Private Bank citi

Planning for your wealth

Essential US wealth planning strategies

Table of contents

Lasting success seldom happens by chance. Behind visionary individuals, businesses, champion sports teams and thriving community projects, there is almost invariably a thoughtful plan.

While the critical nature of planning is widely acknowledged, it can be neglected in practice. This can be especially true when it comes to wealth. Having successfully planned to create meaningful wealth through entrepreneurship or investment, wealth creators and recipients often fail to plan for its preservation.

Others create a wealth plan, but then they do not adapt it as circumstances change.

There can be many different reasons for failing to create and update wealth plans. The consequences, however, are typically all too predictable. Improper planning may result in lack of protection of assets during your lifetime and afterwards, inheritance disputes, slow administrative procedures, asset depletion and unnecessary taxes.

Ideally, you should create a plan at the earliest opportunity and revisit it regularly or as warranted by a change in circumstances including changes in your family, your wealth, or the economic, legal, and tax environment. By acting sooner rather than later, you may be able to create tax savings and ensure that appropriate fiduciaries are in place and assets are distributed to desired beneficiaries.

Exemption amounts for federal gift and estate tax are still at all-time highs of $12.06 million per individual and $24.12 million per married couple, up from $11.7 million and $23.4 million respectively in 2021. While these annually adjusted exemption amounts are scheduled to decrease by about half at the beginning of 2026, the reduction could conceivably be greater and occur sooner, depending on whether new tax legislation is enacted. With the executive and legislative branches currently under the control of the same party, federal tax legislation to reduce the exemption amounts might be enacted this year.

Other proposed changes have included higher scrutiny of valuation discounts, reining in the advantages of Grantor Retained Annuity Trusts (GRATs), curtailing the benefits of grantor trusts, and modifying the availability of annual gifting. The large-scale economic stimulus packages in 2020 and 2021 have intensified the debate about raising taxes to reduce the deficit.

> Of course, no one can predict which, if any, of these proposals might eventually be enacted. What we do know is that current law enables transfers of wealth to future generations in tax-efficient ways. However, those laws could be changed.
>
> Additionally, because changes in transfer tax rates and exemption amounts might be made effective retroactively to January 1, 2022, donors may wish to consider various strategies that can mitigate the risks of retroactive tax changes.

Information as of December 2021 and is subject to change.

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Gifting when US Federal transfer tax exemption amounts are at an all-time high

The current window of opportunity to make substantial gifts could close quickly, as new tax legislation could reduce the transfer tax exemption amounts much sooner than 2026.

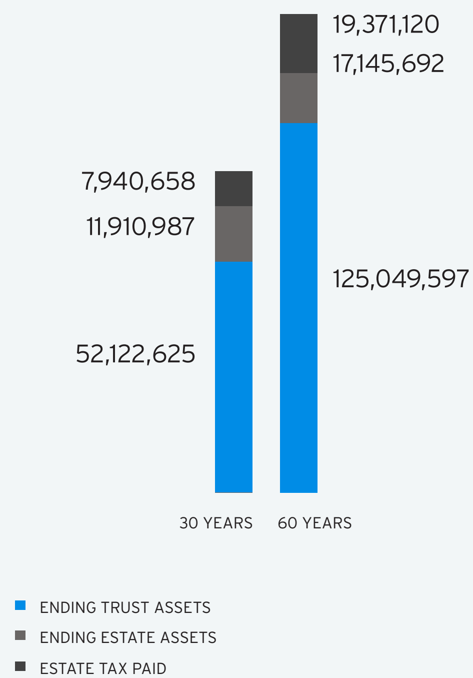
Gifting now, potentially to a Dynasty Trust, can help you attain your long-term wealth planning goals, as well as to help mitigate the tax effects on wealth creation and transfer. Thoughtful planning impacts not only your estate, but also the legacy you leave for future generations.

