Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Income and Estate Tax Planning Toolkit

Wealth and Estate Planning Strategists
Family Office Resources

OVERVIEW

EXECUTIVE SUMMARY

Family Office Resources is a differentiating resource within Private Wealth Management and serves as "virtual" team members for Private Wealth Advisors in the creation of customized strategies for ultra-high net worth families. The goal of the group is to provide Private Wealth Advisors and clients with holistic solutions that integrate structural, behavioral and investment decisions.

The members of Family Office Resources work closely with clients to thoroughly explore factors relevant to existing or future estate structures and strategies, and educate clients on general tax and estate planning strategies given specific objectives, philosophies, concerns, income needs as well as other considerations.

The goal of the *Income and Estate Tax Planning Toolkit* is to help clients develop a general understanding of tax and estate planning techniques. This presentation dedicates one chapter to each technique. Each chapter comprises three complementary sections: ***summary of considerations***, ***graphic illustrations***, and ***custom examples***.

This presentation was designed to illustrate the financial impact of a particular planning decision. The slides herein do not constitute a recommendation. Caution: many estate techniques share the common risk of the loss of control of the assets once the gift of the assets is complete.

Important: The projections regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results.

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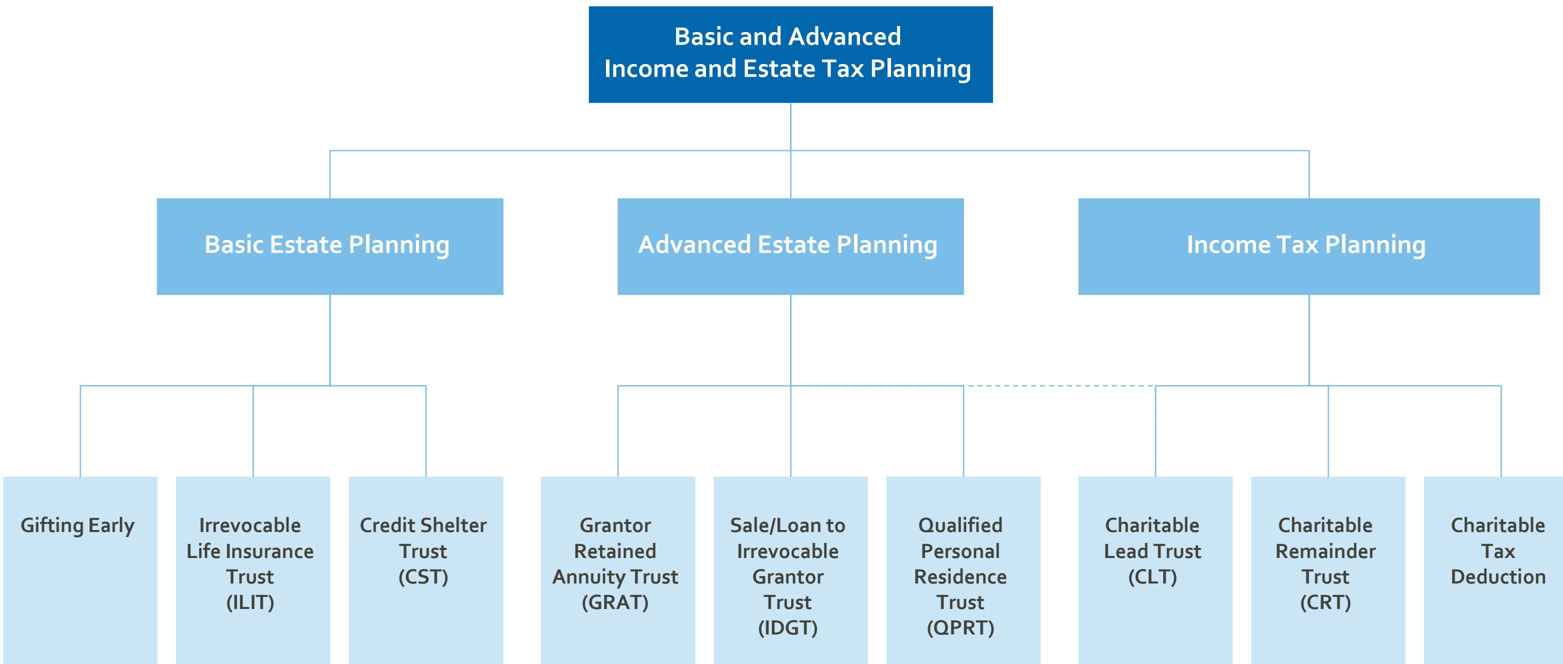
BASIC AND ADVANCED INCOME AND ESTATE TAX PLANNING



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TECHNIQUES BY WEALTH LEVEL

	INCOME TAX PLANNING	INCOME TAX AND ESTATE PLANNING		ESTATE PLANNING
	INCOME TAX PLANNING	**SPLIT INTEREST GIFTS**	**PHILANTHROPY**	**WEALTH TRANSFER**
All Wealth Levels	• Long-Term Capital Gains • Qualified Dividends • Options • Charitable Tax Deduction • Tax-advantaged Investment Vehicles		• Donor Advised Fund (DAF) • Public Charity	• Wills / Revocable Trusts • Health Care Documents • Financial Powers of Attorney • Annual Exclusion

$11MM+		• Charitable Remainder Trusts (CRT)
		• Charitable Lead Trusts (CLT)
				• Qualified Medical and Tuition Exclusions
				• Testamentary Credit Shelter Trust (CST)
				• Irrevocable Life Insurance Trusts (ILIT)
				• Leveraged Gifting
				  • Grantor Retained Annuity Trusts (GRAT)
				  • Sale to Irrevocable Grantor Trusts (IDGT)
				  • Qualified Personal Residence Trusts (QPRT)

$25MM+			• Private Foundation	• Lifetime Exemption • Irrevocable Trusts • Dynasty Trusts

Individuals and estates may want to consider life insurance and lending for liquidity for estate tax purposes and spending to maintain lifestyle.

OVERVIEW OF CURRENT LAWS

	2019	2020
GIFT (LIFETIME) AND ESTATE TAX EXEMPTION	• $11.4MM	• $11.58MM
GENERATION SKIPPING TRANSFER TAX EXEMPTION	• $11.4MM	• $11.58MM
TOP GIFT, ESTATE, GST AND INCOME TAX RATES	• Transfer Tax 40% • Income Tax 37% • Additional Medicare Tax 0.9%	• Transfer Tax 40% • Income Tax 37% • Additional Medicare Tax 0.9%
TOP LONG TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS RATE	• 20% • Net Investment Income Tax 3.8%	• 20% • Net Investment Income Tax 3.8%
QUALIFIED CHARITABLE CONTRIBUTION (FROM IRA FOR THOSE OVER 70.5)	• Yes	• Yes
GRATs/FLP DISCOUNTING	• Unchanged	• Unchanged

"Portability" allows the unused estate tax credit of a deceased spouse to be portable; i.e., to be used by the surviving spouse during life or at death, rather than being lost or wasted. That said, portability may not be the optimal use of the estate tax exemption. Further, portability is not available for the generation-skipping transfer tax exemption. Please refer to slide 11 for more detail on this subject.

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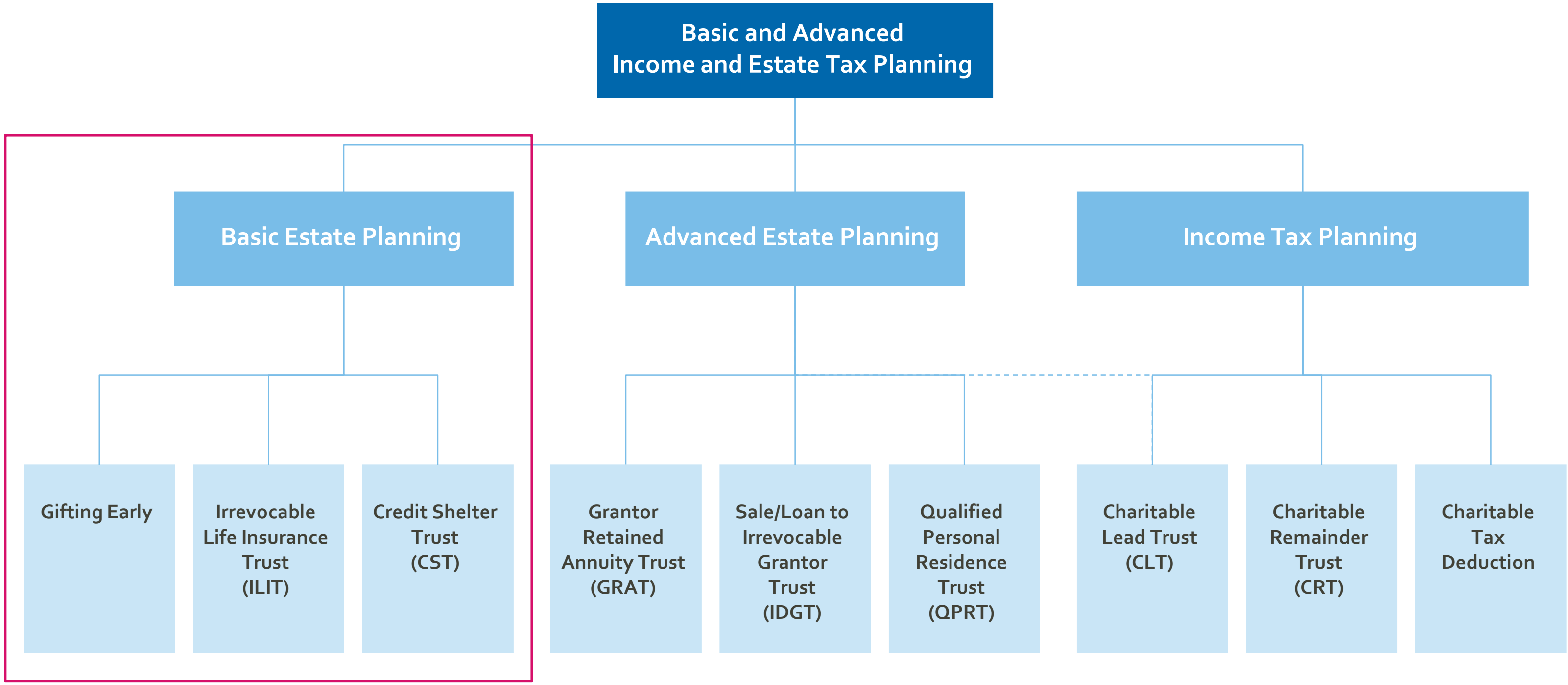
BASIC ESTATE PLANNING



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Chapter 1

GIFTING EARLY

Basic Estate Planning

GIFTING EARLY

Gift and Estate Tax

- Generally, gratuitous transfers a donor makes (except to charity or a U.S. citizen spouse) during his/her lifetime and/or at death are subject to the unified gift and estate tax. A donor may make $15,000 "annual exclusion" gifts to any number of recipients each year that are not subject to the tax. Additionally, qualifying medical and tuition payments made directly to a provider/institution (i.e., not to an intermediary with the understanding that he/she will pay the expenses) are also exempt from transfer taxes.
- In 2020, the combined federal gift and estate tax exemption is $11.58MM per person and will be indexed for inflation in subsequent years. Note that in 2026 the exemption will revert to $5MM , indexed for inflation after 2010. The value of gifts made in excess of a donor's available exemption amount is subject to gift and estate tax at a maximum rate of 40%. Some states also impose a separate state-level gift and/or estate/inheritance tax.
- The cost basis of assets that are included in a decedent's gross estate will generally be adjusted to fair market value as of the date of his/her death. This is often referred to as a "step up" in basis. Assets can also receive a "step down" in basis.

