Philanthropic Vehicles for Generational Wealth Preservation 2021

Nicola Lawrence MSc CFRE CAP®

Director, Legacy and Gift Planning

Children's Medical Center Foundation

Philanthropic Vehicles for Estate Planning 2021
Overview

- Opportunities existed prior to 2021
- Special opportunities this year
- Became more pressing with tax proposals

- SECURE Act Implications
- 2021 QCD tax traps
- Stretch Replacement
- Charitable Remainder Trust
- Charitable Gift Annuity
- AGI limits for 2021

- Roth charity offset
- CGA - IRA conversion
- CLAT vs GRAT
- Historic low interest rates
- Lure of 0% tax bill
- Tax proposals and planning

IRA and Philanthropic Planning

- Setting Every Community Up for Retirement Enhancement (SECURE) Act
- Signed into law on December 20, 2019
  - Overshadowed by Covid
- Considered by many experts to contain most significant changes to the laws governing retirement accounts passing of the Pension Protection Act of 2006

children'shealth®

IRA and Philanthropic Planning

- Increased the starting age for Required Minimum Distributions (RMDs)
  - Changed 70.5 to 72 those born after *June 30, 1949*
- Impacts to Required Beginning Date (RBD)
  - Attached to above ages unless still working
- Removed the maximum age for Traditional IRA contributions
  - Some nuances exist for high income, employer sponsored plans etc
- Created QCD ‘anti-abuse’ provisions
- Eliminated the ‘stretch’ options for most non-spouse designated beneficiaries
- Was a beautiful estate planning vehicle
  - Now an ‘Ugly Duckling’ tax challenged asset

IRA and Philanthropic Planning

- Lifetime spenddown of IRA helps estate
  - Awareness of new tax traps
  - Solutions to SECURE act challenges to lifetime philanthropic IRA distributions
- Elimination of Stretch IRA
  - Estate planning philanthropic strategies
    - Reduce taxes
    - Preserve intergenerational wealth

children'shealth

Lifetime spenddown of IRA helps estate

First Dollars Out Rule

January is new December for tax planning

RMD 72 and older (for most in 2021) QCD beneficial

QCD must be taken first to be given tax advantaged treatment

- EXAMPLE:
    - Sally is 73
    - Sally is required to make a $5,000 distribution from her IRA
    - Sally is charitable and has always supported her church, the food pantry and the symphony
    - Sally always made year end gifts before she retired
    - Sally knew QCD’s were beneficial way to give and keep the dollars from her taxable income
    - Sally takes $5,000 from her IRA in July to decorate her home and go on a cruise
    - Sally makes a several charitable YE distribution’s totaling $5,000 believing it will be tax advantaged – SURPRISE – NO
    - If Sally had used her QCD first, then it would have met her RMD and been deductible

Lifetime spenddown of IRA helps estate

Last in, First Out Rule

SECURE act allows for post retirement contributions

Sounds good at first glance

- Pitfall exists for charitable clients who plan to use QCD
- If tax deductible IRA contribution, made QCD will be taxable
  - No double dipping

Lifetime spenddown of IRA helps estate

Last in, First Out Rule

- EXAMPLE
  - Nathan, Single IRA owner 70.5 at beginning 2020
  - SECURE Act's changes to the RMD and contribution rules
  - He does not need to begin taking any RMDs from his IRA until 2021, when he will turn 72
  - Nathan makes a $7,000 a year, 2020 & 2021 (including catch-up contributions) deductible contribution to his Traditional IRA, giving him a total of $14,000 of deductible Traditional IRA contributions from the year he reached age 70 1/2 and onwards
  - In 2021 Nathan calculates his RMD to be $12,000
  - Nathan always donates to his synagogue
  - Nathan has heard QCD's are beneficial way to give and satisfy RMD
  - Nathan sends $12,000 to his synagogue from his IRA
  - SURPRISE - When he files his tax return QCD disallowed

Lifetime spenddown of IRA helps estate

Last in, First Out Rule

SOLUTION 1

- Have client contribute to ROTH and donate from preexisting taxable IRA

SOLUTION 2

- If married, have one spouse do the tax-deductible IRA contribution, the other do the QCD from their traditional IRA.

SOLUTION 3

- Voluntarily decide to forgo taking a IRA contribution deduction in favor of the QCD

children'shealth®

Lifetime spenddown of IRA helps estate

DAF Tax Trap

- **QCD must go to immediate public benefit**
- 501(c) 3 only eligible recipient without income being counted income
- Any donation other than a 501 (c) 3 must first be counted in taxable income and then treated as a tax deduction
- Donations to DAF, private foundations, split-interest charitable trusts, or supporting organizations
- This method will lose Medicare tax exemption
- For high income retirees the distribution may affect capital gains tax considerations

children'shealth®

Lifetime spenddown of IRA helps estate

IRA Distributions and Philanthropic Estate Planning

- CARES Act and Consolidated Appropriations Act created opportunity to deduct 100% AGI cash
- Taking money from an IRA over the $100,000 IRA charitable rollover limit will trigger additional taxes
- High Income Clients might use 2021 100% AGI opportunity to include additional income to create income tax deductions
- Lifetime philanthropic opportunities discussed later
  - Same as all taxable income

children'shealth®

IRA and Philanthropic Estate Planning

- SECURE Act has massive implications for beneficiaries
- Elimination of lifetime stretch IRAs, 401(k)s & Other Retirement Accounts
- Prior to SECURE
  - 2 groups Designated and Non-Designated Beneficiaries
- After SECURE
  - Designated and Non-Designated Beneficiaries still exist
  - Designated split into 2 subgroups
    - Designated eligible
    - Non eligible designated

children'shealth®

IRA and Philanthropic Estate Planning
IRA Beneficiaries After SECURE Act

Eligible Designated Beneficiary	Designated Beneficiary	Non-Designated Beneficiary
Lifetime	10 Years	5 Years

Eligible Designated Beneficiary – Lifetime

- Spouse
- Minor Children*
- Disabled
- Chronically Ill
- Not more than 10 years younger
- Certain Trusts

Designated Beneficiary – 10 Years

- Non-Spouse
- Certain Trusts

Non-Designated Beneficiary – 5 Years

- Charities
- IRA Owners Estate
- Certain Trusts

* Age of majority is a matter of state law ranging from high school graduation to age 21. May be overruled by Treasury language regarding education to age 26.

