consider this ...

Charitable Advise for Planning Professionals

OKLAHOMA CITY
COMMUNITY FOUNDATION

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CHARITABLE TRUSTS . . . FOR ALL THE RIGHT REASONS

As a financial adviser, you are seeing a lot of press on the planning possibilities available via charitable trusts and annuities. It's a hot topic, so getting beyond all the hype, you might be trying to decide whether or not to become involved with this type of planning.

Bottom line . . . **Why should your clients consider a charitable remainder trust in 1995?**

"Top Ten" List of Reasons

The writers on the Letterman Show might offer this "top-ten reasons" list:

10. The remainder is toxic.
9. Leaving real estate outright to kids was recently ruled a form of child abuse.
8. The deduction - after all, for every $1 your client gives away, he/she saves over 40 cents in Federal and State income taxes.
7. Alphabetic superiority - CRUT comes before FLIP, GRAT, GRIT, and SPLIT in the Encyclopedia of Estate Planning Acronyms.
6. They already have a living trust!
5. Save estate taxes - your clients attended a recent seminar where they learned that "giving away everything over $600,000" eliminates the Federal estate tax.
4. They get their name listed in the back of the university's football program with all the other Pigskin Patrons.
3. Avoid capital gains - If they sell the farm that Auntie Doris gave them, it will generate significant capital gains tax and worse yet, a visit from Auntie Doris.
2. Diversification and Liquidity - On the road to success, your client acquired 132 parcels of real estate and little else.
1. More income wouldn't hurt.

Well, forgive the attempt at levity but beyond the entertainment value, there is a message here. People don't create charitable remainder trusts simply for the tax benefits. The motivations are many, but primary in most cases is INCOME. Yes, for many clients the truth is - **more income wouldn't hurt.**

So, who are the clients in your database who would benefit from a charitable remainder trust (CRT) or gift annuity?

Well, get out the list and we'll identify a few we know well.

Filling the Income Need . . . Common CRT Profiles

1. Recent Retiree

Here is a client who suddenly must look to his/her accumulated capital to replace earned income. To complicate matters, most of the assets on their balance sheet have been invested for growth during their earning years since more income just meant more tax. Now, some repositioning is necessary. Undeveloped land, industrial stocks, growth mutual funds must give way to higher yielding portfolios. Also, management-intensive assets like rental real estate may lose some of their appeal as our retired client may be more oriented to travel and relaxation than property management hassles.

A charitable remainder trust will allow this client to transfer low yielding, appreciated assets for a diversified income oriented portfolio of investments without tax erosion. What is more, this client reduces his/her management role to cashing the quarterly checks generated by the trust - an appealing scenario.

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2. Not-So-Recent Retiree

Here is a client who has enjoyed 10+ years of retirement, is approaching 80 years of age, holds much of his/her wealth in bank instruments and is beginning to feel the pinch of inflation. Having seen many of his/her peers pass on, this client has contemplated his/her mortality and would like to direct a part of their legacy to worthwhile causes in their community.

Not incidentally, this client's children are now in their fifties and established financially. Dependency no longer exists here.

To this client, a charitable remainder annuity trust or charitable gift annuity represents increased income, freedom from money management worries and the opportunity to take an active position in supporting a meaningful charitable cause.

Often T-Bills, bank CDs, tax-exempt bonds or even a personal residence (where the donor is moving to an assisted living facility) fund this trust.

3. Early Retiree

Here is a client who is becoming more common in today's workplace. With the current trend in corporate downsizing and consolidation, the "golden handshake" is being offered to more and more executives in their 50's. Such programs often provide short- term income continuation and/or bonuses to those electing early retirement, but a restricted lifestyle may result. Combining the lack of social security eligibility with a deferral of qualified plan distributions, our client may face a five or ten-year periodlean in cash flow.

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To this client, a five or 10-year charitable remainder trust designed to provide a high rate of payout, e.g. 10%-12%, can fill the income gap until the aforementioned programs kick in. Often a second home or company stock position is the capital asset used to fund such a trust.

