

13th National Conference
on Planned Giving

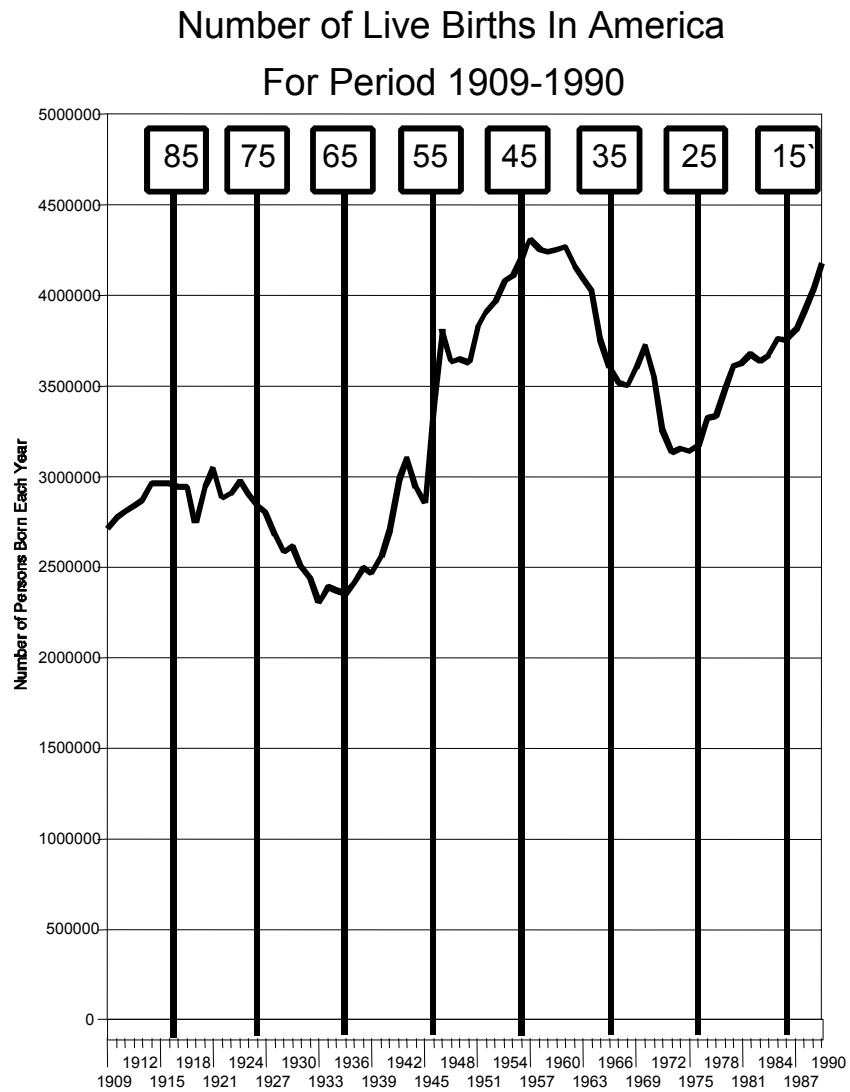
Waiting on the Wealth Transfer – Will You Miss the Boat?

Thursday, October 26, 2000

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- I. Introduction.
 - A. The great American wealth transfer.
 - 1. Cornell study.
 - 2. Boston College study.
 - B. Current estimates are for transfers up to \$136 trillion.
 - 1. Time periods of 50 years or more are involved.
 - a. Could be longer.
 - b. U. S. Census Bureau estimates that 40% of women who reach the age of 50 in 2000 will live to be 100 years old.
 - 2. Assumes compounding of current values.
 - 3. Does not account for changes in Social Security and Medicare that may result in significant “transfers” prior to death.
 - C. Publicity surrounding wealth transfer has increased interest in the subject among the entities that would logically benefit from it.
 - 1. Baby boomers.
 - 2. Government.
 - 3. Financial services providers.
 - 4. Charities.

- D. Older generation will be transferring wealth to baby boomers over the next 25 to 30 years.



II. The Nature of the Wealth To Be Transferred.

- A. Wealth can be in the form of assets.

1. Stocks.
2. Bonds.
3. Real estate.
4. Other.

B. Wealth can be in the form of income.

1. Annuities.
2. Salary.
3. Trust income.
4. Royalties.
5. Other

C. Transfers of wealth can involve assets or income.

1. Right to income can be a valuable “asset.”
2. Value of assets depends on when they will be received.
3. Split interest charitable gifts have always revolved around separating ownership of income from ownership of assets.

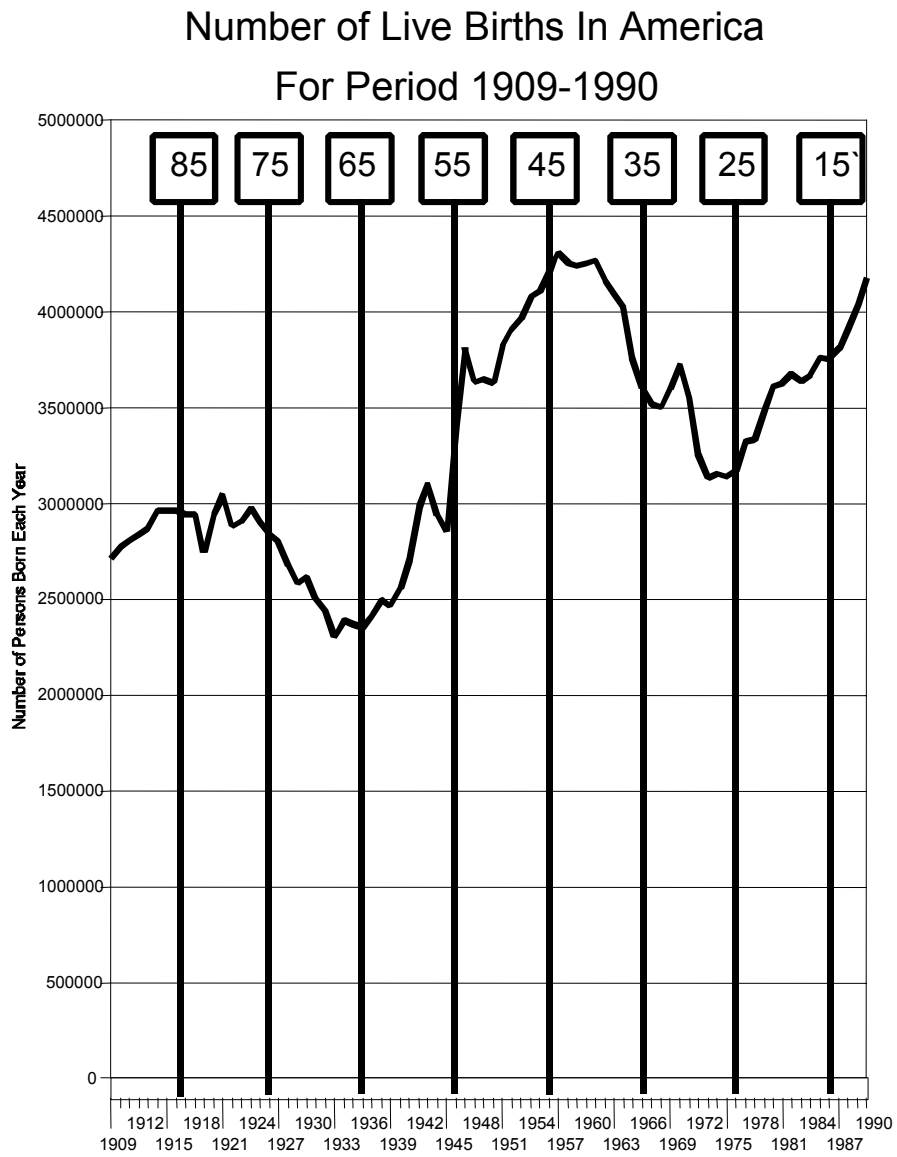
III. The Charitable Dimension of the Wealth Transfer.

A. Estimates are from \$6 trillion to \$25 trillion for charitable component of the wealth transfer.

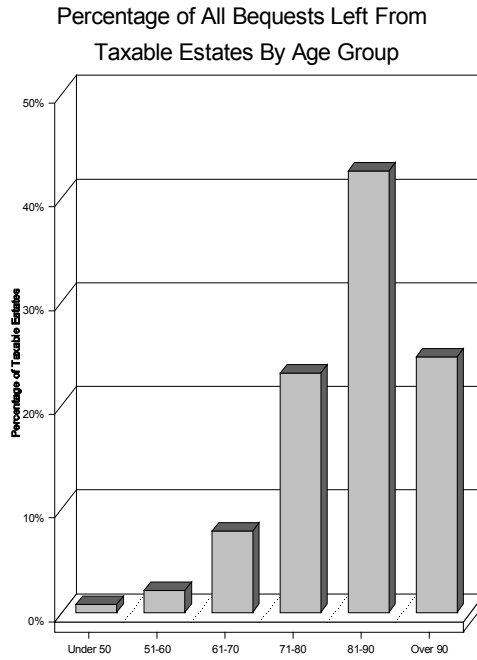
1. \$15 billion bequeathed to charity in 1999 according to Giving U.S.A.
2. Approximately 87,000 charitable trusts exist with total assets in the range of \$8 billion. From \$1 billion to \$2 billion per year being placed in charitable trusts.
3. At the low end of the charitable transfer estimates, the total for the next 50 years would be 375 times the amount transferred to charity in 1999, or an average of 8 times current levels - an average of \$125 billion per year over the next 50 years. For this to occur, the 4,000 charities represented in NCPG would have to have an average of \$30 million per year in asset transfers each year for 50 years.

