

ESTATE PLANNING QUARTERLY REPORT

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Charitable Remainder Trusts

By John F. Petrini

This issue of the Borton Petrini, LLP's *Estate Planning Quarterly Report* continues our discussion of how to disinherit the IRS.

There are many different factors to take into account when planning for the future. Children and other loved ones are usually in the forefront when trying to organize a stable future. Planning for this alone can be a laborious and financially burdensome task without giving thought to charitable causes. However, there is a way that you can provide for loved ones and also express philanthropic desires.

A charitable remainder trust, sometimes called a life-income program, allows a person to put stocks, bonds, real estate, or cash into a charitable remainder trust designated to a particular charity such as a church, college, or organization. Then, he, she, or anyone designated by the donor will receive income for life along with an income tax charitable deduction in the year of the gift. This allows a person to leave a portion of his or her estate while still providing for other pressing matters, such as loved ones.

Benefits of this plan are numerous. Not only can one provide for himself but also for his or her loved ones while at the same time expressing his or her philanthropic wishes. This type of plan also allows for various kinds of tax savings including income tax, capital gains, gift taxes, or estate taxes.

Charitable remainder trusts come in several forms. One is the gift annuity. This agreement provides a guaranteed fixed annual income for one or two individuals. This particular agreement allows one to increase his or her after-tax income. The gift to the charitable organization would allow one to claim a charitable deduction on one's tax return to reduce income tax liability in the year in which the gift is made. Furthermore, a portion of the annual payment may be tax-free. The extent of the tax free portion of the payment depends on the life expectancy of the income beneficiary. If the gift annuity agreement is funded with appreciated assets, a significant portion of the long-term capital gain will be avoided.

An example illustrates the advantage of a charitable remainder annuity trust. Assume a husband and wife has \$200,000 in certificates of deposit that are maturing shortly. The renewal rate for current CDs is 4.5%. They want more income than the CDs are able to generate, but are concerned about incurring the risk associated with investing in higher return securities such as corporate bonds. They decide, instead, to create a charitable remainder annuity trust. They put the \$200,000 into such a trust for the benefit of a charity they designate in return for an 8% return for life. Sixty-four percent of the annual payment is tax free, and the remainder of the annual payment is taxed at ordinary income rates for their life expectancies. If they live longer than their life expectancies, then the entire annual payments from the trust are taxed at ordinary income rates. They can also claim a charitable contribution deduction of \$59,386 in the year they make the gift. Upon the death of the last to die, the principal of the trust goes to the charity.

A gift annuity is not the only kind of agreement available. One may also choose a deferred gift annuity,

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John F. Petrini



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Mr. Petrini served as President of the Kern County Bar Association (1987), and sits on the board of the Petroleum Club of Bakersfield and the Southern San Joaquin Emmaus Group.

CONSERVATORSHIPS

By Grant W. Peters

A conservatorship is a protective court proceeding. A conservator can assume responsibility for the PERSON, the ESTATE or BOTH. The effect of a conservatorship is to shift responsibility from the conservatee to the conservator.

A conservator of the PERSON, is appointed by the court to manage the personal care of an adult who can not properly manage his or her personal needs for physical health, medical care, food, shelter, or clothing. The conservator decides where the person lives (at home or in an institution), but must choose the least restrictive option. A conservatee is presumed to have the capacity to make health care decisions, such as consenting to or refusing medical care, unless the court finds otherwise.

A conservator of the ESTATE, is appointed by the court to manage the financial affairs of a person who is substantially unable to manage his or her financial resources or to resist fraud or undue influence. The primary obligation of the conservator is to conserve, manage and use the person's property for the benefit of the person and those who the person is obligated to support.

Conservatorships deal with adults. When a minor is involved, a guardianship is used. A conservatorship may be established for the estate of a missing person. A conservatorship may also be set up for a person who voluntarily requests the appointment of a conservator and satisfies the court that there is good cause to for the appointment.

MECHANICS OF A CONSERVATORSHIP

Setting up a conservatorship requires a petition to the court, an investigation by a court appointed investigator, notice to relatives and a hearing. If the conservator will have power over assets, a bond will be required.

Because a conservatorship curtails individual rights, the court will require clear and convincing evidence of the need for the conservatorship. The court will also periodically review the conservatorship to ensure that it remains in the best interest of the conservatee. Where assets are involved, periodic accounting will be required.

ALTERNATIVES

A conservatorship is seldom needed for a person with a well planned estate. The estate plan will usually include both a power of attorney and an advance directive that together will designate one or more agents to make decisions for the individual when the individual can no longer do so. With advance planning, a person can avoid the situation where there is no one with legal authority to manage the person's affairs when they can not do so themselves.

