increasingly real in light of Congressional gridlock.

With continued low applicable federal midterm rates, charitable lead trusts (CLTs) continue to be a popular way to leverage the $5.12 million exemption while it's still in place.[2] Not surprisingly, the IRS recently released a report indicating that CLTs have been the fastest growing type of charitable trust over the past decade, and CLTs are now providing more dollars each year for charitable use than charitable remainder trusts (CRTs) or pooled income funds.[3]

On the income tax front, the Obama administration continues to propose limiting the charitable income tax deduction to the 28 percent tax bracket. If that occurs, along with repeal of the Bush tax cuts, there will be a significant increase in the after-tax cost of charitable gifts in 2013. Individuals in the 35 percent tax bracket (or 39.6 percent bracket if the Bush tax cuts expire), may have to pay taxes of up to 11.6 percent on income used to make charitable gifts.

The rule requiring a reduction in charitable and other itemized deductions by 3 percent of income above a threshold level (the Pease Amendment) is also scheduled to return on Jan. 1. It may, therefore, be prudent for those with outstanding gift commitments to fulfill them, to the extent possible, this year.

A positive sign on the tax planning front is the fact that the charitable deduction would apparently have been the only adjustment to income allowed under the recently defeated Buffett Rule, which would have required individuals with income over $1 million to pay a flat tax rate of 30 percent. This is good news, because taxpayers who would have been subject to a Buffett Rule with no charitable deduction available would have to earn $144,000 to make an after-tax gift of $100,000. To maintain the income required for a gift at $100,000, the gift would have to be reduced to $77,000, with $23,000 held back to pay tax on the $77,000 donated. If a variation on the Buffett Rule eventually becomes law in its current form, it appears that charitable gifts will be excepted from the tax axe and charitable income tax planning would remain a central focus for the highest income Americans.

## Asset Values

Research shows that much of the drop in giving in 2008 and 2009 was due to large reductions in gifts of securities. As of early 2012, the Dow had doubled in value since its low point in April 2009. The return of giving to 2007 levels will, no doubt, be largely driven by a comeback in gifts of appreciated securities. As these gifts may be negatively impacted by a reduction in the value of charitable contributions next year, gifts of securities and other appreciated property currently provide an attractive alternative to cash gifts.

Making gifts of appreciated securities and immediately repurchasing them using cash that might otherwise have been donated can be an excellent way for investors to make gifts while upping their cost basis to current market levels. A future sale then results in less gain, while a decline from current values would generate losses for tax purposes.

We can also expect contributions of appreciated, low yielding securities to increase during 2012. Making gifts of such assets through CRTs can be an excellent way to diversify an overly concentrated investment position on a tax-free basis, while providing immediate income tax savings and a significant future gift.

For these reasons and others, charitable giving for this year shouldn't be paralyzed by uncertainty. Real benefits exist for those who act in 2012 to take advantage of significant windows of opportunity.

## Endnotes

1. *See, e.g.*, Robert F. Sharpe, Jr., "A Year of Speculation," *Trusts & Estates* (January 2012) at p. 28.
2. *Ibid.*
3. "Split Interest Trusts—Filing Year 2010," *Internal Revenue Service Winter 2012 Statistics of Income Bulletin, www.irs.gov/pub/irs-soi/12eowinbulsplitinterest.pdf.*

RETIREMENT BENEFITS

# Post-Mortem Action Can Limit Class Of Beneficiaries

By Bruce D. Steiner, an attorney with Kleinberg, Kaplan, Wolff & Cohen, P.C., in New York

In Private Letter Ruling 201203003 (Oct. 11, 2011), the decedent left his retirement plan benefits to a trust for the benefit of his wife. Upon his wife's death, the balance of the trust was payable to his children, in separate trusts for their benefit. Each child's trust was divided into an exemption trust that was generation-skipping transfer (GST) tax-exempt and a primary trust that wasn't GST tax-exempt.

Each child had the right to withdraw one-half of the primary trust at age 30 and the balance at age 35. They also both had a testamentary general power of appointment (POA). The daughter was over age 35 when the decedent died, but the son wasn't.

Further, each child had a special testamentary POA over the exemption trust, exercisable in favor of the decedent's issue.

In default of exercise, the balance of each trust was payable to the child's issue, or if none, then to the decedent's other issue, or if none, then to a charity

The trustee set up an inherited individual retirement account and transferred the retirement benefits to the inherited IRA, as permitted by Internal Revenue Code Section 402(c)(11).

The goal was to stretch the inherited IRA over the spouse's life expectancy.

From an income tax standpoint, transferring the retirement benefits to the inherited IRA wasn't as favorable as if the decedent had left his retirement benefits to his wife outright. She then could have rolled them over into her own IRA, named new beneficiaries, converted to a Roth IRA and obtained a much longer stretchout. However, in some cases, the desire to control the principal outweighs the income tax benefit of the rollover, especially if the retirement benefits are a large portion of the total assets, and the spouse will need substantial distributions.

## Obstacles to Stretchout

There were two obstacles to the stretchout. First, the son had a general POA over his primary trust, which he could exercise in favor of someone older than the surviving spouse. Second, if the son was the last survivor of his father's issue and died before age 35, with respect to his primary trust, without exercising his POA, the remainder would go to charity. Similarly, if either child was the last survivor of the father's issue, the remainder of his exemption trust would go to charity.

## Solution

The son solved the first problem by partially releasing his POA, so that he could only exercise it in favor of individuals who weren't older than the surviving spouse. This still allowed for a broad class of permissible appointees. The Internal Revenue Service approved a similar class of permissible appointees in PLR 200235038 (June 4, 2002). In this regard, while the regulations require that the beneficiaries be identifiable, the members of a class capable of expansion are treated as identifiable if it's possible to identify the class member with the shortest life expectancy, that is, the oldest one.[1]

What about the charity? If the son survived the decedent's spouse, but died before age 35 without exercising his POA, and if he were the last survivor of his father's issue, the balance of his primary trust would go to charity. If either child were the last survivor of his father's issue, the balance of his exemption trust would go to charity.

However, the Treasury regulations provide that a "mere successor beneficiary" can be disregarded in determining the trust's beneficiaries. The test is based on the facts as of the decedent's death.[2] In this case, if a child survived the decedent's spouse and then died without exercising the POA, the balance of that child's trusts would go to the other child outright. The charity would only take if the other child didn't survive the sibling. That made the charity a mere potential successor beneficiary to the daughter, so it could be disregarded.[3]

This ruling is significant because it illustrates how post-mortem action can limit the class of beneficiaries (the PLR approved a broad class of permissible appointees) and how an outright remainder beneficiary can act as a blocker, allowing successor beneficiaries to be disregarded.[4] TE

## Endnotes

1. Treasury Regulations Section 1.401(a)-9-4, A-1.
2. Michelle L. Ward, "Michelle Ward & PLR 201203003: Trust Qualified as Designated Beneficiary After Beneficiary Released Certain Powers," *LISI Employee Benefits and Retirement Planning Newsletter #594* (Feb. 1, 2012); Natalie Choate, "Natalie Choate on PLR 201203003: How to Analyze & Clean Up a See-Through Trust," *LISI Employee Benefits and Retirement Planning Newsletter #593* (Jan. 31, 2012).
3. Treas. Regs. Section 1.401(a)(9)-5 A-7(c).
4. *See* Bruce D. Steiner, "Bruce Steiner & PLR 201203003: Stretchout of IRA Payable to Trust with Broad Powers of Appointment & Charitable Beneficiary," *LISI Employee Benefits and Retirement Planning Newsletter #596* (Feb. 14, 2012).