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LUKINOVICH
A PROFESSIONAL LAW CORPORATION

Lukinovich, APLC has law offices in Metairie and Baton Rouge, Louisiana. Our areas of practice include estate planning, wills and trusts, business planning, wealth preservation, probate administration and charitable gift planning.

Our mission is to devote our best skills, efforts and resources to advise our clients enthusiastically and creatively to accomplish their business, tax, family and estate planning goals and objectives, and we offer superior personalized attention with the utmost regard for privacy and confidentiality.

Learn more about our areas of practice online:
www.lukinovichlaw.com

(504) 818-0401

<u>**Suggested Reading**</u>:

Finishing Well
What People Who REALLY Live Do Differently!
By Bob Buford

Remarkable stories of individuals who have gone from success to significance in their lives.

Practical Financial Reasons for Making Charitable Gifts


Bonnie Wyllie

There are number of reasons donors make charitable gifts – they are charitably inclined or may have personal or family reasons. However, a donor may want to make a charitable gift because its financial benefits address a specific need in his or her life. Some of these beneficial financial arrangements are discussed below, but to understand them, a quick overview of charitable trusts may be helpful.

I. <u>An Overview of Key Features of Charitable Remainder Trusts and Charitable Lead Trusts</u>

A **charitable remainder trust ("CRT")** enables the settlor to receive a revenue stream at least annually from the CRT beginning with the creation of the CRT. This trust can remain in existence for a specified period of time or for the duration of the settlor's life and/or spouse's life. The remaining assets are distributed to the charitable beneficiary at the termination of the trust. Hence the name charitable remainder trust.

A **charitable lead trust ("CLT")** enables the settlor to give a charitable organization a revenue stream of time or for the duration of his life and/or spouse's life. The assets held in the trust then revert from the CLT from the creation of the CLT for a specific period back to the beneficiaries named in the trust. This type of trust typically is utilized by an individual that already has an adequate income stream and can afford to donate a revenue stream to charity. If the trust has a named beneficiary other than the settlor, such as the settlor's child, then at the termination of the trust the asset can be transferred to the child with a significant transfer tax savings.

Charitable Remainder Trusts also are useful for highly appreciated non-income producing assets. The donor can set up a Net-Income Makeup Provision Charitable Remainder Trust (or "NIMCRUT"), which means the NIMCRUT makes no distributions until it has trust accounting income. This trust can go for years without making a distribution, but these distributions are accrued until there is trust accounting income to pay them. When the asset is sold, then there will be income to distribute. The NIMCRUT can then begin paying the beneficiary the accrued and unpaid distributions for the prior years to the extent there is income. The NIMCRUT works well when the donor wishes to postpone distributions until a future date.

Another way a charitable remainder trust can be structured is to start as a NIM-CRUT and then convert to a regular CRUT when a triggering event occurs that is not within the control of the trustees or any other person. This is called a "FLIP-CRUT," and the triggering event can be a birthday, a death, a marriage, etc. The FLIP-CRUT works well when the donor wishes to postpone distributions until a future date.

Selecting the Payout

If the settlor selects an **annuity** payout structure either for a CRT or CLT, the payout is based on a flat percentage of the assets that funded the trust at creation. The annuity payment is calculated in the initial year and remains constant for all subsequent years. In this way, the settlor knows exactly how much will be distributed annually.

If the settlor selects a **unitrust** payout structure either for a CRT or CLT, the payout is computed on a flat percentage of the fair market value of the assets in the trust on a particular date each year. In this way, the settlor is able to take advantage of any appreciation of assets in the trust.

For more technical information on CRTs and CLTs, see the Oct. 2016 issue of the Lukinovich Lagniappe Volume VIII "Utilizing Charitable Trusts for Wealth Conservation." This can be found on our website at:
http://www.lukinovichlaw.com/lagniappe/LukinovichLagniappe_2016_Oct.pdf

II. Examples of How Charitable Trusts Can Be Used

A. Diversifying Assets or Increasing Cash Flow

An investor owning highly appreciated low-basis stock might like to diversify this investment. However, he or she would be faced with paying significant capital gains taxes if it was sold. The investor can transfer these assets to a CRT. The trustee can sell the asset and reinvest in a diversified, income-producing portfolio without capital gains tax reducing the sales proceeds.

Since the trust is exempt from tax, it allows the assets to appreciate. The trust tracks its earnings as ordinary income, capital gains, and tax-exempt income. Then any distributions from the trust will be taxed to the beneficiary in the following order: ordinary income, capital gains tax, tax-exempt income, or corpus.

If a donor is considering whether to make a lifetime gift of stock to a CRT or make a testamentary gift to a CRT, a lifetime gift of stock to a CRT for which the donor is the sole noncharitable beneficiary can have the same estate tax effect as an outright charitable bequest in the donor's will. The reason is the entire value of the remainder interest is included in the donor's gross estate and the estate receives a deduction equal to the value of the CRT. In addition, the donor also receives a charitable income tax deduction if the gift is made during life.

B. Selling a Business or Assets of a Business:

An owner can contribute the stock of his corporation to a CRT, which then sells the stock to an unrelated third party. This enables the donor to avoid the capital gains tax on the sale of the stock.

