

PODCAST
PRESENTATION

WEALTH TRANSFER STRATEGIES

Host: Hello and welcome. Northern Trust is proud to sponsor this podcast, "Wealth Transfer Strategies," the third in a series based on our book titled "*Legacy: Conversations about Wealth Transfer.*" Today's podcast will be of interest to you if you are considering transferring your wealth, either while you are alive or at your death. We will discuss which strategies offer the greatest opportunity to reduce taxes, allowing you to maximize the amount that goes to your beneficiaries.

Joining us today is Hugh Magill. Hugh is the Chief Fiduciary Officer and National Director of Trust Services at The Northern Trust Company in Chicago. Hugh practiced law as an estate planner before joining Northern Trust 20 years ago. He is responsible for Northern Trust's fiduciary and philanthropic services to private clients nationally.

Please understand that this podcast is not intended to be legal advice. As always, you should contact your



legal advisors to review any strategy in light of your own specific situation.

Let's begin.


Hugh, when and how should an individual transfer wealth?

Hugh: This is a great way to begin our discussion. To determine when and how your beneficiaries should receive your assets, you need to focus on three factors:

- **First**, the size and liquidity of your estate versus your need for cash flow during your lifetime;
- **Second**, the age and maturity of the beneficiaries; and
- **Third**, the tax implications.

Outright transfers may seem simple, but they can create complex problems. For example, an outright transfer to a second spouse may leave children from a prior marriage unprotected. In contrast, a trust with appropriate discretionary standards can provide for the well being of a surviving spouse, and ensure that assets are preserved for children.

Host: So how much can I transfer at death without paying estate tax?



Hugh: There are unlimited estate tax deductions for properly structured transfers to either a spouse or to charity. Beginning in 2009 the federal estate tax exemption has increased to \$3.5 million per person. Thus a married couple, with proper planning, may transfer up to \$7 million to their family or other individuals without federal estate tax. Similarly an individual may transfer up to \$3.5 million. It is possible that there may be estate taxes at the state level, depending on the state of residence.

Host: How can the marital deduction reduce estate taxes?

Hugh: Any assets passing to a surviving spouse pass tax-free at the time the first spouse dies, as long as the surviving spouse is a U.S. citizen and the transfer is properly structured.

You can take full advantage of the unlimited marital deduction by making outright gifts or bequests, titling assets in joint tenancy with rights of survivorship or tenancy by the entirety, naming a spouse as the beneficiary of life insurance or retirement plan proceeds, or transferring assets to a trust that qualifies for the marital deduction.

Host: Hugh, since the marital deduction is unlimited, why shouldn't I leave everything to my spouse?

Hugh: That's a good question. If you or your spouse's estate will exceed the available exemption amount, it will be necessary to use the estate tax exemptions of both spouses.

Host: How can I use my available estate tax exemption amount to provide for my spouse and children?

Hugh: Credit shelter trusts (sometimes also called Bypass or "B" trusts or family trusts) are funded with an amount up to the estate tax exemption and are typically used when the husband's or wife's estate will exceed the amount exempt from federal estate tax.

Depending on your objectives, a credit shelter trust can be used to benefit:

- A surviving spouse;
- A surviving spouse and your children;
- Your children alone; or
- Anyone else.


Host: Can a transfer to an irrevocable trust for the benefit of a spouse qualify for the marital exemption?

Hugh: Yes. A properly structured marital trust (also known as an "A" trust) will qualify for the marital deduction and typically is funded with assets that exceed the estate tax exemption amount. One alternative is a qualified terminable interest property, or QTIP trust, that provides income and discretionary principal to your spouse during her lifetime – and then distributes to beneficiaries selected by you. This type of arrangement is a frequent choice where there are children from a first marriage – or where the surviving spouse is not financially sophisticated.

Host: Hugh, what about those individuals who are not married – what tax strategies are available to them?

Hugh: For single individuals, as for married couples, the basic question is: "To whom should I transfer my wealth?" Before you begin to consider tax strategies, first consider your potential beneficiaries, including charities, that you wish to benefit.

