Course:
Understanding and Using the Primary Planning Tools

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Course:
Understanding and Using the Primary Planning Tools

Advisor Training Ministry

Course Number: PTS 100

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The TOOLS

<u>Charitable Planning Tools</u>

Charitable Lead Trust (4)

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Dynasty Trust

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Intentionally Defective Grantor Trust

Irrevocable Life Insurance Trust

Qualified Personal Residence Trust

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(#1) Charitable Lead Annuity Trust
Non-Grantor

Characteristics

CLAT is NOT a tax-exempt trust

Governed under the private foundation rules

Income from trust is paid to charity for term of years or lives At end of the term of years or lives, asset passes to the heirs CLATs can be either inter vivos or testamentary

No minimum annuity payout is required

The payment to charity is fixed for the life of the trust

There is no tax deduction for making a transfer into a non-grantor CLAT

The income paid to charity is not taxable to the client as income

The NPV of the charitable income stream is deducted from the value of the initial gift to the CLAT

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(#1) Charitable Lead Annuity Trust
Non-Grantor

Characteristics (continued)

Excess, non-distributed earnings will be taxed at the current trust tax rates

The sale of any asset will be subject to capital gains taxes at the current trust tax rates

Applications

To zero out the gift/estate tax on the asset transfer Where the family has specific assets to pass to their heirs When the client's current giving is meeting or exceeding his AGI charitable deduction limit

To phase in inheritances to heirs

To create a charitable endowment in the client's foundation

To accelerate gifting when life expectancy shortened

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(#1) Charitable Lead Annuity Trust
<u>Non-Grantor</u>

<u>Best Assets for Use</u>

- High income assets where the income is not needed by the client
- Assets that can receive substantial valuation adjustments
- Highly appreciating assets (with or without income production)

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(#2) Charitable Lead Annuity Trust

Grantor

Characteristics

- CLAT is NOT a tax-exempt trust
- Governed under the private foundation rules
- Income from trust is paid to charity for term of years or lives
- At end of the term of years or lives, the asset passes either back to the client or heirs
- CLATs must be inter vivos (lifetime)
- No minimum annuity payout is required

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(#2) Charitable Lead Annuity Trust

Grantor

Characteristics (continued)

- Client receives tax deduction for the gift to the CLAT
- Client report annual annuity payout as income each year

Applications

- When client has huge spike of income in a tax year and needs a deduction offset
- CLAT buys tax-exempt bonds, income paid to charity is not taxable to the client
- When the client's giving is meeting or exceeding his AGI charitable deduction limit

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(#2) Charitable Lead Annuity Trust

Grantor

Best Assets for Use

- Cash
- High income producing assets
- Municipal bonds

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(#3) Charitable Lead Unitrust Trust
Non-Grantor

Characteristics

CLAT is NOT a tax-exempt trust
Governed under the private foundation rules
Income from trust is paid to charity for term of years or lives At end of the term of years or lives, asset passes to the heirs CLATs can be either inter vivos or testamentary
No minimum unitrust payout is required
The payment to charity fluctuates as asset values change There is no tax deduction for making a transfer into a non-grantor CLAT
The income paid to charity is not taxable to the client as income
The NPV of the charitable income stream is deducted from the value of the initial gift to the CLAT

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(#3) Charitable Lead Unitrust Trust
Non-Grantor

Characteristics (continued)

Excess, non-distributed earnings will be taxed at the current trust tax rates

The sale of any asset will be subject to capital gains taxes at the current trust tax rates

Applications

When wanting to name skip generation beneficiaries.

To zero out the gift/estate tax on the asset transfer Where the family has specific assets to pass to their heirs When the client's current giving is meeting or exceeding his AGI charitable deduction limit

To phase in inheritances to heirs

To create a charitable endowment in the client's foundation

To accelerate gifting when life expectancy shortened

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(#4) Charitable Lead Unitrust Trust

<u>Grantor</u>

You'll never use or need it!

