Balancing Act

Estate planning options for appreciated assets that consider future income tax consequences.

Clay R. Stevens

Estate Tax laws are constantly changing[1] and the current exemption amount of $13.61 million per person is the highest it has ever been.[2] Proposals to reduce the exemption were floated in 2021 when the amount was $11.7 million but they were not passed.[3] Regardless, the threat of the lower exemption caused some taxpayers to make large taxable gifts in advance of possible legislation[4] – especially older taxpayers with significant taxable estates who were able to afford to gift the full $11.7 million. But, by gifting, those taxpayers gave up their ability to realize a step-up in income tax basis to fair market value upon their death on the appreciated assets they chose to transfer.[5] Depending on the appreciation of the gifted assets, state and federal income tax rates, and timing of future sales, the additional income tax paid by beneficiaries who receive appreciated assets may exceed the estate tax saved through lifetime gifting.[6] As will be explained in this article, if the taxpayer is unable to utilize their full exemption due to insufficient assets or future spending needs, the additional income taxes imposed may far exceed any estate tax savings.[7]

Under current law, the estate tax exemption automatically drops by 50% after 2025.[8] Taxpayers who want to use their increased exemption before the change and who need to do so by gifting appreciated assets again will be faced with the decision of whether to make gifts to reduce estate tax or retain such assets until their passing to get a step-up in income tax basis. This article will review the factors that determine whether gifting in advance of such change will have a positive tax benefit and will discuss five unique estate planning options available to these taxpayers regardless of any change in the estate tax exemption:

1. Exercise of Replacement Right in a Successful Sale to a Defective Grantor Trust,
2. Rolling Grantor Retained Annuity Trust and Swap,
3. Post First Death Planning for Spouses,
4. Lifetime Charitable Planning, and
5. Family Charitable Remainder Trust.

TOTAL TAX CONSEQUENCES OF GIFTING APPRECIATED ASSETS

Before discussing the various solutions, it is important to understand the tax issues. The assumption among many taxpayers (and advisors) may be that gifting assets will yield the largest tax savings since any appreciation on those gifted assets will be shielded from estate tax and the estate tax rate is higher than the tax rate on capital gain. If the estate tax exemption is expected to be reduced, then it could be further assumed that gifting makes even greater sense. However, the opposite is likely true in many cases when total tax is considered. For example, assume a taxpayer with a $9 million estate gifted $5 million of assets[9] with an income tax basis of $4 million in year 2024 presuming her available exemption was going to drop from $13.61 million to $6.805 million. While the estate tax savings if she passed away would be zero, even if the law changed, the later sale of the gifted assets would subject the beneficiary to as much as $300,000 in income tax.[10] The counter argument would be that by gifting, the future appreciation on the assets would also be excluded from estate tax and provide more benefit. But, in many cases the estate tax saved on the appreciation is offset by the additional income tax incurred on the growth.[11] If the gifted assets are likely to be sold prior to death of the taxpayer, the loss of the step-up in basis is less applicable, but the estate tax benefit of passing the growth outside the estate is still lessened by the additional income tax incurred by the recipient.[12] Even in the unique situations where there is some net overall tax benefit considering the interplay between estate and income tax, that benefit can be much less than the taxpayer expected and may not be worth the spending constraint on the taxpayer giving up access to a larger portion of their net worth.[13]

The assumption among many taxpayers (and advisors) may be that gifting assets will yield the largest tax savings since any appreciation on those gifted assets will be shielded from estate tax and the estate tax rate is higher than the tax rate on capital gain.

While increased overall taxes by gifting can be the result when a taxpayer has a smaller estate subject to tax, some taxpayers (and advisors) assume that if the taxpayer has sufficient assets to gift their full $13.61 million, the loss of the step-up will be far outweighed by the estate tax savings. However, if the only assets available for gifting have a very low basis – such as depreciated real property or closely-held founder stock – the opposite will often be true. Specifically, if the taxpayer gifted $13.61 million of assets with a $4 million basis, due to the negligible difference between the income tax rates and estate tax rates and loss of the step-up in basis, the gift does not produce any net overall tax savings[14] even if the estate tax exemption

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drops in half after year 2025.[15] Furthermore, in situations where the income tax basis of the property gifted is more than 30% of the total value such that gifting could produce some overall tax savings, if the taxpayer passes away before year 2026 or if the increased exemption is renewed, the gift will result in more overall tax to the beneficiaries.[16] To prevent this worst case scenario where gifting to reduce estate tax only increases income taxes, a taxpayer may be better off waiting until 2025 to decide whether to make a gift. This is especially true for married taxpayers who receive a step-up in income tax basis at the first death and can avoid any estate tax at that time using the unlimited marital deduction on transfers to a spouse.[17] The loss of the step-up in income tax basis has less negative effects if the recipient has no plans to sell the asset but may still create more income tax if the property is depreciable.[18] If the taxpayer instead believes the asset will be sold prior to death at a higher price and can use a grantor trust to shield the recipient from having to pay the income tax, then the loss of the step-up in income tax basis will also have a less negative effect.[19] However, a premature death before the asset is sold could negate any benefit of engaging in estate planning to shift the appreciation out of the estate.

While waiting until closer to December 31, 2025 to do outright gifting is beneficial for most taxpayers with predominately appreciated property, outright gifting for the reasons stated above may never be desirable. However, that does not mean those taxpayers who are likely to have a taxable estate should be resolved to do nothing and pay higher estate taxes. This is especially true if the assets of the taxpayer are likely to appreciate over time. Instead, taxpayers will need to look to more creative solutions that are designed to reduce future estate tax and preserve the step-up in basis. One option is to use a relatively common strategy, a Sale to a Defective Grantor Trust, but plan to take additional steps to preserve the step-up in basis.

EXERCISE OF REPLACEMENT RIGHT IN A SUCCESSFUL SALE TO A DEFECTIVE GRANTOR TRUST

A sale to a defective grantor trust or "DGT" is relatively common strategy used by taxpayers for decades to shift the appreciation on growth assets out of the taxpayer's estate.[20] The technique involves a taxpayer creating an irrevocable trust for the benefit of the taxpayer's heirs or other beneficiaries and retaining a power that causes the trust to be treated as a "grantor trust."[21] If the trust is a grantor trust, all transactions between the taxpayer and the trust are ignored for income tax purposes.[22] One of the powers that causes a trust to be a grantor trust, that is often included in a DGT, is the right to replace trust assets with other assets of equivalent fair market value.[23] Once the trust is created and some initial gift is made to settle the trust, the taxpayer sells appreciating assets to the trust in exchange for a promissory note.[24] If the value of the asset sold appreciates at a higher rate than the interest rate on the note, the excess appreciation will grow outside the taxpayer's estate.[25] Once the note has been repaid, the value of the property is retained by the irrevocable trust and passes to the trust beneficiaries free from estate tax.[26]

> If the grantor passes away during the initial term when she is entitled to annuity distributions, the trust assets are included in her estate and subject to estate tax. For this reason, it is often suggested that older taxpayers use alternative estate tax planning strategies, such as a sale to a DGT, without the risk of estate tax inclusion on a premature death.