A Power of Attorney allows a person to designate someone to act for the person in financial matters. The person appointing the agent must have the mental capacity to make the appointment when the Power of Attorney is executed. A power of attorney can be limited to specific matters, like paying routine bills, or it can be broadly written to cover most important areas. The powers can become effective immediately, or they can lay dormant until the person no longer has capacity, when the power of attorney springs into effectiveness.

An advance Directive for Health Care allows an individual to set out their desires for health care and to designate an agent to make health care decisions for them when they can no longer make those decisions themselves. An advance directive can avoid conflicts within the family

over what care the individual would have wanted. It can also include directions for funeral or memorial services and for the disposition of remains.

Our office is available to assist with conservatorships. For those favoring less expensive alternatives, we can assist in advance planning for the future. ❖

REDUCING POTENTIAL FOR ELDER ABUSE

By Grant W. Peters

Physical and mental abuse of elderly or disabled individuals is usually a tool for the abuser to gain financial advantage from the abused. Often greedy friends and family members want to get a slice of the elderly person's assets before the other greedy friends and relatives get their slice. A family member or care giver may believe that with the right pressure, they can gain financial rewards from the individual. Physical and mental abuse is the most frequent form of pressure.

When there is a risk of abuse, it may be helpful to place all substantial assets in a trust and appoint a professional trustee. A professional trustee can essentially remove the assets from the reach of pushy children, friends or relatives and assure that the assets remain available for the needs of the elderly individual. The trustee can attend to the needs and desires of the beneficiary while screening for undue influence and inappropriate choices. When necessary, the trustee can be the "bad guy" that says no.

For example, mom wants everything to be split evenly between her three kids. A son may demand that he be put on the bank account and deed to the house to avoid probate or "for convenience" in paying bills. The son probably won't mention the fact that adding his name to the deed will effectively disinherit his two sisters. Mom may have a hard time resisting her son, especially if she is lonely or dependent on him.

In this case, placing the house and other assets in a trust will avoid probate, and use of a professional trustee can relieve mom of the unpleasant job of saying no to her son. Even if the son is designated as trustee, he has a fiduciary duty to the other beneficiaries of the trust - his sisters - to be fair and protect their interests.

Taking this example just a step further, what if mom goes ahead and puts the assets in son's name because he is taking care of her? She then loses control over the assets and becomes even more dependent on a son who now

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Grant's estate planning practice focuses on helping individuals and families develop a realistic plan for their assets that benefits the people and causes that are important to them. Many plans include asset protection and tax reduction strategies; others simply assure that assets are passed to the designated family members at the appropriate time. An important part of each plan is planning for the possibility of infirmity, ill health, or accidental injury.

DISCLAIMER: THE INFORMATION PROVIDED IN THIS UPDATE IS NOT A SUBSTITUTE FOR LEGAL ADVICE. READERS SHOULD BE ADVISED THAT IF THEY HAVE QUESTIONS ABOUT THIS OR ANY OTHER AREA OF ESTATE PLANNING, THEY SHOULD SEEK THE ADVICE OF COMPETENT COUNSEL SPECIALIZING IN ESTATE PLANNING.

has what he wants. Mom now becomes a burden, and is no longer a source of future inheritance. Son then cuts back on all expenses related to mom. After all he doesn't want to spend his money. All but the cheapest food becomes too expensive. Mom has congestive heart failure, but gets a stern lecture if she uses too much oxygen. Hiring someone to help mom at home becomes way too expensive. The daughters have to start buying mom's medical and other supplies.

In a slightly different, but all too real situation, son received more than a million dollars in assets from mom, and when she died, her daughters received nothing. Of course, Papa, who had died a year before mom, had seen it coming, but his warnings didn't persuade mom not to place her total reliance on son.

Proper planning can avoid the need for probate, reduce the likelihood that a conservatorship will be needed and help avoid the situations where elder abuse is likely to occur. Planning needs to be done early, while the person can make good rational decisions. When the individual no longer has capacity, it is too late to employ the most effective estate planning tools. Planning can't absolutely prevent elder abuse entirely, but it can reduce the risk. ❖

CHARITABLE REMAINDER TRUSTS? *continued from Page 1*

which resembles a regular gift annuity; however the payments do not start until a future date selected by the donor. This kind of agreement is similar to an Individual Retirement Account (IRA) and, in fact, may be a worthwhile supplement to such an account. Like a retirement plan, a deferred gift annuity can give you charitable deduction during peak earning years and a stream of income for life.