The SECURE Act makes no direct changes to the rules for non-designated beneficiaries & their 5-Year Rule

children'shealth®

IRA and Philanthropic Estate Planning

- **Points to note**

- 403 (b) or 457 plans sponsored by governmental and non-profit groups are under old rules until 2022
- Not much not yet defined regarding trusts
- Expected that flow through/conduit trusts where beneficiaries are eligible spouses or disabled persons will be allowed to stretch
- Qualified see through trusts may be tax advantaged

IRA and Philanthropic Estate Planning

Philanthropy Answer to SECURE?

- IRA was a beautiful estate planning vehicle
- SECURE Act turned the large IRA into a tax heavy ugly duckling
- Can a charitable gift vehicle turn it into a beautiful swan?
- We'll discuss pros, cons and opportunities for replacing the stretch IRA

children'shealth®

IRA and Philanthropic Estate Planning

CRT Answer to SECURE?

- Lifetime CRUT for 2 non spouse beneficiaries
- Can be for many beneficiaries
- Charitable deduction maybe helpful to estate
- Works for middle age or older due to 10% remainder
- Young beneficiaries may need 20-year term
- CRT tested vehicle for IRS
- Various models helpful for various situations

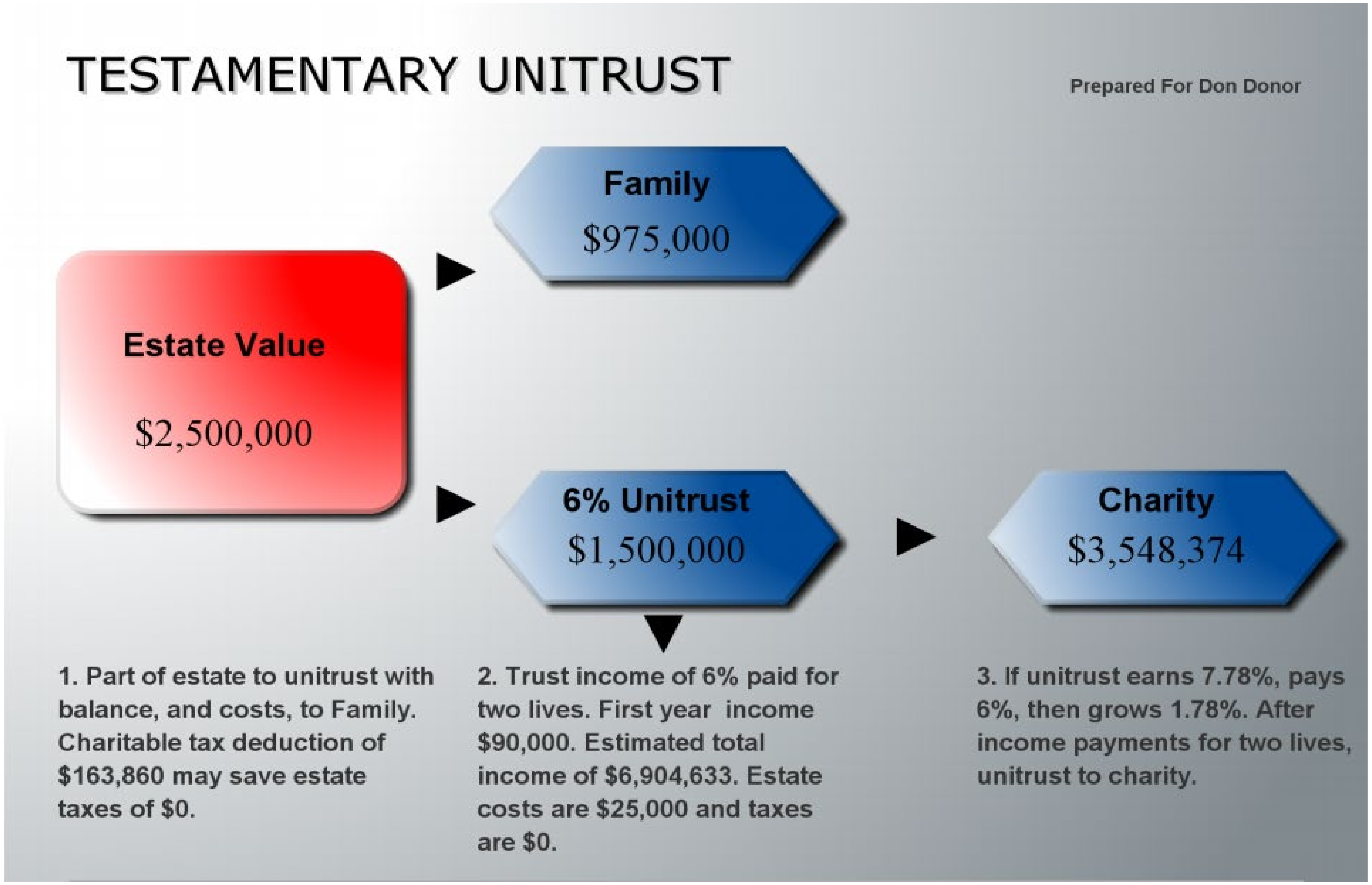


Illustration Crescendo ©

IRA and Philanthropic Estate Planning

CGA Answer to SECURE?