While transferring appreciating assets into a DGT can significantly reduce a taxpayer's estate tax, any appreciation on the assets held in the irrevocable trust will miss out on the step-up in income tax basis at taxpayer's death and subject the trust beneficiaries to additional income tax.[27] However, if the taxpayer exercises her right to replace assets by swapping out the appreciated assets with high-basis assets, such as cash, fixed income, or newly purchased assets prior to their death, then the appreciated assets included in the taxpayer's estate will receive a step-up in basis, leaving less or possibly no income tax due on sale of the non-appreciated assets in the irrevocable trust.[28] As long as the exchange occurs while the trust is a grantor trust and prior to the death of the grantor, the grantor would receive a step-up in basis on the assets she receives from the trust in the exchange and the then fair market value of the non-appreciated assets transferred into the trust would escape estate taxation.[29] While such an exchange is explicitly prohibited with some estate planning techniques such as a Qualified Personal Residence Trust,[30] there is no such prohibition for a standard DGT.[31] To the extent the grantor does not have non-appreciated assets to exchange into the trust, an option would be for the grantor to purchase the appreciated property from the trust in exchange for a promissory note – a reverse DGT sale.[32]

The inherent problem with doing the exchange for non-appreciated assets or a note is that the grantor does not know when she will pass away, and an unexpected death would result in loss of the desired step-up. To hedge against a premature death, the grantor could purchase life insurance to offset the additional income tax created due to the loss of the step-up in basis.[33] Assuming the taxpayer has some forewarning of her eventual death, she could allow the assets to grow inside the grantor trust until death seems more likely and conduct the exchange close to the time of death to get the maximum benefit. However, to the extent that the taxpayer passes away before the appreciated assets can be exchanged with the non-appreciated assets, the gain inherent in the DGT assets is locked into the irrevocable trust.[34] The worst case scenario arises if the taxpayers sells appreciated assets into the DGT for a note and passes away unexpectedly before the assets can appreciate. Not only is the taxpayer now deceased, the promissory notes received from the sale are included in the taxpayer's estate at the same fair market value of the assets transferred. Furthermore, the appreciated assets do not receive any step-up in income tax basis at the taxpayer's death and the beneficiaries will pay unnecessary income tax on the sale.[35] In situations where this strategy is not appropriate because death is more likely in the near future, another option is to use another relatively

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common strategy, a Grantor Retained Annuity Trust, with some enhancements.

ROLLING GRANTOR RETAINED ANNUITY TRUST AND SWAP

A Grantor Retained Annuity Trust ("GRAT") is a codified strategy that has been around for decades as a technique to freeze the value of one's estate by exchanging assets for a fixed annuity payable to the grantor over a number of years.[36] The payments are fixed upon contribution and are typically high enough so that the exchange does not create gift tax.[37] To the extent the assets appreciate at a rate above the prescribed interest rate, the growth can pass to the grantor's beneficiaries tax-free.[38] If the grantor passes away during the initial term when she is entitled to annuity distributions, the trust assets are included in her estate and subject to estate tax. [39] For this reason, it is often suggested that older taxpayers use alternative estate tax planning strategies, such as a sale to a DGT, without the risk of estate tax inclusion on a premature death.

> To the extent that a taxpayer decides to transfer highly appreciated assets to a GRAT to minimize future growth from being included in the estate, there are still steps that can be taken to minimize the risk of a premature death.

However, to the extent the GRAT is funded with highly appreciated assets, it is often more beneficial from an overall tax perspective to use a GRAT if death is more likely. If a taxpayer transfers highly appreciated assets to a DGT in exchange for a note and passes away, the note is still included in the estate at death so only the post transfer appreciation above the interest rate on the note escapes estate taxation.[40] While a premature death with a GRAT can cause all the assets, including appreciation, to be included in the taxpayer's estate, the beneficiaries will receive a step-up in income tax basis on all of the assets transferred to the GRAT.[41] With a state and federal income tax rate on capital gain as high as 30%, compared to the 40% estate tax rate, the loss of 100% of a step-up in basis on appreciated assets often outweighs the estate tax benefit of allowing the growth to escape estate tax. For example, assume a taxpayer has $10 million of stock with a $1 million basis and contributes the stock to existing DGT in exchange for a note bearing interest at 4%. Even if the stock appreciates to $12 million and that the stock dividends cover the annual interest on the note, a premature death will only reduce the taxpayer's estate by $2 million and save $800,000 in estate tax. However, the heirs will have to pay tax on capital gain of $11 million resulting in more than $3 million in income tax. With the GRAT, a premature death would have resulted in $800,000 in estate tax but the net tax savings from the avoidance of income tax would be over $2.2 million. Even if the assets transferred had only $2 million of gain upon contribution (i.e., an $8 million income tax basis and $12 million value at death) the additional $1.2 million in income tax would still outweigh the estate tax savings. While there may be some particular tax situations or growth scenarios where the estate tax savings with the DGT will exceed the GRAT on a premature death,[42] it should not be automatically assumed that the GRAT is not the preferred option of someone with a shorter life expectancy.

To the extent that a taxpayer decides to transfer highly appreciated assets to a GRAT to minimize future growth from being included in the estate, there are still steps that can be taken to minimize the risk of a premature death. First, instead of doing a longer term GRAT, the taxpayer could create the GRAT with the minimum two year term.[43] If, at the end of the second year, the appreciated assets have not been sold, the GRAT must return most of the appreciated assets to the taxpayer as annuity payments (therefore including those assets in the taxable estate but benefiting from a step-up in basis at death).[44] However, to the extent the growth on the assets exceeds the stated applicable federal rate on the date of contribution and therefore the total GRAT assets exceed the required annuity payments, the excess can remain in a trust and be excluded from the estate.[45] That remainder trust can be set up as a grantor trust so that taxpayer can then swap non-appreciated property for the remaining appreciated assets held by the remainder trust without income tax consequences.[46] If the taxpayer retains those appreciated assets until death, she would then receive a step-up in basis on those appreciated assets and the unappreciated assets would escape estate taxation.[47] This is similar to the DGT strategy mentioned above although the exchange would typically occur immediately at the end of the two year GRAT so there is little risk of the assets missing out on the step-up in income tax basis.

