices:

- Make charity a partial beneficiary of the account and leave the rest to the spouse, who would then roll over the benefits into his or her own IRA or receive distributions over his or her life expectancy under the general stretch-out rules for inherited accounts (because the surviving spouse is not the sole beneficiary, life expectancy can't be recalculated annually). Alternatively, an account can be split into two accounts, one naming charity as beneficiary and the other naming the surviving spouse.

- Leave part or all of the retirement account to a testamentary charitable remainder trust in which the spouse is the *sole* beneficiary (required for qualification for the estate tax marital deduction);

- Leave the account to a qualified terminable interest property (QTIP) trust with charity as remainder beneficiary. However, this plan will result in accelerated distribution of the account to the trust (and higher trust tax rates), under the "multiple beneficiary rule." That is, the account will be deemed not to have a designated beneficiary [Reg. §1.401(a)(9)-5, Q&A A-7(d)].

- Ideally, where both spouses are committed to the same organization, the surviving spouse would be made the sole beneficiary of the IRA, with the expectation that he or she would leave part or all of their rollover IRA to the charity. Of course, the first spouse to die has no absolute certainty that charity eventually will benefit under this "reliable spouse" strategy. So a CRT distribution may have the best practical and tax results.

C. Achieving personal estate planning goals. As noted earlier, donors who wish to benefit charities and family members may be attracted to charitable remainder trusts, charitable gift annuities and even charitable lead trusts because of the money management or trusteeship services these vehicles provide to beneficiaries. . If gift arrangements are established during life, they also avoid probate and offer income tax and capital gains tax savings. With lead trusts, the donor's goal may simply be to "stagger" the distribution of his or her estate, so that a large part of children's inheritance is deferred for 10 or 15 years, during which time payments assist one or more charities.

Providing for "financially disabled" beneficiaries. A charitable remainder trust may pay income to a noncharitable trust for the life of an individual who is "financially disabled" (Rev. Rul. 2002-20, 2002-17). The IRS has indicated that such arrangements are appropriate where the income beneficiary, by reason of a medically determinable physical

or mental impairment, is unable to manage his or her own financial affairs. The trustee of the noncharitable trust could have broad discretion as to how much income or principal would be paid to the beneficiary, and could take into account government benefits to which the beneficiary may be entitled. The noncharitable trust could pass at the beneficiary's death either to charitable or noncharitable remaindermen.

Ruling from the grave. When billionaire Leona Helmsley died, newspaper accounts dwelled upon her controversial personality, tax problems, career as a hotel tycoon, and an unusual estate plan that included a $12 million trust (later reduced) for her pet dog (named "Trouble"). What didn't come out in the media was that almost all of her billions were left to charity, and that she gave millions of dollars away to worthwhile causes during her lifetime. Mrs. Helmsley's will also established three charitable remainder trusts, one for her brother and one for each of her two grandchildren. Most interesting was a clause in the grandchildren's trusts that they would receive income for life – but only if they visited the grave of their father at least once a year for the rest of their lives. The clause was framed as a "qualified contingency" under IRC §664(f)(2), which permits CRTs to terminate early upon the happening of specified contingencies. Here, if a grandchild ever failed to make an annual cemetery visit, the trust would come to an end, with all assets passing to charity.

Lifetime income for family outcasts – in privacy. Case: Mrs. Haskell is planning her estate and wants to provide for a charitable organization and also create some financial security for her wayward son, Eddie, who has a history of drug and alcohol problems. The challenge: She doesn't want her other children to find out that she's doing anything for Eddie. She feels she can't help him through a will or living trust because the family surely would learn of it. What can we suggest to Mrs. Haskell?

Life income gift arrangements may help in families where certain relatives are considered outcasts or lack ability to manage money. Charitable organizations that offer charitable gift annuities generally will preserve confidentiality regarding any gift. Mrs. Haskell could provide Eddie with either an immediate or deferred payment annuity, and no one has to know. If the value of her son's life annuity is less than $13,000, Mrs. Haskell need not file a gift tax return (for an immediate payment gift annuity). A gift tax return would be required for a deferred payment annuity, which is a future interest that does not qualify for the gift tax annual exclusion, but this may not be an issue if Mrs. Haskell won't owe estate taxes. Could she establish a "testamentary" gift annuity for Eddie *outside her will*? Based on the "flexible deferred gift annuity" concept, she might be able to arrange a deferred annuity for Eddie with a starting date likely to occur after her death. The contract would provide that the start of annuity payments will be moved up to the year of her death, but with reduced annual payments (that are set out in a schedule that preserves actuarial values reflecting the original transfer). Even if the charity does not offer gift annuities, it may offer to act as trustee of a charitable remainder trust, which also could provide income and money management for a beneficiary.

D. Strategies for organizations when most donors won't face federal estate tax

Charities should place additional emphasis in their marketing on the nontax aspects of charitable estate planning, on revocable estate gifts, and gifts that solve problems and

achieve personal goals for donors. Constituents should be encouraged to compose "ethical wills" – documents that enable people to express to family members and friends their values, beliefs, lessons life has taught them, hopes, love and forgiveness. Composing an ethical will may remind people of organizations that have been important in their lives – and suggest that they might wish to include these charities in their estate plans. If they have not done so already, organizations should establish or strengthen:

- Wills and bequest programs that also encourage various beneficiary designations and other nonprobate transfers. If multimillion dollar bequests decline as a result of fewer estates being taxable, charities will need to increase the number of modest bequests to make up the difference.