- Lifetime CGA payout for 2 non spouse beneficiaries
- Can be offered for many beneficiaries
- Payment estimates show to life expectancy but will continue
- Can be deferred for retirement options 65+ or set period e.g., 5 years college
- Charitable deduction helpful for large estates
- No set up fees

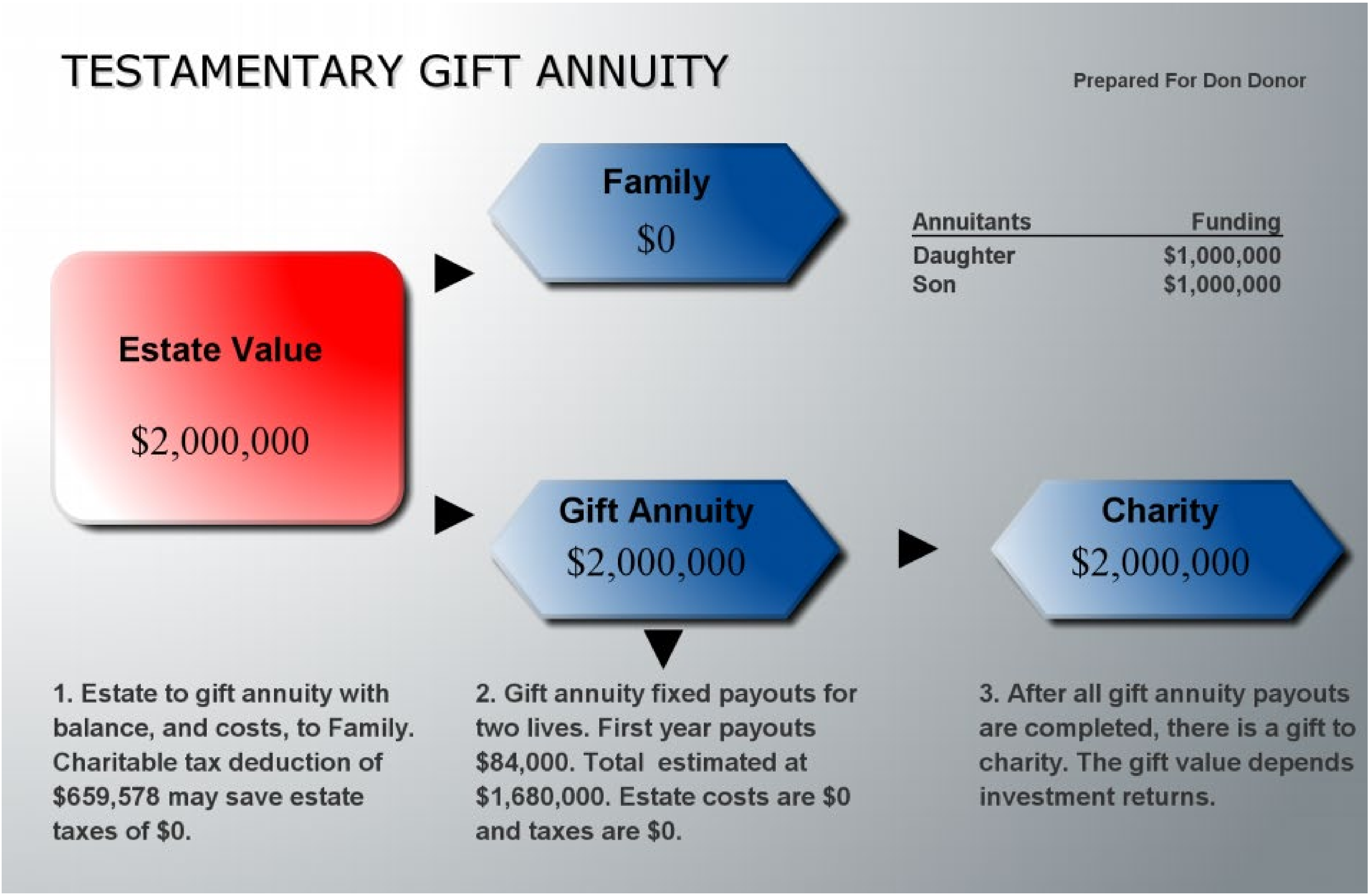


Illustration Crescendo ©

children'shealth

2021 100% Deduction Opportunities

- CARES Act and Consolidated Appropriations Act created opportunity to deduct 100% AGI cash 2020 and 2021
- Particularly important when taken in consideration with tax proposals
- Can be combined with CRT, ROTH Conversion, CGA
- Only impacts cash
- Combine with CRT and Irrevocable Life Insurance Trust (ILAT) for estate planning purposes

