WISCONSIN

LEGACY

Fall 2003

CONTENTS SUMMARY

Russell N. Howes

A Message to Our Friends and Supporters

I'm pleased to present the latest issue of *Legacy*.

Our newsletters are designed to provide information about financial and estate planning, as well as thoughtful charitable gift arrangements. Each issue features a different topic and includes a reply card that you can return to request further information. In this issue we feature methods of reducing taxes by taking advantage of transfers and reducing the size of your estate during your lifetime.

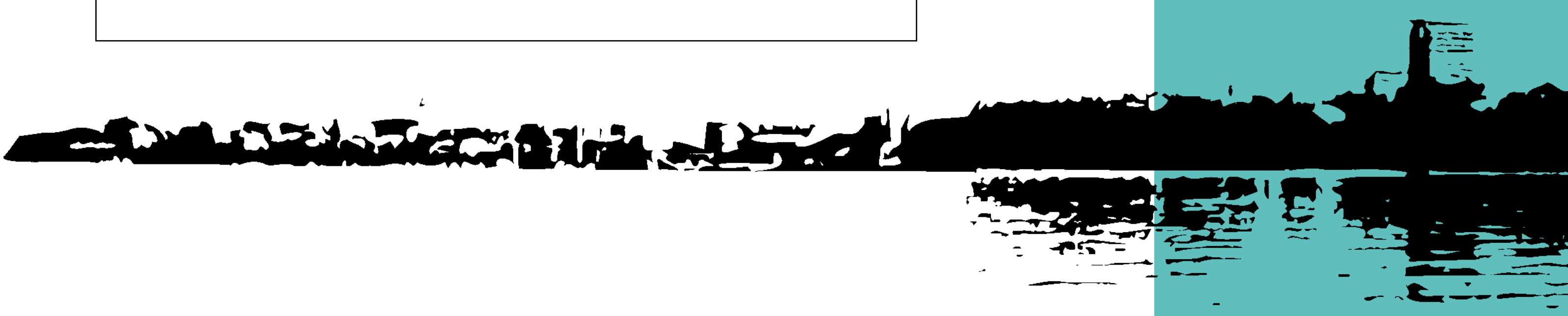
While everyone's specific circumstances are different, we all want to identify the best ways to support our families as well as charitable organizations that are important to us. I would welcome the opportunity to talk with you to design a gift to fulfill your philanthropic wishes and provide meaningful support to the University of Wisconsin Foundation.

I look forward to the opportunity to serve you.

Best regards,

Russell N. Howes
Vice President, Planned Giving and Legal Affairs

UNIVERSITY OF WISCONSIN FOUNDATION
Philanthropy makes the difference



Wealth Preservation and Family Transfers

Without proper planning, transferring family wealth can be a taxing issue. Generally speaking, moving wealth from one generation to another while minimizing income, gift and estate taxes is the primary objective. To do so, one needs to know how the IRS taxes assets passed on to heirs either during life or at death. The traditional planning scenario has been to leave money and other assets to heirs when you die; however, the current planning strategy is to give away as much as possible during life to take advantage of lifetime-transfer benefits and to reduce the size of your estate. The challenge is to use the credits and deductions available and to use gift-transfer techniques to your advantage.

The following tax-wise considerations will be valuable to you for preserving family wealth and transferring it to succeeding generations or charities of your choice. Knowing about these opportunities is essential to sound planning.

Transfer Techniques–

- **Family Limited Partnership (FLP)**

The family limited partnership is an arrangement that can facilitate gift-making to heirs during life and still maintain control over the assets placed in the FLP. It is used to consolidate and preserve family assets such as a family business or real estate. Parents are usually general partners, and limited partnership interests are transferred to children and possibly grandchildren at discounted values. This allows for effective management of

The Transfer-Tax System–

- **Gift and Estate Taxes** Taking full advantage of the $11,000 annual gift-tax exclusion and the gift-tax and estate-tax credits is a prudent way to minimize transfer taxes and increase the amount your beneficiaries receive. Under the 2001 tax act, you can currently transfer up to $1,000,000 cumulatively free of either gift or estate tax. While the gift-tax credit will remain constant, the estate-tax credit will increase periodically, allowing you to transfer free of tax up to $1,500,000 in 2004, $2,000,000 in 2006 and $3,500,000 in 2009. The estate tax is scheduled to be repealed in 2010, but it will return in 2011 at levels determined under pre-2001 laws unless Congress takes action.

