Sherwood Oaks
CHRISTIAN CHURCH

CHARITABLE
CASE IN POINT

ISSUE 1

2700 E. Rogers Road, Bloomington, IN 47401
Sherwood Oaks Christian Church

CHARITABLE CASE IN POINT

This is the first of what we hope to be a beneficial and continuing communication, designed to share with our friends in the professional disciplines of financial and estate planning.

Each quarter, we will review a case study in which a charitable gift concept is used to meet an individual's financial needs, as well as benefit a charitable interest.

OUR REASON FOR THIS COMMUNICATION

We are sure this question has entered your mind, "Why are we publishing ***Charitable Case in Point?***"

Naturally, we desire to see that individuals are given the opportunity to fulfill their charitable giving interests, and we'll talk more about this in later communications.

But one important reason for this publication is that we believe that the tax planning tools which have charitable implications should be "on the table" with the other tax and estate planning tools, and should be given consideration in meeting the donor's tax, income and distribution planning needs.

For example, in this issue, we will present a special charitable trust which can be used to greatly reduce or eliminate federal estate taxes payable.

However, it has been our experience that many professional planners have not presented this option to their clients, to be considered with other potential solutions, such as purchase of life insurance, liquidating existing assets, timed gifts, capital freezes, etc.

When the charitable trust has been presented with other options, many individuals have chosen to postpone distribution of a percentage of their assets to family members, through use of the trust, rather than pay federal estate taxes.

And we have found it interesting that many individuals wish to use this tax planning tool, even when they do not have charitable giving desires.

Why has this charitable tool not been presented more frequently?

We believe the basic reason is because the professional planners may not be aware of how the trust operates, and the benefits it can provide to their clients.

We trust ***Charitable Case in Point*** will help you become more familiar with this tool, so it can be "placed on the table" with other planning options to better serve your clients.

THE CASE IN POINT

Client and spouse have an estate valued at $8 million. At present, they own no life insurance. Their current estate plan provides for a revocable living trust to become two trusts at the death of the first spouse, funding the second trust with the value offset by the federal estate tax credit.

With the two-trust tax planning, the client will still be responsible for a federal estate tax of $450,000 (assuming death occurs in 2009).

The client also gave consideration to making lifetime gifts to family members, but this did not provide a complete solution. Because of the types of assets held by this estate, and the number of beneficiaries, lifetime gifts using the $13,000 per year, per individual personal gift tax exemption, would only effectively eliminate the tax on future growth of the estate.

THE CHARITABLE SOLUTION

We suggested that the client consider placing the taxable portion of the estate into a special charitable trust, designed to pay income to a charitable organization for a period of years. At the end of the trust period, the assets remaining will be distributed to family members. This trust will be funded at the death of the surviving spouse.

The trust will provide the estate with a charitable estate tax deduction for the present value of the income paid to the charitable organization.

The client has considerable flexibility in the design of the trust and the deduction it will produce, even to the point of creating a 100% charitable deduction, to fully offset federal estate taxes payable.

The following chart illustrates the number of years and the percentage payouts from the trust which are necessary to equal a 100% charitable deduction.

Length of Trust	Income Payable
10 years	12.7%
12 years	11.1%
14 years	9.9%
16 years	9.1%
18 years	8.4%
20 years	7.9%

Note: Above calculations are for a charitable lead annuity trust, with a 5% AFR factor.

OTHER PLANNING OPTIONS AVAILABLE

Establishing the Trust with a Lower Payout or for a Shorter Term

There are options available, other than creating a 100% charitable deduction. The client could choose to pay income to the charity at a lower percentage rate or for a shorter period of years, to offset a percentage of the tax payable, rather than the total estate tax.

For example, a trust designed to pay 10% per year to a charitable organization for ten years, making distribution to family members at the end of the trust period, would offset approximately 75% of the taxes due.

In the columns of the following chart, we have indicated the approximate percentage of taxes which can be saved when establishing a fixed payment trust paying 8%, 10% or 12% income (assuming a charitable lead annuity trust making annual payments, and a 5% midterm AFR factor) to a charitable beneficiary for the length of trust indicated.

	% Tax Avoided with Payment of		
Trust Term	8%	10%	12%
10 yr	62%	77%	93%
12 yr	71%	89%	100%
14 yr	79%	99%	—
16 yr	87%	100%	—
18 yr	94%	—	—
20 yr	100%	—	—

Establishing Multiple Trusts

Delaying distribution to personal beneficiaries for a period of twenty years to eliminate estate taxes may not be practical. However, there is a way to reduce the taxes substantially, and allow earlier distribution to personal beneficiaries.

Rather than establishing one trust at the death of the surviving spouse, the client could establish a series of trusts, designed to pay income to the charitable organization for varied periods of years.

For example, let's distribute the tax credit equivalency amount from the first spouse's estate at death of the surviving spouse, and place the remainder of the estate in a series of trusts, 25% distributed at the end of four, eight, twelve, and sixteen years.