2021 100% Deduction Cautions

Lure of 0% tax bill

- Caution when maxing out a donor's taxation and rolling forward deductions
  - May inadvertently reduce deduction to lower tax brackets
  - If donor is in 37% not all income taxed at that amount
  - Weigh risk of donation waiting until next year against potential loss of annual deductions becoming estate taxed if client passes
- Must be to 501 (c) 3
  - Cash donation to DAF 60%
  - Cash to private foundation 30%
- Must be cash
  - Donations of assets 30% to DAF and 501 (c) 3
    - 20% to private foundation

children'shealth

ROTH Conversion Charitable Opportunity

Plan now – 2021 extra benefit

- During Life:
- Probability for married couples, one partner will eventually be single
  - Will be taxed at a higher tax rate with large RMDs
    - ROTH IRA conversion may cost now for benefit later
- After Death:
- Large IRA creates large tax issues for beneficiaries
  - Convert to ROTH IRA subject to 10-year payout but pass tax-free

children's health

ROTH Conversion Charitable Opportunity
Strategy

- Convert a taxable IRA (or a nondeductible IRA) into a Roth IRA by paying the taxes on the conversion
- Pay taxes from assets outside the IRA
- Allow to accumulate 5 years or longer as a retirement or estate planning strategy
- Offset taxes due with charitable contribution
- Usually, 60% of income available as deduction 2021 more?
- Estate planning opportunity

children'shealth®

ROTH Conversion Charitable Opportunity
Strategy Example

- Let's take a couple, over 59 ½, with a 401(k) plan, making $100,000 annually
- Itemized deductions are $30,000, which include annual charitable contributions of $10,000
- Do an in-service withdrawal from their 401(k) to an IRA
- Convert that IRA to a Roth
- This creates $100,000 of income
- They can offset this with a $100,000 contribution from savings
- Prior years advisors have recommended DAF which offered same 60% cash deduction as 501(c) 3
- 2021 strategy might be to combine that donation to a charity as a payment for multi-year pledge
    - Life income strategy discussed later (CGA)
- Increased income by $100,000 with the Roth conversion offset it with a charitable contribution of $100,000
- Presuming they live 30 years, would accumulate about $574,000 in their Roth (30-year time - 6% PA)
- Leave to kids who left it alone for 10 years, a little over a million bucks

children's health

IRA - CGA Conversion Opportunity

- Already discussed benefit of reducing IRA in life so less of burden to estate
- Well known strategies – QCD, discussed ROTH
- Little known option is CGA conversion
- Much like ROTH conversion tax is due at time of conversion
- Also, like ROTH benefits may outweigh, temporary drawbacks
- RMD from a variety of retirement accounts to create CGA creates stream of tax-advantaged income
- CGA creation offers tax deduction
- Important to start this strategy after 59.5 to ensure no 10% penalty

children'shealth®

IRA - CGA Conversion Opportunity
Strategy Example

Donor withdraws $50,000 from his or her IRA and establishes a $50,000 CGA:

Qualified Distribution from IRA	$50,000
Owner's marginal income tax bracket	35%
Net Investment Income Tax (“Medicare Surtax”)	3.8%
Effective tax rate on IRA distribution	38.8%
Federal income tax on distribution	$19,400
Amount contributed to charity for CGA	$50,000
Income tax deduction for CGA	$18,589
Tax savings from CGA	$6,506
Net federal tax on combined transactions	$12,894

Calculations PG Calc

- Gift annuity results in a charitable income tax deduction of $18,589, investment in contract is $31,411
- The Investment in contract is the present value of the projected stream of future tax-free annuity payments based on the annuitant’s estimated life expectancy
    - more than double - the net tax cost of the gift plan, which is $12,894

children’shealth®

IRA - CGA Conversion Opportunity
Strategy Review

- Donor withdraws $50,000 from his or her IRA (which they may be required to take as an RMD anyway)
- Uses the money to establish a CGA
- The estimated federal income tax on the withdrawal is $19,400
- Establishment of the CGA results in a tax deduction of $18,589
- That saves the donor $6,506 in actual tax dollars
- Net tax on the combined transactions is $12,894
- The gift annuity provides the donor with payments for his or her remaining lifetime, the present value of which is $31,411
    - (guaranteed for life – many live longer)
- Some IRA owners be willing to pay $12,894 in taxes up front for a benefit whose value is at least $31,411
- QCD not only option for IRA tax savings and IRA reducing estate planning