> Minimize taxes and maximize assets transferred.

- **Generation-Skipping Trust** If you leave assets to your children who then leave them to their children, those assets–plus any appreciation–can potentially be subject to transfer tax twice. If you leave assets *directly* to your grandchildren, those assets may be hit with a generation-skipping tax in addition to gift or estate tax. You are allowed a generation-skipping tax exemption –currently $1,120,000–and many people use that exemption to create a trust that can benefit children before passing to grandchildren. The child can even serve as trustee with broad investment and distribution discretion. Such a strategy avoids the generation-skipping tax and shelters any appreciation on the assets in the trust from further transfer tax. (*Note:* Generation-skipping exemptions are set to increase on the same schedule and in the same amounts as the estate-tax exemptions noted above.)

assets into the future and avoids gift and estate taxes.

“Lend” assets to charity through a lead trust.

- **Charitable Lead Trust (CLT)**

A charitable lead trust provides income distributions to charity annually; and at the end of the trust period the principal returns to the grantor’s children or grandchildren, generally producing significant transfer-tax savings. You are, in essence, lending assets to a charity important to you for a period of years. Lead trusts can be funded with cash, marketable securities, closely held securities or income-producing real estate and can be created during your lifetime or through your estate at death. Because your beneficiaries will avoid taxes on any future appreciation, this could be a very effective “estate freeze” technique for assets that are anticipated to grow in the future.

- **Grantor-Retained Annuity Trust (GRAT)**

Essentially, a grantor-retained annuity trust is a noncharitable lead trust. The donor retains the right to receive an annuity for a fixed period of years, with the principal passing to heirs after a stated period of time. For tax-planning purposes, you are treated as though you have currently completed a gift of the present value of this future gift. Provided you survive the fixed period, assets can pass to heirs at a significantly reduced transfer-tax cost.

- **Qualified Personal Residence Trust (QPRT)**

A qualified personal residence trust allows you to retain the use and control of a personal residence for a stated term of years and eventually pass the residence to children or grandchildren. Provided you survive the stated term of years, the tax benefits are similar to a GRAT. Your taxable transfer is the discounted present value of this future gift to the family members who receive the residence.

- **A Defective Grantor Trust**

A defective grantor trust allows a donor to make irrevocable and completed gifts to family members through a trust while remaining responsible for the taxes due on both income and capital gain generated by the trust. Most tax advisors believe that under the current law payment of income tax and capital-gain tax is not considered an additional gift.

- **Intrafamily Sale**

Under this arrangement, you sell an appreciating asset or a remainder interest in an asset to one or more family members in exchange for an installment note. Such intrafamily sales represent a way to “freeze” the value of the asset because the note will not grow in value beyond any interest that accrues. Capital-gain tax in such an arrangement can be reduced if a long-term installment note is used. Or you may consider transferring the note to a defective grantor trust.

- **Charitable Remainder Trust (CRT)**

A charitable remainder trust is an effective way to move out of appreciated investments, increase income, avoid immediate capital-gain tax and ultimately make a charitable gift at the same time. Donors can diversify their investments and fund trusts with cash, marketable securities, closely held stock and unencumbered real estate, as well as other assets. The CRT is tax-exempt and can sell the assets without incurring capital-gain tax.

Increase income and make a gift through a CRT.

You may arrange income distribution to yourself, your spouse or others as you wish. Either variable or fixed income is possible. The remainder interest can also be specified for multiple charitable beneficiaries.

- **Private Family Foundation**

A private family foundation (or alternative supporting organization or donor-advised fund) allows a donor to set aside funds for charitable purposes. You can make gifts by lifetime transfers or at death or through a charitable lead or remainder trust. Family members can have an impact on society by being involved in the causes that are important to them.

We're Here to Help–

Wealth-preservation planning allows for the effective use and transfer of assets by, and for, your family, as well as the charities that are meaningful to you. Deciding how much you need for yourself, how much to leave your heirs, how much tax will go to the IRS, and how to benefit charity leads to effective distribution of wealth using a variety of techniques chosen by you.

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