Gifting Early

- A taxpayer whose assets have an aggregate value that exceeds the federal gift and estate tax exemption might consider using a portion of his/her available exemption to make lifetime gifts. Doing so removes the value of the gifted assets AND any future appreciation on those assets from his/her taxable estate. This may decrease or even eliminate his/her gift and estate tax exposure.
- A taxpayer may enhance the potential benefit of gifting early by making gifts to an irrevocable grantor trust. If a trust is structured as a grantor trust, the grantor of the trust is treated as the owner of the trust assets for income tax purposes. He/she will report any income generated in the trust on his/her own individual tax return. This is effectively an additional indirect gift to the trust not subject to gift tax.
- If the gift is a non-managing membership interest of a Family Limited Partnership (FLP) or Limited Liability Company (LLC), a qualified appraisal of the assets may reflect discounts for lack of marketability and/or control. Making discounted gifts may provide an opportunity to transfer greater actual value out of the taxable estate than the gift tax value.

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HYPOTHETICAL ILLUSTRATION

GIFTING EARLY

Donor

Donor makes gifts to the beneficiary.

Beneficiary

Potential future appreciation of the gift is removed from the estate.

Valuation Discount

Gifting with valuation discounts (i.e. liquidity discount, lack of marketability, lack of control discount) may further enhance the wealth transfer.

Irrevocable Grantor Trust

If the gifts are made to an irrevocable grantor trust, of which the donor is the grantor, the donor pays taxes incurred in the trust, thus making an indirect gift that is not subject to gift tax.

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HYPOTHETICAL ILLUSTRATION

GIFTING EARLY USING LIFETIME EXEMPTION

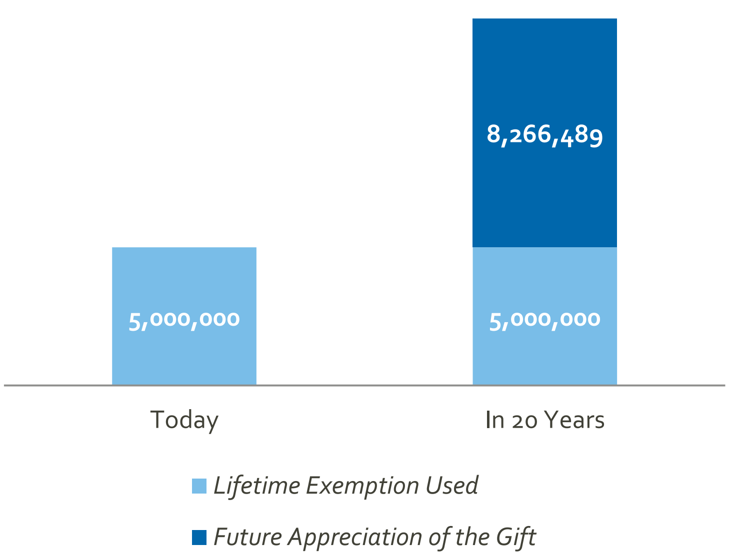
GIFTING TO AN IRREVOCABLE GRANTOR TRUST

- The following illustrates a hypothetical scenario where a donor makes a gift to an irrevocable grantor trust for the benefit of his/her children using a portion of his/her lifetime exemption .
- The value of the gift and any future appreciation is removed from the donor's estate.

Assumptions	
Value of Gift to Irrevocable Grantor Trust	5,000,000
Annual Investment Gross Return	5%
Time Horizon (Year)	20

In 20 Years	
Assets held in Irrevocable Grantor Trust	13,266,489
Lifetime Exemption Used	5,000,000
Appreciation Transferred Free of Estate and Gift Taxes	8,266,489
Gift or Estate Tax %	40%
Transfer Tax Savings from Early Gifting	3,306,595

Assets Outside the Estate



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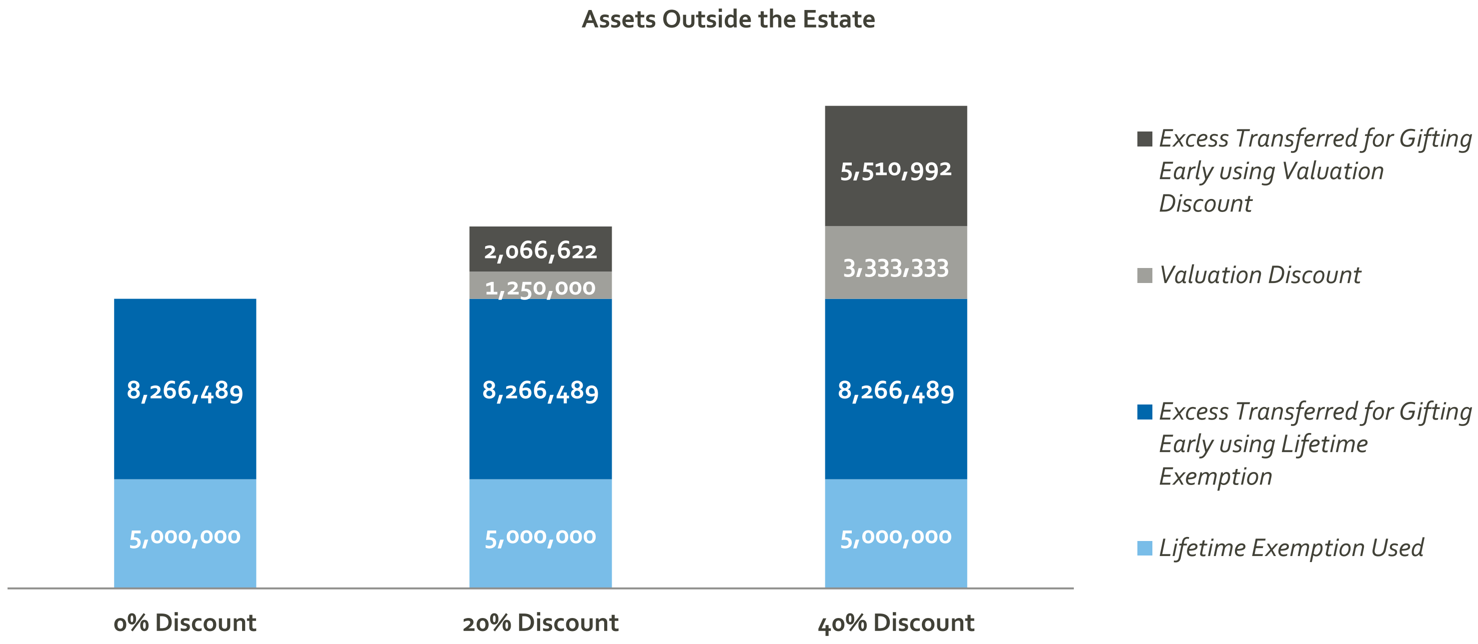
HYPOTHETICAL ILLUSTRATION

GIFTING EARLY USING VALUATION DISCOUNT

GIFTING TO AN IRREVOCABLE GRANTOR TRUST

- The following is a continuation of the hypothetical scenario illustrated on the previous page. Here, the gifted assets qualify for valuation discounts.
- The application of valuation discounts may enhance wealth transfer.



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Chapter 2

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

Basic Estate Planning

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

Life insurance can replace lost future earnings or provide liquidity to pay estate taxes or other expenses. However, the proceeds of a life insurance policy owned or controlled by the insured will be included in his or her gross estate for estate tax purposes. This can be avoided if an irrevocable trust (rather than the insured himself or herself) owns the insurance policy/policies.

- **Creating an Irrevocable Life Insurance Trust (ILIT):** Generally, an ILIT is established by the insured/grantor in order to purchase a life insurance policy/policies on the his/her life. The ILIT should be named as both the owner and beneficiary of the policy/policies. Generally, proceeds are paid to the ILIT at the death of the grantor/insured free of income and estate tax (assuming the grantor lives more than 3 years after the transfer of the policy to the trust or the trust purchased the policy initially). Note, however, that if the insured transfers an *existing* insurance policy to the ILIT , the proceeds will still be subject to estate tax in his/her estate unless he or she survives the transfer by three years (the "three-year contemplation of death rule").
- **Paying Premiums:** The insured typically makes annual gifts to the trust to fund the policy premiums. Gifts made to a trust will generally qualify for the annual gift tax exclusion ($15,000 per recipient in 2019) if the trust beneficiaries are given notice that a contribution has been made and have a right to withdraw the contribution for a period of time("Crummey powers"). The value of the gifts made in excess of the annual gift tax exclusion amount per beneficiary, will erode a corresponding amount of the grantor's lifetime exemption ($11.58MM in 2020). If the value of the gifts exceeds both the annual gift tax exclusion amount per beneficiary *and* the donor's available lifetime exemption, a gift tax will be triggered on the excess.
- **Payment of Death Benefit:** Life insurance proceeds paid to an ILIT upon the death of the insured are generally received income tax free and estate tax free (assuming the grantor lives more than 3 years after the transfer of the policy to the trust or the trust purchased the policy initially). Once received by the trustee, the proceeds are administered according to the terms of the trust agreement. Depending on the trust terms, the ILIT assets may be exempt from the claims of a beneficiary's creditors.
- **Selecting a trustee:** The insured cannot serve as trustee of an ILIT. A trust beneficiary (e.g., the insured's spouse or children) may serve as a trustee if the distributions from the trust are limited to an ascertainable standard (e.g., to permit distributions of income and/or principal for a beneficiary's health, education, maintenance, and support). Alternatively, an independent individual or corporate trustee can serve as trustee.