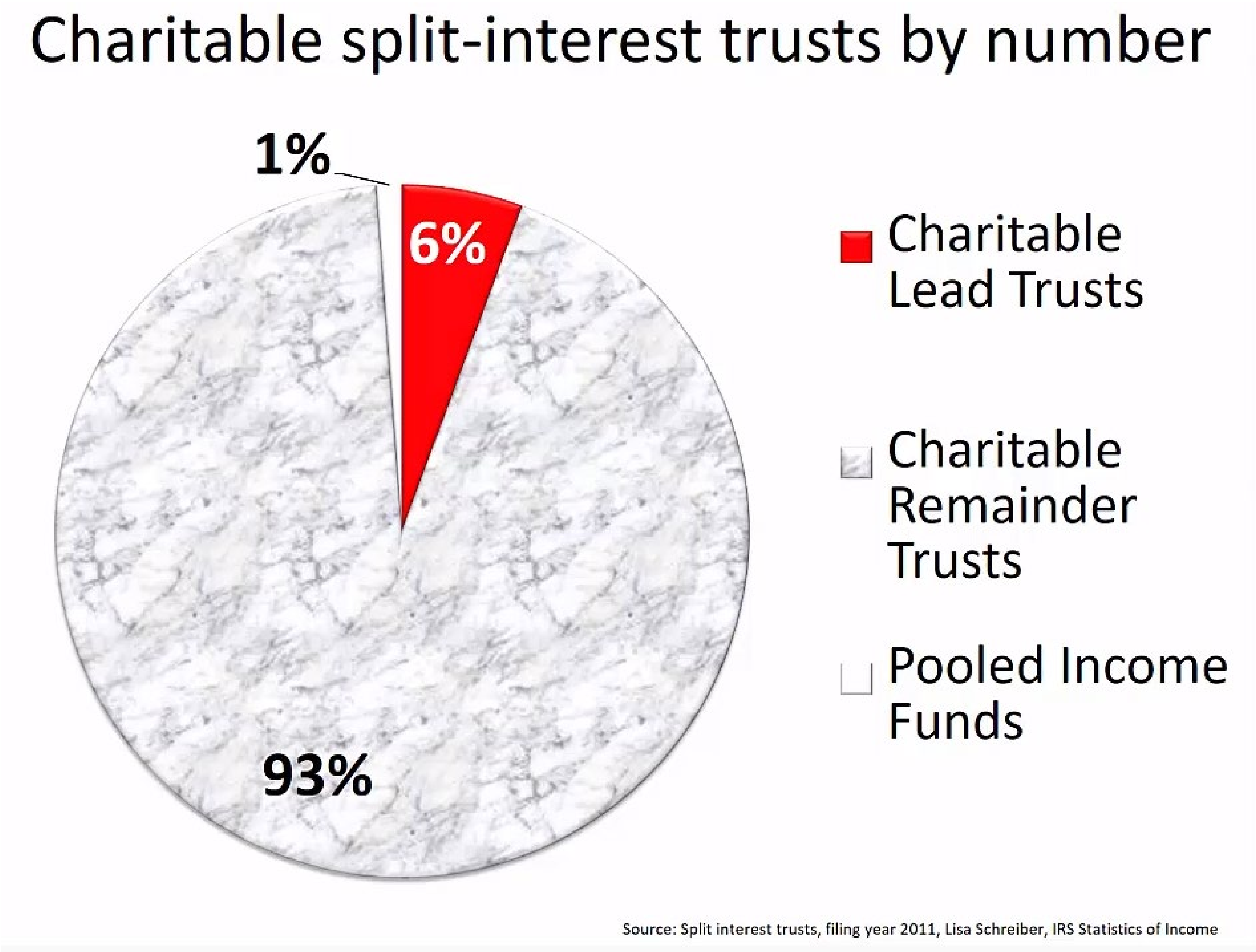
children'shealth®

Charitable Lead Trusts
Comparison to CRT

- Charitable Remainder Trusts pay one or more persons first, charities are the beneficiaries later
- Charitable Lead Trusts pay one or more charities first and pay one or more persons later
- Charitable Lead Trusts do not have a minimum or maximum percentage requirement
  - Unlike the CRT (5%-50%)
- The state rule against perpetuity allows for the CLT to have no 20 yr term limit like the CRT
- CLUT does not allow for FLIP provision like a CRUT

Charitable Lead Trusts

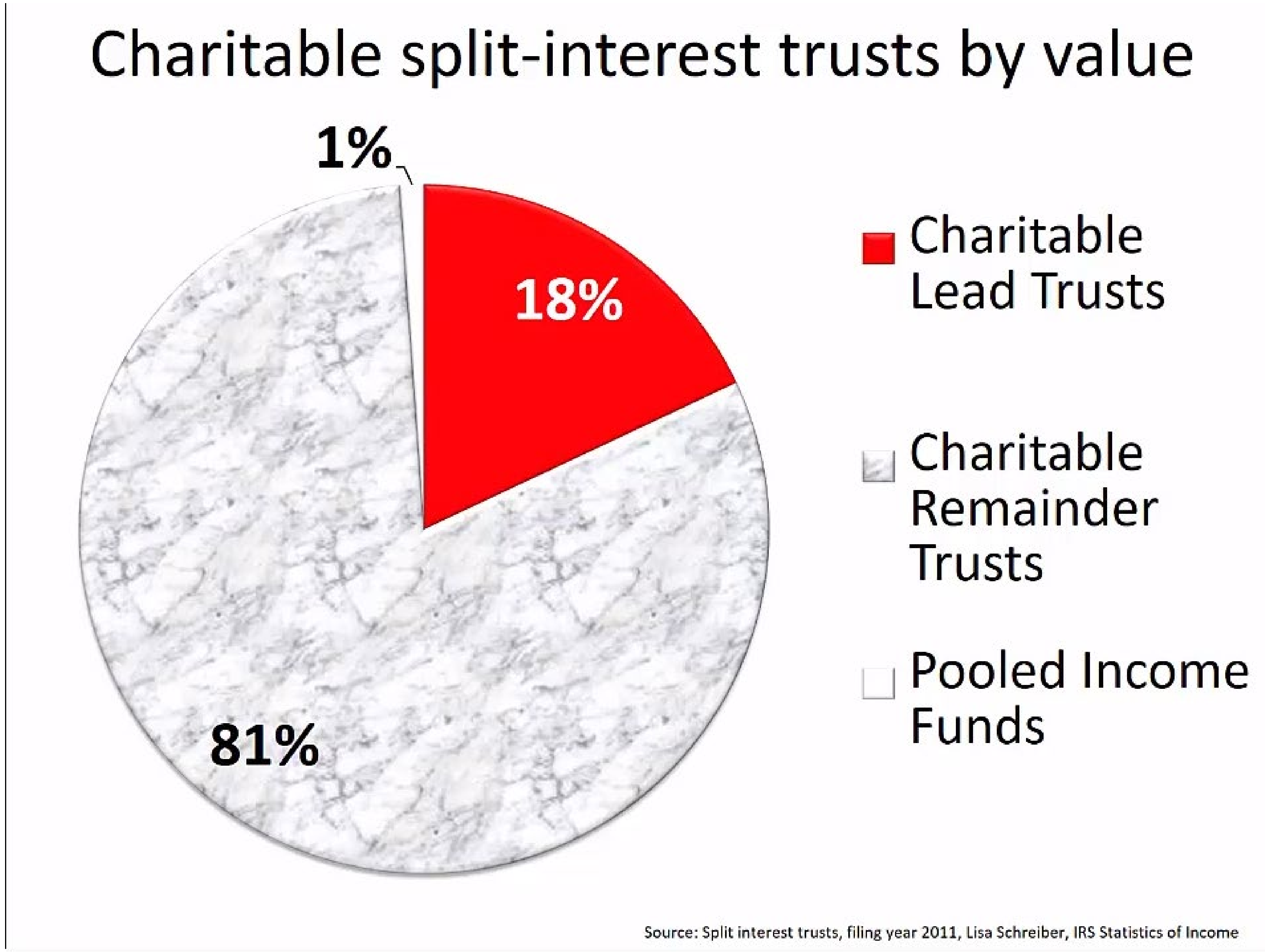
Comparison to CRT



- CLT is infrequently used as a planning tool
- Non-Grantor used most commonly for estate and gift taxes and at times income taxes
- Grantor CLT income taxes only
- Small fraction of total percentage of split-interest philanthropic planning trusts