B. Demographics will drive the timing of the wealth transfer.

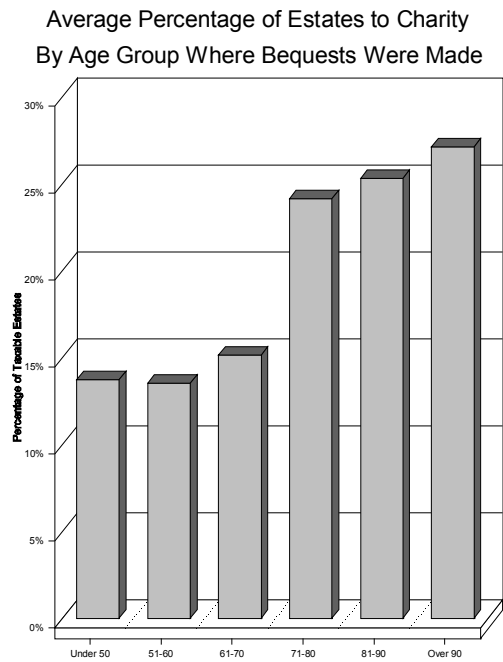
1. Recall age distribution of American population.



2. Internal Revenue Service studies show that approximately 19% of persons who die with taxable estates utilize the charitable deduction. Note the age distribution of this group of persons.

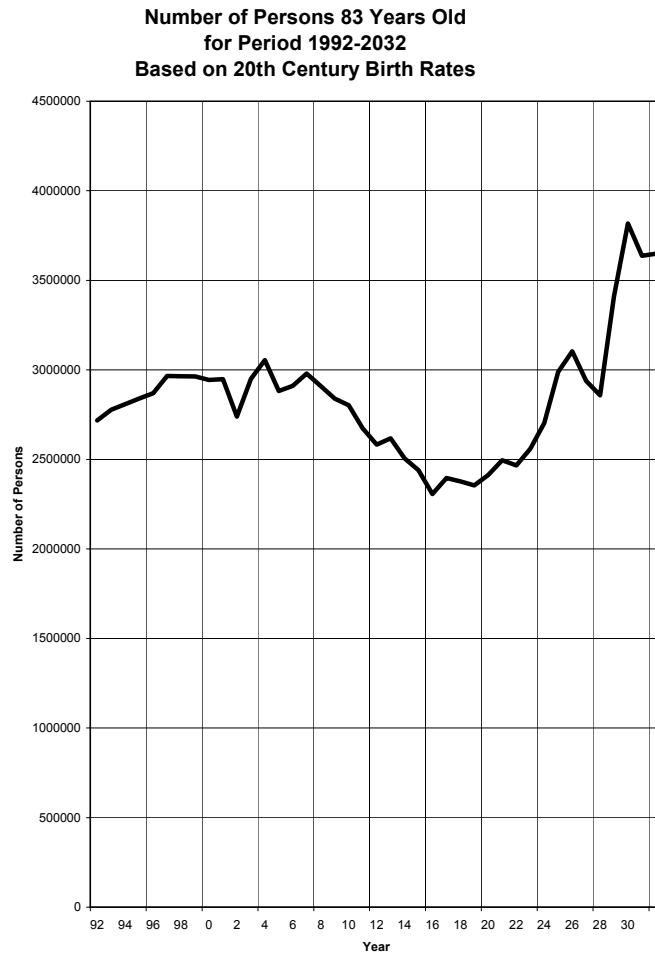


2. The older persons are at death, the greater percentage they leave to charity according to the same IRS study.

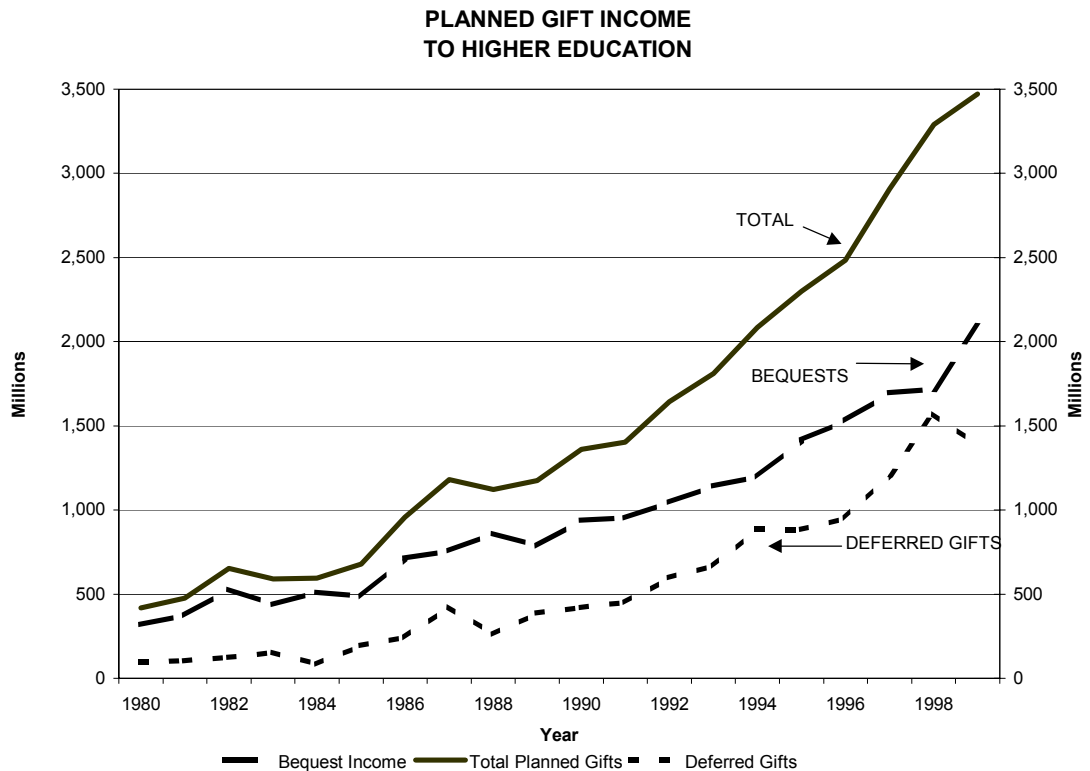


3. There are a number of possible explanations for these statistics.
 - a. For whatever reason, persons who are wealthy and charitable tend to live longer.
 - b. Numerous studies of bequests received by leading charities indicate that average age of bequest donors at death is approximately 83, with women somewhat older on average and men somewhat younger.
 - c. The older a person is at death, the more likely it is that her or she will not be survived by heirs, and charitable residual clauses thus come into play more often for older persons.

4. To help project future trends in bequest and other gift income that is realized at the death of donors, it is useful to look at the expected rate of deaths of 83-year-olds over the coming years based on the number of persons born in the early years of the 20th century. Immigration data shows little impact on these numbers.



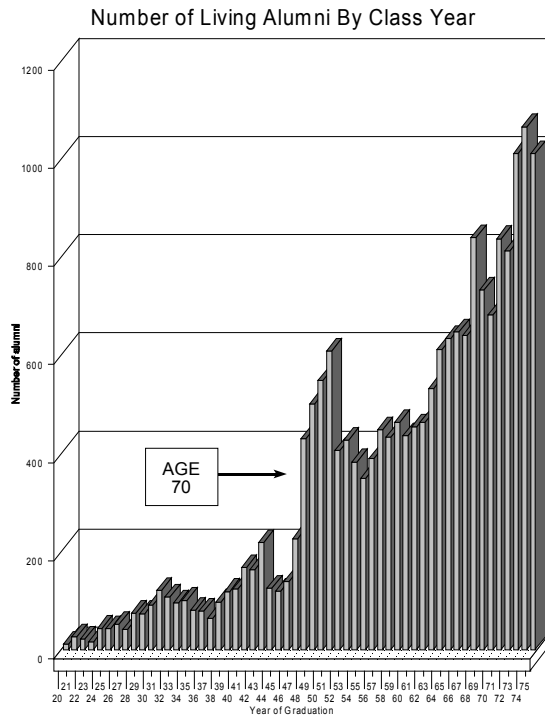
- a. This data explains why there may be peaks and valleys in the transfer of wealth, the receipt of which is dependent on the death of one or more transferors.
 - b. A dip in the intermediate term can be expected for some organizations that depend on gifts that mature at the death of one or more persons.
5. Demographics will affect different types of charitable gift planning tools in different ways.
- a. Charitable bequests will continue to be a major source of charitable transfers for most of the coming decade.
 - (1) Note trends in bequest income to higher education. Bequest income to higher education increased by 22% in 1999 to a record \$2.1 Billion. The bequest increase of \$377 Million in 1999 was more than the total bequest income of \$374 Million in 1981. Trusts and other deferred gifts dropped slightly in 1999 after increases of 27% in 1997 and 30% in 1998.



(2) Note the combined totals of ten leading educational institutions.

