Sherwood Oaks
CHRISTIAN CHURCH

HOW TO SAVE ESTATE & GIFT TAXES USING A CHARITABLE TRUST

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

2700 E. Rogers Road, Bloomington, IN 47401

PREPARED BY: Sherwood Oaks Christian Church

Phone: 812.334.0206
E-mail: rclark@socc.org

HOW TO SAVE ESTATE AND GIFT TAXES USING A CHARITABLE TRUST

If you have a taxable estate and wish to transfer property to personal beneficiaries estate and gift tax free, I invite you to consider the charitable lead trust.

WHAT IS A CHARITABLE LEAD TRUST?

A charitable lead trust is a transfer of cash or property to an irrevocable trust, during lifetime or at death. It provides current income payments to a charitable beneficiary, followed by distribution to personal beneficiaries at the end of the trust period.

The assets which you transfer to a charitable lead trust are managed as a separate trust fund for the benefit of the charitable organization and your personal beneficiaries, and are never commingled with other funds. The payments which the charity receives are based upon a percentage of the fair market value of the assets transferred to the trust and are received by the charity for either your lifetime or for a period of years.

Because the income paid to the charitable beneficiary is actually a gift to charity, Congress has passed laws allowing special charitable estate and gift tax deductions to participants in such trust agreements.

THE ADVANTAGES OF A CHARITABLE LEAD TRUST

- Your charitable beneficiary receives income, payable as stated in the trust agreement.
- At the end of the trust period, the assets remaining in the trust are transferred to your personal beneficiaries.
- By proper design of the trust, this transfer can reduce or eliminate gift or estate taxes payable.
- And perhaps most important, you have the satisfaction of knowing that your charitable gift supports ideals and programs of eternal worth that will long outlast your own life.

USE OF A TRUST

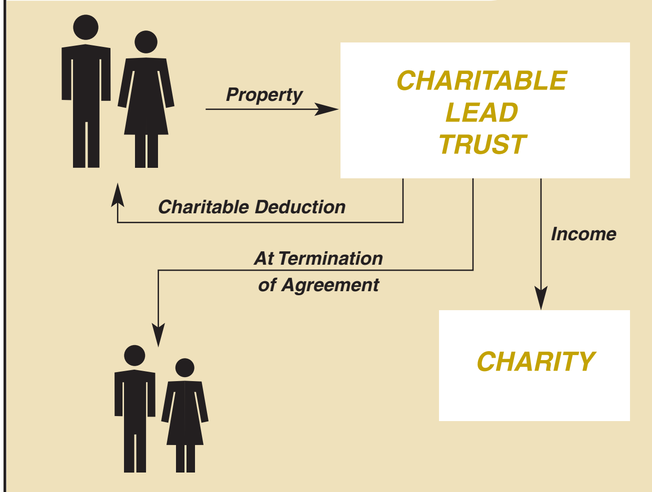
It is important for you to know that your property is not transferred to your charitable beneficiary, but is placed in trust for the benefit of both your charitable and personal beneficiaries, under the administration of the trustee you have selected.

The trustee may sell the asset and reinvest the proceeds in other property. But continues to manage the investments to provide income to the charitable beneficiary, and to preserve the asset for your personal beneficiaries.

With the exception of the income payments made to the charitable beneficiary and the operating expenses of the trust, no distribution is made from the trust until the end of the trust period, at which time assets remaining in the trust are distributed to your personal beneficiaries.

A charitable lead trust (which is a legal contract) provides guidelines for the payment of income and management of property. As additional security, the agreement is subject to very specific trust laws. This document, backed by the experience and capability of your trustee and the strength of the property you transfer, becomes the security for your beneficiaries.

HOW A CHARITABLE LEAD TRUST WORKS



TYPES OF AGREEMENTS

Two types of agreements are available for the avoidance of estate and gift taxes:

- A ***variable income agreement***, which pays income to the charitable organization based upon a percentage of the trust assets as valued annually.
- A ***fixed income agreement***, which pays income to the charitable organization based upon a percentage of the assets originally transferred to the trust.

In addition, the agreement can be established:

- ***During your lifetime***, providing an added advantage of removing the income from your taxable income stream if you do not need it, and placing the property in the hands of your personal beneficiaries for their use at an earlier date, or
- ***Through your estate***, at the time of death.

