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Executive Compensation ■ Succession ■ Wealth Transfer Planning

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CRTs—Appreciating the Gifts of Charitable Gifting

Are you considering a transaction that will generate a significant tax liability such as **capital gains**? Do you need income now or in the future? Do you have charitable goals and interests to support? If you answered yes to these questions, you may find the following information useful. By using a financial planning tool called the **charitable remainder trust (CRT)**, you can eliminate capital gains taxes, receive a charitable tax deduction, receive a stream of income for life, and benefit the charity of your choice.

The CRT starts with a contribution of assets (stocks, bonds, mutual funds, restricted securities, exchange traded funds, real estate, art, or other tangible property) into an **irrevocable trust**. The **trustee** agrees to pay you an income each year for either your life or a term of years. If you select a term of years, as opposed to life payments, the maximum term is 20 years. The minimum payout you must receive is 5%, while the maximum is 50%. When the trust's term of years ends, the remaining interest that passes to charity must be at least 10% of the original assets in the trust.

Let's take a closer look at some of the advantages a CRT can provide to see how it might benefit your particular situation. Assume that Mr. and Mrs. Baker decided to fund a CRT with $250,000 of stock they purchased 20 years ago for $25,000. Because the CRT is tax exempt, the trustee can sell the Bakers' stock tax free and reinvest the full $250,000 in income-producing assets. If the Bakers decided to receive monthly payments for 15 years and set the CRT's payout rate at 9% (assuming the payout rate satisfies certain legal limitations), the Bakers would receive an annual income of $22,500. They would also be able to take a charitable deduction on their personal income tax return (based on the amount of time the charity must wait to receive payment, the percentage rate of funds payable to income beneficiaries, and the current rate of return as determined by the applicable Federal rate). The charitable deduction may be limited by the type of property donated, the kind of organization receiving the gift, the nature of the donor, and the trust's income payout rate. If the Bakers' deduction is limited on their current year's tax return, Internal Revenue Service (IRS) rules allow them to ***carry forward*** any excess for five years.

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Tips for Home Buyers and Sellers

The recent real estate market left both prospective buyers and sellers on edge. While sellers once had the advantage and could sit back and wait for buyers to outbid each other, buyers now seem to have the upper hand. However, with lending tight, buyers must meet specific financial criteria to have their loan approved and have the sale go forward.

Sellers may be concerned that they won't be able to sell their homes for what they're worth, and buyers may be worried that their loan applications will be denied because of tighter qualification rules. However, both buyers and sellers can take steps to achieve their goals.

For Buyers

- Get prequalified by an FHA lender. Prequalification demonstrates you are serious about buying and that you are creditworthy. FHA support adds extra value to your offer.
- If you are planning to sell your home and move into a new one, consider listing it immediately. On average, it takes at least three months for a house to sell. Don't wait to list it until you find the right property to buy.
- Once you do find the right property, be flexible about your offer. Avoid making any offer so rigid that it leaves you no choice but to walk away if it isn't accepted. Many owners are emotionally invested in their homes and have already discounted the price based on falling real estate values. Be realistic and keep the seller's perspective in mind.
- Remember, there are many houses on the market. So try to keep your enthusiasm to a minimum when you find the "perfect" home. Recognize that being able to walk away may be the best bargaining chip you hold in a buyer's market.

For Sellers

- Prepare yourself for low-ball offers that may seem more like insulting bluffs than valid offers. These offers will come your way, and the best defense may be to tactfully refuse them and politely encourage the buyer to come back with a more realistic offer.
- Hire a home inspector. Having a home inspection report in hand is a good way to handle negotiations and prevent unpleasant surprises. You can get problems fixed or factor the price of repairs into the price of the home.
- Be prepared to move quickly if you get an offer. A seller who needs two or three months to move out may put the sale at risk.

With the simple strategies outlined here, both buyers and sellers can be in a better position to achieve their goals, whatever the state of the real estate market. ■

CRTs—appreciating the gifts of charitable gifting

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In addition to a sizable income tax deduction and an enhanced income, the Bakers will realize three additional benefits. First, since the $250,000 is no longer in their estate, they have effectively reduced their potential estate tax burden. Second, since there is no tax on the transfer, they have avoided the potential capital gains tax they would have faced had the stock been sold first. Finally, they have provided a significant gift to the charity of their choice.

With higher income tax brackets on the books, charitable income tax deductions are worth correspondingly more to taxpayers who find themselves in high tax brackets. Moreover, since donations of appreciated property are no longer **preference items** for the **alternative minimum tax (AMT)**, donating such property may now be much more advantageous. (Under prior law, the AMT could, in many cases, have significantly trimmed the income tax deduction for donations of appreciated property.)

Additional Opportunity

When the Bakers first took the CRT into consideration, they may have felt some apprehension about transferring property out of their estate for the ultimate benefit of a charity, rather than for their children. What could the Bakers have done to ensure their children would receive something similar (or, perhaps, even greater) in value to the transferred property?

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Credit Card Debt after the Death of a Loved One

After a loved one dies, who is responsible for his or her remaining credit card debt? This is a question you are unlikely to be thinking about in the days and weeks after the death, but it is one you will ultimately need to face.

In many cases, family members are not responsible for the debt, but there are a few exceptions. Luckily, while you and other family members sort out the financial impact of the death, you are protected by the Federal Fair Debt Collection Practices Act (FDCPA), which prevents debt collectors from using abusive or deceptive practices to collect a debt. According to the FDCPA, a debt collector might be a collection agency, a lawyer who regularly collects debts, or a company that buys debts and later attempts to collect payment.