The main problem with this strategy is that about half of the property is returned to the taxpayer at the end of year one, much of the remaining property is returned at the end of year two, and even the growth on the excess swapped back to the taxpayer on a successful GRAT is included in the grantors estate. Therefore, if the assets continue to appreciate, that growth will be included in the taxpayer's estate. However, if the taxpayer sets up a series of GRATs by immediately rolling the GRAT annuity distributions at the end of years one and two, as well as any additional property swapped back into the estate from a successful GRAT, into a new GRAT then the taxpayer can get the future appreciation on the property out of the estate.[48] When the taxpayer passes away, only the GRATs created during the last two years will be included in her estate and either way the property in those GRATs will receive a step-up in income tax basis at death.[49] To minimize the administrative inconvenience of managing multiple trusts long-term, the annual distributions of assets from any outstanding GRATs can be added to a single new GRAT each year and the excess from any successful GRAT can be passed into a single remainder trust.

While this strategy does involve several transfers and requires the creation of at least one new GRAT each year, it can be very successful for taxpayers with highly appreciated assets that are likely to continue to appreciate. However, this strategy does not allow generation-skipping tax ("GST") planning since the GST exemption cannot be allocated to the property until the end of the initial GRAT term after the property has appreciated.[50] Additionally, this strategy does not work well when the property being contributed is difficult to value since it will require a new determination of value upon the contribution to the GRAT and upon each annuity payment in-kind. Lastly, to the

extent the taxpayer has no non-appreciated assets to exchange with the remainder trust at the end of the term, then some of the appreciated property will remain in the remainder trust and not receive a step-up in basis. However, unlike the DGT sale where the entire property misses out on a step-up in income tax basis at death, in this situation only the appreciation held in the remainder trust will be later subject to income tax. For older married taxpayers, especially those residing in a community property jurisdiction, doing a modified GRAT or sale to a DGT with appreciated property may not be advisable, at least not until the death of the first spouse.

POST FIRST DEATH PLANNING FOR SPOUSES

For married taxpayers, there is an advantage in trying to preserve a step-up in basis with estate planning since estate tax can be avoided at the first death under the unlimited marital deduction.[51] The surviving spouse will have the ability to do estate tax planning, such as an outright gift or sale to a DGT[52] following the first death with the assets that received a resulting step-up in basis. The married couple will also be able to use the first spouse to die's estate tax exemption to shield future growth on assets without sacrificing the step-up at the first death.[53] If the married couple has high basis assets with which to do planning and/or is unlikely to hold assets until death to get the step-up in basis due to age or the nature of the asset, waiting to do planning will be less effective since the loss of the step-up in basis is less meaningful. However, for a married couple with mostly appreciated assets with which to do planning, this strategy provides some estate tax benefit without the large corresponding income tax detriment.[54] For taxpayers who live in a community property jurisdiction, this benefit is even greater since the surviving spouse will receive a step-up on 100% of their community property assets at the first death.[55]

One concern in proposing the surviving spouse gift away assets after the death of his spouse is that the surviving spouse still needs assets to support his lifestyle spending throughout the remainder of his lifetime. To the extent the estate plan is set up to fully fund a Bypass Trust for the benefit of the surviving spouse at the first death, then the surviving spouse can rely on those assets if he exhausts his share of the non-gifted estate.[56] For example, if the estate consists of $18 million of appreciated community property at the first death in 2026 and the exemption has returned to $7 million per person, the deceased spouse's estate could set up an irrevocable trust for the benefit of the surviving spouse (the "Bypass Trust") with $7 million of non-appreciated assets, due to the step-up in basis, and the remaining $11 million of non-appreciated assets could pass to the surviving spouse. The surviving spouse could then gift $7 million of non-appreciated assets to the couple's heirs and use the remaining $4 million for living expenses. If the surviving spouse exhausts those funds during his lifetime, then he could receive support and maintenance distributions from the Bypass Trust. In that case, upon the surviving spouse's death, no estate tax would be due[57] and the beneficiaries would have a basis in the remaining assets of no less than $14 million.[58]

> Most of a qualified public charitable organization's income is tax-exempt so gifting or bequeathing appreciated property to them allows them to sell that property without recognition of income tax.

Another complicating factor in this planning arises from the fact that many couples do not want to give the surviving spouse unlimited discretion to dispose of the deceased spouse's share of the estate for fear that the surviving spouse will later decide to disinherit the deceased spouse's heirs. This concern can be mitigated to the extent the estate of the deceased spouse creates a Bypass Trust with the deceased spouse's remaining estate tax exemption.[59] For amounts over the estate tax exemption or to the extent a Bypass Trust is not created at the first death, another common technique is the use of an irrevocable Qualified Terminable Interest Property Trust ("QTIP") at the first death to hold the deceased spouse's share of the estate.[60] While this helps protect against the surviving spouse from disinheriting the deceased spouse's heirs, it may prevent the surviving spouse from maximizing their estate tax reduction opportunities at death.[61] While an alternative would be for the surviving spouse to purchase assets from the Trustee of the QTIP for an interest-bearing note and then to gift some or all of those assets to get the future appreciation on those purchased assets out of the estate, there are fiduciary responsibilities that must be considered[62] and payments of interest on the note may create income tax consequences. Therefore, if the plan is for the surviving spouse to gift assets after the first death or sell assets to a Defective Grantor Trust, the better option is to transfer such amounts outright to the surviving spouse.

A problem with this strategy of waiting for a step-up at first death arises when the spouses have a longer life expectancy and the assets are increasing in value, since waiting to do planning causes the taxable estate to grow and therefore more estate tax to be due. In that case, it is best to pair another strategy, like the Sale to Defective Grantor Trust and exchange,[63] or Rolling Grantor Retained Annuity Trusts and exchange,[64] while the spouses are younger and then use this Post Death Planning as the spouses get older. But, if a taxpayer with appreciated property is also charitably inclined, additional opportunities are available – either as a substitute for the above-mentioned strategies or as a part of an overall strategy.

LIFETIME CHARITABLE PLANNING

For gift and estate tax, the law provides a 100% charitable deduction[65] for amounts passing to a qualified public charitable organization.[66] Most of a qualified public charitable organization's income is tax-exempt so gifting or bequeathing appreciated property to them allows them to sell that property without recognition of income tax.[67] If a taxpayer sells an appreciated capital asset during life and bequeaths the after-tax cash proceeds to their heirs at death, the effective overall tax rate could be as high as 58%.[68] As a result, the after-tax cost to the heirs of gifting the appreciated capital asset to charity could be as little as 42% of the original amount.