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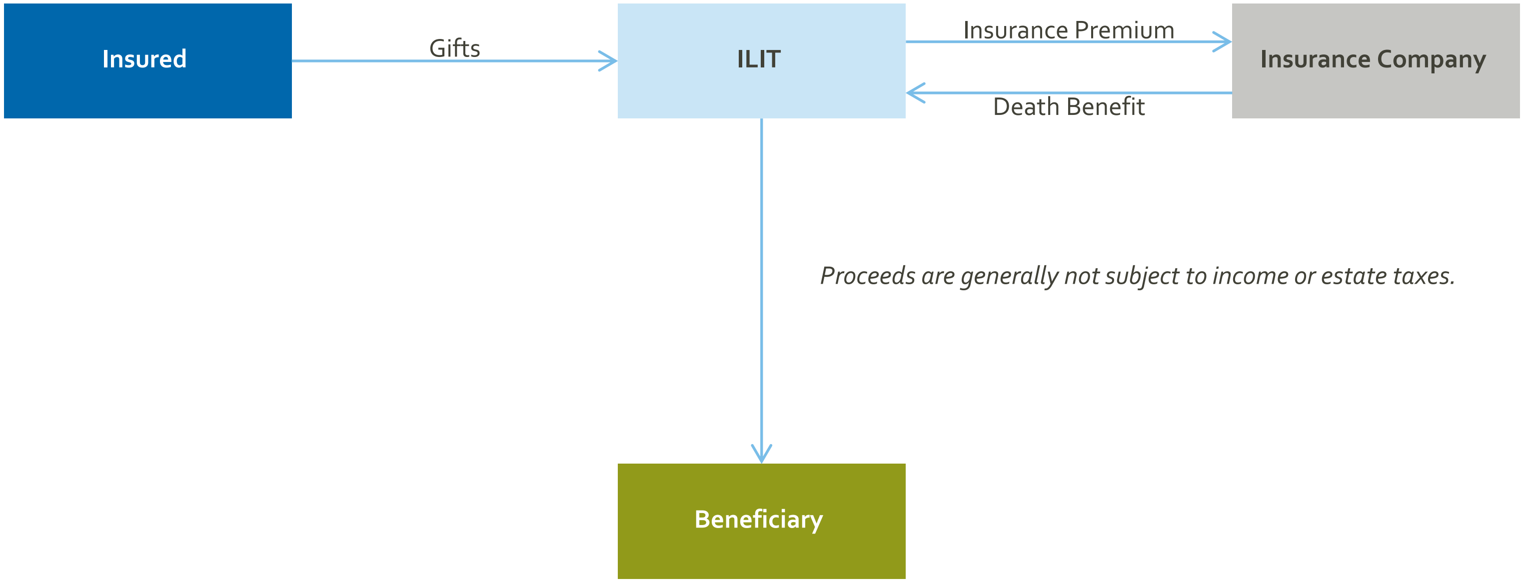
HYPOTHETICAL ILLUSTRATION

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)



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HYPOTHETICAL ILLUSTRATION

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

RATE OF RETURN ON FIXED DEATH BENEFIT WITH SURVIVORSHIP COVERAGE

- The following hypothetical illustrates the rate of return on a $10,000,000 death benefit. This hypothetical sample pricing is for a policy insuring the lives of a healthy male and a healthy female, both age 60, with survivorship coverage. The death benefit under survivorship coverage is not paid until the death of the second spouse.
- The earlier death occurs, the higher the internal rate of return (IRR) will be to the beneficiary. Life insurance proceeds are generally exempt from income taxes (and potentially estate taxes if structured properly).
- The last row in the table below reflects the normal life expectancy of the second spouse to die.

Year	Age	Annual Premium	Cumulative Premiums Paid	Death Benefit	IRR on the Death Benefit
5	65	100,000	500,000	10,000,000	124.0%
10	70	100,000	1,000,000	10,000,000	40.4%
15	75	100,000	1,500,000	10,000,000	21.6%
20	80	100,000	2,000,000	10,000,000	13.7%
25	85	100,000	2,500,000	10,000,000	9.5%
30	90	100,000	3,000,000	10,000,000	6.9%
32	92	100,000	3,200,000	10,000,000	6.2%

The above hypothetical table is for illustrative purposes only.

The above table serves as a high-level analysis, assuming an annual premium of $100,000 and a death benefit of $10,000,000.
In this hypothetical example, should the death occur in **Year 30** (when the insureds are age 90), the corresponding internal rate of return on the death benefit is **6.9%**.
As the example illustrates, the later death occurs, the lower the internal rate of return on the death benefit.

The type of insurance product selected effects the outcome. Not all policies are guaranteed. Clients and their financial advisors should pay particularly close attention to guarantees when electing this type of estate planning technique.

Chapter 3

CREDIT SHELTER TRUST (CST)

Basic Estate Planning

CREDIT SHELTER TRUST (CST)

U.S. citizen spouses may transfer assets to each other free of estate and gift taxes (the "unlimited marital deduction"). With careful planning, a married couple may defer all estate taxes until the death of the second spouse to die.

- Any portion of the federal exemption amount ($11.58MM in 2020) that is not used by the deceased spouse during his/her lifetime and/or at death may be "portable" to the surviving spouse.
  - EXAMPLE: Assume the deceased spouse made gifts during his/her lifetime and/or at death having an aggregate value of $3.58MM and the portability election is made on his/her estate tax return. His/her surviving spouse will be able to shelter $19.58MM from estate and gift tax (i.e., his/her own $ 11.58MM exemption amount *plus* his/her deceased spouse's unused $8.0MM exemption amount).
- Estate plans often provide that an amount of spouse's assets having a value equal to his/her remaining estate tax exemption will be set aside in a "Credit Shelter Trust" (sometimes also referred to as a "Family Trust"), which can be held for one or more beneficiaries (including the surviving spouse). These assets will not be subject to estate tax at the first death. Moreover, whatever remains in the Credit Shelter Trust at the surviving spouse's death—including any appreciation that may have occurred after the deceased spouse's death—can pass free from estate tax.
- Under certain circumstances, it may be more beneficial for a taxpayer to use all of his/her estate and gift tax exemption during his/her lifetime and at death instead of relying on portability.
  - The deceased spouse's unused exemption is fixed at the time of his/her death (i.e., it is not adjusted for inflation after his/her death).
  - If the deceased spouse directed assets to a Credit Shelter Trust upon his/her death, these assets, and any appreciation that occurs over the remaining lifetime of the survivor, will pass estate tax free.
  - Assets held in a Credit Shelter Trust may also be sheltered from the Generation-Skipping Transfer (GST) Tax, allowing the assets to pass from generation to generation free from transfer taxes. NOTE: GST exemption is not portable between spouses.
  - Clients should discuss with their attorneys whether they may be subject to state-level or federal-level estate tax and whether that exemption is portable between spouses. Clients should also discuss with their attorney whether they can allow assets to pass from generation to generation free from transfer taxes. NOTE: GST exemption is not portable between spouses.

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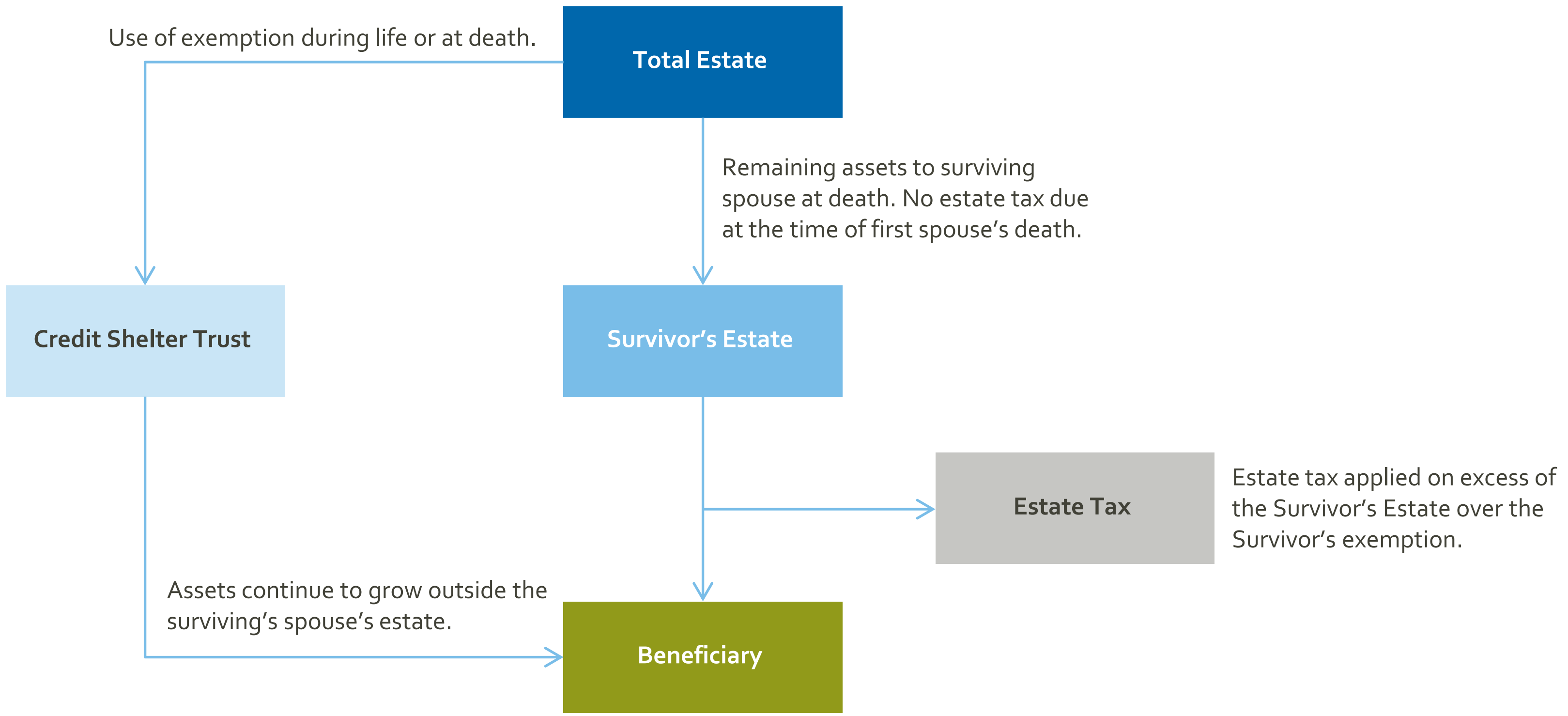
HYPOTHETICAL ILLUSTRATION

CREDIT SHELTER TRUST (CST)