- Estate planning informational services: seminars and publications that educate donors about: thoughtful distribution of their estates, protection of beneficiaries through trusts and other arrangements, avoidance of probate, living wills and powers of attorney for healthcare, plans for money management and trusteeship in the event of disability, such as living trusts, durable general powers of attorney and life income gifts, and testamentary "life income gifts." Potential donors should be reminded that their estate plans can be more than just directives for distributing their estates; they can make a statement about one's life and values and leave the world a better place by providing for worthwhile causes.

III. Charitable Planning after 2010 for Donors Who Still Face Federal Estate Tax

Federal estate taxes historically have played at least some role in wealthy individuals' decisions to make charitable bequests – and how much to leave. Charitable bequests seemingly "get the attention" of wealthy people as a way to combat the severity of the federal estate tax, and the estate tax charitable deduction may enable donors to increase the amounts they leave to organizations, especially where charitable remainder trusts and lead trusts are employed.

A. Maximizing estate tax charitable deductions. Property passing to charity from a decedent generally will qualify for the federal estate tax charitable deduction [IRC §2055(a)] and for a deduction or exemption from state inheritance or estate taxes. For federal estate tax purposes the transfer must be to an organization described in IRC §2055(a), and the property must (1) be included in the decedent's gross estate, and (2) be considered "transferred by the decedent." Charitable bequests are 100% deductible; there are no deduction "ceilings" such as the 30% and 50% of adjusted gross income limits on the income tax charitable deduction.

Estate tax charitable deductions are available only for amounts actually passing to charity. Federal estate taxes and state death taxes and expenses recovered from a charitable bequest will reduce the amount charity receives and the available deduction. Furthermore, reductions in the estate tax deduction will increase the amount of tax due, further reducing charity's share, and on and on – a vicious circle. Will provisions generally should direct that no death taxes or costs of administration will be payable from

charitable bequests or distributions. One common trap in this regard is the will or trust that provides for a charitable bequest of a portion of the residuary estate – where the document also contains a standard "pay from residue" tax clause. The result will be a reduction in the estate tax charitable deduction under IRC §2055(c), and the previously mentioned vicious circle, necessitating an interrelated computation.

B. Selecting gift assets. Donors who face federal estate tax should consider bequests of IRD assets that additionally save income taxes for their estates or beneficiaries (see previous discussion.) Donors might also consider bequeathing ordinary income property and tangible personal property to charities. These assets have poor income tax results if contributed during life; bequests of such property, on the other hand, can be 100% deductible for estate tax purposes.

Ordinary income property. Several years ago, Ted DeGrazia, an artist living in the southwest burned about $1 million worth of his paintings when he found they would be subject to federal estate tax. Had he given some thought to the matter, he might have found it better to bequeath the paintings to a museum, university or other charitable institution. If the artist had given the paintings to charity during life his charitable contribution would have been limited under IRC §170(e)(1)(A) to his cost basis – what he paid for paint and canvas. Paintings in the hands of the artist are one kind of "ordinary income property," defined as property the sale of which would produce any ordinary income or short-term capital gain. No such reduction applies to the estate tax charitable deduction; thus the artist's estate would have been allowed a deduction for the full fair market value of the paintings had he bequeathed them to charity.

Tangible personal property. If an individual makes a lifetime gift to charity of tangible personal property (e.g., a painting, boat or a coin collection), and the charity puts the gift to an "unrelated use," the donor's contribution will be reduced by 100% of any long-term capital gain present in the property [Reg. §1.170A-4(b)(3)(i)]. No reduction occurs, however, with *bequests* of personal property.

C. Alternative charitable bequests. Arguably, every will should contain one or more alternative charitable bequests. These bequests provide flexibility in carrying out an individual's testamentary desires in the face of changing circumstances and unforeseen events.

Qualified disclaimer. If an individual makes a qualified disclaimer of a bequest under IRC §2518 and the bequest property passes under an alternative bequest to a qualified charity, the decedent's estate will be allowed a deduction for the amount passing to charity. This arrangement allows a family beneficiary who feels he or she does not need all that a testator has provided to pass along all or part of a bequest to a worthwhile cause favored by the testator [IRC §2518(c)] – and also provide tax savings to the estate, especially if the bequest that is disclaimed is IRD.

Contingent bequests. Individuals sometimes provide that bequests shall pass to named charities if the primary beneficiary should predecease them.

Ultimate contingent beneficiary. Another use of alternative charitable bequest clauses is to cover the possibility that ALL intended beneficiaries predecease the estate owner, or the possibility that the testator and his or her intended beneficiaries are killed in a common disaster. The advantage of naming a charity as one's "ultimate contingent beneficiary" is twofold: (1) The testator avoids having his or her estate pass to distant (perhaps unknown) relatives, or even escheat to the state; (2) The estate will completely avoid federal estate taxes, and perhaps state death taxes, if everything passes to charity under an alternative bequest. The testator also has the satisfaction of knowing a worthwhile cause will be benefited.

D. Split-interest bequests. Estate owners can divide benefits of property ownership between charities and private beneficiaries in a variety of ways, with or without a trust. Cash or property can be bequeathed to charity conditioned on the charity's promise to pay an annuity to a named beneficiary. Additionally, a farm or personal residence can be bequeathed to charity while reserving a life estate for, say, a surviving spouse [IRC §2055(e)(2)]. All these gifts provide estate tax deductions.

