Sherwood Oaks
CHRISTIAN CHURCH

THE CHARITABLE RETIREMENT INCOME TRUST

A SPECIAL PLANNING REPORT TO ASSIST YOU IN YOUR ESTATE & GIFT DESIGN

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THE CHARITABLE RETIREMENT INCOME TRUST

When you are planning for retirement, wish capital gain tax avoidance and income tax savings from your property that is free and clear, then I invite you to consider a charitable retirement income trust, a gift which will extend far beyond your own lifetime.

Here's why.

WHAT IS A CHARITABLE RETIREMENT INCOME TRUST?

A charitable retirement income trust is a transfer of cash or property to an irrevocable trust which provides income payments to one or more individuals, followed by distribution to a charitable beneficiary at the end of the trust period.

The property which you transfer to a charitable retirement income trust is managed as a separate trust fund, for your benefit, and never commingled with other funds.

The trust is specially designed and managed to provide tax free growth of assets in pre-retirement years. At retirement, trust payout strategy is changed to provide income throughout retirement years.

In pre-retirement years, you receive only the income earned by the trust. At retirement, the trust changes so that it will pay a standard percentage of income, regardless of the actual earnings in any given year.

The trust can be established so that payments will be received for your life, or for the life of you and a survivor.

Because a portion of the charitable retirement income trust is actually a gift to Sherwood Oaks Christian Church, the United States Congress has passed laws allowing a special charitable deduction to you for participating in such agreements.

ADVANTAGES OF THE CHARITABLE RETIREMENT INCOME TRUST

- You receive income payable as stated in the trust agreement (monthly, quarterly, semi-annually, annually).
- You receive income tax benefits, both now and in the future:

  • Because any assets remaining at the end of the agreement are a gift to Sherwood Oaks Christian Church, a federal income tax charitable deduction is allowed in the year in which the agreement is established, as well as any year in which additional contributions are made to the trust.

  • There is no capital gains tax payable on appreciated property at the time of transfer to the agreement.

  • There is no capital gains tax payable if your property is later sold under the agreement.

- You are guaranteed income for the entire agreement period, to the full extent of the value of your property.
- You may manage your own trust, or you may choose to have the assets transferred to your agreement managed by experienced and competent advisors, eliminating management or investment worries.
- You gain valuable advantages in the avoidance of estate taxes and probate costs.
- The charitable retirement income trust provides a hedge against future inflation.

- But most of all, you receive a "measure of immortality here on earth," for your gift supports ideals and programs of eternal worth that will long outlast your own life.

USE OF A TRUST

It is important for you to know that your property is not transferred to Sherwood Oaks Christian Church, but is placed in trust for your benefit, under the control of a trustee whom you select.

The trustee can sell the property and re-invest the proceeds in other income producing property. He continues to manage the investments for growth during pre-retirement years, changing the payout strategy at retirement to provide income to you until the termination of the trust.

With exception of the income you receive and operating expenses of the trust, no distribution is made from the trust until the end of the trust period, at which time any property remaining in the trust is distributed to Sherwood Oaks Christian Church.

A charitable retirement income trust (which is a legal contract) will be prepared for you, which provides a guideline for the payment of income and the management of your property. As additional security, your agreement is subject to very specific trust laws.

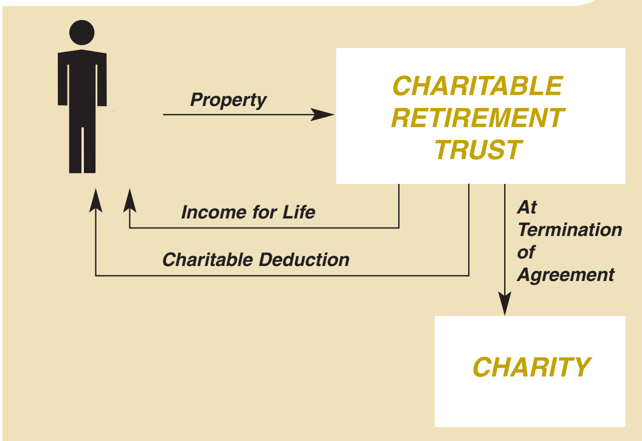
This document, backed by the experience and capability of your trustee and the strength of your property, becomes your security.