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(#1) Charitable Remainder Trust
Standard

Characteristics

CRT is a tax-exempt trust
It pays no income, capital gains or estate taxes
The payout rate must be at least 5% and not more than 50%
There must be at least one non-charitable income beneficiary
Term can run from one year thru 20 years beyond the life of last surviving beneficiary
Corporate CRT can only continue for a maximum of 20 years
Any undistributed income or growth becomes part of the principal of trust
The trust must pay out the stated percentage of assets regardless of investment performance
Charitable income tax deduction must be at least 10% of the value of the gift

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(#1) Charitable Remainder Trust
Standard

Applications

When a client needs a regular income stream, but is willing to allow for some fluctuations

When a client needs to increase his yield on investments

When capital gains taxes are hindering the sale of assets

A corporation (S or C) has an appreciated asset to liquidate

Best Assets for Use

Highly appreciated, publicly traded securities

Highly appreciated real estate

Closely held corporate stock (C or possibly S)

Qualified Funds (into a testamentary CRT)

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(#1) Charitable Remainder Trust
Net Income with Makeup

Characteristics

- CRT is a tax-exempt trust
- It pays no income, capital gains or estate taxes
- The payout rate must be at least 5% and not more than 50%
- If the required payout rate cannot be distributed, it is "owed" and can be made up in later years
- There must be at least one non-charitable income beneficiary
- Term can run from one year thru 20 years beyond the life of last surviving beneficiary
- Corporate CRT can only continue for a maximum of 20 years

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(#2) Charitable Remainder Trust
Net Income with Makeup

Characteristics (continued)

Any undistributed income or growth becomes part of the principal of trust

Charitable income tax deduction must be at least 10% of the value of the gift.

Applications

A client who has more passive income than needed and wants to shut it off

A client who wants to have total control over passive income flow

A client who wants investments to compound tax-free until needed

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(#2) Charitable Remainder Trust

Net Income with Makeup

Best Assets for Use

- Highly appreciated publicly traded securities
- Highly appreciated real estate
- Closely held corporate stock (C or possibly S)
- Qualified funds (into a testamentary CRT)
- Investments that are throwing off unwanted passive income
- Low yielding assets

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(#3) Charitable Remainder Trust

Annuity

Characteristics

CRT is a tax-exempt trust

It pays no income, capital gains or estate taxes

The payout rate must be at least 5% and not more than 50% and is fixed when trust is set up

There must be at least one non-charitable income beneficiary

Term can run from one year thru 20 years beyond the life of last surviving beneficiary

The payout will be fixed for the duration of the trust

Any undistributed income or growth becomes part of the principal of trust

The trust can and will invade principal to make annuity payments if earnings are inadequate

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(#3) Charitable Remainder Trust
Annuity

Characteristics (continued)

- Trust must pass the "5% Probability Test“
- Charitable income tax deduction must be at least 10% of the value of the gift

Applications

- Elderly client (over 75) needs regular fixed income and is not worried about inflation
- A client wishes to make a fixed number of payments to non-charitable beneficiary before making gift to charity

Best Assets for Use

- Highly appreciated publicly traded securities
- Highly appreciated real estate
- Closely held corporate stock (C or possibly S)
- Qualified funds (into a testamentary CRT)

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(#4) Charitable Remainder Trust
Flip

Characteristics

CRT is a tax-exempt trust

It pays no income, capital gains or estate taxes

The payout rate must be at least 5% and not more than 50%

If the required payout rate cannot be distributed, it is "owed" and can be made up in later years

There must be at least one non-charitable income beneficiary

Term can run from one year thru 20 years beyond the life of last surviving beneficiary

Corporate CRT can only continue for a maximum of 20 years

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(#4) Charitable Remainder Trust Flip

Characteristics (continued)

Charitable income tax deduction must be at least 10% of the value of the gift

The trust will "flip" from being a NIMCRUT to a SCRUT at some permissible triggering time or event

90% of assets going into trust must be unmarketable assets

When trust "flips," the Make-Up Provision is lost and becomes part of principal of trust

Applications

A client unmarketable assets now, but will want a fixed income later (after some triggering time or event)

A client who wants to make a gift now, but not be forced to make additional gifts to CRT or sell asset to produce income

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(#5) Charitable Remainder Trust
Flip

Best Assets for Use

- Highly appreciated publicly traded securities
- Highly appreciated real estate
- Closely held C stock
- Limited Partnership interests
- Unregistered securities
- Any asset that is not readily marketable

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(#5) Charitable Remainder Trust

Net Income Without Makeup

You'll never use or need it!