E. Charitable bequests in trust. A charitable bequest can be deferred until the death of a decedent's beneficiary – that is, a family member can receive lifetime income from the bequest property, remainder to charity. This can be accomplished by means of a charitable remainder trust or a bequest to a charity's pooled income fund. Both techniques will produce estate tax charitable deductions. A "deferred bequest" can be made through any form of trust if an estate tax charitable deduction is not important. A testamentary charitable lead trust can pay income to charity temporarily and ultimately pass all trust principal to family beneficiaries, with significant estate tax savings.

F. Estate tax avoidance without the marital deduction

How does a testamentary charitable remainder trust fit into an estate plan? For unmarried and widowed men and women, the testamentary charitable remainder trust can save estate taxes by giving rise to a charitable deduction, even though the decedent's family receives exclusive benefits from the trust for life or a term of years [IRC §2055(e)].

The charitable deduction is based upon the age of the income beneficiary at the time of the decedent's death and the amount of income to be paid from the trust. Estate tax savings mean more of the estate is available to provide an income to the family. The trust invariably increases the funds available to provide income to the primary beneficiary of the estate, where the deceased did not have the unlimited marital deduction. The charitable trust permits a person to confer benefits on a charity without lessening the security he or she wants to provide for family members. This is true even for the estates of married couples.

G. Charitable estate planning for married donors

"Trust your spouse" charitable bequest planning. Spouses who are both committed to a charitable organization might want to forgo a bequest to the charity at the death of the

first spouse and rely on the survivor to make a *lifetime gift* to carry out the philanthropic goals of the first spouse to die. The couple avoids estate tax, thanks to the marital deductions, and the survivor receives an income tax charitable deduction – and the satisfaction of making a memorial gift in the other spouse's name.

Split-interest bequests. A spouse's interest in a testamentary charitable remainder trust or pooled income fund will qualify for the unlimited estate tax marital deduction, if properly planned [IRC §2056(b)(7), (8)]. A qualified terminable interest property (QTIP) trust with charity as remainderman, can generate a 100% estate tax marital deduction when the first spouse dies [IRC §2056(b)(7)] and a 100% estate tax charitable deduction at the death of the surviving spouse [IRC §§2044(c), 2055]. This is a simple, flexible arrangement that permits a testator to provide for a spouse, yet ultimately benefit charity.

Among other things, QTIP trusts are required to pay all trust income, at least once a year, to a surviving spouse, and no other person can be an income beneficiary. Such a trust would not be a qualified charitable remainder trust, in which payments are made as "unitrust" or annuity payouts. But a charitable deduction would be unnecessary because the trust would qualify for the unlimited estate tax marital deduction.

Would spouses ever want to establish testamentary qualified remainder trusts for a surviving spouse? The answer is yes – if there are to be income beneficiaries in addition to the surviving spouse. Such a trust would fail as a QTIP trust, but could nonetheless generate an estate tax charitable deduction.

A testamentary charitable remainder unitrust for a surviving spouse also might make sense as a receptacle for IRD or if the survivor wanted to use the trust as a philanthropic vehicle. The spouse could make additional contributions to the unitrust, realize income tax and capital gains tax savings, and provide further benefit to the charitable remainderman. Additional contributions are not permitted for charitable remainder annuity trusts [Reg. §1.664-2(b)].

A private letter ruling (PLR 9122029, 2-28-91) permitted a spouse to bequeath property to a QTIP trust that pays the surviving spouse income for life, then empties into a charitable remainder trust for children. The estate of the first spouse to die qualifies for the marital deduction, assuming the executor makes a timely QTIP election [IRC §2056(b)(7)]. The surviving spouse's estate will include the value of the assets passing to the charitable remainder trust – but the estate will qualify for a charitable deduction equal to charity's remainder interest [IRC §§2044(c) and 2055(e)(2)(A)]. The same technique reasonably should apply to a charitable lead trust.

Why not just make the children survivor beneficiaries of a qualified charitable remainder trust for the spouse? Under IRC §2056(b)(8), the interest of the surviving spouse will not qualify for the estate tax marital deduction at the first spouse's death because she is not the sole noncharitable beneficiary.

H. "Extra mileage" from the GST tax exemption.

The estate planner's task is to decrease the size of the denominator of the applicable fraction used to compute the generation-skipping transfer tax rate, and virtually the only way to do that is through charitable deductions – specifically, the charitable lead trust.

Famous Example: Jackie Onassis bequeathed $100 million to a charitable lead trust that would pay an 8% annuity amount to various charities for the next 22 years, after which the trust assets will be distributed to her grandchildren (any children of John Jr. and Caroline). The AFR at her death was 6.6%, resulting in an estate tax deduction of $99 million. The inclusion ratio was 1 minus the fraction having a $1 million numerator (her entire exemption at the date of her death) and a denominator of $1 million ($100 million less a $99 million estate tax charitable deduction). The GST rate is 0% (1 minus 1/1 = zero, times 55% = 0%).

$$1.0 - \frac{\$1{,}000{,}000\,^{*}}{\$100\text{ million} - 99\text{ million}} \times 55\% = \text{Zero GST tax}$$

(*Amount of exemption in effect at her death)

GST tax law was changed after Jackie's death to make annuity lead trusts less attractive where grandchildren are remaindermen, *i.e.*, tax results won't be known until the trust terminates. Because of the uncertainty of future trust investments, planners typically use the charitable lead unitrust rather than the unitrust when skip persons are trust beneficiaries.

APPENDIX: State Death Tax Compendium

CONNECTICUT

Type of Tax: Connecticut has a combined gift and estate tax on transfers over $3.5 million (the exemption was $2 million before 2010). For 2010 and later years, tax rates begin at 7.2% on transfers that exceed $3.5 million and increase to a top rate of 12% on taxable amounts over $10,100,000. Taxpayers compute taxable gifts and/or estates, then subtract a $3.5 million exemption and apply the applicable tax rates. In general, all bequests to qualified charitable, educational, religious and governmental organizations are exempt from Connecticut estate tax.