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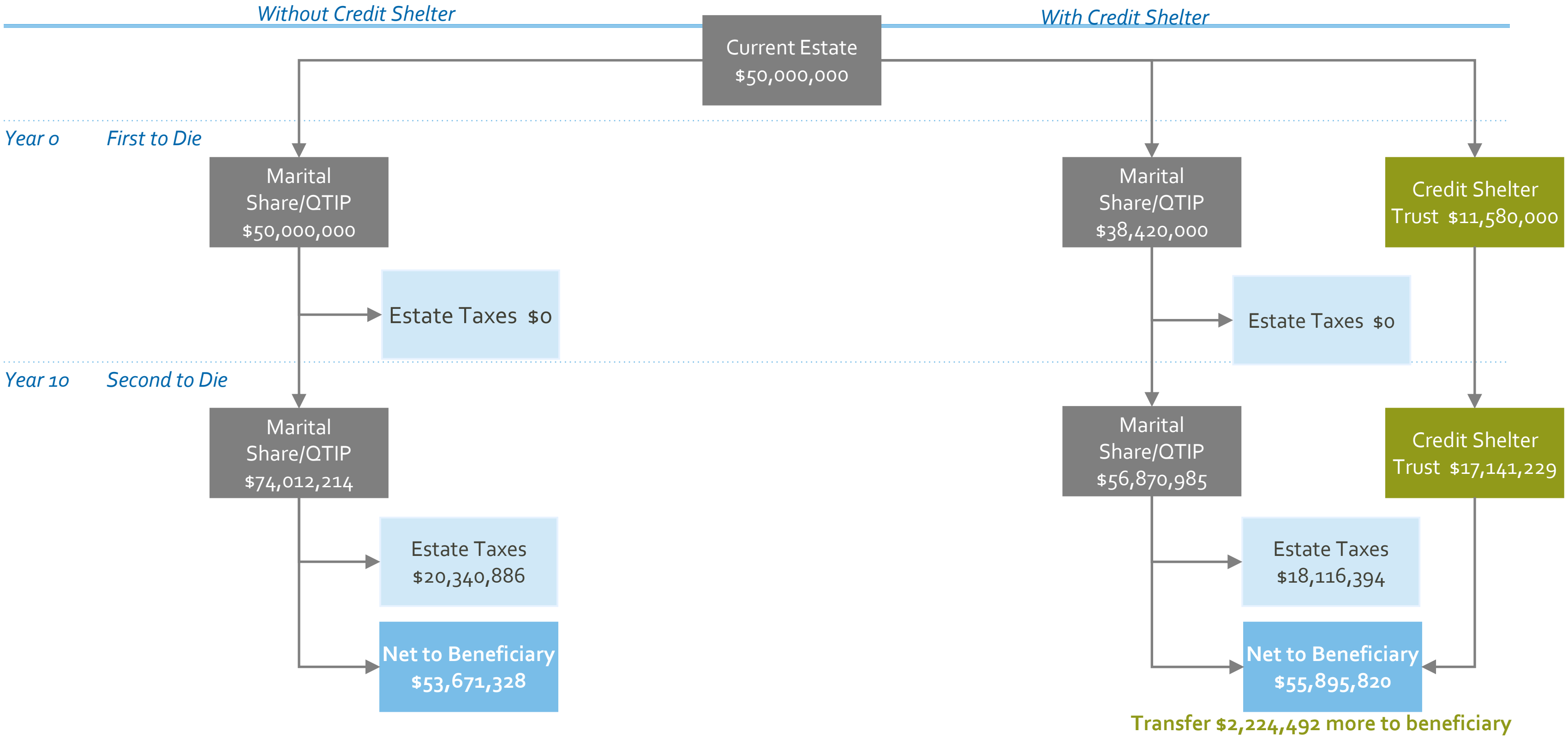
HYPOTHETICAL ILLUSTRATION

CREDIT SHELTER TRUST (CST)

Assumptions	
Lifetime Exemption of the First Spouse	11,580,000
Lifetime Exemption of the Second Spouse	0
Credit Shelter Amount	11,580,000
Estate Tax %	40%
Annual Investment Net Return	4%

In the following example, a Credit Shelter Trust is funded with $11.58MM upon at the death of the first spouse. The Credit Shelter Trust is not subject to estate tax at the death of either spouse.



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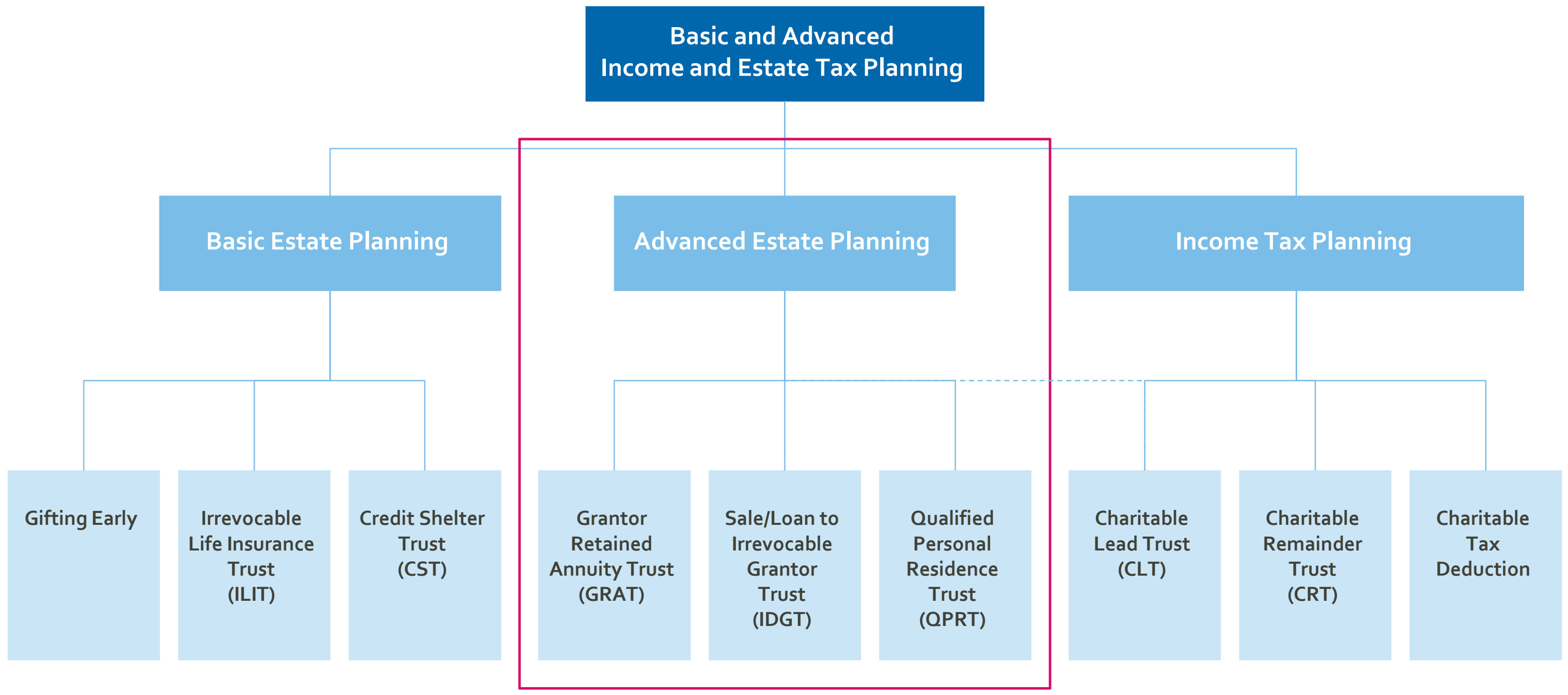
ADVANCED ESTATE PLANNING



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Chapter 4

GRANTOR RETAINED ANNUITY TRUST (GRAT)

Advanced Estate Planning

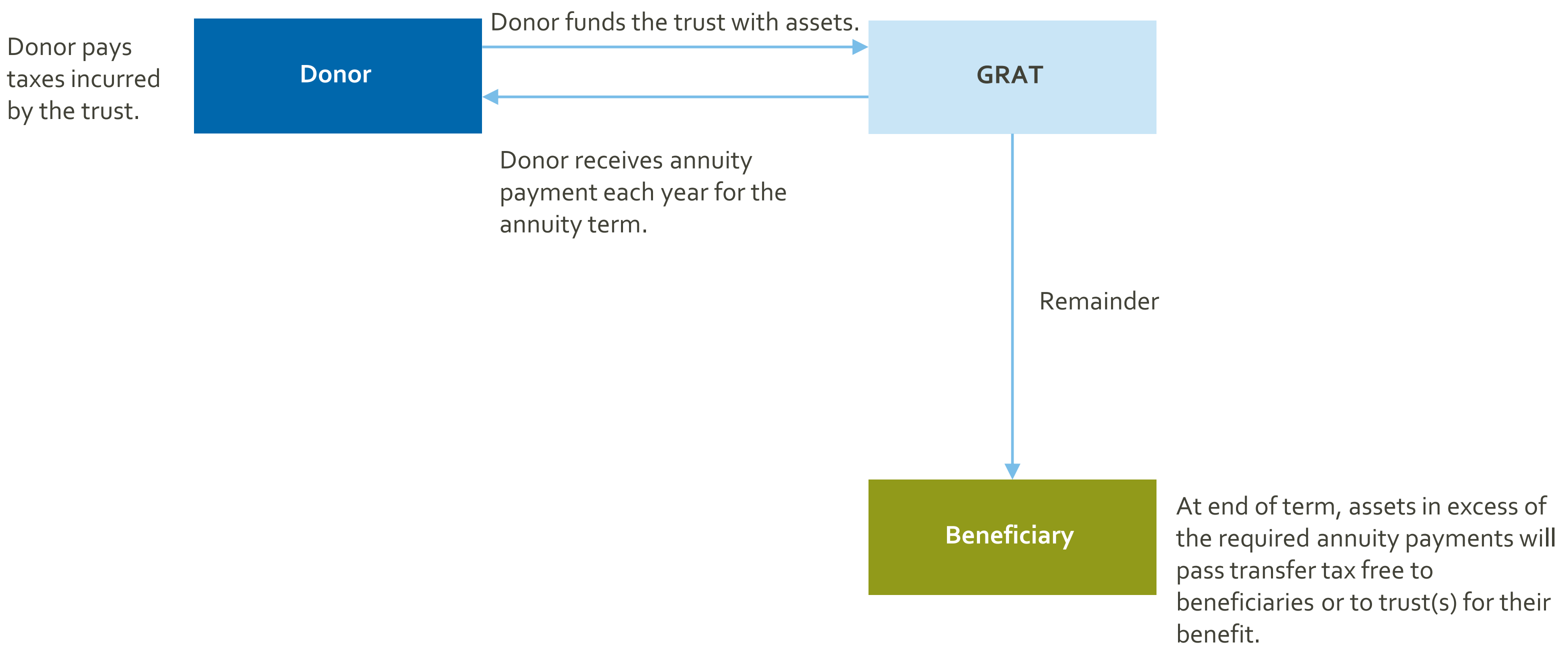
GRANTOR RETAINED ANNUITY TRUST (GRAT)

A Grantor Retained Annuity Trust ("GRAT") may permit a grantor to transfer the future appreciation of assets (if any) above the IRS 7520 rate to the named beneficiaries free of gift and estate tax.