4. Liquidating Investor

Here is a client with an appreciated capital asset (maybe a closely held business interest) who wants to avoid lump sum tax treatment. Ideally, this client would enter into an installment sale and recognize taxable gain over a 15 to 20-year period.
Problem: Installment sales expose the seller to long-term credit risk (buyer's continued ability) and the possibility of adverse tax treatment in the future if the buyer refinances the purchase, sells the business, or simply retires the note early.

To this client, a charitable remainder trust equates to a **non-callable installment sale**. Unlike any other installment sale, the full term of the note will be realized - no surprises.

5. Wanna-Be Annual Giver

Here is a couple who have substantial wealth but current income is fairly well consumed by an active retirement lifestyle. They would like to take advantage of the annual gift tax exclusion and make transfers to their children and/or grandchildren but are reluctant to curtail their lifestyle. It has been pointed out to this couple that their estate is headed for heavy taxation at their demise.

. . . it is the clients with large but cash-flow- poor estates who fail to implement tax-wise strategies . . .

To this client, a charitable remainder trust funded by some asset currently providing little or no yield provides the "excess" income for annual gifts. In recent years, it has become more and more apparent to us that it is the clients with large but cash-flow-poor estates who fail to implement tax-wise strategies and rarely the estate with surplus income. In short, show us a client with excess income and we'll show you a client who will make transfers.

6. Life Insurance Legator

Here is a client much like #5 above. In this case, they have learned how life insurance owned by a third party can maximize their legacy by providing estate-tax-free, income-tax-free funds to the next generation. Problem is, at age 70, even second-to-die coverage for $1 million or so can mean annual premiums of $30,000 or more.

To this client, a charitable remainder trust can mean the **transformation of some highly illiquid, estate-tax-aggravating asset into that regular stream of cash payments** needed for the acquisition of life insurance.

This strategy is particularly valuable in estate situations where a substantial portion of the clients' net worth is represented by a closely-held business interest, real estate holdings or other capital assets not immediately marketable.

Emergency Fund Guidelines Available

Guidelines about the operation of emergency relief and victim assistance funds have been published by the Oklahoma City Community Foundation. The bombing of the Murrah Federal Building on April 19 has generated a tremendous outpouring of sympathy and charitable donations from all over the United States. At least twenty-eight different assistance funds have been started.

"We have received many requests for information about how such funds should be structured and operated", stated Nancy Anthony, Executive Director of the Community Foundation. "There are a few key requirements of which fund sponsors should be aware. These issues related to the tax deductibility of the contributions and the income tax liability of fund sponsors and the potential recipients."

In order for contributions to be deductible they must be made to a qualified charity. This includes any public charity, church, private foundation or community foundation. Additionally, contributions must be for groups of people and not earmarked for specific individuals or families. Fund sponsors need to establish eligibility criteria and an approval process and need to document both of these as well as the expenditures.

These guidelines have been summarized from information provided by the Council on Foundation which were developed after Hurricane Andrew in Miami in 1992. For a copy of the guidelines or additional information, contact the Oklahoma City Community Foundation, (405) 235-5603.

About the Oklahoma City Community Foundation . . .

The Oklahoma City Community Foundation was started in 1969 to assist donors in meeting their personal charitable goals and to help non-profit organizations generate and manage endowment fund support. As of December 31, 1994, the Community Foundation had assets of $107 million in more than 640 Name Funds. Annual distributions from these assets exceed $5 million and benefit two hundred community non-profit organizations and charitable purposes. More than 5,000 donors have utilized the Community Foundation during the past twenty-five years.

The Community Foundation is governed by twelve Trustees chosen from the Oklahoma City community and is staffed by professional managers, accountants, and financial planners. Investment management of the assets is provided by outside investment advisors led by a professional investment counsel.

The Community Foundation has many programs which provide donors with simple, flexible, efficient, and perpetual alternatives for their charitable gifts. The Community Foundation would be happy to visit with a donor and their financial advisor about charitable trusts or any other gift vehicle which might meet the donor's financial and charitable goals.

A Pooled Income Alternative for a Charitable Trust

The Oklahoma City Community Foundation also operates a qualified pooled-income fund for donors who want the advantages of a charitable trust but need a simpler vehicle or who want to make a smaller initial contribution. The pooled-income fund provides income to a beneficiary for life and the corpus is added to the permanent endowment of the Community Foundation after the beneficiaries death.