Residents are taxed on all real estate and tangible personal property within the state, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share. Exceptions exist for most financial accounts under $5,000, certain employee death benefits and pension benefits, social security payments received by other persons, insurance payable to a decedent's estate or to a named beneficiary or trust.

Nonresidents are taxable on all transfers of real estate and tangible personal property located in Connecticut, under the same rules that apply to residents..

Deductions. Estates of residents and nonresidents may deduct debts, estate expenses and certain taxes, gifts to qualified charities and transfers to a surviving spouse or partner in a civil union or same-sex marriage.

Gift Tax Rules. The estate tax rates and $3.5 million exemption also apply to lifetime gifts, but use of the exemption to shelter lifetime gifts reduces the exemption at death, dollar for dollar. A gift tax annual exclusion of $13,000 per donee applies for 2010. Transfers to spouses and partners in civil unions and same-sex marriages are exempt from gift tax, as are gifts to qualified charitable, educational, religious and governmental organizations.

Resources: Title 12, Chapters 216—218, Connecticut General Statutes, Revision of 1958. Forms: http://www.ct.gov/drs/lib/drs/fillable_forms/2009forms/ct-706-709-fill.pdf

DELAWARE

Type of Tax: Persons dying on or after July 1, 2009, are subject to Delaware estate tax if the gross estate exceeds $3.5 million, as calculated for federal estate tax purposes. Non-residents are taxable on the portions of their estates that are subject to tax in Delaware. The Delaware estate tax is linked to the federal estate tax credit for state death taxes, as it existed on January 1, 2001. The deduction for state death taxes under IRC §2058 is not taken into account in calculating Delaware estate tax. Above the $3.5 million threshold, progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000.

Residents are taxed on transfers of all real estate and tangible personal property within the state, with the exception of certain agricultural land and buildings, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share. A credit is provided for death taxes paid to another state.

Nonresidents are taxable on real estate and tangible personal property located in Delaware, based on the proportion of those assets owned in Delaware, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Delaware Code, as amended and, supplemented, Title 30, Chapters 15 and 17; and related statutes. Forms: http://revenue.delaware.gov/services/current_pit/TY09_900r.pdf

DISTRICT OF COLUMBIA

Type of Tax: Residents of D.C. are subject to estate tax on gross estates that exceed $1 million, as calculated for federal estate tax purposes. Non-residents are taxable on the portions of their estates that are subject to tax in the District. The D.C. estate tax is linked to the federal estate tax credit for state death taxes, as it existed on January 1, 2001. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000.

Residents are taxed on transfers of all real estate and tangible personal property within the District, plus intangible personal property within or outside the District. Taxation applies to transfers made by a resident's will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in the District of Columbia, based on the proportion of those assets owned in D.C., under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: District of Columbia Code, 1981 Edition, Title 47, Chapter 37 (1987 Supp.). Forms: http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/tax/forms/2007/2007_d-76.pdf

HAWAII

Type of Tax: The Hawaii legislature has adopted a state estate tax that applies to residents and certain other persons dying after April 30, 2010. The tax applies to taxable estates in excess of $3.5 million, as calculated for federal estate tax purposes under rules in existence on December 31, 2009. Tax is calculated according to the credits for state death taxes that were in effect for federal estate tax purposes on December 31, 2000. Tax rates start at 9.6% above the $3.5 million exemption level and go as high as 16% on "adjusted taxable estates" exceeding $10,040,000. Tax Information Release No. 2010-06, issued by the Hawaii Department of Taxation, indicates that the new Hawaii estate tax will be unaffected by changes in federal estate tax exemptions after 2010.

Nonresidents are taxable on property interests with a situs in Hawaii under Chapter 236D, HRS. Applicable credits are apportioned as provided in HRS §236D-4.

Nonresidents who are not U.S. citizens are taxed under a new provision added by Act 74, which provides an estate transfer tax on transfers of property interests located in Hawaii. Noncitizen transfers include transfers of real property with a situs in Hawaii, whether or not held in trust, a beneficial interest in a land trust that owns Hawaii property, and tangible and intangible personal property having a situs in Hawaii.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Act 74, Session Laws of Hawaii 2010, Chapter 236D, Hawaii Revised Statutes. See TIR Release No. 2010-06 at: http://www.state.hi.us/tax/tir/tir10-06.pdf

ILLINOIS

Type of Tax: An Illinois estate tax applied to residents who died in 2006-2009 with taxable estates exceeding $2 million (as calculated for federal estate tax purposes). The Illinois estate tax is suspended, however, during the one-year repeal of the federal estate tax that took effect January 1, 2010. Both the federal estate tax and Illinois estate tax would return in 2011, under current law – possibly sooner, if state or federal lawmakers reinstate a "death tax" for 2010. The Illinois estate tax is linked to the federal estate tax credit for state death taxes, as it existed on January 1, 2001. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000. In 2011 the

federal estate tax is reinstated with an "exemption" of only $1 million. It's unknown whether the Illinois estate tax exemption will remain at $2 million or be changed by the state legislature to match the 2011 federal amount.