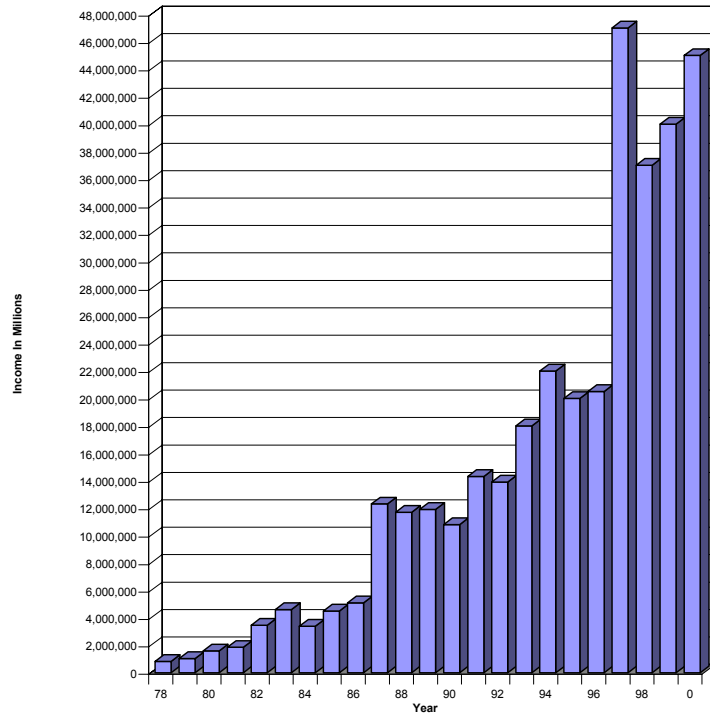
	Bequests	Deferred Gifts	Total	
Brown University	\$ 5,620,000	\$ 1,735,000	\$ 7,355,000	76%
Cal Tech	\$ 70,488,000	\$ 9,633,000	\$ 80,121,000	88%
Columbia	\$ 23,952,000	\$ 7,506,000	\$ 31,458,000	76%
Duke University	\$ 30,915,000	\$ 17,480,000	\$ 48,395,000	64%
Georgetown	\$ 4,795,000	\$ 7,160,000	\$ 11,955,000	40%
New York University	\$ 12,520,000	\$ 1,713,000	\$ 14,233,000	88%
Princeton University	\$ 19,662,000	\$ 10,547,000	\$ 30,209,000	65%
University of Chicago	\$ 17,418,000	\$ 4,927,000	\$ 22,345,000	78%
University of Michigan	\$ 6,982,000	\$ 4,152,000	\$ 11,134,000	63%
Yale University	\$ 36,224,000	\$ 16,058,000	\$ 52,282,000	69%
	\$ 228,576,000	\$ 80,911,000	\$ 309,487,000	74%

(3) Higher education can expect continued growth in bequests and other planned gifts because of impact of G.I. Bill which gave rise to a tremendous increase in “market share” for higher educational institutions. Note the age distribution of the alumni of one major institution.



- (4) Growth in bequests and other deferred gifts is not confined to realm of higher education. Note trend in realized bequests by a health-related institution.

Bequest Income 1978-2000

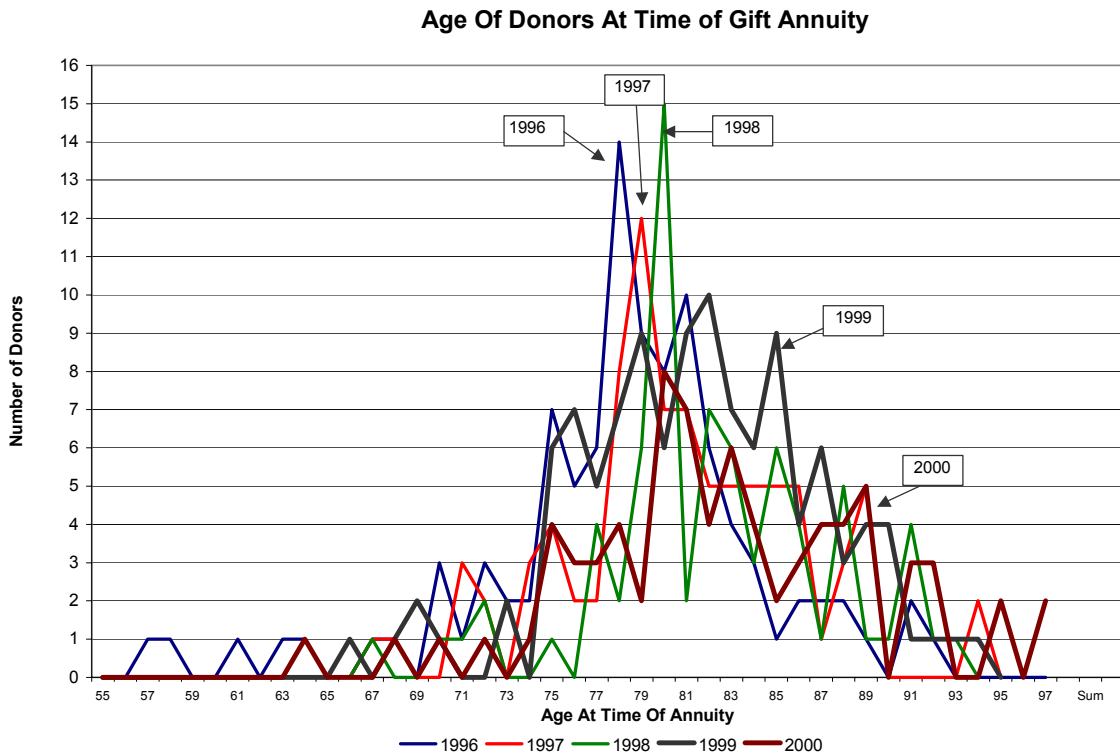


b. Retirement plans.

- (1) Will be tremendous growth source as G. I. Bill generation passes away.
- (2) Big opportunities for current gifts through withdrawal of funds to transfer wealth today rather than at death.
- (3) If estate tax eliminated, will still be a desirable “pocket” from which to make gifts at death, as funds will still be subject to income tax if left to heirs.

c. Gift annuities.

- (1) Gift annuity activity should remain strong.
- (2) Evidence that average age of gift annuitants is getting older as “supply” of persons in the 70 to 80 age range begins to fall. Note five year trend in ages of new annuitants for organization that has averaged approximately 100 new gift annuities in each of those years.



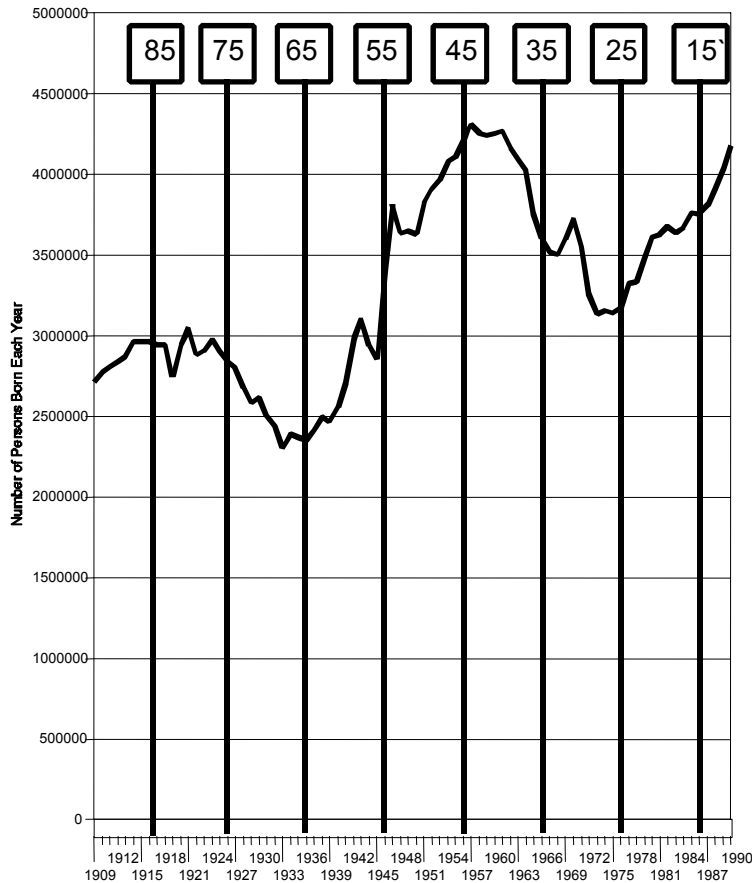
d. Life Insurance.

- (1) Large amounts of wealth in the form of life insurance.
- (2) Can be an excellent “bequest substitute.”
- (3) Big opportunity if estate tax repealed or threshold level where tax applies is increased.

e. Charitable remainder trusts.

- (1) Average age of CRT donors is late 60s.
- (2) Over 70 million persons will reach the age of 65 over the next twenty years.

Number of Live Births In America
For Period 1909-1990



- (3) Life expectancy of 65-year-old couple is 25 years, so it is desirable whenever possible to convert charitable remainder trusts to sources of current income.
- (4) CRTs with wealth replacement may be more common as younger donors can gain more leverage using this technique.

- f. Charitable lead trusts.
 - (1) Lead trusts will remain attractive in lower interest rate environment.
 - (2) Will perhaps be more attractive to baby boomers with younger children as a tax-efficient way to delay inheritances.

- g. Pooled income funds.
 - (1) Large growth in the age group that has traditionally been attracted to pooled income funds.
 - (2) Pooled income funds managed for total return may prove more attractive to younger donors seeking ways to build retirement income.
 - (3) No minimum payout or minimum charitable deduction for gifts to pooled income funds.

- h. Gifts of remainder interests in real property.
 - (1) Attractive to wealthy donors with multiple homes.
 - (2) Cap on capital gains exclusion at \$250,000 per person may make such gifts an attractive way to reap current tax benefits, especially in the event estate taxes are repealed and if carryover basis applies on property left to heirs.
 - (3) More attractive in lower interest rate environment.
 - (4) Note increased income tax deductions for gift of remainder interest in \$500,000 home as discount rates fall.

