PLANNED GIVING STRATEGIES IN A CHANGING ECONOMY

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I. Overview of Planning Giving Strategies

A. Charitable Remainder Trust

1. Definition and Basic Features. An irrevocable trust for the benefit of at least one charitable and one non-charitable beneficiary, which meets the requirements of IRC Section 664.

a. Trust has no income tax liability

b. Pays fixed annuity amount, net income, or unitrust (percentage) amount to non-charitable beneficiary.

c. Amounts paid to non-charitable beneficiaries must be not less than 5 percent of the initial fair market value of all property placed in trust

d. Present value of remainder interest calculated at time of funding must be at least 10%.

2. Types

a. Charitable Remainder Unitrust (CRUT). Pays out fixed percentage of value of trust assets as determined on the same day each year. For CRUT created during lifetime, additional contributions can be made after the trust is created.

b. Net Income Charitable Remainder Trust (NICRUT). Pays out the lesser of the net income or unitrust percentage each year. For NICRUT created during lifetime, additional contributions can be made after the trust is created.

c. Net Income with Makeup Provision (NIMCRUT). Pays lesser of (1) the net income or (2) a unitrust percentage each year, but to the extent that net income is less than the fixed percentage in any year, such deficiency amount is accrued and is later paid out or "made up." For NIMCRUT created during lifetime, additional contributions can be made after the trust is created.

d. "Flip" CRUT. Pays the net income until the occurrence of a pre-determined event that is a date certain or an event beyond the control of the grantor, such as the sale of an unmarketable asset such as real property. For trust crated during lifetime, additional contributions can be made after the trust is created.

e. Charitable Remainder Annuity Trust (CRAT). Pays a fixed annuity amount each year. Additional contributions are not permitted.

3. Testamentary vs. Nontestamentary. Charitable remainder trusts can be established during lifetime or upon death pursuant to a will or revocable trust.

a. Planning Suggestion. A testamentary CRT can be a good solution where the client wants to provide some limited benefit to underage (or other) beneficiaries, and also would like to leave assets to charity and receive an estate tax charitable deduction.

b. Caution. If a CRT is implemented on a testamentary basis, care must be taken to ensure that the terms will qualify. Note that a trust may qualify with a particular set of terms based on the 7520 rate currently in effect, but may not qualify following death when a different 7520 rate will apply.

4. Additional Considerations.

a. Selection of Trustee. Grantor, charity or third party can serve as trustee. Grantor can receive reasonable compensation for service as trustee.

b. Power to Change Charitable Beneficiary. Consider allowing grantor to retain power to re-designate charitable remainder beneficiary. Some charities have a policy that at least 50% of the remainder interest must be irrevocably designated in favor of the charity, for the charity to agree to serve as trustee.

c. Acceleration of lifetime unitrust interest is permitted.

d. Self Dealing Rules

e. Investment Restrictions

i. Jeopardy Investments

ii. Excess Business Holdings

f. Unrelated Business Taxable Income (UBTI)

g. Debt-Encumbered Property

i. Generally no debt-encumbered property can be held by CRT

ii. Potential Solutions

h. Income Tax Considerations

i. Charitable Deduction Limitations

ii. Taxation of Distributions from CRT.

(a) Deferral of income taxation

(b) Four-tiered income taxation of distributions

B. Charitable Lead Trust

1. <u>Definition and Basic Features</u>. During the trust term, pays a fixed annuity or unitrust amount to the charitable beneficiary. At the end of the trust term, pays the remaining assets to one or more non-charitable beneficiaries.

2. <u>Types</u>

a. <u>Grantor/Nongrantor</u>.

i. <u>Grantor CLT</u>. "Grantor trust" for income tax purposes. Grantor receives an income tax deduction upon creation for the present value of the interest passing to charity. The grantor has income tax liability for trust income each year without an annual charitable deduction for distributions to charity.

ii. Nongrantor CLT. The grantor does not receive an income tax deduction upon creation. The trust has income tax liability but receives an income tax charitable deduction each year.

b. Charitable Lead Unitrust (CLUT). Pays an annual amount to the charitable beneficiary that is a fixed percentage of the asset value determined on the same day each year.

c. Charitable Lead Annuity Trust (CRAT). Pays an annual fixed annuity amount each year.