children's health

Charitable Lead Trusts
Comparison to CRT



- Typical CLT holds 3.5 times more assets than CRT
- Average CRT 2011, $857,297
- Average CLT
- 2011, $3,165,337

Charitable Inter Vivos Charitable Lead Trusts
Seize the Day

- 2021 offers multiple planning opportunities
  - Historically low IRS discount rates (Applicable Federal Rate, Section 7520)
  - Looming estate and capital gains taxation changes
  - Stock market exponential growth
    - Stack with other gift vehicles for maximum impact
      - Ability to write off 100% AGI rather than usual 60% of cash donations

children's health

Charitable Inter Vivos Charitable Lead Trusts

Seize the Day

- Non-Grantor Lead Trusts beneficial for donors with large estates
  - Pass assets to heirs with substantial tax savings while creating charitable impact
    - The 2021 American Families Plan announced proposal to eliminate the step-up in cost basis for estate transfers of capital gains above $1 million ($2.5 million for a married couple when combined with existing real estate exemptions)
    - These gains would be taxed at new proposed top federal income tax rate 39.6%
    - These gains currently would also be subject to medicare surtax (3.8%)
      - For the same asset to be taxed with capital gains and estate at death remains controversial, unusual and much to be debated
      - There is likely to be much negotiation
      - Only guarantee is there will be change and there will be taxes

children'shealth®

Charitable Inter Vivos Charitable Lead Trusts

Seize the Day

- Grantor Lead Trust helpful for client with large cash windfall or looking for vehicle to transfer hard to value asset that creates income
  - Offers tax deduction opportunity that may balance assets for estate while creating charitable legacy now
    - No indebted assets allowed
  - Tax efficient way to pay off a multi year pledge
  - Current low maximum tax rates on dividends and capital gains allow assets within trust to outgrow low AFR

- High performing stock market
  - Funding trust with stocks allows only the annual sell of stocks necessary to pay annuity
  - Incremental sales provides capital gain management
  - CLT can not off set proposed eradication of step up in cost basis as capital gains must be paid at time of liquidation when assets received or granted back

children'shealth

Charitable Lead Trusts

Seize the Day

- Many forms of CLT – not one size fits all
- Most common form previously was Testamentary CLT
- Opportunity in 2021 is Non-Grantor CLT – create now before proposed estate tax changes
- Appeal to wealthy
  - Pass to heirs free of estate taxes through ‘zeroing out’
    - ‘Zeroing Out’ – Projected value of gift going to charity equal to projected value of gift going to family
  - Must have substantial assets in addition to those placed into the trust as access to assets in trust is lost
  - Useful for asset that family wants to retain such as business though caution regarding self dealing
      - CLT not a Foundation though subject to same rules

children'shealth

Charitable Inter Vivos Charitable Lead Trusts

Seize the Day

- Some donors have considered delaying Grantor CLAT to fulfill multi year donation due to top income tax rate proposal of 39.6%
  - Be aware of delay – additional discussion of capped charitable deduction at 28%

- Previously CLT only useful to ultra high net worth due to estate tax limits
  - With proposed lower limits, wider client base

- Creating a CLT now may help remove some of the unknown and avoid increased gift and estate taxes

Charitable Lead Trusts
Non-Grantor

- Trust is taxable
  - Trust pays income tax on the net income in excess of the gifts given to charity
  - Trust does not receive income tax deduction but gift tax deduction

- Trust and asset is removed from estate
  - When assets placed into trust, grantor pays taxes on the projected amount of gift
  - In right conditions assets left in trust when trust terminates pass to heirs' estate tax free

Charitable Lead Trusts

Non-Grantor

- Conditions currently:

- When market outperforms projection based on section 7520 rate (120% AFR) gift to charity IRS does not reassess
  - Allows for tax free transfer of asset plus growth

- Lower AFR create higher charitable deduction as it sets projection of growth
  - At start of pandemic AFR was historically low
  - Still very low - 1.2% (20 years ago 6%)