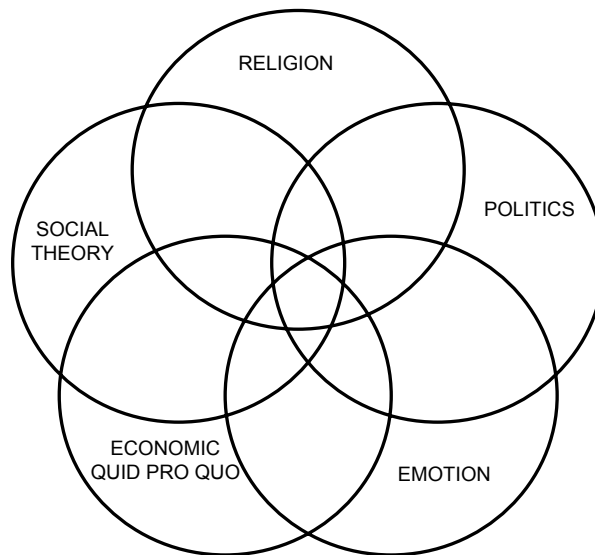
	Home Value	\$500,000
Discount Rate	Deduction Percentage	Deduction Amount
6%	51%	\$255,000
7%	47%	\$235,000
8%	44%	\$220,000
9%	41%	\$205,000
10%	39%	\$195,000

- (5) This gift may be more attractive if estate taxes are reduced or eliminated as donors may be more interested in current tax benefits for gifts that may otherwise have been made in the form of a bequest.

- IV. Charitable Transfers in Context of Wealth Transfer Planning.
 - A. Goals are basically simple.
 - 1. Transfer wealth to family, friends and charity.
 - 2. Maintain economic security for remainder of lifetime.
 - B. Four P's of estate planning.
 - 1. People.
 - 2. Property,.
 - 3. Plans.
 - 4. Planners.
 - C. Philanthropy is the fifth "P."
 - 1. Must balance other considerations.
 - 2. Typical priorities.
 - a. Personal financial security.
 - b. Security of loved ones.
 - c. Charitable interests.
 - D. All planning takes place in light of four primary concerns.
 - 1. Dying too soon.
 - 2. Living too long.
 - 3. Illness and economic misfortune.
 - 4. Mental or physical disability.
 - E. Role of taxation in the process.
 - 1. Planning to minimize or eliminate the impact of estate, gift, and income taxes has been a major part of the estate planning process for many years.
 - 2. Estate taxes first introduced in 1917.
 - 3. Gift taxes date to 1935.

4. Goals of tax planning.
 - a. Reduce size of taxable estate.
 - b. Plan for valuation of assets in estate.
 - c. Delay payment of taxes as long as possible.
 - d. Provide funds for payment of taxes.
 5. Accomplishing tax planning objectives frequently limits charitable and non-charitable options available to those with taxable estates.
 - a. Married persons typically rely on “two trust” plan backed up by insurance trust.
 1. Family trust.
 2. Marital trust.
 3. Life insurance trust.
 - b. Single persons have fewer options.
- F. Charitable transfers are sometimes part of the estate tax planning process.
1. Unlimited amounts may be deducted from estates for federal estate tax purposes.
 - a. Income tax limitations on deductions for charitable transfers tend to interfere with split interest transfers.
 - b. Gift taxes act as disincentive to make gifts to loved ones with or without a charitable dimension to one’s plans.
 2. The Tax Reform Act of 1969 DID NOT create planned giving, it constricted the use of split interest gifts that had become increasingly popular in tax planning in the 1960s.
 3. Goal of Congress and IRS then and now is to make certain a person can not make a profit by giving money to charity. If it costs nothing to make a gift, it is no longer a “social capital” transfer

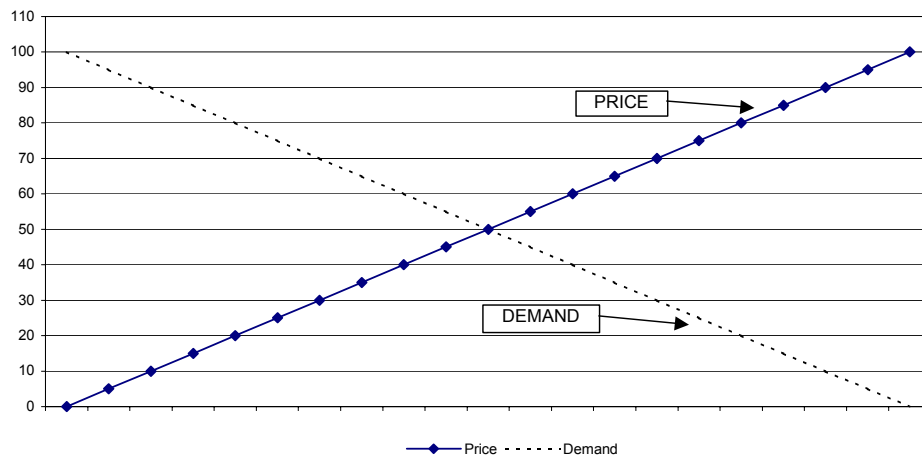
- G. Impact of proposed elimination of gift and estate taxes on charitable giving via estates.
1. Congress has passed legislation that would phase out estate taxes over time.
 2. Presidential veto promised as of August 1.
 3. If Republican Congress and Administration is elected in November, 2000, likelihood of elimination of estate tax is high.
 4. President Clinton has stated publicly that the estate tax is now affecting too many people and should be modified.
 5. Regardless of outcome of November election, at the least a higher threshold for estate taxes is likely to become a reality.
 6. What impact might an elimination of estate taxes have on gifts via estates?
 - a. Under today's laws, it costs a minimum of \$.45 per dollar to leave assets to charity given the 55% estate tax.
 - b. Important to understand that there are many motivations for charitable gifts.



- c. Vital to understand mission of organization.
 1. Short-term needs.

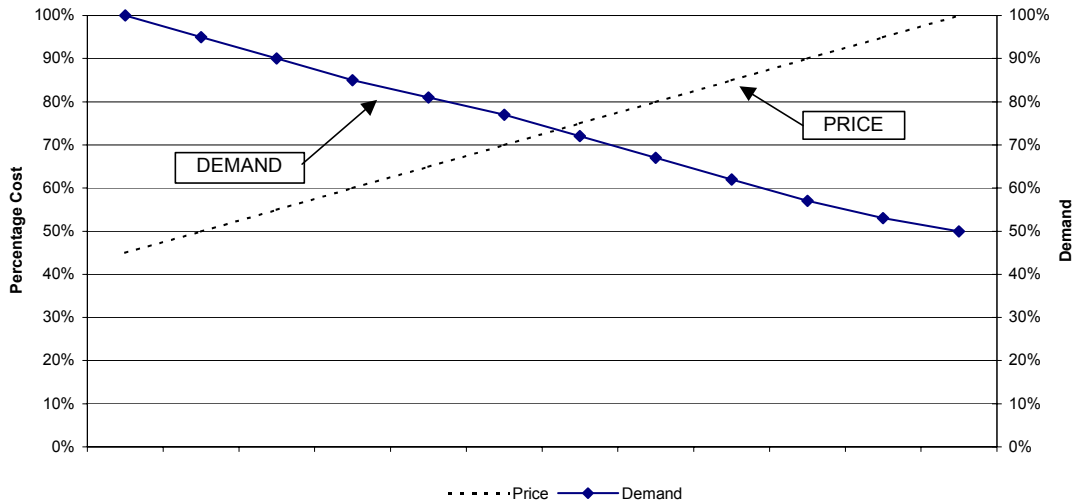
2. Intermediate needs.
 3. Long-term needs.
- d. If donors are motivated to fund mission goals, that becomes the “cake.” while tax benefits if they exist are the “icing.”
1. Can sell cake without icing if necessary.
 2. Difficult to sell icing alone.
7. Economic theory is at the base of controversy surrounding the impact of estate tax repeal on charitable giving via estates.
- a. Under the concept of elasticity of demand, as the price of certain “products” rises, the demand for them will fall.

ELASTICITY OF DEMAND



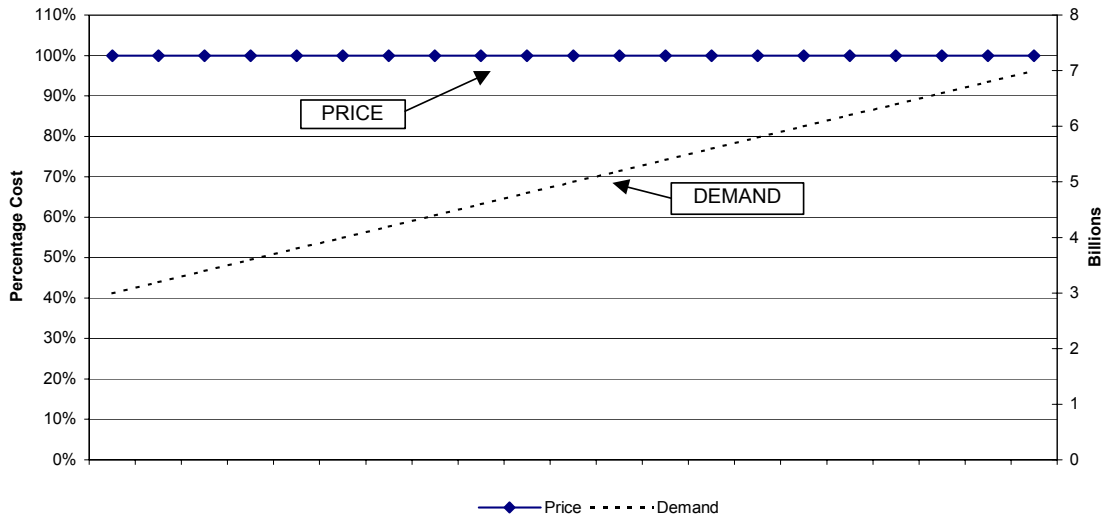
- b. If the “demand” for charitable gifts via estates is “elastic,” then the number of gifts via estates should fall as the price goes up. Currently the minimum cost for a gift via the estate is \$.45 per dollar. With no estate tax, the price would rise to \$1.00 per dollar, or 100%. Economic theory would then dictate that estate gifts would decline as price rose with phaseout of estate taxes.