- The donor irrevocably transfers assets to a trust and retains the right to receive a fixed dollar amount from the trust each year for the annuity term. If the value of the assets transferred is greater than the present value of the annuity he or she retains, the difference is considered an upfront taxable gift to the remainder beneficiary/beneficiaries.
- The aggregate value of the annuity payments is generally calculated to result in a nominal gift—the GRAT is "zeroed out" so there is virtually no gift tax cost to funding the GRAT.
  - The annuity is valued using the IRS 7520 rate.
  - A GRAT may be structured so that annuity payments increase annually to allow for greater compounding in the trust.
- The annuity term must be carefully considered because the trust assets generally will be included in the donor's estate if the donor dies during the trust term.
- Where the GRAT's total return (income and appreciation) exceeds the value of the assets contributed plus the IRS 7520 rate used in valuing the annuity (and the donor outlives the trust term), the excess will pass transfer tax free at the termination of the trust.
- A GRAT is typically structured such that the donor is treated as the owner of the trust assets for income tax purposes (making it a "grantor trust"), thus further enhancing the wealth transfer to the beneficiaries.

HYPOTHETICAL ILLUSTRATION

GRANTOR RETAINED ANNUITY TRUST (GRAT)



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HYPOTHETICAL ILLUSTRATION

GRANTOR RETAINED ANNUITY TRUST (GRAT)

"ZEROED-OUT" FLAT ANNUITY GRAT

- The following is an illustration of a "zeroed-out" flat annuity GRAT funded with $1,000,000 marketable securities.
- In this hypothetical scenario, the donor receives an annuity worth $357,616 per year for 3 years and the remainder beneficiaries receive (outright or in trust) assets worth $30,240.

Assumptions:

Term of Trust	3
Principal	$1,000,000
7520 Rate	3.6%
Annual Investment Return	5.0%

Key Outputs:

Annuity to Donor (%)	35.8%
Annuity to Donor ($)	$357,616
Remainder	$30,240

Hypothetical example is for illustrative purposes only.
Not representative of any specific investment.

Year	Beginning Principal	Growth	Annuity Payment	Remainder
1	$1,000,000	$50,000	$357,616	$692,384
2	$692,384	$34,619	$357,616	$369,387
3	$369,387	$18,469	$357,616	$30,240

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HYPOTHETICAL ILLUSTRATION

GRANTOR RETAINED ANNUITY TRUST (GRAT)

"ZEROED-OUT" GROWING ANNUITY GRAT

- The following example is the same as the "zeroed-out" flat annuity GRAT except the annuity grows 20% per year. There is still no taxable gift on funding the trust (i.e., the value of the annuity stream is still roughly equal to the principal contributed to the trust).
- However, the value of assets passing to the beneficiaries at the end of the term may increase reflecting the potential benefit of having assets stay in the trust longer and generate compounded returns for the beneficiaries. In this hypothetical scenario, the remainder beneficiaries receive assets worth $32,073, or $1,833 more compared to the flat annuity scenario.

Assumptions:

Term of Trust	3
Principal	$1,000,000
7520 Rate	3.6%
Annual Investment Return	5.0%
Annuity Growth	20.0%

Key Outputs:

Remainder (Growing Annuity)	$32,073
Remainder (Flat Annuity)	$30,240
Difference	$1,833

Hypothetical example is for illustrative purposes only.
Not representative of any specific investment.

Year	Beginning Principal	Growth	Annuity Payment	Remainder
1	$1,000,000	$50,000	$296,003	$753,997
2	$753,997	$37,700	$355,204	$436,493
3	$436,493	$21,825	$426,245	$32,073

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HYPOTHETICAL ILLUSTRATION

GRANTOR RETAINED ANNUITY TRUST (GRAT)

ROLLING GRATS

- Relative to a standard GRAT, so-called "Rolling GRATs" may provide greater opportunity for compounding returns while reducing mortality risk through the creation of a series of sequential short-term GRATs with each subsequent GRAT being funded with an annuity payment from an earlier-created GRAT. The potential compounding benefit results from Rolling GRATs keeping all principal (and interest, in some cases) "at work" over a longer period of time.
- The following is an illustration of two sequential two-year rolling GRATs. In this hypothetical scenario, the remainder beneficiaries receive assets worth $34,420, or $4,180 more than they would with one three-year GRAT.

Assumptions:

Rolling Period	3
Principal	$1,000,000
7520 Rate	3.6%
Annual Investment Return	5.0%

Key Outputs:

"Remainder Trust" Ending Principal	$34,420
3-Year Flat GRAT Remainder	$30,240
Difference	$4,180

Hypothetical example is for illustrative purposes only. Not representative of any specific investment.

Rolling GRATs

Year	Principal	Growth	Annuity	Remainder
1	$1,000,000	$50,000	$527,159	$522,841
2	$522,841	$26,142	$527,159	$21,824

Year	Principal	Growth	Annuity	Remainder
2	$527,159	$26,358	$277,897	$275,620
3	$275,620	$13,781	$277,897	$11,505

Remainder Trust

Year	Beginning Principal	Growth	Remainder Added	Ending Principal
1	$0	$0	$0	$0
2	$0	$0	$21,824	$21,824
3	$21,824	$1,091	$11,505	$34,420

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Chapter 5

SALE/LOAN TO IRREVOCABLE GRANTOR TRUST

Advanced Estate Planning

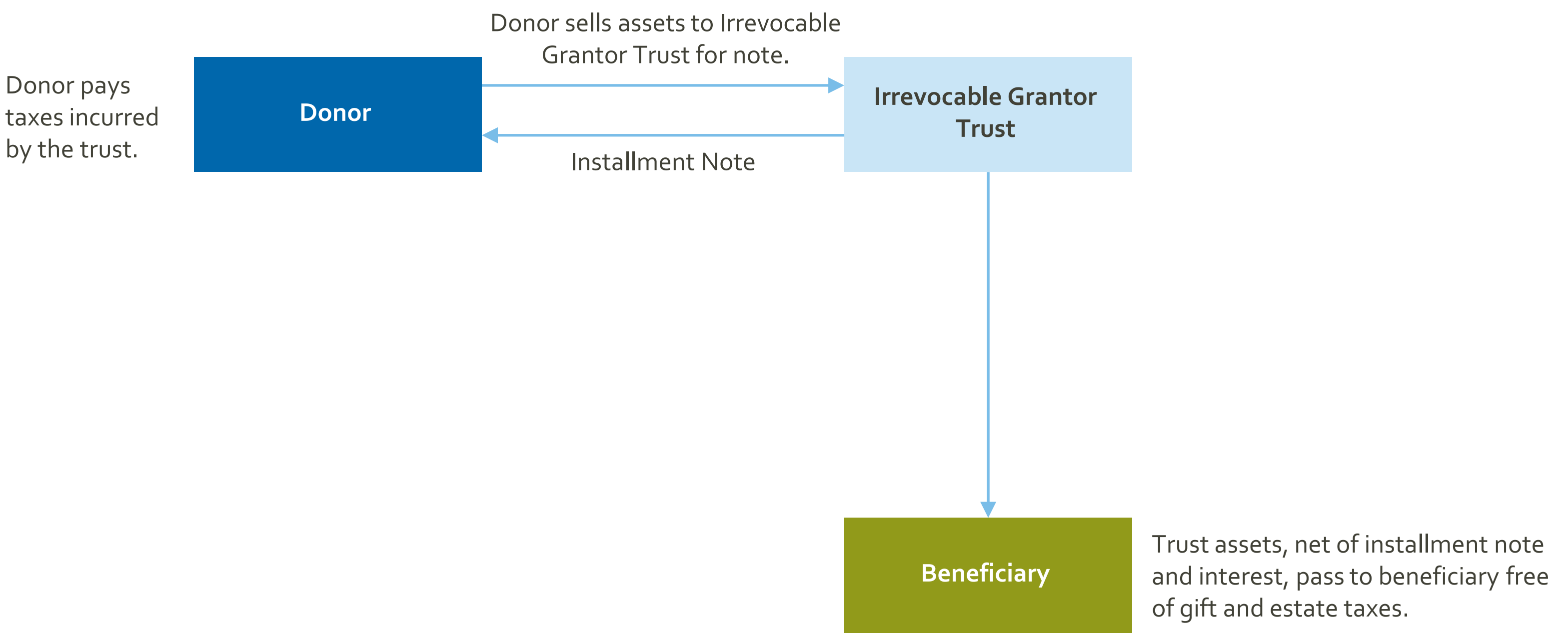
SALE/LOAN TO INTENTIONALLY DEFECTIVE IRREVOCABLE GRANTOR TRUST

A donor can establish a trust that he or she is considered to own for income tax purposes and sell assets to the trust in exchange for an interest bearing promissory note.

- A donor can establish a trust and the donor (or his or her spouse) can retain certain powers with respect to the trust which cause the donor to be treated as the owner of the trust assets for income tax purposes (making it a "grantor trust"), but not for gift and estate tax purposes.
  - By paying taxes on trust income, the donor effectively makes additional gift tax free transfers to the trust.
- The donor can sell assets to the trust in exchange for an interest bearing promissory note.
  - The interest rate will be based on the Applicable Federal Rate (AFR), which is often lower than the 7520 rate used with a GRAT.
  - The note may be structured as an amortizing loan or an interest-only balloon loan.
- Because the trust is a grantor trust, no gain or loss is recognized by the donor on the sale to the trust and payment of the interest pursuant to the promissory note has no income tax consequences to the donor or the trust.
- The sale may produce estate and gift tax savings if the trust assets produces an annual return in excess of the interest rate on the note over the term of its repayment.
  - The sale in exchange for a note may produce greater transfer tax savings than a GRAT because of the lower interest rate and because the note repayment structure can allow more of the payments from the trust to be deferred allowing more assets to compound for the benefit of the trust beneficiaries.
- If the donor dies before the note is paid off, the donor's death may trigger a gain for income tax purposes up to the amount of gain outstanding in connection with the note.
- Note: Some commentators argue that the trust must have assets other than the assets sold or else the note may be deemed to be disguised equity rather than a real debt, resulting in gift treatment rather than a sale. An individual considering this strategy should consult their tax advisor.

HYPOTHETICAL ILLUSTRATION

SALE/LOAN TO IRREVOCABLE GRANTOR TRUST



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HYPOTHETICAL ILLUSTRATION

SALE/LOAN TO IRREVOCABLE GRANTOR TRUST

BALLOON PAYMENT

- The following example illustrates a sale of $1,000,000 of assets to a grantor trust in exchange for a $1,000,000 promissory note bearing interest at the rate of 3.05% per year for a 9-year term.
- In this hypothetical Illustration, the donor receives interest payments of $30,500 per year and the $1,000,000 loan principal at the end of the term. After repayment of the note, the trust has $215,018 of assets remaining.

Assumptions:

Term of Trust	9
Sale Price	$1,000,000
AFR Rate	3.05%
Annual Investment Return	5.0%

Key Outputs:

Ending Value	$215,018

Hypothetical example is for illustrative purposes only.
Not representative of any specific investment.