Example: Dynasty planning with $12.06 million in trust

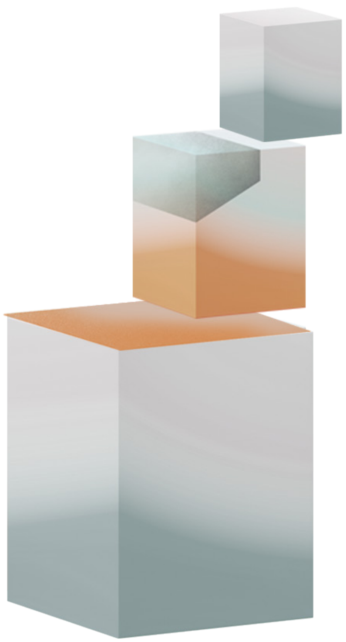
We begin with an estate valued at $30 million and project growth over time, with estimates of the legacy you would leave to your descendants, using the following assumptions:

- You begin with $30 million and have not used any of your available transfer tax exemption amount
- Assets grow at an annualized rate of 5%
- You are in the highest income bracket and live in a state that has no state income tax and no gift, estate or GST tax
- Trusts are structured as grantor trusts and grow free of income tax while the grantor is alive; upon the grantor's death, income tax is paid from trust assets
- Thirty years between each generation; one child for each generation

You act now by gifting $12.06 million to a grantor trust, and the remaining $17.94 million grows as part of your taxable estate. Trust assets grow for 30 years outside your taxable estate, during which time you pay income tax on behalf of the trust out of your own assets. After your death, trust assets continue to grow another 30 years outside your child's taxable estate, but the trust pays its own income tax.



After the first 30 years, trust assets will total $52.1 million with the grantor paying the income taxes. At the end of the next 30 years, trust assets will total $125 million when the trust is paying the income tax. By planning now, you could more than double the legacy left to a grandchild.



How interest rates can impact wealth planning

It is important to understand the planning opportunities that exist in a lower interest rate environment and what to do when the tide turns, and rates go up. Although rates are still low, they are increasing, and the Federal Reserve has announced additional hikes in the near future.

The current interest rate environment could enable the transfer of substantial assets – including any appreciation in value – to future generations with minimal gift tax implications.

Estate planning strategies to take advantage of now may include:

- Making loans to family members
- Grantor Trusts – gift/sale/loan
- Grantor Retained Annuity Trusts (GRATs)
- Charitable Lead Annuity Trusts (CLATs)

MAKING LOANS TO FAMILY MEMBERS

Using an intra-family loan is one of the estate planning tools that may help you build wealth for future generations without incurring gift tax.

To help ensure the transaction is not classified as a gift, the loan must have economic substance and be documented by an enforceable promissory note. Further, the interest rate on the note should be no lower than an IRS-published Applicable Federal Rate (AFR), for the month when the loan is made.

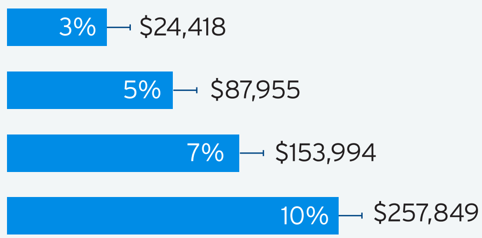
Whether the recipient uses the loan for investment purposes, to purchase a home or pay down debt, the intra-family loan is an important strategy to understand.

By loaning money to a family member, you can effectively transfer wealth free of gift tax to the extent that the family member can invest the funds in a way that generates a total return (income and/or appreciation) greater than the interest rate charged on the loan.

Example: Intra-family loan

In June 2022, a parent made a loan to her child of $1 million for 3 years. The promissory note provided for annual interest-only payments, using the short-term AFR of 2.21% for June 2022. Full repayment of $1 million was due at the end on the 3 years. This table shows the remaining value of assets that the child would retain at the end of 3 years (without any gift tax consequences to the parent) at different after-tax return rates generated by the child.

Hypothetical after-tax annual return / remaining assets



An additional use of the intra-family loan is to allow the recipient access to funds they could not otherwise obtain or to gain access to funds at a reduced cost. The loans can be used to help a child with a poor credit rating or to make a large purchase, such as a home. Benefits associated with these types of loans include:

- An interest rate lower than a comparable commercial loan
- Avoidance of transactions costs
- Funds are kept within the family as interest payments are not made to a third party

Other issues to consider before entering this type of transaction include understanding:

- The ultimate use of the loan proceeds.
- As with any loan, there are consequences if the borrower is unable to repay the loan.
- The income tax impact to the lender and the borrower. The interest received by the lender will generally be taxable at ordinary income tax rates.

Although there may be some downsides to this type of loan, this is certainly an appealing strategy which should be considered as part of your overall estate plan.

