



# consider this ...

A CONTINUING DIALOGUE ON CHARITABLE  
TAX PLANNING CONCEPTS PUBLISHED  
FOR FINANCIAL PLANNING PROFESSIONALS  
**OKLAHOMA CITY COMMUNITY FOUNDATION**

DECEMBER, 1994

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## LIFE INSURANCE PLANNING ...LEVERAGING THE LEGACY

You've heard that only two things in life are certain.....death and taxes? Problem is, for many of our clients, they occur at nearly the same time. Federal estate taxes are due just nine months from the date of death.....in cash!

Unfortunately, most estates are a mixture of real property, business assets, securities and tangible personal property. Cash is often a small part of the equation.

That's where life insurance shines. While individuals argue the merits of life insurance as a lifetime investment..... accumulation plan for retirement..... systematic savings vehicle, etc., its value in testamentary planning is undeniable.

Consider the perfect legacy asset:

- It matures automatically at death for the full face amount regardless of the equity built or deposits made to date.
- It passes immediately to the beneficiaries named by the owner.
- It passes free of the costs and delays of the probate process.
- It passes in cash.
- It passes free of income tax (IRC Sec 101a) even though the owner may have lived to pay only modest premiums.
- It passes free of federal estate tax where the insured has no incidents of ownership in the policy contract.

Yes, that's life insurance. When it comes to leaving legacies, nothing, absolutely no other property on earth, does it as well.

Fact is, if we could magically turn all of our assets into life insurance on the day before we died, we'd have the perfect estate plan.

Speaking of legacies, you may find it ironic that the IRS "values" each of us by our collective accumulations over a lifetime as declared on Form 706, while society "values" us on our collective contributions to one another over that period.

Question is - How can the magic of life insurance assist us on the "contributions" side of the ledger?

## Charitable Transfers .....Existing Policies

Consider the case of a recent widow who used the insurance policy on her life, originally naming her husband as beneficiary, to fund a charitable endowment in his memory at the community hospital.

The mechanics of the plan go something like this - a gift is accomplished by naming the charity as the irrevocable beneficiary of the policy and assigning all incidents of ownership in the policy to the charity.

If a fully paid-up whole life policy is transferred, the charitable deduction is the lesser of the donor's basis in the policy (premiums paid minus dividends received) or the replacement cost of the policy. If the paid-up policy is group term (no cash value), the charitable gift is the replacement cost up to the donor's basis in the policy. IRC 170(e)(1); Treas. Reg. 1.170-4(a).

# !! WARNING !!

## TAX ALERT

*On December 31, 1994, a provision in the tax code expires which will change the rules for gifts to PRIVATE FOUNDATIONS. Gifts of stock will generate a different deduction if the stock is highly appreciated. The gift TAX DEDUCTION will be based on the cost paid by the stock owner, NOT the market value on the date of the gift. Community foundations and their components are exempt from this change. If you normally contribute stock to a private foundation, you may want to establish a Fund at The Oklahoma City Community Foundation and enjoy the maximum tax deduction.*

If the policy is not fully paid-up, the charitable gift is valued at the interpolated terminal reserve (available from insurance company) up to the donor's cost basis. **Subsequent premiums paid by the donor on the gifted policy constitute additional charitable contributions.** Since the charity owns the cash value of the policy, the payments are considered "to" and not "for the benefit of" the charity and are subject to the 50% of adjusted gross income deduction ceiling.

### **New Life Insurance .... Philanthropy on the Installment Plan**

Here is a plan which will allow modest contributors to amplify the gift to their favorite charity and, by creating a new asset, keep the existing estate intact for personal beneficiaries.

Consider the 35-year-old making cash contributions of approximately \$850 each year to charitable causes. By acquiring life insurance on his/her life with these annual sums, a \$25,000 gift can be secured in his/her name in just 5 years. That's pretty good leverage, **\$4,250 in contributions become a \$25,000 bequest.**

Naturally, if the charity is owner and beneficiary of the policy, our 35-year-old may deduct his/her premiums up to 50% of his/her adjusted gross income. Instead of

numerous receipts for a series of unplanned charitable contributions, our donor has a definite plan evidenced by a series of monthly or quarterly premium payments.

This type of planning can be very attractive to the executive or professional who serves as a board member or is active in a support group at a local charity and, while involved in their annual giving program, would like to do more. By splitting annual contributions between cash gifts and life insurance premiums, our contributor can realize the satisfactions of providing both current and long-term financing for their favorite cause.

### **Charitable Beneficiary Designations .... A Revocable Option**

Another method of making a charitable bequest via life insurance is to simply change the primary or contingent beneficiary to name the charitable organization.

In this case, the policyholder can maintain ownership of the contract, keeping the right to borrow or cash in the policy at any time. Naturally, no income tax deduction is allowed in such cases since the policyholder still owns the contract.