TYPES OF AGREEMENTS

Three types of agreements are available.

- A single life agreement, which will provide income to you for as long as you live,
- A joint and survivor agreement, which provides income to you and another for life, with payments continuing to the survivor for life,
- A survivorship agreement, which provides income to you for as long as you live and continues to pay income to a survivor for life.

HOW A CHARITABLE RETIREMENT TRUST WORKS



TAXATION OF A CHARITABLE RETIREMENT INCOME TRUST

Charitable Contribution Deduction

You will be entitled to a charitable contribution deduction on your federal income tax. This can be deducted up to 50% of adjusted gross income in the year a contribution is made, providing the contribution is of cash or property which has not appreciated in value.

If your property has appreciated in value, your contribution is deductible up to 30% of adjusted gross income. If the amount of the deduction exceeds this percentage, any "excess" can be carried over for up to five additional years.

When funding your agreement with appreciated property, it is possible to increase the 30% limitation to 50% of adjusted gross income (with a five year carryover for any "excess"). To qualify for the increased percentage, you must reduce the charitable deduction by the taxable portion of the appreciation. You must also make this election regarding all contributions of long term appreciated property during the year, and long term appreciated property gifts being carried over.

You should consult your own advisers for the method which would be most advantageous to you.

Avoidance of Capital Gain Tax

Because your agreement qualifies as a charitable remainder trust, there will be no capital gains tax payable at the time of transfer of appreciated property to the agreement. Neither will there be any capital gains tax payable when the trustee sells the property.

There are capital gains tax implications when the gain is distributed in the form of income.

Taxation of Income

The taxation of your income retains the character it had in the trust. Therefore, it will vary from year to year, depending upon the management of the trust. Each payment is treated as follows:

First, as ordinary income to the extent of the trust's ordinary income for the year (and any undistributed ordinary income from previous years).

Second, as capital gain to the extent of the trust's capital gain for the year (and any undistributed capital gain from previous years).

Third, as tax-exempt income to the extent of the trust's exempt income for the year (and any undistributed exempt income from previous years).

Fourth, as tax-free distribution of principal.

With proper design of the investment strategy, it is possible for the income received to be taxed at capital gains tax rates, rather than ordinary income tax rates. Under current tax law, this can result in income being taxed at 15% (plus state capital gains tax), rather than a maximum of 35% federal income tax rate (plus state tax). Over the life of the trust, this can provide substantial tax benefit.

The trustee will provide you with the data needed to report your trust income for federal income tax purposes.

Federal Gift Tax Implications

When a husband and wife are the only beneficiaries of a charitable retirement income trust, there are no gift tax implications.

However, when your agreement provides an income interest other than to a spouse, there is a taxable gift of the value of that beneficiary's interest. It is often possible to design the trust so that the gift is not deemed to be made during lifetime, by reserving the right in your will to revoke the beneficiary's interest.

Federal Estate Tax Implications

There are no federal estate tax implications when a husband and wife are the only beneficiaries of the trust.

However, when another individual, other than a spouse, is named to receive income from the trust, the value of his or her right to receive income is taxable in the estate.

CASE STUDY — MR. WILLIAMS

Mr. Williams is presently 37 years of age, and wishes to begin a retirement income planning program.

To illustrate the benefits of the charitable retirement income trust, we have assumed that Mr. Williams makes annual contributions of $5,000 to a retirement income trust until age 65, for total contributions of $140,000.

The trust would be designed so that Mr. Williams receives only the income earned until retirement. At his pre-determined retirement date, the trust changes so that it will pay a standard percentage of income, regardless of the actual earnings in any given year. This is called a "flip trust."