A charitable contribution will result in zero gift or estate tax regardless of whether one contributes during life or at death, but by satisfying the bequest with appreciated capital assets during life, the donor receives

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additional income tax benefits. If the appreciated capital assets are gifted to a public charity, and not a private foundation, then the donor can also take an income tax deduction equal to the fair market value of the assets - regardless of whether the assets have appreciated.[69] While the amount of the income tax deduction that can be used to offset the income tax of the donor in any year is limited to a percentage of the donor's adjusted gross income for the year,[70] the full fair market value of the contributed asset is deductible. Assuming the taxpayer can utilize the full deduction against ordinary income, the after-tax cost of gifting appreciated capital assets to charity during life drops to as little as 12% of the original amount of those assets.[71] Even if one does not account for the estate tax due on passing the sale proceeds to a beneficiary, since it occurs much later, the avoidance of capital gains tax on the sale plus the income tax deduction can result in an after-tax cost of giving appreciated assets to charity for as little as 20% of the original amount.[72]

If the taxpayer has charitable intent but has not yet identified a charitable organization that she would like to gift the appreciated asset during life, a good option is to transfer the appreciated asset to a private foundation[73] or a donor advised fund created at a sponsoring organization qualified as a public charity.[74] If the contribution of the appreciated property to the charity is made well in advance of the later disposition by the public charity,[75] then the charity will be able to dispose of the property without income tax[76] and the donor can distribute the full fair market value of the proceeds from the sale of the property to charities over time. However, if the appreciated property is not publicly traded securities, then giving to a private foundation will limit the donor's income tax deduction to the donor's income tax basis so giving outright to a donor advised fund at a public charity provides a better income tax result.[77] Additionally, a gift to a private foundation versus a donor advised fund also reduces the percentage of the donor's adjusted gross income that can be offset in any given year from 30% to 20%.[78] However, a taxpayer can divide the gift of appreciated property between a private foundation and a donor advised fund in order to be able to deduct up to 30% of the donor's adjusted gross income in any year.[79] In either case, any charitable deduction not used in any taxable year can be rolled over for up to five years and can offset future taxable income of the donor.[80]

> For taxpayers with strong charitable intent, transferring appreciated assets to a charitable vehicle allows the taxpayer to satisfy her charitable goals in a tax efficient manner.

If the taxpayer with an appreciated assets has charitable intent but needs some of the proceeds from the later sale, a good option is the use of a charitable remainder trust. Charitable remainder trusts are statutorily approved vehicles that taxpayers can use to defer recognition of income tax on the sale of appreciated property.[81] Like other charitable vehicles, to the extent appreciated assets are contributed to the charitable remainder trust in advance of disposition,[82] a taxpayer can effectively diversify his holdings and defer recognition of any gain until the taxpayer receives distributions from the charitable trust.[83] The taxpayer will receive annuity distributions each year from the charitable remainder trust based on a percentage of the value of assets held in the trust.[84] The annuity distributions to the donor can continue for the lifetime of the taxpayer or a term of years no greater than 20 years.[85] Since the taxpayer is retaining an annuity interest in the trust assets, the deduction will only be the present value of the charitable interest passing to charity at the end of the term[86] and that amount must be at least 10% of the assets contributed to the trust.[87] However, at the end of the term, the trust assets are distributed to charity, which can include the taxpayer's private foundation, and so there is no estate tax due. As a result, like outright gifts to charity, the taxpayer using a charitable remainder trust can avoid immediate recognition of the gain upon the sale, avoid estate taxation, and get an income tax deduction to offset other taxable income.

For taxpayers with strong charitable intent, transferring appreciated assets to a charitable vehicle allows the taxpayer to satisfy her charitable goals in a tax efficient manner. Some taxpayers are less charitably motivated but may instead provide large amounts to charity at their passing for fear that giving their entire estate to their children will have negative effects on their children's productivity.[88] Other taxpayers provide large bequests to charity at their passing primarily to avoid the 40% estate tax due.[89] In all of these cases, satisfying these testamentary charitable goals by gifting appreciated property during life provides the best overall tax result and can minimize the need to other tax planning. Again, these charitable strategies can be paired with some of the above-mentioned estate planning techniques to provide estate tax and charitable benefits. However, there is another option that uses a single strategy for appreciated assets to achieve both estate and charitable benefits in a tax efficient manner – the Family Charitable Remainder Trust.

FAMILY CHARITABLE REMAINDER TRUST

While making outright gifts of appreciated property to charity or transferring appreciated property to a charitable remainder trust during life is a great way to satisfy charitable intent in a tax advantaged way, these are not great options for taxpayers who want to transfer their appreciated property to family or other individuals.[90] One option that provides the tax advantages of a charitable transfer while providing a substantial wealth transfer to individual beneficiaries is a Family Charitable Remainder Trust ("FCRT").[91]

The FCRT is a technique that effectively allows a taxpayer to diversify an appreciated position without immediate income tax and pass wealth to individuals like successive generations without substantial transfer tax.[92] Additionally, like the charitable options mentioned above, it provides the taxpayer with an immediate income tax deduction and a significant benefit to the taxpayer's favorite charity.[93] The FCRT in its most simple form combines three established structures, a family limited partnership, a charitable remainder trust, and a sale to a grantor trust, in a unique way.[94]

The FCRT starts with a family limited partnership funded with highly appreciated publicly traded securities.[95] The taxpayer would hold all the limited partnership interests in the entity and such interest

would represent 99% of all interests in the entity.[96] The taxpayer would then create a DGT for the benefit of her heirs and gift cash or property to the trust.[97] The amount of the "seed" gift is typically equal to 10% of the amount to be later sold to the trust but can be less if the taxpayer does not have sufficient lifetime exemption remaining.[98] The taxpayer will also want to allocate generation-skipping transfer tax exemption to the gift so that the trust can be held estate tax-free for multiple generations.

Where the strategy differs from a normal sale to a DGT is that the partnership then creates a 20-year fixed term[99] charitable remainder trust with the largest permissible annuity that provides a charitable remainder equal to 10% of the fair market value of the property contributed—typically about 11% per year.[100] The contribution would create a charitable deduction and at least 99% of the charitable deduction passes to the taxpayer as the owner of all the limited partnership interests in the entity.[101] The taxpayer then sells the limited partnership interests to the previously created DGT in exchange for a secured promissory note equal to the appraised fair market value of the interest.[102] The appraised fair market value will be reduced by the 10% remainder interest set-aside for charity and likely will garner a minority interest discount equal to, if not greater, than the marketability discount applicable to a standard family limited partnership holding marketable securities.[103]

The appreciated property contributed to the charitable remainder trust can then be liquidated without immediate income tax and the sale proceeds reinvested in a diversified portfolio.[104] The charitable remainder trust would make the 11% distribution annually to the entity in cash and the entity can either reinvest the cash in the entity or distribute some of it to the partners – 99% of which would pass to the DGT.[105] The DGT could then use the distribution to make interest and principal note payments to the taxpayer.[106] While any distribution passes 99% to the DGT, the gain passing to the partners from the charitable remainder trust distribution passes to the taxpayer due to the grantor trust nature of the irrevocable trust.[107] As a result, the trusts effectively receives the 11% distribution tax-free. The taxpayer can then use the note payments to pay any income tax associated with the distribution.[108] Depending on the growth assumptions, it is expected that the notes could be fully repaid to the taxpayer from the DGT in 10-12 years.[109] The remaining 8-10 years of distributions from the charitable remainder trust accumulate in the DGT income tax-free and the taxpayer will further deplete her estate by continuing to cover the income tax associated with such distributions for the full 20 years.[110] At the end of the 20 years, the balance of the charitable remainder trust then passes to the taxpayer's chosen charity, which can include the taxpayer's private foundation.[111] In the end, the FCRT allows the taxpayer to liquidate out of an appreciated position without immediate recognition of income tax and converts the proceeds into an income stream passing in part to a taxpayer's beneficiaries, like children and grandchildren, in a highly tax advantaged way.[112] The main caveat with the FCRT is that the taxpayer does have to want a portion of their estate to pass to charity. If they do not then the first three strategies suggested above are likely better options.