TAXATION OF A CHARITABLE LEAD TRUST

Charitable Income Tax Deduction

If your goal is to make a tax-free transfer of assets to personal beneficiaries, you will not receive a charitable income tax deduction for your contribution of property to the trust.

Capital Gains Taxation

Because the agreement qualifies as a charitable trust, there will be no capital gains tax payable at the time of transfer of appreciated property to the agreement.

However, if the trust sells appreciated property, there may be capital gains tax implications at the time of sale.

If the trust is established during your lifetime, your personal beneficiaries will maintain your cost basis in the property when ownership is vested with them. If the trust is established through your estate, your beneficiaries will receive a stepped-up basis in the property at the time of your death.

Taxation of Income

The income earned retains the character it had in the trust and is taxed to the trust. However, income received by the charitable beneficiary is deductible by the trust. The charitable beneficiary pays no taxes on the income it receives.

Federal Gift Tax Implications

If the transfer is made to the trust during your lifetime, the value of your gift to personal beneficiaries at the end of the trust term will be reduced by the value of the charitable beneficiary's right to receive income for the period of the trust.

With the right combination of years and percentage payout from the trust, it is possible to greatly reduce or eliminate gift taxes payable on the property transfer.

Federal Estate Tax Implications

If the trust is established through your estate, your estate receives a charitable estate tax deduction for the value of the charitable beneficiary's right to receive income for the trust period.

Again, with the right combination of years and percentage payout from the trust, it is possible to greatly reduce or eliminate estate taxes payable on the property transferred to personal beneficiaries.

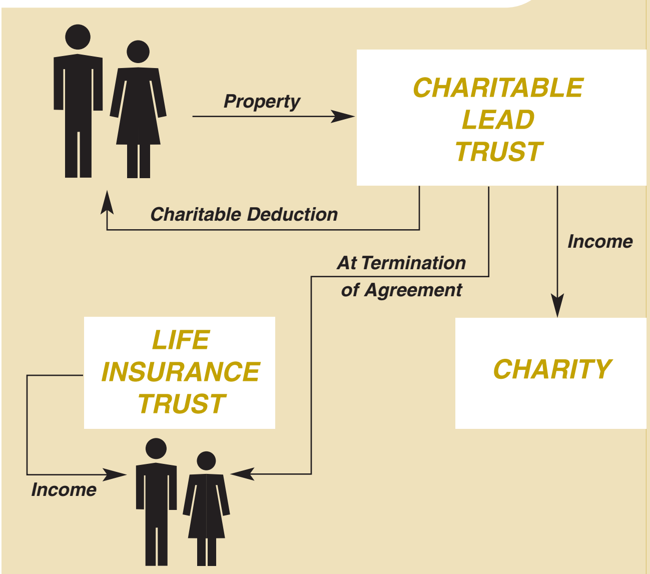
REPLACEMENT OF INCOME TO PERSONAL BENEFICIARIES

When the charitable lead trust is established, many individuals desire to replace the income their personal beneficiaries may have earned from those assets, during the period of the trust.

Let's assume that an individual has created an estate plan which provides for the payment of federal estate taxes with life insurance. When that individual establishes a charitable lead trust and places the life insurance policy into an irrevocable life insurance trust, the proceeds from life insurance (which are no longer needed to pay federal estate taxes) can be used to replace income to personal beneficiaries.

The life insurance proceeds can be invested to make regular payments to personal beneficiaries.

These payments can replace a portion or all of the income earned by the property invested in the charitable lead trust, which would have been payable to the personal beneficiaries.



HOW A CHARITABLE LEAD TRUST IS CREATED

- A proposal is made for your consideration and that of your personal legal and tax advisers.
- If the trust is to be established at your death, your attorney will integrate it into your existing estate plan, or will design a new estate plan for you incorporating the charitable lead trust.
- If you determine that a charitable lead trust established during your lifetime is desirable, you make a commitment to establish the trust and provide information on the property you wish to place in the trust, to the trustee.
- The charitable lead trust is prepared and presented to you for review by your legal and tax counsel.
- You sign the trust and transfer title of your property to the trustee.
- At the end of the first pay period, your charitable beneficiary begins to receive income payments, which are made regularly until the end of the trust period.
- You will receive from your trustee all the necessary information to assist your tax advisers in claiming your gift tax charitable deduction.
- At the end of the trust period, your personal beneficiaries receive the property.