The donor gets a current tax-deduction based on the age of the beneficiary. The donor may be the beneficiary or the fund may be established to benefit another individual. With a minimum contribution of $15,000 and no initial fees for drafting documents, the pooled-income fund provides a very simple and inexpensive alternative to a charitable remainder trust.

consider this . . . Charitable Remainder Trusts

The Oklahoma City Community Foundation is an ideal charitable remainderman for a Charitable Trust. Often the charitable remainder trust is a good tax and estate planning vehicle but the potential donor has some problems with either chosing a charity to be the beneficiary or with how the gift will be utilized when it is received. The Community Foundation can help donors in the following ways:

- The Oklahoma City Community Foundation is a public charity and is a qualified charitable beneficiary for a charitable trust.

- The donor can chose for the charitable remainder to be used in any of several different ways including endowments for specific non-profit organizations, scholarships, general support for community needs, or support projects or areas in which the donor is particularly interested.

- The donor can describe his charitable interest through a letter which can be written after the trust is established. The donor can change the instructions by letter at anytime without having to make a formal amendment or codocile to the document. The donor can go ahead and establish the charitable trust and take time to determine how the charitable remainder should be used.

- The charitable remainder will establish a Name Fund in the name of the donor or any other person whom the donor wished to honor. The earnings from this fund will be used as the donor instructs the Community Foundation and will be identified as coming from the donor's Name Fund each year. The Community Foundation will insure that the donor's intention for this fund is always preserved.

The Community Foundation has worked with many donors over the past twenty-five years helping them meet their personal charitable goals. Some of the donors who have utilized charitable remainder trusts include the following:

A couple with no children created a charitable trust at his retirement. After his death, the wife continued to receive all of the income. At her death, the Community Foundation received the remainder and established a scholarship fund in the name of the couple to benefit the graduates of a high school they both had attended. The Community Foundation administers the scholarhip fund as the couple had described in the trust document.

A donor established two charitable trusts to benefit two elderly relatives. He received a substantial tax deduction at the time the trusts were established and the relatives received an important income supplement during their latter years. At the death of the relatives, the charitable remainder came to the Community Foundation where each year the donor choses organizations to receive the earnings from the fund.

A real estate developer established a charitable remainder trust with some undeveloped residential lots. Over time, the lots were sold and the income generated supported his retirement. At this death, he had established a list of ten non-profit organizations to receive endowment gifts. The Community Foundation distributes the income from the Name Fund for this donor to the ten non-profit organizations every year.

A donor with no close relatives established a charitable remainder trust to take advantage of some highly appreciated stock and increase her retirement income without having to pay capital gains on the sale of their stock. She was particularly interested in helping less fortunate individuals take care of their health and human needs. At her death, the Community Foundation used the remainder to establish a Name Fund which makes grants each year to non-profit organizations who provide health and welfare assistance.

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.

7. Providing Income For Others

a. Partially Dependent Parents

Here is a client who is assisting an aging parent financially. Unfortunately, there is no tax deduction offered for such generosity and the provider/child is often in a high marginal income tax bracket. Not only is it difficult for the child to fund these needs on an after-tax basis but it is emotionally difficult for the parent to accept the checks signed by his/her son or daughter.

To this client the charitable remainder trust solves both the financial and emotional issues. By transferring an asset to a CRT and naming the parent as primary income beneficiary, the income tax liability is transferred to the parent's lower tax bracket and, from an emotional standpoint, the check the parent receives is signed not by their child but an independent trustee.

If the parent's age and life expectancy are a concern, the donor/child could name himself/herself as contingent beneficiary. In this way, we have created a two generation plan - dependent income for the parent and supplementary retirement income for the child.

b. A Great Grandparent

Here is a client who wants to assist in the funding of his/her grandchildren or greatgrandchildren's education. Consider this recent case:

Grandmother in her nineties looks at her testamentary plans and is advised that leaving her wealth to an affluent, aging son will result in two estate taxes over a short-term period.

Grandmother creates 20 year charitable remainder annuity trust paying 8% on $750,000 ($60,000 per year) to each of three grandchildren (son's children). What is more, each of these grandchildren have children approaching college age. Imagine, this great-grandmother is providing $20,000 per year per family for the next twenty years which will no doubt educate her great-grandchildren.