Often a purchaser will not purchase a C Corporation's stock because the purchaser may be reluctant to assume unknown liabilities. However the purchaser may want to buy the C Corporation's assets. The C Corporation can sell the assets and pay the tax. The owner can contribute his C Corporation stock to a CRT, and then the C Corporation can liquidate. The donor avoids paying tax at the shareholder level on liquidation, but receives a charitable income tax deduction for the contribution of his C Corporation stock to the CRT.

An owner of a closely held C Corporation can do a stock bailout. He or she can contribute the stock to a charitable remainder trust, and the trustee can present the stock to the corporation for redemption without the owner being taxed on the gain. For the stock bailout to work, the C Corporation has to have enough cash to redeem the stock. It is important that the trustee is not legally bound to surrender the stock and that the C Corporation cannot force the surrender. An advantage to doing a stock bailout is that if other family members own stock in the C Corporation, their interests are proportionately increased without incurring any gift or estate taxes.

A donor can transfer his or her partnership or limited liability company interests into a CRT. The trust can then sell the units to a third party. If the partnership interest includes ordinary income items, such as unrealized receivables, depreciation, recapture items, and substantially appreciated inventory, the donor must reduce the value of the contribution by the amount of gain attributed to these items. Also, if the partnership has liabilities, the partner is treated as relieved of his or her pro-rata share of the liabilities. The donor must recognize gain if his or her share in the liabilities exceeds his or her basis in the partnership. In addition, this gift requires careful planning to avoid problems with unrelated business taxable income and self-dealing.

Another method the donor can use is to withdraw selected assets from the partnership or LLC and contribute them into a CRT. If this withdrawal is a non-liquidating distribution, the partner will not have a tax consequence since the partner's basis in the property is the same as the partnership's adjusted basis prior to the distribution.

C. Estate Planning:

Donating Assets to a CRT and Creating a Wealth Replacement Trust

The donor can create a CRT and transfer a significant amount of assets to it. In addition, the donor can create a life insurance trust to replace the wealth transferred to the CRT and name his or her children as the beneficiaries. The trust can purchase a life insurance policy on the donor's life or a joint policy on the lives of the donor and spouse, payable on the death of the last spouse to die. The life insurance policy should have a greater face amount than the value of property contributed into a CRT. The donor may have to make annual contributions to this trust to pay the life insurance premiums. If these payments are less than the annual exclusion for gift tax purposes, the donor will not pay any gift taxes. However, if these payments exceed the annual exclusion amount, then the donor may incur gift taxes on the transfer to the trust, or at a minimum, exhaust a portion of the donor's lifetime gift tax exemptions. When the donor and/or spouse dies, the life insurance proceeds will be distributed to the children free of estate taxes.

Using a CLT to Reduce or Eliminate Estate Taxes:

If a donor has a large estate, he can execute a will with provisions for a CLT. The will can be structured to zero out any federal estate taxes owed. Depending on how it is planned, at the end of the term it is possible for the beneficiaries to receive almost the full date of death value of the assets.

If the donor does not want his beneficiaries to wait a long time until the payout, it is possible for the donor to use several layered testamentary CLTs with different term lengths so that the beneficiaries receive periodic distributions.

Another strategy is to create a testamentary CRT with layered CLTs. The beneficiaries will receive distributions quickly with the CRT. Then when the income stream from the CRT is scheduled to end, the layered CLTs will begin to periodically terminate and distribute their assets to the beneficiaries.

D. Using C Corporations, LLCs, and Partnerships for Charitable Giving

A C Corporation can establish a CRT with itself as the beneficiary and contribute some of its assets to this CRT. The trust can sell these assets and avoid tax on the gain. The C Corporation gets a charitable income tax deduction for up to 10% of its taxable income with a carryforward for 5 years.

Caveats:

- Do <u>not</u> contribute assets encumbered with debt.

- Do <u>not</u> arrange the sale of an asset before contributing it to a CRT or CLT. It will be considered an assignment of income and the gain will be taxable to the donor. Also, the donor will not have access to the proceeds from the sale to pay the capital gains tax.

- Do not contribute to a CRT an asset that generates unrelated business taxable income because the CRT will have to pay an excise tax equal to the amount of UBTI—a 100% tax.

- Do not contribute tangible personal property to a CRT because the charitable deduction can be delayed until the charity actually takes possession. Also, if the tangible personal property would have an unrelated use by the charity, the charitable deduction would be limited.

- CRTs are subject to some of the same excise taxes that apply to private foundations, such as excise taxes on self-dealing, excess business holdings, investments jeopardizing charitable purpose, and taxable expenditures. With careful planning the CRT can be set up so that it does not run afoul of these excise taxes.

III. Conclusion

These charitable giving strategies require careful planning. If structured correctly, these charitable gifts can have a significant beneficial impact on the donor and his or her family.

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4415 Shores Drive
Suite 200
Metairie, LA 70006
(504) 818-0401

717 Highlandia Drive
Suite 201
Baton Rouge, LA 70810
(225) 756-5454

www.lukinovichlaw.com