Mr. Williams will choose the percentage payout he wishes to receive, based upon his long-range objectives, current income needs, and present tax position. The higher the payout, the lower the charitable deduction which will be available, and there will be less potential for future growth.

Since current income is not an objective, we will assume that the trust is designed to pay 6% income, allowing greater potential for tax-free growth within the trust.

Summary of Benefits

Based upon his present age, and assuming that he is in a top pre-retirement income tax bracket, benefits from the transaction will be as follows:

- In pre-retirement years, Mr. Williams will receive only the income earned by the trust. At retirement he will begin receiving a percentage of the trust assets as valued each year.
- In addition, he will receive a federal income tax charitable deduction for his contributions each year, for a combined charitable deduction of approximately $34,625.
- If he transfers appreciated property to a charitable retirement income trust, Mr. Williams will pay no capital gains tax on the appreciation at the time of the transfer or when the property is sold by the trust. This will provide an additional tax savings.
- Mr. Williams' trustee will work closely with him to design an investment plan to meet his needs. The trustee will use a growth oriented investment strategy prior to retirement. Therefore, minimum income will be distributed. However, upon retirement, the trust will begin paying income equal to 6% of the trust assets, as valued annually, regardless of the actual earnings in any given year.
- Mr. Williams' trustee estimates that he can earn an average of 10% per year. If this is true, the assets of the trust will appreciate to more than $700,000 by the time of Mr. Williams' retirement at age 65. This will produce an initial retirement income of over $40,000 per year, and could be greater, based on trust design.
- Mr. Williams also has the satisfaction of knowing that property which he has accumulated during his lifetime will eventually be used to help fulfill his charitable giving desires.

Use of Tax Savings from Charitable Deduction

The above illustration does not take into consideration the savings which Mr. Williams receives from the charitable deduction.

An obvious use of this tax savings would be to increase his spendable income. However, if he desires to replace the value of assets transferred to the trust for personal beneficiaries, this can be accomplished. He can gift the tax savings and increased income during lifetime directly to family members or to an irrevocable trust established for their benefit.

This will possibly allow accumulation at a lower tax bracket, and remove property from the probate and taxable estate, saving estate taxes of 41% to 45% of the property value.

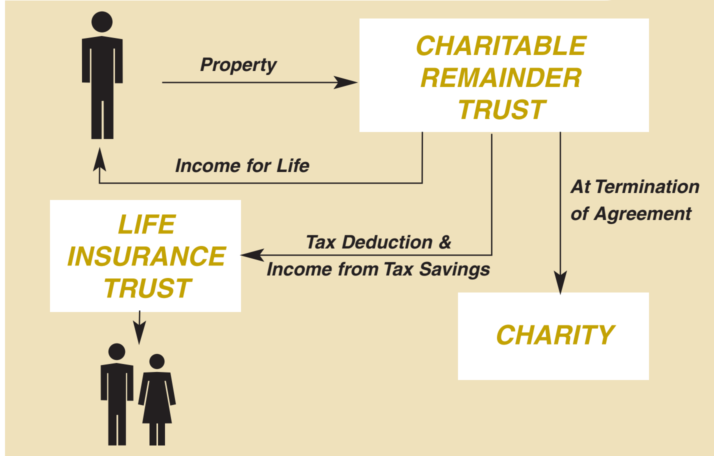
Another practical use of the income tax savings would be to purchase life insurance, to replace all or a portion of the value of the property in the estate for personal beneficiaries. If life insurance is purchased, it should either be gifted to family members or placed in an irrevocable life insurance trust, so that the proceeds will be distributed to personal beneficiaries estate tax free.

HOW A CHARITABLE RETIREMENT INCOME TRUST IS CREATED

The steps to establish a charitable retirement income trust are:

- A proposal is made for your consideration and that of your personal, legal and tax advisers.
- After you have determined that this type of agreement is desirable and beneficial to you, a request for trust is forwarded to Sherwood Oaks Christian Church, along with information about your property.