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(#1) Pooled Income Fund (PIF)
<u>Total Return</u>

<u>Characteristics</u>

Pooled Income Funds are offered by charities.

Investor/donors “pool” their resources into one fund

Investor/donors receive a substantial, current, charitable income tax deduction when they invest in the PIF

Fund manager invests for total return on portfolio

Investor/donors are paid their share of the total return of the fund

Payments to the investor/donor can run for single/joint life or for a term of years

Once the term is completed, the principal goes to the charity No set up costs to investor/donor

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(#1) Pooled Income Fund (PIF)
Total Return

Applications

- Investors who want to rebalance their portfolios without paying capital gains tax to do so
- Investors who want to receive a substantial, current charitable income tax deduction now for a deferred gift made much later
- Investors who have non cash assets that they are ready to liquidate and reinvest

Best Assets for Use

- Highly appreciated publicly traded securities
- Highly appreciated real estate

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(#2) Pooled Income Fund (PIF)
Loan Regime

Characteristics

Pooled Income Funds are offered by charities

Investor/donors "pool" their resources into one fund

Investor/donors receive a substantial, current, charitable, income tax deduction when they invest in the PIF

PIF loans its funds to charity at a predetermined rate of interest

Investors receive the interest payments on the loan to the charity

Payment to the investor/donor can run for single/joint life or for a term of years

Once the investor term is completed, that portion of the loan is effectively cancelled

No set up costs to investor/donor

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(2) Pooled Income Fund (PIF)
Loan Regime

Applications

A way for investors to increase the fixed income return on that portion of their investment portfolio

A way for a donor to make a deferred gift that can actually help a charity immediately

A way to create a substantial tax deduction while increasing cash flow

Best Assets for Use

Highly appreciated publicly traded securities

Highly appreciated real estate

Any other non cash asset that is ready to be liquidated

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Charitable Gift Annuity (CGA)

Characteristics

CGA's are offered by charities.

Term can run for single or joint life expectancy

Annuity payments can be immediate or deferred

CGA pays you back interest, capital gain and a return of principal

Any undistributed income or growth goes to the Charity

The charity must pay out the stated annuity amount regardless of investment performance

Charity can accept financed real estate in exchanged for a CGA

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Charitable Gift Annuity (CGA)

<u>Applications</u>

- Elderly client (over 75) needs regular fixed income and is not worried about inflation
- A client who wishes to enjoy the benefits of a CRT while avoiding the complexities of a CRT (The poor man CRT)
- A client has leveraged assets that will not work in a CRT

<u>Best Assets for Use</u>

- Highly appreciated publicly traded securities
- Highly appreciated real estate (May have debt)
- Closely held corporate stock (C or possibly S)

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Charitable Life Estate Agreement

<u>Characteristics</u>

An irrevocable agreement to donate to charity a 1st or 2nd residence after death

The present value of the future gift to charity creates a current income tax deduction

<u>Applications</u>

When no one in the family wants the residence

When the family plans to give the residence to charity at death as a testamentary bequest

<u>Best Assets for Use</u>

1st residence

2nd residence

Farm

Houseboat

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(#1) Family Foundation
Public - Donor Advised Fund

Characteristics

- It is a segregated account under the tax and administrative umbrella of a qualified 501(c)3 public charity
- It is treated for tax purposes as a public charity
- The 501(c)3's board has ultimate control of all DAFs
- The family makes distribution requests which must be approved by the board
- DAFs are very inexpensive to open and operate
- DAFs can either be operating or endowment family foundations
- A DAF can be set up in a matter of days
- No minimum annual distributions are required

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(#1) Family Foundation
Public - Donor Advised Fund

Characteristics (continued)

- Most community foundations do not allow DAFs to run perpetually
- Most community foundations severely limit gifts to charitable causes outside their community

Applications

- To serve as remainderman beneficiary of a CRT
- To serve as income beneficiary of a CLAT
- To be used by the family for current giving