If each trust was established to pay 8% per year to the charitable organization, the estate would be allowed a charitable deduction which would eliminate the taxes payable.

Establish a Trust During Lifetime

If your client is currently making substantial charitable gifts, and is post-retirement age, he might consider establishing a trust during lifetime, allowing income from the trust to continue the client's current giving patterns.

This option allows an earlier distribution of assets to family members, and is often desirable for more wealthy individuals. Many individuals desire to transfer property to family members during lifetime, but want to avoid the gift taxes which accompany lifetime transfers in excess of $13,000 per year, per individual.

COMBINING A CHARITABLE TRUST WITH AN IRREVOCABLE LIFE INSURANCE TRUST

One of the most common products used to provide liquidity for estate taxes is life insurance. And if life insurance is held in an irrevocable life insurance trust, the proceeds of the life insurance policies will not be part of the taxable estate.

However, instead of paying taxes with the life insurance, let's assume an individual establishes a special charitable trust designed to avoid estate taxes, and funds an irrevocable life insurance trust with insurance in the approximate amount of the estate taxes which would have been payable without the charitable trust. At the death of the surviving spouse, the insurance proceeds can be annuitized to replace a substantial portion of the income lost by family members, through use of the charitable trust.

While it is difficult to annuitize the insurance proceeds to equal the earnings from the assets transferred to the charitable trust, for many clients, the satisfaction of making a major charitable gift in lieu of paying federal estate taxes is well worth the difference.

COMPARISON OF BENEFITS

The following summary does not take into consideration the time value of money. However, it does illustrate the impact of establishing a trust paying 10% income to charity for 14 years, with distribution of assets to family members at the end of the trust period.

Our example assumes that the client will avoid 100% of the estate taxes payable, and that the combined appreciation and earnings of the trust during the fourteen-year period will equal the payout from the trust.

	Without Charitable Trust	With Charitable Trust
Estate Taxes Paid [1]	$ 450,000	$ 0
Property to Family	7,550,000	8,000,000
Income to Charity	0	1,400,000

[1] *Assuming death occurs in 2009.*

SUMMARY OF BENEFITS TO CLIENT

The decision for the client is, "Who is his favorite charity?" Is it Uncle Sam, with a contribution of approximately $450,000 in taxes? Or is it another charitable organization with a contribution of $1.4 million, over the next fourteen years?

The disadvantage of the charitable trust is that the family must wait until the end of the trust period to receive that portion of the estate. However, the family will receive $7 million (plus life insurance in trust) at the death of the surviving parent, and for most clients with whom we have worked, that is far more than the client received as an inheritance, and the delay of the remainder will not be a concern.

In fact, many clients, because of their concern over the impact which too large an inheritance can have upon the lifestyles and work ethics of their children, feel this delay is a benefit.

This is where we must listen to and counsel with our clients. Many times, as professional planners we assume that the objective is to distribute as much of the estate to family members as possible. And we often do not take time to discover our clients' real goals and objectives for their families.

BENEFIT TO THE CHARITABLE ORGANIZATION

The benefit to the charitable organization is obvious, it will receive an annual income during the period of the trust, to be used for its goals and objectives.

This not only benefits the charitable organization, but in almost all situations provides a sense of satisfaction for the client, knowing that which has been accumulated over a lifetime will be available to family and charity to accomplish good… a choice preferred over paying taxes.

CONCLUSION

This vehicle will not be accepted by every client. As we stated early in this newsletter, we believe it is a vehicle which should be on the planning table, along with the other estate tax planning tools.

But we're sure there are many clients with whom you work who should consider this type of special trust, as part of their estate tax planning. When you have such a client, may we suggest one of the following:

- If you will furnish us with your client's estate data, we will be happy to prepare a personalized presentation with tax implications based upon your client's current circumstances. Please call us and let's discuss the options.

- Or, if you prefer, we will be happy to forward to you our special planning report discussing the charitable lead trust. Simply write or call my office, and we'll see that it is forwarded to you.

Thank you for allowing us to share this ***Charitable Case in Point*** with you. We trust that you have found it to be of interest and value, to benefit your professional practice, and to provide great satisfaction to the clients with whom you work.

RESPONSE CARD

❑ Please send me the Special Planning Report offered in ***Issue 1*** of ***Charitable Case in Point***.

❑ I have a client whom I believe could benefit from this type of vehicle. Please contact me to further discuss its possibilities.

Name ____________________

Address ____________________

City __________ ***State*** __________ ***Zip*** __________

Profession __________ ***Daytime Phone*** __________

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Note: *The information in this newsletter is of a general nature only, and should not be interpreted as legal advice. Illustrations were calculated using a 5% mid-term AFR rate. The rate in effect in the month of a transfer or in either of the two months preceding the transfer will be used to calculate the charitable deduction available for a specific gift.*

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