CONCLUSION

For taxpayers holding highly appreciated assets, gifting those assets in advance of any potential estate tax law change in 2025 can result in more overall tax when considering the additional income tax created by the loss of step-up in basis at death. However, there are planning options available to taxpayers with appreciated assets who are likely to have a taxable estate. Taxpayers with time can transfer appreciated assets to a defective grantor trust and later exchange of those appreciated assets back for higher basis assets. Taxpayers with a shorter life expectancy could instead do a series of rolling grantor retained annuity trusts to prevent against the risk of a premature death before the exchange. However, for older married taxpayers, waiting to do such planning until after the first death may be more advisable. For charitably minded taxpayers, using the appreciated assets to fund charitable transfers during life or at death can provide substantial tax benefits. For those charitably minded taxpayers who also want to benefit their heirs or other individuals, the family charitable remainder trust can achieve both income tax and estate tax benefits. Therefore, despite the pressure of impending tax tax law changes in 2025, taxpayers should consider all these tax planning options with a qualified professional before simply gifting away highly appreciated assets.

End Notes

1 While the estate tax regime was relatively consistent from 1981-1997 with the amount one could pass estate tax-free at $600,000 per person and the top estate tax rate at 55%, changes in the exemption or rate occurred almost every year since then. See Jacobson, Raub, and Johnson, "The Estate Tax: Ninety Years and Counting", Internal Revenue Service, Compendium of Federal Transfer Tax and Personal Wealth Studies, pages 122-124, at https:/www.irs.gov/pub/irs-soi/ninetyestate.pdf

2 Rev. Proc. 2023-34, section 3.41; see Jacobson, *supra* note 1.

3 Boxer and Jerabek, *Disappearing Act: What You Need to Know About the Estate and Gift Tax Provisions of the House Ways and Means Committee Tax Proposals*, National Law Review, October 15, 2021.

4 The proposed law was to be effective on January 1, 2022, and many estate planning professionals advised their clients to make taxable gifts in advance of the pending change. See *id*.

5 See I.R.C. Section 1014(a). For married taxpayers in a community property jurisdiction, both the decedent and her spouse would receive a full step-up in income tax basis to fair market of their community property assets at the first death regardless of whether the assets avoided estate tax under the unlimited marital deduction. See I.R.C. Section 1014(b)(6).

6 See *infra* notes 9-20 and accompanying text.

7 See *infra* notes 10-11 and accompanying text.

8 The basic exclusion amount for gift or estate transfers before December 31, 2025 is $10 million (indexed for inflation) and reverts to $5 million (indexed for inflation) automatically thereafter. I.R.C. Section 2010(c)(3)(C); see I.R.C. Section 2010(c)(2)(B); Pub L. No. 115-97, section 11061(c), 131 Stat. 2054, 2155 (2017).

9 The financial planning limitation for many taxpayers is that gifting $13.61 million (or $27.22 million per couple) to fully take advantage of the existing higher exemption before the law changes creates real or perceived spending limitations on the taxpayers.

10 Upon death, the taxpayer's remaining exemption would drop from $6.805 million to $1.805 million so the taxable estate would be $2.195 million with $878,000 in tax with or without gifting. Furthermore, by gifting, the loss of the step-up in basis could create $300,000 in income tax assuming a combined 30% federal and state income tax rate. The rate may be higher or lower depending on the state income tax rate, whether the gain on the assets is capital gain, includes depreciation recapture, or is ordinary income, and whether the taxpayer is at the top margin rate.

11 Even if the gifted assets appreciated by $2 million between the date of gift and date of death so the estate saves 40% in estate tax on the growth or $800,000, the additional income tax on that $2 million would be $600,000 at the same 30% rate. Therefore, the total tax would still be $1.778 million

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after gifting ($878,000 in estate tax and $900,000 in income tax on the $3 million of appreciation) and only $1.678 million (all estate tax on $11 million) by not gifting. The exception would be situation where the growth on the gifted assets was expected to be much larger or the federal and state tax rates were much lower. There is also a timing issue in that the additional estate tax is due immediately upon death versus the gains are not recognized until the gifted assets are sold.

[12] If the gifted assets had a $4 million income tax basis and were sold for $7 million by the donee, the $800,000 in estate tax saved by getting the $2 million in growth out of the estate would be primarily offset by the $700,000 in income tax incurred by the donee (assuming the same 30% tax rate). The exception would be for gifts made to a grantor trust since if the assets were sold prior to death of the grantor then such tax is not imposed on the donee but the grantor. See *infra* note 19.

[13] See *supra* note 9. Another option that might be considered for an older taxpayer with unencumbered real property is to have taxpayer borrow against the real property and gift the cash with the plan to repay the debt following the taxpayer's death and after the real property receives a step-up in basis. This results from the fact that I.R.C. Section 1014(a) provides a basis increase for the gross fair market value whereas the estate tax is imposed on the net value. See I.R.C. Section 2053(a)(4). Borrowing costs, interest rates, and the investment of the borrowed funds dictate whether this is an economical solution but could be a short-term option.

[14] Assuming the state and federal combined income tax rate is 30% and the estate tax exemption drops by 50%, gifting assets equal to the full $13.61 million saves $2.722 million in estate tax or 40% of the $6.805 million in exemption that will be lost when the law changes. However, the 30% income tax imposed on the $9.61 million in appreciation results in $2.883 million in income taxes. If the sale of the property produces depreciation recapture income or the taxpayer resides in a state with a high state income tax such as California or New York, then the income tax rate may be higher than 30%.

[15] See *supra* note 8.

[16] If the taxpayer passes away before the expiration of the increased estate tax exclusion, gifting itself will provide no estate tax benefit and only subject to the beneficiaries to more income tax on the sale of the assets due to the loss of the step-up in basis.

[17] The step-up in income tax basis under I.R.C. Section 1014 is not dependent on the imposition of estate tax so transfers at death to a spouse can be estate tax-free and allow the spouse to sell the assets without income tax. See I.R.C. Section 2056(a). If the taxpayers reside in a community property state, the step-up in basis can even include the surviving spouse's one-half of the community property. See *supra* note 5.

[18] If the appreciated property is business real property, the loss of the step-up in basis will prevent the donee from taking depreciation deductions to reduce the future taxable income from the property even if the property is not intending to be sold. See I.R.C. Section 167.