Charitable Lead Trusts
Non-Grantor

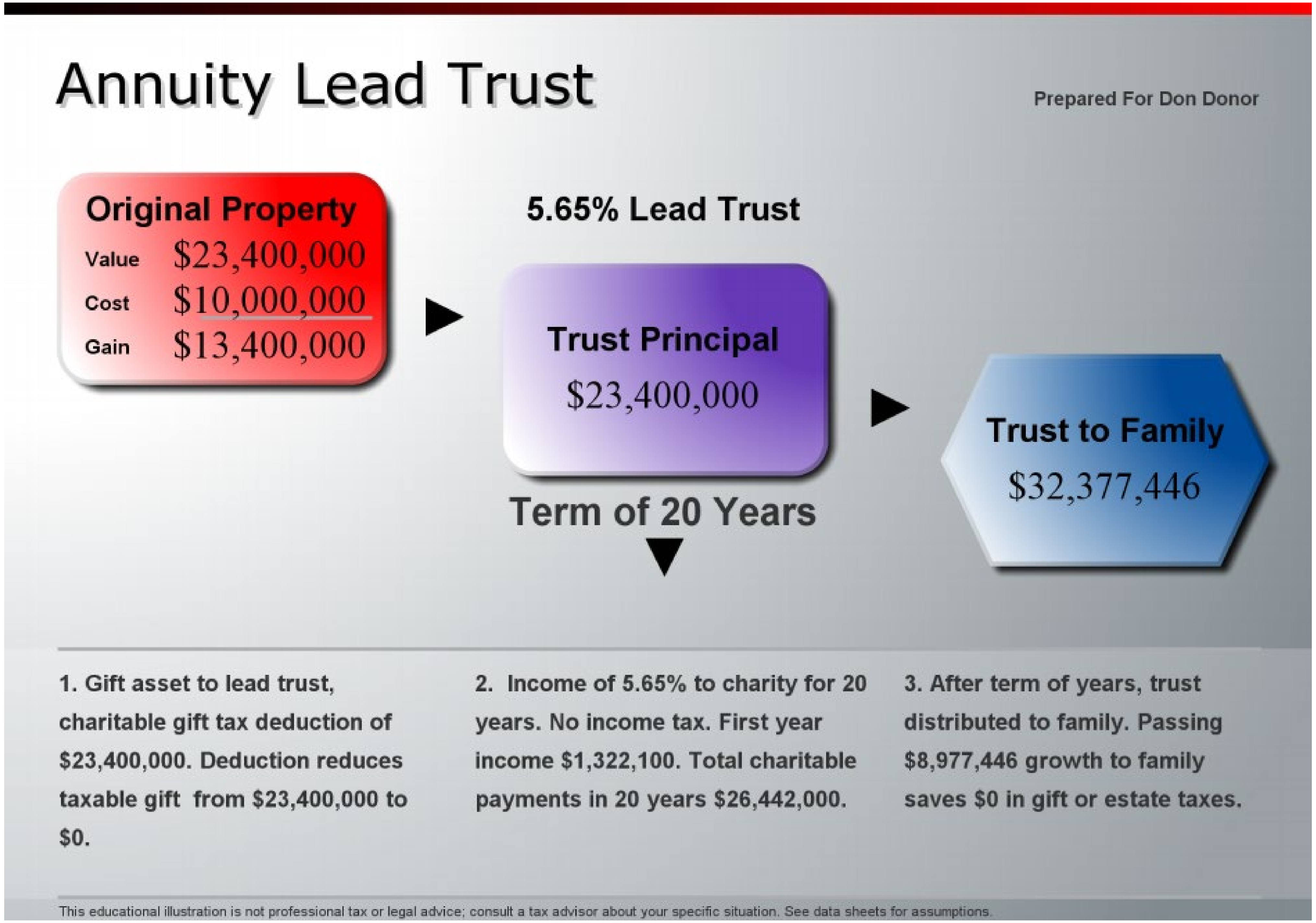


Illustration Crescendo ©

- Donor at current Estate tax threshold
- CLAT using June 1.2% AFR and 5.65% charitable payout – Assets pass to family grown with *zeroed out tax liability*
- Outperforms projections
- 7% return $32 Million passes to family tax free
- Consider for families with assets near proposed threshold

children'shealth

Charitable Lead Trusts
GRAT vs Non-Grantor CLAT

- Grantor Retained Annuity Trusts (GRAT) and Charitable Lead Trust (CLAT) work essentially the same way

- GRAT pays an annuity to grantor instead of charity
  - GRAT has income taxes due – in this environment CLAT likely not

- Lower AFR (Section 7520 rates) allows for the present value to be computed at a low rate of return

- Fund the trust with taxable gift for final beneficiaries equal to the funding assets less the present value of the annuity payments
  - This action creates a zero-gift tax outcome

children'shealth®

Charitable Lead Trusts
GRAT vs Non-Grantor CLAT

Example

GRAT started by Bob

$1,000,000 with 4% AFR

Annuity payment $123,291 to Bob for 10 years

Zeroed out at 4% growth

However, if asset grows at 6%

Bob's heir Billy receives $166,000 tax free

- Both ideal vehicles for transferring closely held securities

Charitable Lead Trusts
GRAT vs Non-Grantor CLAT

- Be aware GRAT comes with **mortality risk**
- If grantor passes before trust term all assets become taxable

- Non-Grantor CLAT holds no mortality risk
  - Planner's note – If chosen charity is grantor's private foundation over which they have authority their may be adverse tax consequences
  - DAF or non-profit is surer outcome

  - *For donors of high net worth and philanthropic interest CLAT offers guaranteed outcome*
  - *Remember philanthropy offers community impact*
  - *Valuable visibility*
  - *Allows the passing of values*
  - *Enduring legacy*

children'shealth

Charitable Lead Trusts

Grantor

- Combination of low AFR and high market returns make Grantor CLT very appealing
- Lower AFR create higher charitable deduction
  - At start of pandemic AFR was historically low.
  - Still very low - 1.2%
- The donor or grantor transfers asset into trust. After the selected term of years, trust assets are returned to the donor
- Grantor CLT donor is treated as an owner of the trust under the grantor trust rules of IRC Sections 671 through 677
  - This is because trust principal will be returned to the grantor at the end
- Grantor can be trustee though can not retain right to chose charitable beneficiaries

Charitable Lead Trusts
Grantor

- Owner of grantor CLT is taxed on growth however in current environment it is possible to zero out taxes just like non-grantor CLT

- A qualifying grantor lead trust generally enables several years worth of deductions to be compressed into the current year

- Tax deduction taken when trust is currently established. Since the income stream to charity is a future distribution, the deduction should be treated as a gift for the benefit of charity and therefore subject to the 30% of adjusted gross income limit cash, 20% assets