Without a marital deduction, it is even more important for single individuals – and unmarried couples – to reduce their taxable estates by making effective use of lifetime gifting strategies. Possibilities range from simple annual exclusion gifts to complex structures such as family limited partnerships. An additional opportunity is offered by the unlimited charitable




deduction under both the gift tax and the estate tax. Techniques like charitable gift annuities and charitable remainder trusts allow you to benefit both charity and one or more individual beneficiaries, while reducing your overall estate tax burden.

Host: Now you've referred to lifetime gifting several times. How can lifetime gifting reduce my taxable estate?

Hugh: Even with maximum use of estate tax exemptions and deductions, you may still have considerable estate tax exposure. An effective and popular way to reduce a taxable estate is to transfer assets *before* you die through lifetime gifting.

Because it shifts assets out of your taxable estate before they appreciate further, lifetime gifting leverages the use of your gift tax exemption.

The annual gift tax exclusion allows individuals to gift as much as \$13,000 per year (in 2009) to as many people as they wish without gift tax consequences and without depleting the gift or estate tax exemption. As an example, suppose you are married, with three children and six grandchildren. You could give them each \$13,000 annually, for a total of \$117,000, without tax implications. Your spouse could also make gifts and



double the amount to \$234,000 a year you can transfer from your taxable estate.

For this annual exclusion to apply, the donor must gift a present interest in the property to the recipient. This usually means giving the recipient access to the funds.

Host: What assets are best to gift?

Hugh: Gifts don't need to be cash; you can gift any asset. But you will save the most in estate taxes by gifting assets that have the greatest potential for future appreciation.

Recently, I've heard quite a bit about the opportunities presented by the current low interest rate environment. Can you explain what this means?


Definitely – we have received a number of inquiries along these lines. The low interest rate environment, combined with depressed asset values, has created a unique wealth transfer opportunity.

At the heart of these strategies is the premise that you can transfer assets today that have a high probability of appreciating at a rate in excess of the IRS's assumed discount rate.

Host: Can you give me some examples of these strategies?

Hugh: Yes. The first strategy is the Grantor Retained Annuity Trust, often called a GRAT. With a GRAT, appreciating assets are placed in an irrevocable trust that requires fixed annual payments to the grantor. At the end of the trust term, the remainder is paid to the designated beneficiary – for example, a child. Because the payments to the remainder beneficiaries are deferred, the value of the taxable gift (which is determined when the assets are transferred to the trust) is discounted for gift tax purposes. Moreover, if the GRAT assets have a higher rate of return than the IRS's assumed discount rate, the actual value of the remainder will exceed the amount subject to gift tax.

Another simple and potentially very effective way to take advantage of the current low rates is through an intrafamily loan. In its simplest form, a parent, grandparent, or other high-net-worth relative makes a loan to a family member. The loan proceeds are then invested in assets that everyone hopes will have a total return in excess of the interest rate on the loan. The net effect of this strategy is that future appreciation in excess of the loan interest rate will go to the loan recipient as a tax-free gift.



These are sophisticated strategies, and potential legislation may limit their effectiveness. If you are interested in these vehicles, I encourage you to speak with your estate planning attorney.


Host: This discussion has been very informative, Hugh. Do you have any final words of advice for our listeners?

Hugh: Yes, I do. In times that are as difficult as these, it's more important than ever to seek the advice of professionals whom you trust. While you may be tempted not to do *anything* until the financial and economic environment improves – or at least stabilizes – the current environment presents some remarkable opportunities for wealth transfer. Make sure that if your circumstances or your objectives have changed, you communicate with your advisors to ensure that your plans can be revised to reflect your current situation.

Host: Thank you for joining us, Hugh.

Hugh: You're very welcome – it's been my pleasure.

Host: For our listeners, we hope that after spending this time together, you've learned a bit about wealth transfer strategies that may be relevant for your particular situation.



For 120 years, Northern Trust has worked with clients and their advisors to help craft wealth transfer plans that not only reflect their financial goals, but also their personal values. And as a professional fiduciary and trusted advisor, we help ensure that as the circumstances of your family, the financial markets or the tax environment change, your plans continue to reflect your objectives.

If you have enjoyed this podcast, please join us for future podcasts where we will discuss specific solutions and strategies that can make your wealth transfer plan truly effective. For a comprehensive listing of our podcasts, please visit northerntrust.com/podcasts. On behalf of Hugh Magill and Northern Trust, thank you for listening.