[19] To the extent the gift is made to a trust classified as a grantor trust under I.R.C. Section 671 then any income tax on the sale of the asset during the grantor's lifetime would be imposed on the grantor and not reduce the benefit passing to the recipient. See I.R.C. Section 671.

[20] Mulligan, *Sale to a Defective Grantor Trust: An alternative to a GRAT*, 23 ETPL 3 (January 1996). See Aucutt, *Installment Sales to Grantor Trusts*, 4 No. 2 Bus. Entities 28 (March/April 2002).

[21] See Mulligan, *A Sale to a BIDIT Should Work as Well as a Sale to an IDIT*, 46 ACTEC Law Journal 307, 308-309 (Summer 2021) (describing the use of a sale to a defective grantor trust as part of a different transaction).

[22] *Id.* at 309.

[23] I.R.C. Section 675(4)(C); see Mulligan, *Power to Substitute in Grantor Does Not Cause Inclusion, With a Significant Caveat*, 109 JTAX 31, 32 (July 2008).

[24] See Stevens, *The Family Charitable Remainder Trust: Achieving Wealth Transfer and Charitable Goals in a Tax-Efficient Manner*, Taxes – The Tax Magazine 53, 57 (May 2010), (reviewing this strategy as well as a joint strategy combining the benefits of a family limited partnership, sale to a DGT, and charitable remainder trust).

[25] See Mulligan, *supra* note 21, at 310-311.

[26] See *id.* at 311.

[27] See *supra* note 5.

[28] See Stevens, *The Reverse Defective Grantor Trust*, 151 Trusts & Estates 33, 38 (October 2012) (discussing the ability to step up the basis of assets transferred from a grantor trust back to the grantor prior to death).

[29] *Id.* at 38 (even if the transfer occurs within one year of death it should not prevent a step-up in basis).

[30] Treas. Reg. 25.2702-5(c)(9).

[31] This is one reason a sale of a residence to a grantor trust often provides better results than a qualified personal residence trust. See Stevens, *Using a Personal Residence DGT to Capitalize on Reduced Property Values*, 84 PTS 329, 332 (June 2010) (discussing the ability to exchange out the residence to obtain a step-up in basis at death with a sale of a residence to a grantor trust instead of a QPRT).

[32] Stevens, *supra*, note 28.

[33] If one is purchasing life insurance for estate tax purposes, it is often recommend to purchase the life insurance inside an irrevocable life insurance trust to prevent the life insurance proceeds from being subject to estate tax. See Gallo, *Life Insurance Trusts Offer Tax Savings*, 50 Tax'n for Acct. 324 (1993). For example, if the taxpayer transferred $5 million in growth assets with a built-in gain of $2 million to grantor trust with the assumption it would appreciate to $10 million in the next 9 years, there could be $7 million of inherent gain if the grantor passed away just prior to year 9 and the sale by trust could create as much as $2.1 million. If the grantor purchased a $2 million 10-year term policy inside an irrevocable insurance trust, the $2 million in proceeds could effectively offset the anticipated gain upon sale without increasing the estate tax.

[34] Some commentators had speculated that the DGT should be entitled to an income tax basis increase on the trust assets under I.R.C. Section 1014, at least to the extent of any promissory notes outstanding at death. See Blattmachr, Gans, and Jacobsen, *Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death*, 97 JTAX 148, 159 (September 2002). This argument was explicitly rejected in 2023 by a revenue ruling that stated in order for I.R.C. Section 1014 to apply the specific asset needed to be included in the taxpayer's estate. Rev. Rul 2023-2, 2023-1 C.B. 1.

[35] For example, assume a taxpayer engages in a "Sale to a Defective Grantor Trust" strategy wherein she transfers $12 million of privately company stock with little basis to a trust in exchange for a promissory note under the premise that the stock may double in five years and then be sold. If the taxpayer passed away unexpectedly before the asset had increased, the estate would not save any estate tax, but the beneficiaries would lose a step-up in basis on the full $12 million. That would result in $3.6 million in increased income taxes assuming a combined state and federal income tax rate of 30%.

[36] I.R.C. Section 2702; see Saret, *The Estate Planner—Planner's Toolbox: Grantor Retained Annuity Trusts (GRATs)*, 93 Taxes – The Tax Magazine 33, 34-35 (Mar. 2015).

[37] See Saret, *The Estate Planner—Planner's Toolbox: Grantor Retained Annuity Trusts (GRATs), Part 2: Tax Consequences of a GRAT*, 93 Taxes – The Tax Magazine 31, 33 (May 2015) (discussing the ability to zero-out a gift to a GRAT).

[38] See *id.* at 36 (discussing the mechanics of the GRAT and that any remainder interest after the annuity payments have been repaid to the grantor escape estate taxation).

[39] See *id.* at 34-35 (discussing the portion of the GRAT included in the grantor's estate upon death during the term).

[40] See Manning and Hesch, *Deferred Payment Sales to Grantor Trusts, GRATs, and Net Gifts: Income and Transfer Tax Elements*, SSRN: https://ssrn.com/abstract=158489 or http://dx.doi.org/10.2139/ssrn.158489 1, 22 (Mar 31, 1999).

[41] See Treas. Reg. 1.1014-2(b).

[42] In situations where the beneficiaries reside in a state with no income tax, have other income tax losses to shield the gain, or the property is real estate that might be later sold using a tax-free 1031 exchange, then the loss of the step-up in basis may be less impactful. If the property is likely to increase rapidly after contribution, then the additional estate tax at 40% can offset the additional income tax at a lower rate. This is especially true if some portion of the property will be sold after contribution and prior to the death of the taxpayer since that lessens the loss of the step-up in basis. Additionally, if the beneficiaries do not intend to sell the asset for a long time, then the present value of paying estate tax at the death of the taxpayer may be more than the present value of the future income tax. However,

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if the property is depreciable, even if not sold, the beneficiaries will not get the annual income tax depreciation deductions.

[43] To get the maximum deferral, the terms of the GRAT can provide that the annual payments increase by 20% per year so that a smaller payment is required at the end of year 1. Treas. Reg. 25.2702-3(b)(1)(ii)(A).

[44] See Saret, *supra* note 37, at 36 (discussing the payment of annuity payments in-kind).

[45] See *supra* note 38 and accompanying text.

[46] See Saret, *supra* note 37, at 37 (discussing the retention of grantor trust status after the end of the GRAT term); see Saret, *supra* note 36, at 34 (discussing the ability of the grantor to exchange assets with a grantor trust tax-free).

[47] See *supra* note 28 and accompanying text.

[48] See Saret, *The Estate Planner—Planner's Toolbox: Grantor Retained Annuity Trusts (GRATs), Part 3: GRAT Structure and Administration; Comparison of GRAT to IDGT*, 93 Taxes – The Tax Magazine 21, 23 (Nov. 2015).

[49] See *supra* notes 38 and 41 and accompanying text.