Charitable Lead Trusts
Grantor

- Funding trust with stocks allows only the annual sell of stocks necessary to pay annuity
  - Incremental sales provides capital gain management
  - CLT can not off set proposed eradication of step up in cost basis at capital gains must be paid at time of liquidation when assets received or granted back
- Should a donor pass away before a Grantor CLAT term expires the income tax deduction brought forward will be recaptured on the final return
  - Consider age in length of trust when planning

children's health

Charitable Lead Trusts
Grantor

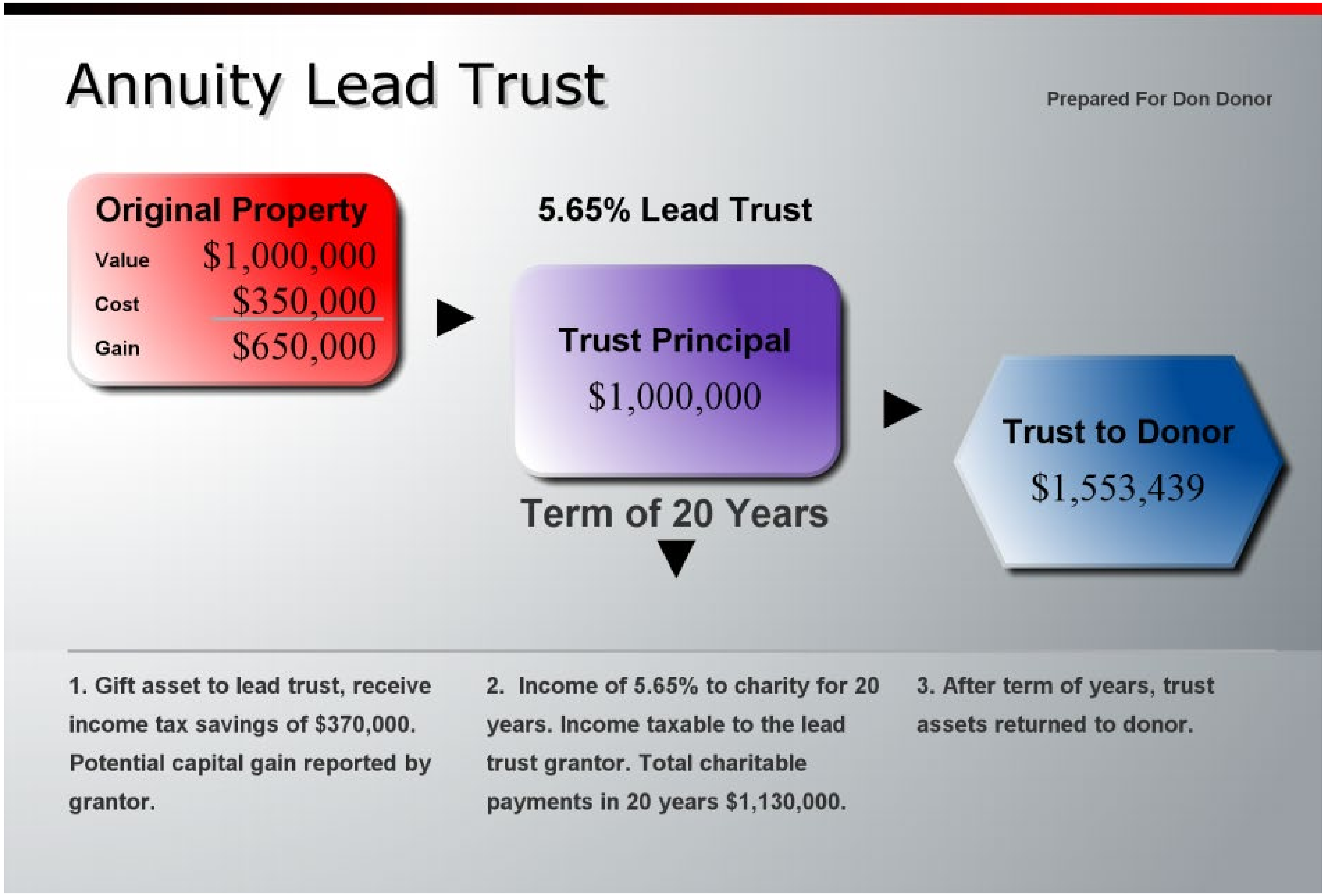


Illustration Crescendo ©

- 20-year CLT provides income tax deduction up front
- Tax will be transferred to grantors 1040 however low AFR allows for zeroed out taxation
- Provides valuable tax deduction in 1 year
- Over $1.1 mil to charity
- And $1.5 mil back to donor tax free

Charitable Lead Trusts

Final Considerations

- There is not a one size fits all in CLT
  - Might consider zeroed out Testamentary CLAT – created from Revocable Living Trust (RLT) to eliminate estate tax
    - Considerations are timing, length, 7520 at time of donor’s death
- Be aware CLAT only work for next generation. A CLAT is not suitable for wealth transfers to grandchildren
  - CLUT better accounts for generation skipping transfer taxes

- It may also be possible to obtain both a gift tax charitable deduction and an income tax charitable deduction with another technique known as a “Super CLAT.” A Super CLAT is created from creating an intentionally, defective grantor trust.
  - Slight inconsistency in tax code – Grantor substitutes property of equal value for property inside trust
    - IRS hasn’t ruled finally but appears to meet language rules

Thank you for the opportunity to be with you today

Happy to provide models, illustrations and projections

Nicola.Lawrence@Childrens.com
469-744-1986

Nicola Lawrence MSc CFRE CAP®
Director, Legacy and Gift Planning
Children's Medical Center Foundation

children'shealth

Questions?