Another type of charitable trust is called a flexible gift annuity agreement. This offers flexibility when dealing with unpredictable income sources. One may elect to start receiving payments on any one of a range of dates, subject to a maximum range of 20 years. For example, a person approximately 60 years of age wants to fund a charitable gift annuity now, but also wants the flexibility to determine the date when the annuity payments would start. The charitable trust can provide for the commencement of payments at five, eight, and ten years. This type of agreement is ideal for those facing unpredictable income at retirement.

For those who would like to save as much as possible on taxes, there is a basic unitrust. This provides payments that are a fixed percentage of the annual value of the trust assets. Typically, these percentages would be agreed upon between the two parties, the donor and the donee. At the beginning of each year, the trust is valued and the percentage is set. If the value of the trust will change slightly year to year, the payments will vary slightly. A unitrust offers flexibility and allows for additional contributions in the future. Additional contributions will entitle the donor to a charitable deduction for income tax purposes.

Another option similar to the basic unitrust is the net income unitrust. This agreement provides for the payments of the interest and dividend income earned by the trust each year, up to the maximum amount. As with the basic unitrust, the maximum amount distributed during the year of the trust is a value calculated as a fixed percentage at the beginning of each year. Capital gains are retained and not distributed. If the trust does not earn income in any year, it may defer payments of income to the donor until it generates income. Since appreciation of the trusts is not distributed, all principal, including the appreciated portion of the assets of the trust is distributed to the charity upon the death of the donor.

A "flip" trust combines the benefits of the net income unitrust and the basic unitrust. These are best fit to donors who would like a trust that will pay little or no income to them for a period of years as the assets appreciate, followed by a period in which the trust will pay

regular income. These trusts begin as net income unitrusts, which are invested to provide for growth. During this period, the trust can hold low-income, highly appreciating assets. When the beneficiary reaches a certain age, or another triggering event occurs, the trust changes its nature to become a basic unitrust. The trust then begins making payments at a fixed percentage of the value of the trust assets, as established annually.

While most charitable remainder trusts are designed to provide income for the lifetimes of the named beneficiaries, trusts may also be written to provide income for the a fixed number of years between one year and twenty years. These term-certain trusts offer larger charitable deductions than trusts for lifetimes in cases where the payees are young or where a number of payees are named. Term-certain trusts can be net income unitrusts, basic unitrusts, or annuity trusts.

A pooled income fund is another agreement option. In many respects, a pooled income fund resembles a no-load mutual fund. Ownership of an interest in a pooled income fund is represented by units, which, like shares in a mutual fund, vary in value from month to month. All of the dividend and interest income received by a fund is distributed to the income beneficiaries by proportionate shares. The income distributed from each fund is taxable as ordinary income.

The following is illustrative of a pooled income fund. A person want to donate a total of \$100,000 in highly appreciated assets to a 501(c) (3) charity: \$90,000 as a deposit to the charity's pooled income fund and \$10,000 as an outright gift. This pooled income fund is similar to an income oriented mutual fund. It is projected to distribute a yield of about 3.2% in 2006. Therefore, the donor will receive about \$2,884 on an annual basis in the first year after his gift. The donor will also avoid the capital gains tax on the stock's appreciation. He is now 72 years old, so the charitable deduction on his income tax in the year of the donation will be \$51,156 for the pooled income fund plus \$10,000 for his outright gift to the annual fund, for a total of \$61,156. This is, of course, only an example and actual benefits will vary.

A charitable lead trust is another agreement option. With this agreement, the donor may transfer assets to the trust for a specific term of years or for a lifetime, during which the trust would provide payments to the donor's selected charity. At the end of the trust's term, the principal will go the donor's designated heirs. The gift tax is based on the initial value funding the trust. Your charitable contribution reduces gift and estate taxes. Charitable lead trusts enable the donor to benefit the charity as well as pass assets to family members with substantial tax benefits.

Finally, if one is interested in giving various types of real estate, this is possible with the "retained life estate" agreement option. This allows one to give different kinds of real estate, it need not be the principal residence, and retain the right to live in or use the property for the rest of one's life. Unencumbered property is most suitable for this type of donation. When one transfers the real estate irrevocably to the charity subject to a retained life estate, he is able to claim a current income tax charitable deduction. The deduction will reduce income taxes. The life tenant is usually responsible for maintenance, gardening, insurance, and property taxes to the contributed property, but this may vary from charity to charity. At the death of the last tenant, the charity is free to dispose of the property and use the proceeds. If the life tenant decides, after creating a retained life estate, that he or she wishes to move out of the property, there are several options available with respect to the disposition of the property.

These are several different options all concerning the charitable remainder trust. Whichever path seems to suit your interests, it is always wise to discuss matters with an estate planning professional. ❖

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