Residents are taxed on transfers of all real estate and tangible personal property within Illinois, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Illinois, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Ch. 35, Ill. Comp. Stats., 1992, Act 405, 35 ILCS 405/1—405/18. Forms: http://www.ag.state.il.us/publications/estatetax.html

INDIANA

Type of Tax: An inheritance tax applies to transfers at death, except those made to surviving spouses and qualified charitable, religious, educational and governmental organizations. Other beneficiaries are divided into three classes: A, B, and C, with different exemptions and tax rates assigned to each category:

Class A: $100,000 exemption for parents, children, grandchildren, grandparents, great-grandchildren, and other lineal descendents or ancestors. Adopted children, descendents of adopted children, and stepchildren are also covered. Tax rates start at 1% on the first $25,000 of transfers above the exempted amount and go as high as 10% of transfers exceeding $1,500,000.

Class B: $500 exemption for brothers, sisters, descendents of brothers or sisters (nieces and nephews), wife or widow of a son, husband or widower of a daughter. Tax rates start at 7% on the first $25,000 of transfers above the exempted amount and go as high as 15% of transfers exceeding $1,500,000,

Class C: $100 for all other beneficiaries, including aunts, uncles, cousins, friends, nieces and nephews by marriage, etc. Tax rates start at 10% on the first $25,000 of transfers above the exempted amount and go as high as 20% of transfers exceeding $1,500,000.

Residents: Tax applies to transfers of all Indiana real estate, all intangible personal property (cash, deposits, mortgages, notes, stocks and bonds, life insurance) wherever located, and all tangible personal property. Deductions are available for death taxes assessed by other states on property taxable in Indiana.

Non-Residents: Real estate and tangible personal property located in Indiana is subject to tax.

Resources: Indiana Code of 1976, Title 6, Article 4.1. Instructions: http://www.in.gov/dor/files/ih-6inst.pdf; Forms: http://www.in.gov/dor/3509.htm

IOWA

Type of Tax: An inheritance tax applies to transfers at death, except those made to Class 1 beneficiaries, as listed below. No tax is due where estates total $25,000 or less, after deductions.

Class 1: Spouses, parents, grandparents, great-grandparents and other lineal ancestors, children, including legally adopted children or biological children entitled to inherit under the laws of the state, stepchildren, grandchildren great-grandchildren and other lineal descendants. Exemption is 100%.

Class 2: Brothers, sisters, sons-in-law and daughters-in-law. Zero exemptions. Tax rates start at 5% on transfers up to $12,500 and rise to a high of 10% for transfers exceeding $150,000.

Class 3: Persons not included in Class 1 or 2. Zero exemptions. Tax rates start at 10% on transfers up to $12,500 and rise to a high of 15% for transfers exceeding $150,000.

Class 4: Charitable organizations outside Iowa, subject to the charitable exemption shown below. Tax rate is a flat 10% on transfers that do not qualify for the exemption.

Class 5: Transfers to for-profit organizations and to societies that do not qualify as charities under federal law. Tax rate is a flat 15%.

Residents: Inheritance tax applies to transfers of all real estate and all tangible personal property located in Iowa, and all intangible personal property wherever located. Jointly owned property is taxable to the extent of the resident's fractional ownership. Deductions are available for death taxes assessed by other states on property taxable in Iowa.

Non-Residents: Real estate and tangible personal property located in Iowa is subject to tax, according to the same rules that apply to residents.

Charitable Exemption: All property transferred to qualified Iowa charitable, religious, educational and governmental organizations and organizations located in other states that provide exemptions for transfers to Iowa organizations.

Resources: Iowa Code (1966), Chapters 450, 450A, 450B, and 451. Forms: http://www.iowa.gov/tax/forms/inherit.html

KENTUCKY

Type of Tax: An inheritance tax applies to transfers at death, except those made to "Class A beneficiaries," defined as surviving spouses, children (including adopted children and stepchildren), grandchildren, parents, brothers and sisters (including half-brothers and half-sisters). Other beneficiaries are divided into classes B and C, with different exemptions and tax rates assigned to each category:

Class B: Nieces and nephews (including children of half-brothers and half-sisters), sons and daughters in law, aunts and uncles. A $1,000 exemption applies, and tax rates range from 4%, up to $10,000 above the exemption amount, to 16% on amounts over $200,000.

Class C: All persons not in Class A or Class B. Tax rates start at 6% on the first $10,000 of transfers above a $500 exemption and go as high as 16% of transfers exceeding $60,000.

Residents: Tax applies to transfers of all real estate, all intangible personal property wherever located, and all tangible personal property. Deductions are available for death taxes assessed by other states on property taxable in Kentucky.

Non-Residents: Real estate and tangible personal property located in Kentucky is subject to tax, plus intangible business property located in Kentucky.

Charitable Exemption: All property transferred to qualified charitable, religious, educational organizations, and municipalities in Kentucky.

Resources: Title XI, Chapter 140, Kentucky Revised Statutes. Forms: http://revenue.ky.gov/forms/curhrfrms.htm

MAINE

Type of Tax: Maine assesses an estate tax on the estates of residents that exceed $1 million, as calculated for federal estate tax purposes. Non-residents are taxable on the portions of their estates that are subject to tax in Maine. Progressive tax rates apply and reach a top rate of 16% on amounts exceeding $10,040,000. Estates under $1 million need to file Form 706ME-EZ to avoid having a tax lien imposed by the State of Maine.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share. A credit is provided for death taxes paid to another state.

