Trust & Estates Update: February 2014

By RIW on February 11, 2014

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THE BENEFITS OF CHARITABLE REMAINDER TRUSTS

As many may know by now, income taxes increased in several ways as of 2013. Not only have the tax rates for personal income increased, but so has the capital gains tax rate for those in the highest tax bracket. Additionally, certain deductions are now phased out for the higher brackets and there is a new Medicare surtax of 3.8% on certain unearned income (i.e. investment income). Those of you who are charitably inclined may wish to re-think how you can benefit the non-profit organizations that you support, while reducing income taxes in the most efficient manner.

Charitable Remainder Trusts (CRTs) are a very useful tool for making a charitable gift while retaining an interest in the CRT for life or a term of years, and minimizing income taxes. Typically an individual or a couple transfers appreciated assets (securities, real estate, etc.) that he/she/they anticipate will be sold at a gain, to a CRT in exchange for a lifetime or term of year interest (non-charitable payout), during which a fixed percentage payment of at least 5% but not more than 50% of the value of the trust property is paid out annually to the individual or the couple for their joint lives (the non-charitable beneficiary). The non-charitable payout may be limited, however, by the added requirement that the charity must be projected to receive at least 10% of the value of the trust calculated as of the date the gift is made to the CRT. At the termination of the non-charitable interest (for example upon the individual's death or the death of the surviving joint non-charitable beneficiary), the remaining trust property will pass to the charity or charities the individual or couple has specified in the trust.

Since the CRT is a tax-exempt irrevocable trust, when it sells appreciated assets, the trust itself does not incur income or capital gains tax. Instead, as the annual payments are paid to the non-charitable beneficiary, the non-charitable beneficiary may receive taxable income, but only in the amounts distributed rather than on the entire sale of the property. This capital gains tax deferral is very valuable, particularly as a tool to minimize the new Medicaid Surtax because the surtax has very distinct income thresholds. This deferral may mean the difference between owing and not owing the surtax in the year of the sale. Last, but certainly not least, the contribution to the CRT may result in a charitable income tax deduction on your income tax return for the year of the gift, in an amount equal to the present value of the charitable remainder interest.

If you have appreciated property that you would like to transform into an income stream but for the income tax ramifications, and you would like to leave a charitable legacy to your favorite non-profit, a CRT may be the right vehicle for you. Please contact any member of the Trusts & Estates Group for further information.

NON JUDICIAL SETTLEMENT AGREEMENTS

Prior to the enactment of the Massachusetts Uniform Trust Code (MUTC) in July of 2012, if unforeseen circumstances caused an irrevocable trust to no longer function as the creator of the trust intended, the only option to modify the trust was through a judicial reformation. Such a proceeding is time consuming, public and expensive. The enactment of the MUTC brought with it a simpler option, known as a Non-Judicial Settlement Agreement (“NJSA”). Irrevocable trusts can now be changed with an out-of-court agreement between the trustee and the trust’s beneficiaries, provided that the agreement does not violate a material purpose of the trust and includes terms and conditions that could properly be approved by a court. It may be advisable to seek court approval of an NJSA in certain circumstances.

- Matters which may be resolved by a NJSA include:
  - The interpretation or construction of the trust’s terms;
  - The approval of a trustee’s report or accounting;
  - The direction to a trustee to refrain from performing a particular act or the grant to a trustee of a necessary or desirable power;
  - The resignation of a trustee and the determination of a trustee’s compensation;
  - The transfer of a trust’s principal place of administration; and
  - The liability of a trustee for an action relating to the trust.
- An NJSA may not be used to terminate a trust in a manner not otherwise authorized under applicable law.
- If there are minors and others who cannot participate in the agreement, the virtual representation procedures of the MUTC can be used to achieve the Agreement.
  - Parents can represent the interests of their minor or unborn children; and
  - Conservators and guardians can represent the interests of their ward or protected person.

OTHER TAX ITEMS

As projected last fall, the 2014 federal estate, gift and Generation-Skipping Transfer Tax exclusions, as adjusted for inflation, are listed below:

- The annual gift exclusion amount for 2014 remains unchanged at $14,000 per donee.
- The annual gift exclusion amount for gifts to a non-citizen spouse is increased to $145,000.
- The unified estate and gift tax exclusion amount is increased to $5,340,000 for 2014.
- The GST tax exemption amount is increased to $5,340,000 for 2014.

Taking advantage of the 2014 annual gift exclusion amount listed above ($28,000 total for a married couple) by putting in place an annual gifting program to children and grandchildren, will allow those with estates above the federal unified estate and gift tax exclusion amount to reduce their taxable estates substantially over time. Additionally, unlimited amounts can be paid directly to educational institutions for tuition payments and medical providers without using any of an individual's annual gift tax exclusion. Although the 2014 federal estate tax exemption is substantial, the Massachusetts exemption remains at $1 million per decedent and must be planned for. Annual gifts are an effective way to reduce Massachusetts estate taxes.

MEMBER SPOTLIGHT

Annette Eaton is an associate of the firm in the Trusts & Estates Group. Ms. Eaton concentrates her practice in the areas of estate planning, tax planning, business succession planning, estate and trust administration, special needs planning and elder law.

Ms. Eaton counsels clients on various estate planning matters, including the drafting of wills, revocable trusts, durable powers of attorney and health care proxies. She also advises clients serving as executors and fiduciaries on matters of estate and trust administration. Ms. Eaton assists clients with various wealth transfer strategies through the use of irrevocable insurance trusts, qualified personal residence trusts, grantor retained annuity trusts and charitable trusts. Ms. Eaton has been recognized by New England Super Lawyers Magazine and Boston Magazine as a "Super Lawyer: Rising Star" in the area of Trusts and Estates.

Annette is also on the Professional Advisors Network of the Boston Foundation and volunteers with Habitat for Humanity.

For a full description of our Trusts & Estates Group and a list of all of our practice areas, visit www.riw.com or contact any member of the T&E Group listed below.

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