When a spouse or other individual is a joint owner of a credit card account, that person is obligated to pay the debt after the death of the other co-owner. Most often, the co-owner is a spouse, but adult children will sometimes become authorized to use a parent's credit card account, to help the aging parent with financial matters. They then become liable for unpaid credit debt after the death of the parent.

If the widowed spouse lives in a "community property" state, such as California and a handful of other states, he or she may be liable for the credit card debt, even if the account was not co-owned. In such states, debts incurred after the marriage may qualify as community property, which means that, regardless of the credit card agreement, the surviving spouse is responsible for the debt. Also, some states may require that particular kinds of debt, such as debts related to health care, be paid by the spouse. Particularly given the differing state laws, it's a good idea to speak to an attorney to better understand your obligation.

When a relative or other person is not responsible for the uncollected debt, the responsibility falls to the deceased person's estate. The executor of the estate (or an administrator appointed by the court if there is no executor) is responsible for using the estate assets to pay the debt. If the assets do not cover all or any of the debt, the debt is wiped out. This means that the deceased person's heirs will not inherit the debt. ■

CRTs—appreciating the gifts of charitable gifting

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Using the savings from their charitable deduction (and possibly a portion of their monthly income stream), the Bakers could make gifts to an **irrevocable life insurance trust (ILIT),** which, in turn, would purchase a life insurance policy on the lives of ***both*** Mr. and Mrs. Baker. After they die, the proceeds of the life insurance policy would be passed to the trust beneficiaries (their children), free of estate and income taxes. Keep in mind that, if the Bakers never transferred any assets to the CRT and instead left them for their children, the transferred assets would be subject to estate and gift taxation. This underscores the wealth preserving potential that life insurance offers the Bakers and their children.

Philanthropy—It's Up to You

While most people may be resigned to the inevitability of taxation, many may be unaware that they have a choice with respect to estate taxes. Since a certain amount of your money is likely to give back to society one way or another, the choice is in ***what form*** your contribution to society will be. When viewed from the perspective of channeling your funds through the government or directly to the charity of your choice with a CRT, charitable giving takes on new meaning. ■

Customizing Life Insurance with Policy Riders

When most people think of life insurance, the first question that usually comes to mind is, "How much do I need?" However, there are other aspects of life insurance policies that provide important benefits and are worthy of consideration.

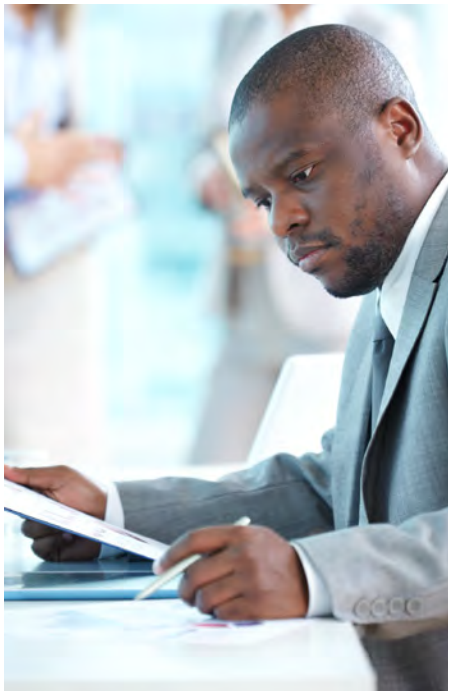
A **rider** is a provision that can be added to an insurance policy, generally at an additional cost, to alter or expand the policy's conditions or terms of coverage. Riders essentially allow policyowners to obtain extra protection in certain situations for themselves and their **beneficiaries**. Examples of life insurance riders include the option to purchase additional insurance without having to provide evidence of insurability; the accelerated death benefit, which allows the insured, under certain circumstances, to receive the policy proceeds before death; and the accidental death benefit, which provides an additional benefit if the insured dies by accident.

Another common rider is the **waiver of premium rider**. This provides protection in the event that the insured becomes totally disabled and can no longer afford to pay the insurance premiums. With this provision added to a policy, the insurance company pays the premiums according to the terms of the contract if the insured sustains a disability.

If the insured owns a **whole life policy**, the policy's **cash value** generally continues to accumulate. This growth in policy values can be a ready source of income to help pay expenses if the insured can no longer work and can be accessed through loans or surrenders. However, access to cash values through borrowing or partial surrenders can reduce the policy's cash value and death benefit, can increase the chance that the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.

Like an applicant's insurability, eligibility for the waiver of premium rider may be determined by certain risk factors, such as general health and medical history. Typically, policies contain a specific waiting period before the waiver of premium rider will take effect. Some policies apply waiver of premium coverage differently for a disability that occurs prior to age 60, compared to one that occurs between the ages of 60 and 65. Under many policies, the waiver of premium provision terminates at age 65. While a waiver of premium rider on term and whole life policies will usually cover the entire premium, in other policies, it may only cover the cost of insurance, not the cost for the cash value or investment options.

When considering a waiver of premium rider, the definition of



"disability" in your policy is crucial. It will determine *when* your obligation to pay premiums ends. While some policies consider disability to mean that the insured is no longer able to work in his or her profession due to an illness or injury, other policies may contain a clause that states the insured must be unable to perform *any* type of work.

Policy riders are often overlooked when purchasing insurance because the initial focus is on how much coverage is necessary to provide adequate protection. However, part of the process involves taking full advantage of the opportunities to customize your life insurance policy to meet your needs. ■

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