

ADVISOR TRAINING MINISTRY
COURSE NUMBER: PTS 100A

Understanding and Using the Charitable Planning Tools

TAYLOR UNIVERSITY



The Tools

Charitable Planning Tools

Charitable Lead Trust (4)

Charitable Remainder Trust (5)

Pooled Income Funds (2)

Charitable Gift Annuity

Charitable Life Estate Agreement

Family Foundation (7)



(I) Charitable Lead Annuity Trust Non-Grantor

CHARACTERISTICS

- NOT a tax-exempt trust
- Subject to the private foundation rules
- Income from CLAT is paid to charity for term of years or lives; thereafter, assets pass to remainder beneficiary (typically heirs)
- The PV of the income paid to charity is deducted from the FMV to determine the PV of the remainder interest
- CLATs can be either inter vivos or testamentary
- No minimum annuity payout is required
- The payment to charity is normally fixed/variable
- There is no income tax deduction for making a transfer to a non-grantor CLAT



(I) Charitable Lead Annuity Trust Non-Grantor

CHARACTERISTICS

- CLAT is taxed on income, but it gets a deduction as a complex trust for distributions to charity

APPLICATIONS

- To zero out the gift/estate tax on the asset transfer
- To pass specific assets to pass to their heirs
- To avoid limitations on giving (e.g., when the client's current giving is meeting or exceeding his AGI charitable deduction limit)
- To phase in inheritance to heirs
- To create a charitable endowment in the client's foundation
- To accelerate gifting when life expectancy shortened



(I) Charitable Lead Annuity Trust Non-Grantor

BEST ASSETS FOR USE

- 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)



(2) Charitable Lead Annuity Trust Grantor

CHARACTERISTICS

- NOT a tax-exempt trust
- Subject to the private foundation rules
- Income from CLAT is paid to charity for term of years or lives; thereafter, assets pass to remainder beneficiary (typically heirs)
- The PV of the income paid to charity is deducted from the FMV to determine the PV of the remainder
- CLATs can be either inter vivos or testamentary
- No minimum annuity payout is required
- The payment to charity is normally fixed/variable
- Client receives income and gift tax deduction for the PV of the income interest payable to charity



(2) Charitable Lead Annuity Trust Grantor

CHARACTERISTICS

- Client reports income of CLAT on his personal tax return 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 earned on bonds is not taxable to the client
- When the client's giving is meeting or exceeding his AGI charitable deduction limit



(2) Charitable Lead Annuity Trust Grantor

BEST ASSETS FOR USE

- Cash
- High income producing assets
- Municipal bonds



(3 & 4) Charitable Lead Unitrust Non-Grantor and Grantor

CHARACTERISTICS

- Same attributes and characteristics as a Non-Grantor/Grantor CLAT

APPLICATIONS

- Normally does NOT zero out estate tax
- Used primarily with GST planning



(I) Charitable Remainder Unitrust Standard

CHARACTERISTICS

- CRUT 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 is usually 1-2 lives, but can run from up to 20 years (but not beyond the life of all beneficiaries)
- Corporate CRT can only continue for a maximum of 20 years
- Any undistributed income or growth becomes part of the principal of trust when the term of the CRT ends



(I) Charitable Remainder Unitrust Standard

CHARACTERISTICS

- The trust must pay out the stated percentage of the FMV of assets (usually on Jan. 1st) regardless of investment performance
- PV of charitable remainder interest must be at least 10%

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



(I) Charitable Remainder Unitrust Standard

BEST ASSETS FOR USE

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



(2) Charitable Remainder Unitrust Net Income with Makeup

CHARACTERISTICS

Same rules as a Standard CRUT, except:

- If the required payout is not earned and cannot be distributed, it is “owed” and can be made up in later years

APPLICATIONS

- A client who has more 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



(2) Charitable Remainder Unitrust 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)
- IRAs and Qualified funds (into a testamentary CRT)
- Investments that are throwing off unwanted passive income
- Low yielding assets