Year	Beginning Principal	Growth	Annual Payment	Ending Principal
1	$1,000,000	$50,000	$30,500	$1,019,500
2	$1,019,500	$50,975	$30,500	$1,039,975
3	$1,039,975	$51,999	$30,500	$1,061,474
4	$1,061,474	$53,074	$30,500	$1,084,047
5	$1,084,047	$54,202	$30,500	$1,107,750
6	$1,107,750	$55,387	$30,500	$1,132,637
7	$1,132,637	$56,632	$30,500	$1,158,769
8	$1,158,769	$57,938	$30,500	$1,186,208
9	$1,186,208	$59,310	$1,030,500	$215,018

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HYPOTHETICAL ILLUSTRATION

SALE/LOAN TO IRREVOCABLE GRANTOR TRUST

BALLOON PAYMENT WITH SEEDING GIFT

- The following example illustrates a sale of $1,000,000 of assets to a grantor trust in exchange for a $500,000 promissory note. The difference of $500,000 is a taxable gift upon funding the trust.
- In this hypothetical Illustration, the donor receives interest payments of $15,250 per year and the $500,000 loan principal at the end of the term. After repayment of the note, the trust has $883,173 of assets remaining, or $668,155 more compared to the scenario with no seeding gift.

Assumptions:

Term of Trust	9
Principal	$1,000,000
Seed	$500,000
AFR Rate	3.05%
Annual Investment Return	5.0%

Key Outputs:

Ending Value (Seeding Gift)	$883,173
Ending Value (No Seeding Gift)	$215,018
Difference	$668,155

Hypothetical example is for illustrative purposes only. Not representative of any specific investment.

Year	Beginning Principal	Growth	Annual Payment	Ending Principal
1	$1,000,000	$50,000	$15,250	$1,034,750
2	$1,034,750	$51,738	$15,250	$1,071,238
3	$1,071,238	$53,562	$15,250	$1,109,549
4	$1,109,549	$55,477	$15,250	$1,149,777
5	$1,149,777	$57,489	$15,250	$1,192,016
6	$1,192,016	$59,601	$15,250	$1,236,366
7	$1,236,366	$61,818	$15,250	$1,282,935
8	$1,282,935	$64,147	$15,250	$1,331,832
9	$1,331,832	$66,592	$515,250	$883,173

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HYPOTHETICAL ILLUSTRATION

SALE/LOAN TO IRREVOCABLE GRANTOR TRUST

AMORTIZED PAYMENT

- The following illustrates a sale of $1,000,000 of assets to a grantor trust in exchange for a $1,000,000 promissory note is amortized over time.
- In this hypothetical Illustration, the donor receives $128,733 of interest and principal payments per year. At the end of the term, the trust has $131,840 of assets remaining, or $83,178 less compared to the balloon payment scenario.

Assumptions:

Term of Trust	9
Principal	$1,000,000
AFR Rate	3.05%
Annual Investment Return	5.0%

Key Outputs:

Ending Principal (Amortizing)	$131,840
Ending Principal (Interest-Only)	$215,018
Difference	-$83,178

Hypothetical example is for illustrative purposes only.
Not representative of any specific investment.

Year	Beginning Principal	Growth	Annual Payment	Ending Principal
1	$1,000,000	$50,000	$128,733	$921,267
2	$921,267	$46,063	$128,733	$838,596
3	$838,596	$41,930	$128,733	$751,793
4	$751,793	$37,590	$128,733	$660,649
5	$660,649	$33,032	$128,733	$564,948
6	$564,948	$28,247	$128,733	$464,462
7	$464,462	$23,223	$128,733	$358,951
8	$358,951	$17,948	$128,733	$248,165
9	$248,165	$12,408	$128,733	$131,840

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Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Chapter 6

QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)

Advanced Estate Planning

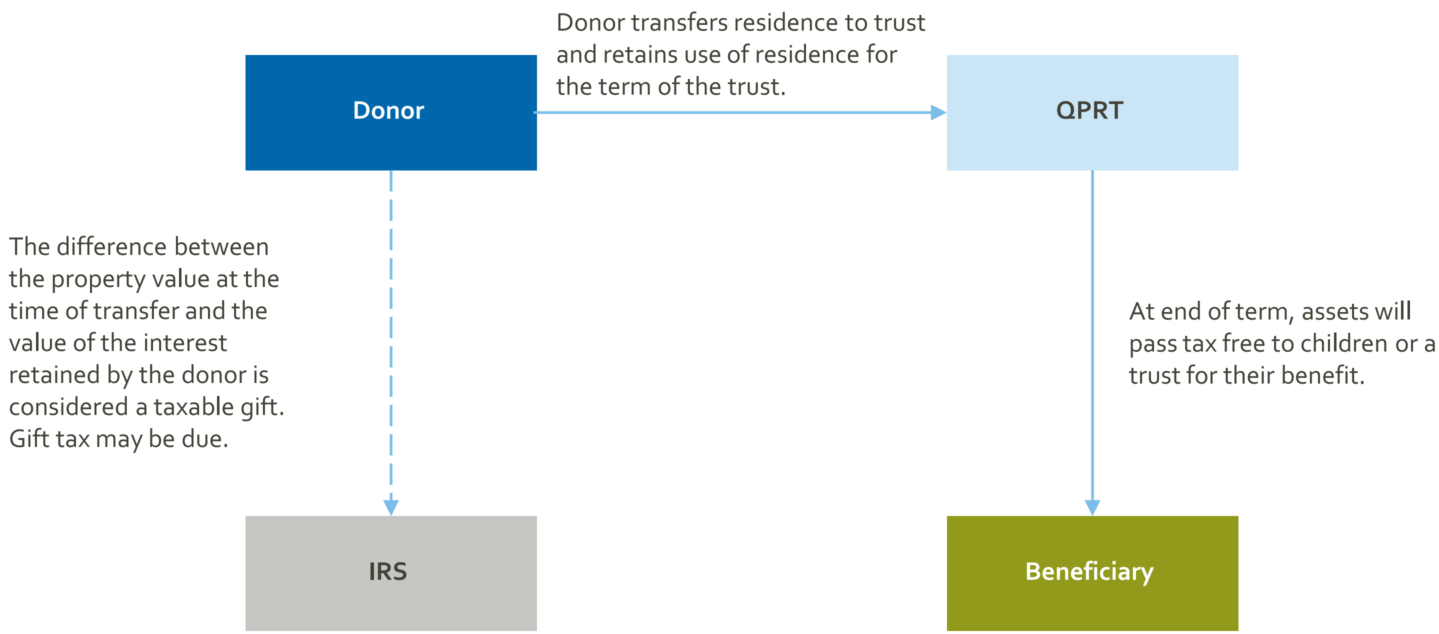
QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)

A QPRT gives an individual the opportunity to retain the use of a principal residence and/or vacation home for a term of years and potentially freeze the value of the residence at the time the trust is created for estate tax purposes.

- The donor irrevocably transfers a residence to a trust for a term of years, retains use of the residence for the term and selects a beneficiary or beneficiaries to receive the residence at the end of the term of the trust. QPRT beneficiaries are typically children (but not grandchildren).
- The donor may transfer a primary residence or another personal residence, such as a vacation home, or a partial interest in either to the QPRT. A donor may establish a QPRT for no more than two residences.
- By retaining the use of the residence for a term of years, the donor retains an interest in the residence. Thus, although the transfer of property to an irrevocable trust is taxable for gift purposes, only a portion of the property value is considered a taxable gift. The taxable gift—the remainder interest—is the difference between the property value at the time of transfer and the value of the interest retained by the donor. The retained interest is determined using the IRS 7520 rate.
- Generally, the higher the interest rate and/or longer the trust term, the lower the discounted value of the gift. However, the longer the trust term, the greater the mortality risk. See the following slide for an illustration.
- The term of the trust must be carefully considered because the trust assets will be included in the donor's estate if the donor dies during the trust term.
- When the term of the trust ends, the assets pass to the remaindermen (or a trust for their benefit) free of additional transfer taxes.
- The donor can continue to use the residence by renting back the assets (from the trust or the beneficiaries) at fair market rent.
- If the residence in the QPRT is sold, the proceeds must, in general, be rolled over to another residence. If the cost of the new residence is less than that of the old, a certain amount of property must be distributed back to the grantor (based on how much the property has appreciated or depreciated since the transfer) or converted to a grantor retained annuity trust (GRAT).
- If the donor outlives the term interest, the property will pass to the remainder beneficiaries. The donor will have removed the value of the residence from his or her estate with a relatively small gift. The estate and gift tax savings are enhanced if the residence appreciates over the term. Fractional interests in a residence gifted to the trust can be discounted.

HYPOTHETICAL ILLUSTRATION

QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)



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HYPOTHETICAL ILLUSTRATION

QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)

FUNDING A QPRT

- The following assumes that a QPRT is set up with property interest worth $5,000,000.
- The taxable gift amount is calculated for several scenarios with various combinations of term and IRS 7520 rate. The scenario comparison shows that the longer the term and/or the higher the IRS discount rate, the smaller the gift.
- The donor's survival of the term is necessary for any transfer tax savings. Appreciation of the assets enhance the benefits of the technique. QPRTs tend to not be attractive in low interest rate environments absent meaningful depreciation in the personal residences' value.
- Note that one would need to know the donor's age to compute the tax valuation discount on the retained interest.