Nonresidents are taxable on real estate and tangible personal property located in Maine, based on the proportion of those assets owned in Maine, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Title 36, Part 6, Revised Statutes, Annotated, as amended. Forms: http://www.maine.gov/revenue/incomeestate/estate/index.htm

MARYLAND

Type of Tax. Maryland has both an inheritance tax and an estate tax. If the inheritance tax paid is equal to or exceeds the amount of the state estate tax, then no Maryland estate tax is due.
The inheritance tax exempts all persons in Class 1 but taxes all others (Class 2), as shown below:

Class 1: Spouses, parents (including step-parents), grandparents, children (including stepchildren), grandchildren and other lineal descendants, spouses of children or spouses of children's descendants, brothers and sisters, and corporations with stockholders consisting of certain Class 1 beneficiaries. All transfers are exempt from inheritance tax

Class 2: All others. The rate of tax is 10% on the entire share, except for transfers under $150, which are not taxed. No inheritance tax is due on estates under $20,000. An exemption is provided for the value of an interest in a primary residence that is jointly owned with a domestic partner and passes at death to the domestic partner.

Residents: Inheritance tax applies to transfers of all real estate and all tangible personal property located in Maryland, and all intangible personal property wherever located. Jointly owned property is taxable to the extent of the resident's fractional ownership. Deductions are available for death taxes assessed by other states on property taxable in Iowa.

Non-Residents: Real estate and tangible personal property located in Maryland is subject to tax, according to the same rules that apply to residents.

Charitable Exemption: All property transferred to qualified Maryland charitable, religious, educational and governmental organizations and organizations located in other states that provide exemptions for transfers to Maryland organizations, is exempt from inheritance tax.

The Maryland estate tax applies to residents with gross estates that exceed $1 million, plus "adjusted taxable gifts," as calculated for federal estate tax purposes. Form MET-1 must be filed. Non-residents may be taxable on the portions of their estates that are subject to tax in the state. The Maryland estate tax is linked to the federal estate tax credit for state death taxes, as it existed on December 31, 2000. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Title 7, subtitle 2, Annotated **Code** of **Maryland**. Estate Tax Forms: http://forms.marylandtaxes.com/current_forms/MET1.pdf;

MASSACHUSETTS

Type of Tax: Residents of Massachusetts are subject to estate tax on gross estates that exceed $1 million, as calculated for federal estate tax purposes. Non-residents may be taxable on the portions of their estates that are subject to tax in the state. The Massachusetts estate tax is linked to the federal estate tax credit for state death taxes,

as it existed on December 31, 2000. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside Massachusetts. Taxation applies to transfers made by a resident's will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Massachusetts, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Chapter 65C, General Laws of 1932, as amended. Forms: http://www.mass.gov/Ador/docs/dor/Forms/Est_Tax/PDFs/m_70603.pdf

MINNESOTA

Type of Tax: Residents of Minnesota are subject to estate tax on gross estates that exceed $1 million. Non-residents may be taxable on the portions of their estates that are subject to tax in the state. The Minnesota estate tax is linked to the federal estate tax credit for state death taxes, as it existed on December 31, 2000. Above the $1 million threshold, progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000. Form M706 must be filed for gross estates exceeding $1 million or estates for which an estate tax return (Form 706) was required.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside Minnesota. Taxation applies to transfers made by a resident's will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Minnesota, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Sections 291.005—291.47, Minn. Stats., 1994; Forms: http://www.taxes.state.mn.us/forms/m706.pdf

NEBRASKA

Type of Tax: Nebraska assesses an inheritance tax on all transfers except for those made to spouses or qualified charitable organizations, which are 100% exempt. Different exemptions and tax rates apply to three classes of beneficiaries:

Class 1: Parents, grandparents, brothers, sisters, sons, daughters, legally adopted children, other lineal descendants (including legally adopted persons), or the spouse or surviving spouse of any of the above persons. Each beneficiary is entitled to a $40,000 exemption and a flat 1% tax applies to amounts over $40,000.

Class 2: Uncles, aunts, nieces or nephew related to the deceased by blood or legal adoption, or other lineal descendants of these beneficiaries. Each beneficiary is entitled to a $15,000 exemption, and a 13% tax rate applies to amounts above the exemption.

Class 3: All other beneficiaries, with the exception of charitable organizations. Each beneficiary is entitled to a $10,000 exemption, and an 18% tax rate applies above the exemption amount.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside Nebraska on applies to transfers made by a resident's will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Nebraska, under the same rules that apply to residents.

Resources: Nebraska Revised Statutes of 1943, Chapter 77, Article 20, Sections 77-2001—77-2040, and Article 21, Sections 77-2101—77-2115. Forms: http://probateforms.bashasys.com/nebraska-probate-forms/nsba-psv-5-forms-commentary.html

NEW JERSEY

Type of Tax. New Jersey has both an inheritance tax and an estate tax.
Inheritance Tax. Beneficiaries are divided in Classes A, C and D (Class B has been eliminated). Charitable organizations are exempt, as are Class A beneficiaries, as listed below.
Class A: Spouses, civil union partners and domestic partners, parents, grandparents and descendants, including adopted persons.
Class C: Brothers, sisters, spouses of sons and daughters or spouses of deceased sons and daughters, and civil union partners of children or deceased children. Beneficiaries are entitled to a $25,000 exemption. Transfers exceeding the exemptions are taxed at rates starting at 11% and increasing to 16% on amounts over $1,700,000.
Class D: All other beneficiaries. There is no tax on transfers of $500 or less, but larger bequests are taxed at a 15% rate on the first $700,000 and 16% on amounts exceeding $700,000.