(3) Charitable Remainder Unitrust Flip

CHARACTERISTICS

Same as a Standard CRUT except:

- Trust starts off being a NIMCRUT or “income only” CRUT
- 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”, if the initial Trust is set up as a NIMCRUT, the Make-Up amount is lost and becomes part of principal of trust

APPLICATIONS

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



(3) Charitable Remainder Unitrust Flip

APPLICATIONS

- 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

BEST ASSETS FOR USE

- Highly appreciated publicly traded securities (less than 10%)
- Highly appreciated real estate
- Closely held C stock
- Limited Partnership interests
- Unregistered securities
- Any asset that is not readily marketable



(5) Charitable Remainder Annuity Trust

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)
- IRAs and Qualified funds (into a testamentary CRT)



(I) Pooled Income Fund (PIF) Total Return

CHARACTERISTICS

- Pooled Income Funds are offered by charities
- Investor/client “pools” their resources into one fund
- Investor/client receives a substantial, current, income and gift tax charitable deductions
- Fund manager invests for total return on portfolio
- Investor/client (as an income beneficiary) receive pro-rata share of the total return of the fund (O.I. and LTCG)
- Payments to the income beneficiaries can run for single, joint, or multiple lives
- Once the term is completed, the principal goes to the charity
- No set up costs to investor/client



(I) Pooled Income Fund (PIF) Total Return

APPLICATIONS

- Investor/client who wants to rebalance investment portfolios without paying capital gains tax to do so
- Investor/client who wants to receive a substantial, current charitable income tax deduction now for a deferred gift made much later
- Investor/client who has non-cash assets that ready for liquidation and reinvestment



(I) Pooled Income Fund (PIF) Total Return

BEST ASSETS FOR USE

- Highly appreciated publicly traded securities
- Highly appreciated real estate
- Business being liquidated



(2) Pooled Income Fund (PIF) Loan Regime

CHARACTERISTICS

Same as the Total Return PIF, except:

- The PIF can loan its funds to charity at interest
- Upon the death of the last income beneficiary, that portion of the loan is effectively cancelled
- No set up costs to investor/client



(2) Pooled Income Fund (PIF) Loan Regime

APPLICATIONS

- A way for Investor/client to increase the fixed income return on a portion of their investment portfolio
- A way for Investor/client to make a deferred gift that can actually help 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



Charitable Gift Annuity

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



Charitable Gift Annuity

APPLICATIONS

- 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

BEST ASSETS FOR USE

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



Charitable Life Estate Agreement

CHARACTERISTICS

- 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

APPLICATIONS

- 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



Charitable Life Estate Agreement

BEST ASSETS FOR USE

- 1st residence
- 2nd residence
- Farm
- Houseboat



(I) 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



(I) Family Foundation Public - Donor Advised Fund

CHARACTERISTICS

- 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



(I) Family Foundation Public - Donor Advised Fund

BEST ASSETS FOR USE

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



(2-4) Family Foundation Public - Supporting Organization

CHARACTERISTICS

- There are three types of SOs
 - ✓ Type I - Parent Child (same board, same charity)
 - ✓ Type II - Sibling (different boards, same charity)
 - ✓ Type III – “In conjunction 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 its SO
- It must specifically name all the charities that it ever intends to support, no limit to the number



(2-4) Family Foundation Public - Supporting Organization

CHARACTERISTICS

- It is treated as a public charity - not regulated by the private foundation rules - most favorable tax treatment
- Must pass attentiveness test
- Distributions: For Type I and Type II, no minimum distribution on gifts received
- Distributions: For Type III, greater of 3.5% of FMV of assets or 85% of SO's net income must be distributed
- 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



(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



(2-4) Family Foundation Public - Supporting Organization

BEST ASSETS FOR USE

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



(5-6) Family Foundation Private, Non-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



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

CHARACTERISTICS

- 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



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

APPLICATIONS

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

BEST ASSETS FOR USE

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



(7) Family Foundation Private - 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



(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
- No operating business (S Corp stock)
- Cash



Questions and Answers

