THE NAUTILUS GROUP®

The "Zero Estate Tax" Strategy



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The "zero estate tax" strategy is designed to pass the portion of a decedent's estate subject to estate taxes to the decedent's favorite charities, thereby minimizing what is paid in estate taxes to the federal and applicable state governments. This strategy operates by making full use of a decedent's applicable exclusion amount (or for a married couple, the applicable exclusion amounts of both spouses), through appropriate will provisions, which may allow assets to pass to family members estate tax-free.

By implementing several different charitable giving techniques, an individual with a large estate can often design an estate distribution structure to generate no estate taxes.

Charitable bequests at death

The simplest route is frequently to make bequests of specific dollar amounts (referred to as "pecuniary amounts") or assets in excess of an individual's applicable exemption amount, or certain percentages of an individual's estate, directly to charitable beneficiaries. Such bequests are generally estate tax deductible; the deductibility of testamentary bequests to split-interest trusts (like the charitable lead trust and the charitable remainder trust), however, will depend on the value of the charity's interest at that time in light of the current interest rate environment.

Identifying which assets are most appropriate for bequests is also an important consideration. Generally, liquid assets such as cash, money market funds, and marketable securities (that can be easily converted to cash) are preferred. Closely held business, real estate investment properties and investment partnership interests may be less desirable as a bequest. Additionally, there are limits and restrictions on vehicles that can be utilized for certain assets. For example, a charitable remainder trust cannot own shares of an S corporation, and certain entities may generate taxable income for the charitable entity.

Charitable contribution from surviving spouse

Rather than making a bequest from the estate, a contribution from assets left to a surviving spouse may offer additional income tax benefits. A charitable bequest from the estate may be eligible to offset an estate's taxable income, but that deduction may be much better utilized by the surviving spouse. A bequest made in this manner to a surviving spouse is effectively estate tax deductible as well via the unlimited marital deduction.

Generally, two questions must be addressed:

- Can my spouse afford such bequest?
    - Requires a determination of sufficient liquidity and income resources.
- Can my spouse be required to make such bequest?
    - The contribution must be at the sole discretion of the spouse, from property of which the spouse generally has unfettered access.

Split interest charitable trust planning

Testamentary charitable remainder trust

While not frequently employed, a charitable remainder trust (CRT) can be a vehicle for bequests at death to provide a stream of income to family members, while leaving the balance of assets to charity.

As a tax-exempt trust, the assets likely will experience greater rates of capital appreciation. The value of the estate tax deduction for the bequest is based on the charity's actuarial interest. Payments to non-charitable beneficiaries, of course, carry out deferred trust income.

Testamentary charitable lead trust

A charitable lead trust (CLT) is frequently employed to reduce or eliminate the estate tax on assets passing to heirs. For example, under a "zero estate tax plan," a charitable lead annuity trust (CLAT) is funded with some or all the taxable estate (above available estate tax exemptions) and made payable to charity for a term of years, with balance of trust assets continuing for the benefit of family.

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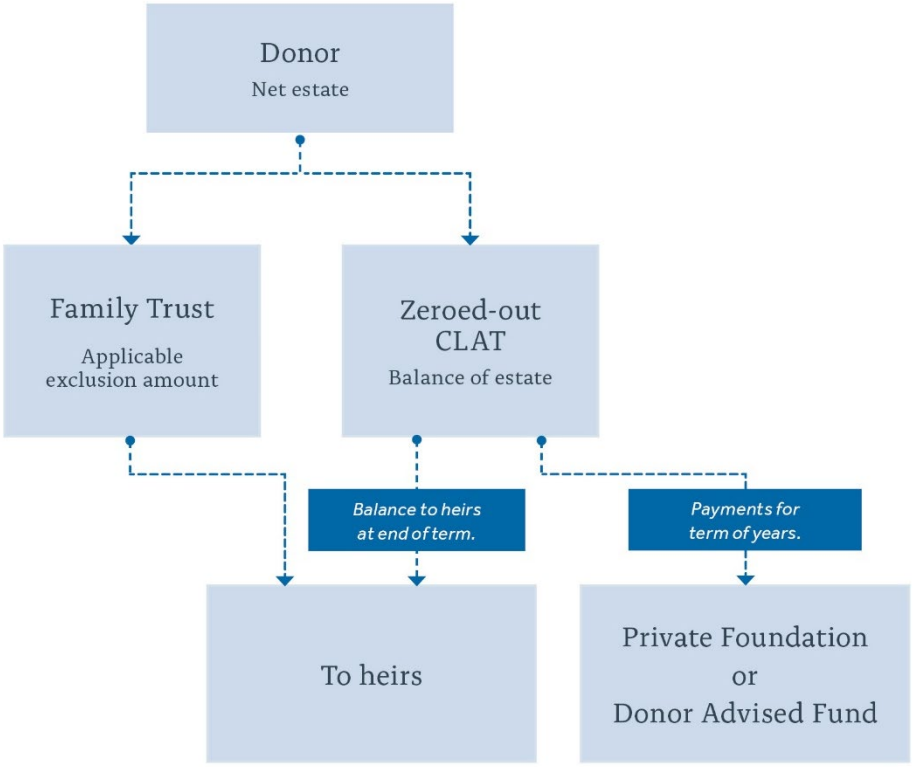

Potential drawbacks of zero estate tax plan

- An individual may not wish to leave additional assets to heirs through a CLT.
- Any such heirs may likely be in subsequent generation—as described above, a CLT is not generally effective for generation-skipping transfer (GST) tax planning, and thus, assets passing to future heirs may still incur GST tax.

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