GRANTOR TRUSTS – GIFT/SALE/LOAN

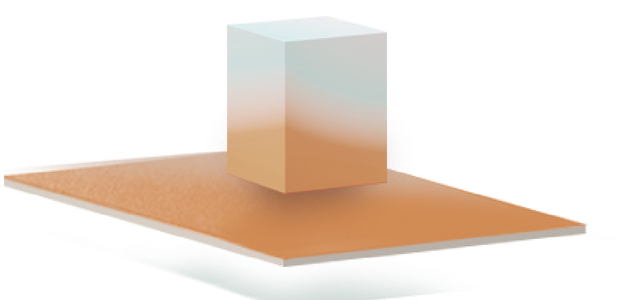
If you create an irrevocable trust during your lifetime, you can structure it as a grantor trust so that you are treated as the owner for federal income tax purposes, but not for federal gift, estate, or generation skipping transfer (GST) tax purposes.

To fund the trust, you would make an initial gift using some or all of your lifetime gift tax exemption amount. The trust can then purchase assets from you in exchange for a promissory note at an interest rate no lower than the AFR.

As the owner of the trust for federal income tax purposes, you will be responsible for reporting the trust's income and capital gains on your personal income tax return. Any income taxes you pay from your own assets (due to reporting the trust's income and capital gains on your tax return) will not be treated as an additional gift to the trust, allowing the trust's assets to grow without erosion by income tax payments.

Also, the sale of assets and your loan to the grantor trust will generally have no income tax consequences for you or for the trust. As a result, if the total return of the assets sold to the trust exceeds the promissory note's stated interest rate, such excess return – both realized and unrealized – will remain captured in the trust and thus held outside your estate.

However, if the total return does not exceed the interest rate, the trust will likely remain liable for repaying the loan, which could bring the assets back into your estate.

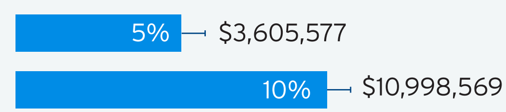


Example: Sale to a grantor trust

In June 2022, the grantor transferred $1 million of stock to a grantor trust. The grantor then sold $9 million of stock to the trustee of the grantor trust in exchange for a $9 million promissory note. The promissory note is provided for annual interest-only payments, using the mid-term AFR of 2.93% for June 2022. Full repayment of the outstanding principal was due at the end of 9 years.

The following table shows the value of the grantor trust's remaining assets at the end of 9 years (after the $9 million note was repaid) at different annual return rates generated on the grantor trust's assets.

Trust's hypothetical annual return / remaining assets



GRANTOR RETAINED ANNUITY TRUSTS (GRATs)

A GRAT is an irrevocable trust to which you transfer assets but retain the right to receive an annuity payment for a fixed term of years. The annuity payment is based on the initial value of the GRAT's assets, the selected term of years, and an interest rate prescribed by the IRS at the time the GRAT is funded. If structured properly, the initial transfer of assets to the GRAT may result in either no gift or a minimal gift.

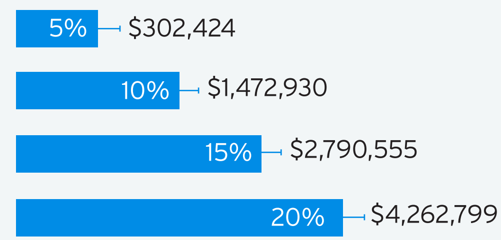
When the GRAT term ends and the final annuity payment is made, assets left in the trust can either pass outright to family members / other beneficiaries or stay in the trust for their benefit. When the IRS rate is low, this can be an effective strategy to shift appreciation to future generations.

Example: GRAT

In June 2022, the grantor transferred $10 million of stock to a three-year GRAT and retained a fixed annual annuity. The IRS Section 7520 rate when the GRAT was funded was 3.6%. To make a gift nominally greater than $0, the grantor would need to receive $3,576,154 in stock and/or other assets from the GRAT at the end of each of the first, second and third years.

The following table shows what the remainder beneficiary would receive at the end of three years given different annual return rates on the GRAT's assets.

Hypothetical annual return / remaining assets



Note: These examples use a level annuity. Using an increasing annuity may further augment the remainder amounts.

CHARITABLE LEAD ANNUITY TRUSTS (CLATs)

A CLAT is an irrevocable trust to which you transfer assets, after which an annuity payment is paid to a charity for a fixed term of years. You or your trustees select the charity. As with the GRAT, the annuity payment is based upon the initial value of the CLAT's assets, the selected term of years and an IRS-prescribed interest rate.

When the CLAT's initial term ends, the assets remaining in the trust either pass outright to family members / other beneficiaries or remain in trust for their benefit, free of transfer tax. When the IRS rate is lower than the rate of growth of assets held in the CLAT, you can shift appreciation to future generations while benefiting charitable causes.