**GIFTS FROM ESTATES IF
DEMAND IS ELASTIC**



- c. Only 19% of persons who die with taxable estates now make charitable gifts and use the estate tax deduction. This amounts to about 17,000 persons per year from among the approximately 2,500,000 deaths each year. The cost to the families of these persons can be as much as 45% of the amounts donated via the estate.
- (1) These persons are contributing in the range of \$10 billion each year.
 - (2) Treasury economic models predict that charitable giving via estates will decline by \$6 billion per year, or approximately 60% of the amount currently being left to charity by persons with taxable estates.
- d. This assumes that the demand for charitable bequests is in fact elastic. To examine that premise it is helpful to examine the trends in gifts from non-taxable estates, where the price has always been 100% of the amount donated via bequests. Indications are that as many as 95% of the number of bequests each year comes from the estates of those who are motivated for reasons other than tax savings. The “demand” for these gifts could be said to be “inelastic.” There has been significant growth in bequests from non-taxable estates in recent years, despite the cost of \$1.00 per \$1.00 donated.

**DEMAND FOR ESTATE GIFTS
FROM NON-TAXABLE ESTATES**



- e. A case can be made that charitable bequests and other testamentary transfers are done for many reasons. The tax system subsidizes these gifts, but in the final analysis, families are always deprived of something as a result of the gift. If there are other motivators at work, one could argue that charitable bequests might actually *increase* as a result of the repeal of estate taxes.

Example:

Harold Schmidt has amassed an estate of \$10,000,000. His estate will pay taxes at the rate of 55% of amounts over \$3,000,000. As part of a capital gift development effort, he made a commitment of \$2,500,000 via his estate and a gift in this amount was announced. Mr. Schmidt has two children, and he decided he wanted them to share the balance of his estate amounting to approximately \$1,700,000 each at his death.

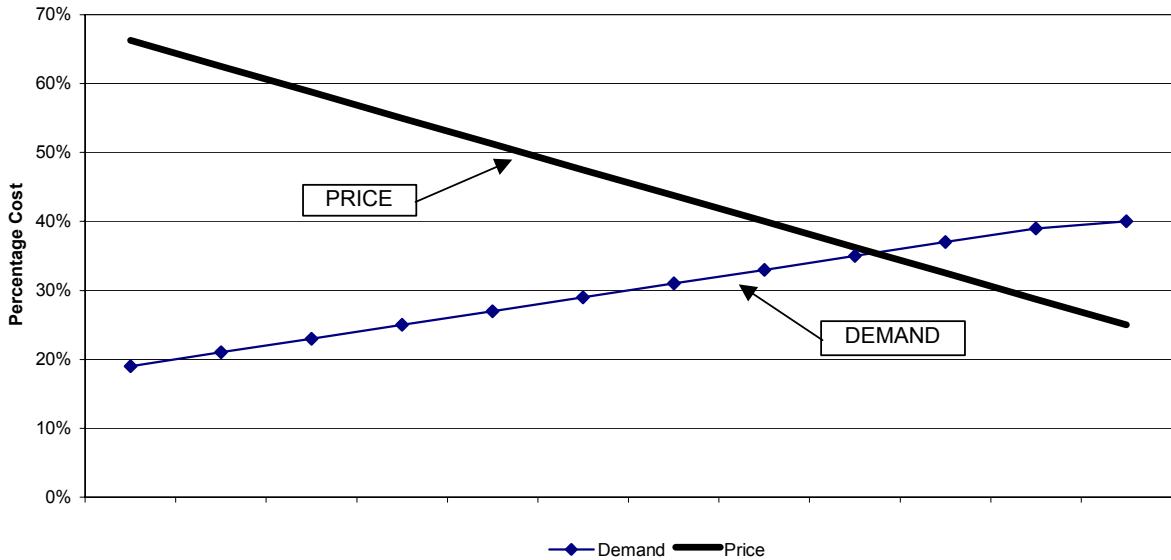
Note the approximate cost of this gift to his family net of the combination of estate taxes and the gift assuming various estate tax rates:

Gross Estate	Charitable Bequest	Taxable Estate	Maximum Tax	Tax Paid	Net To Family	Percent To Family	"Price" To Family
\$10,000,000	\$ 2,500,000	\$ 7,500,000	55%	\$ 4,125,000	\$ 3,375,000	34%	66%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	50%	\$ 3,750,000	\$ 3,750,000	38%	63%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	45%	\$ 3,375,000	\$ 4,125,000	41%	59%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	40%	\$ 3,000,000	\$ 4,500,000	45%	55%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	35%	\$ 2,625,000	\$ 4,875,000	49%	51%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	30%	\$ 2,250,000	\$ 5,250,000	53%	48%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	25%	\$ 1,875,000	\$ 5,625,000	56%	44%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	20%	\$ 1,500,000	\$ 6,000,000	60%	40%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	15%	\$ 1,125,000	\$ 6,375,000	64%	36%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	10%	\$ 750,000	\$ 6,750,000	68%	33%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	5%	\$ 375,000	\$ 7,125,000	71%	29%
\$10,000,000	\$ 2,500,000	\$ 7,500,000	0%	\$ -	\$ 7,500,000	75%	25%

Upon learning of the proposed repeal of estate taxes and the impact of that on his children's inheritance, he decided that he would rewrite his will in such a way that the bequest would remain in his will following estate tax repeal and actually be increased somewhat, as he could now "afford" to do so while his children would actually receive more.

- f. In economic terms, it could be argued that under current tax law the glass is now half-full, and that elimination of the estate tax would fill the glass and actually stimulate demand for bequests by lowering the cost of charitable bequests to the non-charitable heirs.

**EFFECT ON DEMAND IF ASSUME
BEQUESTS MADE FOR NON-TAX REASONS
AND "PRICE" TO NON-CHARITABLE HEIRS DROPS**



- g. The argument that because of our nation’s tax laws persons are going to be charitable either voluntarily or involuntarily, and are thus stewards of a certain amount of “social capital” will no longer be valid, as redirection of a portion of one’s life’s accumulation of assets for charitable use will be fully voluntary. In the area of gift planning, greater focus will of necessity be placed on the gift element while assuring the correct plan is chosen that helps balance the donor’s multiple objectives.
- h. For years, gifts of appreciated property have been made because it is possible to give more at less cost using this method of giving. The same analysis can be applied to gifts via the estate, where it will now be possible to give the same amount to charity at less cost or more to charity at the same cost to heirs as during the time when estate taxes applied.

V. Charitable Asset Transfer Tools Serve Various Purposes.

A. Gifts by will.

1. Transfer of assets at death.
 2. Offers high degree of flexibility.
- B. Beneficiary designations.
1. Life insurance.
 2. Retirement plans.
- C. Charitable remainder trusts.
1. Can transfer assets at death.
 2. Can transfer assets at expiration of time period.
- D. Gift annuities.
1. Immediate asset transfer.
 2. Asset transfer is offset to greater or lesser extent by liability for payments.
 3. While asset transfer is immediate, offsetting liability is for the lifetime of one or two persons.
- E. Remainder interests in real property.
1. Property interest is transferred immediately.
 2. Full ownership of property delayed until death of one or more persons.
- F. Charitable lead trusts.
1. Income interest is transferred.
 2. Corpus never becomes property of charity unless it is necessary to transfer principal to make required payments.
- G. Other tools.

VI. Charitable Planning Techniques Can Be Used Effectively With or Without Estate Tax Savings to Help Charitable Entities Participate in the Coming Wealth Transfer.

- A. Review of participants in the wealth transfer.
 - 1. Baby boomers.
 - 2. Government.
 - 3. Financial services providers.
 - 4. Charities.

- B. Social capital transfer may or may not be voluntary.
 - 1. May see total elimination of estate taxes.
 - 2. May see threshold level raised.

- C. Timing of gifts will be vitally important when working with younger donors.
 - 1. FASB rules require gifts to be present valued.
 - 2. CASE and other crediting guidelines will continue to create incentives to produce greatest value in shortest period of time.

- D. Balancing needs of charitable recipients with the needs of donors utilizing the correct properties at the right point in life will, as in the past, be the key to success in gift planning in future years, regardless of changes that may be on the horizon in our nation's tax laws.
 - 1. Charitable remainder trusts can offer immediate as well as long range benefits.

Example:

Mr. & Mrs. Arnold, ages 61 & 59, have built a successful business over the past thirty years. They are still very active in the business. but their son is now beginning to assume more management responsibilities. They currently plan to retire in about ten years.

The Arnolds have been generous donors of time and money to a particular organization for a number of years. They have been approached and asked to consider a large commitment to a campaign for new facilities and endowment. They have decided that they would like to make a gift in the \$1,000,000 range over the near term and provide for an endowment that will be funded at the end of their lifetimes. The challenge is to arrange for a pledge of \$1,000,000 that will be paid over as short a period of time as possible with an eventual endowment that will be realized after the Arnolds have been provided for financially for remainder of their lives.