Estate Tax. Estates of residents must file a New Jersey estate tax return (Form IT-Estate) if the gross estate, plus "adjusted taxable gifts" exceeds $675,000. The tax will be either the maximum state death tax credit permitted under federal estate tax laws in effect on December 31, 2001, or an amount calculated under the "Simplified Form Method" set out in Form IT-Estate. All deductions available against the federal estate tax, including the marital and charitable deductions, apply in calculating New Jersey estate tax. Additionally, a deduction equivalent to the marital deduction is available for transfers to surviving partners in a civil union. Tax rates go as high as 16% on taxable amounts in excess of $10,040,000.

Resources: Title 54, Chapters 33-38A, Revised Statutes of New Jersey, 1937. Tax Forms: http://www.state.nj.us/treasury/taxation/pdf/other_forms/inheritance/itestate.pdf (estate tax); http://www.state.nj.us/treasury/taxation/pdf/other_forms/inheritance/itrbk.pdf (inheritance tax).

NEW YORK

Type of Tax: New York has an estate tax that applies to gross estates of residents that exceed $1 million, plus "adjusted taxable gifts," as computed for federal estate tax purposes. A federal estate tax return must be completed and filed with state estate tax Form ET-706. Non-residents may be taxable on the portions of their estates that are subject to tax in New York. Progressive tax rates apply and reach a top rate of 16% on amounts exceeding $10,040,000.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share. A credit is provided for death taxes paid to another state.

Nonresidents are taxable on real estate and tangible personal property located in New York, based on the proportion of those assets owned in New York, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Consolidated Laws, Chapter 60, Art. 26; Chapter 60, Art. 8, Sec. 171; and Chapter 13, Art. 4, Sec. 124, all as amended. Constitution, Article XVI, Section 3. Forms: http://www.tax.state.ny.us/pdf/2009/et/et706_1209.pdf

NORTH CAROLINA

Type of Tax: An estate tax applied to North Carolina residents who died in 2009 with taxable estates exceeding $3.5 million (as calculated for federal estate tax purposes). The North Carolina estate tax is suspended, however, during the one-year repeal of the federal estate tax that took effect January 1, 2010. Both the federal estate tax and North Carolina estate tax would return in 2011, under current law – possibly sooner, if state or federal lawmakers reinstate a "death tax" for 2010. The North Carolina estate tax is linked to the federal estate tax credit for state death taxes, as it existed before 2002. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000. In 2011 the federal estate tax is reinstated with an "exemption" of only $1 million. It's unknown whether the North Carolina estate tax exemption will remain at $3.5 million or be changed by the state legislature to match the 2011 federal amount.

Residents are taxed on transfers of all real estate and tangible personal property within North Carolina, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in North Carolina, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Chapter 105, Subchapter I, Article 1A, General Statutes of North Carolina, as amended and supplemented. Forms: http://www.dor.state.nc.us/downloads/individual.html.

OHIO

Type of Tax: An estate tax applies to the net taxable estates of residents exceeding $338,333. Deductions are permitted for debts, costs of estate administration and funeral expenses, and any amounts left to a surviving spouse or charitable organizations. Taxable estates are further reduced by the value of real estate and personal property located outside Ohio and life insurance payable to beneficiaries other than the estate. The tax rate is 6% on taxable estate to 7% on amounts from $338,333 to $500,000 and 7% on amounts over $500,000.

Residents are taxed on transfers of all real estate and tangible personal property within Ohio, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share; one-half of jointly owned property of spouses is included in the estate of the first spouse to die.

Nonresidents are taxable on real estate and tangible personal property located in Ohio, based on the proportion of those assets owned in the state, under the same rules that apply to residents. Intangible property is taxable to the extent used in an Ohio business operation.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Chapters 5731, 5717, 5703, Ohio Revised Code. Forms:
http://tax.ohio.gov/documents/forms/estate/2006/ET%20Return%20Booklet_FI_092306.pdf

OREGON

Type of Tax: Estates of Oregon residents must file Oregon estate tax returns (Form IT-1) where the gross estate exceeds $1 million plus "adjusted taxable gifts." Non-residents are taxable on the real and personal property located in the state. The Oregon estate tax is linked to the federal estate tax credit for state death taxes, as it existed on December 31, 2000. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside Oregon. Taxation applies to transfers made by a resident's will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Oregon, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Title 12, Chapter 118, Oregon Revised Statutes, 1997. Forms: http://www.oregon.gov/DOR/BUS/forms-fiduciary.shtml#Forms__Non_Year_Specific_

PENNSYLVANIA

Type of Tax: Pennsylvania assesses an inheritance tax on all transfers except those made to spouses and qualified charitable organizations, which are 100% exempt. Transfers from the estate of a resident age 21 or younger to a natural parent, stepparent, or adoptive parent are exempt from the inheritance tax. Transfers to other beneficiaries are taxed as follows:

Class A: A 4.5% tax rate applies to transfers to parents, grandparents, sons, daughters, legally adopted children, other lineal descendants (including legally adopted persons), or the spouse or surviving spouse of any of the above persons. A $3,500 deduction is allowed as the “family exemption.”

Class A1: A 12% tax rate applies to transfers to brothers and sisters, half-brothers and half-sisters.

Class B: A 15% tax rate applies to transfers to all other beneficiaries.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside Pennsylvania on applies to transfers made by a resident’s will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident’s fractional share; joint property of spouses is exempt. Life insurance proceeds are not taxed.

Nonresidents are taxable on transfers of real estate and tangible personal property located in Pennsylvania, under the same rules that apply to residents.