USE OF LIFE INSURANCE TO REPLACE ASSET VALUE



- A charitable retirement income trust is prepared and presented to you for review by your legal and tax counsel.
- In your attorney's office or the bank trust office, you sign the trust and transfer title of your property to the trustee.
- At the end of the first pay period (monthly, quarterly, semi-annually, annually), you receive your first income payment, and regular payments continue until the end of the agreement.
- You receive from your trustee all the necessary information to assist your tax advisers in claiming your income tax charitable deduction and reporting your income.

CONCLUSION

I hope that this information on the charitable retirement income trust is of interest and value to you. It provides many tax advantages, while at the same time allowing you the opportunity to make a substantial gift to Sherwood Oaks Christian Church.

QUESTIONS FREQUENTLY ASKED

Q. Is Sherwood Oaks Christian Church financially secure?

A. While Sherwood Oaks Christian Church is financially secure, it is important to understand that the financial security of the organization is immaterial to the financial security of the agreement. Property is held by a trustee for your benefit and the strength of the property held by the trust is what provides the financial security.

Q. Are my income payments always the same?

A. No. Your income is determined by applying a fixed percentage to the value of the trust assets, as valued annually.

Q. What happens to my agreement upon my death?

A. If the charitable retirement income trust is for your life only, upon your death the assets held in the agreement are made available to the charity to carry out its programs.

If your agreement covers the life of another individual who survives you, the agreement will continue for that life. At termination, the assets will be distributed to the charity.

Q. Can I make additional contributions to my agreement?

A. Yes.

Q. When I establish a charitable retirement income trust, can I withdraw the funds later?

A. No. The agreement is irrevocable. To qualify for the income tax charitable deduction and avoidance of capital gains tax, the agreement must meet certain requirements, which do not allow withdrawals in excess of annual income.

Q. Will my charitable retirement income trust be part of my taxable estate?

A. If the agreement covers your life only, the assets go directly to your charitable beneficiary at your death, avoiding estate taxes. If the agreement covers the life of a survivor other than a spouse, a portion (based on the age of the survivor) will be included in your estate. In either case, the agreement will be excluded from the probate estate.

Q. What if my charitable deduction exceeds the maximum amount I am allowed to deduct from my income tax return in the year of my contribution?

A. If your charitable deduction exceeds the amount deductible in the year you make a contribution to the trust, you may carry over the excess for up to five additional years.

Q. Is my income absolutely guaranteed?

A. Under the terms of the agreement, the trustee has full responsibility to use the assets of the trust to guarantee your payments, even if this reduces the remainder for charity.

Q. What secures my agreement when the property I transfer is sold?

A. The trustee is required to reinvest the proceeds in "prudent" investments for your security. At no time is property transferred or sold without proper security in return.

Q. I do not understand taxes. What assistance will I receive?

A. You should rely upon your own counsel. However, as a service, we will provide information to assist your legal and tax counsel in securing the maximum deductions on your federal and state income tax returns. Also, the trustee will report to you annually how the income you receive should be reported for income tax purposes.

CITATIONS OF AUTHORITY

Because this information is of a general nature only, and should not be interpreted as legal advice, we provide the following citations of authority for use by your legal and tax advisers, to verify its applicability to your specific circumstances.

Charitable remainder unitrust - description. Specifies that income beneficiary is to receive annual payments determined by multiplying a fixed percent (which cannot be less than 5%) by the net fair market value of the trust assets, as determined each year. On death of beneficiary (or survivor beneficiary, if more than one) charity gets the remainder. IRC §664(d)(2).

A variation calls for trustee to pay only trust income if actual income is less than stated percent. Deficiencies in distributions (i.e., where trust income is less than stated percent) are made up in later years if trust income exceeds the stated percent. Another variation provides that deficiencies are not to be made up. IRC §664(d)(3); Reg. §1.664-3(a)(1)(i)(b).