Depending on how the CLAT is structured, you may be entitled to receive an upfront charitable income tax deduction equal to the present value of the payments to be made to charity during the initial CLAT term.

Planning in a rising interest rate environment

Suppose interest rates increase as currently projected throughout 2022. In consultation with your independent tax advisor, you may then want to consider other strategies that take advantage of a rising interest rate environment, including:

- Qualified Personal Residence Trust (QPRT)
- Charitable Remainder Trusts (CRT)

QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)

A QPRT is an irrevocable trust that (1) through a gift from the grantor, owns either a grantor's primary or secondary residence, (2) allows the grantor to use the property rent-free during a certain term and (3) at the end of the term distributes the property outright or in trust for the named beneficiaries.

Although the contribution of the property to the trust is a taxable gift, the value of the gift will not equal the full value of the property. The gift will be discounted for certain factors, including the grantor retaining the right to use the property. The value of the gift is calculated using a prescribed IRS rate. The higher the federal rate, the lower the gift value of the trust's remainder interest.

Unlike some wealth transfer strategies, transferring a residence to a QPRT is an estate planning technique approved by the IRS. However, the governing code section and its underlying regulations are complex and require a thorough review to determine whether this is an appropriate strategy. Some of the considerations include:

- The grantor can live rent-free in the property during the term of the QPRT
- During the QPRT term the grantor will be responsible for the ordinary carrying costs of the property such as minor repairs, insurance, and real estate taxes. These expenses are not considered gifts to the QPRT
- The QPRT is a grantor trust and accordingly the grantor can deduct the real estate taxes paid, subject to any applicable limitation on deductions
- Any capital improvements made by the grantor will be considered an additional gift
- If the property is sold during the term of the QPRT, the proceeds must either be invested in a new home or distributed back to the grantor
- If the property transferred is subject to a mortgage, the principal portion of the payment made by the grantor will be an additional taxable gift to the QPRT
- At the end of the QPRT term, if the grantor wants to continue to reside in the property, the grantor must then pay a fair value rent
- If the grantor survives the QPRT term, all appreciation in the property passes to the beneficiaries free of transfer tax
- If the grantor dies during the QPRT term, the fair market value of the trust property (determined at the time of the grantor's death) will be includible in the grantor's estate for federal estate tax purposes
- If the grantor dies after the term of QPRT, there will be no step-up in basis in the property upon the grantor's death
- A QPRT is not an appropriate strategy for generation-skipping transfers

QPRTs can be a highly effective planning tool. In this time of rising interest rates and increasing real estate values, the QPRT is a strategy for consideration if you are looking to maximize the wealth you want to transfer to the next generation.

CHARITABLE REMAINDER TRUSTS (CRT)

A CRT is an irrevocable trust, often used for income tax planning, designed to benefit both individuals and charities. The donor or other non-charitable beneficiaries receive payments from the trust for a term of years, and one or more charities receive the remainder interest upon the conclusion of such term. CRTs can be structured several ways.

Charitable Remainder Annuity Trust (CRAT) provide annual payments to non-charitable beneficiary(ies) in a fixed dollar amount determined as a percentage (which must be at least 5%) of the initial fair market value of the trust.

Charitable Remainder Unitrust Trust (CRUT) provide annual payments to non-charitable beneficiary(ies) in a fixed percent (at least 5%) of the fair market value (revalued annually) of the trust assets (the unitrust payment). Unlike fixed dollar payments from a CRAT, CRUT payments will vary from year to year, depending on the changing value of the trust assets.

Additional issues to consider include:

- The donor will receive a charitable income tax deduction based on the present value of the remainder interest passing to charity
- A CRT can be a good tool to diversify appreciated assets as there is no immediate capital gain taxes when a CRT sells appreciated assets
- Because there is no taxation to the CRT upon the sale of appreciated assets, the annuity payment will be based on the full value of the assets contributed to the CRT
- The annuity payments will be taxed to the recipient. The tax consequences will be based on the nature of the income distributed by the CRT

> High-interest-rate strategies will become more attractive as interest rates rise. In particular, clients with significant built-in gain assets facing high federal and state income taxes could benefit from the deferral of income taxes in a CRT.

Ensuring trust terms remain aligned with your intentions

Trusts can be established as revocable or irrevocable. A revocable trust is typically created by its grantor to hold assets that can be managed by the grantor or on the grantor's behalf if he or she becomes incapacitated. A revocable trust can also dispose of the trust assets outside of the probate process when the grantor dies. The grantor often serves as the initial trustee. While competent, he or she can revoke or amend the trust at any time.