Resources: Tax Reform Code of 1971, Article XXI (added by Act 22, Laws of 1991), as amended and supplemented. Forms: http://www.revenue.state.pa.us/portal/server.pt/community/inheritance_tax/14695

RHODE ISLAND

Type of Tax: Estates of Rhode Island residents must file Rhode Island estate tax returns (Form 100A) where the gross estate exceeds $850,000 (2010 amount), as adjusted for inflation) plus “adjusted taxable gifts.” Non-residents are taxable on the real and personal property located in the state. The Rhode Island estate tax is linked to the federal estate tax credit for state death taxes, as it existed on January 1, 2001. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside Rhode Island. Taxation applies to transfers made by a resident’s will, trust, or under intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident’s fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Rhode Island, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Title 44, Chapters 22, 23, and 40 General Laws of Rhode Island, 1956, as amended. Forms: http://www.tax.state.ri.us/taxforms/estate.php.

TENNESSEE

Type of Tax: Tennessee has a state estate tax (officially called an "inheritance tax") that applies to gross estates of residents that exceed $1 million, plus "adjusted taxable gifts," as computed for federal estate tax purposes. A federal estate tax return must be completed and filed with state estate tax Form INH-301. Non-residents may be taxable on the portions of their estates that are subject to tax in Tennessee. Above the $1 million exempted amount, a 5.5% tax rate applies to the first $40,000; 6.5% to amounts between $40,000 and $240,000; 7.5% to amounts between $240,000 and $440,000 and 9.5% to amounts over $440,000.

Residents are taxed on transfers of all real estate and tangible personal property within the state, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share. A credit is provided for death taxes paid to another state.

Nonresidents are taxable on real estate and tangible personal property located in Tennessee, based on the proportion of those assets owned in Tennessee, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Gift Tax. Tennessee also assesses a gift tax. Gifts to spouses and charities are 100% deductible. A $13,000 annual exclusion is available, per donee, for transfers to Class A beneficiaries: spouses, children, lineal ancestors, lineal descendants, brothers, sisters, stepchildren, sons-in-law or daughters-in-law, persons related as a result of legal adoption and nieces and nephews and their descendants, if the donor has no child or grandchild. The exclusion is $3,000 for gifts to all other donees (Class B). Graduated tax rates range from 5.5% to 16%.
Resources: Title 67, Chapter 8, Parts 2 through 6, Tennessee Code Annotated, 1983, Replacement, as amended. Gift Tax: Tennessee Code Section 67-8-102(1). Forms: http://www.tennessee.gov/revenue/forms/inhgift/

VERMONT

Type of Tax: For deaths occurring after 2008, a Vermont estate tax return (Form E-1) must be filed for residents with gross estates exceeding $2 million (as calculated for federal estate tax purposes, minus any real estate and tangible personal property located outside Vermont). The state estate tax is linked to the federal estate tax credit for state death taxes, as it existed on January 1, 2001. Progressive tax rates apply, reaching a top rate of 16% on amounts exceeding $10,040,000. In 2011 the federal estate tax is reinstated with an "exemption" of only $1 million. It's unknown whether the Vermont estate tax threshold will remain at $2 million or be changed by the state legislature to match the 2011 federal amount.

Residents are taxed on transfers of all real estate and tangible personal property within Vermont, plus intangible personal property within or outside the state. Taxation applies to transfers made by a resident's will, trust, or under state intestacy law. Jointly owned property is generally taxed, but only to the extent of a resident's fractional share.

Nonresidents are taxable on real estate and tangible personal property located in Vermont, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Vermont Statutes Annotated, Title 32, Chapter 190. Forms: http://www.state.vt.us/tax/formsincome.shtml

WASHINGTON

Type of Tax: For deaths occurring after 2005, a Washington estate tax return must be filed for residents with gross estates exceeding $2 million (or federal taxable estates of $2 million plus taxable gifts). The state estate tax is "free standing," with progressive tax rates ranging from 10% on the first $1 million of taxable estate to a top rate of 19% on amounts exceeding $9 million. Tax rates are applied against the "Washington taxable estate," which is the federal taxable estate before deducting state death taxes, minus a $2 million exemption.

Residents are taxed on the date of death value of all assets owned at time of death, for federal estate tax purposes.

Nonresidents are taxable on real estate and tangible personal property located in Washington, based on the proportion of those assets owned in the state, under the same rules that apply to residents.

Deductions. Estates of residents and nonresidents are entitled, in effect, to all the deductions available for federal estate tax purposes, such as debts, estate expenses, taxes, bequests to qualified charities and transfers to a surviving spouse.

Resources: Washington Revised Code, Chapter 83.100, as amended and supplemented. Forms: http://dor.wa.gov/content/FindTaxesAndRates/OtherTaxes/tax_estateOnAfter051705.aspx

BIOGRAPHICAL INFORMATION

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Marc Carmichael, J.D., is president of the R&R Newkirk Company and has worked in the field of charitable gift planning since 1976. His company provides gift planning training and marketing assistance for hundreds of organizations. R&R Newkirk also publishes the *Charitable Giving Tax Service*, an online reference library on planned giving and charitable estate planning, "The Advisor" charitable estate planning newsletter and "The Federal Tax Pocket Guide for Advisors and Planners." Marc is a graduate of the Indiana University School of Law and is a member of the Indiana State Bar Association. He is a past president of the National Committee on Planned Giving (now "PPP") and served on the board of directors of the Chicago Planned Giving Council. He has spoken at the national conferences of PPP, AFP, ACGA and AHP, and chaired the National Conference on Planned Giving. He served as chair of the PPP editorial advisory committee, which publishes *The Journal of Gift Planning,* for four years. In 2005 he received the Russell V. Kohr Memorial award for excellence in gift planning from the Chicago Council on Planned Giving.

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