Best Assets for Use

- Cash
- Any asset except an operating business (S Corp. stock)
- Life insurance

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(#2-#4) Family Foundation

Public - Supporting Organization

Characteristics

There are three types of Sos

Type I - Parent Child (same board, same charity) Type II - Sibbling (Different boards, same charity) Type III - "In conjuntion with" (different board, many

charities

It has all the characteristics of a private family foundation except the family is a minority on the board

The family can appoint the other board members it's SO

It must specifically name all the charities that it ever intends to support, no limit to the number

It is treated as a public charity - not regulated by the private foundation rules - most favorable tax treatment

Must pass attentiveness test

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(2-4) Family Foundation

Public - Supporting Organization

Characteristics

Distributions: 85% of SO's net income must be distributed; no minimum distribution on gifts received

It is a legal entity that must be created by an attorney and approved by the IRS

The costs can be about $10,000

It can take several months to set one up

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(#2-#4) Family Foundation

Public - Supporting Organization

Applications

When client wants to be more actively involved in the operation of the foundation

When family wants large amounts of closely held C stock owned by SO

When a family wants to receive maximum tax benefits for gifts of non-publicly traded securities

When a family wants to create a "family bank“

When client is willing to retain relative retain control in exchange for no private foundation rules

Best Assets for Use

Cash

Any asset except an operating business and S Corp.

stock Life insurance

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(5-6) Family Foundation
Private - Non-Operating/Operating

Characteristics

- Family has absolute control over entire operation of PFF
- It is typically an endowment
- It is under the regulations of the private foundation rules
- It must distribute at least 5% of the value annually
- Reduced deductions for gifts to PFF
    - Cost Basis vs. Fair market value
    - 30% vs. 60% of AGI on cash gifts
    - 20% vs. 30% of AGI on appreciated assets

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(#5-#6) Family Foundation
Private - Non-Operating/Operating

Characteristics (continued)

- Limitations on excess business holdings
- Jeopardy Investment rules
- Self-dealing rules
- 2% annual income tax
- Subject to numerous excise taxes of up to 50%
- It is a legal entity that must be created by an attorney and approved by the IRS
- The costs can be about $10,000
- Operating PFFs do charitable work
- Non-operating PFFs simply support existing charities

Applications

- When absolute control of Social Capital overrides all other financial and economic considerations

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(#5-#6) Family Foundation
Private - Non-Operating/Operating

Best Assets for Use

Cash

Any asset except an operating business or S Corp. stock

Life insurance (recent PLR approval)

(#7) ***Pass Through***

Characteristics

It is considered a PFF but is treated as a public charity

It must distribute 100% of all assets to qualified 501(c)3s

It is a legal entity that must be created by an attorney and approved by the IRS

The costs can be about $10,000

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(#7) Family Foundation
Private - Pass Through

Applications

- Can receive maximum tax benefits on gifts to PFF
- What makes this PFF appealing is the very thing that makes it unpopular
- The client might as well just make gifts directly to charity -- no difference on taxes or control

Best Assets for Use

- Appreciated assets
- Cash
- No operating business (S Corp. stock)

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Dynasty Trust

<u>Characteristics</u>

An irrevocable trust

Gets its name because it holds family wealth for multiple generations

In 18 states there are no laws against perpetuities, and six more that run from 150 years to 1,000 years

Trusts using these state laws can literally go on forever and never terminate

Beneficiaries have right to income and use of trust assets, but no ownership

Trustee controls the trust, not beneficiaries

Often ILITs are designed to be Dynasty Trusts

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Dynasty Trust

<u>Applications</u>

When avoiding estate and GST taxes is desired

When client wants heirs to enjoy benefits of wealth, but not to own it

To insure that future generations will be cared for according to the client's wishes

<u>Best Assets for Use</u>

Any asset is appropriate for a Dynasty Trust

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Family Limited Partnership/ Limited Liability Company

<u>Characteristics</u>

- The FLP has a general partner, usually 1%, and limited partner(s), usually 99%
- The general partner makes all administrative decisions for the entire partnership
- The limited partner(s) only have an equity position, but no control whatsoever

<u>Applications</u>

- Protection of Wealth
  - FLP makes assets very difficult for creditors to attach
  - If they do get a Charging Order, they may end up with only phantom income to pay taxes on
  - It forces the creditors to the negotiating table