By contrast, an irrevocable trust is typically established by the grantor to hold assets for the benefit of others. Usually, the grantor cannot serve as trustee, revoke the trust, or take back the trust assets. In addition to completing gifts or transfers to others, an irrevocable trust often also serves the purposes of minimizing estate taxes and ensuring the proper management of the trust assets, over multiple generations.

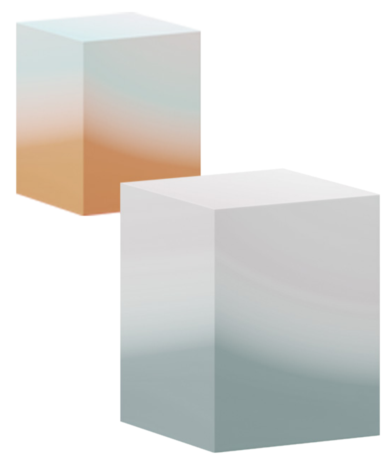
> Just because a trust is irrevocable, however, does not mean it is unalterable. This is especially true when its terms or provisions have become outdated or undesirable. In certain situations, it may be possible to modify the trust terms, even if the trust agreement states that it cannot be amended or revoked.

Depending on the terms of the irrevocable trust agreement and governing law, trusts may be modified with the relevant parties' consent and without court proceedings, pursuant to what is referred to as a "non-judicial settlement agreement."

It may be possible for an existing trust to transfer its assets to a new trust. This method of changing the trust terms is known as "decanting." You may seek to modify or decant a trust not only to improve its provisions but also to take advantage of jurisdictions with favorable trust laws, such as Delaware and South Dakota.

Benefits of these jurisdictions include:

- no state income tax on accumulated income
- flexibility to carve out different trustee roles, possibly allowing the grantor to serve as investment advisor to the trust
- silent trust provisions to delay notification of the existence of the trust to beneficiaries



Urging family members to plan for their wealth

Understandably, younger people seldom contemplate mortality. Nevertheless, your adult children should prepare estate planning documents of their own. While it may be sensitive to discuss, you might encourage each of your children aged 18 and above to sign the following legal documents:

- durable general power of attorney (for financial purposes)
- medical power of attorney or health care directive
- authorization to release protected health information

The first two documents allow a child to appoint an agent to make financial and medical decisions on that child's behalf, should the need ever arise.

Your child should understand the importance of signing such documents and the negative consequences of not having them in place.

Your child may have bank accounts, interests in a family entity or other assets acquired as gifts or from a custodial account. They should consider signing a will and/or revocable trust, which provides a testamentary plan for distributing assets and/or titling assets in a way that will allow that child's assets to pass to his or her beneficiaries without the need for probate.

> Begin a conversation with your adult children about the importance of creating an estate plan and introduce them to trusted advisors who can guide them through the next steps.

Making gifts to minors

A parent, grandparent or other family member can make a gift to a minor in several ways. During 2022, a donor can transfer up to $16,000 in cash or property to a minor as an Annual Exclusion Gift. To the extent that the donor gives the minor an amount during the year that exceeds the Annual Exclusion Gift amount, the excess portion will reduce the donor's available lifetime gift tax exemption amount or, if none is available, trigger gift tax.

Listed below are some ways to make gifts to a minor. Factors you should consider include how much control you want to retain over the transferred assets, your goals in making the gift, the purposes for which the gift will be used, income tax and estate tax considerations, and when the minor will be entitled to receive the assets.

- UTMA account
- Custodial IRA
- 529 savings plan account
- Irrevocable trust

An UTMA account ("UTMA") for a minor is typically established with a financial institution under a particular state's Uniform Transfers to Minors Act. An UTMA does not require a trust to be established by the donor. A custodian – either the donor or, preferably for estate tax reasons, another adult – manages and invests the property in the UTMA and spends funds for the minor's benefit.

Depending on state law and how the UTMA is established, the UTMA usually terminates when the minor reaches an age between 18 and 21 (the "Termination Date"). At the Termination Date, the custodian turns over the remaining assets in the UTMA to the now-adult beneficiary. If the donor serves as custodian and dies before the Termination Date, the date-of-death value of the UTMA may be subject to estate taxation because of the level of discretionary control the donor/custodian retained with respect to distributions to the beneficiary.