[50] See Saret, *supra* note 48, at 26.

[51] See I.R.C. Section 2056(a).

[52] See *supra* note 20 and accompanying text.

[53] The first spouse to die's assets can be used to fund a Bypass Trust that will skip estate taxation at the surviving spouse's death or can pass assets to the surviving spouse who can then use the deceased spouse's exemption under the portability rules. See Blattmachr, Bramwell, and Zeydel, *Portability or No: The Death of the Credit Shelter Trust*, 118 JTAX 232 (May 2013). If the married couple is passing all the assets to the surviving spouse and relying on portability, a gift by the surviving spouse will first utilize the deceased spouse's lifetime exemption and then the surviving spouse's exemption. Treas. Reg 25.2505-2(b).

[54] For example, assume a married couple has $24 million of zero basis real property which is expected to grow by 6% per year, the first spouse passes away in year 5 and the second in year 15. If the couple gifts the real property in year 1, the property will have grown to $54,261,695 in 15 years and $30,261,695 would escape estate tax—a good result. However, the recipient's basis in the property would be zero. If instead the spouses waited to gift until the first spouse passes away in year 5 when the property is worth $30,299,447, they could still shield 79.2% of the property from estate tax with the same $24 million gift and reduce the still reduce the estate by $18,980,345 (79.2% X $54,261,695 - $24,000,000). However, the recipient's income tax basis in the property would be $35,281,350 instead of $54,261,695 with the early gift. As a result, the estate tax savings of gifting early of $4.5 million (($30,261,695-$18,980,345) X 40%) is outweighed by the $7,907,541.81 in additional income tax upon sale (($54,261,695-$30,299,447)) X 33%). This example assumes the spouses gets a full step-up in basis on the gifted assets at the first death but may be affected in a non-community property jurisdiction. See *infra* notes 39-41 and accompanying text.

[55] I.R.C. Section 1014(b)(6).

[56] It is common in a traditional estate plan to create a trust for the benefit of the spouse and/or children at the first death called a Bypass Trust to the extent of the deceased spouse's remaining estate tax exemption. Even if the surviving spouse is serving as Trustee, this Trust can provide income and principal distributions to the surviving spouse for his "health, education, support, and maintenance" without estate tax inclusion. See I.R.C. Section 2041(b)(1)(A).

[57] See *id*.

[58] Even if the $7 million in assets in the Bypass Trust and gifted to the heirs were held until the death of the surviving spouse, those assets would retain the fair market value at the death of the deceased spouse.

[59] A concern in automatically creating a Bypass Trust at the first death arises when the size of the estate is not large enough at the second death to be taxable since the Bypass Trust will not receive a step-up in basis at the surviving spouse's death. For smaller estates, it is then advisable to provide a mechanism to not fund the Bypass Trust such as only funding the Bypass to the extent the surviving spouse disclaims assets within nine months of the first death. See I.R.C. Section 2518.

[60] See I.R.C. Section 2056(b)(7).

[61] See *id*. (providing that the surviving spouse is the only beneficiary of the trust during life to qualify for the marital deduction and therefore there's no ability to transfer funds to other desired beneficiaries).

[62] One way to mitigate some of the fiduciary responsibilities of the Trustee is to specifically provide in the QTIP that the Trustee has the right to sell assets to the surviving spouse for a promissory note.

[63] See *supra* notes 20-35 and accompanying text.

[64] See *supra* notes 36-50 and accompanying text.

[65] Unlike income tax charitable deductions which are limited to a percentage of the donor's annual gross income, no such percentage limitations apply for gift or estate tax purposes. See I.R.C. Section 2522(a); I.R.C. Section 2055(a).

[66] See I.R.C. Section 2522(a); I.R.C. Section 2055(a). Unlike income tax charitable deductions, gifts to organizations for "charitable, religious, literary, or educational purposes" whether based inside or outside the United States will not be subject to gift or estate tax. See *id*.

[67] See I.R.C. Section 501(a). There are exceptions that would require charitable organizations to pay income tax, such as the tax on unrelated business taxable income, those typically do not apply to sales of appreciated property received as a donation. See I.R.C. Section 512 (applies to gross income derived from the organization carrying on a trade or business). There are also excise taxes imposed on the net investment income of certain charitable entities, like private foundations, but those amounts are typically nominal unless the charitable entity is engaged in some prohibited activity. See I.R.C. Section 4941(a); I.R.C. Section 4942(a) (1.39% on all net investment income of private foundations versus 30% excise tax on failure to distribute the required minimum distribution).

[68] Assuming the property worth $1 million has little or no basis and the combined state and federal capital tax rate is 30%, then the cash proceeds of $700,000 would create $280,000 of estate tax and result in $420,000 of the $1 million passing to the taxpayer's heirs. The overall tax would be less if the taxpayer was not using her lifetime exemption elsewhere or lived in a state with little or no capital gains tax but could be higher if the property sold included deprecation recapture income under I.R.C. Section 1245).

[69] See Treas. Reg 1.170A-1(c) (provides full fair market value deduction except to the extent the property if sold would produce short-term capital gain or ordinary income or is tangible personal property).

[70] To the extent the appreciated capital asset is gifted to a public charity described in I.R.C. Section 170(b)(1)(B), the donor can deduct up to 30% of her adjusted gross income for the year. See I.R.C. Section 170(b)(1)(C).

[71] Using the facts in note 68 *supra*, the income tax saved by making a $1 million lifetime charitable gift can be as high as $500,000 (assuming a combined state and federal original income tax rate of 50%). If that $500,000 in income tax savings by the donor were gifted to the heirs, the heirs would receive $300,000 even after gift tax were imposed. As a result, the after-tax cost to the heirs from not receiving the after-tax proceeds drops from $420,000 to $120,000.

[72] Using the facts in notes 68 and 71 *supra*, gifting the $1 million in appreciated property to charity results in $300,000 in less capital gains tax and a charitable deduction worth $500,000 to the donor so the after-tax cost of the gift can be as low as 20%.

[73] See I.R.C. Section 509(a) (an organization operated for religious, scientific, or other charitable purpose that is not otherwise qualified under I.R.C. Section 170(b)(1)(A) and not an operating foundation). A private foundation allows the funds to be managed by the donors and distributed over time and generally requires only 5% to be distributed each year. See Treas. Reg. 53.4942(a)-2(c)(1)-(5).

[74] See I.R.C. Section 4966(d) (noting that a donor advised fund is a separate account held at a sponsoring organization qualified as a public charity under 170(c) wherein the donor is given advisory privileges over the investment and distribution of the assets to public charities).