However, at the demise of the insured, the charity receives that part of the proceeds designated to it as a beneficiary, free of federal estate tax.

**Important!** Your clients should be aware that **the charity can be named for a part (10% or 25%) of the policy proceeds with the balance paid to their children or other personal beneficiaries.**

Subsequent planning reviews may cause these percentages to change over time as the "children" become more established financially.

### **Insurance Dividends ... Non-taxable "In" Deductible "Out"**

Your client bought a substantial life insurance policy some years ago with one of the major mutual companies, now he/she receives an annual dividend amounting to several thousand dollars. Since such dividends are considered a return of unused premium and are non-taxable distributions for income tax purposes, they allow an effective tax reduction strategy.....non-reportable as received, but deductible as contributed to charity.

It's as simple as changing the dividend option.

## GIFT PLANNING SERVICE

**Tim Sloan** recently joined the Oklahoma City Community Foundation as the Director of Gift Planning Development. Tim has many years experience in banking, gift planning and managing charities. He lived in the Oklahoma City area for 19 years before spending a



few years in Houston and Tulsa. The Trustees of the Community Foundation are committed to providing superior service in advising donors. Supporting professional advisors also helps in creating special gifts/trusts. Donors can derive many benefits from GIFTS THAT PAY INCOME, ANNUITIES, OR GIFTS OF LIFE INSURANCE. There are special laws and benefits for gifts of appreciated assets like STOCKS, BONDS, REAL ESTATE OR RESIDENCES. If you have a special situation and want to visit with an experienced advisor, call Tim at 235-5603 and welcome him back to Oklahoma City.

## ABOUT THE OKLAHOMA CITY COMMUNITY FOUNDATION

Since 1969 the Oklahoma City Community Foundation has helped donors accomplish their personal charitable goals and assisted non-profit organizations through grants and endowment fund support

The Foundation is governed by 12 trustees who represent a broad range of community organizations and interests. The Foundation's staff works with the Board of Trustees, donors and charitable organizations. They administer the asset base and seek ways to fill needs in the community.

For the fiscal year that ended June 30, 1994, the Foundation's assets were valued at \$81 million. During the year, more than 250 charitable organizations received grants and distributions from endowment earnings of \$3.2 million.

Through the Community Foundation, donors can provide ongoing support for specific institutions or general causes by advising the staff and Trustees of their wishes. By donating money to the Fund for Oklahoma City, their contributions can be used at the Trustees' discretion to support needs in the community as they arise.

A gift to the Oklahoma City Community Foundation is a lasting gift to the community.

### 7% Charitable Remainder Trust

\$1,000,000

Vacant Land .....	\$225,000
Company Stock .....	\$275,000
Rental (4 Unit) .....	\$500,000

### Irrevocable Life Ins. Trust

\$1,000,000 Survivor Policy  
\$20,000 Annual Premium

### Remaining Personal Estate

1. Personal Residence .....	\$475,000
2. Vacation Home .....	175,000
3. Other Securities .....	80,000

Using the same assumptions as before...married... credit shelter trust...no growth in the estate, it looks like this:

Total Estate .....	\$1,555,000
Minus Unified Credit Trust .....	600,000
Taxable Estate .....	955,000
Minus Federal Estate Tax .....	328,250
Minus Income Tax on IRD Qual. Retirement Plan .....	215,622
Net Remaining .....	411,128
<b>Plus Life Insurance .....</b>	<b>1,000,000</b>
<b>Legacy to Heirs .....</b>	<b>\$2,011,128</b>
<b>Legacy to Charity .....</b>	<b>\$1,000,000</b>
<b>Total Legacy .....</b>	<b>\$3,011,128</b>

Now that's estate enhancement via life insurance and charitable planning.

Unfortunately, out there in industrial America are thousands of estate owners with highly valued but illiquid estates.....some with large inventories of real property.....some with closely held business interests.....some with highly appreciated securities portfolios.....all destined to lead a "highly valued life" based on IRS Form 706 and the U.S. Treasury.

The task is clear. If we can tumble the walls of financial complacency and demonstrate the value of swapping estate-taxable holdings for estate-tax-exempt property, we will not only increase our client's legacies to their heirs but allow them to contribute to society in a more meaningful way.

## NOT ASSET "REPLACEMENT" ... ASSET "LEVERAGE" OR "ENHANCEMENT"

Now we come to all those other planning strategies where life insurance is not the charitable gift but rather the catalyst for a more effective estate distribution strategy, charity and heirs included.