How payments taxed to recipient. Amounts paid to the recipient retain the character they had in trust. Each payment is treated as follows:

First, as ordinary income to the extent of the trust ordinary income for the year and undistributed ordinary income for prior years;

Second, as capital gain to the extent of the trust capital gains for the year and undistributed capital gains for prior years;

Third, as other income (e.g., tax-exempt income) to the extent of the trust's other income for the year and undistributed other income for prior years;
Fourth, as a tax-free distribution of principal.

IRC §664(b); Reg. §1.664-1(d).

Unitrusts are exempt from taxation. But a trust is not exempt in any year it has income which would be taxable unrelated business income if trust was an exempt organization. IRC §664(c). Payments to income beneficiary taxed as above.

Governing instrument requirements. To assure charitable deductions and avoid adverse tax consequences, governing instrument must contain specific provisions. See: Reg. §1.664-1 through §1.664-3; IRC §508(e); IRC §4947(a)(2); Rev. Rul. 72-395, 1972-2 CB 340; Rev. Rul. 82-128, IRB 1982-27, 7; Rev. Rul. 82-165, IRB 1982-40, 8.

Income tax. Contribution deduction allowed for value of remainder interest, computed using Treasury tables. IRC §170 (f)(2); Reg. §1.664-3(c) and §1.664-4; IRS Pub. 723B.

When unitrust is funded with cash or non-appreciated property, remainder interest is deductible up to 50% of donor's adjusted gross income. IRC §170(b)(1)(A); Reg. §1.170A-8. Five year carryover allowed for any "excess." IRC §170(d)(1), Reg. §1.170A-10(a).

When unitrust is funded with securities or real estate held long-term, remainder interest is deductible up to 30% of adjusted gross income. IRC §170(b)(1)(C)(i); Reg. §1.170A-8(d)(1). Five year carryover allowed for any "excess." IRC §170(b)(1)(C)(ii).

Under election, donor can increase ceiling to 50% of adjusted gross income (with five year carryover for any "excess") by making the same gift, but:

(1) Reducing the amount of the deduction for all long-term property gifts during the year by the appreciation, and

(2) Similarly reducing the deduction for long-term property gifts being carried over from earlier years.

IRC §170(b)(1)(C)(iii); IRC §170(e)(1)(B); Reg. §1.170A-8(d)(2).

Capital gain. No capital gain incurred on transfer of appreciated assets to trust. Rev. Rul. 55-275, 1955-1 CB 295; Rev. Rul. 60-370, 1960-2 CB 203. Nor is there capital gain to donor on a sale by trust (except as taxable under four tier system, above).

Exception: Gain taxable to donor if trust assets sold and invested in tax-exempt securities pursuant to express or implied agreement between donor and trustees. Rev. Rul. 60-370, 1960-2 CB 203.

Estate tax [IRC §2055(e)(2)(A)].

<u>One life (donor is beneficiary)</u>. Fair market value of trust principal at death included in gross estate and then deductible as charitable contribution.

<u>Two lives (funded with donor's separate property, donor is first beneficiary and another is to be survivor beneficiary)</u>. Fair market value of trust principal at donor's death included in gross estate but deductible as charitable contribution if second beneficiary not surviving. If second beneficiary survives, charitable remainder based on survivor's age at donor's death is deductible.

Marital deduction. Qualifies for unlimited marital deduction as qualified terminable interest property. IRC §2056(b)(8); IRC §2523(g).

Gift tax [IRC §2522(c)(2)(A)]. Value of charitable remainder is fully deductible, thus charitable gift is immune from gift tax. Where there is a life interest other than donor's, a gift is made to non-charity beneficiary of value of beneficiary's life interest. Value of gift depends on type of property ownership and when beneficiary's payments begin. It is possible to draft trust so that a gift is not deemed made to non-charity beneficiary by reserving right by will only to revoke life beneficiary's interest. Reg. §1.664-3(a)(4). Rev. Rul. 74-149, 1974-1 CB 157.

Note: The information in this planning report 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.