[75] See Schmolka, *Income Taxation of Charitable Remainder Trusts and Decedents' Estates: Sixty-Six Years of Astigmatism*, 40 Tax L. Rev. 1, 22-23 (Fall 1984) (discussing the anticipatory assignment of income issues to the extent the assets are not transferred to the charitable entity far enough in advance). While no set amount of time, generally a month or more is a good guideline. However, an argument can be made that even if the transfer occurs only one day prior to the sale that the anticipatory assignment of income may not be violated. *Id*. However, one must be careful when such sale is tied to the sale of other stock (such as in a public offering) where the charitable entity might be obligated to sell regardless of how soon the shares are added to the trust.

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[76] The private foundation described in 509(a) and a donor advised fund created at a sponsoring organization are both exempt from income tax. See I.R.C. Section 501(c).

[77] To the extent the qualified charity is instead a private foundation described in I.R.C. Section 170(c)(2), the donor's deduction is limited to the donor's basis in the property and 20% of her adjusted gross income for the year. See I.R.C. Section 170(b)(1)(D)(i). Any exception applies, however, for contributions of "qualified appreciated stock" such as most publicly traded securities, the donor's deduction is not limited to basis and only the 20% adjusted gross income limit applies. See I.R.C. Section 170(e)(5)(A).

[78] See I.R.C. Section 170(b)(1)(D)(i).

[79] See I.R.C. Section 170(b)(1)(A)-(D). For example, if a taxpayer with an adjusted gross income of $1 million gifts $100,000 of appreciated publicly traded stock to a donor advised fund and $200,000 of appreciated publicly traded stock to a private foundation, the taxpayer could fully deduct the $100,000 gift to the donor advised fund under I.R.C. Section 170(b)(1)(B) and the $200,000 gift to the private foundation under I.R.C. Section 170(b)(1)(D) since the total amount of the deduction for the contribution of capital gain property exceeded 30%. See I.R.C. Section 170(b)(1)(D)(i)(II).

[80] See I.R.C. Section 170(b)(1)(D)(ii); Treas. Reg. 1.170A-10.

[81] See Hoyt, *Transfers from Retirement Plans to Charities and Charitable Remainder Trusts: Laws, Issues, and Opportunities*, 13 Va. Tax Rev. 641, 673-676 (Spring 1994) (describing in detail the requirements for a Charitable Remainder Trust).

[82] See *supra* note 75.

[83] Treas. Reg 1.664-1. Gain will be recognized upon receipt as either ordinary income, capital gain, or tax-exempt income depending on the nature of the assets sold in the charitable remainder trust and the nature of any future income generated inside the trust. *Id.* When the charitable trust distributes cash of property to the beneficiary, the beneficiary will recognize ordinary income to the extent the trust had recognized prior ordinary income on the sale of assets and such ordinary income has not previously been distributed to the beneficiary. *Id.* However, to the extent the donor originally contributed a capital asset to the charitable remainder trust and the trust assets are invested in a way to minimize ordinary income, the distributions can then be characterized as capital gain.

[84] For a charitable remainder unitrust, the taxpayer will receive a preset percentage (of no less than 5%) of the fair market value of the assets held in the trust valued each year. I.R.C. Section 664(d)(2). There are other types of charitable remainder trusts, such as a charitable remainder annuity trust with a fixed percentage based on the initial value of the contribution, although generally the charitable remainder unitrust is the preferred option to hedge against future inflation. See Price and Donaldson, Price on Contemporary Estate Planning, section 8.29 (2021).

[85] See I.R.C. Section 664(d)(2)(A).

[86] Depending on the length of the term selected, the size of the retained interest percentage, and the existing applicable federal rates at the time of creation, the tables in Treas. Reg. 1.664-4 will determine the value of the remainder interest and thereby the amount of the charitable deduction.

[87] See I.R.C. Section 664(d)(1)(D) (noting the present value of the charitable interest must be no less than ten percent of the initial fair market value of the contribution).

[88] See Buffett, *Comments by Warren E. Buffett in conjunction with his annual contribution of Berkshire Hathaway shares to five foundations*, Berkshire Hathaway Press Release (June 23, 2021) (noting that wealthy should "Leave the children enough so that they can do anything but not enough that they can do nothing").

[89] Rooney, *How the new estate tax rules could reduce charitable giving by billions*, The Conversation (April 13, 2018) (noting that a rise in the estate tax rate alone increases charitable donations).

[90] One option for replacing the assets passing to charity is to use the some of the cash from a charitable remainder trust distribution or from the tax savings on the charitable gift to purchase life insurance to provide for the taxpayer's family. To the extent life insurance is owned in an irrevocable life insurance trust where the insured retains no incidents of ownership then the proceeds will not be included in the taxpayer's estate at death. See I.R.C. Section 2042(b).

[91] See Stevens, *supra* note 24.

[92] *Id.* at 54.

[93] *Id.*

[94] *Id.* at 55.

[95] *Id.* at 56. Ideally the taxpayer would have previously created the entity and any controlling interests would be held by the taxpayer's children or trusts for their benefit, but such appreciated property could also be contributed to a newly created entity. *Id.* In that case, however, steps should be taken to prevent the partnership assets from being included in the estate of the taxpayer under I.R.C. Section 2036. *Id.*

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] An entity, like any taxpayer, may create a charitable remainder trust. I.R.C. Section 7701(a)(1); see PLR 199952071 (Sept. 24, 1999); PLR 9512002 (Sept. 29, 1994); PLR 9205031 (Nov. 5, 1991). The only limitations on the creation of such a trust by an entity is that the term of the trust must be stated as fixed term since the entity can have no life expectancy and the payments during the term must pass directly to the entity. PLR 9205031 (Nov. 5, 1991). As a result, the charitable remainder trust would make annual payments for up to 20 years to the entity. See Treas. Reg. 1.664-3.

[100] See *supra* note 91 at 57. Since 1997, the present value of the charitable remainder of any qualified charitable remainder trust must be at least 10% of the fair market value of the contribution. See I.R.C. Section 664(D)(2)(d); *see* Blattmachr and Zaritsky, *Estate Planning After the Taxpayer Relief Act of 1997*, 87 JTAX 133 (Sept. 1997). The percentage varies depending on the current applicable federal rate and in most cases cannot be more than 11% and still meet the 10% present interest requirement. See Treas. Reg. 1.664–4(e).

[101] See *supra* note 91 at 57.

[102] *Id.*

[103] *Id.* The appraisal would need to determine the fair market value of a nonvoting interest in an entity holding only a future expectancy from a charitable remainder trust. *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] *Id.* at 57-58.

[108] *Id.* at 58.

[109] *Id.* at 60 (providing detailed modeling establishing how the structure works in practice).

[110] *Id.* at 58.

[111] *Id.* If the entity creates the charitable remainder trust with publicly traded securities, it can name a private foundation as the charitable remainderman and still qualify for a deduction equal to the fair market value of the contribution. See *supra* note 64. To the extent the contributed asset is not publicly traded securities, then the taxpayer can still get a charitable deduction equal to the fair market value of the contributed property as long as the possible charitable remainderman are all public charities. *Id.*

[112] See *supra* note 78 at 58.

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