The challenge here is for planner and client to get outside the confines of conventional thinking. Going back to the original premise of this newsletter - that life insurance is the perfect legacy asset - the question is, **how can we swap other less effective assets accumulated or inherited over the years to acquire more life insurance?**

And, don't call it asset replacement! When you swap an asset like rental real estate which is management intensive, steeped in unrealized capital gain and destined for 55% shrinkage under federal estate tax for an equal amount of cash, passing immediately, without probate, without tax.....**that's not replacing; that's enhancing, leveraging, optimizing, etc.**

Problem is.....most of our clients are conceptually trapped within the "box" of assets which make up their current estate.

They've held this property most of their lives.

It's what they've done with their earnings.

It's where they are.

It's what they are.

The walls of the "box" are heavy, drawn deeply over the years, inflexible, nearly impenetrable.

Let's look at one of your clients.

1. Personal Residence .....	\$475,000
2. Vacation Home .....	175,000
3. 2 Parcels Vacant Land ....	225,000
4. Company Stock .....	275,000
5. Other Securities .....	80,000
6. Qual. Retirement Plans ..	825,000
7. Rental (4 unit) .....	500,000

Well, not bad.....\$2,555,000. Not much retirement cash flow though. Items 1, 2, and 3 produce no income. Items 4 and 5 average 2% in dividend yield or \$7,100 annually. Item 7 nets \$18,000 per year. Frankly, social security and withdrawals from the retirement plans fund a modest retirement.

How about their legacy? If they are married, have drawn a credit shelter trust and we assume no growth in the estate, it looks like this:

Total Estate .....	\$2,555,000
Minus Unified Credit Trust .....	600,000
Taxable Estate .....	\$1,955,000
Minus Federal	
Estate Tax .....	760,550
Minus Income Tax	
on IRD Qualified	
Retirement Pln.....	199,287
Net Remaining.....	995,163
<b>Total Legacy .....</b>	<b>\$1,595,163</b>

## Escaping The "Box" ..... And The Walls Come Tumbling Down

Imagine for a moment that your clients break into the box and stir the contents about. Reaching in they begin to examine each asset... the vacant land produces no income..... the company stock only 2% and a lack of diversification provides concern here.....the rental unit is a hassle to manage and nets little more than 3%.

In a moment of hysteria, they wrest these assets from the box and give them away.

*They what....???*

Well, they transfer them to a charitable remainder trust paying 7% for their joint lifetimes and ultimately creating a charitable endowment in their community.

*Can they afford it?*

Well, these assets were providing slightly more than \$25,000 per year of income to our clients. Now, the cash flow is \$70,000.

Additionally, an income tax deduction of \$300,000+ promises substantial tax savings over the next 6 years.

*What next?*

Once outside the "walls", our clients create a new "box", an irrevocable life insurance trust. Using \$20,000 of the annual cash flow from the charitable trust, they acquire \$1,000,000 of survivorship (2nd-to-Die) life insurance.

This still leaves them \$25,000 more in annual cash flow than they enjoyed before all this "radical" planning.

**Well, sure.....by consuming all these assets our clients enjoy more retirement income but what about their legacy?**

Take a look.....now we have 3 boxes.

## THE COMMUNITY FOUNDATION CAN EASE PROBLEMS WITH YEAR-END GIVING

Timing of charitable gifts is often a problem in maximizing the tax benefit for the donor. The Oklahoma City Community Foundation has three types of funds that allow donors to make contributions during the years which provide the greatest benefit for them and extend the benefit to charity for years into the future. These options can simplify charitable giving and record-keeping especially for donors who contribute appreciated assets to several charities. Donors may give cash or appreciated assets to the Community Foundation to be used in any of the following ways:

**CREATE A DONOR-ADVISED FUND** with annual earnings which can be contributed to a wide variety of charitable purposes each year. This fund is an excellent alternative to a private foundation and provides the donor with flexibility for future giving and easy administration.

**UTILIZE AN ESCROW FUND** to make a single charitable contribution with the principle paid out to a number of charities over a period of time. The donor gets a deduction at the time of the gift and avoids maintaining receipts from several organizations. Securities need only be transferred to the Community Foundation and beneficiaries can be determined at a later time.

**DESIGNATE A GIFT TO PERMANENT ENDOWMENT** of any of more than 200 local charities and thus create an annual contribution in the donors name. Gifts of appreciated assets can be easily divided among several organizations with just one transfer.

In order to receive a tax deduction for 1994, all gifts must be made before December 31, 1994. However, the Community Foundation offers donors the flexibility to designate the beneficiary charity or purpose at a later time. Please contact the Community Foundation office for more details on utilizing any of these options

## FREE PROSPECTUS

The Oklahoma City Community Foundation provides a prospectus on charitable giving, at no charge to you. This pamphlet describes the various ways donors can make a gift of assets, instead of cash. There are ways a donor may make a gift and receive income for their lifetime. There are ways a donor can transfer assets to children or grandchildren without paying gift taxes. If you are interested in receiving a "Prospectus on Giving", please call Tim Sloan, at the Oklahoma City Community Foundation, 405-235-5603.



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