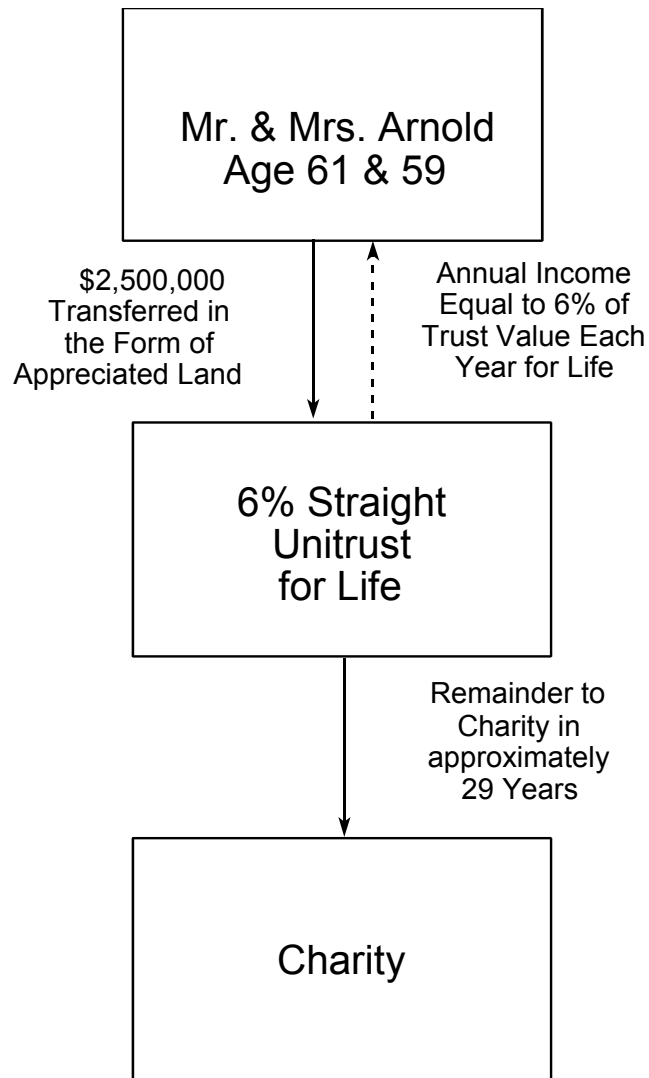
They have contributed to a retirement account over the years, but like many entrepreneurs, they have reinvested much of their earnings in their business. Their income today is in the range of \$350,000 per year, most of which is in the form of salary from their business. They have approximately \$2,000,000 in mutual funds and receive \$20,000 to \$30,000 per year from those funds. They have said they do not feel comfortable in donating from those funds because this is their only source of liquid wealth. The Arnolds want to leave their funds in their retirement accounts to grow tax free as long as they possibly can. At retirement, they plan to fund living expenses through withdrawals from their retirement accounts and earnings from their mutual funds. They have gradually been transferring ownership of the business to their son. The business has been appraised at a relatively low value, and they have been giving stock to their son for many years, effectively transferring majority control to him while removing the asset from their estates.

Twenty years ago the Arnolds purchased a five acre parcel of property located in a rural area outside their city with the idea that they would someday build a new headquarters building for their business. The cost of the land was \$200,000. They have recently completed paying for the land which was financed over a twenty year period. Another part of their retirement plan was to build the company headquarters building on the land and rent it to the business. The lease would provide for payments that were tied to the gross receipts of the business so they would have protection against inflation and their income would grow with the business.

The Arnolds now face a challenge. The land has grown in value to \$2,500,000, and it is now not feasible to use it for their company headquarters as the rent on a building constructed on the land would be too much for their company's budget. They are also faced with the ownership of an illiquid asset that could give rise to significant estate taxes.

How can the Arnolds achieve their goal to make a \$1,000,000 gift over time, maintain economic security for their lifetime, and provide an eventual endowment?

It was initially proposed that the Arnolds fund a net income charitable remainder unitrust structured as a FLIP trust that following the sale of the property would pay income of 6% of the value of the trust each year until the death of the survivor.



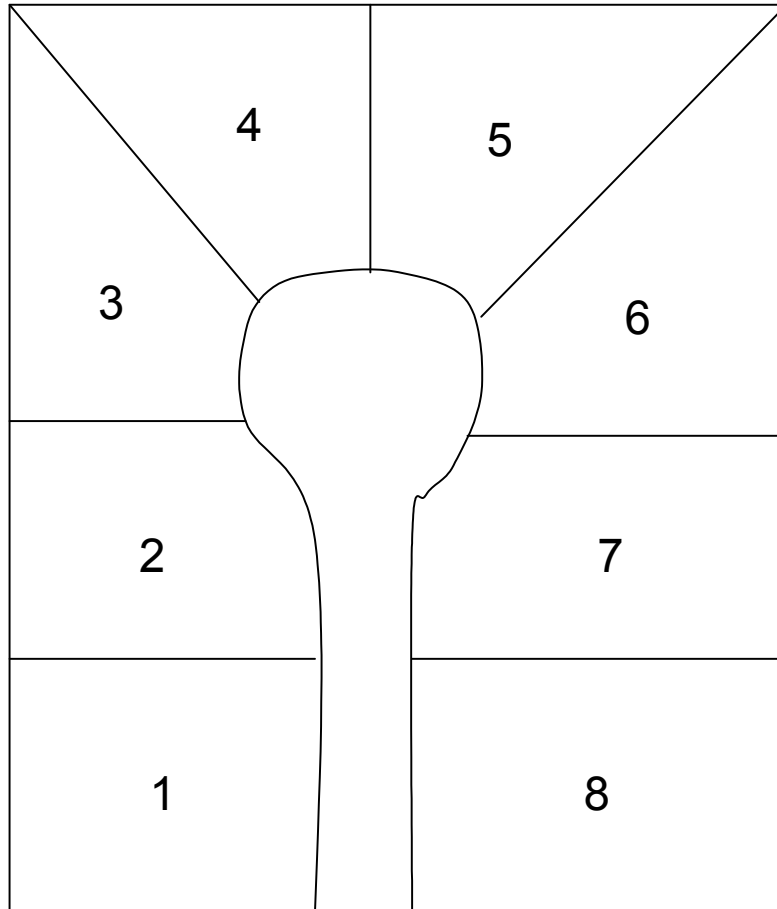
Over their joint life expectancy of 29 years, their income stream could be depicted as follows, assuming a 9% total return in their trust each year:

Year	Principal	Earn	Growth	Pay	Payment
0	\$ 10,000,000	4.00%	\$ 400,000	5.00%	\$ 500,000
1	\$ 9,900,000	4.00%	\$ 396,000	5.00%	\$ 495,000
2	\$ 9,801,000	4.00%	\$ 392,040	5.00%	\$ 490,050
3	\$ 9,702,990	4.00%	\$ 388,120	5.00%	\$ 485,150
4	\$ 9,605,960	4.00%	\$ 384,238	5.00%	\$ 480,298
5	\$ 9,509,900	4.00%	\$ 380,396	5.00%	\$ 475,495
6	\$ 9,414,801	4.00%	\$ 376,592	5.00%	\$ 470,740
7	\$ 9,320,653	4.00%	\$ 372,826	5.00%	\$ 466,033
8	\$ 9,227,447	4.00%	\$ 369,098	5.00%	\$ 461,372
9	\$ 9,135,172	4.00%	\$ 365,407	5.00%	\$ 456,759
10	\$ 9,043,821	4.00%	\$ 361,753	5.00%	\$ 452,191
11	\$ 8,953,383	4.00%	\$ 358,135	5.00%	\$ 447,669
12	\$ 8,863,849	4.00%	\$ 354,554	5.00%	\$ 443,192
13	\$ 8,775,210	4.00%	\$ 351,008	5.00%	\$ 438,761
14	\$ 8,687,458	4.00%	\$ 347,498	5.00%	\$ 434,373
15	\$ 8,600,584	4.00%	\$ 344,023	5.00%	\$ 430,029
16	\$ 8,514,578	4.00%	\$ 340,583	5.00%	\$ 425,729
17	\$ 8,429,432	4.00%	\$ 337,177	5.00%	\$ 421,472
18	\$ 8,345,138	4.00%	\$ 333,806	5.00%	\$ 417,257
19	\$ 8,261,686	4.00%	\$ 330,467	5.00%	\$ 413,084
20	\$ 8,179,069	4.00%	\$ 327,163	5.00%	\$ 408,953
21	\$ 8,097,279	4.00%	\$ 323,891	5.00%	\$ 404,864
22	\$ 8,016,306	4.00%	\$ 320,652	5.00%	\$ 400,815
23	\$ 7,936,143	4.00%	\$ 317,446	5.00%	\$ 396,807
24	\$ 7,856,781	4.00%	\$ 314,271	5.00%	\$ 392,839
25	\$ 7,778,214	4.00%	\$ 311,129	5.00%	\$ 388,911
26	\$ 7,700,431	4.00%	\$ 308,017	5.00%	\$ 385,022
27	\$ 7,623,427	4.00%	\$ 304,937	5.00%	\$ 381,171
28	\$ 7,547,193	4.00%	\$ 301,888	5.00%	\$ 377,360

The Arnolds would be entitled to a charitable deduction of some \$584,000 that could be used beginning in the year of their gift. With the addition of the \$150,000 in income from the trust, their adjusted gross income will increase to \$500,000. Given the 30% of AGI limitation, it will take them four years to realize tax savings of some \$232,000. They plan to use the tax savings to purchase a life insurance policy that will serve to “replace” for their heirs a large portion of the value of the property placed in the trust. The present value to the charity of the anticipated remainder of \$5.7 Million at an 8% discount rate is \$613,900. At a 4% discount rate, the remainder is worth \$1,800,000. It is proposed that they receive campaign credit for \$1,800,000.

The Arnolds were told that they needed to obtain a qualified appraisal to establish the value of the property for tax deduction purposes. The charity also suggested that they talk to a commercial real estate broker who agreed to volunteer time to help the Arnolds. The real estate developer suggested that instead of contributing the entire

parcel at once and selling to a developer, that they should make basic improvements and divide the property into eight parcels to be sold over time.