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Family Limited Partnership/ Limited Liability Company

Applications (continued)

- Control of Wealth
  - As GP, the entire wealth of FLP can be controlled by one person
  - GP can divest himself of considerable wealth without losing control of the assets
- Transfer of Wealth
  - Because of the lack of control and marketability, major valuation adjustments are possible
  - Limited partnership interests are very easy to transfer to heirs and charity
  - GP can transfer large blocks of wealth to heirs tax free

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Family Limited Partnership/ Limited Liability Company

<u>Best Assets for Use</u>

- Assets hard to divide (i.e. real estate)
- Assets that can be exposed to the claims of creditors
- Assets that have a legitimate business use (business or investment)
- No S Corp. stock

<u>Factors Used for Calculations</u>

- Valuation Adjustments:
- Lack of Marketability
- Lack of Control
- Valuation adjustments can run as high as 80% of the FMV of assets

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Grantor Retained Annuity Trust

Characteristics

Grantor retains an annuity income from trust for a term of years

The annuity payment is fixed for the term of years

The annuity payment being retained reduces the value of the asset being transferred

If grantor dies during term of trust, the entire asset comes back into his estate as if the trust had never been set up

There are no income tax benefits of any kind

Applications

To pass specific assets on to heirs at specified period of time

When client has an income producing asset in which he needs/wants to retain income for a period of time

Buying term insurance eliminates the risk of premature death prior to termination of trust

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Grantor Retained Annuity Trust

<u>Best Assets for Use</u>

S. Corp. stock

Rental real estate

Any income producing asset

Highly appreciating asset (with or without income)

Intentionally Defective Grantor Trust

Characteristics

An irrevocable trust

Income of trust taxed to the client

An asset sold to IGT is not a completed sale for tax purposes

The client (and spouse) use their annual exclusions and/or lifetime exclusions to make tax-free transfers of initial capital contributions

The distribution of the assets in trust are totally at the discretion of client when he sets up the trust

All assets sold to IGT are completed gifts for gift and estate tax purposes and consequently outside the taxable estate

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Intentionally Defective Grantor Trust

<u>Applications</u>

- When a client wishes to freeze the value of a rapidly growing asset and get it to the heirs
- When a client wants to postpone payment of capital gain taxes on the sale of an asset to IGT
- When a client wants to further reduce the estate size by paying income taxes on assets owned by heirs

<u>Best Assets for Use</u>

- Highly appreciating asset
- Other income producing and appreciating assets no longer needed by client

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Irrevocable Life Insurance Trust

Characteristics

An irrevocable trust

Life Insurance is applied for by the trust and the client makes annual gifts to the trust

The client (and spouse) use their annual exclusions and/or lifetime exclusions to make tax-free transfers

The distribution of the assets in trust are totally at the discretion of client when he sets up the trust

If $10,000 is used for the annual exclusion, "hanging powers" or sub-accounts must be used in the trust

The Crummey letters must be sent out annually

All assets in this trust are outside the estate of the client for estate tax purposes

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Irrevocable Life Insurance Trust

<u>Applications</u>

- Replacing value of assets to the heirs that have been gifted to the charitable entities
- To discount the cost of estate taxes
- To provide cash for the purchase of assets the heirs want to reacquire from the foundation

<u>Best Assets for Use</u>

- Life Insurance
- Other income producing or appreciating assets no longer needed by client

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Qualified Personal Residence Trust

<u>Characteristics</u>

Client retains the right to use home for specific term of years

The retained right to use the property reduces the value of the asset being transferred

If client dies during the term of trust, the entire asset comes back into his estate

Reversionary vs. Nonreversionary provision

The residence can no longer be repurchased from the trust and the replacement assets passed on to the heirs

Fair market rent not part of $10,000 annual exclusion

Can only do two QRPT per person

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Qualified Personal Residence Trust

<u>Applications</u>

When a family wants to pass residence on to heirs

To pass value of home to heirs with an adjustment in valuation

Best Assets for Use

1st residence

2nd residence

<u>Factors Used for Calculations</u>

Value of asset

7520 rate

Retained use of property

Useful life

Salvage value

Debt

Term of years

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