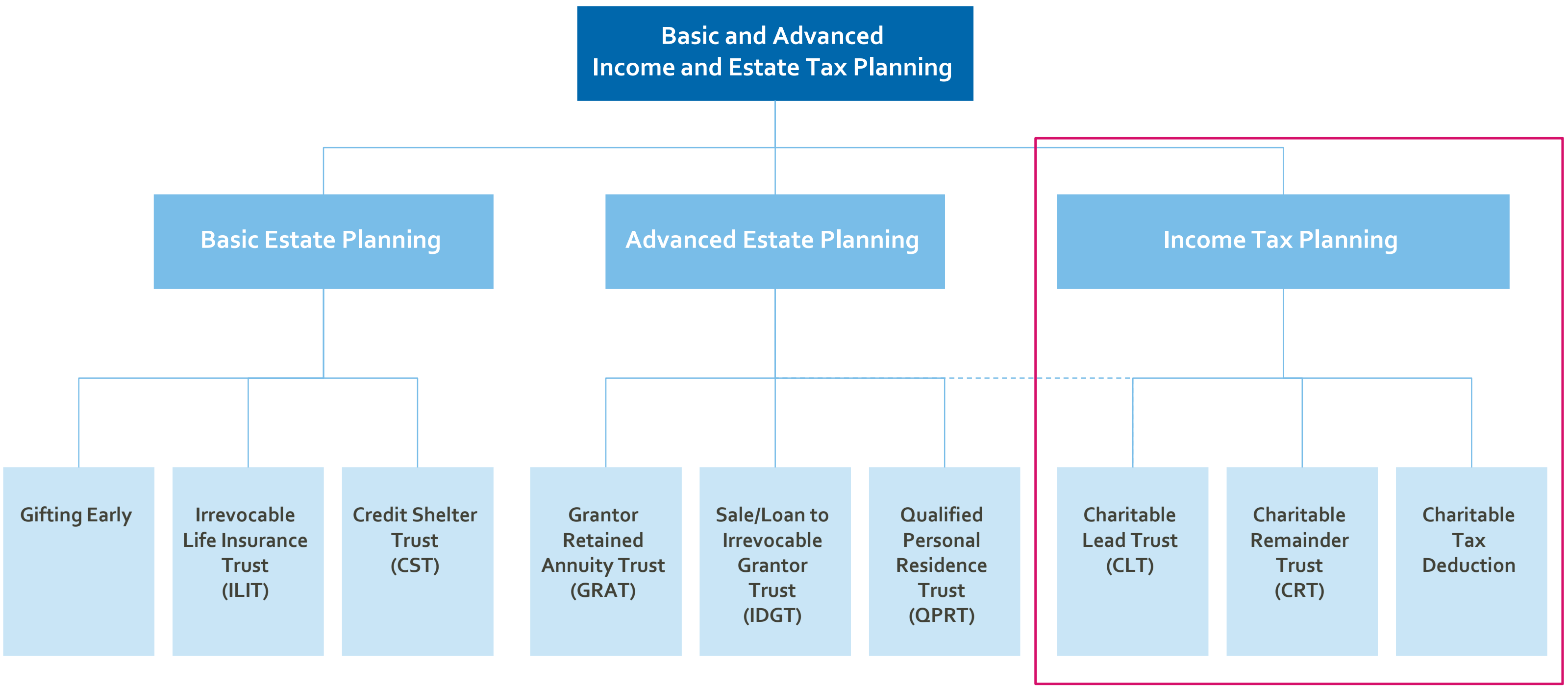
Different terms, Same 7520 rate

Term	7520 Rate	Residence Value	Retained Interest	Taxable Gift
10	3.6%	5,000,000	1,489,472	3,510,528
15	3.6%	5,000,000	2,058,467	2,941,533
20	3.6%	5,000,000	2,535,239	2,464,761

Same terms, different 7520 rates

Term	7520 Rate	Residence Value	Retained Interest	Taxable Gift
15	3.0%	5,000,000	1,790,690	3,209,310
15	4.0%	5,000,000	2,223,677	2,776,323
15	5.0%	5,000,000	2,594,915	2,405,085

INCOME TAX PLANNING



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Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Chapter 7

CHARITABLE LEAD TRUST (CLT)

Income and Estate Tax Planning

CHARITABLE LEAD TRUST (CLT)

A CLT allows a donor to transfer assets to a trust that makes annual payments to charity and remove future appreciation (if any) above an IRS 7520 rate from the donor's estate.

- A **CLAT** provides one or more charities with an annuity for a period of years. When the period ends, the remaining trust assets are paid to one or more designated non-charitable beneficiaries.
  - The value of the charity's annuity interest is calculated using an IRS 7520 rate. The difference between the initial value of the assets contributed to the trust and the present value of the charity's annuity interest is a taxable gift to the remainder beneficiaries.
  - The annuity can be structured to result in no taxable gift, i.e., the CLT is "zeroed out" so there is no tax cost to funding the CLT.
- A CLT may also be structured as a **CLUT** (unitrust), where the charity receives a set percentage of the fair market value of the trust's assets, as predetermined annually. These structures are not commonly used because any appreciation is shared with the charity, thus reducing the remainder.
- If the total return (income and appreciation) exceeds the IRS 7520 rate used in valuing the periodic payments, the excess passes to the remainder beneficiaries (typically, children and/or grandchildren) at the termination of the trust free of gift and estate taxes.
- The donor may or may not be treated as the owner and thus subject to tax on all of the trust's income during the charitable term:
  - **Grantor Trust**: where the donor is treated as the owner of the trust, he or she is entitled to a charitable income tax deduction equal to the actuarial value of the charity's interest in the trust. The benefit of that income tax deduction may be recaptured over the trust's term because the donor is taxed on all of the trust's income.
  - **Non-Grantor Trust**: where the donor is not treated as the owner of the trust, he or she does not receive a charitable income tax deduction on the creation of the trust. The trust is a separate taxable entity which receives a charitable income deduction for the payments made to charity each year.
- If structured carefully, the donor's own private foundation can receive the periodic payments to charity.
- Certain prohibitions associated with private foundations may also apply to a CLT (regardless of the identity of the charitable beneficiary).

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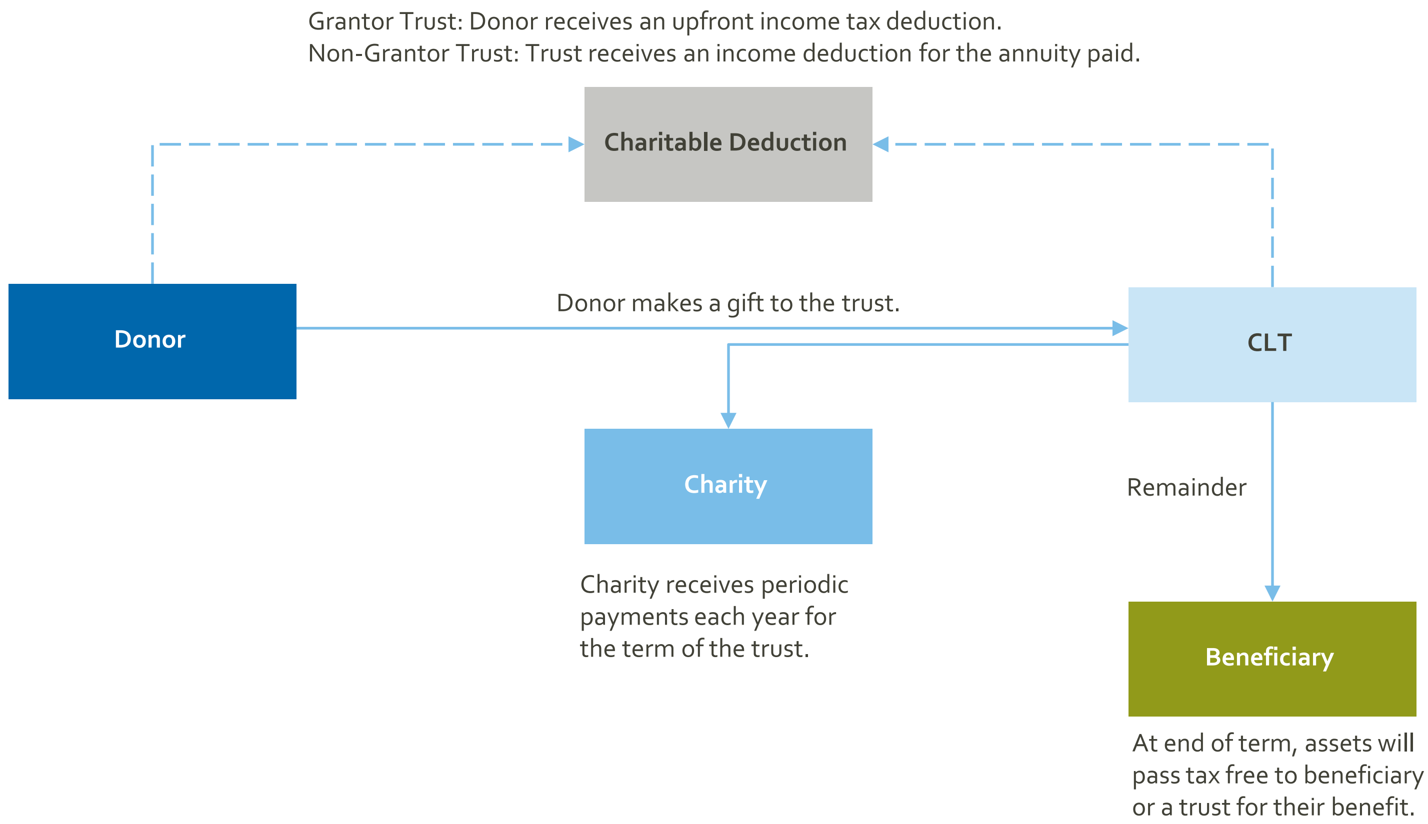
HYPOTHETICAL ILLUSTRATION

CHARITABLE LEAD TRUST (CLT)



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HYPOTHETICAL ILLUSTRATION

CHARITABLE LEAD TRUST (CLT)

FUNDING A "ZEROED-OUT" GRANTOR CLAT

- The following is an illustration of a "zeroed-out" grantor CLAT funded with $1,000,000.
- In this hypothetical illustration, a charity receives an annuity of $120,848 per year for 10 years and the remainder beneficiaries receive (outright or in continuing trust) $108,879 free of gift and estate taxes.

Assumptions:

Term of Trust	10
Principal	$1,000,000
7520 Rate	3.6%
Annuity (% of funding amount)	12.1%
Annual Investment Gross Return	5.0%

Key Outputs:

Marginal Tax Rate	40.8%
Tax Savings from Deduction	$408,000
Taxable Gift	$0
Remainder	$108,879

Hypothetical example is for illustrative purposes only.
Not representative of any specific investment.

Year	Beginning Principal	Growth	Annuity Payment	Remainder
1	$1,000,000	$50,000	$120,848	$929,152
2	$929,152	$46,458	$120,848	$854,761
3	$854,761	$42,738	$120,848	$776,651
4	$776,651	$38,833	$120,848	$694,635
5	$694,635	$34,732	$120,848	$608,519
6	$608,519	$30,426	$120,848	$518,097
7	$518,097	$25,905	$120,848	$423,153
8	$423,153	$21,158	$120,848	$323,463
9	$323,463	$16,173	$120,848	$218,788
10	$218,788	$10,939	$120,848	$108,879

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Chapter 8

CHARITABLE REMAINDER TRUST (CRT)

Income Tax Planning

CHARITABLE REMAINDER TRUST (CRT)

A CRT allows an individual to retain an income interest in assets, diversify a low-basis position without an immediate capital gains tax and give the remainder to charity.