3. Testamentary vs. Nontestamentary. Charitable lead trusts can be established during lifetime or on a testamentary basis pursuant to a will or trust agreement. A testamentary CLT can be a good solution where the client wants to defer distributions to individual beneficiaries and also would like to leave assets to charity and receive an estate tax charitable deduction.

C. Gift of Remainder Interest in Personal Residence or Farm.

1. Gift Must be Irrevocable. Treas. Regs. Section 1.170A-7(b)(3),(4).

2. Gift Must be Not in Trust. Only an outright gift will be deductible for income tax and gift tax purposes. Treas. Regs. Section 1.170A-7(b)(3),(4).

3. Permissible Term of Retained Interest. The retained interest can be for the life of one or more individuals, for a term of years, or the longer of the life of one or more individuals and a term of years. Treas. Regs. Section 1.170A-7(b)(3),(4).

4. Charitable Donee Cannot be Required to Accept Proceeds from Sale of Property in Lieu of Remainder Interest in Property. In Rev. Rul. 77-305, 1977-2 C.B. 72, the taxpayers made a gift of the remainder interest in their personal residence, under which the charitable donee was required, as a condition of the gift, to sell its remainder interest in the event the donors decided to sell the residence. The IRS held that the charitable gift was not deductible."

5. Definition of "Personal Residence." "Personal residence" includes any property used by the donor as his or her personal residence even though it is not used as his or her principal residence. For example, the donor's

vacation home may be considered a personal residence. Treas. Regs. Section 1.170A-7(b)(3).

6. Inclusion of Surrounding Land and Improvements in "Residence." This will be dependent on the facts and circumstances. In Rev. Rul. 75-420, 1975-2 C.B. 78, the IRS approved of the contribution of a remainder interest in real property consisting of 20 acres of land and improvements thereon. The improvements included a main house with 25 rooms, a caretaker's cottage, a barn, a swimming pool, a gymnasium, and a tennis court. Members of the taxpayer's family had owned the property since 1900, and since the taxpayer had acquired the property in 1960, the taxpayer had used the property exclusively for summer vacations.

7. Furnishings Excluded. The remainder value of household furnishings contained in residence at the time of death do not count as part of the deductible remainder interest in a personal "residence." Rev. Rul 76-165, 1976-1 C.B. 279.

8. Definition of "Farm." "Farm" means any land used by the donor or his or her tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock. Improvements located on such land are included. "Livestock" include cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry. Items of tangible personal property are excluded. Treas. Regs. Section 1.170A-7(b)(4).

9. Contribution of Less than All of Remainder Interest. To qualify for income and gift tax deductions, the donor need not contribute the entire remainder interest to charity. In Rev. Rul. 87-37, the IRS approved the contribution of 10% of remainder interest in the donor's principal residence to charity, with 90% of the remainder interest passing to an individual, so that the charity and the individual would hold the remainder interest as tenants in common. However, in valuing the gift of the remainder interest to charity, an appropriate valuation discount must be applied due to the co-tenancy arrangement.

D. Charitable Gift Annuity

1. Advantage: Simplicity and Low Cost

2. Charity Must Qualify with State to Issue Charitable Gift Annuities

3. Disadvantages

a. Limited Options for Creative Applications

b. Not Offered by All Organizations

II. Adapting Planned Giving Strategies to a Changing Economy

A. Valuation Issues.

1. Qualified appraisal must be obtained to qualify for charitable deduction.

2. Special Requirements apply to unmarketable assets.

B. Timing Issues

C. Effect of Changing Interest Rates on Planned Giving Strategies

1. Role of 7520 Rate

2. Historical 7520 Rate (PowerPoint Slide)

3. Comparisons of various strategies in higher and lower interest rate environments (PowerPoint Slide)

III. Recent Developments in Planned Giving

A. "Shark Fin" CLAT

B. Discussion of Recent Cases

C. Trends