To go with the personal satisfactions, our client receives a large income tax deduction, has stayed within the confines of the generation skipping tax exemption and her unified credit equivalent (present value of gift is less that $600,000), and has funded a major charitable endowment in her family name.

This great-grandmother will no doubt educate her great-grandchildren

Planner's note - Due to lifestyle and estate motivations this plan works better for grandparents than parents.

c. The Concerned Parent

Here is the client who is asking such questions as:

- **How do I prepare my heirs to manage their inheritance?**
- **How do I avoid creating a "dis-incentive" to their personal development?**
- **How can I transfer my values as well as my wealth?**

While the tax aspects of estate planning get muchattention, the human issues are often overlooked or ignored when formulating strategies. The result....loss of values transferred due to mismanagement, investment inexperience, unchecked spending, demands of other family members, costs of litigation, etc.

It's a sad thing to see one generation's hard-earned wealth squandered by the next....to see property transferred in the spirit of love and caring end up creating strife among family members.....to see monies and property left to make life easier for a young adult, result in that individual's developmental undoing by eliminating the need for career self-determination.

The concerned parent asks, how can I avoid this fate?

Common sense calls for this client to:

1. *Make modest lifetime transfers* - giving their heirs the experience in handling funds they will need in the future.

2. *Share some of their philosophy* - involving the children in their philanthropic plans can build common values which become a bond between the generations.

3. *Create trusts to distribute family assets over time* - as opposed to overwhelming the beneficiaries with a single sum.

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All of these objectives can be achieved with a charitable remainder trust which translates an unproductive asset into a stream of current income.

Other Primary Motivations . . . Beyond The Income Need

1. Alternative To Outright Gift

Here is the client who is actively involved, supporting a charitable cause and wishing to make an outright contribution. However, this client is hesitant to gift a substantial asset because of the possibility that some unforeseen future event might require the cash flow from this holding.

To this client, a CRT provides the perfect solution - a transfer of the asset now with an option on the income each year.

If the client finds that he/she does not need the income as received, these payments may be gifted back to the charity. However, the client can still anticipate income in future years.

Some clients like the continued involvement this provides. Each payment period, the donor is able to direct the income from their gift to current specific needs of the charity.

2. Alternative To Bequest

Here is the aging client, probably without children, with a sibling or two who is also approaching life expectancy. While these siblings are well-established financially, our client knows that their feelings would be hurt if they were left out of his/her will. Yet, an outright bequest to beneficiaries this age means two estate taxes on the same property in 10 years or less.

To this client, a testamentary charitable remainder trust solves the problem. While the sibling is remembered with a lifetime of income, most of the corpus escapes a second round of transfer taxes.

3. Desperate For Diversification

Here is the client who holds nearly all of his/her net worth in a single asset position. Perhaps they worked for the same employer for 30 years and invested heavily in their stock purchase program or owned a business which was sold for a stock position in the purchaser's company or did successive Sec. 1031 real estate exchanges until a 200 unit rental property dominated their balance sheet.

To this client, a charitable remainder trust offers the opportunity to reposition this singular asset base into a diversified portfolio of investments without tax consequences.

Some Final Advice

As with most estate planning strategies, you will find that many clients who would benefit from this type of planning will not act. Irrevocable transfers can lead to separation anxiety and inertia. For best results:

1. **Suggest a modest initial transfer**. Future additions are permissible with charitable remainder unitrusts.

2. **Don't make the mistake of feeling you need to quote high payout rates.** Most trustors are concerned with a dependable stream of income based on reasonable assumptions rather than short-term dramatics.

3. **Don't get too hung up with present value calculations.** I recently listened to an accountant tell his client that a $350,000 lump sum at death was better than leaving his son $100,000 in cash and $20,000 per year for 20 years. The client did the trust, not surprising to me; I'm a father too.

4. **Don't wait too long to get the charity involved**. There is valuable motivation and third party influence in networking.

5. **Tell the story to more than one client in 1995**. To quote and old friend and consummate estate planner, when it comes to telling the story....

Keep it simple....Tell it often

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