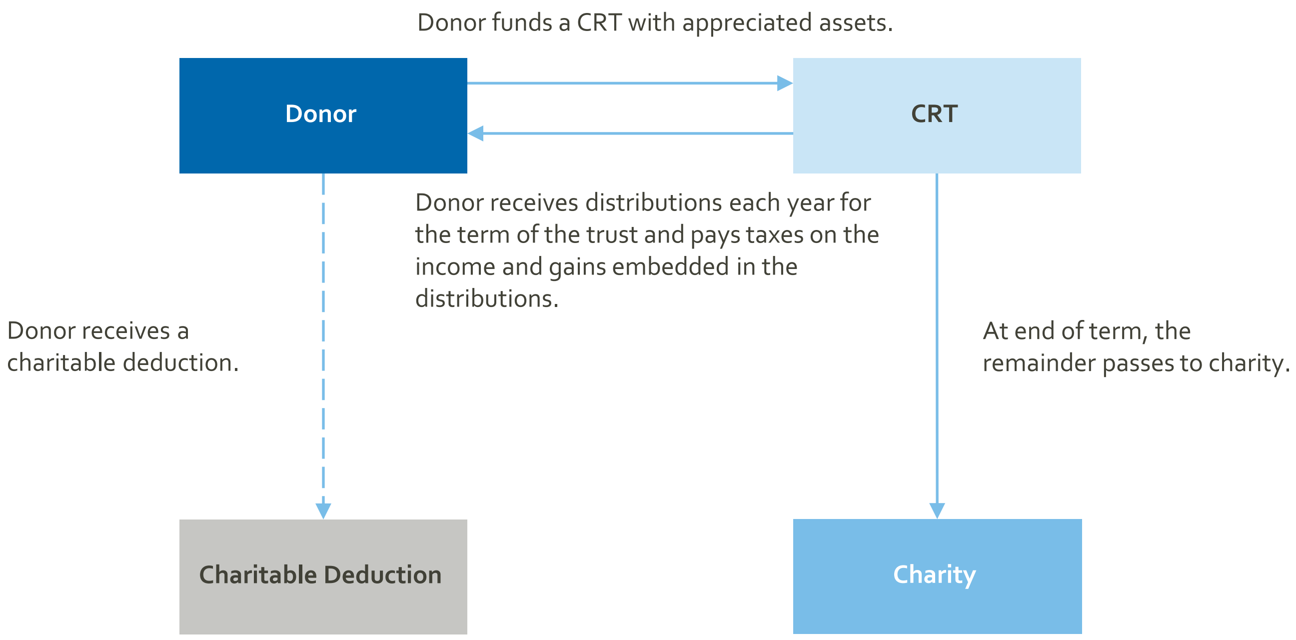
- With a CRT, the donor transfers assets to a trust that makes annual distributions to the donor for a period of time. Assets remaining in trust at the expiration of the term are paid to charity.
- Generally speaking, there are two types of CRTs:
  - Charitable Remainder Annuity Trust (CRAT): A CRAT pays the individual beneficiary a fixed dollar amount each year. The amount must be at least 5% (but not more than 50%) of the market value of the assets, determined at the time the trust is established.
  - Charitable Remainder Unitrust (CRUT): A CRUT pays the individual beneficiary at least 5% (but not more than 50%) of the fair market value of the trust's assets, determined annually.
- The donor's income interest may last for one life; two or more lives; a term not to exceed 20 years; or the shorter (but not the longer) of one or more lives and a term of years.
- The present value of the charity's remainder interest must be at least 10% of the initial value of the trust assets when the trust is created.
  - If a CRT fails the 10% test, it does not qualify as a charitable trust and loses all the favorable tax treatment of a qualified CRT.
  - Subject to certain limitations, the donor is allowed to deduct for income tax purposes the fair market value of the charity's remainder interest.
- The remainder beneficiary can be a public charity and/or a private foundation. The donor may retain the right to change the charitable beneficiary or beneficiaries named or name one or more charitable beneficiaries in the future.
  - The classification of the charitable remainder beneficiary as well as the type of assets contributed to the CRT impact the charitable tax deduction available to the donor upon funding the trust.

CHARITABLE REMAINDER TRUST (CRT)

- CRTs are generally not themselves subject to income tax.
  - The annuity or unitrust amount distributed is, in general, taxable to the donor and the character of the income is based on the character of the income earned by the trust.
    - Tiering rules generally force the "worst" income to the non-charitable beneficiary first. Distributions from the CRT are deemed to occur in the following order: ordinary income (interest, dividends not qualified for a reduced rate and then qualified dividends), short-term then long-term capital gains, tax-exempt income and, finally, principal of the trust.
  - However, a CRT that has any Unrelated Business Taxable Income (UBTI) is taxed at the rate of 100% on all of its UBTI for that year.
    - The IRS defines UBTI as the net income from an activity that is a regularly carried on trade or business not substantially related to furthering the exempt purpose of the CRT. UBTI also includes income generated by the use of borrowed funds.
- Certain of the private foundation rules apply to CRTs.
- Use of a CRT allows diversification and reinvestment of 100% of the proceeds of sale of any (low basis) assets contributed to the trust on a tax-deferred basis.
  - Compared to a taxable sale of appreciated assets, the net effect of the use of a CRT includes:
    - The tax deferral benefit associated with the donor paying capital gains taxes on the realized appreciation over time.
    - The charitable income tax deduction available to the donor upon funding the CRT.
  - However, whether or not the donor is "better off" just selling the assets and reinvesting the after-tax proceeds depends on the applicable tax rates and the assumptions made about how assets would be invested inside or outside of the CRT.

HYPOTHETICAL ILLUSTRATION

CHARITABLE REMAINDER TRUST (CRT)



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HYPOTHETICAL ILLUSTRATION

CHARITABLE REMAINDER TRUST (CRT)

FUNDING A CRUT WITH APPRECIATED ASSETS

- The following is an illustration of a Charitable Remainder Unitrust (CRUT) funded with $1,000,000 in appreciated assets (zero cost basis). The trust has a 5-year term and a 10% charitable deduction. The donor's personal account collects the Unitrust distributions from the CRT.
- In this hypothetical illustration, the charity receives a remainder of $132,683 at the end of the term, whereas the personal account has an ending value of $903,340.
- Note that the numbers below are dependent on additional information such as the payment period and the number of months by which the valuation precedes payout.

CRT

Gross Principal	$1,000,000
Cost Basis	$0
7520 Rate	3.6%
Term of Trust	5
Unitrust Rate	38.2%
Annual Investment Gross Return	5.0%
CRUT Remainder	$132,683

Year	Beginning Value	Growth	Unitrust Amount	Ending Value
1	$1,000,000	$50,000	$382,328	$667,672
2	$667,672	$33,384	$255,270	$445,786
3	$445,786	$22,289	$170,436	$297,639
4	$297,639	$14,882	$113,796	$198,725
5	$198,725	$9,936	$75,978	$132,683

Personal Account
(initial value reflects tax savings from charitable deduction)

Charitable Deduction	$100,000
Marginal Tax Rate	40.8%
Potential Tax Savings	$40,800
Investment Period	5
Effective Investment Tax Rate	20.0%
Annual Investment Gross Return	5.0%
Ending Portfolio Value	$903,340

Year	Beginning Value	Net Unitrust Payment	After Tax Growth	Ending Value
1	$40,800	$293,234	$1,632	$335,666
2	$335,666	$195,784	$13,427	$544,877
3	$544,877	$130,720	$21,795	$697,391
4	$697,391	$87,278	$27,896	$812,565
5	$812,565	$58,273	$32,503	$903,340

Hypothetical example is for illustrative purposes only. Not representative of any specific investment.

NOTE: The strategies set forth herein are shown for educational purposes only, are not tailored to any specific client, and do not constitute a recommendation to employ any strategy identified. To that end, they do not capture all possible outcomes but are based on limited set of assumptions. If the assumptions upon which they are based are not realized, the efficacy of the strategy may be materially different from that which is reflected in the illustration. Accordingly, clients must consult their tax advisor when considering the utility and appropriateness of any strategies identified herein. Please see the additional Important Disclosures at the end of this presentation.

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PRIVATE WEALTH MANAGEMENT

Chapter 9

CHARITABLE TAX DEDUCTION

Income Tax Planning

CHARITABLE TAX DEDUCTION

A person may make gifts to certain charitable organizations and receive income, gift and/or estate tax charitable deductions. The organization may be a public charity, private foundation created by a private individual (including the donor) or a hybrid of the two. The classification is important because gifts to a public charity are generally treated more favorably for income tax purposes than comparable gifts to a private foundation. Federal law also restricts the activities of a private foundation and may impose excise taxes on the foundation and its managers and donors (or their family members) for violations of its rules.

In general, either the basis or the fair market value (FMV) of assets given to a U.S. charity may be deducted for income tax purposes subject to a limitation expressed as a percentage of the donor's adjusted gross income (AGI). The amount of the deduction and the applicable limitation are a function of the type of assets given (cash vs. long-term capital gain assets) and the classification of the charitable organization as a public charity or private foundation (for this purpose). Gifts in excess of the limitations can be carried forward and used in any of the five years following the year of the gift. The following is a summary of some of the basic rules:

	PUBLIC CHARITY AMOUNT OF DEDUCTION	AGI LIMITATION	PRIVATE FOUNDATION AMOUNT OF DEDUCTION[1]	AGI LIMITATION
Cash	Fair Market Value	60%	Fair Market Value	30%
Short-Term Capital Gains Assets	Lower of Fair Market Value or Basis	50%	Lower of Fair Market Value or Basis	20%
Long-Term Capital Gains Assets	Fair Market Value	30%	Cost or Fair Market Value[2]	20%

1. The summary for deductions for private foundations does not apply to private operating foundations.
2. Gifts of only certain types of long-term capital gain assets called "qualified appreciated stock" to a private foundation may be deducted at fair market value.

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HYPOTHETICAL ILLUSTRATION

CHARITABLE TAX DEDUCTION FOR YEAR OF CHARITABLE GIFT

Gifting Cash to a Donor Advised Fund (DAF)

Fair Market Value of Charitable Gifts	**$1,000,000**
Adjusted Gross Income	$3,000,000
AGI Limit (Itemized Deduction)	
AGI Deduction Limit (%)	60%
AGI Deduction Limit ($)	$1,800,000
Itemized Charitable Deduction	**$1,000,000**
Carryforward	$0

Gifting LTCG Assets to a Donor Advised Fund (DAF)

Fair Market Value of Charitable Gifts	**$1,000,000**
Adjusted Gross Income	$3,000,000
AGI Limit (Itemized Deduction)	
AGI Deduction Limit (%)	30%
AGI Deduction Limit ($)	$900,000
Itemized Charitable Deduction	**$900,000**
Carryforward	$100,000

Gifting Cash to a Private Foundation

Fair Market Value of Charitable Gifts	**$1,000,000**
Adjusted Gross Income	$3,000,000
AGI Limit (Itermized Deduction)	
AGI Deduction Limit (%)	30%
AGI Deduction Limit ($)	$900,000
Itemized Charitable Deduction	**$900,000**
Carryforward	$100,000

Gifting LTCG Assets to a Private Foundation

Fair Market Value of Charitable Gifts	**$1,000,000**
Adjusted Gross Income	$3,000,000
AGI Limit (Itemized Deduction)	
AGI Deduction Limit (%)	20%
AGI Deduction Limit ($)	$600,000
Itemized Charitable Deduction	**$600,000**
Carryforward	$400,000

This analysis does not account for Alternative Minimum Tax. This analysis assumes that the individual makes no other charitable gifts during the year. The numbers in the hypothetical illustration could change if the individual gave a large cash gift or gifted other capital gains property during the same year.

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PRIVATE WEALTH MANAGEMENT

Chapter 10

APPENDIX & DISCLOSURE

APPENDIX & DISCLOSURE

This presentation was designed to illustrate the financial impact of a particular planning decision. The slides herein do not constitute a recommendation.

Caution: many estate techniques share the common risk of the loss of control of the assets once the gift of the assets is complete.

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CRC 2852778 (1/2020)