CONCLUSION

I hope this information on the charitable lead trust is of interest and value to you. You will note that it provides many tax advantages, while allowing you the opportunity to make a substantial gift of income to charity.

QUESTIONS FREQUENTLY ASKED

Q. Are charitable lead trusts designed for wealthy people?

A. Not necessarily. However, a charitable lead trust established for the avoidance of estate and gift taxes is only applicable for individuals whose estates are large enough to be subject to estate and gift taxes.

Q. How do I know my charitable beneficiaries are financially secure?

A. It is important to understand that the financial security of the organization is immaterial to the financial security of the trust. Property is held by an independent trustee to benefit the charity and individuals you select, and the strength of the property held by the trust is what provides the financial security.

Q. Are the income payments to my charitable beneficiary always the same?

A. If your trust is a variable income agreement, the payment to charity will be determined by applying a fixed percentage to the value of the trust assets, as valued annually. If your trust is a fixed income agreement, the annual income payments to charity will be determined by applying a fixed percentage to the value of the trust assets when you fund the trust.

Q. What happens to my trust upon termination?

A. When your trust terminates, the property held by the trustee is transferred to your personal beneficiaries for their use.

Q. Can I make additional contributions to my agreement?

A. If your trust is a variable income agreement, additional contributions can be made. If your agreement is a fixed income agreement, additional contributions would have to be made to a separate trust.

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

A. No. The agreement is irrevocable. To qualify for the tax benefits provided by the charitable lead trust, your agreement must meet certain requirements. These requirements do not allow withdrawals in excess of annual income.

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

A. If the charitable lead trust is established during your lifetime and you maintain no ownership of the trust, then the trust will not be part of the taxable estate. If the trust is established as part of your estate distribution, it will be part of your taxable estate, but will qualify for an estate tax charitable deduction which will offset a portion or all of the estate tax liability.

Q. What security do my personal beneficiaries have if 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 any property transferred or sold from your trust without proper security in return.

Q. In previous years, I have depreciated my property for tax purposes. Does this affect the taxation of my charitable lead trust?

A. Probably not. If the trust is established as part of your estate plan, then property transferred to the trust will receive a stepped-up basis. However, if you establish the trust during your lifetime, the trust will maintain your cost basis in the property and there can be capital gains tax implications when the property is sold, either by the trust or by your beneficiaries.

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

A. You should rely upon your own counsel. However, as a service, your trustee will provide you with detailed information to assist your legal and tax counsel in securing the maximum benefits on your tax returns.

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.

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 lead trust - description. A trust which makes payments to a charitable beneficiary for lifetime or a term of years, with transfer to personal beneficiaries at the end of trust term.

Income tax. No income tax charitable deduction is allowed for value of charity's income interest when the remainder beneficiaries of the trust are personal beneficiaries and the donor has no reversionary interest. IRC §170(f)(2)(B); Reg. §1.170A-6(c)(2).

Income interest is deductible up to 30% of adjusted gross income, with a five year carryover for any "excess". IRC §170(b)(1)(B).

Capital gains tax. There is no capital gains tax at the time of transfer of property to a charitable lead trust. Where donor has no reversionary interest in the trust, capital gains are taxable to the trust. Where there is a sale of assets within two years of trust's creation, any capital gains is taxed to the trust at donor's tax rates. IRC §644.

Gift and estate taxes. The charitable lead trust must be in the form of a guaranteed annuity which provides that charitable interest is a fixed percentage of the fair market value of the trust principal at the time of the transfer to the trust, distributed annually. Or, the charitable lead trust must be in the form of a unitrust interest which provides that charitable interest is a fixed percentage of the fair market value of the trust principal as valued annually, and distributed annually. IRC §2522(c)(2)(B); IRC §2055(e)(2)(B); Reg. §25.2522(c)-3(c)(2) and §20.2055-2(e)(2); Rev. Rul. 77-300, 1977-2 CB 352.

Estate and gift tax deduction allowed for value of income interest. Computed using Treasury tables. Unitrusts - IRC §170(f)(2); Reg. §1.664-3(c) and §1.664-4; IRS Pub. 723C. Annuity trusts - IRC §170(f)(2); Reg. §1.664-2(c); Reg. §20.2031-10; IRS Pub. 723E.

Unitrusts and annuity trusts 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).

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, 1982-2 CB 71; Rev. Rul. 82-165, 1982-2 CB 117.