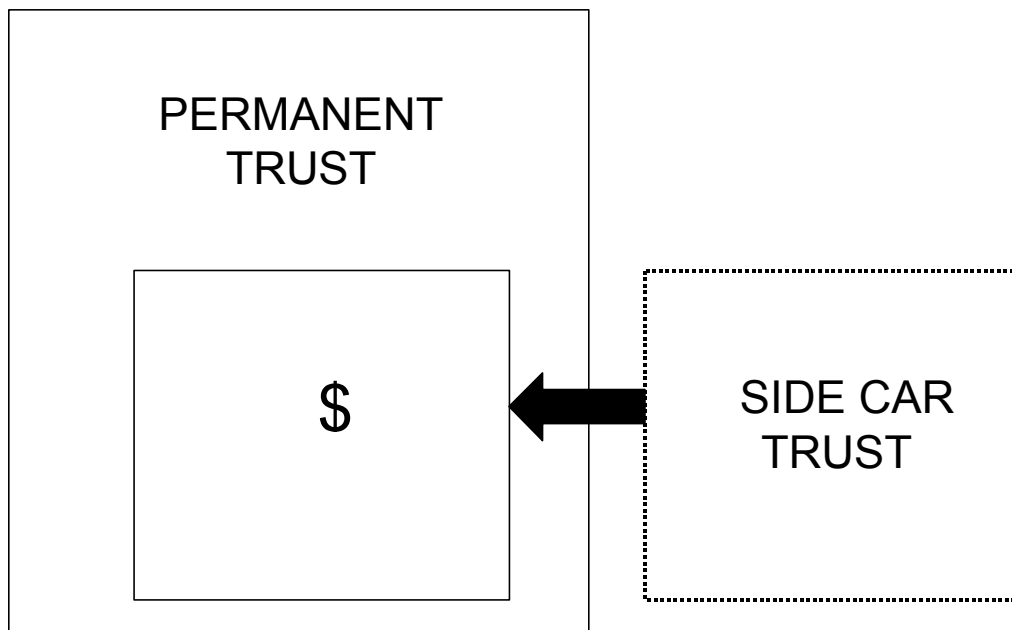


It was decided the Arnolds would contribute parcels at the rate of two per year for four years. They have been advised that this will result in the maximum total sales proceeds.

The Arnolds had been advised to structure their trust in the form of a FLIP unitrust. The plan had been for the single undivided parcel to be placed in a trust that would function as a net income unitrust until the property was sold, at which time it would become a straight unitrust. With the alternative plan to fund the trust with subdivided parcels over time, the concern was raised that a parcel contributed after the trust flipped may not sell before the end of a tax year and give rise to a liquidity problem, as it is not possible to “unflip” a trust after additional land was contributed.

This problem was solved through a plan to create an initial flip trust that would convert to a straight 6% unitrust after the sale of the initial parcels that were contributed. This trust would be known as the “Permanent Trust.” The following year another trust would be created that would be identical in terms except it would

be a flip trust. This trust would receive the parcels contributed in the second year and would function as a net income trust until the second parcel was sold, at which time it would flip. Because the temporary trust would then be identical in all respects to the permanent trust, under state law and I.R.S. regulations the two trusts would be merged and function as one trust from that point forward. The second trust might be referred to as a “side car” trust, as it functions alongside the permanent trust until no longer needed and is jettisoned. This process would be continued each year until all parcels were contributed, sold, and the proceeds “reassembled” in one trust.



The tax considerations would be as follows:

Parcel	Year Contributed	Parcel Value	Annual Contribution	Deduction Percentage	Deduction Amount	Tax Bracket	Tax Savings
1	1	\$400,000					
2	1	\$425,000	\$825,000	23.40%	\$193,050	39.60%	\$76,448
3	2	\$450,000					
4	2	\$475,000	\$925,000	24.50%	\$226,625	39.60%	\$89,744
5	3	\$530,000					
6	3	\$560,000	\$1,090,000	25.70%	\$280,130	39.60%	\$110,931
7	4	\$595,000					
8	4	\$600,000	\$1,195,000	26.90%	\$321,455	39.60%	\$127,296
Totals			\$4,035,000		\$1,021,260		\$404,419

Note that this plan gives rise to almost twice as large a tax deduction and tax savings. This will allow the Arnolds to purchase a much greater amount of life insurance with the additional tax savings. This may be necessary to “replace” the wealth if estate taxes are repealed, as under current law they arguably only need to replace 45% of the

assets contributed to make the family “whole.”

The Arnolds will also have four years longer to use their tax savings than if they had contributed the entire parcel in one year.

Over the anticipated 29-year period of the trust, the Arnolds will also enjoy much greater income under the alternate plan.

Year	Contribution	Principal	Earn	Return	Pay	Payment
1	\$825,000	\$ 825,000	9.00%	\$ 74,250	6.00%	\$ 49,500
2	\$925,000	\$ 1,774,750	9.00%	\$ 159,728	6.00%	\$ 106,485
3	\$1,090,000	\$ 2,917,993	9.00%	\$ 262,619	6.00%	\$ 175,080
4	\$1,195,000	\$ 4,200,532	9.00%	\$ 378,048	6.00%	\$ 252,032
5		\$ 4,326,548	9.00%	\$ 389,389	6.00%	\$ 259,593
6		\$ 4,456,345	9.00%	\$ 401,071	6.00%	\$ 267,381
7		\$ 4,590,035	9.00%	\$ 413,103	6.00%	\$ 275,402
8		\$ 4,727,736	9.00%	\$ 425,496	6.00%	\$ 283,664
9		\$ 4,869,568	9.00%	\$ 438,261	6.00%	\$ 292,174
10		\$ 5,015,655	9.00%	\$ 451,409	6.00%	\$ 300,939
11		\$ 5,166,125	9.00%	\$ 464,951	6.00%	\$ 309,967
12		\$ 5,321,109	9.00%	\$ 478,900	6.00%	\$ 319,267
13		\$ 5,480,742	9.00%	\$ 493,267	6.00%	\$ 328,845
14		\$ 5,645,164	9.00%	\$ 508,065	6.00%	\$ 338,710
15		\$ 5,814,519	9.00%	\$ 523,307	6.00%	\$ 348,871
16		\$ 5,988,955	9.00%	\$ 539,006	6.00%	\$ 359,337
17		\$ 6,168,623	9.00%	\$ 555,176	6.00%	\$ 370,117
18		\$ 6,353,682	9.00%	\$ 571,831	6.00%	\$ 381,221
19		\$ 6,544,292	9.00%	\$ 588,986	6.00%	\$ 392,658
20		\$ 6,740,621	9.00%	\$ 606,656	6.00%	\$ 404,437
21		\$ 6,942,840	9.00%	\$ 624,856	6.00%	\$ 416,570
22		\$ 7,151,125	9.00%	\$ 643,601	6.00%	\$ 429,068
23		\$ 7,365,659	9.00%	\$ 662,909	6.00%	\$ 441,940
24		\$ 7,586,629	9.00%	\$ 682,797	6.00%	\$ 455,198
25		\$ 7,814,227	9.00%	\$ 703,280	6.00%	\$ 468,854
26		\$ 8,048,654	9.00%	\$ 724,379	6.00%	\$ 482,919
27		\$ 8,290,114	9.00%	\$ 746,110	6.00%	\$ 497,407
28		\$ 8,538,817	9.00%	\$ 768,494	6.00%	\$ 512,329
29		\$ 8,794,982	9.00%	\$ 791,548	6.00%	\$ 527,699

The anticipated remainder of nearly \$8.8 Million has a present value of \$943,000 at an 8% discount rate. At 4% discount rate the remainder is worth \$2,819,000, more than the appraised value of the land today.

While this is a valuable gift, there is no charitable benefit for an estimated 29 years. To fund their \$1,000,000 pledge, the Arnolds decide to direct the trustee to pay to the charity an amount equal to the greater of \$100,000 per year, or 90% of the unitrust payment amount each year for the first ten years the trust is in existence. The 90% limit is put on the amount of the payment to charity, as it is undesirable under tax laws for all of the income to be paid to a charitable entity. At the end of the ten years, they will have the option to continue the payments to charity or have the entire amount paid to them. The end of the ten year period will coincide with the time that Mr. Arnold will be 71 and will be fully retired. This plan will make it possible for the land to serve as a source of retirement income for the Arnolds as they originally planned while making a very generous gift in the near term and a substantial endowment as part of their estate. In fact the unitrust payment may be enough to fully replace Mr. Arnold's income from his business at the time of his retirement.

The Arnolds could be credited with \$1,000,000 charitable deduction amount for the trust plus \$702,000 which would be the value for federal tax purposes of the income stream for a total campaign credit of \$1,700,000. Using alternative present value analysis, the present value of the anticipated remainder at a 4% discount rate would be \$2,819,000 and the present value of the \$1,000,000 income stream at 4% would be \$811,000, with total campaign credit of \$3,630,000. Many programs would not find it too much of a stretch to credit the entire \$2,500,000 value of the land as the gift for campaign purposes.

In effect this trust incorporates elements of a lead trust into a unitrust. In coming years, younger persons may regularly create charitable remainder trusts with a "lead" element to fund pledges during years when the donor does not yet need the income. For donors who are making other charitable gifts, the fact that the gift from the trust income is flowing outside their income tax return makes it possible for them to make more charitable gifts without running into percentage of AGI limitations. Not receiving income is the same, in effect, as receiving it and then giving it to charity.

This planning tool might be described as a "Lunitrust." It might also be referred to as a "Striptrust," as the income is substantially "stripped" from the trust for a period of time. This concept is similar to the manner in which interest is "stripped" from a bond to create a zero coupon bond where one party purchases at a discount the right to receive the face value of the bond in the future, while another party purchases the right to receive the interest on the bond.

Transfers of income from assets for a period of time with eventual gifts of remainders will be an important source of nonprofit funding in the years before realizing gifts that are only received at the death of persons who may enjoy increasingly long life expectancies.