> Understandably, minors do not spend their time contemplating retirement. Nonetheless, if a minor has earned income – wages, tips, and self-employment – a donor can establish and fund a Custodial IRA (traditional or Roth) for the minor's benefit. This is one way you can help start a minor's retirement savings.

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Like an UTMA, a custodian maintains control of the Custodial IRA until the time the minor attains a certain age. The maximum amount a donor can contribute to a Custodial IRA during the year is the lesser of the minor's earned income for the year or the maximum annual IRA contribution amount, currently $6,000.

If your goal is to provide for a minor's future college expenses, you may consider creating a 529 savings plan account ("529 account") under a plan sponsored by a state or educational institution. The donor – or another adult – is the account owner of the 529 account and the minor is the designated beneficiary. The donor and other persons can contribute only cash to fund a 529 account. 529 account plans provide different investment options that the account owner can select.

Earnings in a 529 account accumulate free of income tax. Withdrawals from a 529 account do not trigger income tax if used for the beneficiary's "qualified education expenses" to attend college, university, trade and vocational schools and other eligible post-secondary institutions. Qualified education expenses include tuition, books, fees, computers and some room and board expenses.

Federal tax law also allows tax-free annual distributions up to $10,000 for a minor's tuition at a K-12 school. Withdrawals from a 529 account for other reasons do trigger federal and state/local income tax and possibly an additional 10% tax penalty.

Note that a state's income tax treatment of withdrawals may not fully conform to the federal income tax laws for 529 plans. Special rules allow a donor to frontload a 529 account with up to five years' worth of annual exclusion gifts and permit an account owner to change the designated beneficiary if the new minor beneficiary is a family member of the current minor beneficiary.

The tax laws allow you to pay anyone's tuition expense without any gift tax consequences if you pay such expense directly to an educational organization. This "Tuition Expense Exclusion" does not have any dollar limit. The Tuition Expense Exclusion does not apply to (i) amounts paid for room and board, books, or supplies, and (ii) contributions to 529 plans. You can use this Tuition Expense Exclusion to directly pay tuition to the educational organization while using a 529 plan to pay other qualified education expenses.

If your goal is to limit a minor's access to assets during adulthood – and particularly if the assets are poised to grow substantially – you should consider establishing and funding an irrevocable trust. The irrevocable trust can specify detailed guidelines for distributions to the minor and also provide for the timing of outright distributions, whether at a particular age or remaining in trust for the minor's lifetime. Lifetime trusts offer benefits such as asset protection, creditor protection and potential transfer tax savings.

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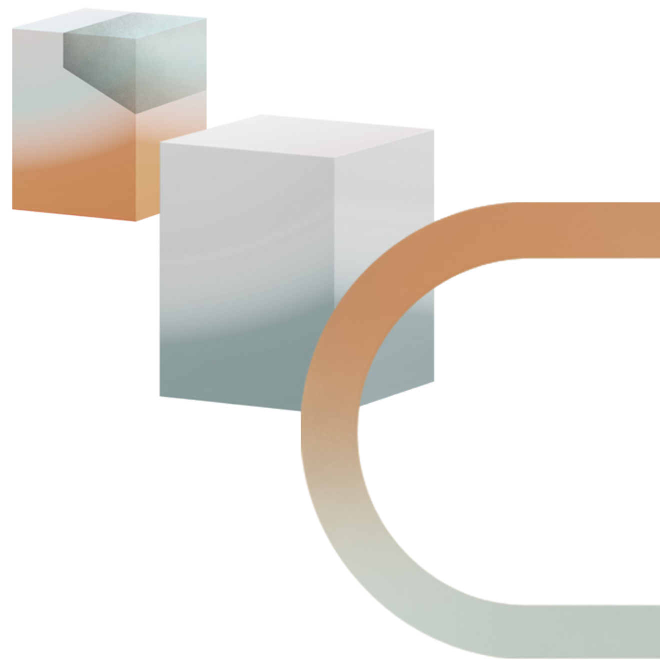
The time for a dynamic wealth plan is now

Life is often unpredictable, but effective wealth planning can reduce the uncertainties.

Your wealth and family, as well as the tax, legal, and economic environment are constantly evolving. As such, your wealth planning needs to be dynamic too. Regular engagement with your Wealth Planner and other independent advisors can help establish whether your current structure is optimal for goals, which may include asset protection, growth opportunities, and the longevity of your legacy.

Before implementing a wealth plan, consult your independent legal and tax advisors in the relevant jurisdictions regarding the appropriate strategy to achieve your objectives.

Please contact your Private Banker or Wealth Planner for more information.



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