2. Unleashing the gift potential in the assets of entrepreneurs.
 - a. Entrepreneurs have accounted for much of the wealth that has been created during the past twenty years.

- b. They often do not engage in philanthropy until later in life after they have retired and “cashed out” their capital.
 - (1) They can earn much greater returns on their capital than endowment managers.
 - (2) Capital is a precious commodity and must be obtained through borrowing, accumulating profits, or selling a portion of a business.
 - c. Many don’t want their children and grandchildren to inherit too much money too early in life and want to make sure their heirs are responsible before “endowing” them with the wealth the entrepreneur has earned.
3. Using “Virtual Endowments” to provide current and future resources.
- a. Donor makes commitment for substantial sum.
 - b. Annual payments are made equal to the charity’s opportunity cost.
 - c. Endowment is indexed at rate of growth of charity’s endowment assets.
 - d. Commitment is fulfilled at time of sale of business, death, or some other agreed upon time.

Example:

John Gronlund, age 48, is the founder of a very successful computer services firm. He started the business on a shoestring fifteen years ago. Today it is worth \$100,000,000. John has sold much of the equity in the company over the years to raise working capital. He now owns \$25,000,000 worth of the stock and does not wish to further dilute his ownership in the company. He believes that his shares will grow in value by an average of 18% per year and be worth more than \$100,000,000 in ten years when he plans to sell his remaining stake in the business and retire. His income is now in the range of \$2,000,000 per year.

John was rated as capable of making a \$5,000,000 gift to a campaign for endowment. After being asked for a gift of this size, he responded that he was flattered to be considered to be capable of making a gift of this size, but he did not have liquid assets sufficient to fund the gift and he was not in a position at this point to take more capital out of his company to make it possible to make this gift.

After subsequent discussions, John agreed to fund a virtual endowment in the amount of \$5,000,000.

The terms of his gift are as follows:

1. He makes an irrevocable, legally enforceable pledge in the amount of \$5,000,000.
2. Each year he is notified of the percentage of endowment assets spent on programs and the percentage of return in the endowment in excess of the percentage spent.
3. John pays an amount equal to the percentage of endowment spending applied against the amount of his virtual endowment.
4. The virtual endowment amount is indexed upward or downward depending on the growth or decline in the charity's endowment assets.
5. John agrees to pay the indexed virtual endowment amount at the end of a specified period of time, at a time of his choosing, or at his death. The pledge is backed by a contingent bequest or other testamentary gift.

The following chart illustrates why both John and the charity consider this gift commitment to be a “win-win” situation:

		Donor's Growth Rate			18%		
		Endowment Spending Rate			5%		
		Endowment Growth Rate			4%		
		Endowment Total Return			9%		
Year	Virtual Endowment Amount	Annual Payment to Charity	Annual Index Amount	Donor's Capital	Donor's Wealth Net of Pledge	Pledge As % of Wealth	
1	\$5,000,000	\$250,000	\$200,000	\$25,000,000	\$20,000,000	20.0%	
2	\$5,200,000	\$260,000	\$208,000	\$29,240,000	\$24,040,000	17.8%	
3	\$5,408,000	\$270,400	\$216,320	\$34,232,800	\$28,824,800	15.8%	
4	\$5,624,320	\$281,216	\$224,973	\$40,113,488	\$34,489,168	14.0%	
5	\$5,849,293	\$292,465	\$233,972	\$47,041,451	\$41,192,158	12.4%	
6	\$6,083,265	\$304,163	\$243,331	\$55,204,749	\$49,121,485	11.0%	
7	\$6,326,595	\$316,330	\$253,064	\$64,825,274	\$58,498,679	9.8%	
8	\$6,579,659	\$328,983	\$263,186	\$76,164,841	\$69,585,182	8.6%	
9	\$6,842,845	\$342,142	\$273,714	\$89,532,370	\$82,689,525	7.6%	
10	\$7,116,559	\$355,828	\$284,662	\$105,292,368	\$98,175,809	6.8%	
11	\$7,401,221	\$370,061	\$296,049	\$123,874,934	\$116,473,712	6.0%	
12	\$7,697,270	\$384,864	\$307,891	\$145,787,558	\$138,090,288	5.3%	
13	\$8,005,161	\$400,258	\$320,206	\$171,629,061	\$163,623,899	4.7%	
14	\$8,325,368	\$416,268	\$333,015	\$202,106,023	\$193,780,656	4.1%	
15	\$8,658,382	\$432,919	\$346,335	\$238,052,188	\$229,393,806	3.6%	
16	\$9,004,718	\$450,236	\$360,189	\$280,451,346	\$271,446,629	3.2%	
17	\$9,364,906	\$468,245	\$374,596	\$330,464,343	\$321,099,437	2.8%	
18	\$9,739,502	\$486,975	\$389,580	\$389,460,950	\$379,721,447	2.5%	
19	\$10,129,083	\$506,454	\$405,163	\$459,057,467	\$448,928,384	2.2%	
20	\$10,534,246	\$526,712	\$421,370	\$541,161,098	\$530,626,852	1.9%	
21	\$10,955,616	\$547,781	\$438,225	\$638,022,315	\$627,066,700	1.7%	
22	\$11,393,840	\$569,692	\$455,754	\$752,296,640	\$740,902,800	1.5%	
23	\$11,849,594	\$592,480	\$473,984	\$887,117,555	\$875,267,962	1.3%	
24	\$12,323,578	\$616,179	\$492,943	\$1,046,182,537	\$1,033,858,959	1.2%	
25	\$12,816,521	\$640,826	\$512,661	\$1,233,854,567	\$1,221,038,046	1.0%	

If the charity experiences a total return of 9%, spends 5% on programs, and leaves 4%

in its endowment funds, and John can earn 18% on his capital, in ten years John will be able to pay off his commitment which has been indexed upward over time to \$7.1 million while netting \$98 million on a sale of his stock after payment of the pledge balance and all of the annual payments over the years. Because of the growth rate differential, it will require just 6.8% of his assets to satisfy the pledge in ten years rather than the 20% of his assets it would require today. If the arrangement continued and John's estate fulfilled the pledge at his death in twenty five years, it would require just 1% of his capital to complete a pledge that would be indexed to \$12.8 million at that time.

One technique that has been used to "back up" virtual endowment pledges is the use of a unitrust that pays a higher amount to the donor each year than the charity's spending rate. The donor pays the annual commitment from a portion of the unitrust payment each year, and at the donor's death the principal of the unitrust is used to fulfill the commitment under the virtual endowment.

From a crediting standpoint, the virtual endowment will often be announced as a gift for the full value of the commitment, as the charitable recipient has all the practical benefits it would have if the funds were resident in its endowment fund. Elimination of the estate tax would have little impact on this gift as it functions as a substitute for a current gift. With no estate tax, donors would have a greater incentive to fulfill the pledge during lifetime when income and capital gains tax savings could be realized, as there would be no tax advantage to a bequest and capital gains taxes would under current proposals no longer be avoided at death if the so-called "stepped up" basis were eliminated.

4. Transferring wealth to heirs while teaching social responsibility.
 - a. With or without estate taxes many wealthy persons wish to control the amount and timing of wealth that will be inherited by their heirs.
 - b. The charitable lead trust offers an opportunity to transfer wealth to charity in the form of a stream of income while providing inheritances for loved ones.

Example:

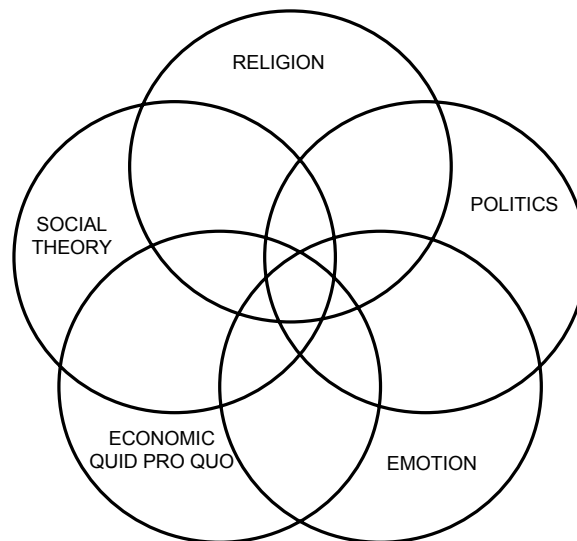
Mary Pruitt, age 54, was recently widowed. She now owns assets with a total value of \$20,000,000. She wants the bulk of her wealth to eventually pass to her only son who is 24 years old. He has recently embarked on a career in investment management and is seeking to manage a portion of his mother's investment portfolio. He believes he can earn an average return of 12% per year.

Mary decides to create a charitable lead annuity trust and fund it with \$5,000,000. The trust will pay 9% per year. She names her son as the trustee of the trust. The trust payments are designated for research and treatment for the disease that took her husband's life. There will be no gift tax due at the time the trust is funded and the

assets are removed from Mary's estate.

Mary's son has a tremendous incentive to manage his "inheritance" well, as any net amounts in excess of the payout amount will eventually accrue to his benefit.

What would the impact of elimination of the estate tax be on this gift? Would Mary's basic motives change?



If the estate tax were eliminated, along with the gift tax, would Mary have more or less flexibility? She will pay no gift or estate tax under current law, but she gives up significant flexibility to achieve that result. Without those tax considerations, Mary can achieve the same results and set the payout rate and time period in accordance with her overall objectives.

VII. Conclusion.

- A. Demographics will usher in a golden age of planned giving.
 - 1. Charitable entities can help older generations transfer their wealth.
 - 2. Can also help younger generation inherit and manage it well.

- B. Tax laws will play an important role.
 - 1. Strategies may change.
 - 2. Basic fairness will always dictate that Americans not be taxed on wealth that is voluntarily devoted to charitable use.

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